Challenges, Threats and Opportunities for Australian International Trade

European Australian Business Council (EABC)
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Europe, in a global environment where international trade policy is increasingly determined by the tactics of populism and where any recognition of the value of closer integration between markets is being challenged daily, has moved from being a source of concern to a beacon of hope.

It wasn't so long ago that the consensus view of Europe was that it was condemned to being a slow growth environment, with ever-worsening youth unemployment, an ageing population with generous social security and a huge structural inconsistency between the common currency and the absence of fiscal discipline to match that standard.

Added to that, was the north-south inequality of access to everything from education to opportunity - a source of much internal and external disquiet.

And the Global Financial Crisis put all this on very public display.

These problems are not all resolved. But the resilience of the institutions and shared determination between the principal nations of continental Europe, combined with an effective central bank, have held Europe together in ways that many commentators once doubted was possible.

Brexit too, was said to be a big challenge for Europe, but so far it has not proven to be. Again, the resilience of institutions and a shared determination has to be credited with higher respect.

From the Australian perspective, Europe perhaps today matters most as a source of relative stability in a world where there is precious little of that.

And where the commentary that most of us encounter daily treats international economic challenges similar to a major sporting event, like the Winter Olympics. One where Australia isn't for the most part competing, but an occasional upset win or loss reminds us there is a fight for global supremacy going on somewhere over there.

This illusion of remoteness is a big mistake.

None of the big players in this brutal game care much about us. But that doesn't make us irrelevant.

Not only are we still a global stand-out example of how unilaterally reducing protection rather than trading it away in small increments in return for equally small barrier reductions by another economy is a far more successful strategy, but we also have diversified the international perspective of us.

Our immigration policies, currently again under fire at home, are seen in the developed world as benchmarks for how to integrate a highly diverse set of cultures into a fairly harmonious and stable society. Some 49% of the Australian population was born overseas, or has a parent who was born overseas. This is the highest level of any developed nation, except for Switzerland, well in excess of countries that are struggling to assimilate much smaller proportions.

And more than a quarter of our labour force was born overseas, again well in excess of other developed nations.

We cope well with foreigners, generally, because for a long time now it has been true that **they are us**.

Plus we have 300,000 of other people's children studying here, at great cost to their parents, participating in a society that with all our petty ills and intolerances is seen as safe, open and interesting.

And over 1 million of the citizens whose country will probably dominate this century in the way the US dominated last century visit us annually and take home generally positive impressions.

These internationalisations – lowering barriers to foreigners' ability to sell us things we need; actively seeking skilled migrants to grow our workforce; welcoming students and tourists and setting them up with a positive impression of us for life – are changes we made as a nation that have internationalised us.

At the Productivity Commission, we see a tiny version of this, hosting economic reform agency staff from APEC nations. The Australian model of reform, drawn from decades of experience, is well-regarded in East Asia and South America, even as we tend to increasingly disregard it here today.

And the developed world, represented by the OECD amongst others, remains very interested in our latest efforts to reinvigorate structural reform.

Late last year, we supplied the Treasurer with an assessment of how to go about the task of revitalising productivity growth in Australia, at the national scale and over the medium-term, a five year plan.

And via that to revitalise flagging national income growth.

Shifting the Dial we called it – a working title that stuck.

The plan is novel in its approach – to treat productivity as the function not just of workplace level reform in industrial relations or removal of barriers to competition, (well-traversed ground by this agency), but increasingly as sourced from the quality (or lack of it) in our education, health and infrastructure polices.

The reforms we outline for health, education and infrastructure are ones that indisputably are aimed at improving the quality of lives:

- A shift to favour locally-generated health solutions aimed at both reducing and better managing chronic disease
- A concerted attack of out-of-field teaching
- Bringing roads and motorists associations into the process for both choosing and funding transport projects in cities
- A Hilmer-style review of planning and zoning restrictions will also find ways to relieve housing supply pressures
- And many more - cited in our Report.

These are almost all policy propositions that are well-known to practitioners in the relevant field but rarely heard outside it.

We have gone, as we prefer to do, with expert advice and solid evidence of improvement. The gains are very substantial, at least as large as more traditional sources of micro reform, but here mostly accrue to human beings rather than remoter entities like the fiscal balance or the competition environment.

In return for sharing with the Commonwealth the task of jointly pursuing these reforms, we offer as an incentive for the States, who have so much responsibility in these areas, not a bucket of dollars but rather the opportunity to improve the reliability of their revenue bases via tax reform.

