

# Trade policy lessons from Australia

By Bill Carmichael

Australians have been repeatedly misled about our trade negotiations and agreements. We have been misled into accepting that all the gains available from negotiations come from market access for our exports; before negotiations begin we are misled about the likely benefits; and after the event we are misled into believing the resulting agreements are, to quote Prime Minister Turnbull, "a gigantic foundation stone" for the economy.

The purpose of this paper by Bill Carmichael (a member of the Tasman Transparency Group) is to clarify the objectives of trade policy, to review how trade negotiations have been conducted to date and to identify what needs to change.

As Australian experience in the Uruguay Round has confirmed, the major gains from trade negotiations have come from liberalising our own markets. It follows that the goal of trade policy is not limited to increasing export opportunities but, even more important, it provides an opportunity to improve the productive base of the economy. That is the test applied in this assessment of Australia's experience with bilateral trade agreements.

## Three case studies

The current approach to trade policy is evident in the language used to communicate trade policy developments. It is reflected, for instance, in the often-stated proposition that Australia 'fights above its weight' in trade forums. That is meant to convey that we cast a long shadow in trade circles and that we usually get more than we give in trade negotiations. A sobering test for this view is provided by the outcome of the bilateral agreements negotiated with the United States, Japan, South Korea and China. Like pronouncements about 'historic meetings' and 'negotiating breakthroughs', it is part of the theatre that surrounds trade negotiations. It makes no contribution to community understanding of what is at issue in trade liberalisation, and it is this understanding that determines how much domestic liberalisation actually takes place.

## Bilateral agreement with the United States

Worthwhile gains in national wealth provide the only economic justification for entering into trade agreements – whether these are concluded in a bilateral, regional or multilateral context. Yet in negotiating the agreement with the United States (AUSFTA) the transparency body relied on by successive governments to inform them (and us) about the effects of policy induced change was sidelined. Instead, a consulting firm was engaged to assess the gains for Australia. That firm's first assessment, made before negotiations began, was used to suggest annual gains of A\$4 billion.<sup>1/</sup> This compares with probable gains of not more than \$50million estimated for the Senate committee established to review the outcome, after negotiations were complete.<sup>2/</sup> The original assessment assumed the negotiations would

provide comprehensive access to US markets, eliminate all our remaining protection against US competition and all US farm support against Australian competition. The outcome of negotiations meant that these estimates wildly overstated our gains from the agreement. Yet gains of that order (and higher) were still being quoted to support the agreement after it was signed, as though they reflected the actual outcome for Australia.

US Trade Representative Robert Zoellick described how he approached those negotiations: "Trade negotiators live in the real world and in the real world objectives must be balanced by sensitivities...The history books of free trade are filled with agreements that successfully balanced ambition with sensitivities and exclusions."<sup>3/</sup>

His 'real world' was one in which the power of 'sensitive' US industries resulted in their exclusion from the coverage of negotiations, or in having safeguards introduced that minimise the scope for international competition. Their power over decision-making in the United States was dramatically demonstrated by Zoellick's explanation that the extension of farm subsidies, although a backward step, was necessary in order to secure authority to negotiate. Their influence is also evident in the agreed conditions of entry for our farm products. Australian beef producers will have to wait 18 years – and survive several US presidential elections – before any worthwhile gains are possible. Under the agreement, as signed, they will then face permanent price-triggered barriers against entry to the US market. Some Australian farm industries will face more immediate hurdles. If the prices to US farmers decline, for reasons that may have nothing to do with Australian competition, a 'safeguards' barrier will be raised against them.

When accounting to the US Congress for the outcome of negotiations with Australia, Zoellick explained that on beef: 'We have an 18-year phase out that Prime Minister Howard personally was pushing to get lowered, which we didn't lower. And it should work well with our industry...because we only increased the quota for manufactured beef.' On dairy products he explained that Australian negotiators had been unable to end the protection for US dairy farmers: 'And, frankly, in terms of dairy, I think we've increased our quota – didn't touch the tariffs one bit – the huge amount of about maybe US\$30 or US\$40 million a year.'<sup>4/</sup>

How much better would the outcome have been – for both Australia and the United States – if, instead of excluding 'sensitive' domestic industries from competition, negotiators had been prepared to secure the greater national rewards available from reducing their own barriers.

