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PERSPECTIVES ON FREE TRADE

Australia's Productivity Commission will release a draft review in June 2010 of the impact of bilateral and regional trade agreements. In March, officials from eight Pacific Rim countries met in Melbourne to begin talks on a Trans-Pacific trade agreement. This follows the signing of a series of bilateral pacts, including the historic conclusion of the ASEAN-Australia-New Zealand Free Trade Agreement in January.

In this Essay, Asialink invites CEO of the Australian Industry Group, Heather Ridout, and trade policy expert, Professor Ann Capling, to share their perspectives on these regional developments, their impact on Australia's trade and economic performance, and the role of trade agreements in lending support to the international trading system and the World Trade Organization.

Heather Ridout

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Heather Ridout is Chief Executive of the Australian Industry Group, the leading association representing businesses in manufacturing, construction, automotive, ICT, transport, defence and labour hire. She is a leading figure in Australian public policy debate, and is a member of a number of policy setting and consultative groups including Skills Australia, the Business Advisory Group on Workplace Relations, Infrastructure Australia and the Henry Review into Australia's Taxation System.

Ann Capling

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Heather Ridout

Free Trade: What Australian industry wants

With 17 of the G20 countries quietly erecting some form of trade protection in the six months immediately following the global financial crisis, it is not surprising that business has grown more skeptical of the power of the Free Trade Agreement.¹

Even the United States, despite driving the adoption of a number of international agreements to encourage the free movement of goods, wrote new protectionist “Buy American” provisions into law, engaged in a trade skirmish with China over the importation of tyres into the United States and reintroduced the Dairy Export Incentive program, a subsidy scheme by any other name.

Only one in 20 Australian companies exports their goods or services. This is despite the opportunities provided by three decades of growth in the economies of our global neighbourhood, across the Asian region.

Australian industry has gone through a major transformation through the same period, with the phased collapse of tariffs and other forms of industry assistance. The changes in key manufacturing industries, such as automotives and textiles, clothing and footwear, have been enormous. With the pain of employment losses has come the ability of the survivors to compete both at home and abroad. In the past two decades, Australia has become one of the most open economies in the world with average tariffs at less than 3.9 per cent.

A hand-up not a handout

Australian industry is aware – now more than ever – that in order to grow it has to be part of the global supply chain where appropriate. It has to compete on productivity, price and quality. The

phase out of the remaining assistance is planned and there is no need to reheat that debate because no successful or ambitious Australian company wants a government handout to survive. What companies do want, when it comes to exporting, is a hand *up* to thrive.

Realising that exports are our best means to long-term economic growth, Australian governments and industry have long acknowledged the need to clear a path and encourage Australian businesses to take the calculated plunge into foreign markets.

With the recent completion of the first round of talks on a Trans-Pacific free trade agreement, and President Obama’s proposed Australian visit in June likely to focus on trade links between our nations, now is an excellent time to examine the effectiveness of recent trade liberalisation efforts in terms of their application for Australian business, and to consider what else might be done. The results of much laudable effort in recent years in opening new markets for Australia in parts of Asia, the United States and Latin America are unfortunately mixed.

How do Australian companies see the success of the various free trade agreements signed by Australia?

Only one in 20 Australian companies exports their goods or services. This is despite the opportunities provided by three decades of growth in the economies of our global neighbourhood.

1. Elisa Gamberoni and Richard Newfarmer “Trade Protection: Incipient but Worrisome Trends”, *Trade Notes*, International Trade Department: World Bank. March 17, 2009

According to Federal Government figures, there has been a modest increase in export volumes from January 2003 to the middle of last year, a time when four new free trade agreements came into effect (Singapore, Thailand, the United States and Chile). According to the Mortimer Review undertaken by the Rudd Government into Australia's trade performance 'the growth in export volumes has been markedly slower in this decade than the previous two decades. Australia has lost global market share in manufactures, services, agriculture and resource exports'.²

To assess the impact of Australia's various free trade agreements, in late 2009 the Australian Industry Group surveyed 50 member companies with annual exports valued at between \$40,000 and over \$1 billion in the manufacturing, construction, food and beverage, the production of metals, chemicals and coal machinery, printing and publishing, ICT, retail and homewares sectors. On average, a little over one-third of exporters reported they had received any benefit from exporting to destinations with existing free trade agreements. Of the individual agreements, only 55 per cent of respondents saw the USFTA as being effective, with effectiveness figures for other agreements being New Zealand, 48 per cent; Thailand, 25 per cent; Singapore, 18 per cent; and Chile, 17 per cent.

