

Submission to the Productivity Commission's study on trade agreements – Response to the draft report

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9 September 2010

The terms of reference for the study ask the Commission to report on the contribution regional and bilateral trade agreements make to Australia's trade policy goals – that is, to enhance national welfare. The reference also reminds the Commission that, consistent with those goals, Australia's highest trade policy priority is to support the multilateral system.

We submit the following observations and suggestions on the Commission's draft report.

Ambiguous Messages

The draft offers two distinct and quite different responses to the reference, and reads as though it has two authors – one for each response. One response places Preferential Trade Agreements (PTAs) in the longer-term, economy-wide context in which trade policy contributes to national welfare. This is consistent with the Commission's obligation to provide advice reflecting "a broad, economy and community-wide view, rather than focussing on the interests of particular industries or groups in its analysis" [11.2]. The other, narrower, response sees PTAs primarily as a means of exercising the opportunities to gain market access available following the failure of the Doha Round.

Each has its own life in the document.

As a result, the draft's overall response to the reference is ambiguous.

The Broader Response

The broader approach to the study is consistent with the guidelines in the Commission's statute, which call for advice that helps Australian governments:

- "improve productivity and economic performance in order to achieve higher living standards for the whole community"; and
- "encourage the development of efficient and internationally competitive Australian industries;" [*Productivity Commission Act 1998*]

That approach to the study is expressed in the following passages of the draft's Overview:

- "The benefits of trade liberalisation are greatest if the liberalisation is undertaken on a multilateral basis. ... By lowering barriers to all countries, multilateral reform avoids the potential for trade diversion inherent in PTAs, and affords the liberalising economies with access to lowest-cost imported supplies." [xxi]
- "Over the longer haul, getting substantive trade liberalisation ... is likely to also require reforms to the policy processes of countries. In this context, it has been widely acknowledged that one obstacle to international trade reform is resistance raised in the domestic debate of each country. ... As the Commission has previously noted and as Australia's experience shows, this problem could be overcome in time through the use of transparent policy processes to shed light on the economy-wide impacts and benefits of lower barriers." [xxi]

- "... (C)ontrary to mercantilist notions that focus on export promotion and market access and often cloud debates about trade policy, the main benefits that arise from trade liberalisation result from a country purchasing its inputs and final goods from the lowest cost sources of supply, and exposing its industries to greater import competition by reducing its own trade barriers. This creates a competitive environment that drives productivity and a more efficient utilisation of resources within the economy." [xx]; and
- "While substantive trade liberalisation through the WTO may be unlikely in the near term, it does not automatically follow that Australia should pursue further BRTAs (Bilateral and Regional Trade Agreements). ... (A)t a minimum, the economic value of Australia's preferential BRTAs has been oversold." [xxii]

The Narrower Response

The narrower response, on the other hand, steps outside the Commission's guidelines and relies on arguments that often deny both fact and logic. The following examples explain why we believe that response should not find its way into the final report:

- The first example deals with the conditions of entry for Australian beef into the US market agreed in the AUSFTA. It argues that "... the improved access arrangements to the US market ... represent a contingent benefit for the Australian industry. Such developments can give domestic producers a greater incentive to increase their productive capacity in the knowledge that an alternative – and relatively accessible – export destination exists." [7.10] In fact, Australian beef producers will have to wait 18 years – and survive several more US presidential elections – before any real gains in market access are possible. Under the agreement, as signed, they will then face permanent price-triggered barriers against entry to the US market.
- In a second example the report argues that "BRTAs may place pressure on inefficient and production distorting domestic policies by subjecting industries to increased competition that would otherwise be unattainable. Such increases in competition may then contribute to broader reforms within a domestic economy" [10.1]. This contention is without factual or logical support. If trade agreements continue to be influenced by the needs of particular interest groups, and result from a tit-for-tat exchange of market 'concessions', they are more likely to place contractionary pressure on our more efficient domestic activities rather than on our more heavily assisted activities like cars and textiles. For example, in the bilateral agreement negotiated with the United States we gained no additional access for beef (in which we are world competitive) for the following 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 inconsistent with the policy objectives in the Commission's guidelines, which call for advice that helps Australian governments encourage competitive domestic development and thus enhances national prosperity.
- A third example argues that "The involvement or otherwise of Australia in BRTAs will have little effect on the extent of the global proliferation of bilateral and regional agreements, and hence Australian involvement in BTRAs is unlikely to have any effect on the multilateral trade liberalisation process" [6.19]. This may or may not be true, but in any case is irrelevant. Apart from support for APEC's structural reform agenda, Australia's trade policy effort now focuses on two short-term goals: salvaging the best outcome available from the

