

AUSFTA – A “Plus” Agreement A plus for Australia, “WTO Plus” and a plus for APEC

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1 March 2004**

Summary

This Agreement is a very effective instrument for economic liberalization for Australia. Importantly it also enables us to benchmark against economic standards in the world’s most competitive economy. While valuable for its own sake, it also creates an inbuilt protection against a risk attendant from the inevitable intensification of our economic, particularly trade, relationship with East Asia: inadvertent alignment with economic standards prevalent in East Asian economies. They are generally not competitive in the sectors that will determine global competitiveness in the developed world in the future.¹

AUSFTA achieves more than could be achieved through the WTO. Trade experts call this a “WTO-plus” result. The most consistent complaint about the Free Trade Agreement is that it does not free all trade between Australia and the US. This does not diminish the importance or value of agreement: this is not a standard used to judge the WTO. Finally, The Agreement gives important momentum to securing trade liberalization among APEC economies.

The Agreement in summary

The Agreement eliminates tariffs, valued between three and five percent, on most industrial goods. It expands access for dairy products and establishes virtually full market access for beef over 18 years (despite comments to the contrary, this is one of the most significant outcomes.)² It removes other agricultural barriers.

It significantly reduces barriers to investment from the US, creates protection for US investors in Australia and Australian investors in the US, provides for equal treatment for providers of services and establishes a long-term process to enable professional qualifications to be recognized in each economy. It has provisions on use of ecommerce, regulation of digital products and telecommunications which reinforce maintenance of open markets dependent on IT.

¹ This generalization applies to the developing economies in the region. But even among the advanced economies, like Japan, significant industries particularly in the services sector are not globally competitive.

² Our initial estimation is that the commitments on beef add a minimum additional A\$300 million per annum in today’s dollars to annual exports by year 18, providing an average annual increase in exports per year over the phase in period of A\$100 million. Because all tariffs are to be phased out, the ultimate increase in exports is likely to be significantly higher. For a discussion of the beef issue, go to www.austa.net/analyst/analyst27.html

It provides greater security of access for Australian exporters to the US market by creating protection against harassment from safeguard import controls. It also provides access to each country’s government procurement market.

It establishes processes to harmonize or cross recognize standards and conformance and it is likely to lead to processes to ease movement of people between the countries.

It establishes a formal, permanent mechanism for consultation over economic issues in the bilateral relationship.

AUSFTA liberalizes Australia

The Agreement will make the Australian economy more competitive. That is the point of trade liberalization. It initiates the process of reducing Australia’s tariffs to zero. It greatly frees controls on investment. The Howard Government has until recently been reluctant to embrace the rhetoric and philosophy of trade liberalization. It has never indicated how it would reach the APEC Bogor goal of zero tariff and investment barriers by 2010, nor set out its ambitions for global reduction of industrial trade barriers in the Doha Round in the WTO.

Taking these steps in the US FTA with one of Australia’s most important trading partners make it easy for the Howard Government to take the remaining steps to removing the residual impediments in Australia to trade and investment. It will also enable Canberra to move to adopt concrete targets for full liberalization by Australia in APEC and the WTO, and then lead on them in those forums.

Canberra cannot for long treat foreign investment from Europe and Japan (and for that matter New Zealand) less favourably than the US, as the FTA provides. It will now be a simple matter in time to extend the standard of more liberal treatment of foreign investment in the FTA to other sources. The AUSTA business group has always argued it should.³

When the history of the Howard Government is written, the US FTA will be the principal milestone which marked its contribution to ensuring Australia stayed focused on open markets and international rules for free commerce and investment. As things stand, it is unlikely there will be any results in the WTO to which the Howard Government today or a reelected Coalition Government could point to to lay claim for such a result.⁴

An Agreement for the future, not the past

The excessive focus on treatment of agriculture in the FTA is a backward look. This has been largely the consequence of the debate over the FTA.

³ Details of AUSTA are available on www.austa.net

⁴ This judgment is based on an assessment by the author of the likely timetable for progress in the WTO. See special edition No 7 of ITS Reporter on www.itsglobal.net

What is the significance of the point that Australia did not secure full access to the US agricultural market? It's not a commercial or economic point. All farm exporters recognize the FTA creates valuable increases in farm exports. It is a political point. Did the PM get less than hoped for? Wasn't that a political setback? Because the political answer to those questions is “yes”, and because the media focus on the agreement is predominantly on the political significance of the Agreement to the Government, the diminished political benefit of the Agreement to the Government, as political reporters have seen it, has been allowed by default to become the judgment about the substantive benefit to Australia of the Agreement. It has fed into the groupthink that operates in much of the debate about public policy in Australia.⁵

The effect is that debate about the FTA gives the impression that agriculture is the most important feature of the Agreement. The Agreement will deliver important additional returns to Australia's farm sector. But agriculture is not today the economic cornerstone in the economic relationship. Australia's economic relationship with the US has been reshaping since Australia made its manufacturing and services sectors competitive 20 years ago. Agriculture will diminish even further in importance. Like in the US, Australia's services sector is the leading generator of growth and jobs. The real importance of the agreement is how it fosters economic integration of the sectors which will drive growth and competitiveness in the future.

