

Attachments – Senate Select Committee on the Free Trade Agreement Between Australia and the United States of America – 15.6.2004

1. Garnaut and Carmichael letter to Prime Minister John Howard and Leader of the Opposition, Mr Simon Crean, 10 March, 2003.
2. Prime Minister's letter to Garnaut and Carmichael, 29 May, 2003
3. Draft Australian proposal for domestic transparency arrangements in the WTO, 20 February, 2004.
4. Garnaut and Carmichael letter to Senator Peter Cook, 19 April, 2004

10 March 2003

Mr John Howard
Prime Minister
Parliament House
Canberra ACT 2600

Mr Simon Crean
Leader of the Opposition
Parliament House
Canberra ACT 2600

Dear Mr Howard and Mr Crean,

We are writing as two Australians who helped build support for the trade liberalisation that has made ours a relatively open economy. It is one lesson of our experience that Australia's trade liberalisation emerged from Australians recognising that it was in our interest to reduce our own trade barriers, with almost no contribution being made by tit-for-tat negotiations with other countries. Another lesson is that disinterested analysis and wide dissemination of information about the costs of protection was a critical element in persuading Australians that reducing our barriers was in our own interest.

We believe that these lessons now hold the key to mutually beneficial trade liberalisation with Australia's trading partners, and that there is scope (and a need) to introduce them into the WTO system. The current bilateral discussions with the US provide an opportunity to develop a joint initiative aimed at doing that. Australia's experience, including establishing a widely respected institutional basis for independent advice about the costs of maintaining our own protection, provides a sound basis on which to develop such an initiative. The resulting benefits for both countries, from WTO negotiations and from a bilateral agreement, would greatly exceed any that might result from tit-for-tat market access negotiations between them.

Trade Minister Vaile has placed the estimated annual gains for Australia from a bilateral agreement with the US (one that completely removed all barriers to trade in goods and services between the two countries) at nearly \$4 billion, and has foreshadowed much greater gains from the present WTO Round. Government studies show that most of the estimated gains from the US agreement would come from Australia's own removal of its import restrictions against American goods and services.

The estimates Minister Vaile has used measure only potential gains. Whether they eventuate will depend on the decisions governments make at home, about their own barriers, when preparing for negotiations and subsequently in meeting their commitments arising from the agreements struck. The crucial decisions about opening or closing domestic markets are made at home, in the domestic policy environments of participating countries, not at the negotiating table.

The influence of protected domestic producers over these decisions is illustrated by recent developments in the US, the country regarded as crucial to successful global liberalisation. The power of the US farm lobby, for instance, was demonstrated by Trade Representative Zoellick's explanation that the extension of farm subsidies, although a backward step, was necessary in order to secure authority to negotiate. The US Ambassador to Australia said at the

time (on Australian TV) that the Farm Bill was the price for the United States agreeing to enter negotiations for a free trade agreement. How many more such backward steps will it take before US negotiators are able to open agricultural markets? Under these constraints we are not likely to see anything resembling free trade in farm products from an agreement with the US or from multilateral negotiations in the WTO. The problem, however, is not limited to agriculture.

This power of protected producers over decision-making on protection (trade barriers) has been institutionalised in the major industrial countries—the EU, Japan and the US. For instance, US procedures and criteria for providing relief from import competition actually increase the difficulties US governments face in dealing with pressure for protection from domestic producers. In formulating its advice the US International Trade Commission is required to use narrow legal rules to determine whether a particular industry is being 'injured' by import competition. The positive domestic effects of liberalising domestic markets --for other domestic producers, for consumers and for the US economy as a whole--are not brought into account. The President and his advisers are left to work out for themselves the answer to the broader, more important, question-- whether it is in the national interest to provide relief from import competition. Thus the usual roles of advice and decision-making are reversed in existing US procedures. The objective behind trade liberalisation-- to secure the national gains at issue-- is turned on its head as US governments succumb to pressure from protected producers seeking to avoid the adjustment involved (for them) in liberalising domestic markets.

The same influences and institutional arrangements dominate advice and decision-making in Japan and the European Union—the countries initially responsible for corrupting world agricultural markets. Until a way is found to deal with them the gains for Australia from a free trade agreement with the US, and from the present WTO Round, will fall well short of those foreshadowed by Trade Minister Vaile. The estimated gains he has used raise expectations about outcomes that international negotiations and agreements alone cannot deliver.

