3

The evolution of Australia's trade policy

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 to the third quarter of the 20th century, those elements basically included border measures like 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 filled the trade policy space with 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, like 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. It comes down to ensuring that trade perspectives are given adequate weighting in the deliberations of Treasury and departments with specific sectoral responsibilities, either through the Department of Trade and its successors having a role in shaping domestic economic policy settings; or having a competitiveness brief and the capacity to prosecute it; or through the central agencies of state sharing the same policy view about broad economic priorities and approaches.

During Australia's protectionist past, domestic policy was complemented by trade policies that offered little by way of tariff or other market-opening concessions to our trading partners and yet sought to open other countries' markets to Australian commodities and manufactures, thereby denying for ourselves many of the gains from trade.[1] Liberalising policies for the most part developed slowly and incrementally, though with occasional bursts of speed and dash as in the 1957 Commerce Treaty with Japan and the 25 per cent across-the-board tariff cut in 1973. During the past quarter of a century, the pace of economic policy change has been far faster than at any other time in Australia's history, and trade policy has interacted more closely with domestic policy to promote domestic adjustment and a more open and productive economy.

National goals and protectionism

The third quarter of the 20th century was mostly a time of optimism and prosperity in Australia. Employment was secure, home ownership and living standards were rising, and better education and decent health care were available to an increasing proportion of the population. There was limited questioning of 'protection all round' that was popularly believed to have produced this bounty.

The 1945 White Paper on Full Employment set the framework for Australia's economic policy for the next 30 years. Nation building, full employment, an increasing population, rising living standards, and national security were the key goals. Nation building meant major public works and finding jobs in capital cities and regional centres for the hundreds of thousands of migrants who came in search of a better life. Agriculture could not deliver the growth or jobs, and there were fears about the long-run decline in Australia's terms of trade because of declining real prices for agricultural exports. Dependence on agriculture also clashed with post-war leaders' vision of a modern, economically strong Australia. Support for manufacturing was seen as the key to growth and jobs to satisfy that vision. There was little or no appreciation of the contribution of the services sector in the economy.

Unfortunately, Australian manufacturing industry was a hotchpotch of import replacement industries; industries like shipbuilding and textiles and clothing that had expanded during the 1930s behind high tariffs; and industries like munitions, metals and heavy engineering that had expanded to meet wartime requirements. These industries were preserved and new ones, like passenger motor vehicles, were added wherever possible (Butlin & Schedvin 1977, p. 742). Higher tariffs, import quotas and restrictive import licensing requirements made this practical, insulating the domestic market, allowing some decentralisation of manufacturing away from the main capital cities, and compensating for lack of economies of scale, lack of capital, lack of advanced skills, and high nominal wages that reflected notions of egalitarianism more than relative economic performance.

The resort to more protection was obvious enough and had sound provenance in Australia, as elsewhere in the developed world at that time. It was ingrained in national economic life almost from Federation (and was a prominent part of Victoria's colonial history). It was ingrained among the men running the country. Liberal or Labor, it made little difference. It also was instinctive among most Australians who readily accepted strong interventionist government and tariff protection as a key policy instrument for developing the nation (Capling, Considine & Crozier 1998, pp. 20–22; Capling 2001, p. 73). Britain had been protectionist during the early phases of its industrialisation. The United States had been protectionist until it was on the verge of industrial dominance shortly before the First World War. Why should Australia's development story be any different?

Box 3.1 Early protectionism in Australia

Throughout much of the 19th century Australia had an open economy, reflecting our small manufacturing sector and dependence on international trade for goods we could not produce ourselves. This openness began to change after the gold rushes and the take-off of domestic manufacturing. Victoria became strongly protectionist and New South Wales held firmly to free trade. This split was essentially a product of how political coalitions were formed. In New South Wales, the political bargain was between the Free Trade Party and groups wanting to redistribute income from landowners to workers via taxes on land and income. In Victoria, the bargain was between protectionists and groups willing to use protection as a device to redistribute income by reducing land rents and boosting workers' wages. These bargains held during the decades to Federation in 1901.

Three parties were represented in the first federal parliament: the Free Trade Party, the Protectionist Party and the Labor Party. New South Wales members tended to be free traders; Victorians and members from most other states tended to be protectionist; Labor Party members had no settled position on protection. Overall, most members favoured protection and had protectionist instincts.

By 1910 the federal parliament was solidly protectionist. The Labor Party had turned protectionist, and the Free Trade Party had abandoned its commercial policy, merged with the Protectionist Party in an anti-Labor coalition and soon disappeared. This clean sweep had some economic foundations. Customs and excise taxes constituted the bulk of federal government revenue – over half in the first ten years after Federation – and remained the single largest component until surpassed by income tax in 1941. A good deal of creativity therefore went into increasing revenue to meet growing spending requirements. But the decisive factor was 'New Protectionism' – the agreement between the Protectionist and Labor parties to make protection conditional on assisted industries providing superior wages and conditions to their employees.

