1
Australian Trade Policy
Strategy Contradictions

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1. BACKGROUND

THE WTO’s trade policy review (TPR) of Australia in 2011 – its fourth and first since 2007 – was undertaken in the context of a strong Australian economy that avoided going into recession in the 2007–08 global financial crisis and an economy which was enjoying historically high terms of trade in its aftermath. Australia managed to weather the financial crisis despite, as the TPR acknowledges, being one of the most open economies in the world. It was also undertaken soon after an inquiry into bilateral and regional trade agreements by the government’s independent policy review institution, the Productivity Commission. With the multilateral trading system weakened because of the stalled Doha Development Round at the WTO and the continued proliferation of bilateral and regional trade agreements in the Asia Pacific region and beyond, Australia has been among many countries actively pursuing its own preferential trade agreements (PTAs).

Previously, a champion of non-discriminatory, unilateral liberalisation and open regionalism (Garnaut, 1996), in the past decade and a half, Australia has pursued PTAs while espousing the primacy of the multilateral system and the consistency of its PTAs with that system. Australia continues to negotiate PTAs with key trading partners.

Yet Australia does not yet have PTAs with either of its two largest trading partners, China or Japan (see Table 1.1). Australia has been negotiating PTAs with both China and Japan, but negotiations have been stalled, and the trading relationships have prospered nonetheless.

The WTO’s TPR report was mostly positive about Australia’s openness and its progress in removing residual barriers to trade. Australia continues to reduce some
of its remaining tariff barriers unilaterally, albeit gradually, and to review and reform its institutions and domestic settings to increase competitiveness and productivity. The results have been mixed. Increases in national welfare in the past decade have mostly derived from a high and rising terms of trade, and there is a lack of evidence that it is from productivity growth (Gruen, 2012).

Given the largely positive TPR report of Australia, this paper focuses on the question of Australia’s role in the multilateral system as it prosecutes PTAs and examines ways of multilateralising some of those preferences, especially in a broader regional setting and under the WTO. It is argued that the current strategy of supporting the multilateral system while signing, negotiating and concluding preferential agreements is not consistent – creating contradictions in Australia’s strategic policy choices.

The paper is organised as follows. Section 2 provides a brief history of Australian trade policy and the current context within which the trade policy regime is operating. Section 3 provides a summary of the Trade Policy Review findings and contrasts them with recent and current trade policy initiatives. Section 4 examines the inconsistency of pursuing preferential trade deals while emphasising multilateralism and support for the global trading system as primary objectives, before Section 5 concludes.

### 2. THE AUSTRALIAN TRADE POLICY CONTEXT

Australia’s interests have aligned closely to a global trade policy framework predicated on keeping markets open and having a robust, non-discriminatory...
global trading system. Underpinned by confidence in the global trading system, and institutions such as Asia-Pacific Economic Cooperation (APEC) at a regional level, many of Australia’s neighbours in the region undertook much of their trade liberalisation unilaterally, without binding agreements (Elek and Soesastro, 2009). This was the only way forward for a region as diverse as the Asia Pacific region as countries at different stages of development and institutional reform, and with different economic and political systems, could not readily sign on to binding agreements with uniform provisions (Elek, 2010). Australia played an important role in that process entrenching this strategy after the 1980s with its own unilateral reforms and support for the creation of, and initiatives within, APEC, for example.

The most significant period of trade liberalisation and opening up for Australia began in the 1980s and continued into the 1990s (see Figure 1.1). That occurred unilaterally and not because of any binding agreement with another country or external institution, although progress with liberalisation was subsequently bound under the GATT. Even when its trade policy remained quite protectionist, as agricultural commodities were excluded from the early GATT rounds of trade liberalisation, Australia has had a history of support for the multilateral trading system which can be seen most prominently in the granting of most favoured nation (MFN) status in trade to Japan in 1957 and its retreat from the British preferential system in the same year, not long after the Second World War and before any other major trader except the United States, and later the establishment of MFN treatment for foreign direct investment from Japan in 1976 (Drysdale, 2006).
The Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or the CER Agreement) is a preferential agreement that has been in force since 1983, but the overall trend of Australian trade policy until the mid-1990s was multilateral in orientation, and the agreement with New Zealand was negotiated in the context of both countries’ commitment to multilateral liberalisation. That agreement is perhaps the only preferential trade agreement which covers all trade in goods as well as all services other than a very short negative list.

