

Hope Springs Eternal

The Stan Kelly Lecture

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Stan Kelly, an advocate of tariff reductions

It is an honour to have been asked to deliver the Stan Kelly lecture.

Not because I knew Stan Kelly, but because I support his worldly philosophy – his advocacy of tariff reductions and open trade.

And because his son, Bert Kelly, also a farmer, was an avid supporter of free trade when it was totally unfashionable politically to be so. It was Bert who established this lecture in honour of his father.

Having looked at the list of previous guest lecturers, I find I have a strange connection with Stan.

Those lecturers include Frances Adamson, with whom I worked closely as Australia's trade minister and Andrew Leigh, a highly trained and talented member of the Albanese government's front bench.

They also include Lindsay Tanner, a parliamentary colleague in the Rudd government. Lindsay and I worked towards creating for Australia a seamless national economy.

They include Professor Ross Garnaut, my PhD thesis supervisor, and a peerless economist with whom I have spoken most weeks in the last four decades.

It was Ross who in 1983 persuaded resources and energy minister, Peter Walsh, to hire me to advise him on the introduction of what is now known as the Petroleum Resource Rent Tax, or PRRT.

Like Stan and Bert Kelly, Peter was a farmer who recognised the damage that high tariffs caused farmers by elevating their costs when they sought to compete in international markets – which were often heavily protected from the produce of Australian farmers.

Another former guest lecturer was Bob Hawke, who employed me as a microeconomic and trade adviser from 1986 until 1990, when Ross Garnaut did a runner to become Australia's Ambassador to China.

Reading Bob's address to this gathering in 1985, I note he mentioned his relationship with Sir John Crawford, who I also knew, from my PhD days in the Coombs Building at the Australian National University.

By that time, Sir John was Chancellor of the ANU. Hearing of my imminent move to Peter Walsh's office at the old Parliament House, Sir John offered me wise counsel: "Be careful, Craig, they drink a lot over there and you don't want to get caught up in that."

At the beginning of my interview with Peter in his office, he pointed to a little cubby hole and said: "That's your office." He suggested we have dinner in the Members' Dining Room for a further discussion about his manifold dislikes and prejudices, which occurred over two bottles of Houghton's White Burgundy.

Wisely or not, I'd forgotten Sir John's counsel and was judged suitable for the position.

Mercantilism and geopolitical rivalry

Soon after the end of World War II, in 1948, the General Agreement on Tariffs and Trade – the GATT – was established. Its purpose was to encourage countries to trade with each other rather than invading each other, thereby preventing World War III.

The idea was that if countries were economically interdependent, there would be less incentive to invade each other to gain access to each other's resources.

This philosophy, championed by the United States, worked for a long while, paving the way to an era of post-war peace and prosperity, as countries reaped the gains from trade.

But now it is breaking down, with potentially disastrous consequences.

Never, in the post-war era, has support for free trade been so weak in major countries.

Once a champion of free trade, the United States is now the leader of protectionism, in a rare display of bipartisanship among congressional Republicans and Democrats.

It began with the election of Donald Trump, who promised to Make America Great Again by building walls to keep Chinese imports and South American people out of the United States.

Trump declared a trade war on China, imposing tariffs of up to 25 per cent on a large range of goods. China soon retaliated with its own tariffs, resulting in an all-out trade war between the two countries.

But Trump's tariffs weren't restricted to China. He imposed tariffs on imports of steel and aluminium from the EU and many other countries, purportedly on national security grounds.

The Biden Administration has kept most of the China tariffs in place. It has replaced the tariffs on imports of EU steel and aluminium with a tariff-rate quota that permits only

specified quantities of steel and aluminium to enter the United States duty free, with any quantities exceeding those limits being subject to the pre-existing 25 per cent tariff.

More recently, the Biden Administration has legislated the Inflation Reduction Act that is replete with subsidies for carbon-reducing products such as electric vehicles that are made in America. These subsidies and local content rules discriminate against trading partners and US allies such as the EU and Australia.

The actions of the Trump and Biden Administrations are in clear breach of the WTO rules. Nobody seriously contends otherwise.

But the US faces no penalties. Why? Well, because the WTO's dispute-settling procedures are in tatters.

The US has alleged judicial activism on the part of members of the Appellate Body, which is responsible for dispute settlement. Those allegations probably have merit, but it doesn't really matter, because the Appellate Body is no longer functioning.