There are, of course, pockets of true success in each agreement. However, while existing exporters report some moderate benefits in the markets they already serve, new entrants do not flock to join in. The value of the agreements is not being translated – whether in reality or perception – to Australian industry.

In other words, the signing of these agreements alone does not ensure broad benefits to Australian industry, nor does it motivate companies to seek new export opportunities. The mere fact of an agreement does not immediately position industry to take advantage of the Government's handiwork. A range of factors are at play, including the continuing high value of the Australian dollar, domestic economic circumstances, the overall market maturity, industry capability and the usual risk factors that industry takes into account when moving into new markets, including political, economic, legal and technological risk.

Australian companies also report facing a growing number of "offset" obligations – effectively compensation – in many markets. Previously relevant to the defence sector, offsets are being increasingly used in infrastructure and construction activities to "balance" foreign contracts with local content. This has the effect of reducing competition and efficiencies in the global trading environment.

It is hard for Australian industry not to be just a little cynical when confronted with newly increased port fees, increased customs duties, new administrative arrangements, new licensing arrangements and fees, new standards requirements, new quarantine requirements and even increased tariffs in parts of Asia, which can dramatically impact on the success of a business.

The effects of Doha

It is important in examining the current global appetite for free trade and the perceived value of free trade agreements for Australian industry, to look at the impact of the multilateral agenda. Since the establishment of the World Trade Organization (WTO), the average number

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2. "Winning in World Markets: Review of Export Policies and Programs", by David Mortimer AO, 1 September 2008, commissioned by the Department of Foreign Affairs and Trade.

of preferential trade agreements signed per annum is 20, compared to only three or four during the time of its predecessor, the General Agreement on Tariffs and Trade (GATT).

However, the current reality is that the Doha Round of negotiations to obtain a global agreement on free trade has been a massive disappointment and is now a major distraction for those nations, including Australia, who have put an enormous amount of effort into developing a multilateral free trade agenda. For many nations, it has become an excuse not to pursue free trade. The rationale of not wanting to act outside the Doha constraints for fear of being seen to walk away from the Doha goals has held back momentum towards worthy bilateral, regional or sectoral free trade agendas (India, Brazil for example). For now, Doha has become an impediment to free trade.

From an Australian industry perspective, it is difficult to see how European, Chinese, American, Indian and Brazilian interests will all be reconciled in the short term as the Doha process plods along and the world focuses on recovery from the global financial crisis. Certainly President Obama's focus on a Trans-Pacific free trade agreement, along with the reality of a low US dollar, as the key vehicles towards an export-led US recovery – with little or no mention of Doha – make its prospects for success exceedingly remote. Perhaps the time has come to park Doha to one side, to allow the development of the web of those multilateral, bilateral and sectoral agreements that must come to enhance fair and comprehensive free trade.

Regional economic integration

The most recently signed agreement, the ASEAN Australia New Zealand Free Trade Agreement (AANZFTA), which came into being on 1 January 2010, is the latest attempt to more closely integrate Australian trade with our region. Currently around 55 per cent of our trade is with the broader Asian region, and ASEAN accounts for a significant 15 per cent.

There is currently little cohesion in our ASEAN trade, with each of the 10 nations having different objectives and central relationships in their trade policies. But there is the real likelihood that ASEAN nations will become increasingly important to Australian exporters as they seek to diversify, and as the key markets for Australian industry, especially Indonesia, Malaysia, Thailand and Singapore, become more mature and open. Asia will unquestionably be the key market for Australian exporters in the decades ahead. This is where global economic growth will be driven, where markets will develop and to where global capital will shift. Given our geography, resources and skills, Australia is uniquely placed.

