‘Implications for East Asia of the Australia-US Trade Agreement’

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27 October 2004

From time to time, Australian governments have considered the idea of a bilateral trade agreement with the United States. And on a number of occasions – in 1985, 1992 and 1997 – Washington has raised the possibility of a bilateral trade agreement with Australia. On each occasion, the Australian government considered and then rejected the idea, and each time its reasoning was the same.

First, economic analyses suggested that commercial benefits of a bilateral agreement would not be worth the cost -- not to mention the problems of negotiating an agreement given the power imbalance between the two countries.

Second, Canberra believed that Australia’s trade interests – including its desire to secure greater disciplines on the agriculture subsidy practices of the United States – were better served by multilateral negotiations in which the European Union would be seen to share the burden of winding back unfair practices in international agriculture trade.
Thirdly, Australia was concerned by the impact a preferential agreement would have on Australia’s commitment to non-discrimination, and its potential to jeopardise relations with major customers in East Asia. Indeed, US bilateralism in the region – particularly Washington’s efforts to prise open the markets of countries it labels as “unfair traders” – has always been a concern for Australia. During the late 1980s and early 1990s, unilateral and bilateral attempts by the United States to secure greater market share in countries such as Japan had the potential to cause considerable trade diversion and displace Australian exports to those countries.

These same concerns informed the Howard government’s decision in 1997 to reject President Clinton’s proposal for a trade agreement. Australia was not willing to enter an agreement with the United States that would discriminate against its other trade partners, especially those in the East Asian region. The Howard government also believed that the US Congress would never agree to a bilateral deal that opened the US market to highly competitive Australian exports such as agriculture and high-speed ferries. It understood that these were issues that could only be tackled at the global level, through a new round of WTO negotiations.

Nonetheless, Australia now has a trade agreement with the US – an agreement that provides few market openings for Australian exports in agriculture and high-speed ferries, and an agreement that discriminates against our other major customers in East Asia. To put this into perspective, in 2003 the US accounted for about 9 per cent of Australia’s merchandise exports. By contrast, Japan remains Australia’s biggest single customer (18 per cent of exports), even after a decade of economic difficulty. China continues to grow in importance (8 per
cent) while the ten members ASEAN account for about 14 per cent of Australia’s exports (equal to the European Union).

Much of the controversy surrounding the agreement relates to the meagre economic benefits of the agreement and the way in which AUSFTA will affect a wide range of policy areas that have not been previously implicated in Australia’s trade agreements with other countries, including culture and public health.

However in my discussion today, I want to focus on a dimension that has received much less public attention – namely, the implications of the AUSFTA for East Asia. In particular, I want to explore some of the implications of the agreement for East Asia, especially with regard to Australia’s relations with the region and future liberalisation prospects.

**Discrimination against our trade partners**

The AUSFTA signals a dramatic break from Australia’s longstanding commitment to non-discrimination in its trade relations. Australia has long been a champion of the multilateral trade system and its central norm of non-discrimination. This policy has made a great deal of sense given the diversity of our trade partners, our geographical isolation, and our inability to rely on “great and powerful friends” to protect our interests in the global economy. However, the Australia-US TA breaks with this long tradition of non-discrimination by granting preferential treatment to imports of goods, services and investment from the United States. To put it another way, the trade agreement with the United States involves discrimination against our other major trade partners, including Japan, China, and South Korea.
The significance of this decision to extend preferential treatment to one major trade partner, but not to others, should not be underestimated. Yet there has been very little political debate about the implications of Australia’s embrace of trade discrimination, and in particular, the consequences for the East Asia region.

To be sure, Prime Minister Howard has scoffed at suggestions that Australia’s trade partners in East Asia might be offended by our decision to negotiate a bilateral agreement that discriminates against them in favour of the United States. Indeed, he has claimed that our ability to conclude a deal with the United States makes us the envy of the region, and has pointed to the lack of formal complaints from our trade partners as evidence that this discrimination will not cause any damage to our trade relations. But formal complaints were never likely, and governments in the region are more likely to respond through actions rather than words. There is a risk that the trade deal will reinforce the view that Australia has given up its independent role in the region in favour of a much closer relationship with the United States.

**Preferential trade agreements in the East Asia region**

In line with the recent proliferation of preferential trade agreements around the world, we have witnessed a strong interest in preferential trade agreements in the East Asia region. This has been attributed to a number of developments including:

1. the glacial pace of multilateral trade liberalisation (and fears that the Doha Round could fail)
2. the bandwagon or ‘street gang’ effect, as countries jump into preferential trade agreements for fear of being left out

3. the faltering of APEC as an institution, and along with this, the decline of its twin roles in promoting non-discriminatory trade liberalisation and in keeping the US constructively engaged in the region

But the tilt towards preferential agreements in East Asia has also been strongly influenced by domestic political and electoral considerations. Since the financial crisis, there has been a strong trend towards liberalisation of many East Asian economies, some of which has been done unilaterally. However, governments find themselves drawn to preferential trade agreements because they provide opportunities for countries to liberalise in some sectors while protecting others. Consider for example Japan and Korea, where there is strong support for liberalisation in the steel sector, but not in agriculture. As economists have observed, because they are selective in their coverage, preferential trade agreements enable liberalisation without political pain. And for this reason, they are very attractive.