Australia concluded its first PTA, after the Closer Economic Relations agreement with New Zealand, with Singapore in 2003. But a more significant shift in Australian trade policy strategy occurred with the negotiation of the Australia–United States Free Trade Agreement (AUSFTA) which came into force in 2005. The Singapore PTA did not include agriculture and was not of the same scale or importance economically or politically as was AUSFTA. AUSFTA did cover agriculture, but the only significant new access to United States agriculture markets was for lamb, largely at the expense of New Zealand. There was no significant progress on sugar, beef or dairy.

Since then Australia has signed PTAs with Thailand (2005), Chile (2009) and with ASEAN and New Zealand (2010), Malaysia (2012) and has PTAs under negotiation with China, Japan, Korea, India and Indonesia. Australia is now also negotiating the Trans-Pacific Partnership (TPP) with 11 APEC members, including the United States, the Pacific Agreement on Closer Economic Relations (PACER) plus with its Pacific Island neighbours and the Gulf Cooperation Council (GCC), comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The most important of these negotiations are the TPP and the bilaterals with Japan and China, but the latter are the two bilaterals with which negotiations have stalled.

Some in Australia see the TPP as an important way to keep the United States engaged in the East Asian region and would argue that it had a promising open accession clause before it expanded from its original four members. That now seems to be under threat with recognition that China, Indonesia and others in the region will find it very difficult to join given the way in which accession hurdles are being crafted. Some in Australia also felt that the TPP was an opportunity to obtain greater access to US markets than was achieved under the AUSFTA and to lock in the established relationship with United States (Ranald, 2011). The TPP aims to be a ‘high standard’ agreement that has strong intellectual property rights protection, investor-state dispute settlement clauses, high labour and environmental standards, and set the trade rules in the region. Others argue that it is not clear

Australia should be part of an agreement of this kind that many large developing countries and Australia’s key trading neighbours cannot join.

Another plurilateral trade initiative has recently been launched in Asia called the Regional Comprehensive Economic Partnership (RCEP). It has open accession as one of its main principles and is more flexible towards accommodating membership at different stages of development than the TPP (Das, 2012). It could supersede both the trade agreements put forward by the ASEAN+3 (ASEAN plus Japan, China and Korea) and ASEAN+6 (ASEAN+3 plus Australia, New Zealand and India) groupings and could play a role in connecting up the different FTAs that the ASEAN grouping has with all ‘plus six’ countries.

In key political relationships, once political commitment has been made to negotiate and conclude a PTA, there is significant incentive to complete a deal no matter what its quality, in order to save face geopolitically. A retreat from either the Australia–Japan or Australia–China PTAs without having something else supersede them would likely hurt bilateral relations politically. PTAs can be structured, so that any preferential elements can be phased out over time, yet, unlike the example of ASEAN, Australia has not incorporated this element into its negotiation of PTAs. While Australia’s PTA initiatives have been prosecuted under the rhetoric of the priority attaching to the multilateral trade system, and the PTAs have been labelled WTO-plus or at least WTO-consistent despite PTAs being in direct contradiction of the core WTO MFN principle, there is no clear strategy for reconciling these elements.

More recently, there have been some signs that Australian trade policy strategy is moving back towards a non-discriminatory stance. The Australian government commissioned the report on Bilateral and Regional Trade Agreements by the Productivity Commission in 2010 which concluded that, thus far, the economic gains from Australia’s PTAs have been ‘modest’ and, given the lack of strong economic or trade benefits, are probably best described as political, rather than economic agreements. The economic value of PTAs have been oversold to the public (Productivity Commission, 2010) with the agreements driven more by political-strategic interests than economic objectives (Ravenhill, 2009).

Australia’s PTA with the United States, the AUSFTA, excluded sugar and other sensitive sectors, as most PTAs have. If Australia and the United States, who are political allies, could not liberalise sensitive sectors in an agreement with strong political backing, it is likely to be very difficult to do so with countries that Australia is less close to, politically.