The agreement with ASEAN was as comprehensive as it could have been under the circumstances. It suffers from fragmentation among ASEAN nations which forced the acceptance of compromise. Some of the harder bilateral issues between Australia and its neighbors had to be pushed aside to individual agreements either under consideration or in negotiation. Without comprehensive agreements on some of those tough issues related to market access, the benefits from the AANZFTA will unfortunately be muted. However, the agreement does present significant opportunities for parts of Australian industry to operate more fully in key ASEAN markets.

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What business needs

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What is required is clear and strong follow-through assistance and support from government to turn benefits from free trade agreements from a theory to a reality: programs to encourage industry to look beyond these shores – an extremely costly enterprise for a small business – to develop and maintain contacts and credibility in new markets. These programs are investments in Australian productivity and ingenuity, not a handout.

The Mortimer Review found that \$1 created under the Export Market Development Grant Scheme generated up to \$27 in additional exports – a significant economic multiplier. Another program, TradeStart, has assisted 2000 companies since 2002 achieve more than \$750 million in exports on the back of very limited funding. Industry seeks guidance to get started but has demonstrated an ability to quickly establish itself where it finds a niche.

So what do Australian companies want from free trade agreements? Free trade agreements, at a minimum, must be WTO consistent – meaning the agreement must substantially cover all trade, with substantial sectoral coverage, and they must eliminate discrimination. They must also be WTO-plus, meaning liberalisation should be delivered more rapidly and fully than could otherwise be achieved through the WTO. The coverage and scope of the agreement must be as broad as practicable. And Australian exporters need some level of comfort that their export markets will not change the rules of the game overnight, either overtly or covertly, to their material disadvantage.

Australian industry has not walked away from the free trade agenda. But it must be an agenda that delivers practical results, not vague promises of success. The free trade agreement process does not end with the justifiably proud signature of political leaders. It is industry that does the trade, and industry that ultimately determines if a free trade agreement is a success. The lesson taken from our survey of exporting companies is that more needs to be done to assist Australian companies to export. For industry – and for government, too – those signatures must represent the start of a new phase of cooperation to make the agreement actually work.

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Ann Capling

ASEAN-Australia-New Zealand Free Trade Agreement and regional trade cooperation

The signing of the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) in 2009 was historic. It brought together the markets of Australia, New Zealand and ten of our closest neighbours. ASEAN, as a bloc, remains Australia's largest two way trading partner of goods and services at an annual value of over 80 billion dollars.

One year on since the signing of the agreement, it is timely to consider its achievements and potential for promoting greater regional economic cooperation and integration. This essay has three objectives: surveying trends in trade relations in the region and some of the concerns about these developments; situating the AANZFTA within this larger context; and offering some thoughts about future challenges for the AANZFTA parties.

Trends and concerns in regional trade relations

Three key trends in regional trade relations have emerged over the past ten years or so.

1. There has been significant unilateral trade liberalization, especially by ASEAN, Australia, New Zealand and India. As a result, tariff levels on the whole are quite low, but it is important to note that much of this liberalization has not yet been bound through international commitments at the World Trade Organization (WTO).
2. Preferential trade agreements (PTAs) have proliferated. This is despite the region's traditional preference for non-discrimination and 'open regionalism' through the Asia-Pacific Economic Cooperation (APEC) forum. Many of these are bilateral deals between a developed and developing country, and many have been negotiated by the emerging trade giants, China and India. As a result of this activity, three broad 'types' of PTAs have emerged in the region: those negotiated by the US, Australia and New Zealand, which are

deeply liberalizing, comprehensive and 'WTO-Plus'; those negotiated by Japan and South Korea, which are also WTO-Plus and include development assistance; and the China and ASEAN deals which tend to be more weakly liberalizing and less comprehensive in their scope and coverage.

3. Much of this preferential trade agreement activity is driven by foreign policy, geo-political, diplomatic or strategic considerations rather than commercial considerations.

This rapid spread of preferential trade agreements has led to several concerns in the trade policy community. First, and most frequently debated, is the concern about the 'noodle bowl' effect where different agreements with different rules have the potential to increase costs for business, divert trade, and fragment regional production networks. Fortunately, there is not yet a lot of evidence of this occurring to date in East Asia: existing low tariff levels in the region has seen only a limited take up by business of the preferential access on offer.