If you talk to any trade negotiator or economist, they will readily admit that preferential trade agreements are really sub-optimal instruments for advancing economic welfare. Many of the arguments against preferential trade agreements will be well know to this audience. But let me summarise the five principal arguments.

First, most economists believe that discriminatory trade agreements are more likely to divert trade, rather than create trade – and they are therefore
economically inefficient and welfare-reducing. Indeed the 2001 modelling of the AUSFTA predicted that Australia’s imports of cars and car parts from the US would rise by nearly 50 per cent, to the detriment of imports from Japan and Europe.

Second, preferential trade agreements entrench protectionist interests – editorials in major US newspapers thundered against the omission of sugar from the Aus-US FTA, and the message that this sent to other highly protected sectors in the USA.

They can increase the costs of doing business. PTAs demand complex ‘rules of origin’ that define what proportion of the value of a product must be added by the partner to the agreement in order for it to qualify for preferential access. Rules of origin must be supported by administrative arrangements and inspection procedures, which increase costs to both businesses and taxpayers.

As PTAs proliferate, we are confronted with what prominent US trade economist Jagdish Bhagwati calls ‘the spaghetti bowl’ effect – an entangling of trade agreements each with their own rules. In this scenario, any economic gains from trade liberalisation in specific agreements may be negated by the costs of implementing and administering different trade agreements with diverse, and possibly, conflicting rules.

Apart from the specific economic effects of PTAs, there are wider concerns about their overall effect on the multilateral trade system. They may dampen enthusiasm for multilateral trade liberalisation, for example. Bilateral trade
negotiations strain the institutional and negotiating capacity of even the largest bureaucracies, effectively diverting resources away from multilateral trade negotiations. Certainly this has been a concern among WTO officials, who fear that the proliferation of bilateral trade negotiations has sucked the oxygen out of the Doha Round.

The Howard government rejects this view, and has always argued that it can “walk and chew gum” at the same time. But the sidelining of the Cairns Group over the past few years suggests a very different story, one that belies these glib assurances. Indeed, there is very clear evidence that the negotiation of bilateral agreements with Singapore, Thailand and the United States has detracted from Australia’s efforts in the WTO Doha Round and eroded its ability to influence negotiations.

Several prominent foreign observers have noted that Australia has gone missing in action in the Doha Round. Mike Moore, former prime minister of New Zealand (a Cairns Group member) and immediate past director-general of the WTO, has been especially critical of Australia in this context. In February 2004 Moore wrote that “the big loser of the Doha round so far is the Cairns Group of agricultural exporters. This group, led by Australia, has not provided the leadership, the compromises, the ministerial papers or the political momentum that was so vital in the last round.” Similarly, at a symposium held in Brisbane in February 2004, a member of the European Union delegation to Australia noted that Australia has been “highly distracted” in the Doha Round and has not “played its expected role” in the negotiations.
For now, many of the bilateral agreements that are currently being considered or negotiated by governments in the region are between countries that have relatively insignificant trade relations with each other, and in many cases the agreements themselves are insubstantial in their scope and coverage. Examples of the latter include some of Singapore’s agreements. However, I would not include the Australia-US agreement in this category, and for that reason, I think it sets a very bad example across the region.

**Implications of the deal for future Australian trade agreements in the region**

There are many elements of the Australia–US agreement that undermine Australia’s credentials as the champion of fair trade in agriculture. For instance, Australia has agreed to the carve-out of one major agriculture sector altogether – sugar. The provisions concerning beef are also highly problematic. Australia’s quota for beef exports to the United States remains, but the tariffs on above-quota beef exports will be phased out – over a period of eighteen years. While this appeared to represent a significant liberalisation of Australia’s access to the US market, at least over the long term, the deal includes a mechanism that allows the Americans to apply temporary import restrictions against Australian beef whenever there is a surge in imports or a drop in US beef prices. Trade experts believe that these safeguards will kick in every other year, effectively negating the extra access benefits on beef. Moreover, the deal has set a very poor precedent that will make it much more difficult for Canberra to resist efforts by Japan to impose similar safeguards on imports of Australian beef.

Australia’s willingness to accept such a poor offer on agriculture in the US deal has a number of consequences for Australia’s trade relations with East Asian nations. For years, the United States, the European Union and Japan have
claimed that agriculture is not like other industries and so deserves different

treatment under international trade rules. Until now, Australia has argued

against this position, and has rightly pointed out that there are other ways of

supporting farmers that do not depend on the use of trade-distorting practices.