The Country Party, formed in 1920 and in government with the Nationalist Party between 1923 and 1929, threw in its lot with protectionism for reasons of political expediency. Protectionism was inconsistent with the interests of big wool, meat and grain producers, who were keen to keep farm costs as low as possible. But it was consistent with the interests of numerous small-scale sugar, dairy, wheat, and tobacco farmers who formed the backbone of the Party. Some farmers had natural protection through high transport costs. Others were dependent on subsidies or government intervention to keep domestic prices above world prices. The Country Party entered into a wider bargain with protectionists to keep it that way.

Protection soared after Federation. Almost from the outset, sugar was protected with high tariffs while subsidies compensated growers for high labour costs associated with Australia's 'All White Policy': the Kanaka workforce was repatriated and replaced with more expensive European labour. Export subsidies were later added to the mix. Beyond agriculture, average tariff protection for non-food manufactures nearly doubled in the decade to 1920 and then doubled again by 1932. By the late 1920s, only the United States among high-income countries had average tariff levels higher than Australia's.

SOURCES Anderson & Garnaut (1987, pp. 40–48); Pincus (1995, pp. 58, 62)

Post-war 'all round protection' represented a fine balancing act between trade, industry, industrial relations and social policies. Manufacturing was protected from the spectre of Asian sweatshops and unfair competition. Farmers were protected by marketing and price stabilisation schemes. Australian wages and conditions were improved through the centralised wage system: changes in the metal trades award generally flowed through to wage determinations in other industries. Rent seeking became more entrenched in the political system – a development reinforced by Trade Minister Sir John McEwen's move in the 1960s to give the Country Party an enduring base by welding rural and manufacturing protectionist interests into a single political grouping (Reid 1972, pp. 41–42). Unprotected industries demanded assistance to compensate for higher input costs or the higher exchange rate associated with protection. Protected industries then demanded, and usually received, yet more assistance to maintain their competitive position (IAC 1974, pp. 14–16). Income was redistributed between export industries (agriculture and later minerals and energy) and import competing sectors, with the important caveat that large agricultural export industries like dairy and sugar were core parts of the protectionist system.

This interlocking system of ideas, attitudes and institutions broadly satisfied vested interests, represented tried and trusted policy, and distilled what generations of Australian leaders from various walks of life had learnt about how Australia could adapt economically and prosper in a difficult and at times dangerous world. The 1960s marked the system's 'fullest flowering' (Castles 1988, p. 143) as mainstream Australia basked in its own economic success – high per capita incomes, good employment opportunities, reasonable hours of work, holiday pay, long service leave and, from the late 1960s, equal pay for equal work.

International trade policy complemented domestic policy in two important ways. McEwen and officials from his department worked doggedly to hang on to British trade preferences for agricultural products and increase access to markets, particularly in the Asia-Pacific region. The government also worked assiduously in the GATT to retain autonomy to set tariffs.

Australia made uneven progress multilaterally. Direct market access gains in multilateral trade rounds were limited prior to the Uruguay Round (1986–94). The main offensive interest was improving market access for agricultural commodities but it was not seriously on the table. Agricultural protection rose in major developed countries to the mid-1980s and international agricultural markets became more distorted. Australia secured some minor access improvements in commodities like beef during the Tokyo Round (1973–79) and benefited more generally from increasing openness of major markets to inputs into manufacturing like coal, iron ore, wool and cotton (Snape, Gropp & Luttrell 1998, chapter 3). But, by and large, offensive interests were stymied: Australia gave little and gained little.

It was a different story with Australia's defensive GATT interests. The key interest was retaining autonomy to adjust tariffs, including even the few that were bound. This position was based on concepts of development and fairness. On the former, Australia argued the 'midway' view that we were neither a fully developed nor developing country and that 'all round protection' was required to deliver 'more industries, more types of factories, more investment and, above all, more output' (Glezer 1982, p. 179). These convictions explain why Australia (along with New Zealand and South Africa) was prepared to leave the GATT unless exempted from the 50 per cent linear tariff cuts negotiated in the Kennedy Round (1964–67), and perhaps why other governments took our threats seriously and ultimately accepted small piecemeal concessions instead (Snape, Gropp & Luttrell 1998, p. 365). On fairness, Australia argued that our major agricultural trade interests were subject to much weaker GATT disciplines on market access and export subsidies than the disciplines applying to international trade in industrial products. To have become party to the tariff cuts on industrials agreed by major developed countries would only have increased the unfairness. It was a hard sell.