The signing of the ASEAN-Australia-New Zealand Free Trade Agreement in 2009 was historic.

A second worry relates to the ways in which preferential agreements undermine the non-discriminatory, rules-based system of global trade relations governed by the WTO. This has been a concern on the part of both business and governments in the region and it has prompted APEC members to coordinate a number of initiatives designed to address this. These include the identification of 'model measures' for high quality agreements and analytical work that explores the potential of merging or docking existing trade agreements. In addition, the proposed Trans-Pacific Partnership (TPP) agreement that would include Australia, Brunei, Chile, New Zealand, Peru, Singapore, Vietnam and the United States has emerged from an earlier APEC-sponsored initiative to forge high quality multi-member agreements.

Apart from this APEC-driven activity, there are also ongoing efforts to promote the development of broader trade and economic architecture in the region. Most notably, in East Asia there a number of proposals for the establishment of larger plurilateral trade agreements including several which have ASEAN at their core. These include proposals for ASEAN+3 (ASEAN, China, Japan and Korea) and ASEAN+6 (ASEAN+3, Australia, New Zealand and India). At present, intense inter-state rivalries between Japan and China have meant that none of these has advanced very far. In the meantime, ASEAN has negotiated a range of ASEAN+1 agreements with its most important trade partners in the region: China, Korea, Japan, India, Australia and NZ. The most recent – and most comprehensive – of these is the ASEAN-Australia-NZ Free Trade Agreement (AANZFTA).

What is unique and important about the AANZFTA

Since 1992, when ASEAN members agreed to work towards the creation of an ASEAN Free Trade Area (AFTA), Australia and NZ have been keen to negotiate a link between AFTA and the Australia-NZ Closer Economic Relations agreement (CER) between Australia and NZ. Indeed, negotiating a preferential trade agreement with ASEAN has been a strategic priority for Australia, due in part to ASEAN's importance as a trade partner, but also because of fears that Australia could be excluded from emerging regional economic architecture. Efforts to launch a negotiation in 1999 were stymied by opposition from Malaysia and Indonesia, prompting Australia and NZ to negotiate bilateral preferential trade agreements with Thailand and Singapore instead. More recently, political changes in Malaysia and Indonesia created a renewed opportunity for Australia and NZ to seek a preferential trade agreement with ASEAN.

It was a difficult negotiation involving Australia, New Zealand, and the ten ASEAN countries which are highly diverse in terms of their stage of development, their openness, and their domestic sensitivities, and the market access commitments reflect these differences. Negotiations were conducted between Australia, NZ and ASEAN as an entity but there are separate market access commitments for all 12 parties to the agreement. The AANZFTA was signed on 27 February 2009 and it entered into force for Australia in January 2010.

The AANZFTA is important for a number of reasons. The agreement encompasses 12 economies and 600 million people with an annual GDP of \$3.1 trillion AUD. It is the most comprehensive agreement negotiated by ASEAN, covering trade in goods, services, intellectual property, competition policy, and investment. The chapters on services and intellectual

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property are WTO-plus, which is notable for a preferential trade agreement involving ASEAN.

One of the most important features of AANZFTA is its approach to Rules of Origin, which allows businesses to use either the ASEAN or the Australia/New Zealand-preferred approach. To those who are uninitiated in the arcane and technical world of trade policy, a simple explanation of rules of origin regimes may be helpful here. Rules of Origin are a necessary part of preferential trade agreements as they determine which goods are eligible for preferential treatment under the terms of the agreement. There are two different approaches to the rules in the Asia-Pacific region: the value content approach which is preferred by ASEAN and the change in tariff classification approach which is preferred by Australia and New Zealand. The value content approach sets a minimum level of value added to be acquired by the product in the exporting country or region in order to qualify for preferential access. The change in tariff classification approach requires that the input for a specific final product have a different tariff classification than the final product itself.