As a result of our preoccupation with concluding an agreement, negotiations degenerated into a struggle to find an acceptable compromise on market access that had little to do with enhancing national economic welfare. When justifying the outcome for Australia, officials argued that the agreement deserved public support because it was 'the best that could be achieved' and because 'any agreement was better than none'. As further justification for the agreement, as negotiated, the spokesman for industry groups supporting the outcome argued that 60 per cent of Australians believed it would deliver substantial net benefits for

Australia. 5/ This level of public support should not be surprising, given the basis provided to inform public understanding of the outcome for Australia.

The confusion and contradictions in the information available hindered, rather than helped, public understanding of what had been achieved. It is a testimony to the power of such obfuscation that in the end no industry group represented by the National Farmers Federation expressed concern about the outcome of negotiations. Each constituent farm industry was persuaded not to oppose the outcome unless its access to US markets would be less with the agreement than it had been without it. If that is the test we apply to future trade negotiations, we are most unlikely to secure gains in either market access or national wealth from the resulting trade agreements. Like the rest of us, farm industries were persuaded to accept a view delivered by fiat, not by disinterested analysis, that we would benefit from a bilateral agreement linking ours to the largest economy in the world.

This does not mean that a strong trading relationship with the United States is not in Australia's interests. But it does mean that such a relationship, offering the substantial benefits promised, has not emerged from the bilateral agreement negotiated.

The AUSFTA, as negotiated and before ratification, was examined and subsequently endorsed by two Parliamentary committees. While having all agreements examined by the Joint Standing Committee on Treaties (JSCOT) is a welcome (and necessary) innovation, limiting the scrutiny of future agreements in this way denies the relevance of the transparency arrangements that prepared the way for the reforms of the 1980s and 1990s. Nothing in the established approach to negotiations has changed as a result of scrutiny by JSCOT. During a recent hearing by that committee a DFAT official confirmed that none of Australia's existing agreements has been subjected to an independent analysis to establish whether the claims made for them at the outset of negotiations had subsequently been checked against the actual outcomes.

## **Bilateral agreement with Japan**

When justifying the agreement struck with Japan, our trade officials and former trade 'experts' again argued that it deserved public support because it was the best that could be achieved. As further justification for the agreement, as negotiated, DFAT pointed to the near unanimous support from those accompanying the Prime Minister on his Asian tour at the end of negotiations.

Again, that level of support was to be expected given the information provided at the end of negotiations about the outcome for Australia. The only 'facts' available publicly when that support was voiced were based on projections made in 2005, before negotiations began, of what Australia would gain if all barriers (sic) between the two countries were removed immediately. The potential GDP gains projected for Australia based on that scenario were \$A39 billion over 20 years. This estimate of potential gains was still being used by DFAT to support the agreement after it was signed, as though it reflected the actual outcome for Australia.6/

We now know the outcome of negotiations bears no relationship to the unrealistic scenario that provided the basis for that support.

The disconnect between the expectation generated by DFAT and the outcome of negotiations was inevitable, given the rules for the negotiating process established at the outset. Instead of seeking an assessment from the Productivity Commission, a "study group" (made up of Australian and Japanese public servants) was formed to assess the potential gains for Australia, and to establish the negotiating ground rules. Unsurprisingly, the group recommended that negotiations be conducted exclusively by public servants from both countries. It also provided that "representatives from the business and academic sectors may be invited to present their perspectives". But when this happened their representations were received by negotiators "in accordance with Chatham House Rules"--that is, in secret.<sup>6/</sup>

The public was thus shut out of the negotiating process. As a result of the negotiating arrangements established at the outset, two groups of domestic constituents had a dominant influence over the negotiating agenda for each country. While market access requests were naturally structured in response to domestic producers seeking external markets, the reciprocal offers of access to domestic markets were influenced by producers who felt threatened by liberalisation. For instance the Japanese warned, before negotiations began, that "negotiators should be mindful to avoid any adverse effects on agriculture, forestry and fishery products of Japan.." It was agreed that there were "sensitivities on both sides and that... such sensitivities needed to be handled in an appropriate manner.." <sup>6/</sup>As a result, many of our world competitive producers missed out.

