

**AUSTRALIA AND THE WORLD TRADE ORGANISATION**

**Supplementary submission to the inquiry into the WTO**

**conducted by**

**the Joint Standing Committee on Treaties**

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## **FOREWORD**

Policy makers in the US and the EU, and leaders of the major political parties in Australia, have recognised that progress in liberalising world markets through the WTO depends on building support for trade liberalisation at home, where decisions about protection and domestic adjustment are made. This involves engaging the community more directly in preparations for international trade negotiations-- and subsequently, when petitions are received from protected producers seeking to avoid the adjustment consequences for themselves.

Our submission of 30 January outlined an approach which does that-- an approach which has been supported by developing countries, by past and present Directors- General of the GATT and WTO, and by the US Trade Representative in the Uruguay Round.

This brief supplementary submission answers five questions arising from consideration of that approach which were not dealt with directly, or not documented fully, in our earlier submission:

1. How does the approach outlined in our earlier submission differ from Australia's existing approach to the WTO?
2. What has happened to the multilateral processes that warrants introduction of the proposed domestic procedures?
3. Do developing countries have the resources, or the inclination, to introduce these procedures?
4. Can current consultative arrangements in Australia or elsewhere fill the role envisaged for domestic transparency procedures?
5. How can consideration of the proposed domestic procedures be introduced into the WTO?

**1. How does the approach outlined in our earlier submission differ from Australia's existing approach to the WTO?**

The approach proposed in our submission does not involve replacing any existing WTO process. It does involve adding a new domestic process, however, to focus the attention of participating governments on the gains from liberalising their own markets. This will strengthen the capacity of the WTO to deliver the benefits available from liberalising in a multilateral context. The approach recognises that:

- the greatest gains for each country liberalising through the WTO result from reducing its own barriers (these are the gains countries secure when they liberalise unilaterally);
- the residual gains, which result from greater access to world markets, materialise in full only when other countries also reduce the barriers protecting their less competitive industries;
- the gains for all countries participating in the WTO, including those resulting from greater access to world markets, therefore depend on each country approaching international negotiations with their negotiating offer structured to secure the gains from liberalising their own markets.

The importance of approaching international negotiations in this way was demonstrated by Australia's different experiences in the Tokyo and Uruguay Rounds.

The Tokyo Round took place before our program of domestic reform had begun. Our emphasis in that Round was on meeting external commitments arising from multilateral trade negotiations, not on the domestic gains available from liberalising our own barriers. We were able to meet those commitments by reducing the average level of our frontier barriers by 40 per cent. But we did so in a way that markedly increased the disparities in the levels of protection between industries, thus reducing our gains from liberalising. The logic behind our membership in the WTO—to participate in world trade on the basis of what we do best—was thus turned on its head. Our least competitive industries were shielded from adjustment pressure. And our world-competitive producers were

disadvantaged in their production environment against less efficient domestic producers.

In the Uruguay Round, on the other hand, our barrier reductions were part of an on-going domestic process aimed at making the economy more internationally competitive—and not a response to external commitments. The domestic tradeoffs at issue were resolved at home through domestic processes. Because protection was being reduced to make the Australian economy more competitive, the economy-wide gains at issue received priority over the adjustment difficulties for particular protected industries. We were able to offer the nationally-rewarding **unilateral** reductions in our trade barriers to meet Australia's **multilateral** commitments arising from the Uruguay Round. We sought and obtained credit for the 1988 and 1991 reductions undertaken for purely domestic reasons. Those reductions accounted for 80 per cent of Australia's gains from participating in the Uruguay Round.

The insights provided by our own experience help explain the importance of adding domestic transparency procedures to the existing WTO processes. We could address the adjustment implications of reducing the barriers protecting our less competitive industries when the domestic costs of maintaining them was the issue, but not when the context was trade bargaining. When reductions in our protection arose solely from international commitments, uncompetitive domestic industries were shielded from the adjustment effects of those commitments—and our gains from participating in international trade negotiations were greatly diminished.