Bilaterally and regionally, Australia made significant progress in accessing new markets. The key shifts in these years were weakening dependence on British markets, manufactures and capital and growing engagement with the United States, Japan and emerging Asia.[2] Australia outwardly remained a British outpost, but hard-headed national self-interest determined the course as Australians increasingly understood the potential of the Asia-Pacific region. Britain's failed attempt to join the European Common Market in the early 1960s, and its successful attempt in 1973, fuelled efforts to develop alternative markets. The Australia, New Zealand, United States Security Treaty (ANZUS) became the bedrock of Australia's security policy from the beginning of the 1950s, inevitably setting in train broader changes in Australia's relationship with its new 'great and powerful friend', particularly in commercial and cultural areas.

The push towards Asia, and particularly the initial focus on Japan, began in earnest in the mid-1950s. It was driven by McEwen and Sir John Crawford (Secretary of the Department of Trade from 1956 to 1960) and mostly by economic circumstances. The Australian public, understandably enough, were very distrustful of Japan. Wartime memories were vivid and raw. But Japan was the only large market for Australia's agricultural products with real prospects for strong medium-term growth. It had been a significant market for wool and wheat pre-war and had re-emerged as a major market for wool and other agricultural products in the immediate post-war years (see chapter 2). Prospects in alternative and politically less problematic markets, such as the United States and Europe, were blighted by their protectionist agricultural regimes. Additionally, Japan was keen to restore international relationships while Australia was keen to forestall Japan switching decisively from wool to synthetics (Capling 2001, pp. 61–62).

This set the scene for the 1957 Australia–Japan Commerce Treaty, arguably Australia's most important bilateral trade agreement. The agreement exchanged MFN treatment between the former foes, became the cornerstone of a highly productive trade relationship over the following half-century, and paved the way for the reorientation of Australia's trade towards Asia in later years. It stands as a personal triumph for McEwen and a fine example of far-sighted vision and leadership by both governments. In Australia's case, it also stands as an example of a government being prepared to make hard and unpopular policy decisions based on the strong conviction that they were in the national interest and would be vindicated by history.

The Whitlam government's recognition of 'Red China' in 1972 was another far-sighted decision. It was taken for political reasons – it was part of a raft of measures that reflected the Australian labour movement's frustrations with two decades of conservative Cold War politics – and was a bold initiative given that the United States had followed a policy of isolating China until a few months earlier. Possible commercial benefits did not appear to loom large in the decision. China was an intermittent buyer of Australian agricultural products, was deeply mired in its Cultural Revolution and seemed to have unpromising medium-term prospects. But Australian business must have hoped that early recognition would boost trade to some degree. Since the late 18th century, traders have always had a romantic vision of how China could make them rich. Manchester textile manufacturers once dreamed of the riches to be reaped if every Chinese wore a pair of their socks. The dream never came true but this probably did not stop Australian farmers, miners and manufacturers having similar dreams. And, by and large, their dreams did come true on a scale that would have seemed unimaginable to the handful of Australian officials, business representatives and academics with any direct knowledge of China in those years.

Complementing and reinforcing the increasing policy focus on the Asia-Pacific region, the Trade Commissioner Service (Austrade's predecessor) worked hard to increase access for primary products and manufactures. Developing new markets in Asia and the Middle East was the priority and many of Australia's trade posts were located there, following precedents in the 1920s and 1930s (Schedvin 2008, p. 170; Goldsworthy 2003, pp. 2–3).[3] In the case of manufactures, this focus probably reflected the logic that our offerings were generally not competitive either in quality or marketing but might be competitive in countries where manufacturing was judged to be even less efficient than in Australia.

Opening the economy

The complacent acceptance of continuing good times and of the role of heavy regulation in delivering prosperity suggests that the debate on protectionism, which had been going on through the 1960s, had largely failed to make a significant impression on mainstream political parties because it had failed to capture the attention of the general public. In the early 1960s this was hardly surprising: the debate was confined to a handful of academics and economic journalists. But it was not true by the late 1960s: the debate on protectionism still had a long way to go before it grabbed wider public attention or made significant inroads into business and the trade union movement, but it moved up several gears around this time among some political and business groups and among economists (Rattigan 1986, p. 272). Slowly but surely, the view that Australia's long-term growth depended on finding markets and being internationally competitive was gaining traction.

At the start of the 1970s, the great majority of Australians continued to look forward to strong economic growth, rising living standards and assured employment. The major parties going into the 1972 federal election expected that too. Winning government for the first time in a generation, Labor was confident that historically fast rates of economic growth would generate the revenues needed to finance ambitious social programs. Losing narrowly, the Coalition was equally confident with the soundness of its economic policies: no review of their appropriateness or effectiveness was undertaken (Howard 2010, p. 54) and criticisms of heavy regulation by maverick Liberal members of parliament like Bert Kelly went mostly unheeded.