## Bilateral agreement with China

Those same processes were at work in our preparations for other bilateral negotiations. The feasibility study on an agreement with China also relied on projections of possible gains for Australia. Although those projections were appropriately qualified in the body of the study, they were subsequently used without qualification to support the conclusion that 'there would be significant economic benefits for...Australia...through the negotiation of an FTA (sic).' Such a conclusion could not be drawn from either the projections of possible gains or from the outcome of negotiations, which had not yet begun. As happened in negotiations with the United States, the all important distinction between possible gains (as measured in the initial projections) and the actual outcome of (future) negotiations became blurred. This is evident, for instance, in the study's conclusion that: 'Australian merchandise exports to China are estimated to increase by around A\$4.3 billion or 14.8 per cent in 2015 as a result of the FTA (sic).'

The contribution this slide from possible to actual outcomes made to community understanding is reflected in a Sydney Morning Herald editorial comment, following release of the study: 'The government has released a feasibility study which promises (sic) a \$24.5 billion bonanza for Australia from the China deal over the next decade (sic)'.<sup>7/</sup> While the study was used to create this quite specific public expectation about the magnitude of our gains from negotiations, and that those gains would materialise over the following decade, the government responded to concern expressed about the adjustment implications for our most vulnerable (standard technology, labour intensive) industries by saying that it was too early to consider adjustment problems that may never materialise. <sup>8/</sup>

We were left to conclude that the projected (possible) gains from negotiations (which had yet to begin) were in the bank, while a policy to deal with the adjustment involved for those industries most vulnerable to Chinese competition was premature. Whether intended or not, the effect was to encourage a quite positive public expectation about the outcome of negotiations that had no basis in fact. This is probably inevitable when the information available to the community is delivered by officials whose job it is to sell the agreements being negotiated.

Finally, the China FTA contains a get-out clause, similar to one in the agreement with the US, which debases its value as a binding commitment: "a temporary bilateral safeguard measure may be applied if either an Australian or Chinese domestic industry faces "serious injury" due to a surge in imports following a reduction in tariffs under ChAFTA."

Australia already has form on dumping. Austrade has for many years encouraged Australian producers to export at prices that recover marginal costs. When our Asian trading partners do that, we call it dumping. When we do it, we call it marginal pricing.

The effect of this double standard on relations with our Asian trading partners hardly needs to be spelled out. Already this year seventy per cent of notices registered on our dumping authority's website involve competition from our Asian trading partners. And over eighty per cent of these involve China.

If we wish to develop a 'transformational' trading relationship with China and other countries in the region we will need to remove the double standard that pervades our present approach.

## Trade policy as part of Foreign Policy

Administrative arrangements still treat trade policy as a branch of foreign policy, as though it is not primarily about establishing the conditions for internationally competitive domestic economic development. As a manifestation of this mindset, our trade officials advised the government against the use of our own domestic transparency procedures – for which the Productivity Commission is now responsible – when preparing our 'offers' for the Uruguay Round. This is the system established in 1973 to provide advice about the future economy-wide consequences of protection changes under consideration by Australian governments. They argued that this would disclose Australia's negotiating position to other parties in the trade bargaining process: 'From a trade perspective ... the very process of public inquiry ... advertises to the world the very nature of the Government's concerns and likely direction of reactions, thereby leaving little or no negotiating possibilities.'<sup>9</sup>

Keeping Australia's negotiating position secret was considered more important than employing public procedures to help structure our negotiating 'offers' – that is, the reductions we were prepared to offer in our own protection – in a way that would enhance national economic welfare.

Nothing has changed since then.

DFAT defends its approach, limited to negotiating access to external markets, on the grounds that the scope for reducing our own trade barriers has been exhausted. This is not supported by the facts. Although our border protection, in the form of tariffs, are now quite low the Productivity Commission has reported that assistance to industry (ie, our remaining barriers to trade ) was over \$17 billion in 2013-14. That does not include an unknown amount of hidden assistance in non-border forms. And we need only reflect on the present approach to dumping to recognise that the scope for removing domestic impediments to trade is very far from exhausted.