As the terms of the various judges appointed to the Appellate Body have expired, the US has vetoed the appointment of replacements. Now the Appellate Body has no members.

US complaints about China's behaviour in subsidising its state-owned enterprises formed an early trigger for its grievances against China. Such practices, however, are not covered adequately by the existing WTO rules.

I am not asserting that China has behaved impeccably or even in accordance with the spirit of the WTO.

Indeed, China has imposed tariffs or embargoes on a substantial number of Australian goods, including barley, wine, thermal coal, timber, cotton, hay and lobster. These measures would clearly be found to be in breach of WTO rules.

But disagreements about what is and is not acceptable practice are what new rounds of negotiations for updated global trading rules were meant to address.

More fundamentally, the US Congress has embraced the old notion of mercantilism – that exports are good for the United States and imports are bad. The MAGA philosophy – that trade surpluses should be sought, and trade deficits avoided – led to the Trump tariffs. Trump complained explicitly about America's trade deficit with China and promised to rectify it.

It's as if Adam Smith had never been born. In *his* era, Britain and other countries measured the wealth of nations in terms of how much gold and silver they had accumulated. Bullion was the international medium of exchange. Exports earned bullion while imports had to be paid for in bullion, so mercantilists argued that national wealth would rise the more a country exported and the less it needed to pay for imports.

Trade, in mercantilist theory, was a zero-sum gain. There were no mutual gains to be had; the nation with the largest exports and the smallest imports, as reflected in the accumulation of bullion, was the winner.

Mercantilist theory supported colonialism. Governments of colonial powers built up their navies in what was a cosy relationship with merchants.

Now, after many centuries, mercantilism is enjoying a revival, especially in the US.

China is to be put back in its place – where it was before being allowed entry into the WTO in 2001.

Since that time, China has become a manufacturing powerhouse, initially through using low-cost labour as peasants moved from paddy fields into the major cities. Entire American cities were hollowed out as manufacturing shifted to China.

To give two examples, Detroit's population is now around 630,000 people, well below its 1950 peak of 1.8 million. Pittsburgh's population has more than halved, from 675,000 in 1950 to just over 300,000.

As labour costs rose in China, it shifted its attention to sophisticated manufacturing and services, while relocating labour-intensive manufacturing to countries such as Bangladesh and Vietnam.

President Xi Jinping more recently has taken China along a journey to high-tech industries incorporating artificial intelligence, where it is already a world leader.

Through the Belt and Road Initiative, China has forged a pathway through, and economic connection with the 'Stans' of Central Asia – Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan – formerly of the Soviet Union.

When Bob Hawke met with Deng Xiaoping in China in May 1986, Deng explained that one of the reasons for opening China's economy was a fear of Soviet communism as an overbearing, hegemonic power.

China had learned harsh lessons from closing itself off to the rest of the world. In the 1400s, China owned the greatest fleet in the world, numbering up to 3,500 vessels. It despatched its 'Treasure Fleet' to bring back riches from as far away as Africa. But by 1430, the emperor had banned all voyages and had the entire fleet destroyed.

One theory for the motivation to turn inwards was that the emperor's court was worried about the rise of an affluent merchant class that might challenge the emperor's authority.

Whatever the reason, this act of destruction marked the beginning of China's isolation that eventually resulted in the Century of Humiliation from 1835 to the 1940s. Gunboats from western powers and Japan sailed up its rivers, established their own settlements and insisted on unequal treaties, including ceding Hong Kong to Britain.

The Century of Humiliation is etched into the psyche of the Chinese leadership. Its attitude is 'never again', partially explaining its growing military assertiveness in the South China Sea and beyond.

China and America are now in direct competition for global economic dominance.

To make matters worse, instead of economic integration, America and China are on a path of decoupling. On national-security grounds, America has compiled a growing list of restrictions on exports to, and investments in China, and is urging – if not requiring – other countries to join in the decoupling process.

In these circumstances, it is inconceivable that the United States and China will be sitting at the WTO negotiating table working on ways to better integrate their economies and those of the other 162 members.

America, understandably, will insist on China agreeing to new WTO disciplines on the use of state-owned enterprises to subsidise Chinese industries. China will not agree to these constraints, knowing America's plan is to restrict market access for China and to contain its economic growth and expansion as a rival superpower.

America and China are not alone in thwarting new global trade agreements

Where does the US-China impasse leave other members of the WTO and of the global trading system? Some will opt to align themselves with one or the other superpower. Others will want to stay out of it.

