Increasing Australia's Prosperity: The contribution of trade policy

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A MINERALS COUNCIL OF AUSTRALIA **BACKGROUND PAPER**
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The views expressed in this publication are those of the authors. This publication is part of the overall program of the MCA, as endorsed by its Board of Directors, but does not necessarily reflect the views of individual members of the Board.

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Trading Nation: Advancing Australia's interests in world markets, UNSW Press, Sydney.

Summary

Australia's trade policy has international and domestic dimensions. The international dimension, such as trade negotiations of various kinds, is instantly recognised as core trade policy, but the real foundation of trade policy is domestic economic policy, irrespective of whether it serves a protectionist or liberalising purpose.

Domestically, trade and international perspectives need to become more prominent on a range of issues – from removing tariffs and limiting the damage from soaring energy costs, to eliminating unnecessary regulation and confronting domestic protectionism. This will require articulation of a consistent view about trade and trade policy and their contribution to Australia's future. At an operational level, it will require strengthening Australia's whole-of-government processes within and between all levels of government so that trade and international perspectives can connect more smoothly with the priorities and strategies for domestic economic and social reform.

Internationally, the way seems to be open for a new phase of international trade policy focused on creating new rules for 21st century trade through mega free trade agreements. At the same time, Australia, as a mid-sized trading nation, has a big stake in restoring the World Trade Organization to the centre of the world trading system.

The G20 Leaders' meeting in Brisbane could be an important starting point. The Group is not a trade negotiating forum but would have unique value if it stamped Leaders' authority on trade. This could involve encouraging members to identify and make changes to domestic economic settings that are judged to be in their national interests and that could lead to more growth, trade and jobs. Beginning an invigorated leader-level dialogue on strengthening the global trading system would also be useful. ■

1. Introduction

Trade policy occupies a space within general economic policy that is filled with a changing assortment of elements depending on its purpose and scope. Up until the third quarter of the 20th century, those elements basically included border measures such as tariffs and quotas and defensive and offensive interests in manufacturing and agriculture. More recently, the increasing prominence of regional and global value chains has placed the trade policy spotlight on behind-the-border measures – and therefore on domestic regulatory reform – and added to trade policy a broader range of issues from tariffs to services to trade-related aspects of investment to protecting intellectual property to addressing anti-competitive practices.

Australia's trade policy, like the trade policies of other countries, has international and domestic dimensions. The international dimension, such as trade negotiations of various kinds, is instantly recognised as core trade policy, but the real foundation of trade policy is domestic economic policy, irrespective of whether it serves a protectionist or liberalising purpose.

Domestic policy settings form the basis of negotiating positions. Modifying those positions, in conjunction with adjusting or changing domestic policy settings, is the most challenging aspect of trade policy. In Australia's current circumstances, this means injecting trade perspectives – the implications of a fast changing world and of an uncertain and patchy international trading environment – into a (hopefully) invigorated program of economic and social reform that can deliver growth, jobs and higher living standards.

The direction of change in the international trading system is difficult to forecast, but some basic trends in world trade and trade policy over the next decade stand out:

- Relatively slow growth in advanced economies has the potential to retard growth in emerging and developing economies and stoke protectionist pressures.
- Economies in East and South Asia are likely to become more important. China, in particular, should become a key partner in bilateral trade relations with more countries. South-South trade and investment should increase in significance.
- Technological change and competitive pressures will lead to a further unbundling of functions in manufacturing and services, boosting two–way trade in many economies, with value added often sourced from many different countries in delivering final products and services to consumers. More supply chain trade will occur within large multinational companies, not only from advanced economies but also from emerging economies, especially China.
- Trade in intermediate goods and services will not only increase but also become more volatile as economies become more interconnected and production across countries becomes more fragmented in finer value chains. Just-in-time delivery imperatives carry the risk of quickly transmitting shocks from localised disruptions to production to entire networks.
- There will be more bilateral and regional trade agreements, most of them free trade agreements (FTAs). While there are no guarantees, mega FTAs – particularly between the United States and European Union and among the parties negotiating

the Trans Pacific Partnership (TPP) agreement – could well set global rules for world trade and investment. This raises difficult questions about how to return the World Trade Organization (WTO) to the centre of the world trading system after the effective failure of the Doha Round of Multilateral Trade Negotiations in terms of its original mandate.

- Trade policy will become more complex with more prominent countries wanting to play a role, more issues and more politics as countries trade more of their economies across national borders. With their different histories and priorities, leading developed and emerging countries will struggle at times to manage their relationships on trade and other matters.

Given this context, the most realistic scenario for weighing strategies for Australia's trade and trade policy should stress the continuing strong links between emerging Asia and the developed economies; the magnitude of the changes needed if China, in particular, is to move towards growth led by domestic consumption; and the prospect that growth will remain quite high but still significantly below average rates of the last decade. This more sober view is arguably a better guide for policy development and puts the onus squarely back on Australia to do more than it is currently doing to improve trade performance across all sectors.

Exchanging commodities, especially resources, for manufactures will continue to account for the bulk of our trade for years to come. It is the natural consequence of our comparative advantages. The emergence of Asia as a ready market for resources and as a world manufacturing hub has only reinforced this enduring pattern (see Box 1). But however Australia's trade profile evolves, the one certainty is that there will be more competition in global and regional markets for resources, food products, advanced services and manufactures.

The collapse of car manufacturing in Australia is an example; the race to win shares of the minerals and energy markets of emerging nations is another. Luck will carry us so far in grasping the opportunities that undoubtedly exist in the region and beyond, but opportunities will be lost and standards of living will be compromised if Australia does not respond to the prospect of lower terms of trade with reforms that lift productivity and competitiveness.