While trade liberalisation is pursued through the WTO as an external issue--involving international negotiations, agreements and rules--the influences working against better WTO outcomes operate in the domestic policy environments of participating countries. The external processes on which the WTO depends abstract entirely from those influences. They do not address the issue primarily responsible for holding back progress in the WTO —pressure at home from domestic producers seeking to avoid the (nationally rewarding) adjustment involved for them in liberalising domestic markets. The influences that gave rise to the recent market closing actions in the US, for instance, originated in the domestic political arena and exercised power over domestic decision-making. Those influences explain why governments in the major industrial countries are under constant pressure to minimise their market-opening commitments during negotiations and subsequently to avoid the commitments arising from WTO agreements-- by replacing the forms of protection negotiated away with other, less visible, forms. The growing power of these influences in the domestic policy environment of those countries was confirmed in Australia's recent Foreign and Trade Policy White Paper, which observed that 'protectionist forces in major developed countries have become more active, and opposition to liberalisation...is growing'. That is why governments now need help to counter these negative influences over domestic decision-making, and why the present system of international rules cannot provide the help needed to win the argument for trade liberalisation at home.

An additional process is needed to underpin trade negotiations—bilaterally, regionally and in the WTO system—one that focuses on the positive (domestic) reasons for liberalising, rather than continuing to rely solely on what are increasingly perceived as negative (external) reasons for doing so. The additional process is needed for two reasons:

- ◆ to help participating countries improve their *own* outcomes from international trade negotiations; and
- ◆ to renew the ability of the WTO to deliver the gains available from liberalising in a multilateral context.

Ownership of this process must reside where responsibility for future progress in liberalising world trade now rests—in the domestic policy environments of individual countries.

The case for strengthening the WTO system in this way is compelling. It is as follows:

1. The major gains available to individual countries liberalising through the WTO system come from reducing their own barriers. These are the gains each can make by liberalising unilaterally, and do not depend on international negotiations or the WTO system. The preoccupation with market access in international negotiations has undermined understanding that the major gains from multilateral liberalisation depend on what each country does about its own barriers.
2. The additional gains available from liberalising through the WTO—those resulting from access to other countries' markets—also depend on what each does about its own barriers. The barrier reductions each country must make to enable the WTO system to deliver these additional gains are the same as those required to secure the gains from liberalising unilaterally. In both cases it involves lowering the barriers protecting their less competitive industries. That is proving to be an intractable problem for existing WTO processes, where the only incentive to do so is to meet international commitments. Would we have undertaken our program of protection reform, and accepted the adjustment involved for our less competitive industries, simply to meet external commitments? It has proved to be less of a problem, however, when countries have liberalised unilaterally. This was demonstrated by our own experience. Australia did not reduce the barriers protecting our less competitive industries in the Tokyo or Uruguay Rounds. We did so unilaterally after the Tokyo Round and before completion of the Uruguay Round—to raise Australian living standards and to reduce the burden placed on the rest of the economy. We were able to reduce those barriers when the cost of maintaining them was the issue, but not in order to meet external commitments.
3. All the gains available from liberalising through the WTO therefore depend on the decisions governments make at home-- about their own barriers. The gains they collectively take away from the negotiating table depend on what each takes to it.
4. In early Rounds of multilateral negotiations tariffs were the principal form of protection being negotiated. The simple decision rules involved in negotiating tariff reductions were responsible for the very substantial liberalisation that took place in North Atlantic countries in early Rounds. But the forms of protection in use have changed. Pressure from protected domestic producers has caused governments, particularly those in industrial countries, to introduce less visible forms of protection to replace the tariffs negotiated away. While the level of industrial tariffs in OECD countries is now only 4 per cent, non-tariff barriers affect a major part of world trade. This new protection is often in non-border forms and is seen (by governments introducing it) as part of domestic policy, beyond the reach of international agreements and rules. That is the case, for instance, with the recent US action to extend its

farm subsidies. Moreover, the scope for replacing traditional forms of border protection with less visible, non-border forms is endless. The simple decision rules that produced nationally rewarding outcomes when tariffs were being negotiated away are therefore no longer available or relevant. The domestic decisions governments must now make to secure the rewards available from liberalising through the WTO are more complex. In the case of major industrial countries—particularly the EU, Japan and the US-- they involve decisions about forms of protection that are arguably outside the remit of WTO negotiations.

5. Countries liberalising through the WTO system therefore have an incentive—and a need--to invest in the effort now required to work through those more complex decisions at home, and to counter the negative influences in their domestic policy environment that increase the difficulties of doing so. There is nothing in existing WTO procedures to help them do that.

It follows that any initiative to strengthen the WTO system must satisfy two requirements. First, it must include procedures and criteria—operating within participating countries-- that focus advice and decision-making on the national (economy-wide) benefits of liberalising domestic markets. Those domestic producers who felt they would be adversely affected by barrier reductions that are widely perceived to be nationally beneficial would then find it more difficult to get public support for resisting market opening commitments. Second, it must ensure that WTO procedures begin with domestic decisions that resolve the domestic (unilateral) issues involved in liberalising through the WTO and culminate in international negotiations and agreements to reduce protection-- rather than the other way around. The domestic commitment to accept the adjustment involved can then result from decisions based on what is nationally rewarding, rather than emerge as the accidental outcome of a balancing act---in the international arena--- between the market-opening requests of foreigners and the market-closing demands of protected domestic producers.

