

# DEAL OR NO DEAL

While multilateral trade liberalisation is stalled, **Clarissa Keil** argues that Australia may need to stay in the race for free trade deals and gamble on a bad deal being less damaging than no deal at all

**A**n election debate held at the Lowy Institute in Sydney last November saw Trade Minister Warren Truss and then Shadow Trade Minister Simon Crean go head to head on trade policy.<sup>1</sup> Both men agreed that the multilateral Doha Development Round talks are their key priority, and not 'dead as a dodo' as proclaimed by Kevin Rudd in 2006, but they had differing views on the value of bilateral agreements. Crean believed that the free trade agreements (FTAs) Australia is negotiating independently with its trading partners undermine multilateral negotiations, while Truss insisted they are necessary as a defensive strategy to protect Australia's market advantage while other nations do deals left, right, and centre with Australia's major trading partners. Unfortunately, both Truss and Crean might be right. If so, it's a double bind, a catch-22. Both abandoning and continuing the negotiation of bilateral deals could have dire consequences for Australia's trade.

## Deals, deals, deals

Australia already has FTAs in force with New Zealand, the USA, Singapore, and Thailand. It is in the process of negotiating a raft of new bilateral and regional deals, including ones with China, Chile, India, Japan, Malaysia, ASEAN, and the Gulf Cooperation Council. It is also conducting FTA feasibility studies with Indonesia and Korea. While Australia has been relatively slow-moving on FTAs, its main trading partners have been busy doing lots of bilateral deals in recent years. According to the World Trade Organization (WTO), 380 bilateral

and regional trade agreements currently exist or are in the process of being negotiated.<sup>2</sup> China, in particular, is flexing its bilateral muscles and has made twenty-five of these agreements over the last three years alone.

Since the WTO's multilateral Doha trade talks continue to stall as developed and developing countries bicker over agricultural subsidies and industrial tariffs, FTAs appear to have mushroomed, especially in the Asia-Pacific region. Their main attraction is the faster liberalisation of trade. Multilateral negotiations are usually painfully slow: the Uruguay round lasted eight years, the Tokyo round six years, and the Doha round has now been going for nearly six years (pessimists doubt that it will ever conclude). In multilateral negotiations, the sheer number of participants and their diverse and often conflicting interests makes it very difficult to reach consensus (every WTO member must agree to the text for the round to conclude). It is certainly much more difficult to align the standards and regulations of 151 nations than two, particularly when you move beyond simple tariffs to the deep integration areas of competition policy, government procurement, and investment regulations.

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### Dirty deals: Caveat emptor

Another reason for the popularity of FTAs is that it is usually easier for the more powerful partner to carve out domestically sensitive industries from the agreement than it is in a multilateral forum where negotiating power is more evenly distributed. America's ability to exclude sugar from its FTA with Australia is one example. Japan's push to exclude rice and sugar from its FTA negotiations with Australia, citing the precedent set by the Australia-US FTA, is another. Professor Jagdish Bhagwati of Columbia University summed up his concerns over the impact of the FTAs on developing countries when he warned 'caveat emptor—buyer beware' at a recent WTO debate.<sup>33</sup>

While it is certainly not a developing country, Australia is in a precarious position. It has few concessions to offer its FTA partners, since it has unilaterally lowered many of its trade barriers since 1983. In contrast, many of Australia's main trading partners have highly protected and very desirable markets, such as those for agricultural products in Japan and the US. Australia is also not particularly competitive in the area of manufactured goods, due to a combination of already low tariffs and high labour costs, and this is where the focus of recent bilateral deals has been. 'Japan wouldn't gain much' was Japan's initial response to a proposed FTA with Australia, although Japan's fear of having to compete with China for Australia's energy goods, mineral resources, and food eventually spurred it into action.<sup>4</sup>

Australia's FTA with the United States (AUSFTA) highlights its lack of negotiating clout. It has been widely acknowledged that the economic models—suggesting up to \$6 billion in benefits—used by the Australian government to sell the deal were too optimistic.<sup>5</sup> In fact, the IMF originally predicted that AUSFTA would shrink the Australian economy.<sup>6</sup> The Department of Foreign Affairs and Trade's (DFAT's) own 2006 trade statistics also speak of the asymmetry in AUSFTA.<sup>7</sup> Australia's trade deficit with the US has widened considerably since AUSFTA, rising 17% in 2006 alone. To the US's delight, its exports to Australia grew at a much faster rate than its imports from Australia. This occurred at a time when Australia's overall trade deficit fell from \$16.8 billion to \$11.6 billion.