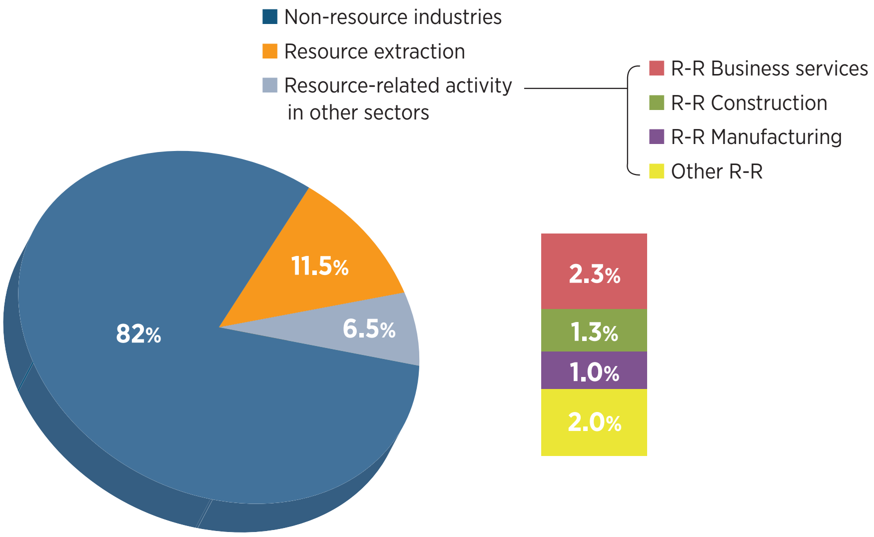
This paper will show how trade policy can help to advance the reform agenda domestically by shaping Australian attitudes on issues like protectionism and structural change and by influencing domestic regulatory settings that affect trade. It will also show how Australian trade policy needs to adapt to a changing international environment where the rules of the game are increasingly being developed in mega FTAs and where effectiveness – including for minerals and energy trade, which is highly sensitive to world economy growth and global supply responses – will depend increasingly on the imaginative blending of trade, economic and foreign policy perspectives. ■

Box 1. Understanding the significance of the resources sector

The minerals sector is critical for Australia's economic health. When inputs from other sectors (such as business services, construction and manufacturing) are taken into account, the resource economy accounted for around 18 per cent of gross value added in 2011-12, about double the 2003/04 share (Figure 1).

The minerals sector provides the biggest share of Australia's exports and has a significant impact on the broader economy through income effects and its contribution to taxation and employment. It accounts for almost 10 per cent of total employment when the contributions of sectors that provide inputs to mining are included. Key mineral and energy exports are continuing to expand as Australia moves to the production/export phase of the minerals boom.

Figure 1. Resource economy, share of gross value added (2011-12)

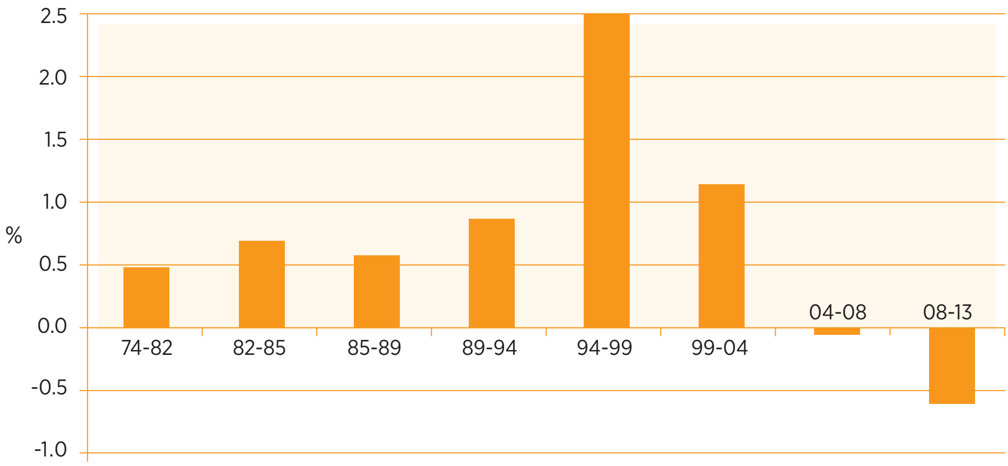


Source: Rayner, V and Bishop, J, Industry Dimensions of the Resource Boom: An Input-Output Analysis, *Reserve Bank Research Discussion Paper 2013-02, February 2013.*

R-R = resource-related.

2. The imperative for economic reform: the trade perspective

Figure 2. **Australia's multifactor productivity growth, average annual rates**



Source: ABS Catalogue 5260.0.55.002, released 6 December 2013.[1]

In the past decade, Australian productivity growth has been lacklustre at best (Figure 2). Part of the poor productivity record may simply reflect the impact of massive investment in mining and mining-related services and the fact that investments are very lumpy and take years to produce new output. Once they do, productivity should rise. Part of the productivity story also reflects the impact of drought and the effects of the decade-long increase in the terms of trade lessening the urgency of domestic-led productivity improvement. But part also reflects the reluctance of successive governments to embrace significant and explainable economic and social reform.

Increasing productivity growth through policies that deliver a more open, flexible and efficient economy, and that are backed up by policies that assist individuals and communities to adjust to changing economic conditions, are the key to having strong industries and rising living standards. But regaining and sustaining even trend growth in productivity will be challenging as the population ages and the workforce participation rate declines.

This will place more pressure on improving communications, infrastructure, education, skills and health services, and on reducing business costs from inefficient taxation and regulations. It will also place more pressure on the Council of Australian Governments (COAG), and its supporting arrangements and processes, to work more effectively in advancing key parts of the reform agenda.

The links between sectors, in particular the flow-through effects of inefficiency and low productivity, mean that no sector can be exempt. The breadth of the needed pro-competitiveness agenda is daunting: Gary Banks' 'to do list' for government remains the best starting point.[2]

Building a more trade focused economy

Trade policy contributes to domestic productivity by encouraging more efficiency (for example, through specialisation in line with comparative advantage), increasing access to markets (giving rise to economies of scale and making additional trade growth possible), increasing competition in the domestic market (for example, through price, quality, foreign commercial presence) and providing unique perspectives or different priorities on aspects of the productivity agenda (for example, on infrastructure development and the costs to business and the wider economy of inefficient regulation). Trade performance – imports meeting business and consumer demands and keeping prices and costs down, and growing exports underpinning scale economies – will depend on these types of productivity-raising strategies, and on trade policy working indivisibly with economic policy in fact, as well as rhetoric.

The quality and pace of domestic economic reform have always mattered for a trading nation like Australia, but are likely to matter at least as much, and probably more, given ongoing difficulties in the international economy. The alternative is unpalatable. The potentially bumpy ride from Asia's economic transformation would become bumpier. Worse, Australia could be condemned to some kind of half-life on the periphery of the transforming world economy.