The domestic tradeoffs involved in liberalising domestic markets—between the gains in national wealth and the adjustment involved for protected domestic industries—cannot be addressed through existing WTO processes. The domestic procedures we (and others) advocate are therefore needed to underpin the WTO, by providing a basis for dealing with these domestic issues. They enable governments (and their domestic constituents) to work through the domestic issues at home, in their own policy environment. WTO processes can then **begin** with domestic decisions which resolve the domestic tradeoffs involved in

liberalising, and **culminate** in international negotiations—rather than the other way around.

There is synergy between the economic and political reasons for introducing such procedures. The economic reason for doing so is to enable participating countries to secure more fully the domestic gains that multilateral liberalisation makes possible. The other reason is to provide a basis for community participation in the process by which the important domestic policy issues involved are settled. This recognises that governments will always be under pressure to avoid the adjustment involved in liberalising domestic markets until those they represent are persuaded that the national benefits which trade liberalisation makes possible outweigh the adjustment costs.

As the key decision-making process moves into the domestic policy arenas of participating countries, governments become more accountable domestically for WTO outcomes. Apart from the increased benefits it makes possible for participants, this must engender greater trust and confidence in the WTO system.

Australia's present approach to the WTO holds that nothing need be added to existing WTO processes—international agreements, enforced by international rules and dispute settlement procedures—to resolve the domestic issues involved in trade liberalisation. That was conveyed by Trade Minister Fischer, when responding to the approach suggested in our submission:

‘The role of the WTO in the move towards greater trade liberalisation is the establishment of rules and other commitments by governments and then to ensure that the negotiated balance of rights and obligations is maintained...If the rules are not sufficient...then the solution is to seek to extend or tighten the rules, which is what is done in each round of multilateral trade negotiations.’ (*letter of 2 Dec. 1996*)

This approach has been confirmed in official submissions to the present inquiry. Would we have undertaken our own program of protection reform, and accepted

the adjustment involved for our uncompetitive industries, simply to meet external commitments? The answer is eloquently conveyed by our very different experiences in the Tokyo and Uruguay Rounds.

The present focus on trade liberalisation as an external commitment enforced by external compliance rules abstracts entirely from the domestic issues at the heart of trade liberalisation. In this approach there is no process that helps individual participating countries resolve the domestic tradeoffs involved. It therefore should not be surprising that governments are having difficulty mobilising a strong domestic commitment to reduce their national barriers in a trade bargaining context, and to maintain reductions agreed in that context.

**2. Multilateral negotiations have in the past produced substantial reductions in trade barriers. What has happened to warrant introduction of the proposed domestic procedures?**

Multilateral negotiations have been conducted on the *assumption* that the resulting reductions in trade barriers would increase opportunities for trade, and hence for domestic development in the economies of participating countries, according to their comparative advantages. Negotiations in early GATT Rounds involved reducing tariffs, the main form of barrier operating at that time. The assumption was realistic then, because the tariffs on highly protected (less competitive) industries were automatically included in the reductions made. The resulting agreements to reduce barriers were effective, due to the relatively simple nature of the decision rules involved when *tariff* reductions were being negotiated. The proportional reductions of tariffs in the 1960s (under the Swiss Formula, for instance) automatically had the greatest impact on the most highly protected (least competitive) industries of each participant.

In that environment, international negotiations and agreements achieved a great deal. They were responsible for the very substantial liberalisation that took place among North Atlantic countries.

But the world has turned. The rise of *non-tariff* barriers over the last several decades, replacing the tariffs bargained away, has meant that multilateral negotiations can no longer unambiguously provide trading opportunities on the basis of what each country does best. When governments individually seek to minimise adjustment for their own protected industries, by introducing non-tariff barriers to replace the tariffs bargained away, they cannot collectively (through international agreements to reduce trade barriers) increase export opportunities in their respective areas of economic strength.