AANZFTA is quite innovative among trade agreements in that it allows both approaches. In effect, both approaches are co-equal, which allows businesses to choose which provides them with the best access. The use of the co-equal approach is fairly new in the region and it is considered to be liberalizing and flexible, in recognition of the increasing trend towards regional and global production chains. Moreover, the availability of the change in tariff classification approach could be beneficial to some of the developing country members of AANZFTA, which might struggle to meet even a relatively low value content

threshold (e.g. 40 per cent) due to low their labour costs and low value-added processing.

The AANZFTA also has relatively permissive rules of cumulation, which are the rules that determine the countries whose products can be considered to have originating status for the purpose of the agreement. AANZFTA allows 'regional cumulation' whereby the originating materials from one party to the agreement used in the manufacture of goods in another party of the agreement can be treated as materials from the second country in determining the origin of the final product. During the AANZFTA negotiations, Australia pushed unsuccessfully for full cumulation, although there was genuine interest among the ASEAN countries in this possibility. This is reflected in the final agreement, which provides for the establishment of a committee on rules of origin to look at moving to full cumulation as part of a work program. This too is potentially an interesting development in the Asia-Pacific region. To the extent that competition between the 'East Asian' and 'Australia/NZ/North American' approach to rules of origin is likely to pose obstacles to efforts to converge preferential trade agreements in the Asia-Pacific region, the AANZFTA co-equal approach is a model for the promotion of greater regional integration.

There are weaknesses in the AANZFTA agreement. For instance, there is very little substance in the competition policy chapter, reflective of the reality that most ASEAN members have weak competition policy regimes. Due to the opposition of some ASEAN members, there is no chapter on Government Procurement, which would normally be expected in a high quality agreement. The investment access commitments have not yet been scheduled, so there remains much work to be done here.

The AANZFTA co-equal approach is a model for the promotion of regional integration.

But set against these shortcomings, there are also several noteworthy elements of the AANZFTA. In particular, it is a ‘living’ agreement that has established work programs across a number of different areas for the promotion of ongoing cooperation between governments. For instance, the competition policy chapter includes provisions for cooperation through the exchange of information and officials. There is the work program on rules of origin to explore the potential for full cumulation. And importantly, the AANZFTA also includes provisions for economic cooperation, which are aimed at building confidence and capacity in ASEAN countries in their ability to effectively engage under the agreement, with the work program being funded largely by Australia. To the extent that this assistance is aimed at helping ASEAN governments to identify policies that are appropriate to their circumstances, while also being supportive of the goals of transparency and non-discrimination, this must be seen as a welcome development.

Prospects for the future

Looking ahead, there are a number of important challenges to be addressed in regional trade relations. While the AANZFTA is clearly an important building block for regional economic integration, it is unlikely there is enough to interest other countries in the region that are looking for high quality preferential trade agreements. In that sense, the proposed Trans-Pacific Partnership agreement may emerge as a more likely platform for enhanced or accelerated regional integration in the Asia-Pacific. As its membership is likely to include at least five parties to the AANZFTA – Australia, Brunei, New Zealand, Singapore and Vietnam – this will likely generate interesting trade policy dilemmas for the other members of ASEAN, who may have been inclined to move less slowly, but will not want to risk being left out.

More importantly, it is worth noting that preferential trade agreements – even relatively good ones such as AANZFTA – are complementary to but not a substitute for multilateral negotiations at the WTO. It is only at the WTO that some trade issues – such as production subsidies in agriculture and fishing – can be addressed. It is only the WTO that can address truly global problems such as the spillover effects into international trade of climate change or financial regulation. And it is only the WTO that provides international rules that define a minimum and justiciable standard of trade policy conduct. And preferential trade agreements, by their very nature, are unlikely to be adequate to the task of dealing with other perennial and/or emerging trade problems, such as policies that restrict exports in the name of food or energy security, competitive currency devaluations, unilateral approaches to inward foreign investment, and the potential for conflict between domestic regimes to reduce greenhouse gas emissions and trade policy regimes. These are problems that are best dealt with at a global level through the WTO and the G20 Leaders’ Summits. In that sense, perhaps the most important area for future cooperation between ASEAN, Australia and New Zealand are collective endeavours within these international forums.

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