Doha Round and, because that seems increasingly unlikely to bear fruit, simultaneously pursuing less comprehensive agreements. The opportunity cost of investing our trade policy effort on these short-term goals, while doing nothing to strengthen the multilateral system, is both substantial and ongoing. If our trade policy continues to focus primarily on the short term it will delay, and perhaps permanently forfeit, our opportunity to secure the major gains available from non-discriminatory unilateral and multilateral liberalisation.

The Upshot

As a result of the two different approaches to the study, the draft offers ambiguous responses to three major challenges now facing international trade:

- how to enable participating countries to secure the gains (unilateral and multilateral) by promoting their more competitive rather than their less competitive activities;
- how to open markets for services, where 'behind-the-border' barriers abound, while respecting the autonomy of national governments over domestic policy; and
- because these questions are relevant for all trading countries, how to promote international discussion of them.

A domestic response to a domestic problem

The response we propose to those challenges was explained in submission 5 and in subsequent submissions 23, 29, 43, 55, 59, 60 and 61. It recognises that:

- the external disciplines on which the multilateral system now relies cannot deal with the domestic pressures that have stalled progress in the Doha Round;
- all the gains available from liberalising in a multilateral context depend on what each country does unilaterally at home, about its own barriers; and
- while the additional gains available from liberalising in a multilateral context can be achieved if the negotiating strategy of participating countries focuses on securing the unilateral gains, that logic cannot be reversed. Domestic reform cannot be imposed from the outside.

Australia's experience confirms the relevance of that response. For instance, the Tokyo Round took place before Australia's transparency process was in place, and before our own trade barriers were reduced unilaterally. When reporting to Parliament, Trade Minister Anthony confirmed that Australia had participated in that Round "without reducing the current level of tariff protection on a single tariff item applicable to any manufacturing industry." In that Round, our barrier reduction was approached as an external commitment. The effects on the domestic economy were a residual outcome of what trade negotiators were able to agree about, rather than the central objective in deciding which barriers to reduce. By contrast, in the Uruguay Round more than 80 per cent of Australia's gains came from our own reductions. We simply offered those unilateral reductions to meet Australia's multilateral commitments. We could reduce the barriers protecting our least competitive industries when the domestic cost of maintaining them was the issue, but not in order

to meet external commitments. That experience has relevance for all trade negotiations, in all forums.

Despite the growing recognition (documented at length in attachment 6 of submission 5) that external disciplines do not provide a strong incentive for governments to reduce domestic barriers, there has been no systematic attempt to develop a response that addresses the domestic causes of the problem facing world trade.

In the approach we have proposed (which has subsequently been endorsed by the Australian and New Zealand Trade Ministers) the emphasis is on resolving, through domestic processes, the domestic (unilateral) issues at stake in trade liberalisation. The proposed domestic transparency process operates in the domestic policy environment, where the distortions in world trade have their origin. In this approach the disputes and trade-offs that now characterise international trade negotiations are internalised and resolved in the domestic arena; the distinction between frontier and 'behind-the-border' barriers disappears; the current high profile that domestic and international trade officials now have as principal actors in international bargaining are downplayed; and the domestic processes for resolving the domestic trade-offs are less politicised.

International discussion of the domestic response

We have asked the Australian and New Zealand governments to sponsor an initiative to promote international discussion of this domestic transparency approach. This involves establishing an international study group, outside governments, to raise discussion of the domestic transparency response in international forums. Australia's Trade Minister has publicly supported both the proposed response and the role of the international study group [see attachment 3 of submission 5, and submission 59]. In his letter of 4 March 2010, supporting the proposed international study group, he observed that:

"A key factor behind the inability to bridge differences on outstanding issues ... (in the Doha Round) is many Members' unwillingness to expose trade-sensitive sectors to international competition."

