

Review of Australia's General Tariff Arrangements

Submission to the Productivity Commission

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Summary

Australia should reduce its general tariff rate to zero by 2005. This would improve the Australian economy, consolidate the global competitiveness of Australian manufacturing, and restore credibility to the Government's tariff policy. Such a commitment would enable the goal of securing an open global economy to be restored as the leading goal of Australian trade policy. Trade policy has become primarily focussed instead on securing greater market access, presumably because of unwillingness by the Government to commit openly to further trade liberalisation. This is leading to policies in APEC and the WTO which are contrary to Australia's economic interest.

If the full benefit of fresh commitments to liberalization is to be secured, the government should also agree to determine this year the rate of reductions of tariffs in the automobile sector and clothing and textile sectors in the period after 2005. Australia cannot effectively pursue its trade interests in the WTO or APEC while doubt remains about its long-term attitudes to protection in those sectors.

Structure of the Submission

This submission will consider three aspects - the impact on the economic welfare of Australia, the impact on tariff policy and the relevance to trade policy.

1. The impact on economic welfare

The economic benefits of tariff reductions are well known. Others will rehearse them more competently than we could. Two points will be made - the relevance of tariff cuts to Australia's economic recovery and the benefits to manufacturing of tariff cuts.

Relevance to Australia's economic recovery

With eight years of straight growth and three years of growth between 4 and 5 percent, there would be an understandable temptation in the community to consider that Australia has "recovered" and that the task of restoring an economy that can deliver prosperity throughout the community is largely completed.

Public policy-making today reflects a political assessment that there is a continuing public aversion to further economic reform. Trade liberalisation is not a publicly-stated government objective and decisions such as the pause on tariffs on PMV and clothing and textiles appeared to have been represented to the public as a departure from previous

policy which emphasised reductions of tariffs. The consequence of this is a public perception that there is no need for further liberalisation.

An average tariff of 5 percent crudely means that Australian companies are 5 percent less competitive than competitors in other economies. Australia cannot afford to be 5 percent less competitive than other economies in the global economy. Given Australia's distance from many markets, Australian producers often have to be more competitive than manufacturers in other markets because, all other things being equal, they also have to bear the cost of transporting products to distant markets.

There are still significant weaknesses in the Australian economy. Unemployment remains high and the deficit on the balance of payments remains high. Although it is more than a decade and half since the process of restructuring began in earnest, the process is not complete. Australia's economic future will not be secure until we have a fully competitive economy and we have rigorous financial and monetary management for up to a decade more.

Committing clearly to eliminate all tariffs would both make an important contribution to increasing the global competitiveness of the Australian economy as well as reminding Australians that we still have a considerable distance to travel before the economic health of the country will produce the level of prosperity which the community expects.

The benefits to manufacturing

One of least appreciated consequences of the program to reduce tariffs which began in the eighties is the emergence of manufacturing as a new, dynamic export sector. Over the decade from the mid-eighties to the mid-nineties, exports of manufactures increased at nearly double the rate of all exports, and particularly exports of agricultural and mineral products. The highest growth was in elaborately transformed manufactures, which now account for around two thirds of exports of manufactures. They accounted for around 30 to 40 percent of manufactured exports in the early eighties.

Although this is one of the great and visible successes of the process of liberalisation, our anecdotal experience is that Australians are always surprised when told exports of manufactures are expanding. We would expect polling to verify this. One of the peculiarities of public policy in Australia over the last decade is that federal Governments have not showcased this as an example of the benefits of economic restructuring and liberalisation. Nor has the Productivity Commission or its predecessor been effective in publicizing these results to the community at large.

There may be several explanations for this. One is that the community of economic analysts who influence public debate in this area themselves have tended not to highlight the changes in manufacturing. The new importance of services would partly explain this. It is the fastest growing sector and therefore biggest employer in the Australian economy, as it is for other industrialised economies.

Some analysts may also have been concerned that government intervention and subsidies were in part responsible for the increase of exports and that export growth of this sort was not competitively based and did not deserve lauding. It is undeniable that government subsidies have fuelled growth in some industries. It is interesting to note however that the rate of increase in manufactured exports seems to feature in all manufacturing industries, not just those where subsidies were available.

There is a generally held perception among economic analysts that the devaluation of the dollar following the floating of the currency in the eighties had as much if not more to do with the expansion in the growth of exports of manufactures than cuts in tariffs. It was certainly important. But it does not explain why manufacturing exports increased at a much faster rate than exports of farm and mining products which also benefited from the devaluation of the dollar.

The case is incontrovertible that tariff cuts have resulted in revitalization and renewal manufacturing in Australia. It may never again be a major employer, but there is good reason to suppose that exports from Australia's manufacturing sector should continue to increase. Exporting is a new form of business for Australian manufacturers. Despite the steady increase in the share of production which is exported, there is ample evidence in studies and from anecdote that this is still a developing business for many manufacturers.

