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MORTIMER REVIEW OF TRADE POLICY: UNFINISHED BUSINESS

Governments around the world have to date made little effort to explore ways of protecting international trade negotiations against the developments that stalled progress in the Doha Round. The Australian government and the incoming New Zealand government are two possible exceptions.

During the Uruguay Round New Zealand's trade representative in Geneva, Tim Groser, (now a member of the National-led government in New Zealand) championed an approach to future multilateral trade negotiations that recognised the domestic source of the problems threatening progress in the World Trade Organisation (WTO). He re-affirmed his commitment to that approach at a recent conference in Sydney, sponsored by the Lowy Institute for International Policy. For its part, the Australian government recently commissioned a review of trade policy by David Mortimer, before deciding how it should meet its commitment to support the WTO - its highest trade policy priority. So the possibilities (and portends) seem positive.

The Mortimer report is now with the Australian government. What follows is an assessment of whether it provides value for money.

Most people have a limited understanding of trade policy. The clarity of what is at issue - the opportunity to enhance national wealth by engaging in world trade on the basis of what we do best - has been corrupted into the language of trade lawyers and negotiators, unintelligible to the rest of us. Policy bystanders are left to accept, and hope, that trade policy is being conducted in a way that reflects our national interest.

Academic and other professional economists, however, are not so constrained. Their training and experience should have given them a much better understanding of trade policy than is available to the rest of us. They therefore have an opportunity (and responsibility) to help build public understanding of the contribution it can, and should, make to our future prosperity. This is an important domestic policy issue that warrants their close attention if Australia and New Zealand are to enjoy the rewards *potentially* available from participating in the WTO. Because they are not under pressure to conform to existing policy orthodoxy, they can help ensure the present re-examination of trade policy does not produce the superficial response that too often follows such inquiries.

The purpose of the following notes is to encourage a public contribution from this group, to help reduce the risk that the Australian government's commitment to the multilateral (WTO) system will fall through the policy cracks left by the Mortimer report. A similar contribution by their colleagues in the 1960's helped raise public awareness of the cost to national prosperity of maintaining Australia's extensive trade barriers. It was this public awareness that ended protectionism as the driver of Australia's trade policy.

The recent release of the Mortimer report coincides with an international review by the WTO of the way forward, initiated by Director-General Lamy. Both reviews have occurred at a time when progress in opening world markets through multilateral trade negotiations has stalled, after seven years of intense negotiating effort.

The notes begin with a summary of major developments that have stalled progress in multilateral trade negotiations, followed by:

- a brief statement of the logic supporting an initiative proposed by Australian and New Zealand industry and business organisations, (which involves adding a domestic transparency process to existing WTO processes) ; and
- the response to this proposal, and to its terms of reference, by the Mortimer panel in its final report.

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11 November 2008

Major developments challenging the WTO system

The **first** of the challenges facing the existing processes of the WTO is the change occurring in the forms of protection in use — a change **from tariff to non-tariff, and from border to non-border**, forms.

International negotiations and agreements achieved a great deal in opening world markets in early GATT Rounds, due to the relatively simple nature of the decision rules involved in negotiating **tariff reductions**. These were responsible for the very substantial liberalisation that took place among North Atlantic countries.

But we have reached the point where progress through such easy decisions is behind us. Governments have found other ways of protecting their less competitive industries. Average industrial tariffs in OECD countries fell from 40 per cent to 4 per cent through multilateral agreements. Meanwhile, however, non-tariff barriers have grown to the point where they now affect nearly half of world trade. In providing protection in these forms, governments have demonstrated that international rules and negotiations alone cannot deliver the national rewards participating countries expect from multilateral trade negotiations.