If Australia is serious about having a 21st century economy, it is well past the time for tolerating tariffs. Remaining tariffs are much lower than they used to be, but they are still a drag on economic efficiency and productivity. They are more than ever a tax on exports given the entrenchment of regional and global value chains, with goods crossing borders multiple times as they are produced. If manufacturers are to be competitive in these chains, they must be able to import world class products without unnecessary imposts.

Convincing government and business to reduce, let alone abolish, tariffs can never be straightforward, especially now that the multilateral route has been severed for a time by the disappointment of Doha and by fiscal imperatives that will pressure the Australian Government into staying its hand. But a window for their early removal has emerged, thanks to the policy of the Abbott Government to rein in industry assistance, in particular to the motor vehicle industry, and the announcements heralding the end of motor vehicle assembly in Australia. There have been calls already for the removal of motor vehicle tariffs and the Treasurer has announced that these tariffs will be taken into account in the Government's forthcoming comprehensive review of the tax system. The review would logically also take into account all impacts of taxation on traded sectors, including taxes that reduce competitiveness (such as carbon taxes applied outside a global framework or frameworks that encompass all major emitters).

Similarly, if Australia is serious about having a 21st century economy, it is not hard to see trade policy playing an ever greater role in the development of Australia's services economy and services trade. Australia's competitiveness in services does not exist in isolation from the rest of the world. This means making and remaking the point that Australia starts adding to costs and limiting its trading potential as soon as reform slows here or becomes a political football. And it means advancing the argument that Australia benefits from open markets – from delivering high-value services to overseas markets, purchasing other services from abroad and combining some of these services with domestic offerings to produce new services for domestic and international markets.

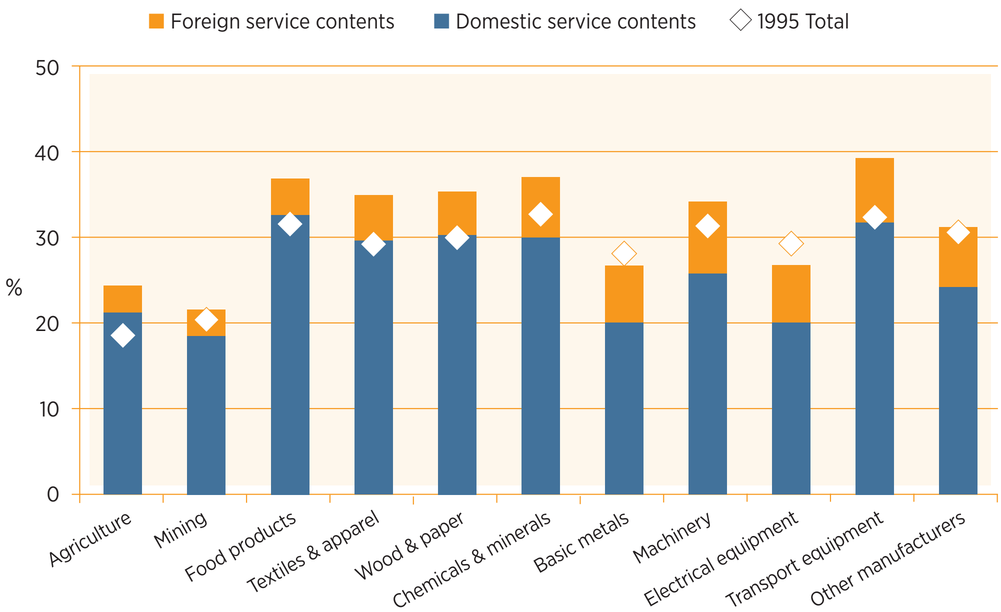
The significance of services in the modern Australian economy and their potential in raising productivity across the economy, generating jobs and increasing two-way trade and investment, is substantial. This is not well understood within the community or even by political elites. The potential importance of services in Australia's trade with Asia over the next 20 to 30 years is understood, but their roles in development processes and contribution to other sectors' exports – including around 20 per cent to the value of Australia's minerals exports and 25 per cent to the value of many of our manufactures exports – are hardly understood (Figure 3).

Equally, if Australia is serious about having a 21st century economy that delivers growth, jobs and higher living standards, it needs to address soaring energy costs. In the past five years, electricity prices paid by Australian manufacturers have increased by more than 70 per cent in Australian dollar terms, whereas general prices have increased by less than nine per cent (Figure 4).

Box 2. Contribution of services to Australia's exports

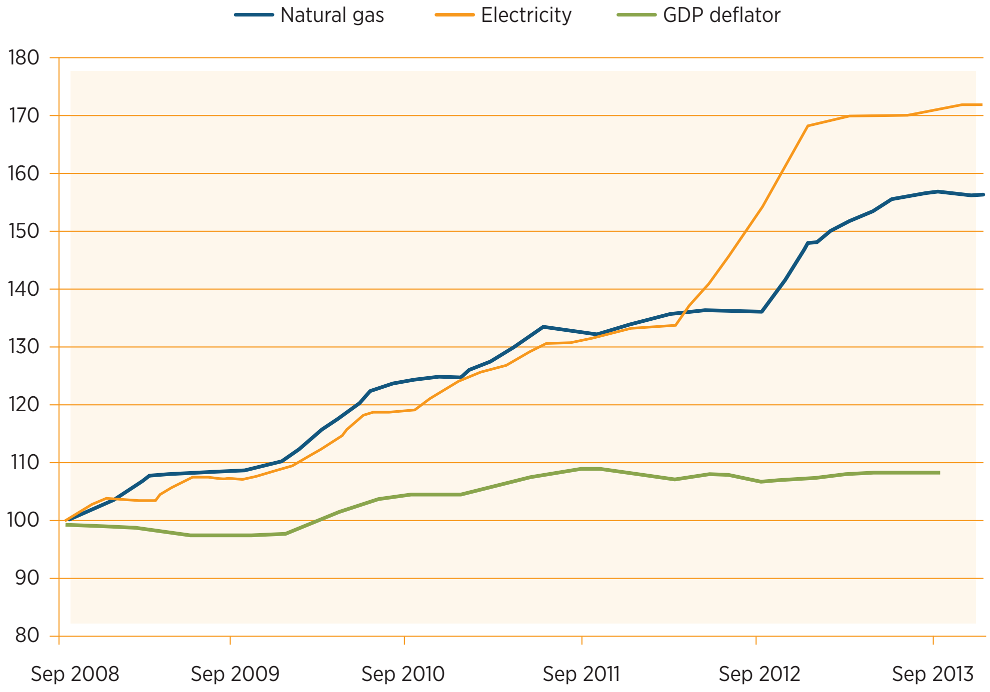
It is not widely appreciated that there are substantial services embodied in resources and manufactures. Newly developed value added based statistics released last year by the OECD and WTO, in which exports are assigned to sectors and countries where value is added to products as they move through various stages of production, show that domestic value added from services sectors contribute more than one-third of Australia's total exports, including around 20 per cent of mining exports and more than 25 per cent of many manufactures exports.