The Australian government provides many reasons for the increasing trade deficit with the US, including the drought, the appreciating Aussie dollar, capacity constraints in the mining industry, and the diversion of oil and beef exports to more profitable markets in Asia. Its focus has been on positive success stories in individual sectors and companies.<sup>8</sup> But, three years after AUSFTA came into effect, the government has still not provided an official, balanced analysis of its impact.

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While AUSFTA is the dirtiest of Australia's FTAs, its deals with Singapore and Thailand have also coincided with a widening trade deficit with both countries. Australia increased its overall exports of goods and services to Thailand by 30% between 2004 and 2005, but only had a modest increase of 4% between 2005 and 2006 (the FTA with Thailand came into force in January 2005).<sup>7</sup> The Australia-Thailand FTA doesn't greatly liberalise services—a major sector in both nations. Australia's export growth to Singapore has slowed only marginally since the implementation of its FTA, perhaps reflecting the more comprehensive nature of the deal. Still, the growth trend is slowing rather than accelerating, which is contrary to what one would expect following an FTA.

Why the attraction to such 'dirty' deals and protectionism when there is widespread agreement amongst economists that lowering a nation's trade barriers unilaterally (with no quid pro quo from the trading partner) benefits consumers with cheaper imports and thereby increases a country's overall wealth? For example, Koreans currently consume rice at four times the international market price.<sup>9</sup> If rice had not been carved out of the US-Korea FTA, Koreans could be purchasing rice at a quarter of its current cost to them. Of course, Korean rice producers would then need to become more efficient or change industries,

and therein lies the rub. Opening markets affects vocal, highly organised interest groups that exert significant political influence.

The powerful American Agriculture Movement is one such lobby group, and it pushed for the exclusion of sugar from AUSFTA. American sugar producers would have suffered under a comprehensive FTA with Australia, but American consumers would have benefited from lower sugar prices, arguably making the nation as a whole better off in the long run, albeit with some interim pain. Another mercantilist concern with providing

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non-reciprocal market access is the potential widening of the trade deficit. While deficits can fuel domestic growth and efficiency, there is disagreement amongst economists about whether a nation can sustain living beyond its means in the long run. Some fear the depreciation of the US dollar is in part a response to sixteen continuous years of American trade deficits. Others maintain that economic theory indicates trade deficits don’t matter in the long run. Either way, there is a strong political aversion to trade deficits, and when it comes to trade policy, politics are paramount. If trade policy were based on economic theory alone, most nations in the world would have dropped all their trade barriers a long time ago.

The Closer Economic Relations (CER) agreement, Australia’s bilateral deal with New Zealand, is the only ‘model FTA’ Australia has managed to negotiate. The deal attacked all sacred cows: no industry or sector was carved out. It is an agreement completed in the true spirit of free trade, and has led in recent years to steady growth in trade between the two nations, in which Australia runs a marginal trade surplus with New Zealand.<sup>10</sup>

## No deal

If Australia is increasingly unlikely to get a good deal when it negotiates FTAs—or, more accurately, preferential ‘discriminatory’ trade agreements (PTAs)—with its larger trading partners, why not stop negotiating them altogether and wait for multilateral negotiations to conclude?

Firstly, the long-term effects of Australia’s FTAs are not yet known. A review in late 2005 of Australia’s FTAs by the government, business, industry, unions, and trade experts concluded that it is ‘difficult to assess the impact of our FTAs,’ as they are ‘living agreements.’<sup>11</sup> Australia’s FTAs include market access provisions that will be phased in over the coming years in line with the agreements’ schedules. DFAT also hopes to negotiate better terms as time goes on and trade ties between parties deepen. Former trade minister Mark Vaile pointed out in 2006 that ‘governments can only negotiate and create a conducive environment to trade and investment. Business also has a responsibility.’<sup>12</sup>