Although recent rounds of multilateral negotiations have continued to produce substantial reductions in tariff levels in industrial countries, governments have been finding other ways of protecting their least competitive industries. Average industrial tariffs in OECD countries have been reduced from 40 per cent to 4 per

cent through multilateral agreements. At the same time, however, non-tariff barriers have grown to the point where they affect about one half of world trade. Many of these take forms which belong to domestic policy and, for that reason, are arguably beyond the authority of international agreements. They have either made use of ‘exceptions’ in the rules for introducing protection (such as for emergency relief, or against ‘unfair’ practices); or exploited loopholes or ambiguities in the rules (such as ‘domestic’ production subsidies and regulations of various kinds); or have simply occurred outside the international rules (such as voluntary export restraints).

The ‘tariffication’ of non-tariff barriers, agreed in the Uruguay Round, has not stopped governments introducing less visible forms of protection to shield their uncompetitive industries from the adjustment involved in liberalising. It has simply caused these adjustment-averting devices to be transferred from border to non-border forms, such as production subsidies and the like. These are seen as part of domestic policy, and hence beyond the reach of the international disciplines on which the WTO relies.

The increase in the use of non-tariff barriers was described in the following terms in a review undertaken for developing countries by UNCTAD:

‘Since the birth of GATT there have been a number of negotiating rounds that have dramatically reduced the level of tariff rates in the major industrial countries...It is generally agreed that tariffs do not constitute a significant barrier to imports into the OECD countries. As tariffs have come down, other restrictions on imports have appeared... There seems to be a movement towards less visible protectionist measures...’ (*Trade Policies, Structural Adjustment and Economic Reform, Geneva, 1992*)

In coming to terms with this ‘new’ (non-tariff) protection, negotiations face great difficulties because

- unlike tariffs, the new forms of protection lack transparency



- some are seen as being out of bounds for international agreements and rules—involving sensitive questions of ‘domestic policy’
- and, in providing protection in these forms, governments have demonstrated that the external discipline which international rules place on their conduct is no longer effective.

This makes it essential now to build onto the existing international processes the domestic considerations involved for each country participating in those processes. The domestic adjustment involved in liberalising must become an explicit issue in the choices governments make about their own barrier reductions, rather than continue to emerge as an accidental outcome from international negotiations and agreements.

There was a growing recognition, prior to the Uruguay Round, that the bargaining approach to trade liberalisation was in trouble and that something had to be done to redeem it. The formation of the special negotiating group on the ‘functioning of the GATT system’ (the ‘FOGS’ group) during the Uruguay Round reflected the need to find ways of restoring the effectiveness of multilateral negotiations and agreements in delivering liberalisation.

Having lost the relatively straight forward path to nationally rewarding outcomes secured in earlier multilateral agreements to reduce *tariffs*, there is no single simple decision rule to replace it. Since the problem has arisen from the conduct of domestic policies, beyond the reach of international disciplines, a way must be found to link the outcome of trade negotiations more directly to the domestic consequences for participants. Progress in the WTO now depends on governments and their domestic constituents deciding that they *want* to reduce their own barriers, in order to secure the domestic gains involved. Domestic transparency procedures are needed to help them resolve the domestic issues involved in reaching that decision. So long as the solution is seen just as an exercise in promoting the international surveillance of barriers, or securing greater observance of WTO rules, the problem will remain.

### **3. Do developing countries have the resources, or the inclination, to introduce domestic transparency procedures?**

Developing countries are not the problem. Many have achieved major reductions in protection outside the multilateral negotiating framework. An increasing number, representing about 60 per cent of the population of the developing world, have been liberalising unilaterally. In addition, a growing number of former eastern-bloc countries are beginning to liberalise as they move from command to market economies.

In general, these countries are liberalising unilaterally to make their domestic economies more competitive. In that context, the domestic tradeoffs are resolved as a matter of course. Only one set of decisions, and only one process, is involved. The decision to reduce protection is made in the knowledge that it will involve domestic adjustment.