Future growth in the Australian US economic relationship will depend on Australian business cueing to contemporary developments in the US economy. Development and adaptation of new technology, particularly information technology, will drive the US economy in future. Australia may remain a minor innovator in IT in global terms, but to succeed it must continue to be a major adapter. The home of adaptation will be the United States.

It is very important for Australia as a middle sized economy to maintain the most competitive standards in the world economy. Australia's economic relationship, particularly trade, with East Asia will expand. China may emerge as Australia's largest export market. East Asia is likely to continue as the fastest growing economic region. We will increase exports of commodities, manufacturing and services, but the latter are likely to remain strongly oriented towards education and tourism. Most countries in East Asia do not have advanced or open services sectors (growth to date has been based on

⁵ One former head of Foreign Affairs and Trade (who did not have a trade background) declared that Australia should have walked away from the Agreement. And one former party leader who was nearly elected Prime Minister revealed the depth of his thinking on the subject by writing that a colleague at the business school drew to his attention that this international agreement entailed a surrender of sovereignty. Every international agreement does. “The Australian”, which gave the Agreement the widest coverage misdescribed the terms of the additional access on beef. The newspaper's writers can be excused for listening to farm groups who roundly criticized that agreement, but not for reporting readily available facts. This was a minor failing in comparison to the Sydney Morning Herald, the only newspaper to cast the announcement of the signing of the FTA in a negative light with a headline something like ‘America Triumphs’.

manufacturing) and need to take significant steps to develop them⁶. Maintenance of a competitive services economy is the key to growth in future for advanced economies like Australia. It is also the essential platform to secure the full benefits of the competitive gains from adapting information technology. As economic relationships intensify, values transfer. It is vital we guard against inadvertently allowing poorer standards in competitiveness in services in East Asia to shape our own.

Australia’s economic relationship with the US will be driven by investment and the ease with which business can be done in the US. The real importance of the Agreement is the extent to which it promotes that.

A “WTO Plus” Agreement

In a review of the economic impact of bilateral and regional trade agreement in 2000, a World Bank study⁷ noted that if two open, advanced economies entered a free trade agreement which promoted greater market discipline in areas beyond the traditional range of measures covered by the WTO, they could secure “WTO Plus” benefits which would enhance growth in both economies and not have a negative impact on trading partners or the global trading system.

AUSFTA provides liberalization that is not attainable or not easily attainable in the WTO. The WTO does not have provisions for liberalizing investment (except where it is to provide services business). Sweeping commitments to remove restrictions on services providers are difficult to secure through WTO procedures and rules on services. Negotiations on services in the WTO are with a large number of other countries. In these circumstances major trading partners are unlikely to give sweeping concessions to all trading partners.

The US and Australia have undertaken in AUSFTA to treat all services businesses on the same terms as domestic producers. Neither extended this right to the other through the WTO. They have agreed to embark on a systematic review of professional qualifications to enable professions to practice in both countries. That is not deliverable through the WTO except over a very long period.

They have also agreed to collaborate in a series of areas – telecommunications, and ecommerce for example - in a way that is not possible in the WTO.

The WTO is not geared to liberalize quickly on services or to update its agenda to include issues which reflect contemporary realities in the changing world economy. The speed of change in the WTO today is pegged to two things: how rapidly the US and the EU are

⁶ To develop fully competitive services sectors requires strong economic legal infrastructure, paramouncy of law over political intervention, effective competition policy, strong and enforceable intellectual property law, developed country standards of corporate governance and prudential financial supervision. No Asian economy matches those standards and it will be a long time before that becomes a standard in East Asia.

⁷ “Trade Blocs”, World Bank, 2000

prepared to liberalize on agriculture⁸; and the willingness of developing countries to add new issues, such as investment, to the WTO agenda. Cancun illustrated that they are unwilling.

Other industrialized economies through bilateral (US and Canada) and regional agreements (the European Unions) are proceeding rapidly to liberalize investment and integrate services sectors. Australia can do this unilaterally, but by doing through an FTA with the US, it can bind commitments in domestic law to liberalize to treaty obligations and, in the process, securing binding commitments to access to the US market.