The role of the domestic transparency response is to help individual governments resist the adjustment averting pressures in their domestic policy environment responsible for that 'unwillingness'. It will help restore momentum in international trade liberalisation in two ways:

- by making the costs to domestic welfare visible domestically when governments give priority to special interests in decisions about protection and trade policy;
- and, as a result of greater policy transparency, by making it politically realistic for governments to resist the demands of the 'trade-sensitive' industries responsible for the present hiatus in the Doha Round.

That is the message we believe the international study group should take to international forums about the future direction of trade reform.

Suggestions for the Commission's final report

The broader approach in the Commission's draft report responds to Australia's trade policy goals and the Commission's guidelines, and therefore deserves support. But we believe there is a need to remove the confusing ambiguity in the draft so that the final report offers clear, evidence-based advice.

In addition, we suggest the final report should address the following issues:

The role of domestic transparency

The domestic transparency response turns on its head the traditional approach to trade negotiations, in which negotiators have sought to gain access to external markets while conceding as little access as possible to protected markets at home. Its strength is that it addresses directly the source of the difficulties that have stalled progress in world trade reform, while leaving national governments in full control of domestic policy. It enables governments, and their domestic constituents, to work out for themselves that the economy-wide (public) benefits from opening domestic markets to international competition outweigh the (private) adjustment costs involved for protected domestic producers. It simply adds a domestic process to underpin the existing international processes of the WTO.

The grounds for adding a domestic discipline to strengthen the multilateral system are compelling. If protection results from domestic policy decisions in individual countries (as it does), and if the WTO has no authority over the conduct of domestic policy in member countries (its charter recognises that the sovereignty of individual member countries is absolute and inviolate), then any response to the threat of protectionism must take place primarily within individual countries.

The draft report's recommendation on domestic transparency confines its contribution to a public assessment of trade agreements, as negotiated, before they are presented to the Parliament. The Report says: "Before an agreement is signed, an independent and transparent assessment of the likely impacts and community-wide benefits of the proposed agreement, commissioned independently of the executive, should be undertaken." [xxvii, xxix] That is an important contribution of the transparency process, but that process must also be involved directly in the conduct of domestic protection policy and in national preparations for trade negotiations. At present, proposals for trade agreements are unduly responsive to the market opening demands of domestic 'stakeholders' seeking export opportunities and the market closing demands of protected domestic producers seeking to avoid the adjustment in prospect for them. If the transparency process is not involved directly in establishing domestic negotiating positions, countries participating in multilateral negotiations will individually fail to secure the gains available from liberalising unilaterally. And they will collectively fail to secure the additional gains potentially available from liberalising in a multilateral context, because these depend on what each does unilaterally at home – about their own barriers.

Comprehensive coverage of PTAs

The draft Report states that "... the Australian Government's policy has been to negotiate comprehensive agreements that liberalise substantially all the trade between the partner countries...", and concludes that "... these aims have largely been met" [xvii, xviii]. It later observes that "... many agreements coming into force tend to be quite comprehensive in their scope..." [5.5] and subsequently concludes that: "The five PTAs signed by Australia in the last decade ... are all comprehensive..." [5.7]. This stream of comments conveys the misleading impression that negotiations that are comprehensive in coverage at their outset (that is, when negotiations begin) have resulted in agreements that liberalise "substantially all the trade between the partner countries" [Our submission of 9 April deals with this issue].

Modelling

The modelling undertaken for the Commission's study suggests that, if certain specific conditions are met, bilateral agreements could yield net benefits for Australia. These assessments do not, and cannot, bring into account the opportunity cost of investing our trade policy resources in pursuing bilateral arrangements, at the expense of the widely acknowledged greater and longer-term gains from liberalising in a unilateral or multilateral context. While this cost defies econometric assessment, it is nevertheless real and quite possibly larger than any likely gains available from focusing all our trade policy effort on less comprehensive agreements. That explains why successive Australian governments have made support for the multilateral system their highest trade policy priority. It is also why we propose that a domestic transparency process be added to the existing external processes on which the multilateral system now relies, and why the Australian and New Zealand trade ministers have supported that approach as the way to counter the domestic pressures that have stalled progress in the Doha Round.