In major industrial countries, on the other hand, the commitment to liberalise has been driven by international bargaining through the GATT and the WTO. In that context the focus is on access to external markets, not on liberalising their own markets. Each round of international trade negotiations is seen as another opportunity to gain access to other countries' markets. As a consequence, interest in the domestic issues in liberalising has been (at best) intermittent—revived every ten years or so as each Round of multilateral negotiations becomes due. This approach to the WTO has produced ambiguous negotiating objectives—increased access to world markets with minimum adjustment at home—and, consequently, ambiguous negotiating outcomes.

The heavy reliance industrial countries place on liberalisation as an externally generated commitment, together with their ambiguity in trade negotiations, has led developing countries to view the bargaining process as a zero-sum game—in which everyone tries to get as much as possible while giving away as little as they can.

It follows that industrial countries have the greatest need for the domestic procedures examined in our submission. Their pre-occupation with market access has undermined domestic understanding that the major gains from liberalising in a multilateral context depend on what they do about their own barriers. The countries needing those procedures most are the EU, the US and Japan. Because worthwhile progress in the WTO now depends on it, they have an incentive to invest in the effort required to approach negotiations with a good understanding of the domestic effects of the choices they make about reducing their own barriers.

The response of industrial countries to this challenge will send a very important message to the large number of developing countries liberalising unilaterally. These represent the major potential growth areas in world trade. A negative response would strengthen the already strident voices in those countries arguing that the clock should be turned back to protectionism. The challenge involves no more than approaching WTO negotiations in a way which gives greater priority than they have been giving to the gains at issue in liberalising their own markets. That will enhance the rewards from international negotiations for all participants, including themselves. Neither industrial nor developing countries can go forward alone. Because they complement each other in the things they trade, the response of industrial countries to the challenge will determine the extent to which their own industries enjoy the increased export market opportunities that liberalisation in developing countries has the potential to generate.

#### 4. Can current consultative arrangements in Australia or elsewhere fill the role envisaged for domestic transparency procedures ?

The role of domestic transparency procedures in underpinning the WTO system is to raise awareness, within participating countries, of the gains from reducing their *own* trade barriers.

Why has that become necessary? For the reasons covered in answers to questions 1 and 2, progress in opening world markets through the WTO now depends on participating governments placing a much higher priority on the gains from liberalising their own markets when preparing for multilateral negotiations. The scope of these negotiations is being expanded to cover most tradeable goods and services. In the new areas, the forms of protection are both complex and diverse. Many are in non-border forms and are seen, especially by those who oppose reform, as belonging to domestic policy—beyond the reach of international rules and agreements. This, together with the rise of less transparent forms of protection to replace tariffs as these were negotiated away, means that the relatively simple decision rules that delivered nationally rewarding outcomes from multilateral negotiations in the past can no longer be relied on to do so.

As a result of these developments, national preparations for WTO Rounds now involve quite complex choices. These will require a much better understanding by governments of the effects on their **own** economy of the options under consideration for liberalising their **own** markets. Among these options there will always be some canvassed vigorously by domestic groups with a private interest in the outcome. The role of the proposed domestic transparency procedures is to enable governments, and their domestic constituents, to work through those options at home and to make informed choices about which will secure the national benefits available from participating in the WTO system. That is why people in other countries who advocate these procedures settled on Australia's Industries Assistance Commission as providing the most relevant institutional model. Its charter requires it (and its successor, the Productivity Commission) to provide advice on the effects on our economy of liberalising our own markets.

The strength of this approach in underpinning the WTO system is that it:

- operates at home, in the domestic policy environment of WTO member countries, where decisions about protection (trade barriers) and domestic adjustment are made ;
- engages the community directly in the process through which those decisions are reached—both in domestic preparations for international trade negotiations and subsequently, when petitions are received from protected producers seeking to avoid the adjustment consequences for themselves ;
- focuses on the economy-wide benefits from liberalising *domestic* markets;
- makes transparent to domestic constituents the basis for decisions about protection and domestic adjustment as they are being made, not after the event.

In this approach the domestic commitment to liberalise, instead of being generated externally as it is at present, involves domestic processes in which the domestic tradeoffs are addressed and resolved.