The Productivity Commission’s report included recommendations that changes to the Australian pharmaceutical benefits scheme should not be negotiated in trade

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agreements, that intellectual property rights should not be strengthened beyond domestic settings through trade agreements and that investor-state dispute settlement should not be included in trade agreements.3

The Australian government response to the Productivity Commission report was outlined in its Trade Policy Statement which essentially accepted most of its recommendations and emphasised five principles: unilateralism; non-discrimination; separation; transparency and indivisibility of trade policy and economic reform. How is this shift to be reconciled with Australia’s continued pursuit of PTAs?

3. TRADE POLICY REVIEW

The TPR acknowledges that Australia is one of the most open economies in the world (WTO, 2011). The TPR is generally positive on Australia’s trade policy measures and its progress with trade liberalisation and reform. Australia is recognised for the high degree of transparency in its trade regime, including institutions such as the Productivity Commission which play an important role in the integrity of that regime.

Australia continues to coordinate reform and reduce internal barriers between states and territories through the Council of Australian Government (COAG) and the move towards a seamless national economy.

Some 96 per cent of tariff rates are now in the zero and 5 per cent range, and the average applied MFN rate is 3.4 per cent on industrial products and 1.4 per cent on agricultural products. Government assistance is low and mostly non-trade distorting (in R&D, for example).

The main trade barriers that remain are in automotive products, textiles, clothing and footwear and key infrastructure industries, and those continue to be reduced on an MFN basis over time, albeit gradually. Local preference policies in government procurement (WTO, 2011; APEC, 2012) also protect local suppliers.

There is still considerable binding overhang on Australian tariffs with the simple average of bound MFN rates much higher than applied MFN tariff rates, despite 96.5 per cent of tariff lines being bound. Australia could lower bound tariff rates, so that there is no uncertainty about applied rates, and there is no ‘space’ to lift tariffs in the future.

Another area the TPR highlights is the issue of sanitary and phytosanitary (SPS) measures where Australia’s strict quarantine laws, under which there is supposed to be proper scientific risk assessment, do not take into account cost-benefit analy-

sis for consumers or supply chain stakeholders. Cost-benefit analyses of the quarantine or biosecurity measures in place would bring transparency to the protections extended. The current settings mean any small amount of risk dominates the quarantine decision whereas, with rigorous cost-benefit analysis, those risks may be able to be safeguarded against in other ways and could create net welfare benefit.

While the TPR reviews the barriers and priority liberalisation areas it also reports the liberalisation affected under PTAs. More PTAs are not suggested, however, as the solution to remaining trade barriers and the implicit argument is that none of those barriers are best dealt with through PTAs. In fact, it is difficult to identify any trade policy objective that is better served with preferential agreements than through the multilateral system.\(^4\)

There is a tension and contradiction between the fundamental principle of the WTO, which is multilateral and non-discriminatory trade, as per Article 1 of the General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS), and the exemption to that which was introduced in Article XXIV of the GATT for trade in goods, in Article V of the GATS for Trade in Services and in the Enabling Clause, that allows preferential – discriminatory – trade. Both the TPR and the Australian government claim Australia is committed to multilateralism while Australia continues to pursue preferential agreements. Resolving this puzzle is discussed later in the paper.

The TPR lists the preferential trade agreements that Australia has signed and is negotiating, and notes that commitments under those agreements are WTO-plus, in that they go beyond WTO agreements in areas such as services, investment and intellectual property rights (WTO, 2011). Yet the Productivity Commission’s Report into *Bilateral and Regional Trade Agreements* found that those agreements ‘do not necessarily lead to significant reductions to services barriers’ and the ‘main impediments to effective competition’ are ‘regulatory and institutional issues that lie outside the scope of [preferential agreements]’ (Productivity Commission, 2010, p. xxxiv). That is consistent with Francois and Hoekman (2010) who show that there is zero evidence of services chapters in PTAs having any impact at all except in Europe. The reason is that negotiations within PTAs are not conducive to finding solutions to complex services issues which go beyond the provision of national treatment and extend deep into a domestic reform agenda.