The increased use of non-tariff barriers was described—over a decade and a half ago—in the following way by developing countries:

‘Since the birth of GATT there have been a number of negotiating rounds that have dramatically reduced the level of tariff rates in the major industrial countries...It is generally agreed that tariffs do not constitute a significant barrier to imports into the OECD countries. As tariffs have come down, other restrictions on imports have appeared... There seems to be a move to other protectionist measures...’ **1/**

In coming to terms with this ‘new’ (non-tariff) protection, traditional negotiations face great difficulties. Unlike tariffs, the new forms of protection lack transparency. As a former Director-General of the WTO observed about existing WTO processes:

‘There is a side to the WTO that leaves in the hands of governments many tools of trade protection...There is no shortage of escape routes from international competition...In the end it all comes down to politics.’ **2/**

The **second** development is **an expansion in the scope of international negotiations to cover services**. In this new area the forms of protection are as complex and diverse as the service industries themselves. Many are in non-border forms and are seen, especially by those who oppose their removal, as belonging to domestic policy—beyond the reach of international rules and negotiations. This, together with the rise of less transparent forms of protection to replace tariffs as these were bargained away, means that the relatively simple decision rules that delivered progress in the past can no longer do so.

The **third** development has been **a flight to negotiate bilateral trade agreements**, adding to the loss of momentum in the WTO.

These developments have exposed the limitations of the traditional bargaining approach to opening world markets, on which the WTO has relied. The impression conveyed by that approach was that the gains for countries participating in multilateral negotiations result from the bargaining skills of their trade representatives in winning market ‘concessions’. That impression was, and remains, false.

To the contrary, **the greatest gains for each country result from reducing its own barriers.** The residual gains available from liberalising in a multilateral context — those resulting from greater access to external markets — materialise only when participating countries agree to reduce the barriers protecting *their own* less competitive industries.

Paradoxically, therefore, the gains for countries participating in the WTO system — including those resulting from greater access to world markets — depend on each approaching the negotiating table with ‘offers’ consciously structured to secure the gains from liberalising its own markets. The domestic decisions needed by national governments to secure the gains available from liberalising unilaterally and in a multilateral context are the same. Progress through international negotiations depends on what each participating country takes *to* the negotiating table, not what they hope to take *away* from it.

This has profound implications for the future of multilateral trade reform and for Australia’s access to world markets. Progress will depend on removing, or reducing, the scope for conflict between the two separate processes involved. One process involves negotiations by trade officials, aimed at reaching agreement to reduce trade barriers.

The other takes place at home, *within* countries participating in multilateral trade negotiations. This involves decisions by governments about what access to their *own* markets should be included in the ‘offers’ their negotiators take with them to Geneva. As has been demonstrated in the Doha Round, this second process is crucial to the outcome of negotiations. When governments individually succumb to pressure at home to minimise adjustment for their own protected industries, they cannot collectively (through trade negotiations) increase export opportunities for their world competitive industries.

The authority and procedures of the WTO are limited to the first process, while the problem that has stalled progress in the Doha Round has its origin in the second. Finding a way to remove the potential for conflict between the two was therefore a major challenge for the Mortimer review, in responding to the government’s commitment to the WTO system.

The impasse that has developed in multilateral trade negotiations, and is manifest in the Doha Round, is not the fault of negotiators. Their ability to reach agreement was constrained from the outset by the domestic market-opening ‘offers’ established at home, under pressure from private interest groups. The influence of those private interest groups has swamped consideration of the economy-wide (national) interest in national preparations for multilateral trade negotiations. It should therefore not be surprising that governments are having difficulty mobilising a strong domestic commitment to reduce their national barriers in a trade bargaining context, and to maintain reductions agreed in that context.

It is only by having a basis for giving priority to national over sectional interests in domestic preparations for the bargaining process that a closer match can be established between the expectation of national gains from international negotiations and the outcome of the negotiating process itself. There is no such discipline in the way domestic preparations for international trade negotiations are structured at present.