India, for example, has never been a strong supporter of the global trading system. When I was trade minister, India did everything in its power to thwart even the Trade Facilitation Agreement. It insisted that 'nothing is agreed until everything is agreed' in the Doha Round, knowing that everything that had been piled onto the Doha agenda would never be agreed.

So the world's fifth largest economy joins the first and second largest in opposing trade and investment liberalisation.

Nor will Russia become a champion of trade liberalisation with its adversaries.

Meanwhile, the EU retains its own penchant for protectionism.

The rules-based global trading system is in its most perilous state since its creation after World War II.

But in an era of intense geopolitical tensions and superpower rivalry, and in which a nuclear-armed power has invaded a neighbour, the need for economic liberalisation could not be greater.

All is not lost

It is hard to see Russia, China and the US at the WTO agreeing on anything of substance.

That has been the experience at other groupings such as the G20 and APEC.

When I was Australia's trade minister from 2010 to 2013, I found the Obama Administration to be genuinely interested in reform of the WTO and its trading rules. But the Doha round of multilateral trade negotiations, launched in 2001, proved too ambitious. It has since been abandoned.

But all was not lost. With the likes of Brazil's ambassador to the WTO, Roberto Azevedo, and Australia's ambassador to the WTO, Tim Yeend, I conceived the notion of 'new pathways' for negotiations.

This approach would select the more prospective elements of the Doha agenda and seek to bring them to fruition separately. Australia's prime minister, Julia Gillard, embraced the 'new pathways' approach, advocating it at meetings of the Commonwealth Heads of Government, the G20, APEC and the East Asia Summit.

At the biennial Ministerial Council meeting of the WTO in December 2011, I spoke of our 'new pathways,' proposing an agreement on trade facilitation. I argued that the developed world owed it to poor countries to assist them in facilitating trade by helping to improve customs procedures at their wharves and airports. That way, equipment could be brought in to build roads to connect poor people to world markets, giving them the opportunity to earn an income from their primary produce.

Following my speech, the Bangladeshi chairman of a group comprising the world's least-developed countries sought me out and told me how much he appreciated my motivation to help the poor.

In 2014, the WTO reached agreement on this 'new pathways' proposal. To its great credit, the US used its weight and influence to prevail over India and achieve this agreement. The Trade Facilitation Agreement came into force in 2017. The WTO's website says its full implementation can reduce trade costs by an average of 14.4 per cent, with least-developed economies forecast to enjoy an even bigger cost reduction.

At the most recent meeting of the WTO's Ministerial Council in June 2022, member countries reached an agreement to prohibit harmful fisheries subsidies. Ministers also agreed to talks on addressing concerns about the WTO's dispute settlement system with the hope of securing a fully functioning system by 2024.

Plurilaterals are permitted under WTO rules

How far can multilateralism take us when the two biggest economies on earth, the two superpowers, are fighting for geopolitical dominance and will not, at least in the foreseeable future, give ground to the other?

Indeed, what, in these dire circumstances, should the WTO's other 162 member countries do?

We can be bystanders, watching the superpower rivalry evolve.

Or we can follow our own new pathway, treading our own course while the superpowers play out their economic rivalry.

The theory of comparative advantage does not rely on every country participating in trade.

By definition, in the production of a particular good or service, one country will have a comparative advantage and the other a comparative disadvantage. But since the operative word is comparative, or relative, the other country will have a comparative advantage in the production of *another* good or service.

Each country stands to gain from specialising in the production of the good or service in which it has a comparative advantage and importing the good or service in which it has a comparative disadvantage.

To see this, consider the case of two neighbours, both of whom are good at mowing lawns. One is a strong young gardener who can mow a lawn in three hours. The other is a medical specialist who mowed lots of lawns while he was studying at university and can mow his lawn in two hours.

Who should mow the doctor's lawn? While the doctor is better at mowing lawns than the gardener, the two can gain from the gardener mowing the lawn.

This frees up the doctor to practice medicine, pay the gardener well and still have ample hourly income left over. While the doctor has an absolute advantage at lawn mowing over the gardener, both can gain if the young gardener mows the lawn and is well paid for it. Despite his absolute disadvantage, the gardener has a comparative advantage over the doctor in mowing lawns.