Can Australia's present consultative arrangements through the Department of Foreign Affairs and Trade fill this role? These arrangements provide a valuable forum for exchanging official and community views about trade policy developments, objectives and outcomes. Like most industrial countries, however, Australia's announced objectives in the new Round are to secure access to external markets through international bargaining and to strengthen the compliance rules governing implementation of the resulting international agreements. Our present consultative arrangements reflect these objectives. While they provide ample opportunity for community involvement, their principal focus is on securing access to external markets rather than on the domestic issues involved in liberalising our own. As a result they can contribute little to resolving the domestic policy choices which must, from now on, provide the basis for securing nationally rewarding outcomes for countries participating in the WTO system. They do not provide an appropriate model for the domestic procedures needed in major industrial countries to restore progress and confidence in the WTO.

Present consultative arrangements are valuable in keeping the community informed of trade developments, and for promoting an exchange of views on trade policy. Using them as the basis for national preparations in WTO Rounds, when more relevant procedures are available locally, is like buying a family car and leaving it in the garage while everyone takes a taxi to work.

## **5. How can consideration of the proposed domestic procedures be introduced into the WTO?**

The institutional model favoured by developing countries in UNCTAD VII, by the Brookings Institute in Washington, and by a study group chaired by former Director-General of the GATT (Olivier Long) during the Uruguay Round, was Australia's Industries Assistance Commission (which has become the Productivity Commission). The particular qualities of that institution responsible for the choice in each case were its public procedures, the fact that its work focuses on the domestic reasons for reducing trade barriers, its economy-wide charter, the scope for community participation in its hearings, its independence from executive government, and its purely advisory role. This and other national institutions with a transparency or advisory function in trade policy have been reviewed by the Trade Policy Research Centre in London and by the National Centre for Development Studies at the ANU.

The Long report, commissioned by the Trade Policy Research Centre, identified the qualities an institution providing this transparency function should have. It also recommended that a formal code be negotiated among participating countries, committing them to introduce the domestic procedures it recommended. This is too ambitious a goal in the short term, especially if the Australian institution identified as the model for introducing the approach is not involved in developing our own negotiating position in the new Round.

An important first step is to have the need for such procedures discussed in the WTO—although not (initially) in a negotiating context. The issue was raised for discussion in that context in the Uruguay Round and became side-lined by the emergence of more urgent negotiating priorities.

There appear to be two options for introducing it for WTO consideration in the time now available. These are: to raise it directly in meetings leading up to resumption of the new Round; to appoint a study group to review the issue, with terms of reference requiring it to provide recommendations for discussion in the new Round. These options are not mutually exclusive. The most important

consideration in deciding on the appropriate course is to ensure that the issue is dealt with in a measured way, that it does not again become hostage to more pressing negotiating priorities.

If the second option is exercised it seems important that any group should include one person, with strong trade policy credentials, from each of the European Union and the United States. As noted in our earlier submission, Leon Brittan of the EU has publicly recognised that the problem exists and that progress in the WTO depends on participating governments addressing it. Clayton Yeutter, the US Trade Representative during the Uruguay Round, has expressed support for the approach outlined in our submission (attached). Both seem obvious candidates for inclusion in any group established to provide recommendations for discussion in the new Round.

Mike Moore, now Director-General of the WTO, was the New Zealand Trade Minister responsible for placing the approach on the agenda of the 'FOGS' Group in the Uruguay Round. It therefore seems likely that he would facilitate action to have it discussed in the new Round.



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Mr. Ron Duncan  
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Dear Mr. Duncan:

Thanks for sending along your recent paper focusing on the domestic policy implications of international trade policy decisions. I recall fully the discussions that Bill Carmichael and I had about a decade ago on that very same subject. Bill has probably done more thinking about those policy relationships than anyone in the world, and the quality of your paper reflects that.

My schedule is so full that I do not have much time to devote to WTO agenda items, but I will certainly be pleased to promote the concepts of your paper when I have occasion to do so. The issues most certainly are relevant to the trade policy decision-making process in all countries.

Many thanks for sending the paper to me, and please give my very best wishes to Bill Carmichael.

Sincerely

Clayton Yeutter