The need for greater domestic transparency

In its submissions to the Mortimer review, the Tasman Transparency Group (TTG) proposed that Australia and New Zealand sponsor action to add a domestic transparency process - designed, owned and operated by individual member countries - to the existing international processes of the WTO, to help governments resist pressure from protected domestic interests when preparing for future multilateral negotiations. 3/

This proposal reflects a growing recognition that:

- the existing **international** disciplines of the WTO are not providing a persuasive **domestic** reason for lowering trade barriers;
- it is the positive or negative perceptions at home about the domestic consequences of liberalising that determine how much actually takes place; and
- it becomes politically realistic to secure the gains from lowering domestic barriers only when pressure from protected domestic groups, who see liberalisation as detrimental to their interests, is balanced by a wide domestic awareness of the overall domestic benefits from adjusting to the changes involved.

The logic supporting the proposal is as follows:

- the major rewards available to countries liberalising, whether in concert with other countries or not, come from reducing their own barriers;
- the domestic barrier reductions needed to gain these rewards are also those needed, in the “offers” negotiators take to Geneva, for the WTO to deliver the additional rewards available from liberalising in a multilateral context;
- both the unilateral gains (from liberalising domestic markets) and the additional gains (*potentially* available from multilateral trade negotiations) therefore depend on improving the trade policy decision-making process at home;
- the role of the proposed domestic transparency arrangements is to counter the negative influence protected domestic interests now exercise over the market opening “offers” participating governments take to Geneva;
- its contribution to strengthening the multilateral system is to help decision-making on protection (trade barriers) by participating governments reflect the interests of the domestic community as a whole, rather than pressure from protected domestic interests;
- it will do so by enabling WTO member governments to raise community awareness of the domestic costs of maintaining their own trade barriers, and the economy-wide benefits from removing barriers to international competition; and
- as a result, protected domestic interests will find it more difficult to gain community support for resisting market opening commitments widely seen as nationally beneficial.

The domestic transparency proposal brings into account a reality that existing WTO processes cannot address. The WTO has no authority to deal with the domestic pressures threatening its future viability. It simply provides an **international negotiating forum** for participating countries. But the pressures that are now preventing meaningful progress operate in the **domestic** political arena, focus on **domestic** policy issues, and exercise power over **domestic** decision-making.

The strength of the TTG proposal is that it addresses directly the domestic pressures threatening the future of the WTO, while respecting the autonomy of national governments over domestic policy. It

has particular relevance for progress in opening markets for services, where access is severely limited by opaque ‘behind-the-border’ barriers. These include domestic regulations introduced (often at the local or provincial level) for reasons unrelated to trade policy, but which have important (unintended) effects on market access and competition. By their nature, many ‘behind-the-border’ barriers are unlikely to reach the negotiating table unless the national ‘offers’ prepared for negotiations in Geneva are consciously structured to secure the (unilateral) gains available from opening domestic markets to international competition. It is only in that context, when the focus is on the gains available from opening domestic markets, that WTO member governments (and their domestic constituents) are likely to recognise that dismantling these non-transparent barriers will also increase their gains from trade liberalisation.

Consistent with that logic, members of the Australian and New Zealand transparency group argued that WTO processes should *begin* with unilateral decisions taken at home, aimed at securing the economy-wide gains at issue in liberalising domestic markets, and *culminate* in international negotiations and agreements—not the other way around.

The Mortimer recommendations

Both the Mortimer review and the international review initiated by the Director-General of the WTO have produced limited (and limiting) views about the contribution transparency can make to the problems that have stalled progress in multilateral trade negotiations. One such view (expressed in the WTO review) is that it simply involves providing information about the *existence* of each country’s trade barriers. Another is that transparency can be imposed from the outside. A third is that the main beneficiaries from greater transparency are each country’s trading partners—those in other countries seeking market access. Both reviews grossly overstate the role of international negotiations as engines of trade liberalisation.

In contrast to that approach, the initiative proposed by the TTG recognises that:

- opening domestic markets to international competition involves domestic policy issues that need to be addressed by, and *within*, member countries—**rather than imposed from outside**;
- information about the *existence* of each country’s trade barriers **does not provide the information domestic constituents need** to understand the major gains from reducing their *own* trade barriers;
- a wide understanding, within WTO member countries, of the economy-wide effects of reducing their own barriers is the key to restoring progress in the WTO--**not the effects on trading partners**.