However, the most important reason for Australia not to pull out of the race known as ‘competitive liberalisation’ is that it would likely lose out as its trading partners turn to their bilateral buddies for imports that may have previously been supplied by Australia. For example, Ross Garnaut believes that China has been systematically discriminating against Australian agricultural products since its ‘early harvest’ deal in the China–ASEAN FTA. Garnaut says this FTA is responsible for Australia’s recent poor performance in fruit, vegetable, and fish exports.<sup>13</sup>

If Congress passes the US–Korea FTA, it is likely to result in discrimination against Australia’s beef exports to Korea. A recent study by the Centre for International Economics (CIE) indicated that Australia’s agricultural exports could decrease by 12% in real terms by 2030 if the US ratifies the FTA it has negotiated with Korea.<sup>14</sup> This is because the US–Korea FTA would make US beef artificially more cost-effective for Koreans than Australian beef, due to lower protection barriers. Korean suppliers would turn to less efficient (but cheaper) American beef producers. The National Farmers Federation, which sponsored the study, urged Australia to fast-track its FTA with Korea to avoid

the loss of trade. According to the CIE, as long as an Australia–Korea FTA had similar terms to the US–Korea deal, Australia’s agricultural exports to Korea would *rise* by 53% by 2030, despite the US–Korea deal. An increasing trade deficit based on slower but still growing export markets starts to look good compared to the prospect of a significant decrease in exports without an FTA.

The threat of exclusion, whether for economic or geopolitical reasons, is real. In 2006, when covering the recalcitrance of China to put any meaningful agricultural offers on the table in the Australia–China FTA negotiations, *The Australian* suggested that ‘John Howard will have to pick up the phone again to his comrades in Beijing, maybe letting slip that FTA talks with Tokyo seem fast approaching.’<sup>15</sup>

Australia cannot afford to sit on the sidelines of competitive liberalisation unless it wishes to see its export markets shrink as trading partners do deals with other bilateral buddies. Australia currently only has one FTA—AUSFTA—in force with its top four trading partners. This means that Australia could lose market share in three of its four largest export markets if it doesn’t complete deals with Japan, China, and South Korea.

### The stumbling block or stepping stone argument

The debate about whether or not FTAs and regional agreements will ultimately lead to or hamper multilateral trade liberalisation rages on. Heribert Dieter,<sup>16</sup> a political science and economics expert, hypothesises that the proliferation of bilateral deals may end up strengthening multilateralism. He believes that as more bilateral deals are negotiated, the value of the deals begins to decrease. He likens the situation to the high value placed on a car if you are one of few people on the road, as opposed to the value when everyone has a car and the road becomes clogged with traffic jams. Peter Lloyd focuses on the potential for what he calls ‘coalescence.’<sup>17</sup> These days, virtually all countries are part of one or more bilateral agreements or regional clubs, and there is a trend towards the emergence of cross-regionals—multiple regional memberships per country—as well as continental clubs such as the EU. There is already speculation that the Europeans and Americans may form a bloc

across the North Atlantic called the Transatlantic Free Trade Area (TAFTA), and there is also talk of a Free Trade Area of the Asia-Pacific (FTAAP) including all current APEC members.

Some economists believe that FTAs force a country’s inefficient producers to undergo at least some structural reform, and thereby may underpin future multilateral free trade. For example, the US–Korea FTA (if ratified) would force Korea’s agricultural sector to undergo some structural reform as cheap imports from the USA replace products from small and inefficient Korean producers. This would almost certainly make it easier for Australia to negotiate access to sensitive beef and dairy markets in a future FTA with Korea.

Yet some economists fear that each time a dirty deal is done, the prospect of free trade in the area that is carved out decreases. Also, increasingly complex rules of origin (where the FTA specifies what percentage of a product must originate from its FTA partner before tariff concessions apply) can become new barriers to trade. Some even suggest there may be a retreat into protectionist trade blocs as bilateralism takes hold, with a tripolar system consisting of American, European, and East Asian free trade areas.<sup>18</sup> America’s efforts to seal bilateral deals across Asia, though, suggest that it is actively trying to avoid exclusion from any potential future Asian bloc.