## What is missing?

The processes currently used to explain the future consequences of bilateral negotiations have clouded our understanding of what is at issue for Australia.

In each bilateral agreement completed to date the 'scoping' and 'feasibility' studies released in preparation for negotiations projected the potential or possible gains for Australia. They did not, and could not, project what was actually achieved from the ensuing negotiations. The complex technical projections were usually undertaken with a fair level of professional competence, and were therefore not problematic in themselves. In each case, however, those projections were subsequently used to create an unreal public perception about the outcome of negotiations. The quite modest outcome for Australia from those negotiations, limited to the gains from winning access to (just some) external markets, meant that the projected gains made available at the outset conveyed nothing about what we eventually achieved from the negotiations. Yet they were still quoted to support the agreements after they were signed, as though they reflected the actual outcomes for Australia.

In the absence of disinterested advice about the market "concessions" to take to the negotiating table and a basis for assessing the agreements, as negotiated, the difference between the potential or possible gains and those actually achieved became blurred for us. Community understanding and acceptance of the agreements have not resulted from the transparency arrangements put in place to help public understanding of the economy-wide effects, but a lack thereof. Australians generally find the whole process bewildering. We have succumbed to official assurances that the agreements would bring substantial, albeit unspecified, national economic benefits.

The language used in trade diplomacy obscures the clarity of what is at issue--securing the gains in national wealth from engaging in trade on the basis of what we do best. This simple logic has been corrupted into the language of trade negotiators, lawyers and consultants, unintelligible to ordinary folk.

The contribution of the transparency arrangements introduced in the early 1970s--and which prepared the way for the reforms of the 1980s and 1990s--is to inform, not to manage, community understanding of what is at issue in opening domestic markets to international competition.

At issue is not just that we do not yet know the outcomes of the agreements (as negotiated) for the Australian economy as a whole, or that the information made available at the beginning of negotiations was subsequently used to foster heightened and unrealistic public expectations about the outcome for Australia. A more important issue is whether we have

learned from the experience, about how trade policy and trade negotiations should be conducted in future.

## What must change

While we cannot now change how we negotiated the agreements with the US, Japan, Korea and China, we can ensure that it does not reflect how we approach future negotiations.

If we are to close the gap between trade diplomacy and economic reality, we need to respect three lessons from experience : first, a major part of our gains from trade agreements depends on what we take to the negotiating table, not what we hope to take away from it ; second, liberalising through trade negotiations cannot be pursued simply as an extension of foreign policy ; and third, as the Harper report on competition policy has recommended, future bilateral agreements should be subject to cost-benefit analysis before ratification.

The governance model that should guide trade policy is based on Australia's conduct in the Uruguay Round of trade negotiations. It confirmed that the domestic decisions needed to secure the gains from liberalising unilaterally and in a negotiating context have converged.

The negotiations in the Uruguay Round took place at a time when Hawke and Keating were liberalising our own barriers unilaterally, to secure the efficiency gains involved. Their productivity enhancing reductions were subsequently offered, and accepted, in Uruguay negotiations as our market-opening contribution to global trade reform. As a consequence, we secured all the gains available from trade negotiations - the major gains in productivity from reducing the barriers protecting our less competitive industries, as well as those available from access to external markets.

That produced the win-win outcome we should be seeking from all trade agreements. It made a substantial contribution to the prosperity we have since enjoyed.

The opportunity to improve the performance of the economy in this way was missed in all three FTAs concluded last year. In those negotiations our agenda was simply a market-access wish-list; negotiations were conducted in secret ; the outcome for domestic efficiency was determined solely by the market-access arrangements negotiators happened to agree on, rather than a central objective in deciding which domestic barriers to reduce ; and success was measured by whether the outcomes improved access to external markets.

It is true that we have gained worthwhile export opportunities from those agreements, but we could have achieved a great deal more if we had recognised that the obligation to reduce our own barriers creates an opportunity to improve productivity. When we fail to structure our market-opening offers to improve allocative efficiency, by reducing the barriers protecting our less competitive industries, we forgo the major productivity gains available from negotiations.