Experience tells us that the motivation for opening domestic markets cannot come from outsiders. The information published by Australia and the Cairns Group on the cost to the US economy of maintaining its high level of farm support may, or may not, help the negotiating position of the Cairns Group in the present Round. Like similar efforts in the Uruguay Round, however, it is unlikely to have any lasting effect on the day to day conduct of US trade policy. The information about the domestic costs of protection needs to be generated domestically, as a routine input to policy advice and decision-making. Introducing this approach into the WTO system, and into the bilateral agreement with the US, would automatically bring the actual gains from international trade agreements closer to the potential gains foreshadowed by Trade Minister Vaile. The alternative is to leave outcomes from these agreements to be driven by process, not objective.

Australia is well placed to sponsor this approach in the WTO-- so long as it re-commits itself to independent, public advice as an important element of the trade policy-making process. Its public inquiry procedures and economy-wide criteria for advice and decision-making, introduced in the early 1970's, provide a widely recognised and relevant model for doing so.

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

- ◆ recognises that governments will always be under pressure to avoid the domestic adjustment involved in meeting international commitments to reduce trade barriers until those they represent are persuaded that the national benefits this makes possible outweigh the adjustment costs;
- ◆ operates at home, in the domestic policy environment of WTO member countries, where the positive or negative perceptions about the domestic consequences of liberalising hold sway and where decisions about protection are made;

- ◆ leaves governments in full control of domestic policy, and more accountable domestically for WTO outcomes;
- ◆ involves public participation in the process through which advice on protection is formulated, thus increasing the likelihood of a more comprehensive domestic commitment to liberalise;
- ◆ raises public awareness of the larger national rewards from reducing domestic barriers, thereby arming governments against pressure from protected domestic producers seeking to avoid the adjustment involved for them.

Australia unlike the EU or the US, lacks the bargaining strength to insist on changes to WTO processes. On this issue, however, we have an opportunity to influence events by the relevance of the approach we offer to deal with it. The need to find a solution is not of marginal, or even second order, importance. It is now a pre-condition for progress in liberalising through international negotiations. At issue for Australia is the opportunity to secure a more hospitable market environment for our world competitive industries—our reason for liberalising in a multilateral context.

While we have dealt in this letter with the problem posed for the WTO system, it applies to all trade liberalising initiatives depending on international negotiations and agreements—including the proposed free trade agreement with the United States. Australia and the US have both committed to using bilateral agreements to strengthen support for the objectives of the WTO system. That is the basis for our suggestion that the present bilateral discussions with the US should focus on developing a joint approach to this important issue—for inclusion in any bilateral agreement between Australia and the US, and subsequently as an initiative in the current WTO Round.

To be credible in proposing this innovation, Australia will itself need to demonstrate that it still accepts the value of disinterested analysis and advice about the economy-wide effects of trade policy changes under consideration. This would require a renewal of Australian Governments' commitment to seek public and independent advice from the Productivity Commission as a basis for public discussion of the economy-wide effects of major trade policy initiatives in prospect. To be effective in Australia, that commitment would require the support of the Opposition.

The challenge, for both government and opposition, is to choose between two quite different paths for Australian trade policy: one that sees trade liberalisation primarily as an external issue, involving tit-for-tat negotiations and relying on international rules to enforce domestic compliance with the agreements struck ; and one that gives priority (in domestic preparations for international negotiations) to the economy-wide consequences of liberalising its own barriers. Which is more likely to engender trust and confidence in the WTO system, and to deliver nationally rewarding outcomes for participating countries? Which leaves governments in full control of domestic policy, and more accountable domestically for WTO outcomes?

Yours sincerely,

Bill Carmichael
Formerly Chairman
Industries Commission 1985-88
CEO Tariff Board and
Successors 1974-85

Ross Garnaut
Professor of Economics
The Australian National University



PRIME MINISTER
CANBERRA

29 MAY 2003

Professor Ross Garnaut
Professor of Economics
The Australian National University
CANBERRA ACT 0200

Dear Professor Garnaut

Thank you for your letter of 10 March 2003, co-signed by Mr Bill Carmichael, regarding Australia's trade policy approach. I apologise for the delay in replying.

I share many of your perspectives, including that:

- countries liberalising trade barriers gain from unilateral action, as Australia has done;
- unilateral action is less frequent in other countries than it should be because the costs of misguided trade barriers are less well understood by foreign citizens; and
- more transparency as to the costs of protection in other countries would help to redress the imbalance between the diffuse interests of consumers who each individually lose a little from protection, but collectively lose more than the concentrated and individually large gains of the few who are protected.

The dynamic supporting trade liberalisation in democracies will only succeed if communities in each country believe that it is in their interests to liberalise. In the Australian context, the work of the Productivity Commission and its predecessors (including in important periods under Mr Carmichael's chairmanship) has been fundamental to building and maintaining Australian public understanding of the benefits of greater openness to international competition.