In the Report, we cite a shift from stamp duty on housing purchases to land tax as offering numerous benefits to the States, and possibly to home buyers too. While the latter is the reason many politicians might possibly entertain the idea, the former is the reason for making the shift in the public interest.

Land tax not only has low collection and transaction costs, causes far less damage to labour mobility and to business investment in real property, but it is a very stable source of funding.

House prices and volumes have been rising for so long that many have forgotten how suddenly damaging can be the effect on State finances of their largest or second largest revenue source after Commonwealth grants to fall as it did in NSW in 2008 (20%) or Perth in 2009 (nearly 50%).

The incentive for the States to shift to a more efficient and stable tax base is poor. The ACT is slowly making the shift over 20 years to keep the household impact to a relatively low level, but the political opportunity to make mischief is extended for equally long a period.

Cuts to stamp duty could be made large in the early years and yet the broadening of land tax could be made small, and incremental, increasing their political appeal.

Ratings agencies have already expressed support for a shift to land tax, and so any borrowing necessary to front-end load such a shift should not cause a reassessment of credit ratings, if well explained as part of a structural reform agenda.

This is not as attractive perhaps as the big bucket of money to buy reforms – it is more akin to a mutual swap of reforms - but it is a responsible *quid pro quo.*

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And we do not propose to use the Council of Australian Governments (COAG) for trying to progress these negotiations.

Rather, we favour using the State and Commonwealth Treasurers as a forum for negotiating broader change, and on to COAG only after any broad agreement is struck.

I have spoken to State Treasurers - once as a group late last year, and to the Victorian and NSW Treasurers earlier this year – about their ability and opportunity to make this work. Both sets of meetings were positive, but as you might expect wary of Federal politics intervening in almost every way.

Throughout the remainder of my term, which finishes in September, I'm going to see other Treasurers one on one to ask them to take this forward.

We allowed, in the *Shifting the Dial* Report, for 2018 to be a period in which all governments, State and Federal, considered the report and how to deal with it.

Our hope is that, as almost all governments will be renewed by the end of this year (NSW being the exception, but nevertheless a positive responder so far) that by the end of 2018, there may be scope for an agreement to be struck as we move towards a Federal election.

But without the States making the Federal Government an offer that it can't refuse, this all probably isn't going to happen.

I'm sure most of you feel that I'm just way too optimistic about getting this sort of structured reform through our feeble Commonwealth-State structures.

All I can say is that the design of both the content and the strategy is the last best hope for something that will indeed shift the dial.

You can play your part by reminding Federal and State Treasurers of this unique document. I will be trying to do that, too.

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As the European-Australian Business Council, some of you may be thinking this is all a little outside your area of expertise – although I know on the last occasion that I spoke to you, the discussion ranged far and wide across domestic as well as international issues.

So let's turn to trade issues.

The Productivity Commission has some special responsibilities in the area of trade policy.

Every year we put out a report, authorised by our guiding legislation, that covers *Trade and Assistance Review* (TAR) levels. The report for 2016-17 comes out later this week. It will focus on what are clearly rising levels of assistance; and the dangers of protectionism.

We already have one piece of work public on this matter. In a paper on the prospect of rising protectionism we authored last year, the Commission noted:

'In the event of a global rise in protection, Australia would face intense political pressure to follow suit and lift its own barriers'.

We indicated in that analysis the very serious impact that a broad outbreak of protectionist sentiment around the world would have on Australia.

A number of variants based on Trump policies were assessed. A general rise of 15 percentage points in tariff levels would tip the world into recession. Global GDP would fall by 2.9% and across all income deciles households in Australia would suffer cuts to real incomes.

We did this analysis so to give our political leaders credible data on which to base a response to the knee-jerk reactions of political and lobby groups that may arise in response to protectionist behaviour.

Interestingly, public responses at the time we published suggested that our political leadership thought this unlikely. They had confidence in their ability to resist the temptation to join in.

And by then end of the year economic commentators were noting in their New Year market advices that the Trump trade wars had not eventuated and seemed unlikely.

By March, of course, any sanguine views were looking a bit premature.

As President Trump announced his steel and aluminium tariffs, and there was doubt about whether our claim to special status would see us exempted, the reaction from steel industry supporters was vociferous.

Steel is particularly well protected already in this country. Our *Trade and Assistance Review* has previously estimated that the sector as a whole receives well over $1 billion in R&D, tariff, anti-dumping and direct subsidy support, per year. And that's growing.