The consequences for domestic efficiency were demonstrated by the agreement with the US. We gained no worthwhile access for beef (in which we are world competitive) for the next

eighteen years, but secured immediate and unrestricted access to the US market for our motor vehicle industry (one of our least competitive industries).

If we continue to approach negotiations in ways that avoid adjustment for our own protected industries, the scope to develop export industries based on our real competitive strengths will diminish.

There is no conflict between the need for secrecy during negotiations and a process that provides transparency and a negotiating agenda that secures the productivity gains available. Both requirements can be met by following the model established in the Uruguay Round.

That would involve the Productivity Commission providing a basis for Australia's market opening offers, by conducting a public inquiry and report to government before future negotiations get under way. Its report would be released only when negotiations are complete.

This would preserve secrecy during negotiations while providing a basis for Australia's market-opening offers and for parliamentary and public scrutiny of the outcome before ratification.

The limitations of the present approach cannot be waved aside, as of little consequence. Each new negotiation provides an opportunity for economy-wide gains that enhance productivity and national welfare.

All that is needed to introduce the change is for the government to ask the Productivity Commission, before future trade negotiations get under way, to report on how Australia's market-opening offers should be structured to secure the productivity gains available--regardless of how other countries approach negotiations.

This proposed change respects the logic underpinning market-based policy and our system of government. The logic providing the basis for market economics assumes the existence of well-informed consumers. The logic behind democracy assumes a well-informed community. Those responsible for articulating the theoretical basis for both--people like John Stuart Mill, David Hume and Adam Smith--placed a condition on the relevance of each in enhancing the quality of governance and community welfare in countries practising them. The condition was, and remains, the existence of a well informed community in the case of democracy and well informed consumers as the basis for market economics.

That is the rationale for the domestic transparency arrangements established in Australia in the early 1970s, structured to operate outside government and independent of private interest groups. Those arrangements were put in place to make our democratic system and market economics relevant in decision-making on protection issues, by providing the information governments, communities and consumers need to promote decisions that enhance community welfare.

Most of us have only a passing interest in debates about trade policy. The negotiators' approach enjoys acceptance in popular perceptions of what is at issue for Australia, because the competing approach is counter-intuitive. DFAT's grip on trade policy has proved impervious to public challenge and will only be removed by strong political direction.



Responsibility for introducing and explaining the need for change rests squarely with political leadership.

It will require a preparedness to embrace (and explain to the rest of us) what is at issue for the economy and community, in language we can all understand.

An important consequence of this change is to allow the community into the debate about trade policy.

The change received strong support from Australian and New Zealand business leaders and industry organisations when it was proposed by the Tasman Transparency Group. 10/ But because their focus has been on the international processes that constitute their policy remit, our trade officials have not engaged with the domestic issues in trade policy. As a consequence, they have been unable to offer an approach that secures the major domestic efficiency gains available from trade negotiations.

There are no grounds for suggesting that DFAT is other than competent in dealing with issues intrinsic to foreign affairs. But trade policy is not one of those issues.

In view of the obvious policy impasse that now exists, it may be time to place ministerial responsibility for trade policy with the Treasurer, who already has responsibility for the Productivity Commission and the rest of microeconomic policy.

## Notes

**1/ Estimate provided by the Centre for International Economics, 22 September 2004**

**2/ by Dr Philippa Dee, for the Senate Committee established to review the agreement**

**3/ In the Australian, 27 February 2004**

**4/ Reported in the Australian, 11 March 2004**

**5/ Alan Oxley, in the Australian, 19 October 1998**

**6/ DFAT website**

**7/Sydney Morning Herald, 21 April 2005 (Emphasis added)**

**8/ Quoted in the Canberra Times, 20 April 2005. Following public concern expressed about that response, Trade Minister Vaile announced that these industries would not lose their existing protection arrangements as the result of an agreement with China**

**9/ Department of Trade submission to government in 1984, following the review of the Industries Assistance Commission by John Uhrig**

**10/ Documents conveying this support are copied on *tasmantransparencygroup.org***