Services

We have argued in our submissions that the relevance of any approach to include barriers to services in trade negotiations hinges on whether it respects the autonomy of national governments over domestic policy. Some behind-the-border measures, while acting as barriers to international competition, were introduced for reasons that have nothing to do with trade. Decisions to remove them are therefore domestic policy decisions, and cannot be made from the outside – by external processes. That is what makes domestic transparency arrangements essential for addressing the domestic issues involved in opening markets for services. They have the same relevance for all initiatives aimed at promoting trade openness, including 'economic integration', because the success of all such initiatives depends on domestic policy decisions. These cannot be made from the outside.

Why an international study group?

The proposed international study group would not be a navel-gazing exercise. Rather its task is to develop a practical response to the domestic pressures responsible for the loss of momentum in world trade reform, and to promote it in international forums.

It is significant that political leaders who are actually experiencing the protectionist pressures are looking for ways to resist them, while the trade officials responsible for operating the now failed reform delivery system are offering more of the same. G20 leaders have committed to fight those pressures in each of their recent Summits. Australian and New Zealand trade ministers have recognised that those commitments are not self-fulfilling, and that gaining international support for a domestic response will take time and patient effort. Indonesia is introducing its own transparency arrangements. Support by New Zealand's Trade Minister has been followed by a commitment to establish a transparency agency modelled on Australia's Productivity Commission. These developments, and the positive response from trade policy institutes in Europe and the US, suggest that political interest and international involvement in the study group are assured.

For as long as it takes

Just as Australian governments are free to accept or ignore the Commission's advice, so other governments must be left to make up their own mind about the relevance of the study group's message. The group must operate outside the WTO and other negotiating forums, for as long as WTO management continues to deny the existence of a problem and trade officials continue to see it as falling outside their job description. The DFAT submission to the present study represents the government's commitment to the multilateral system as involving no more than securing an agreement from Doha negotiations. To the contrary, in supporting the transparency response and the international study group Trade Minister Crean recognised the domestic nature of the problem and the need to promote international discussion of how to deal with it, for as long as it takes.

Why a Productivity Commission involvement?

We believe the Productivity Commission has the independence, experience and capacity to provide Australia's contribution to the study group. Those qualities are also the basis for our suggestion that it should be given responsibility for chairing the group. Our suggestions about how Australia's participation in the group should be resourced, its terms of reference, and how the Commission should be required to account for Australia's contribution, are contained in submission 61. We have avoided offering any further prescription about how it should see its role in the international study group. The model it provides of transparency in advice to Australian governments is highly regarded internationally. It is therefore well placed to develop and argue the case for change in international forums.

A Work in Progress

The study group would not start with a blank page, or with limited opportunities to contribute first-hand experience to international discussion about the future direction of world trade reform.

A substantial body of material on the domestic response we propose has already been published by, among others, the Tasman Transparency Group, the National Centre for Development Studies and the Asia Pacific School of Economics and Government at the ANU, the Trade Policy Research Centre in London, the Lowy Institute for International Policy in Sydney, the Cato Institute in Washington and the East Asia Forum.

Conferences on trade policy have been arranged to coincide with each of the G20 Summits held since November 2008. To coincide with the London Summit the British government engaged an advisory group to explore ways of dealing with the emerging threat of protectionism. Neither that group nor any other recently commissioned to examine the issue has recognised the domestic origin of the threat. That establishes the need for the international study group and the Productivity Commission's role in it.

Government support

The international study group proposal was endorsed recently by Mr Crean, as Trade Minister. We will now ask the minister responsible for trade in the new government to commit the public resources needed for the Productivity Commission to develop the initiative. In doing so, we will reaffirm that:

- the Commission's statutory independence, its well developed in-house analytical skills, the experience and transparency procedures it uses in providing public advice to government, and its ability to call on outside help where necessary, make it the obvious vehicle for Australia's contribution to the international study group;
- while it is not for us to suggest what level of additional resources will be required by the Commission, it will clearly be modest compared with those involved in any one of the bilateral agreements that have been, or are now being, negotiated;
- the substantial and ongoing gains at issue for Australia warrant the relatively modest commitment of public resources involved; and
- the nature of its message suggests that the study group's mission will take time and patience. It should be encouraged to continue its work for as long as it takes.

We believe the government's response will demonstrate its level of commitment to the multilateral system, and to international trade reform.

9 September 2010.