The economic shocks of the 1970s – the two oil shocks, the collapse of the Bretton Woods system of fixed exchange rates, and Britain's accession to the European Economic Community – hammered at Australia's economy. By 1975, inflation was over 14 per cent, unemployment was over 5 per cent – an alarming level when the general public's comfort level was 1.5 per cent or less – and government finances were in a mess. All this brought the debate on protectionism into plain public view. Some in the community were won over to liberalising the economy. Many were fearful of widespread retrenchments in the automotive and textiles, clothing and footwear sectors if protective barriers were removed; and perhaps most were just uncertain and wanted to know more about where Australia stood.

Box 3.2 'Black Jack' McEwen and Bert Kelly

Sir John McEwen was a statesman, leader of the Country Party, one of the architects of Australia's post-war economy, and totally and relentlessly committed to protectionism. Bert Kelly was a Liberal backbencher, promoted to the Ministry for only three years, and totally committed to resurrecting the 'antique' theory of free trade from the dustbin of history. The two men did not get on.

McEwen was a man of his times, his thinking shaped by the hard inter-war years. Unemployment was the great evil. As far as he was concerned, protection provided work, work produced dignity and self-respect, and together they built strong communities. To risk that through applying free trade principles in a world where the economically strong tried to dominate the weak amounted, in his view, to political cowardice and an abrogation of responsibility. Economic efficiency was only part of the picture.

Kelly, though a good deal younger than McEwen, went through the depression years but emerged as a man ahead of his times. He saw high tariffs destroying jobs by inhibiting growth, transferring resources to inefficient industries and stifling the manufacturing export sector. He also saw protection as arbitrary and capricious, conferring benefits on the few, who could suck vigorously on government largesse at the expense of the majority. As a lone voice in the political wilderness his influence was limited, but his straightforward message, his command over facts and figures and his effective media skills won support and influence over time.

The relevance of these two men, now long dead, is the moral, and intensely political, core of their vastly different responses to their life experiences, particularly the spectre of unemployment. Economic theory suggests that, generally speaking, a country will be better off by pursuing free trade even in distorted international markets. But the wider community debate, and beyond that the international debate, is infused with the same moral, social and political elements that so influenced McEwen and Kelly in charting their different paths.

SOURCES Golding (1996); Evans et al. (1997); Kelly (1970, 1978)

A worried general public started to glimpse a future without the certainties and easy comforts of post-war life. The mood was not helped by US defeat in Vietnam and Australia's unusually poor showing in international sporting events. Weaknesses in Australia's post-war economic record became a popular issue for discussion.

Some weaknesses were obvious. Australia was in a trade backwater with few apparent options for trade-led growth, a predicament captured years later by Treasurer Paul Keating's famous 'banana republic' rhetoric. Agriculture continued to face declining real prices; minerals, energy and simply transformed metals had good prospects but could not compensate easily for lost agricultural markets following Britain's entry into the European Economic Community; the services export sector was largely undeveloped; and Australia had virtually excluded itself from fast-growing areas of world trade such as high value-added manufactures (Capling, Considine & Crozier 1998, pp. 29–33).

Other weaknesses were less obvious: slow productivity growth through most of the third quarter of the century; slower average economic growth than in other OECD countries; declines in Australia's rankings in global living standards and share of world trade; and declines, arguably, in our significance to East Asia at a time when its influence and importance to us were rising (Capling 2001, p. 95).

As the 1970s wore on, the nexus between underperformance over recent decades and closeted manufacturing became much better understood. This was thanks largely to the work of the Industries Assistance Commission (IAC),[4] which played a major role in presenting evidence-based analysis of the costs of protectionism, as well as of academic economists and economically literate segments of the media. New analysis revealed that decades of 'anomaly, inconsistency and irrelevance' in industry assistance measures (IAC 1974, p. 3) had produced small-scale, high-cost manufacturing that lacked critical mass for export; high-cost non-traded goods and services; and labour-intensive industries often unsuited to Australia's economic environment (IAC 1977, p. 42).

Reduced to basics, this meant overpriced cars, clothes and televisions, unnecessary hardship for the poor, and the promotion of sectional interests over national ones at massive cost to the community, including many on low incomes. The regressive and undemocratic core of protectionism resonated with a growing segment of the community.

The questioning and unsettled mood of the general public was not reflected in political action to kick-start economic reform because protectionist sentiment was still in the ascendancy and so many vested interests, including millions of workers on award wages, had a big stake in preserving the status quo. The Whitlam government's 25 per cent across-the-board tariff cut in 1973 turned out to be a false start in rolling back protectionism and not a watershed moment in Australia's economic history. It was a one-off measure introduced almost as an afterthought to help control rising inflation and followed a decision to revalue the Australian dollar with the same objective. Any liberalising benefits from the cut were soon overturned by the effects of new tariff increases, quotas, subsidies, temporary assistance that persisted, and 'voluntary' import restraints. Both in government and opposition, the Labor Party clung to trade restrictions: some elements linked this to resisting US multinationals; most, including the leadership of the Australian Council of Trade Unions (ACTU), were critical of microeconomic reform and saw high tariffs as the best way to protect jobs.