Figure 3. Services content of gross exports by industry, 2009



Source: OECD & WTO 2013, Trade in Value Added: second phase release of OECD-WTO TiVA Database.

Figure 4. Natural gas and electricity prices paid by manufacturers
September Quarter 2008 = 100



Source: ABS Catalogue 6427.0, December Quarter 2013, and ABS Catalogue 5206.0, September 2013. The prices for electricity and natural gas are those paid by manufacturers and are used by the ABS in its work on producer price indices.

Australia has moved from having electricity costs well below the OECD average at the turn of the century to a point where electricity bills for industry are among the highest in the developed world. Rising costs reflect a number of influences, but include government policies such as the carbon tax and the Renewable Energy Target. The Australian Energy Market Commission estimates that these policies and various state and territory energy efficiency schemes contribute around 17 per cent of average Australian retail prices.

The trends in Australia have no parallel among other major developed economies. In the United States and the United Kingdom, for example, electricity prices for industry fell between 2008 and 2012 in US dollar terms, while in Japan they rose by around 39 per cent and in Germany by 15 per cent.

As Australia's competitive advantage in this area has diminished, that of some other economies has increased significantly. The United States in particular is developing a competitive advantage through relatively cheap energy, with positive flow-on effects to its manufacturing sector. The implications of high prices for Australian energy are very concerning, given the significance of these costs in Australian export industries, ranging from aluminium to advanced manufactures and even to services such as tourism and education.

Confronting domestic protectionism

As a trading nation, Australia can only lose from protectionism as the process of making products in value chains becomes more fragmented, and as policies that restrict trade and investment flows in these chains impose steadily higher costs through lost efficiency both in the countries implementing them and the rest. Well over half of all world trade (goods and services) is in intermediate goods and services, so effectiveness as an importer is a prerequisite for effectiveness as an exporter.

In Australia, the danger is not predominantly from 'old-style' industry-specific protection and accompanying vested interests, though it is alive and well in industries like coastal shipping (see Box 3). In general, with high levels of intra-firm and intra-industry trade and investment across borders, traditionally protected firms (for example, in textiles, clothing and footwear) do not want protection that undermines their niches and the effectiveness of value chains. Further, no mainstream political party in Australia would

Box 3. **Australia's coastal shipping: a protected anachronism**

Australian coastal shipping provides a vital service particularly for transporting dry bulk commodities such as iron ore, alumina/bauxite, fertilizer, and sugar. An efficient and flexible service that complements and competes with land-based transport would minimise cost burdens on Australian business arising from the 'tyranny of distance'. The converse would also be true. Unfortunately, Australian coastal shipping is inefficient and heavily protected: the cost of shipping products from Asia to Australia is now about the same as shipping products around the Australian coast.

Cabotage – the practice of restricting foreign shippings' access to coastal trade – is the main driver of these higher costs. A feature of coastal shipping since the *Navigation Act 1912*, cabotage was strengthened by the *Fair Work Act 2009*: Australian labour standards were imposed on foreign-registered ships with foreign crews plying between Australia's ports. Cabotage was further strengthened by the *Coastal Trading (Revitalising Australian Shipping) Act 2012*. It restricted the coastal trading operations of foreign vessels through temporary licenses with extensive conditions and reporting requirements (for example, growing upfront information requirements and shrinking flexibilities around changes to shipping, loads and itineraries).

These regulatory changes are harmful to the Australian economy. They increase the transport costs of Australian commodity producers and increase the prospect of bulk commodities being imported from cheaper overseas markets. Higher costs in turn are passed on to consumers of bulk commodities, reducing the competitiveness of Australian manufactures on regional and global markets and risking manufacturing jobs. According to a 2013 report by the Institute of Public Affairs, the 2012 changes alone will reduce the net present value of the coastal shipping industry's net economic benefit to the Australian economy by between $76 million and $150 million compared with business-as-usual.[3]

The Abbott Government is currently reviewing coastal shipping legislation. Creating a more level playing field in coastal shipping should be an important component of the government's broader deregulation and competition reform agenda.

now initiate a serious campaign supporting less open trade: that debate was won in the 1980s and 1990s.

Rather, the danger is from a combination of external and domestic sources. Protectionist impulses in the United States and in faltering European economies are fed by joblessness, middle-class frustration with stagnant incomes, populist hyperbole from general elections, and perceptions and genuine fear of the implicit mercantilism in China's export-driven growth, undervalued currency and underdeveloped domestic demand. So far, the anti-protectionism line has held in Australia, but as reactions to announcements about the closure of automobile assembly and assistance to SPC Ardmona show, the risk remains and is being fanned by rising concerns about jobs. Protecting Australian jobs resonates very loudly in the community (see Box 4).

Similarly, inventiveness in developing new trade barriers across standards (environment, labour, food, industry, private business-to-business regulation of agri-food trade), investment, government and business procurement, and cultural and intellectual property issues poses a long-term risk. Again, the line has held, more or less, but barriers are being developed, including under the innocuous guise of 'fair trade', as well as through blatant appeals to nationalism.

Inventiveness in easing recourse to anti-dumping measures is also a risk. Claims of dumping, injury and unfair trade play well in the court of public opinion, particularly at times of moderate unemployment or when manufacturers are under pressure from the high dollar or when there are scare campaigns against exporters from certain countries, especially China. But such claims should carry a prominent health warning: anti-dumping

Box 4. Protecting jobs?

Difficult global economic conditions understandably fuel unease about joblessness. Australia has been fortunate in having a relatively low level of unemployment. But unemployment has begun to rise and public concerns are being amplified by the demise of car assembly and the restructuring of Qantas.