But the fear of protectionist US action shifting tonnages away from the US market took exactly the sequence of events we forecast last year. Far from calm consideration of the implications, it prompted a burst of public efforts to replicate the same protectionist instincts as the US itself had adopted.

Politicians on both sides, along with steel company executives, competed to sound alarms and promote the concept of even bigger price imposts on steel users in this country, all in the name of supposedly saving jobs.

Knowing that this is how global protectionism breaks out did not stop talk from:

- the Government, of a willingness to consider further ramping up anti-dumping assistance, for the third time this decade
- the Opposition, a preparedness to remove from the Productivity Commission the role of reviewing safeguards tariff increases, the primary statutory mechanism under which unilateral increases in tariffs can occur and still be in compliance with our WTO commitments.

Safeguards are a treaty obligation holdover from the period more than 20 years ago when multilateral trade agreements at the WTO meant many countries were undertaking reductions in assistance and it was expected that for some the shock of change may be too great.

If so, safeguard action could slow or reverse the effect for a period.

In effect, what was once about a shock absorber ***in support of*** liberalisation may become, in the wrong hands, a major alteration to a long-liberalised approach to trade.

Because of this, the Howard Government recognised the need for genuine independence of advice in considering such claims, and gave the job to us.

In a true irony, as Australia was reaching for the industry assistance jar at the first sniff of cannon fire in President Trump's trade war, the US International Trade Commission could and did – because of its independence – reject overwhelmingly another Trump Administration effort at emergency protection that would have seriously damaged if not closed down a Western Australian supplier of silica to the US.

Independence in consideration of safeguards policy will matter, if the US and China continue the dance along the cliff edge that has been initiated this year.

The Productivity Commission last did a safeguards action in 2013 - on a complaint brought by SPC, a subsidiary of Coca Cola Amatil, which had diversified into canned fruit and tomatoes and faced a range of highly competitive foreign suppliers.

The rules for assessing a safeguards action are arcane. We know them well. The Productivity Commission did find that a tariff may be potentially justified for a small proportion of the affected products. But we also found some serious inconsistencies in the data supplied, conflicts that a less skilled agency would struggle to detect. And overall safeguards action was not recommended in most cases.

The Federal Government chose not to assist SPC. Despite the analysis showing limited harm, the Victorian Government offered SPC substantial direct financial aid.

In future, if the rise in protectionism persists globally, we will probably see a rise again in safeguards claims made in Australia. The Federal Government should be advised in these matters by thorough and independent analysis.

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I had planned, as requested, to close this address with a few remarks on the upcoming EU-Australia trade negotiating process.

It's become a hotter topic than I anticipated in recent days. The views I express are not based on overnight reporting, but on our long-held principles and Australia's experience in trade policy reform.

As most of you know well, the Commission strongly prefers that barriers to trade are reduced in the kind of comprehensive shift that involves either multilateral or unilateral elimination of what are after all significant burdens on industries and consumers alike.

Analysis after analysis show that the purported gains to employment from keeping barriers high are overwhelmed by the losses economy-wide. This includes our own actual lived experience of the 1990s.

And moreover that bilateral trade agreements that are said to reduce these burdens are generally pretty poor public policy.

Amongst other things, sticking to multi-party processes limits the power of any single nation to use its leverage to impose disadvantage on its partner or partners.

This may explain why the US flirted only momentarily with re-entering the TPP.

One angle of bilateral agreements usually ignored in all but the most academic analyses is something I raised when I last spoke to this forum: the increasing significance of Rules of

Origin (RoO) as a new form of non-tariff barrier that can make the task of extracting even the small gross benefits out of bilateral agreements almost impossible.

That they are of significance should no longer be in doubt: Rules of Origin are at the heart of the US efforts being made to alter the North America Free Trade Agreement.

In Australia, the noodle bowl of inconsistent rules we have created via bilateral negotiations is potentially going to be topped up further by bilateral deals, when what is really needed is a serious effort to allow mutual recognition of *any* such rule.

It would be strongly preferable for our future trade negotiation with Europe to try push for a clearly liberalising agreement that uses the skills of trade negotiators to model the way to accept *any* of a nation's existing RoOs.

Thus not to add to the noodle bowl of barriers, but to show how to shrink it.

It has been claimed in the past that bilateral agreements may one day help us transition to more liberal multilateral outcome. This will only be a realistic claim if Rules of Origin can be dissolved.

While the negotiations with Europe appear to be still at a preliminary stage, based on public information, the important principle for us is that the breadth and depth of an agreement with the EU, seek to exemplify how to improve the bilateral model, not exacerbate its failings.