Joint Select Committee on Trade and Investment Growth — Inquiry into Business Experience in Utilising Australia's Free Trade Agreements, Hearing of 21 July 2015

Opening Statement by the Productivity Commission Chairman

The Productivity Commission is the successor body to the Industries Assistance Commission, the standard bearer for trade policy reform in Australia.

It is in our DNA, as the successor to that body, to continue its ultimately successful — but occasionally deeply criticised — advocacy for reform of the barriers Australia has maintained to international trade, and the policies related to that which slow effective resource re-allocation — the ultimate objective of trade reform.

We are not, as some have suggested, opponents of trade reform. Some views to this effect from supposedly pro-trade parties followed the recent release of our 18th *Trade and Assistance Review*, where we commented — as we and our predecessor organisations have consistently done over decades — on the good and the bad of public policy in this area.

It should have surprised no one that we might favour transparency in public policy. For those who were surprised, allow me to say you have missed half a century of consistent advocacy from this agency in favour of requests for assistance being considered in open public process, rather than in private between government and selected interested parties.

The original purpose of the Tariff Board was at least to put on public display the decisions of government which favoured certain firms in the international trade context. The important operative language is 'on public display'.

As Richard Snape, one of Australia's most distinguished economists, said in describing the trade policy debates of the 1970s and 1980s:

> *"One of the main weapons of those in the freer trade camp was to bring the battle into the open. Public scrutiny or transparency of policy became the banner under which the Tariff Board and its successor the IAC were to fight."*

The Productivity Commission, today's successor to those two bodies, does not resile from any of its critique of the lack of transparency in today's trade policy, any more that it would have back in the days when it was regularly castigated by those who favoured trade policy solely for reasons of promoting exports or discouraging imports.

Not to waste the Committee's time with what I hope today is common ground, it does a nation no good in the long run to add to the cost of doing business and employing Australians by making imported goods and services more expensive than they need to be; nor to congratulate ourselves on obtaining slightly more export access to another market in

return for that. The transactions involved are complex. And they mix short-term export improvement in goods trade with long-term cost exposures across the economy. The net gains may be positive, but how would we know? Detailed analysis is simply not available.

Of course, the Productivity Commission would prefer that we unilaterally reduced our trade barriers. And yet we are naïve to suggest this, apparently. Despite the fact that this is what Australia did, with clear net benefit to the economy, in the 1980s and continuing through the 1990s.

We have provided the Committee with our 2013-14 *Trade and Assistance Review*. As well as this Review, and others in the annual series, the Commission has produced a number of reports examining trade issues, including a 2010 Research Report on *Bilateral and Regional Trade Agreements*. And as part of our research program, we plan to further examine recent developments in trade agreements — particularly provisions covering intellectual property and investor state dispute settlement, and rules of origin clauses — with a view to further advancing the general guiding principles for key elements of agreements.

All our previous analysis informs the views that we will put to the Committee today. The consistent finding — on which we think it would useful to focus today — is the need for greater transparency of process in:

- first, formulating the approach to trade agreements; and
- second, assessing the impacts of agreements.

To do this is not an impossible task. The Productivity Commission could do it. But for today, the issue is not who, but what and how.

Before I turn to how such a process might work, I'll outline some of the features of agreements that make us think it's needed.

The lack of progress in multilateral forums has accelerated agreement-making at the bilateral and regional or plurilateral level, by Australia and many others. The proliferation of such agreements is adding to the complexity and business transaction costs of trade.

Complexity stems in substantial part from the diverse rules of origin for goods and services and from the variable coverage of services sector liberalisation across agreements. For example, the number of individual origin rules in agreements entered into by Australia varies from a single three-tiered rule in the Australia-Singapore agreement to some 5200 separate rules listed in the Korea-Australia agreement.

It's red tape, and growing at a very healthy rate. It adds to the compliance costs of businesses as they evaluate and attempt to use preferences, as well as the administrative costs to governments — customs authorities and the like.

And risk is elevated too, as today the scope of trade negotiations swings across regulatory structures once simply seen as domestic policies, or matters once managed internationally by UN Conventions and agreements: environment, labour standards, immigration, intellectual property protection, electronic commerce.