Protecting jobs is a natural default setting of many state and federal government policies. Some state governments, for example, fund buy-local campaigns that have been 'massaged' to meet WTO requirements. At the federal level, access to anti-dumping action has been 'streamlined' and opportunities for Australian companies to participate in major projects have been boosted by the *Australian Jobs Act 2013*.

There is nothing wrong with government action that increases opportunities for competitive Australian companies to supply major projects. Procurement entities want to purchase locally where this can be done on a sound commercial and 'value for money' basis. But mandating Australian Industry Participation (AIP) plans for private investment projects over $500 million imposes costly, complex and prescriptive compliance and reporting processes on investors.

AIP plans may create or preserve jobs at one level but could destroy them at another by imposing deadweight costs from unnecessary red tape and more bureaucracy. The best way to 'protect' jobs and increase living standards is through a reform agenda that encourages productivity, innovation and growth.

measures are protectionist instruments if they become political and legal substitutes for necessary (but difficult) structural change.

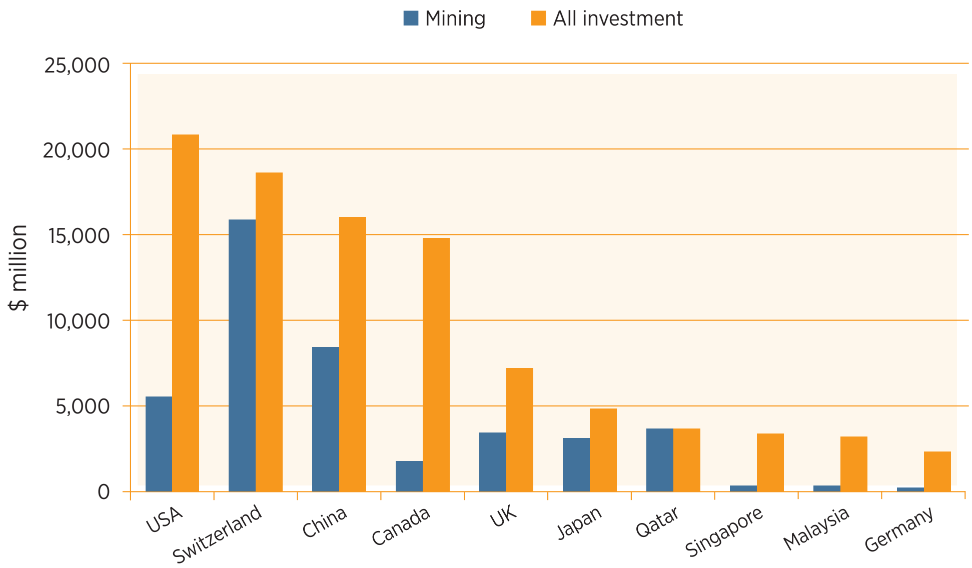
At a theoretical level, it should not matter if overseas firms sell products for less than the price they charge in their home countries, unless the aim or likely consequence is to reduce competition. Price discrimination between markets is a widespread commercial practice. In the real world, of course, it does matter if dumped products disrupt the markets of efficient domestic firms. Governments must act and there would be loud outcries from the public if they did not. But this is not the same as saying that recourse to these measures should become routine or normal or be encouraged by reversing the onus of proof of dumping on to foreign suppliers as the Australian Government appears to be considering.

These various dangers are interlinked, present big risks to emerging countries and international economic governance, and are capable of amplifying incipient signs of protectionist sentiment in Australia.

Continuous public vigilance is needed to prevent even a partial retreat to the 'all round protection' mentality that virtually excluded Australia from many fast growing areas of world trade just a generation or so ago.

Incipient protectionism in Australia is also being fanned by the complex adjustment challenges thrown up by the emerging giants as they compete in markets for manufactures and services once dominated by the major industrialised countries and as they spread their investments around the region and further afield. Foreign direct investment (FDI) from Asia will continue to stir the economic nationalist pot. China is now becoming a major source of inward FDI, particularly in mining and energy, and is now ranked consistently in the top three sources of proposed investment (Figure 5). India has also become a significant source of FDI, investing in minerals, food and agriculture. These developments, even though they represent only a small percentage of the overall stock of foreign investment in Australia, are raising fears of selling the family farm.

Figure 5. Foreign Investment Review Board approvals 2012-13, major sources



Source: Foreign Investment Review Board (FIRB). Approvals refer to intended investment, which may not be realised and differ conceptually from balance of payments data.

Asian investment in Australia seems set to continue increasing as part of evolving regional economic linkages and as a natural response to large (though declining) current account surpluses, especially in China. This poses two challenges for the Australian Government. The first is to contribute to a sophisticated community understanding of the role of FDI in the economy. It should not matter whether foreigners own some mines, farms, ports, and telecommunications infrastructure. What matters is the key role of FDI in supporting and building trade and economic relationships, how it contributes more generally to economic activity, employment and living standards and, flowing from this, the appropriate return to the Australian community from foreign companies developing our resources.

The second challenge is to send a clear message to foreign investors that Australia is an open economy, welcomes foreign investment and recognises the importance of foreign investment in building strong trade and wider relationships. This message is particularly important in relation to non-Japan Asian investment. A sizeable chunk of major foreign investment proposals in Australia now involves Chinese resource and energy companies. Australian ministers travel to China and elsewhere in Asia and welcome our multifaceted economic relationships, including Asian investment. Asian ministers come here to inform their Australian counterparts of their growing interest in Australia's resource sector, among others. And then a small portion of investment proposals – admittedly overwhelmingly in real estate – is rejected, while some proposals are withdrawn if it seems clear that they will not be welcome.

A foreign investment screening regime is needed to assuage community concerns about foreign activity. It works on the assumption that foreign investment is in the national interest but discreetly acknowledges the reality that the government has to consider community concerns, and requires a mechanism for identifying those rare cases

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where major foreign investment proposals would not be in the national interest. This safety valve avoids a potentially worse and more heavy-handed approach to screening. That said, foreign parties' concerns that our actions are discriminatory, including specific concerns in relation to more favourable treatment of direct investment from the United States and New Zealand (and Korea once the newly announced trade agreement comes into force), need to be addressed in a transparent and timely manner. Sending mixed messages to China and other sources of foreign investment is not in our interests.