This has been an important factor underpinning the Australian public's acceptance of reductions in protection over recent decades which, in turn, led to the upsurge in Australian trade-to-GDP ratios that came with our greater economic engagement with world markets and our participation in East Asian growth.

More broadly, this approach to the "supply" side of the economy has been an important factor in the above trend growth in productivity and in Australia's strong overall economic performance.

The government will of course continue to look to the Productivity Commission as an important source of independent advice. We also recognise the role it can play in stimulating informed public discussion of the economy-wide effects of major trade initiatives.

Because of the government's belief in the robustness and transparency of the Australian institutional framework, we have regularly advocated the Productivity Commission as a model for other countries to adopt. If other countries could adopt similar transparent institutional responses, public opinion would be better informed on the cost of trade barriers, and support would be built for good-policies in broader areas of industry protection.

The government sees broader virtues in improved international transparency than in the important area of trade barriers that your letter addresses. In the government's strategic and analytical response to the Asian crisis (the 1998 Report of the Task Force on International Financial Reform), in our work in APEC, the OECD, the international financial institutions and the Financial Stability Forum, we have sought consistently to build international transparency and so to spread the application of best practice - often Australian practices - to other countries.

Your letter touches at several points on the parallel paths of bilateral, WTO- consistent trade liberalisation and multilateral liberalisation through the Doha Round.

Australia has an ambitious free trade agenda - both multilateral and bilateral negotiations offer the prospect of real gains for Australia. The Doha round has the potential to deliver the greatest benefits but it will be held back until the European Union commits to real reforms in agriculture. Slow progress in the round is not the result of the proliferation of free trade agreements (FTAs). Strong advocates of free trade are working for an ambitious outcome for the round as well as seeking to harvest the benefits of free trade in a shorter timeframe through FTAs. Bilateral agreements can support multilateral negotiations by setting a high benchmark for liberalisation and stimulating multilateral negotiations. This is why we are pursuing the most comprehensive and ambitious outcomes from FTAs.

In addition to market access improvements, FTAs offer an unparalleled opportunity for closer economic integration with our key trading partners. This will be critical to help Australians do business internationally, given the growing role of services and investment in our economy and in world economic growth.

A FTA with the United States is a great opportunity to further integrate Australia with the biggest, most advanced economy in the world - stimulating investment, improving business links and driving innovation. Our negotiation with the United States however is not at the expense of enhanced economic and trade relations with the region. The government has already concluded a FTA with Singapore and is working to deepen economic integration with our region through trade and economic negotiations with Thailand, Japan, China and ASEAN. Indeed, many of these countries are themselves seeking to negotiate FTAs, including with the United States. We are also driving closer regional and trans-Pacific economic integration through APEC.

However, I agree that the multilateral or bilateral approach can not be wholly successful if our negotiating partners have a misinformed view that their existing protection is in their overall national benefit, and that lowering their trade barriers will advantage us and disadvantage them.

Both multilateral and bilateral negotiations offer the opportunity to explain to our trading partners the benefits of transparency and to underscore the costs of protection to domestic communities.

You can be assured that Australia will continue to argue, in the WTO and other forums, for the virtues of full transparency and the benefits of domestic processes which expose the economy-wide consequences of trade liberalisation.

Thank you for raising your concerns with me. I have written to Mr Carmichael in similar terms.

Yours sincerely

ATTACHMENT 2

20 February 2004

Mr John Howard
Prime Minister
Parliament House
Canberra ACT 2600

Trade Policy

Dear Mr Howard,

I refer to our letter to you of 6 February, in which Professor Garnaut and I offered to develop a proposal which adds domestic transparency arrangements to existing WTO processes. Because trade policy is now focusing on issues relevant for the Doha Round, we have brought forward that offer in the attached draft.

There may be opposition to this initiative from people who still believe that liberalising world trade through the WTO can be pursued entirely through external processes. We are encouraged by your letter of 29 May that you do not share that view.

Yours sincerely,

Bill Carmichael
41A Storey Street
Curtin ACT 2605

DRAFT

DOMESTIC TRANSPARENCY ARRANGEMENTS IN THE WTO

AN AUSTRALIAN PROPOSAL

DRAFT

OVERVIEW

It is clear from developments in the Doha Round that progress in liberalising world trade through the WTO is at present problematic. It is important that the response to the problems that have developed reflects what has been learned from experience : that the influences working against better WTO outcomes operate in the domestic policy environments of participating countries, where the crucial decisions about reducing protection (trade barriers) are made ; that these negative influences, exercised by domestic groups who see liberalisation as detrimental to their interests, lose their power over domestic decision-making when balanced by a wide domestic understanding of the overall national benefits from adjusting to the domestic changes involved ; that progress now depends on raising awareness, within participating countries, of the national gains at issue in liberalising domestic markets; and that something must therefore be added to existing WTO processes to help governments and their domestic constituents work that out for themselves, in their own policy environment.