And to revert for a moment to “old” and “traditional” areas covered by the WTO, it cannot be said today that Australia could have secured a comparable result on agriculture out of the WTO over the same period of time. There is no certainty that the Doha Round will end with a substantive result, little likelihood it will produce early liberalization of agriculture and low likelihood it will produce radical reduction of agricultural protection.⁹ And if the Doha Round does regain momentum, there is nothing to prevent Australian working in it to secure additional removal of global and US barriers to trade in agriculture.

APEC Plus

There has been a lot of talk about trade liberalization among APEC economies since the Bogor Declaration¹⁰ was adopted. That has been counterbalanced by a shortage of domestic policy to produce liberalization and weak commitments in trade law. AUSFTA is part of a new wave of agreements among APEC economies that produce effective and legally binding commitments.

Whether commitments to liberalize should be binding has been an issue in APEC since the failure a year later at the Osaka APEC Summit to agree that these commitments should be converted into a binding form. The US wanted legally binding commitments. Japan insisted this was not necessary, reflecting an Asian predilection to avoid binding commitments. That predilection has persisted in policy in Asia.

The ASEAN Free Trade Agreement has weak disputes provisions. The ASEAN China Agreement is more in the form of a political agreement. Japan has been unable to conclude a Free Trade Agreement with anyone, preferring political economic cooperation

⁸ This is a political issue, to which Australia itself has contributed significantly. The working reality in the WTO is that the speed of negotiations in all areas is to be only as fast as the speed of negotiations on agriculture. This linkage may not continue to suit Australia in the future.

⁹ To produce a substantive result, the Doha Round will have to be extended by two or three years. That decision may not be taken until the end of 2004. If the round ends in 2007, it is likely to set up a six or ten year program of liberalization of agriculture. It is unlikely to reduce any significant market access barrier to zero. The WTO does not liberalize agricultural trade barriers at that pace.

¹⁰ Under the Bogor Declaration, all countries made political commitments to reduce all barriers to trade and investment by 2010 for industrialized economies and 2020 for developing economies.

agreements. Japan cannot bring itself to negotiate agricultural provisions in its bilateral agreements.

The move by the US, New Zealand, Australia and Singapore to negotiate binding and comprehensive free trade agreements has set a new standard among ASEAN economies. The inclusion of agricultural liberalizing provisions in AUSFTA, however limited, demonstrate that agreements on traditional WTO areas as well as WTO Plus issues can be done and can have effect. These agreements add momentum for pressure for trade liberalization among APEC economies.

Measuring the benefits of AUSFTA

The most reasonable substantive query about the FTA is “Does it provide economic benefit?” The debate about costs has been limited, as befits the circumstances. Australia’s economy was already very open and arguably with higher levels of protection, it was the US which has to make painful concessions, not Australia. That is what has happened, although the pain is slight. Had the debate in Australia not been skewed to domestic political point scoring, an appropriate headline would have been “Australia Wins”.

Debate about the econometric modeling of the outcome of the FTA has been as unedifying as the political debate, and as uninformative. The CIE model commissioned by the Government posited a net economic annual gain of US\$ 2billion to Australia after 20 years. When the report was released, the Government announced the benefit in Australian dollars at around \$4billion. Since the dollar is now around US \$0.80 cents, those with rudimentary mathematical ability declared the Government’s announced dividend has been reduced. The whole thing was silly. No serious economic analyst would attempt to project the average value between two currencies over a twenty year period.

The fundamental error was the way in which the modeling was used, and probably even the commissioning of it in the first place. This is not to reflect adversely on the quality of the analysis done by CIE, merely the benefit to be derived from using that methodology in this case. Because trade barriers between Australia and the US on average were so low, the level of change in reducing existing barriers was going to be small on an economy-wide basis. Econometric analysis is inexact methodology and only really useful for plotting the effects of large changes, and even then to get a sense of the amount and direction of change. The real meaning of modeling of the reduction of barriers between Australia and the US was always going to be limited. The second error was to treat the result as if they were real.¹¹

¹¹ Astonishingly, one economist with a significant reputation did this to “demonstrate” that a preferential agreement would create economic diversion. This issue was the subject of articles in the Journal of the Australian Institute of International Affairs, the result of which was to discredit the “trade diversion” criticism.

Other econometric work was produced which modeled the effect of change from an FTA over five years. Most FTAs have far longer periods of change than this and the work was properly not endorsed by the research agency which commissioned it.¹² Then the Productivity Commission chipped in with “innovative” work on a new framework to assess the liberalizing effect of Free Trade Agreements.