On investment provisions, the Productivity Commission found that Australian preferential agreements did not reduce existing investment barriers but instead generally bound current arrangements and protected against future policy changes (Productivity Commission, 2010).

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Services and investment are areas in which there are potentially large gains from liberalisation but the gains accrue from opening up competition to domestic firms, not only to foreign competition and are therefore not suited to trading concessions in an international negotiating framework (Dee and Findlay, 2009).

As a result of AUSFTA, Australia strengthened its intellectual property (IP) rights regime, and this was, indeed, not carried out preferentially but affected Australian and all foreign participants in the Australian market. While the regime protects commercial interests, it is not clear that IP should be a priority in trade agreements, and there is insufficient evidence that such measures are welfare enhancing. The United States is a net exporter of IP and so AUSFTA resulted in net wealth transfers to the United States from Australia. There is strong evidence that the IP regime in the United States is tipped too much towards the interests of firms and away from the socially optimal balance, and also evidence that strengthening IP protection not only does not increase innovation (Lerner, 2009) but also that it might stifle innovation (Boldrin and Levine, 2012).

There is a growing body of the literature that shows, empirically and theoretically, that strong IP protection and patent regimes help to protect incumbent producers maintain monopoly rents and causes less innovation, not more (Boldrin and Levine, 2012). Hence, there would appear little justification from a social welfare standpoint for including IP in trade agreements. One outcome of including strong IP provisions for pharmaceuticals in AUSFTA was that it limited the ability to supply generic medicine in Australia (Harvey et al., 2004).

The jury is still out on whether preferential trade agreements are building blocks towards multilateral trade or whether they are stumbling blocks – that is having the second best be the enemy of the first best.

PTAs, or trade liberalisation through international negotiations more generally, lack one of the key mechanisms for helping to solve the problem of sensitive sectors – that is, a mechanism for giving voice to the domestic interests who are hurt by import substitution policies. Any mechanism that levers off ‘offensive’ and ‘defensive’ interests will fail to do this (including the process of reciprocal negotiations through the WTO). Such a domestic mechanism was important for unilateral reform in Australia in the 1980s that opened up sensitive sectors to international trade and competition (Findlay et al., 2003).

4. MOVING FORWARD FROM PREFERENTIALISM

The problems with preferential trade agreements are well known. PTAs are used to discriminate among trading partners, and they divert trade and investment away from third-party countries regardless of whether they are members of the WTO and are entitled to MFN trade treatment. They complicate trade and sometimes
increase costs when, as is common in trade now, traded products are not made in a single country, and different preferential tariff rates are applied on a single product depending on the rules of origin of each stage of value add.

PTAs can inhibit competition, rather than encourage it. Preferential trade deals create interest groups around new preferences, or preferential access to investment or service delivery, that can make it harder to liberalise further.

Liberalisation that occurs through negotiating PTAs, it is argued, may engage export interest groups that directly benefit from foreign market opening in overcoming resistance to trade reform. Yet by far the largest gains in trade liberalisation accrue from what you give up, not what you extract from others in a negotiating framework, so it would appear that a more productive catalyst might be found through mobilising the interests of consumers and end-users on importable goods and services in the cause of trade reform and liberalisation.

The failure of the Doha round in the WTO is often cited as the excuse for pursuing PTAs. But PTAs lock in preferences, and the result is that this second best (or even third best) PTA solution has become the enemy of the first best, non-discriminatory multilateral solution. Now that the Doha round is on ice, and the global macro economy is weak, it is a dangerous time to further weaken the multilateral system. Rather, there is need for leadership in reversing some of the damage that bilateral deals have performed to the non-discriminatory multilateral trading system.

Unlike liberalisation through PTAs, unilateral liberalisation does not distort trade towards preferred partners and allows for a more efficient allocation of resources determined by market forces at home.