This proposal is based on that experience and reflects those insights. It is only by having a basis for giving priority to national over sectional interests in domestic preparations for the bargaining process that a closer match can be established between the expectation of national gains through international negotiations and the outcome of the negotiating process itself. The domestic transparency arrangements proposed here are needed to reduce the present gap between expectations and outcomes. The test of its relevance is not whether it could move all nations immediately to a best performance, but whether it would expand the opportunity for substantially better outcomes over time.

Opening world markets through the WTO is determined by two separate, and potentially conflicting, processes. One involves international trade negotiations and leads to agreements by participating countries to reduce their trade barriers (domestic protection). This process takes place in the international arena, between governments, and is part of external policy. The other process takes place within individual countries participating in the WTO and involves decisions about which domestic barriers to offer in negotiations and, subsequently, how to meet the agreements reached. In the second process, which belongs to domestic policy, governments act alone. There is at present nothing in the WTO charter, processes or rules that requires or helps countries participating in the international process to address the domestic issues involved in liberalising.

There was a growing recognition, prior to the Uruguay Round, that the momentum in liberalising world trade through international negotiations was faltering and that something had to be done to restore it. This was reflected in the November 1982 GATT Ministerial 'crisis meeting', just three years after the conclusion of the Tokyo Round. The formation of the 'functioning of the GATT system' (the 'FOGS' group) during the Uruguay Round reflected the same concern, the justification for which has been confirmed by subsequent developments. For instance the agreements on agriculture reached in the Uruguay Round committed governments to liberalise, yet legitimised action to avoid the domestic adjustment involved in doing so. This ambiguity was necessary to make agreement possible. The one positive thing that has emerged from developments in the present Round, and reflected in the Seattle and Cancun ministerial meetings, is that they have highlighted the domestic causes of this ambiguity in WTO outcomes.

The nature of the problem

While trade liberalisation is pursued through the WTO as an external issue--involving international negotiations, agreements and rules--the influences working against better WTO outcomes operate in the domestic policy environments of participating countries. The external processes, on which the WTO presently relies, abstract entirely from those influences. They cannot address the issue primarily responsible for holding back progress in the WTO —pressure at home from domestic producers seeking to avoid the (nationally rewarding) adjustment involved for them in liberalising domestic markets.

When governments refuse to include particular industries in the coverage of international negotiations or fail to honour the agreements reached to reduce protection, it is because they have not been able to mobilise a domestic commitment to accept the adjustment involved in doing so. The influences that gave rise to the recent market closing actions in the US, for instance, originated in the domestic policy arena and exercised power over domestic decision-making. Their power over the ability of the WTO system to deliver the national rewards available from multilateral liberalisation is pervasive. As we saw in Seattle and Cancun, they strongly influence national agendas for negotiations and thus the coverage of WTO negotiations. They also cause governments to minimise their market-opening commitments during negotiations and subsequently to replace the forms of protection negotiated away with other, less visible, forms.

This power of protected producers over decision-making on protection (trade barriers) has been institutionalised in the major industrial countries—the EU, Japan and the US. For instance, US procedures and criteria for providing relief from import competition actually increase the difficulties US governments face in dealing with pressure for protection from domestic producers. In formulating its advice the US International Trade Commission is required to use narrow legal rules to determine whether a particular industry is being 'injured' by import competition. The positive domestic effects of liberalising domestic markets---for other domestic producers, for consumers and for the US economy as a whole--are not brought into account. The President and his advisers are left to work out for themselves the answer to the broader, more important, question-- whether it is in the national interest to provide relief from import competition. Thus the usual roles of advice and decision-making are reversed. The objective behind trade

liberalisation-- to secure the national gains at issue-- is turned on its head as governments succumb to pressure from protected producers seeking to avoid the adjustment involved (for them) in liberalising domestic markets.

The same influences and institutional arrangements dominate advice and decision-making in Japan and the European Union—the countries initially responsible for corrupting world agricultural markets. These major industrial countries have relied heavily on international bargaining through the GATT and the WTO. In that context their focus has been on market access, not on liberalising their own barriers, and on trade liberalisation as an external commitment enforced by external rules. Their interest in the domestic issues involved in liberalising has consequently been intermittent—revived every ten years or so in each round of multilateral negotiations. It should therefore not be surprising that their 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.

So long as the response to these developments in the WTO system is seen just as an exercise in promoting the international surveillance of national barriers (as in the Trade Policy Review Mechanism), or securing greater observance of WTO rules, the problem will remain.

The case for a domestic transparency process

Since it arises from domestic influences which operate in the domestic political arena, which focus on domestic policy issues and which exercise power over domestic decision-making, the problem cannot be addressed from the outside or through international (WTO) rules. A way must therefore be found to link the outcome of trade negotiations more directly to the domestic consequences for participants.

An additional process is needed to underpin the WTO system—one that focuses on the positive (domestic) reasons for liberalising, rather than continuing to rely solely on what are increasingly perceived as negative (external) reasons for doing so. Ownership of this process must reside where responsibility for future progress in liberalising world trade now rests—in the domestic policy environments of individual countries.