Economic management was more rigorous under the Fraser government (1975–83), but the mercantilist and protectionist instincts of the past continued to drive trade policy and economic policy in general. Australia regarded itself as a market economy, but governments and society at large acted on the conviction that the economy was too important to be left to the market. Prime Minister Malcolm Fraser could have done more on domestic economic reform if he had been so inclined. By this time the Liberal Party was less enthusiastic about high levels of protection: it might have been possible to bring down average effective rates of protection faster. Fraser also could have done more with the Country Party/National Party in the post-McEwen era, harnessing farmers' concerns about tariffs on inputs reducing their competitiveness. Instead, the government continued to pursue traditional economic interventionist policies, fought a losing battle against stagflation and worked on a range of important social justice and international issues. It continued the Whitlam government's push into Asia – closer engagement with Indonesia was a high priority – and grappled very creditably with the 'boat people' problem (Goldsworthy 2003, p. 6).

On trade, the Fraser government worked on export incentives, export awareness schemes and refocusing the Trade Commissioner Service. There were reviews galore from managing trade posts better to fine-tuning their distribution – posts were opened, closed and some reopened – to changing head office administration to adjusting the Export Market Development Grants (EMDG) scheme to launching the 'Export Now' campaign (Schedvin 2008, pp. 289–307). This frenzied activity reflected a government looking for savings while trying to respond effectively to Australia's woeful trading situation. Collectively, this activity added up to very little because it missed the point of why Australia's trading situation was so woeful. Addressing lack of competitiveness required comprehensive economic reform. No amount of tinkering with export promotion and administration could be a substitute.

The government also spent time and energy criticising the trade-distorting effect of the EEC's Common Agricultural Policy while erecting barriers to Asian manufactures. Average Australian tariff levels rose during the 1970s, reaching a post-war peak in the late 1970s and early 1980s (Lloyd 2007, p. 23). Tariff dispersion (measuring effective rates of assistance within and between industries) increased substantially, largely as a result of import quotas on textiles, clothing and footwear and on passenger motor vehicles. The potential for diverting resources into less productive activities and for raising the welfare costs of assistance all increased through these years.

While the Fraser government largely failed to recognise and capitalise on the community's emerging receptivity to economic change, the period was important in setting the stage for change in three key ways. First, community attitudes to protectionism hardened as more of its shortcomings were revealed and widely discussed. The precise extent to which attitudes hardened is debatable. It is not easy to grasp the notion that more jobs and higher living standards come from specialising in a sub-set of industries, or parts of industries, which have a comparative advantage, and scaling back the rest. Why should making parts and components produce better outcomes than making complete products and delivering fully developed services? The notion is even harder to grasp when the jobs lost from opening markets are visible, often highly localised and have a human face, while the jobs gained might be scattered and largely hidden across the economy and exist ethereally, at least for a time, in the projections of economic modellers. But whether hard to grasp or not, protectionism was in retreat: by the mid-1980s, many of its long-time advocates were arguing about how to reduce it and through the 1980s 'the centre of gravity of the economic debate [shifted] towards a more free-market approach' (Howard 2010, p. 136). The real divide was no longer between protectionists and liberalisers but between those who wanted to breach the walls of protection sooner and more comprehensively and those who wanted to move more slowly and retain something of the economic and social organisation of the past.

Second, reform proposals started to emerge, even if they got nowhere at the time. The Campbell Inquiry in 1981, for example, recommended deregulating the financial system, including floating the Australian dollar, abolishing exchange controls, admitting foreign banks, and removing controls on interest rates. There was some interest in tax reform, privatising government businesses like Qantas and the Commonwealth Bank and reducing the cost of doing business overseas. The eventual adoption of these types of policies was greatly assisted by the economic momentum of Japan and the Asian Tigers and by the more outward-looking policies being adopted in some developed countries. The economic pendulum was swinging in favour of market openness as tariffs tumbled around the world, key sectors like finance started to open up, and free-market orthodoxy radiated around the world from its epicentres in Margaret Thatcher's Britain and Ronald Reagan's America. All this made reformers in Australia feel politically safer, less lonely and appear to others less like they were playing with matches.

Third, attitudes towards Asia within government and significant areas of business, academia and the media were changing rapidly. Asian industrialisation was recognised as an opportunity to increase exports and, more controversially, as an opportunity to reap the benefits from growing imports – greater choice, lower prices and better quality. Equally important, community attitudes towards Asia were changing. They had been changing among younger people from the 1950s (Horne 1964, p. 10), but in a less certain way started to change more generally as many older Australians moved beyond the point where wartime memories blotted out the good things from closer engagement with Asia.

