

# **Increasing Australia's Prosperity in a Multipolar World: the contribution of trade policy**

## **1. Overview**

This talk is based on Trading Nation.

In the next few minutes I'd like to focus on three things.

- Why regional and global trading conditions are likely to be testing in the decade ahead.
- How Australia's trade policy can link more effectively with other economic and social reforms to boost our productivity and, in the process, jobs and living standards.
- And what trade policy can realistically achieve over the next few years in a difficult international environment.

## **2. Regional and global trading conditions**

Looking at the first of these questions: why are regional and global trading conditions likely to be testing in the decade ahead?

There are many reasons. I'll mention four:

***First, while global trade should grow solidly over the next decade, it is unlikely to grow at rates that have been achieved in recent decades.***

This is principally because of uncertainties and patchiness in the outlook for the world economy in both the short and medium terms:

- Growth in advanced economies will be constrained by high levels of public and private debt. Additionally in the case of Europe and Japan, it will be constrained by unfavourable demographic trends.
- A number of emerging economies, notably China, should continue to grow quite rapidly, but their performance will be affected to some extent by slow growth in the advanced economies – there is no 'de-coupling' as suggested by some economists.
- And this patchiness in the global economic outlook could set the stage for rising protectionism and trade conflict between the United States and China.

In our view there is at least a medium risk of rising protectionism and a high risk of trade conflict between the US and China.

***Second, trade flows will continue to be volatile, perhaps increasingly so***

Part of this volatility will be attributable to continuing problems in significant chunks of the global economy.

Part will result from technological change leading to further unbundling of functions in manufacturing and services.

- Well over half of all world trade (goods and services) currently takes place as intermediate goods and services.
- Continuing technological change and competitive pressures may increase this proportion and lead to more production across countries in finer value chains.
- This would, on balance, be a positive development for the global economy, but just-in-time delivery imperatives carry the risk of quickly transmitting shocks from localised disruptions to production to entire networks.

The disruptions to Japan's global car assembly industry following the recent earthquake and tsunami are a good example.

***Third, developed and emerging countries will struggle at times to manage the complexities of the new multipolar world.***

This is a critical point. Developed countries, in particular the United States, will use their enormous resources and accumulated experience to continue to set the global policy agenda.

Emerging countries, in particular China, India and Brazil, will use their growing economic and political clout to show that the world has changed, that the old ways of doing business are not sustainable and that their priorities and policy choices matter.

Reconciling differences, or at least attempting to do so, is going to be a bumpy process across the spectrum of international policy issues that no doubt will be made bumpier at times by unpredictable developments in the world's hot spots.

*Fourth, there will be more testing regional uncertainties.*

An obvious example is China's manoeuvrings in the East and South China Seas over the last few years.

We have argued that there is a low risk of military conflict between major countries, but there is fertile ground for ongoing strategic competition, particularly between the United States and China and between China and Japan in its multiple forms.

### **3. The imperative for economic reform: the trade perspective**

So what does this all imply for Australia's trade reform agenda and specifically for trade policy's contribution to economic reform in Australia?

The first thing to note is that competition is increasing in overseas markets, as well as in Australia.

Opportunities will be lost and standards of living will be compromised if we do not respond to the prospect of lower terms of trade with reforms that lift productivity and competitiveness.

Australia's productivity growth over the last decade has been lackluster at best.

Trade perspectives need to be injected more deliberately into a hopefully invigorated program of economic and social reform that can deliver growth, jobs and higher living standards

We make three broad recommendations in Trading Nation.

*First, trade policy professionals should be more active in building a trade focused economy*

There are many ways in which trade perspectives could play a more shaping role. Examples are:

- Pushing the case for getting rid of remaining tariffs.

Tariffs more than ever are a tax on exports with the entrenchment of regional and global value chains, with goods crossing borders multiple times as they are produced.

- Another example is increasing understanding within government and the community more generally of the roles of services and investment in Australia's services economy and services trade.

The potential importance of services in Australia's trade with Asia over the next 20-30 years is understood.

But their roles in development processes and contribution to other sectors' exports are hardly understood.

Services for instance contribute 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.

There is a big job of work to be done, both within government and through public diplomacy, in increasing understanding of the role and contribution of modern services.

- Yet another is increasing understanding of the implications of high energy prices for Australian export industries.

In the past five years, Australia has moved from having electricity costs well below the OECD average at the turn of the century to one where the electricity bills for industry are among the highest in the developed world.

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.

The implications of high prices for Australian energy are concerning, especially given the significance of these costs for major Australian export industries – industries ranging from aluminium to advanced manufactures and even to services such as tourism and education.

***Our second broad domestically focused recommendation is that trade policy professionals need to be more active in confronting domestic protectionism***

In Australia, the danger is not from 'old-style' industry-specific protection and accompanying vested interests, though it is alive and well in industries like coastal shipping.