In times of limited capacity for legislated public policy reform, it is not stretching the truth to say that today's trade negotiations are potentially the most powerful microeconomic change force available. Thus it is exceptionally important that change is of net benefit to an economy, and demonstrably so.

The Commission remains a strong supporter of trade policy reform. But we must be hard-headed about what we are seeking. And we need to make the effort to convince those who have questions that there is a strong analytical basis for change.

Turning to what and how to improve the process of entering into trade agreements, we envisage a two-stage process, involving comprehensive analysis independent of our trade negotiators, but closely informed by them. Above all, this would be publicly transparent. We suggested improvements to the process in our 2010 report. Our thinking has evolved a little since then, but remains consistent with it. And we would see the detailed design of an improved process being informed by emerging international experience.

A two-stage process would enable all interested parties to take a well-informed look at what are very complex agreements and help promote understanding of the opportunities and limitations to what might be achieved in any particular agreement. Equally important is that negotiators would work on getting the deal done with the knowledge that such an assessment would occur before signing. This would bring added discipline to negotiations.

Both analyses — the pre-negotiation analysis and the final text analysis — would be published. The pre-negotiation analysis after Cabinet triggers a negotiation and the final text analysis as an input to the pre-ratification Parliamentary review.

The analysis to be undertaken before negotiations commence for a particular agreement would include all areas that could be covered by the agreement. The base case would be the status quo informed by assessments of the contemporary trade and investment relations between the relevant nation(s) and Australia, against which different scenarios would be assessed.

These scenarios must be realistic; for example, reflecting likely carve outs or phase-ins and rules of origin based on measures that have been common in recent trade negotiations by the proposed partner countries. And specific provisions would be assessed against evidence-based General Guiding Principles.

Assessments of provisions such as controls on intellectual property, or investor state dispute settlement, would consider whether there is a market failure or other bases that provisions could effectively address. The preference of the other nation (or nations) for such arrangements would be noted.

The rules of origin arrangements of proposed partners would be assessed, and a threshold consideration would be the additional cost to the current plethora of rules. It should also assess the contrasting effect if there were no new rules of origin imposed, or no rules at all.

The initial assessment would provide a published benchmark of opportunities and risks, against which the rate of success would eventually be assessed — publicly, after negotiations are complete but before any commitment to entering the agreement. The initial *public* discussion need not specify which combination of scenarios is most likely, but such advice could of course still be provided to Cabinet.

The initial assessment would: identify intended incremental changes to existing policy settings and regulations; identify the scale of activities affected; estimate the indicative economy-wide effects and the timescale over which they would occur; identify potential risks and alternatives for reform; consider trade diversion and its costs; and provide an overall assessment and scope for improvement.

The second assessment phase would examine the final text once negotiations are complete, but before the agreement is signed. The analysis of the economic implications of the actual text of the proposed agreement would be a high-level qualitative 'gap' analysis. The negotiated provisions would be assessed against the 'applied benchmark' provided by the initial assessment of what was reasonably expected to be achieved.

If the negotiated text diverges from this 'applied benchmark', the assessment would set out why and any indicative costs imposed. It may still be appropriate to accept such costs in some instances if it's part of a package that is in Australia's overall economic interests. The process would provide a better basis for deciding what's in Australia's best long-run interests overall. The assessment would be published as part of the government submission to the Joint Standing Committee on Treaties.

We think this type of post-negotiation assessment offers a pragmatic, workable approach, and — provided the pre-negotiation analysis is comprehensive and rigorous — could be completed in around four months. I understand the TPP will have around four months in front of the US Congress, so this would appear reasonable based on other countries' practises.

The Productivity Commission, under our Act, is required to have regard to the *overall* economic performance of the economy in order to achieve higher living standards for *all* members of the Australian community. The assessment of trade agreements needs to do the same, and importantly needs to be seen to do so. It also needs analysis of the structure of Australian industry and skill in sectoral analysis — which the Commission has.

But at the end of the day this is not intended to be a self-serving proposal — the analysis needs to be done, and done with transparency and objectivity. If there are other capable institutions, then that choice can be made separately to agreeing the clear need for greater transparency of analysis.