In the early 1980s, continuing economic crisis, in particular the 1982–83 recession, brought these threads together. Inflation was double the OECD average (it peaked at 12.5 per cent in the September quarter of 1982), interest rates were high, the current account deficit had blown out, external debt was rising sharply, and unemployment topped 10 per cent for the first time since the Great Depression. The inner contradictions of mercantilism – seeking access to international markets while denying it to, or limiting it in, the domestic market – were blocking the path to growth and jobs. Far-reaching reform was urgently needed.

Governments probably never know the precise extent and sequencing of their intended major reforms. They suffer rebuffs in some areas and grasp opportunities in others as and when they arise. In the case of the Hawke and Keating governments (1983–96), the traditional question asked by Australian economic policy makers – how can a rich country with a fair distribution of rewards remain rich – was replaced by a very different question: how can a small country that is no longer rich remain moderately rich and equitable. The answer was that it required a 'quite different strategy of adjustment of the national economy to the dictates of world markets' to deliver 'an acceptable combination of affluence and equity' (Castles 1988, pp. 152, 158).

Reform was inevitably messy and bruising. There were competing views within the Labor Party and the wider trade union movement and difficulties in getting legislation through the Senate, even though the Opposition was now clear about reducing protection and engaging with the fast-globalising world (Capling & Galligan 1992, pp. 255–59).[5] Growing exposure to international markets – floating the dollar, abolishing exchange controls, allowing foreign bank entry, phasing in tariff reductions – tested political nerves as the current account deficit ballooned at times in the 1980s and 1990s (see chapter 2). Exposure probed rigidities from excessive regulation, tested weaknesses in industries, challenged vested interests, and reaped an inevitable backlash. But while messy, structural change in a few sectors created pressure on others, generating momentum through the 1990s and first half of the 2000s for further market-based reforms that ultimately embraced labour markets, taxation, the institutions of monetary policy, competition policy, infrastructure, education, privatisation, public sector reform, transparency and accountability, and compliance costs.

[10 pages following are not included in this extract]

Key changes in Australia's trade policy

Behind-the-border policies and FTAs have fundamentally changed the emphasis of trade policy over the last 30 years. Change at an economic level has been driven by fast-evolving globalisation that continues to transform the business environment and business expectations about what a modern trade policy agenda should deliver. Change at the policy level, especially the surge in importance of FTAs, has been driven by fears of exclusion and by the inability of multilateral processes to respond confidently and quickly enough to changing business requirements and expectations.

Reflecting these changes in Australia's engagement with global and regional markets, the links between trade and liberalising economic policies have become closer and the trade agenda itself has broadened and modernised to embrace services, investment, intellectual property, competition, and trade facilitation, as well as agriculture and non-agricultural market access (manufactures). In turn, this broadening has progressively shifted the focus of trade policy from transparent border issues like tariffs and import quotas – traditionally the main impediments to trade in goods – to removing or lessening often ill-defined behind-the-border measures that are central to trade in services, establishing commercial presence and trade in many goods such as food.[12] Negotiating tariff reductions is hard, particularly on agriculture and sensitive manufactures, whether done multilaterally or in FTAs, and progress can be frustratingly slow. But negotiating behind-the-border measures can be even harder as they are tailored to each country's requirements and are overseen by a wider range of regulatory agencies (see chapter 4). Negotiations therefore run up against even more varied and entrenched domestic vested interests.

Multilateral trade negotiations have struggled to deal effectively with this broadening and changing agenda (see box 3.4). Tentatively at first and more powerfully over time, this struggle has provided both the incentive and policy space for countries wanting to move further and hopefully faster on the new trade agenda to pursue high-quality FTAs in parallel with multilateral negotiations. Australia's transformation from firm opponent to supporter of high-quality FTAs arguably ranks as the biggest shift in our trade policy over the past 15–20 years and among the most dramatic changes in Australian public policy generally.

Box 3.4 Liberalising services and investment

The willingness of countries, developed and developing, to liberalise their services and investment regimes in multilateral and FTA negotiations generally depends on their prior inclination or commitment to pursue domestic reform as part of improving overall economic efficiency. This disposition in turn depends on governments and communities understanding that competitive services sectors are needed to deliver decent productivity growth and improve living standards, and that the costs of failing to liberalise exceed the costs of maintaining the status quo.

Well-considered unilateral reform will always be in the national interest, so what is the role of negotiations, particularly given the fact that governments are loath to liberalise services and investment regimes beyond the boundaries defined by their domestic reform agendas unless, say, the United States or the European Union are applying very strong pressure on one or two industries? The answer has nothing to do with hanging on to so-called negotiating coin, which always represents an economic cost if it postpones well thought out and needed economic reform (see chapter 4). The answer is that countries can legally bind their openness in international negotiations and extract a price for it.

WTO bindings of market-opening measures are generally low among developing countries, which is understandable because they fear being swamped by services giants from the United States and Europe. In the Uruguay Round, most developing countries agreed to bind around one-quarter to one-third of their actual openness. In Doha, it was hoped that they might agree to increase this to around one-half. This would be an achievement because it would increase certainty in international services trade, though without delivering additional liberalisation. But it would still fall below what several developing countries have agreed bilaterally.