Liberalisation through PTAs can be phased in but, unlike non-discriminatory framework agreements or agreements based on granting of MFN status, this liberalisation has a tendency to become entrenched, making it a somewhat static instrument for liberalising trade. Interests privileged in participating partners have motivation to protect that privilege and frustrate more general liberalisation. In addition, once a bilateral agreement is completed, for all practical purposes, that is the end of the process for trade negotiators. Renegotiation or further liberalisation in a PTA framework does not usually happen automatically even when review arrangements are built into the outcome, and movement of liberalisation post-negotiation is in fact very rare. Trade liberalisation is an ongoing process of removing barriers to efficiently allocate resources towards their most productive use and to further the division of labour for a freer, flexible and more open economy.

If PTAs are building blocks to multilateral trade, they are yet to prove so. There is no instance of any liberalisation achieved under an Australian PTA in the past decade having been extended on an MFN basis. Where PTAs have changed domestic settings and therefore have applied on an MFN basis, such as the
strengthening of IP laws as a result of AUSFTA, it is not clear that they can be considered trade liberalisation, are trade promoting or welfare enhancing. Such measures are not win-win or positive sum. Liberalisation conducted under preferential agreements has thus far entrenched trade discrimination, and it is therefore difficult to call it a building block for strengthening the multilateral trading system.

There is also the issue of PTAs crowding out the trade policy space in Australia. It occupies trade policy resources including at the political, bureaucratic and policy levels. It is difficult to support the primacy of the multilateral system beyond doing so in rhetoric, while being preoccupied with PTAs on the ground in practice.

The coexistence of PTAs and the multilateral system requires strengthening the multilateral rules and disciplines of the WTO (Heydon and Woolcock, 2009), the continued reduction of MFN tariff rates, and the multilateralisation of preferential investment and services access. It will be very difficult, but it may be possible to phase out the discrimination in PTAs over time.

Some proponents of PTAs as stepping stones towards regional trade agreements and then onto multilateralisation favour a consolidation approach. The consolidation approach would involve bilateral preferential deals being consolidated into regional deals. This sounds attractive in principle, but in practice it is unlikely to succeed in a way that will not be damaging to the global trading system. In cases in which regional trade agreements have been brought into effect involving existing PTA partners, bilateral deals have not disappeared or become less important. The outcome is another layer or set of trade rules and restrictions within that region (Menon, 2009). Neither do PTAs easily expand membership. In fact, overwhelmingly, they have not done so.

In order to reduce and eventually eliminate the distortions in Australia’s PTAs, different aspects of the PTAs have to be dealt with in different ways. Preferential tariffs, for example, can be multilateralised, and MFN rates can be reduced to the lowest preferential rates or reduced to zero. ASEAN managed to multilateralise most of the preferences in the ASEAN Free Trade Area (Basri and Hill, 2008). The ASEAN example is one of the few in which there has been multilateralisation of preferences. Another way to dilute tariff preferences is to reduce MFN rates, so that the margin of preference shrinks.

Preferential treatment under other non-tariff barriers to trade can be extended easily to third-party countries. The Australian economy is not best served by extending preferential treatment or access to a Malaysian, American or Singaporean firm to operate in the Australian market over a Japanese, Chinese or Indian firm.

The dilution or multilateralisation of the adverse effects of PTAs will provide a regional and even a global public good, which can be supported and emulated at APEC, for example. Leading a concerted approach to untangling the PTAs will compound the benefits and is an important interest in any agenda for reform through the WTO.
5. CONCLUSION

The positive news 2011 Trade Policy Review of Australia by the WTO glosses over the fact that Australia continues to undermine the multilateral trading system by prosecuting preferential trading agreements. It is not alone in promoting the proliferation of PTAs but given the success that unilateral reforms brought it, and the way in which the multilateral system has underpinned the growth of its trade and investment relationships with its largest trading partners, especially China and Japan, the consistency in that approach with its main trade policy objectives needs to be re-examined.

The global trading system is on the defensive, and it would seem helpful for open, advanced economies like Australia to return to the trade policy paradigms of unilateral liberalisation, and non-discriminatory, multilateral trade that are at the core of its strengths. One priority is to multilateralise the preferences in its agreements – by reducing the MFN tariffs and extending the preferential access that some investment and services providers enjoy. Another priority is to get domestic regulations and reforms right, so that there is no discrimination between foreign and domestic firms, let alone between foreign firms from different countries.

REFERENCES

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