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To make FTAs easier to integrate into future multilateral forums, Ross Garnaut and David Vines suggest the development of Open Trading Agreements, or OTAs,<sup>19</sup> which in essence would be FTAs that anyone can join. Anyone joining must, however, give existing members of the OTA the same and most liberal market access it has given to any other trading partner. For example, if Australia were to join an OTA it would have to open its market to all members of that OTA to the same very liberal degree it has to New Zealand.

Another avenue to ensure future multilateralism is to only negotiate model FTAs. A model FTA covers a wide range of trade issues rather than focusing on carve-outs. The WTO has recognised the FTA between Australia and New Zealand (CER) as a model FTA because it substantially frees up all trade in goods (including agriculture) and services between the two nations.

Another potential focus point is strengthening the WTO's principles in relation to evaluating FTAs for compatibility with future multilateralism. Currently, article XXIV of the General Agreement on Tariffs and Trade (GATT) sets out three requirements that regional agreements must meet for the WTO to permit them. First, trade barriers against non-members must 'on average' not be more restrictive than before. Benefits in the reduction of trade barriers are therefore often spread unevenly. Secondly, a regional agreement must be a clear plan and schedule spanning at most ten years to integrate it into the multilateral system. Thirdly, 'substantially all trade' between regional partners is expected to be liberalised, though the term 'substantially all' is not defined. No regional agreement has ever been rejected by GATT, even though many of them don't appear to meet the requirements of article XXIV. As WTO director general Pascal Lamy aptly comments on the WTO's consensus decision-making model and the impetus for the majority

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of nations to join regional groups, 'turkeys rarely vote for an early Christmas.'<sup>20</sup> As many WTO members have already done their own dirty deals, they are unlikely to begin highlighting the noncompliance of similar deals done by others. Without effective monitoring and coordination at the multilateral level, the patchwork of bilateral agreements may be difficult to reconcile into a single grand coalition of global free trade.

## Conclusion

It is widely acknowledged that FTAs can often do more harm than good on a global scale, depending on how much trade they divert from efficient producers versus how much new trade they create. The jury is out as to whether or not the 'noodle bowls' or 'spaghetti bowls' of FTAs will eventually coalesce. As for Australia, an already liberal trading environment and the prevalence of carve-outs has meant that at this stage it has not gained as much from its FTAs as have its agreement partners. Hope persists that phased-in market access provisions and future agreement revisions may improve Australian export opportunities.

In an ideal world, instead of FTAs Australia would pursue unilateral liberalisation and multilateral negotiations. This is where the real gains are for Australia, a major provider of services and exporter of agricultural products. Yet as long as the WTO continues to encourage quid pro quo negotiations that gloss over the economic rationale for trade liberalisation, these economically sound solutions will be difficult to make politically palatable. The new trade minister, Simon Crean, was adamant when in opposition in late 2007 that Labor would not support FTAs unless they were model FTAs, and would focus all efforts on multilateral trade negotiations instead. Labor's new economic adviser, Ross Garnaut, is a staunch free trade advocate, instrumental in Australia's unilateral trade liberalisation during the Hawke years. It will be very interesting to observe how the newly elected Labor government will fare when its free trade ideals confront the pragmatic pressure for carve-outs from our larger FTA negotiation partners like China and Japan, as well as from domestic lobby groups such as the Australian Manufacturing Workers Union.

In all likelihood, our new government will not have the courage to fly in the face of political pressure. So until all nations refocus their energies on multilateral negotiations, FTAs may be the best politically acceptable solution. This is because if Australia doesn't stay in the race for trade liberalisation, trade may be channelled completely past it. Even extensive unilateral liberalisation and consequently cheaper imports would not soften the political fallout from an inevitable erosion of our export markets.

Peter Lloyd once likened regional trade agreements to street gangs. He said that while 'you may not like them ... if they are in your neighbourhood, it's safer to be in one.' Garnaut disagreed, remarking that 'medium sized countries like us end up getting beaten up pretty badly if it becomes gangsterland.'<sup>21</sup> Despite this, Australia may need to fight for a spot in the gang and hope that a bad deal might eventually end up being less damaging than no deal at all.

The sad reality is that we would all be better off if there were no gangs in the first place and all nations embraced the real spirit of free trade. Unfortunately, few politicians around the globe today are willing to stare down the barrel of a gun marked political suicide to make this economic ideal a political reality.

## Endnotes

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