Importantly for today's purposes, the doctor and the gardener do not care that very powerful neighbours decide to mow their own lawns; their wellbeing is not dependent upon the behaviour of these non-trading neighbours.

So it is with any subset of the WTO member countries that might want to trade with each other. Even the poorest countries have a comparative advantage over richer countries in the production of some goods and services and can gain from specialising in their production and trading the output with richer countries.

But here's the problem: under the WTO rules, any one member can veto an agreement reached by all the others.

We don't see tiny Pacific Island nations vetoing agreements reached by the other 163 WTO members.

But China, America, Russia and/or the EU *could* veto an agreement reached by every other country.

Or could they?

While WTO rules empower any member to veto an agreement reached by every other member, plurilateral agreements among subsets of WTO members are also permitted.

Literally speaking, any WTO member can also veto the commencement of negotiations for a plurilateral agreement. India and South Africa have expressed their opposition to plurilateral agreements.

But this just drives countries to initiate their own plurilateral negotiations outside the auspices of the WTO, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP).

Existing plurilateral agreements within the WTO include those on government procurement (48 members) and information technology (82 members).

Negotiations for a plurilateral agreement of 18 WTO members (including the US, China and the EU) to limit tariffs on a list of environmental goods commenced in 2015 but were suspended a couple of years later.

The proposed plurilateral agreement on environmental goods is especially instructive.

It emanated from the work of APEC.

In 2012, the US was keen to secure an APEC agreement to limit tariffs to no more than 5 per cent on more than 300 environmental goods.

The American delegation arrived at Vladivostok ahead of the Leaders' meeting with its big list, which it presented at a meeting of APEC trade ministers.

China was opposed to such a huge list of goods and disliked the idea of APEC members negotiating any such agreements.

The host, Russia, told the meeting of trade ministers that it would be happy with a list of 20 environmental goods.

At an informal huddle of like-minded trade ministers at a morning tea break, I undertook on Australia's behalf to announce at the resumed meeting that Australia would not accept a list of just 20 environmental goods. Other trade ministers supported the Australian position.

By late afternoon, the meeting had agreed to authorise officials to negotiate a new list and report back the next morning.

Officials reported 60 goods on which agreement might be possible.

China's vice-minister told me that LED lights must remain on the list of 60 goods, which were a fairly new manufacturing activity in his country. I agreed.

But Russia announced its insistence on *excluding* LED lights, since it saw this as an infant industry for its manufacturing sector and wanted to protect it.

I encouraged the Chinese delegation to meet with their Russian counterparts, which they did, in a large huddle, on the conference floor.

After much deliberation, the huddle dispersed, and the Chinese vice-minister told me that China reluctantly would accept the exclusion of LED lights.

Another five lesser items were removed, leaving a list of 54 environmental goods.

At that time, Mexico's economy minister, Bruno Ferrari, anxiously advised me that he had just been urged by his capital to oppose the agreement. He quickly added that his party had already lost the election and he would finish up as minister towards the end of the year.

Bruno, a good friend and ally, with a big smile, informed me that, in these circumstances, he would ignore his capital and support the agreement.

Leaders unanimously endorsed the APEC List of Environmental Goods when they met shortly thereafter.

It has come into force and, despite it being voluntary, non-binding and non-discriminatory, 19 of the 21 APEC economies have fully implemented their commitments.

Plurilaterals at the WTO and APEC

When WTO Director-General, Dr Ngozi Okonjo-Iweala, visited Australia last year, I asked her what she considered the best-available means of achieving further trade liberalisation at the World Trade Organization. Without hesitation, she replied: "Plurilaterals."

I agree with the Director-General.

Australia enjoys good standing at the WTO and as the founder of APEC.

When an informal meeting was convened in early 2011 on a mountaintop at Davos to try to salvage the failing Doha Round, seven ministers received invitations, those of: the US, China, the EU, India, Brazil, Japan and Australia.

When Australia speaks at WTO and APEC meetings it speaks with credibility, as an honest trader and an honest broker.

On the sidelines of WTO meetings Australia has hosted drinks with what it calls the “friendlies.” These are like-minded countries committed to further liberalisation of trade and investment.

While the membership of the “friendlies” might have changed since I was trade minister, the idea hasn’t.

Some countries that come to mind are New Zealand, Singapore, Brunei, the Republic of Korea, Japan, Vietnam, Malaysia, Indonesia, Canada, Chile, Colombia, Mexico, Peru, Britain and Norway.