The most important insight from experience in the Doha Round is that progress in future multilateral trade negotiations will be determined by how national preparations for those negotiations, involving decisions about what domestic market opening ‘offers’ to take to Geneva, are conducted at home. This insight (uncontested in the Mortimer report) turns on its head the traditional approach to multilateral trade negotiations, in which negotiators seek to gain as much access to external markets as possible while conceding as little access as possible to markets at home.

The Mortimer review provides muddled recommendations by confusing two important, but separate, objectives of trade policy included in its terms of reference—to support the WTO system on the one hand and to integrate economies in the APEC region on the other. It dismisses the proposed domestic transparency initiative, which focuses on the first objective, in the following way:

“Some stakeholders raised the idea of Australia urging other countries to establish public bodies—similar to the Productivity Commission—to promote the benefits of trade liberalisation. The Review sees some merit in the proposal, but considers that an international campaign to this end would be resource-intensive and unlikely to attract support in the short term. We believe the same goal could be advanced in a different way through existing structures. Specifically, the Review believes that current capacity-building exchanges between Australian government agencies and our East Asian trading partners represent a suitable avenue for promoting improved transparency mechanisms in the region.”^{4/}

We are left to conclude that Australia’s approach in APEC is an appropriate response to the difficulties that have stalled progress in the WTO.

Professor Peter Drysdale, a leading economist in Australia’s APEC initiative, has expressed a different view. He has argued that the WTO and APEC initiatives are not substitutes, that they should be seen as complementing each other rather than competing initiatives, and that the comprehensive range of domestic policy issues covered by the APEC initiative goes well beyond what would be acceptable (and therefore appropriate) in the WTO.

There are sound reasons for his view. The scope of the APEC initiative on economic integration covers the full range of domestic policies including, for instance, macro-economic policy and infrastructure development, as well as related issues like governance. Its objective is to remove all impediments to domestic efficiency in APEC markets. It is clearly the appropriate model for integrating economies in the APEC region. But the issue for the Mortimer review, in responding to the problems facing the WTO, was not whether the approach in APEC provides an appropriate model for economic integration in our region. It was whether it is the appropriate response to the problems that have beset the multilateral (WTO) system. As explained by Professor Drysdale, it clearly is not.

The need for a domestic policy response to the present impasse in the multilateral system is confirmed by a recent study conducted within the WTO, based on the experience of 45 member countries. The study concluded that the failure of Doha negotiations to produce an outcome resulted from the influence of protected domestic interests over the market opening offers their governments took to the negotiating table:

“This compilation of forty-five case studies ... demonstrates that success or failure is strongly influenced by how governments and private-sector stakeholders organize themselves at home ... Above all, these case studies demonstrate that...sovereign decision-making can...undermine the potential benefits flowing from a rules-based international environment that promotes open trade.” ^{5/}

The response offered by the Mortimer panel is to persist with existing WTO disciplines-- international diplomacy and negotiations. The reality, confirmed by the experience of the 45 countries covered by the WTO study, is that progress depends primarily on the decisions taken by individual governments at home--about reducing their *own* barriers.

The initiative proposed by the TTG is the only approach on offer that responds to this reality, while leaving governments in full control of domestic policy. It was dismissed by the Mortimer panel on the grounds that it would require an intensive effort by public officials, and is unlikely to gain acceptance “in the short term”. The review panel recommended that those same public resources be applied instead to a response based exclusively on processes (negotiations and diplomacy) that history has

demonstrated *cannot* address the issue. The problem will persist until its domestic source is recognised and addressed squarely, by an approach that *can* deliver the nationally rewarding outcomes we all expect from multilateral trade negotiations.