In agreeing to a deal that excludes sugar and contains such poor provisions in

other agriculture commodities, however, Australia has effectively conceded the

argument that agriculture should be treated differently from manufacturing.

Moreover, in agreeing to a deal that has so many exclusions in agriculture and so

few liberalising elements, Australia has established a precedent that will make it

very difficult to press its claims for better access for its beef, dairy and rice

exports to countries like Japan and Korea. This will also pose a delicate problem

for Australia in its upcoming trade negotiations with the Association of South-

east Asian Nations. Most ASEAN members maintain very high tariffs in sectors

such as dairy products and cars, and will certainly press hard to preserve these.

Given the exemptions in the Australia-US trade agreement, the Coalition

government will not be in a position to refuse a deal with ASEAN that similarly

excludes sectors of importance to Australia – to do so would risk causing great

offence to our Asian neighbours.

The entanglement of economic objectives with other foreign policy objectives

in trade agreements

The weak economics of the case for an Australia-US trade agreement strongly

suggest that Howard’s pursuit of a deal was being driven by other motives,

including Australia’s desire to strengthen its political and strategic links with the

United States. Since the terrorist attacks of September 2001, both governments

have framed the quest for a trade agreement in the context of strengthening
the Australia–US alliance more generally. In August 2002, Foreign Minister Alexander Downer declared that a trade agreement with the United States would “help engender a broader appreciation – in both countries – of the bilateral security alliance.” Similarly, when announcing President Bush’s intention to commence negotiations with Australia in November 2002, US Trade Representative Robert Zoellick declared that a trade agreement would “strengthen the foundation of our security alliance.”

The Howard government has argued that Australia’s pursuit of a trade agreement with the United States provided “a powerful opportunity to put our economic relationship on a parallel footing with our political relationship, which is manifested so clearly in the US alliance.” Others believed that the government’s agenda ran much deeper than that, and that it was aimed at locking Australia into US foreign policy more generally. Indeed, there is a clear expectation in Washington that the trade agreement locks Australia into US foreign policy more generally. This point was underlined in May 2003 when USTR Bob Zoellick declared that any country seeking a free trade agreement with the United States must also offer its cooperation “or better – on foreign policy and security issues.”

It has been a cardinal rule of Australian foreign policy that trade and security should remain in separate boxes and that trade should not be the ‘flywheel’ for other foreign policy objectives. This view has been held by trade, foreign and defence policy experts alike. Yet Australia’s trade interests have become subordinated to other political or strategic interests that have little to do with our economic welfare.
There are many risks inherent in loading up trade initiatives with other agendas. For example, as Bush and Howard both made clear in their words and deeds, the trade agreement carries with it an expectation of Australian support for the strategic framework of US interests – an expectation that does not end with the dispatch of Australian troops to support the Americans in Iraq. This point was underlined by Deputy Secretary of State Richard Armitage in June 2004 when he stated bluntly that the US’s allies could not “pick and choose” the parts of the relationship they wanted. Armitage’s message was clear: if Australia wanted a close relationship with the United States, it would have to support American foreign policy and future military interventions.

On the evidence of the Howard government’s desire to secure a bilateral trade agreement with another economic giant, China, this entangling of trade and security objectives may soon move to another dimension. China is already among Australia’s major trade partners and the economic relationship should only grow stronger. The Howard government is hoping to use a bilateral trade agreement as a means of building, consolidating and locking in a strong relationship between Australia and China. Observing the effectiveness of the Bush-Zoellick strategy, however, Beijing has also decided that its economic partners should be strategic partners. For its part, Beijing expects that a trade deal would help to secure Australian support for China’s opposition to Taiwan’s independence. Should there ever be conflict over Taiwan, conflicting American and Chinese expectations would certainly place Australia in a rather difficult position.

And is it possible to secure a relatively clean agreement with China? Like Australia’s deal with the United States, a trade agreement with China could
potentially involve very little genuine free trade. China has massive problems in its banking system and insurance industry, its agriculture sector, and its state-owned enterprises, and any move towards liberalisation in these sectors would generate enormous political opposition in China. In any event, negotiating a trade agreement in China would be a complex and demanding task that is liable to take many years. This is not a solution to Australia’s trade problems, nor is it necessarily the best vehicle for strengthening the Australia-China relationship.

Conclusion

Bilateralism and discriminatory deals have never been in our Australia’s interests as a trading nation – nor in the interests of our trade partners in the East Asia region. These kinds of arrangements contributed to the Great Depression and the second World War, and to head down that track again while pretending that nothing fundamental is at stake is simply derelict. Preferential deals are neither a solution to trade problems nor a substitute for foreign and defence policy. In any case, if the multilateral trade system is broken beyond repair, then a major overhaul to the region’s approach to trade policy is required. Whether governments and institutions are up to the task remains to be seen.