The case for strengthening the WTO system in this way is compelling. It is as follows:

- The major gains available to individual countries liberalising through the WTO system come from reducing their own barriers. These are the gains each can make by liberalising unilaterally, and do not depend on international negotiations or the WTO system.
- The additional gains available from liberalising through the WTO—those resulting from access to other countries' markets—also depend on what each does about its own barriers. The barrier reductions each country must make to enable the WTO system to deliver these additional gains are the same as those required to secure the gains from liberalising unilaterally. In both cases it involves lowering the barriers protecting their less competitive industries. That is proving to be an intractable problem for existing WTO processes, where the only incentive to do so is to meet international commitments.
- All the gains available from liberalising through the WTO therefore depend on the decisions governments make at home-- about their own barriers. The gains they collectively take away from the negotiating table depend on what each takes to it.
- In early Rounds of multilateral negotiations tariffs were the principal form of protection being negotiated. The simple decision rules involved in negotiating tariff reductions were responsible for the very substantial liberalisation that took place in North Atlantic countries in early Rounds. But the forms of protection in use have changed. Pressure from protected domestic producers has caused governments, particularly those in industrial countries, to introduce less visible forms of protection to

replace the tariffs negotiated away. While the level of industrial tariffs in OECD countries is now only 4 per cent, non-tariff barriers affect a major part of world trade.

- This new protection is often in non-border forms and is seen (by governments introducing it) as part of domestic policy, beyond the reach of international agreements and rules. That is the case, for instance, with the recent US action to extend its farm subsidies. Moreover, the scope for replacing traditional forms of border protection with less visible, non-border forms is endless. The means used have been moved further back into domestic policy, and away from the authority of the WTO. Consequently, the simple decision rules that produced nationally rewarding outcomes when tariffs were being negotiated away are no longer available or relevant. Each new increment of non-tariff barriers, in an already crowded arena, further reduces the scope for multilateral negotiations to liberalise world trade. As a result, the domestic decisions governments must now make to secure the rewards available from liberalising through the WTO are more complex. In the case of major industrial countries—particularly the EU, Japan and the US-- they involve decisions about forms of protection that are arguably outside the remit of WTO negotiations.
- Countries liberalising through the WTO system therefore have an incentive—and a need--to invest in the effort now required to counter the negative influences in their domestic policy environments that increase the difficulties of working through those more complex decisions.
- This will involve building into domestic decision-making the domestic disciplines and policy logic that operate when countries liberalise unilaterally. In a unilateral context the reason for liberalising is unambiguously to secure the gains in national wealth involved. The domestic trade-offs (between the gains for the economy as a whole and the adjustment involved for protected domestic producers) are resolved as a matter of course. Only one process, and one set of decisions, is involved. The decisions to reduce protection are made in the knowledge that this will involve adjustment for protected producers-- the once only price paid to secure the on-going national gains from liberalising. In that context the domestic trade-offs can be brought into play and resolved, because governments and their constituents have something tangible to hold onto. They liberalise domestic markets because they want to secure the domestic gains from doing so.

There is an emerging consensus that external commitments are not providing a persuasive domestic reason for lowering trade barriers ; that it is the positive or negative perceptions at home about the domestic consequences of liberalising that determine how much liberalisation takes place ; that it becomes politically realistic to secure nationally rewarding outcomes from international negotiations only when pressure from domestic groups who see liberalisation as detrimental to their interests is balanced by a wide domestic awareness of the overall domestic benefits of adjusting to the changes involved. Groups engaged to examine the problem during the Uruguay Round all concluded that the functioning of the WTO system must be linked more closely to the domestic choices faced by participating countries. An understanding of the domestic consequences of these choices can then be incorporated into their conduct of trade policy — at home and in the WTO.

The need for domestic transparency arrangements to underpin the existing external processes of the WTO was endorsed in the Leutwiler and Long reports (commissioned during the Round), developing countries (in UNCTAD V11) and the IMF (in its review of the Round). It was supported at meetings of trade ministers in Bali (January 1988) and of Commonwealth representatives in London (July 1988). A proposal embodying the approach was tabled in the special negotiating group on the functioning of the GATT system (the FOGS Group). It was placed on the 'backburner' during the Uruguay Round, however, to make it easier to resolve issues of greater immediacy. Meanwhile developing countries initiated a program of work, which began during the Uruguay Round, to examine the contribution domestic transparency procedures

could make to international liberalisation. The Final Act of UNCTAD V11, in 1988, proposed that:

‘Governments should consider as part of the fight against protectionism...the establishment of transparency mechanisms at the national level to evaluate protectionist measures...and the implications of such measures for the domestic economy as a whole’. (UNCTAD V11, 1988, Final Act,para.5,sub-para. 4)

The institution identified as providing a model for the proposed transparency mechanisms was Australia’s Industries Assistance Commission (which later became the Productivity Commission). The particular qualities of that institution considered relevant for the approach were its public procedures and reports, the fact that its work focused 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. Two former chairmen of that institution were asked to document how that and other existing transparency institutions operate, in order to provide a basis for establishing how the domestic transparency procedures would work. Their response was published by the National Centre For Development Studies at the Australian National University (G.A.Rattigan and W.B.Carmichael, ‘Trade liberalisation: A Domestic Challenge for Industrial Nations’, 1996).