In view of the government's commitment to support the multilateral system, it cannot credibly allow the muddle left by the Mortimer review to become (or remain) official policy. Long term policy problems like the one facing the world trading system will not be resolved by a policy focus that does not extend beyond the short-term. Prime Minister Rudd recently confirmed, in response to the global financial crisis, that the Australian government is committed to developing long-term responses to long-term challenges affecting Australia's future prosperity. This is one of those long-term challenges.

While the WTO and APEC initiatives differ in scope, there are major issues common to both. For instance, both still have a long journey to travel. That journey will extend beyond the life of the present government. It is therefore important that they are recognised and pursued as settled elements of long-term policy. Both emphasise that economic reform is about domestic policy issues, and needs to be pursued primarily through domestic processes. Both recognise that all domestic reforms will have effects throughout the national economy, and that decision-making should reflect an economy-wide perspective. And both draw on Australian experience, which began with trade reform in the 1970s and was extended to include other impediments to domestic efficiency in the 1980s. As the chairman of the Productivity Commission, Gary Banks, recently observed, reducing tariffs "set in train further 'behind the border' reforms that have . . . brought further substantial benefits to our economy". 6/

The key to both initiatives is, therefore, a domestic process – designed, owned and operated by individual APEC and WTO countries – to provide the policy information governments (and their domestic constituents) need to make reform possible. The recent experience of the Productivity Commission confirms that the pressure from domestic interests comfortable with established arrangements is not limited to trade reform. As Banks observed, those whose private interests are best served by existing domestic regulations are unlikely to acquiesce in having the costs to others (and to the broader community) identified and aired in public. That underlines the importance of domestic transparency arrangements in developing the APEC initiative.

The strength of the APEC initiative is that it includes all domestic impediments holding back the performance of economies in the region. The strength of the WTO transparency initiative, in addition to its relevance for reform in APEC, is that it includes all countries formally committed to liberalising global barriers to trade. The challenge for the government is to embrace both, and to pursue them as closely related elements of long-term policy.

Unfinished Business

It is clear, from experience in the Doha Round and the strictly limited authority of the WTO, that any response to the difficulties facing the multilateral system must satisfy three conditions:

- it must help participating governments develop negotiating 'offers' that will deliver the major (unilateral) rewards from liberalising their domestic markets;
- it must encourage and enable them to address their own 'behind-the-border' barriers to trade; and
- it must leave them in full control of domestic policy.

Without a domestic discipline that meets these conditions, outcomes from multilateral trade negotiations will continue to be the accidental result of a balancing act--in the international arena--between the requests of foreigners and the demands of domestic pressure groups.

Australia and New Zealand are small players in world trade, but have an opportunity to provide the support the WTO needs by offering a response that meets these conditions, and which deals directly with the domestic pressures undermining multilateral trade negotiations. The choice for the Australian government in responding to the Mortimer review is therefore straight-forward. It can continue to fiddle around the edges of the problem facing the multilateral system, as did the previous government, while sponsoring self-limiting strategies aimed at improving our position in particular markets. Or it can give substance to its support for the multilateral system, by promoting a relevant and comprehensive solution. Choosing the latter option will involve doing the hard yards required to add a domestic discipline to the existing international disciplines of the WTO. The potential gains for Australia (and New Zealand) are substantial, as are the costs of doing nothing.

ENDNOTES

- 1/ UNCTAD, *Trade Policies, Structural Adjustment and Economic Reform*, Geneva, 1992
- 2/ Peter Sutherland, Director-General of the WTO, in *The Australian*, 18 March, 2002
- 3/ The submissions and related documents are on its website www.tasmantransparencygroup.com
- 4/ Page 97 of the Mortimer report, at http://www.dfat.gov.au/publications/mortimer_report/mortimer_report.pdf
- 5/ *Managing the Challenges of WTO Participation—45 Case studies*, December, 2005
- 6/ *Industry Policy for a Productive Australia*, Colin Clark Memorial Lecture, 6 August, 2008