The fact that developing countries have agreed higher levels of market openness on services and investment in their FTAs than multilaterally begs the question: why? Part of the answer is obvious: the last successful multilateral round was completed in 1994 and FTAs of varying qualities have proliferated since then. The less obvious part may well be that developing countries have tended to shelter more behind special and differential treatment in multilateral negotiations, weakening their influence on the overall packages being negotiated. Under these circumstances, political pressure from protectionist domestic service providers could not be offset by political support from goods exporters. By contrast, in FTA negotiations with developed countries, developing country governments have in some cases exerted more control over the shape and content of packages. This has provided these governments with more opportunities to build domestic support for trade-offs that include greater goods access to developed country markets in return for (usually small) concessions on openness in services and investment in home markets.

For the most part, Australia went through the 1990s with an orthodox view on FTAs. They were seen as trade-distorting and exposing the vulnerability of small- and medium-sized countries in negotiations with more powerful countries. In retrospect this view was naive once the United States moved down the CUSFTA and North American Free Trade Agreement (NAFTA) (1994) routes, and the game was over once some of our trading partners in

East Asia started to move down this path a few years later. There was a flutter of interest in FTAs in Australia in the early 1990s when US President George H Bush, seeking re-election, spoke of extending NAFTA, still under negotiation, to more Asia-Pacific countries. Prime Minister Keating reacted by floating the idea of a bilateral commercial alignment with Japan and Opposition leader John Hewson presented an FTA with the United States as an alternative. This thinking came to nothing in the short term with Bill Clinton's victory in the 1992 US presidential election: there was no hub-and-spokes network of US FTAs for Asia-Pacific countries envisioned at that time (Leaver 2008, pp. 106–107).

Australian interest in FTAs re-emerged at the 1996 federal election. From Opposition, the Coalition proposed an FTA with the United States as a response to reducing the bilateral trade deficit and probably to differentiate its trade policy from Labor's. It would continue to build the economic relationship with East Asia but would invest additional energy and resources in rebuilding 'neglected' traditional trading relationships with countries like the United States and the United Kingdom.

To a significant extent, interest in an FTA with the United States was for electoral purposes. The Coalition government's basic position was revealed clearly during the 50th anniversary celebrations for the GATT/WTO in 1997 – a major occasion that attracted heads of state and government from around the world. Australia hosted a small group of seven or eight economies called 'Friends of MFN'. New Zealand, Singapore and Hong Kong were among those who attended. There was strong group feeling that FTAs were a distraction that would undermine the multilateral trading system and work against the interests of countries lacking economic and political clout whose future depended on strong international mechanisms to deliver order and fairness.

While firmly wedded to multilateralism, Australian interest in FTAs continued to build. The government first considered possible objectives and criteria for selecting FTA partners in 1997 but without any specific partner(s) in mind. The general sense was that

FTAs must support the multilateral trading system; deliver significant net economic benefits over a shorter time than would be possible through multilateral trade negotiations; go deeper on issues like services, investment and government procurement than would be possible multilaterally; and stand essentially on their economic merits while furthering broader relationships. This was in line with academic advice at the time that FTAs could be trade-creating and could support the multilateral trading system in fundamental ways through, for example, opening markets quickly (eliminating the vast majority of tariffs on entry-into-force); implementing effective dispute settlement provisions; extending coverage to services, investment, government procurement, competition, trade facilitation, and economic cooperation; and being open to others joining (Snape, Adams & Morgan 1993, p. xvii).

The decisive shift from examining concepts and possible criteria for FTA partner selection to negotiating FTAs occurred abruptly at the end of the 1990s. The tipping point was a series of fast-moving events over which Australia had little or no control. The East Asian Financial Crisis produced an upsurge of regional interest in FTAs. The big lesson was that East Asia must strengthen economic cooperation to sustain economic growth and stability and to prepare for common challenges. Approaches to growth and development were re-examined in light of the crisis, and the take-off in intra-regional trade gave new prominence to policy discussions on FTAs, especially after trade ministers failed to launch a new round of multilateral trade negotiations at Seattle in December 1999. Singapore was the key marker: it launched closer economic partnership negotiations with New Zealand in 1999, with Japan in January 2001 and with the European Free Trade Area in May 2001. China then took East Asian regionalism to a new level shortly after gaining WTO membership with its surprise proposal in November 2001 for an ASEAN–China FTA. Agreed less than two years later, the agreement forced Japan and Korea to shore up their production and market networks through separate regional and bilateral FTAs. Around this time, the United

States threatened Australia with rolling US tariff retaliation across Australian export interests in the United States over subsidies to the Howe Leather Company.[13] Some Australian business groups started to press for an FTA with the United States to deal with, and hopefully nip in the bud, escalating trade disputes.