The strength of this approach in underpinning the WTO system is that it addresses the underlying problem at its source. It recognises that governments will always be under pressure to avoid the domestic adjustment involved in meeting international commitments to reduce trade barriers until those they represent are persuaded that the national benefits this makes possible outweigh the adjustment costs. It operates at home, in the domestic policy environment of WTO member countries, where the positive or negative perceptions about the domestic consequences of liberalising hold sway and where decisions about protection are made. It leaves governments in full control of domestic policy, and more accountable domestically for WTO outcomes. It involves public participation in the process through which advice on protection is formulated, thus increasing the likelihood of a more comprehensive domestic commitment to liberalise. And it raises public awareness of the larger national rewards from reducing domestic barriers, thereby arming governments against pressure from protected domestic producers seeking to avoid the adjustment involved for them.

There are obvious difficulties in advancing a proposal for domestic transparency procedures in an environment of international bargaining. The established approach, involving negotiated agreements based on reciprocity, is itself part of the problem. Yet a decision to do nothing, because of the difficulty of advancing the issue in a negotiating context, is a decision to continue to pursue trade liberalisation solely as an external issue—as though it is not about nationally rewarding domestic economic development. The importance of the issue for restoring the WTO’s ability to deliver nationally rewarding outcomes, not the difficulties of working through established modalities, should determine the priority given it.

The Australian proposal

An initiative to underpin the WTO system in this way must satisfy three requirements. **First**, it must include procedures and criteria for changing protection in participating countries that focus advice and decision-making on the national (economy-wide) benefits of liberalising domestic markets. Those domestic producers who felt they would be adversely affected by barrier reductions that are widely perceived to be nationally beneficial would then find it more difficult to get public support for resisting market opening commitments. It is the positive or negative perceptions held at home about the domestic consequences of liberalising that ultimately determine how much takes place. **Second**, it must enable WTO procedures to begin with domestic decisions that resolve the domestic (unilateral) issues involved in liberalising through the WTO and culminate in international negotiations and agreements to reduce protection-- rather than the other way around. The domestic commitment to accept the adjustment involved can then result from decisions based on what is nationally rewarding, rather than emerge as the accidental outcome of a balancing act---in the international arena--- between the market-opening requests of foreigners and the market-closing demands of protected domestic producers. To satisfy these requirements the policy advice about the economy-wide effects of changing protection (trade barriers) must be generated as a routine input to decision-making in national capitals, when protected producers petition governments to be excluded from the coverage of negotiations or from the commitments taken to reduce protection. **Third**, it must respect the autonomy of national governments over domestic policy issues.

The challenge is to find the general design of arrangements that will achieve these objectives. Experience with existing domestic procedures will help identify the qualities needed.

The first step is to establish a Transparency Commission within the WTO, as part of the Doha Round outcome. This Commission would not replace any existing WTO process. Its charter would be to review existing domestic transparency institutions and identify the design of arrangements required to raise awareness within each member country of the national rewards from reducing its own barriers.

The Commission would be chaired by the Director-General of the WTO or his nominee, and would comprise no more than six people of substantial standing in public affairs in their own country. A pre-requisite for membership is a sound understanding of the role of international trade in economic development. Selection of the group would be from across the membership of the WTO. The Commission would have access to the resources of a secretariat.

The initial task of the Transparency Commission would be to review existing domestic transparency institutions in member countries. It would be required to report, by the end of this year, on the general design of domestic arrangements needed to build the national gains from multilateral liberalisation into national preparations for trade negotiations, and into the basis subsequently used to assess the demands of uncompetitive domestic producers seeking to avoid the (nationally rewarding) adjustment involved for them. After consideration of this report by a ministerial meeting in early 2005, the Commission would be responsible for helping national governments implement the resulting domestic procedures.

Implementation of the agreed procedures would require the ongoing attention of the Commission, and it would be unwise to set a timetable for its completion. It does appear, however, that the countries most in need--and therefore first in line for attention--are the major industrial countries. 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.

All countries participating in the WTO system have much at stake in seeing that consideration of the issues addressed in this proposal is advanced now. As exporters they might be expected to embrace an approach that strengthens the international bargaining process in this way. As importers they are more likely to accept the adjustments involved for existing structures of domestic production if they have

worked through the domestic consequences themselves, in the course of deciding what to offer in multilateral negotiations and how to meet their resulting market-opening commitments.