Communicating the trade story better at home

The Australian Government must develop and articulate a consistent view about trade and trade policy and their contribution to Australia's future, particularly in relation to achieving a better functioning economy that can continue to deliver better living standards. Neither society's receptiveness to change nor the high-level political skills required to lead and manage successful change are predictable and their conjunction resembles a lottery. But this is no excuse for not preparing the ground: having evidence-based analysis handy on why reform is essential and what open markets mean for peoples' livelihoods and prosperity. And it is no excuse for not using good public diplomacy to cultivate society's tolerance to change and make it as difficult as possible for vested interests to hijack economic reform.

Strengthening whole-of-government systems

Australia's whole-of-government processes within and between all levels of government will need to work better if trade and international perspectives are to connect more smoothly with the priorities and strategies for domestic economic and social reform. Open markets, inward and outward investment, flexible labour markets, efficient services industries, high standards of education and training and innovative cultures across industries are core elements of Australia's future success as a trading nation. Domestic policy makers – at federal, state and local levels of government – might not always see the international connections or place appropriate emphasis on them. But more internationally focused policy makers have to ensure that these perspectives can be brought together in crafting good policy. ■

3. The international agenda in a new trade policy environment

2014 is shaping up as a big year for trade policy globally and for Australia. The death of the Doha Round in terms of its original mandate was formally acknowledged at the end of 2013. The low hanging fruit on trade facilitation has been gathered in (though negotiations will continue on implementation), and other key elements of the agenda (on services, updating the WTO Information Technology Agreement and on environmental goods) will be advanced plurilaterally.

The lesson learnt from Doha is that the WTO is too broad and diverse to achieve consensus – it was hard enough to get agreement on trade facilitation. If the India and Brazil want to go off on their own, so be it. The United States and others will do business with willing partners that should (and hopefully will) include China: China has a far bigger stake in the global trading system than most other emerging economies.

The way therefore seems open for a new phase of international trade policy focused on creating new rules for 21st century trade through mega FTAs and WTO negotiations on specific issues between sub-sets of the membership. The United States is driving much of this agenda. It is preoccupied with trade negotiations with the European Union and Asian-Pacific countries in TPP because: (i) they affect the bulk of world trade and foreign direct investment; (ii) involve serious parties; (iii) can lead to practical outcomes for business; and (iv) may set the global trade policy framework and rules for the next decade or more.

Among others, the new rules should embrace services, investment, intellectual property, government procurement, and competition/state owned enterprises. They should also focus on behind-the-border issues that bedevil regional and global supply chains and that either are not dealt with by the WTO or are dealt with ineffectively. Given enough time and assuming the entry price is not prohibitive, China could plausibly join negotiations after TPP has been agreed. There are probably too many political and economic issues to sort out for this to occur earlier.

This new environment comes with one serious caveat. The weak multilateral negotiating arm of the WTO must, at some point, be restored to health before it weakens the WTO's prized monitoring and dispute settlement functions and puts complex issues like global agricultural reform permanently into the too hard basket. Some US trade policy practitioners are interested in how mega trade agreements like TPP might be multilateralised and brought into the WTO. But this is not a dominant interest. It is different for Australia. As a mid-sized economy whose prosperity depends on the efficient working of the global trading system, there is a keen interest in restoring the WTO to the centre of the world trading system.

In this new environment, Australia will host the G20 Leaders' meeting in Brisbane later this year with trade liberalisation as a key theme; hopefully make progress in TPP and Regional Comprehensive Economic Partnership (RCEP) negotiations; probably complete an FTA with Japan within the next few months and hopefully with China (though this is becoming more problematic); and complete salvage operations on Doha.

Hosting the G20

The G20 Leaders' process is one of the most innovative and important changes in the institutional landscape in the last 30 to 40 years. Its creation marks the point where decision making at the highest level has been shared between established and major emerging powers on an equal basis.

Financial issues (institutional arrangements, regulatory changes, taxation) have been at the core of G20 work. This is an inevitable legacy of the Global Financial Crisis and the G20 finance ministers' process that predates the crisis. But as the world moves further away from crisis management, strengthening other elements of the international economy becomes increasingly important in tackling slow growth, the fragility of several major economies and joblessness. Labour, development and the environment have been added to the G20 agenda in recent years. Trade has been part of the agenda from the outset, particularly through the standstill pledge and the ritual cajoling of trade ministers to finish Doha. But it is now time to take the challenging step of moving trade liberalisation from the periphery and closer to centre stage.

This has to be done prudently because the G20 is not a trade negotiating forum or an alternative venue for an essentially WTO-type discussion. The Group nevertheless has unique value if it can stamp Leaders' authority on trade.

For Brisbane and beyond this agenda might involve:

- Highlighting why trade needs to be a global priority. Trade generates growth and jobs and trade liberalisation matters because it makes economic growth more sustainable. Tackling behind-the-border barriers is the most pressing part of trade liberalisation given lower border barriers and the requirements of regional and global value chains.
- Australia leading by example. In the 1980s and 1990s, Australia led by example in reducing tariffs and binding outcomes in the Uruguay Round of Multilateral Trade Negotiations. This became part of the foundations for a golden period of Australian growth and prosperity. Australia now needs to lead in reducing behind-the-border barriers to trade and investment. This would be profoundly in our interests. It would boost productivity: the Productivity Commission estimates that unnecessary regulation alone could be costing Australia tens of billions of dollars each year.[4] Over time the demonstration effect might also feed into international discussions and negotiations on trade liberalisations.
- Encouraging members to identify and make changes to domestic economic settings that are judged to be in their national interests, that would make value chains work more efficiently and that could lead to more growth and jobs. This demonstration of practical international cooperation might be in the trade space (for example, on tariffs or behind-the-border regulatory barriers) or perhaps in elements of the finance agenda (such as on competition policy) where regulatory changes could help to boost trade. But to have real traction, leaders would need the flexibility to do as much or as little as they judge appropriate for their national circumstances. Concepts of equivalence would not work because outcomes would have to be negotiated. This comes back to the G20 complementing the WTO, not competing with it.
- Starting an invigorated leader-level dialogue on strengthening the global trading system. The dialogue would continue over time and focus on why trade matters and how to strengthen the global trading system with the WTO at its centre. This could embrace how the G20 can provide political support for the WTO and get Leader level views on: new ways of negotiating trade deals and shaping future deals; bringing multilateral rule making up to date; lessening distortions in the international trading system associated with inconsistent and overlapping FTAs;

multilateralising regionalism by more closely defining the relationship between multilateralism and mega FTAs; and options for reforming the WTO as an institution. The answers to these sorts of questions are unlikely to come primarily from within the WTO. It is arguably too rigid, too legalistic and too bound up in the 'old think' of countries selling things to each other as distinct from making things together. The answer could well come from G20 Leaders.