Rather, the danger is inventiveness in developing new trade barriers across standards (environment, labour, food, industry), and in areas like anti-dumping, investment, and government and business procurement.

- So far, the anti-protectionism line has held in Australia.

But the risk remains and is being fanned by rising concerns about jobs. Reactions to the closure of automobile assembly and assistance to SPC Ardmona show this.

Protecting Australian jobs understandably resonates very loudly in the community, as does at times exaggerated claims about foreign investors buying up the proverbial family farm.

These concerns have to be respected. But this is no reason why trade policy professionals should not be more active in developing and articulating a consistent view about trade and trade policy and their contribution to Australia's future.

- This requires having more evidence-based analysis handy on why reform is essential and what open markets mean for peoples' livelihoods and prosperity.
- And it requires stepping up public diplomacy to cultivate society's tolerance to change.

***This leads to our third domestically focused recommendation: the need to strengthen whole-of-government systems***

Agencies like DFAT cannot realistically expect to receive the funding needed to build up the domestic arm of trade policy and make it fully operational.

The possibility of creating a domestically focused division within DFAT was considered in preparing the Mortimer report on Australia's trade policy five or six years ago.

The proposal got nowhere because it was too expensive. In these more financially straightened times, it wouldn't even reach first base.

One way around the lack of funding – and it is fundamentally important – is to ensure that Australia's whole-of-government processes work better so that trade and international perspectives can connect more smoothly with the priorities and strategies for domestic economic and social reform.

Government processes need to work better than they have in the recent past.

And Cabinet processes in particular must work better.

#### **4. The international agenda: pursuing reform in a new trade policy environment**

Finally, let's take a quick look at trade policy and the international agenda. I'll highlight four challenges for Australia.

##### ***The first is to revitalise the ideas market***

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 and understanding on the world and region on issues as varied as:

- Will China's interests align with free trade and investment as its economy grows much larger?
- Are US-China relations likely to set the pace and quality of global cooperation and, if so, what are the implications for Australia?
- How should Australia build on the difficult, and at times unbalanced and brittle economic relationship with India?
- How will Indonesia's rise impact on Australia and the region?
- And is there a danger of mega FTAs dividing regions as much as integrating them?

Pursuing core national interests will depend equally on 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: tight budgets, the short termism of ministers' offices, the difficulty of staff replacement etc.

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.

***Another key challenge is to draw the appropriate lessons from the failure of the Doha Round of Multilateral Trade Negotiations***

The big lesson is that there is absolutely no appetite for another set piece multilateral trade round for years to come.

The failure of Doha in terms of its original mandate seems to have opened the way for a new phase of international trade policy focused on creating new rules for 21<sup>st</sup> 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.

But this new environment comes with a number of caveats. One of the most important is that 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.

For Australia as a mid-sized economy whose prosperity depends on the efficient working of the global trading system, the WTO must be restored to the centre of the world trading system.

***Linked to this is a third challenge: to maximise the opportunity from Australia's hosting the G20 Leaders' Meeting***

Trade has been part of the G20 agenda from the outset, particularly through the standstill pledge and the ritual cajoling of trade ministers to finish Doha.

It is now time to take the challenging step of moving trade liberalisation from the periphery to somewhere 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.

For Brisbane and beyond this should involve Australia leading by example.

- Australia needs to lead in reducing behind-the-border barriers to trade and investment.
- This would be profoundly in our interests.

Unnecessary domestic regulation alone costs Australia tens of billions of dollars each year.

It should also involve 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.

- 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.

The Brisbane G20 Leaders' Meeting also should start an invigorated dialogue on strengthening the global trading system. The dialogue would continue over the years and focus on why trade matters and how to strengthen the global trading system with the WTO at its centre. This could range across:

- new ways of negotiating trade deals and shaping future deals
- the relationship between multilateralism and mega FTAs
- and reforming the WTO as an institution.

We don't see the WTO reforming itself. Perhaps the best prospect might be for the G20 (or a successor body) to shape tangible and digested proposals for institutional reform that could then be applied to the WTO as the last formal step, though how this might be done is far from clear.

***A fourth challenge will be to continue building regional relationships***

No one doubts that Australia's long-term prosperity depends on having 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.

Forums like APEC are important. But at least for 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.

- And they will not be perfect.

Another key priority this year is to advance TPP and RCEP negotiations. 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.
- And 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.

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.

## **5. Conclusion**

So what do we conclude?

The world owes Australia nothing.

We have had a great deal of luck from historically high terms of trade over some of the past 10 years.

But the ball now is in Australia's court, just as it was in the 1980s and 1990s.

We would do ourselves a big favour by going back to basics:

- 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.
- And 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.