The response of industrial countries to this approach will send a very important message to the large number of developing countries liberalising unilaterally and to the many countries moving from command to market economies. These together represent the majority of the population of the developing world and constitute the major potential growth areas in world trade. Most importantly, the response of industrial countries will determine whether their own world competitive industries enjoy the increased export opportunities that liberalisation in developing countries has the potential to generate. Because industrial and developing economies complement each other in the things they trade, that potential is crucial to world competitive exporters in industrial countries.

If the major industrial countries ignore the issue, given its growing importance and their dominance in world trade that would provide a signal that seriously discounts the value of future multilateral trade negotiations. In some major developing countries the commitment to liberalise is still fragile. A negative response would strengthen the already strident voices in those countries arguing that the clock should be turned back to protectionism.

19 April 2004
Senator Peter Cook
Chairman
Senate Select Committee on the FTA with the US
Parliament House
Canberra ACT 2600

Dear Senator Cook,

We write as two Australians who have had substantial involvement in Australia's trade liberalisation and in international trade policy. An important lesson of our experience is that the domestic processes through which trade liberalisation is discussed and trade policy decisions are taken are critical to progress in liberalising world trade. Disinterested analysis and wide dissemination of information about the costs of protection was a critical element in persuading Australians that reducing our barriers was in our own interest.

We believe that the domestic processes involved in convincing us to reduce our own trade barriers hold the key to mutually beneficial trade negotiations with the US and with our other trading partners. The Prime Minister presently has under consideration a draft proposal, reflecting those processes, for Australia to introduce into WTO discussions when the Doha Round resumes.

That proposal and this submission describe the problems that flawed domestic decision-making has introduced into the international trading system in recent years. These are manifest in the process used so far in negotiating the Australian United States Free Trade Agreement.

The Agreement breaks new ground not only in conventional areas of Australian trade and protection policy, but also in a wide range of sensitive policy areas that have hitherto not been affected by trade policy decisions in Australia. The reach of this FTA extends to health policy (the pharmaceutical scheme); patents and intellectual property; foreign investment review; and broadcasting and media, among many policy areas beyond trade and protection. Some of these new departures in Australian trade agreements are covered by the nine pieces of legislation that we understand must be passed by the Australian Parliament before the AUSFTA as negotiated can come into effect. Others, of great sensitivity and importance, do not require legislation. On broadcasting, for example, although the execution of the AUSFTA would not require new legislation it would constrain the Parliament's use of its legislative powers.

For these reasons, we believe it is important to establish a proper process for the Parliament's consideration of the AUSFTA.

It has been suggested that the processes through which the FTA can now be considered are constrained by timing imperatives-- that passage of enabling legislation through the Australian Parliament and approval of the Agreement as a whole by the United States Congress must be completed by October 31, to allow the Treaty to come into effect on 1 January 2005. To meet this timetable, the enabling legislation would need to be in place by October-- or much earlier if an election were to be called for August, September or October.

These timing constraints are entirely political and are not embodied in the AUSFTA as negotiated. Chapter 23 provides for the agreement to come into force 60 days after each government has advised the other that legislative approvals have been completed. If for instance an August, September or October election in Australia made it impossible for enabling legislation to be passed by the Australian parliament before 31 October, and if the new Australian Parliament were not to meet until the New Year, the enabling legislation would be passed in 2005. We have been advised by US officials that the Agreement would then come into effect 60 days after the Australian government advised the United States government that Australian legislative approvals had been completed. Similarly, if proper process required delay in consideration of the enabling legislation until late 2004 or into 2005, the Agreement would still come into effect 60 days after completion of legislative processes in the two countries.

We note that, for reasons entirely beyond the control of the Australian government or Parliament, the United States legislative processes may not be completed in time for the Agreement to come into effect on 1 January 2005. We understand that, as at the date of this submission, the United States government has not decided whether it will ask the Congress to take a decision on the AUSFTA in 2004.

There is therefore time for the Parliament to ensure a proper process is in place for it to consider the FTA.

In our view, proper process in this country begins with transparent analysis and public report on the benefits and costs of the FTA by the Productivity Commission. This is the body in Australia that has the human resources, the technical capacity, the experience and the reputation for independence that can give the Australian community and Parliament confidence that there is a sound basis of fact and analysis for rational debate of the wide range of complex issues raised by the FTA.

We believe that hasty decisions by the Australian Parliament, based on assessments that are not widely recognised as being independent and authoritative across the wide range of issues that arise in the FTA, would be damaging to public confidence in the Australian policy processes, to public support for changes of policy in areas of high political sensitivity and to Australia-United States relations.

In order to ensure proper process in Australia, and to retain the integrity and credibility of the model our government is urging other countries to adopt, we urge your committee to insist that a public inquiry and report be conducted by the Productivity Commission prior to completion of the Parliament's consideration of enabling legislation for the AUSFTA.

Yours sincerely,

Ross Garnaut
Professor of Economics
The Australian National University

Bill Carmichael
Former Chairman, Industries
Assistance Commission