Australia's transition from an orthodox view of multilateralism to a more nuanced one that embraced FTAs was not easy. There was a range of views in DFAT, the government more generally and in the broader community on whether there was a role for FTAs and, if there was, on the balance between multilateralism and bilateralism. In the end, bipartisan support for FTAs was underpinned by concern that Australia must continue to have assured access to regional markets and must not be left behind in the scramble to conclude FTAs. At this time, the higher purpose of FTAs – to go deeper into behind-the-border issues than might be possible multilaterally – was appreciated by officials and surfaced occasionally in government rhetoric, but was not especially influential in policy making.

A High Level Taskforce was set up in October 1999 to explore the feasibility of an FTA between Australia, New Zealand and ASEAN. Reporting the following year, it supported an FTA, but it took time for the proposal to be accepted by all ASEAN members (Leaver 2008, p. 112).[14] In the meantime, Australia launched FTA negotiations with Singapore (November 2000) and Thailand (May 2002) that were significant in their own rights and provided Australia with valuable practical experience that could be applied to subsequent negotiations, in particular with the United States. Singapore–US FTA negotiations took place at approximately the same time as Australia–US FTA negotiations. This allowed Australia and Singapore to compare notes, as well as to build experience in FTA negotiations with a major trading partner.

FTA negotiations with the United States began in March 2003 and were completed in five rounds by February 2004. The Australia–United States Free Trade Agreement (AUSFTA) entered into force in January 2005 and quickly became the second decisive turning point on Australia's road to FTAs. Australia's overall approach to FTAs was reconsidered by the government during the first half of that year and FTA negotiating efforts subsequently intensified. In the following three or four years negotiations were launched with major trading partners like Japan, China, the Republic of Korea, Malaysia, ASEAN and India; as well as with smaller trading partners such as the United Arab Emirates (and later the countries of the Gulf Cooperation Council after Saudi Arabia blocked a bilateral agreement with the UAE) and Chile.

This upwelling of activity was a response to Australia's confidence after negotiating a major agreement with the United States but also reflected the view that FTAs were now a fact of life – imperfect as they might be – from which there was no coming back. A satisfactory and timely conclusion to the Doha multilateral trade round might have slowed their momentum, regionally and globally, but the genie was well and truly out of the bottle and could not be put back in. For Australia, or almost anyone else, to change tack and come out against FTAs, or to downplay them in some way, would not have made the slightest difference. The time for well-intentioned nose holding was over and in reality had been over since our major trading partners went down the FTA road. The time to act had come. Big issues like what would guide our approach to FTAs, how far we would go down the FTA road and how we would improve agreements over time would be worked out on the journey.

Conclusion

Four lessons stand out from Australia's economic transformation over the last three or four decades. First, sensible, explainable unilateral economic reform is always in the national interest and forms the bedrock of effective participation in multilateral and bilateral trade negotiations. Unilateral reform and trade negotiations are natural complements, not alternatives. Domestic reforms that increase an economy's flexibility and efficiency and trade negotiations that eliminate or reduce impediments to international flows of goods, services and investment, collectively play a large part in changing the composition of a country's industrial production and employment and are essential prerequisites for maximising its national income.

Second, trade is a fundamental driver of Australia's economy and trade negotiations are a significant part of accessing markets and lessening distortions on international markets. In an increasingly globalised world, there might be a reasonable expectation that national borders matter less as impediments to trade and investment flows. Technological change, especially the Internet, is linking economies and their infrastructures ever more closely. National self-interest and business pressures to reduce costs are encouraging closer alignment of national policies and regulations, at least in some cases. But borders still matter because of facts like home bias, tariffs and quotas, technical barriers to trade, investment restrictions, exclusions, government red tape, and ever more inventive ways to protect markets. Trade negotiators are in no danger of having a surfeit of spare time.

Third, trade has an importance for Australia and others that far transcends sending widgets whizzing around the world. Trade literally broadens horizons. It increases life choices and creates opportunities that may spin off far and wide beyond their trade beginnings. There are many factors interacting in many different ways, but in a loose way the links forged by trade and investment influence not only the nature and location of economic activity across ever finer value chains, but also what is taught in our schools and universities – foreign languages and the geography, history and literatures of particular countries and regions – and where societies, businesses and organisations of one kind or another choose to focus their curiosity and interest. Trade also is linked in the broadest sense to openness. The contrast in political and economic organisation between China now and during the Cultural Revolution is massive, even though the Communist Party still rules. Similarly, the contrasts between North and South Korea now and between East and West Germany a generation ago are equally massive, underscoring how openness to trade, capital, information and ideas combine to transform societies: the gene pool is still the same but the people are different (Ghemawat 2011, pp. 78–81).

And fourth, 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: being preoccupied with hard economic reform that fitted 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.