The Commission showcased a new framework to assess a number of agreements and produced counterintuitive results. The most significant was that ANZCERTA did not lead to an expansion of trade between Australia and New Zealand. No one believed that.¹³ Inexplicably it modeled the trade liberalizing effects of agreements and arrangements that were not trade liberalizing agreements (they were trade cooperation agreements), then concluded that all the agreements it reviewed showed that overall the economic gains of free trade agreements had been overstated in previous work by others.¹⁴

To its credit the Commission did recognize that until now the standard means of assessing the economic impact of free trade agreements no longer reflected today’s reality that agreements between advanced economies were “WTO Plus” and not only included services, but investment and other measures to reduce impediments to business.¹⁵ However, given its own disposition to us econometrics to model the impact of measures to liberalize trade and its evident lack of expertise with provisions of trade agreements, its institutional capacity to make a useful contribution to this debate is limited.

The only sensible approach to assessing the impact of the measures in the FTA is economic policy analysis. There are trade experts in Australia with a reputation for objectivity and independence who have made distinguished contribution to international thinking on analysis of measure impacting on trade whose advice should be sought if independent assessment is sought.

In practical terms there is no particular mystery to this agreement that anyone experienced in public policy could not themselves work out. Our business group has always considered that the numbers produced by the econometric analysis were way below the benefits this Agreement will produce and have repeated ad nauseam that any assessment that did not take into account increases in two way investment would vastly understate the value of the agreement.

¹² The Rural Industries Research and Development Corporation.

¹³ The Commission should have withdrawn and revised its work. It did not.

¹⁴ The Productivity Commission constructed an index of measures other than tariffs in an effort to measure the liberalizing effects of agreements. The index revealed lack of expertise in trade policy measures and included policy measures (domestic subsidies on agriculture) that were not ordinarily included in free trade agreements, predisposing the model to produce less favourable results.

¹⁵ This was a welcome development. Perspectives on the benefit of trade liberalization among economic commentators in the media appears to elevated the standard view of how to assess the welfare effect of free trade agreements to principle – any diversion is to be avoided – when it was always an empirical test.

There is no credible answer to the question “How much is it worth?” except to say, “A lot”. The second question should also be asked “What are the negative costs?” The Agreement does extend the term of copyright in Australia. It is difficult to assess the opportunity cost foregone as a result of that. Otherwise, economically, this appears to be a “painless” agreement.

Missed opportunity

There were two missed opportunities with this Agreement: making it easier to move between the US and Australia and getting government further out of the way.

Full economic integration requires freedom of movement of all of the factors of production including labor. Freedom of movement of labor is a powerful tool for integration in the European Union. The attack on the World Trade Towers on September 11 2001 increased border security such that loosening rules on movement between Australia and the US through AUSFTA became impractical. The issue is at least on the agenda in the bilateral relationship and we should make it a national objective to secure it in future.

The whole point of committing to reduce barriers to business to achieve economic integration is to remove the scope for government to impede cross border economic activity and allow it to be regulated only by law. Enshrining the commitments in law also ensure that it is difficult for governments to change them. The whole aim is to remove the scope for political intervention in economic decision-making. In effective legal systems, scope for government to intervene in adjudication of disputes about the law is also removed.

Treasury’s preparedness to reduce considerably its right to vet foreign investment proposals was therefore welcome. DFAT’s consistent opposition¹⁶ to inclusion of the “investor/state right” in the FTA (as it is provided in NAFTA) showed in reverse measure lack of commitment to or understanding of what is effective governance for economic integration. The measure would have depoliticized the initiation of legal challenges contesting failure to comply with provisions on investment, removing from trade and government officials the right to decide if disputes should be heard.

The result is that this agreement is not as path breaking or as attuned to the future as it should have been. These shortcomings do not diminish significantly the overall value or importance of the Agreement. Governments in future should work to strengthen the agreement in these respects.

¹⁶ Australian business discovered after conferring with US business during the negotiations that trade officials in both Canberra and Washington were in common mind to keep this out of the FTA. No rational explanation for this was proffered except that they did not believe it was “appropriate”. Heaven forbid that international trade law should remove the power of trade officials.

Conclusion

This is an effective and important free trade agreement. It serves Australia’s national interest. It anticipates the direction of future economic change. It strengthens Australia’s international economic interests at time of uncertainty in the WTO and it encourages the consolidation into formal commitments an ever widening set of proposals in East Asia to promote economic integration. It creates a fresh platform for Australia to encourage greater economic integration in APEC.

Most importantly it signals to the private sector in Australia and the US that the Australian Government understands the importance to Australia’s future economic prosperity of Australia’s private sector harnessing itself to cutting edge technology and business systems.

March 2004.