Building regional relationships

Australia's long-term prosperity depends on assured and expanding access to markets in the Asia-Pacific region and on the region being as well integrated as possible for trade and investment. Australia has a strong trading relationship with the region but investment relations are weaker. This reflects several factors, including greater restrictions on investment in Asian countries compared with Europe and North America and lack of familiarity with business environments – for potential Asian investors in Australia as well as Australian investors in Asia. Addressing these inhibiting factors for two-way investment should be an important part of Australian trade policy in coming years to diversify trade patterns and to strengthen the overall economic relationship with the region.

Australia also needs to be mindful of the reform challenges and imperatives faced by Asian economies if they are to negotiate the perils of the 'middle income trap' and cement their place as key drivers of the world economy. The sustainability of their growth could well depend on how well they handle these challenges. It is very much in Australia's interests that they succeed. The infrastructure development needs that flow from their growth would then underwrite their demand for Australia's resources for years to come. The emerging middle classes of Asia would sustain and raise the demand for Australian rural-based products

> *“Australia's long-term prosperity depends on assured and expanding access to markets in the Asia-Pacific region and on the region being as well integrated as possible for trade and investment.”*

and services. Australia's manufacturers would be able to link more closely into supply chains in the region and grow markets in niche areas of expertise in markets that are becoming increasingly specialized. A wealthier, vibrant Asia would continue to be the major source of the imports needed to meet business and consumer demands and to keep prices and costs in check.

The imperatives for reform are understood, especially in China, which is now grappling with achieving growth driven more by domestic demand and less by exports. Both Asian economies and Australia have clearly defined interests in building economic architecture that supports international cooperation and negotiating trade agreements and pursuing policies that underpin future growth.

Forums like Asia Pacific Economic Cooperation (APEC) can help insofar as they encourage unilateral economic reform, foster habits of reform-oriented collaboration among officials and facilitate close engagement between officials, business and academia on regulatory reform and governance issues. But there are numerous international organisations and groups working on similar issues and indeed on the same issues. If APEC is to survive and prosper as a top-tier process in a crowded international agenda of meetings and dialogues, it must demonstrate that its own agenda is weighty enough to justify the continued investment of time and effort by regional leaders and ministers. That presents a big challenge for countries such as Australia that support APEC as a core component of regional economic architecture.

For at least the past decade, regionalism has been spearheaded by FTAs. This trend will continue. Having concluded negotiations for an FTA with Korea, an obvious priority for Australia this year is to complete bilateral FTAs with Japan and China. They have dragged on far too long. These deals should improve market access, add to regional economic cooperation and trade and investment facilitation, and increase domestic competition (with potential flow-on effects for national productivity). But the deals will not be perfect and will no doubt provoke outcries from sections of the public, particularly on investment. China and Japan want to secure FIRB foreign investment thresholds comparable to those applying to the United States, New Zealand and (soon) Korea. This would be a good thing for the economy.

Another key priority this year is to advance TPP and RCEP negotiations. There has been a good deal of speculation about when TPP will be completed (assuming it ever is). In our view negotiations could extend into 2015 or even beyond:

- The issues are complex.
- New parties such as Japan have joined the negotiations and are playing predictable games.
- The US administration does not have Trade Promotion Authority – and may not get it before the mid-term congressional elections – which means that other parties will not strike a deal with the United States because they cannot be confident it would stand up to congressional horse trading and nit-picking.
- There has been increasing public concern in the United States over the transparency of negotiating processes and on issues like intellectual property protection.

In broad outline much the same could be said about RCEP: making progress will be hard going; timelines could blow out; and ambition could rise or fall. But the sense that the outcome could, on balance, be positive is based on self-interest rather than ideology driving negotiations. There is widespread ASEAN interest in balancing domestic and external integration, and strong interest in the wider East Asian region in building stable and durable regional economic architecture.

Australia has a strong interest in advancing both of these mega FTAs:

- Besides access opportunities, they offer an avenue for reducing transaction costs, including costs arising from inconsistent and overlapping FTAs.
- They should become key parts of evolving regional economic architecture. Australia wants to play a full part in economic and trade developments in East Asia.
- They are part of the strategic competition between the United States and China as each manoeuvres for additional influence in the region. Australia has a fundamental interest in preventing TPP and RCEP 'splitting' the region.
- Over the next decade or two, these agreements, along with other major multiparty trade negotiations such as the Transatlantic Trade and Investment Partnership Agreement, could establish benchmarks for broader international action that could, in turn, be injected back into the multilateral sphere. An ambitious outcome on goods in RCEP, for example, might establish benchmarks on rules of origin (such as on rules on cumulation). TPP might do the same on services, investment, intellectual property, and government procurement. How such benchmarks could be incorporated in global rules is unclear. One possibility would be for useful regional benchmarks to be taken up by a wider sub-group of the WTO membership in sector-specific or issue-specific plurilateral negotiations. Another would be for watered down versions of regional benchmarks to be accepted by the whole WTO membership in forms that would still represent a strengthening of multilateral commitments. But however it is done, Australia has a long term interest in regionalism strengthening the global trading system.

Two final points on FTAs and regionalism. First, it is time to consider an Australia-European Union FTA among Australia's top trade negotiations priorities. Putting aside the historical baggage would clear the way for a negotiation focused on behind-the-border barriers to trade and investment arising from differences in regulatory arrangements in different jurisdictions. Mutual recognition of standards, certification and testing procedures and professional qualifications would be especially valuable in boosting commercially driven two-way trade in food, services and elaborately transformed manufactures.

Second, it is time for a long hard look at the countries of Latin America. Australia's relationship with Latin America is woefully under-resourced at the diplomatic level. Ties admittedly have strengthened. Trade remains minimal, except in travel-related services, but there are significant investment links, especially in mining. Some new diplomatic posts and Austrade offices have opened since the mid-2000s; ministers and capital-based officials engage actively in international forums; and an FTA has been negotiated with Chile. But our diplomatic and trade presence still does not reflect current imperatives, let alone future ones as Latin America's influence grows economically and politically.