While some of these countries retain substantial trade barriers, they have also been advocates of trade liberalisation and have not traditionally been blockers in trade negotiations.

My proposal is for Australia to join with some or all these countries in launching plurilateral trade negotiations on topics of shared interest.

This could be done formally through the WTO’s processes for launching plurilateral negotiations.

And Australia could use its standing as founder of APEC to initiate plurilateral negotiations within the APEC membership.

These would be open plurilateral agreements, such that other countries could join the agreement if they matched its ambition.

Assessments would need to be made of their motivations. If one of the superpowers sought to join the negotiations, members of the plurilateral would need to be confident that the purpose was to advance trade liberalisation rather than bogging down the negotiations to prevent an agreement coming into force.

Australia was a willing participant in negotiations for the Regional Comprehensive Economic Partnership, which did not include the United States.

And Australia participated in negotiations for the Comprehensive and Progressive Agreement for Trans-Pacific Partnership that originally included the United States but does not include China.

Australia’s trade minister, Senator Don Farrell, and assistant trade minister, Senator Tim Ayres, have developed good reputations as trade negotiators. They are affable, persuasive and intelligent.

Senator Farrell has made encouraging progress with his Chinese counterpart in easing trade restrictions on Australia, where a couple of years ago no such progress was in prospect.

Whether or not they see merit in my proposal for working with “friendlies” to launch plurilateral negotiations within the WTO and APEC is a matter for them.

My purpose is to find ways of resisting the wave of protectionism that is washing over the United States and some other countries, and to avoid global trade getting caught up in the superpower rivalry between the US and China.

Pushing ahead with liberalisation without the involvement of either of the two largest economies on earth might not be ideal.

But nor is helplessly accepting the status quo of a reversion to protectionism through the disintegration of the World Trade Organization.

Plurilaterals and climate change

If that sounds like a dire situation, it is, in fact, far worse than that. Since the conclusion of the legally binding Paris Agreement on climate change in 2015, as a group the 196 parties to the agreement have failed to fulfil the commitment to pursue efforts to limit the global average temperature increase to 1.5°C above pre-industrial levels, and to hold the increase to well below 2°C.

The World Meteorological Organization (WMO) predicted in May 2023 that the annual mean global temperature for each year between 2023 and 2027 will be between 1.1°C and 1.8°C higher than the 1850-1900 average and that there is a 98 per cent chance of at least one in the next five years being the hottest year on record.

If ever the world needed an effective global agreement, it is now.

Since some countries will find reducing emissions harder than others, achieving the goals of the Paris Agreement will require trading in carbon offsets. For example, Singapore, Japan and Korea are heavily industrialised and do not have large endowments of natural, carbon-absorbing areas.

Countries such as Australia, Papua New Guinea, Indonesia and Brazil are better placed to store carbon in vegetation. And Australia, Malaysia and several other countries have depleted oil and gas reservoirs, which can be secure places in which to inject carbon.

At the 2021 Glasgow meeting of the parties to the Paris Agreement, Article 6.2 was agreed, allowing trading in carbon credits to help countries achieve their Nationally Determined Contributions – their emission-reduction targets.

A country that has limited capacity to reduce its own emissions will be able to purchase carbon offsets from others that are better positioned to do so. For example, a country such as Korea or Japan will be able to purchase carbon credits from other countries that achieve

reforestation or carbon capture and storage or direct capture of carbon from the atmosphere.

Carbon markets can be bilateral, regional or even multilateral, but will take some time to be established and accredited under the Paris Agreement.

Hope springs eternal

At the gathering I mentioned earlier involving WTO Director-General Dr Ngozi Okonjo-Iweala, she was asked whether she was optimistic about the future of the WTO. She replied that if she wasn't an optimist, she wouldn't have sought to lead the organisation.

It seems highly unlikely that the WTO will agree on the restoration of a fully functioning dispute-settlement system in 2024 or at any foreseeable time thereafter. Instead, it will probably agree to do more work.

In the meantime, and in these circumstances, Australia and like-minded countries could keep the free-trade dream alive by engaging in plurilateral negotiations for further liberalisation within the WTO and APEC.

Again, these would be *open* plurilaterals, enabling other countries to join if and when they were able to match the ambition of the originators.

As best as I can see, this is the only way forward in an era of superpower rivalry and antipathy.

Who knows, it might even bring one or both the superpowers to the negotiating table and rescue the global trading system.