For the relationship to take off, Latin America and Australia need to see each other in new ways and be more certain about what each can offer the other. At a strategic level, the political and global weight of Latin America, especially of Brazil and Mexico, needs to be more fully understood and acted upon by Australia's leaders. No one doubts the importance for Australia of East Asia, but Latin America has emerged as one of the poles of growth and influence in the world economy. It took Australia too long to 'discover' India: it would be unfortunate to repeat the mistake with Brazil and Mexico. ■

4. Conclusion

The world owes Australia nothing. That dawned on Australian leaders and society in general during the 1980s. Then, like now, there was financial stress, uncertainty internationally and lagging productivity at home, but this unwholesome mix provided the context and motivation for a major period of reform. The imperatives, then as now, include being preoccupied with hard economic reform that fits into an explainable strategy; telling the economic narrative often and well; making full use of the skills and experience of ministers, diplomats, bureaucrats, academics and business leaders; binding increased market openness through trade negotiations; becoming more curious about our region and the world; and being prepared to invest more in ideas and strategies to cope with fast-changing technologies, institutions and power balances.

If Australia is to seize opportunities that will still exist in a difficult global and regional trading environment, implementing good processes is a prerequisite. That means:

- Having evidence-based analysis handy on what open markets mean for people's prosperity.
- Making sure that whole-of-government processes are working well so that international perspectives inform domestic debates on economic reform.
- Revitalising the ideas market within government by making full use of the policy ideas and analytical capacity of government agencies, business, think tanks and relevant community groups.

Managing the uncertainties of the multipolar world will be Australia's most important foreign and trade policy challenge in the years ahead. Pursuing core national interests will depend increasingly on the quality of Australia's ideas on the world and region, and being clever enough and productive enough to turn serious ideas into cutting-edge, explainable policy.

This comes back to creating the space and building the resources to move beyond day-to-day policy minutiae. There are obvious constraints such as tight budgets. But there are also huge assets: the talent in key government departments; the in-depth knowledge of different societies, economies and policies that accumulates in Australia's global network of diplomatic and trade posts; and the capacity and imagination of the wider community if harnessed to a genuinely whole-of-nation effort to understand, and respond to, a fast-changing world.

Domestic economic and social reform is the key to all of this. Australia's effectiveness as an advocate of trade liberalisation and as a negotiator of ambitious trade deals rests on our credibility for serious reform and on our capacity to demonstrate the benefits of that reform to others. The absence of a demonstrable commitment to reform would reduce Australia's relevance in forums such as the G20, APEC and the WTO. It would also inject a counter-productive defensiveness into our trade negotiations when at least some of our partners are looking to step up their engagement with a more open and relevant Australia. ■

Annex 1:
Gary Banks' 'To do List'

Governments influence the productivity of firms and organisations through three main channels:

- Incentives: the external pressures and disciplines to perform well
- Capabilities: the human resources and knowledge systems, the institutions and infrastructure, needed to devise productivity-enhancing changes and support them effectively
- Flexibility: the scope to make the necessary changes.

Productivity is unlikely to improve if policy advances in one channel are countermanded by backsliding in others. A 'pro-productivity' agenda needs to proceed on all three fronts. In recent years, the signals have become blurred again, prompting a resurgence of rent-seeking behaviour from firms and industries under market pressure.

Prominent initiatives in the Banks' 'to do' list, prepared in the last months of his tenure as Productivity Commission Chairman, include:

- Tariffs: Abolish remaining tariffs. They still impose unnecessary costs on the community.
- Anti-dumping: Limit provisions for anti-'dumping' action. The rules allowing such 'administered protection' should be tightened in the true spirit of the WTO, not made more permissive.
- Selective industry subsidies: terminate subsidies that cannot deliver demonstrable net social benefits.
- Coastal shipping protection: protection has been strengthened recently, raising costs to user industries and weakening inter-modal competition.
- Government innovation programs: evaluate all government innovation programs to verify that they are achieving 'additionality' and are cost effective.
- Government support for basic and strategic research: focus research where market failures are potentially greatest, rather than commercialisation activities, which are more likely to be privately profitable.
- Cooperative research between businesses and public/academic institutions: facilitate greater cooperation through more 'nimble' mechanisms.
- Public infrastructure investment: undertake transparent cost-benefit analysis of all options prior to any major public infrastructure investment and when determining quality or environmental standards.
- Cost reflective pricing: extend use, including to manage peak demands (electricity) or supply disruptions (water).
- Land transport: introduce institutional reforms for roads to connect revenue with spending decisions, while progressively moving to location-based road pricing, particularly for freight.
- Water utilities: align procurement, pricing and regulatory arrangements with an overarching efficiency objective.
- Electricity: phase out retail price regulation, introduce smart meters, bolster the regulator and modify the regulatory regime to increase consumer orientation and to avoid inefficient investment.
- Policies to promote flexibility: structural pressures of the 'multi-speed' economy lend particular importance to the need to enhance flexibility and adaptability within enterprises and across industries and regions. Priorities include: increasing flexibility in labour markets, removing renewable energy targets (which are costly and can be counterproductive in reducing carbon emissions), streamlining development approval processes and introducing better taxation systems - fewer, less distorting taxes with broader bases and lower rates would enhance labour force participation and industry productivity. ■

Endnotes

1 Data are aggregates for 12 selected sectors and are for financial years. Productivity growth cycles are those identified by the ABS and are constructed to give the most accurate representation of trends in productivity growth. The last cycle to June 2013 is incomplete.

2 Banks, G. 2012, ‘Productivity policies: the ‘to do’ list’, Economic and Social Outlook Conference, ‘Securing the Future’, Melbourne, November. See Annex 1 for details.

3 Berg C. and A. Lane (2013), *Coastal Shipping Reform: Industry Saviour or Regulatory Nightmare*, Institute of Public Affairs, December.

4 Productivity Commission 2007, Commission Research Report: Potential Benefits of the National Reform Agenda, Ch 8 <www.pc.gov.au/research/commission/national-reform-agenda>; Productivity Commission 2013, Major Project Development Assessment Processes. <www.pc.gov.au/projects/study/major-projects/report>. Note: the term ‘unnecessary regulation’ is not used in the 2007 report. The Commission refers to regulatory compliance costs. Unnecessary regulation (or unnecessary compliance costs and unnecessary regulatory burdens) is used more frequently in its 2013 report.

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