Not enough attention has been paid to character of the process of change that has occurred in manufacturing or the length of time that it takes. Any manufacturers which had enjoyed protection needed to rebuild their business before they were in a position to export and had to develop new systems and sometimes products to do business offshore. This could not be done quickly. Having laid the basis for new businesses, the process of expanding those businesses has begun. Manufacturing exporters are just at that phase now.

Given the size and industrial sophistication of the Australian economy, our manufacturing sector is still a long way from generating a level of exports that could be regarded "natural" for an economy the size of Australia's. Provided that the Australian economy maintains its global competitiveness, there is every reason to assume exports of manufactures will continue to expand. We believe it is on track to become Australia's biggest export sector.

The aim of the process of cutting tariffs was to reduce protection of manufacturing. This has created great benefits so far. The process is not complete. Elimination of remaining tariffs will consolidate that success and strengthen the competitive base of manufacturing. Governments in the past may have failed to emphasize the success of the tariff-cuts in generating a dynamic export industry. It is not too late to do so now and it would be highly pertinent to illustrate the benefits of further liberalisation of tariffs.

In its report the Productivity Commission is urged to report on some length on the benefits to manufacturing of the tariff cuts.

2. The impact on tariff policy

No program of liberalisation is successful unless businesses believe the government will not waver from its commitment to cut tariffs. Experience shows that when businesses are so convinced, they will adjust to the new circumstance in advance of the actual reductions.

The pause in tariff reductions in PMV and clothing and textiles has led the private sector to believe that the government might be persuaded again in the future not to maintain reductions. The expectation among some industries is that when the time comes in 2005 to consider further reductions, pressure from industry not to cut tariffs may once again be effective.

The business community has to be persuaded that the government is serious about tariff reductions. That is a key reason why a clear commitment to reduce tariffs from five percent to zero is needed. The reason why zero should be reached at least by 2005 is that it would alter the expectation that the book is open on what will happen after 2005 to an expectation that tariffs on PMV and clothing and textiles *might* be reduced.

This is the minimum that should be done. Post 2005 policy on tariffs for PMV and clothing and textiles should not be left for determination until 2005. If companies are uncertain about what will follow in 2005, business decisions affecting investment in the period after 2005 will be deferred. In most industries, significant investment decisions are taken several years in advance. The Productivity Commission should recommend to the Government that those decisions should be taken earlier, preferably in 2000 so that business has sufficient time to plan for the post 2005 environment.

3. The impact on trade policy

Australia's trade policy has lost much of its effectiveness and that needs to be restored. This is the consequence of a shift of focus of trade policy from being an instrument to foster creation of an environment where an open Australian economy can prosper in a regional and global environment to an instrument for securing market access.

There is nothing wrong with using trade policy to improve market access. It is a prime function. But when it is divorced from the goal of building open and integrated markets, it can produce second-rate or even negative results, as has happened with Australian policy.

It is fundamentally in Australia's national interest that other nations open their economies. There are international policy instruments to promote this, notably the WTO Agreements as well as regional trade agreements. The value of these mechanisms is that they entail an a priori political commitment by Governments to join comprehensive and global processes of liberalisation and institutionalize that commitment.

When liberalisation processes focus primarily on access to markets rather than comprehensive liberalisation, they create situations where access is traded. If the commitments to liberalise do not apply widely across economies, the result can create bad economic effects. The "Early Voluntary Sectoral Liberalisation" (EVSL) package developed in APEC is a case in point. It did not cover all members of APEC and covered some sectors and a few products. Modeling of the effect of the package by the Productivity Commission, as well as agencies in New Zealand and Taiwan demonstrated that the economic welfare effect of the package for those three countries was negative. All three Governments championed an approach to trade liberalisation which was bad for their national economies.

When APEC Governments were unable to secure agreement to implement the EVSL package (not because it did not produce an optimal economic welfare result, but because Japan would not go along with it) the APEC Governments decided to transfer the liberalization proposals to the WTO. It has been put on the table for the next WTO trade round as a package for "Advanced Trade Liberalization" by New Zealand on behalf of APEC¹.

This is a package of measures which is not suitable for the WTO. The WTO is the world's premier institution for global trade liberalization. It has been very successful. Every member of the WTO has made an a priori commitment on joining that all sectors of their economies are subject to global negotiations to liberalise trade barriers. This is a valuable starting point for liberalisation. When an important group of nations put a proposal on the table for liberalisation which entails a set proposal which from the outset exclude a significant number of sectors and commitments, this discards the most valuable tool provided by the WTO. The ATL package is not in the interests of Australia or most other members of APEC.

One has to ask how Australia and other APEC Governments got themselves in a position where they have advanced policies contrary to the national interest in both APEC and the WTO. In the case of Australia, it is contended that this is one consequence of a conscious policy to avoid taking further action to reduce trade barriers and to eschew the language of trade liberalisation and free trade. If there is no preparedness to argue that it is in the national interest to remove trade barriers, it is difficult to argue for a global community of open markets and to argue for policies to achieve that. The failure to date of the Government to demonstrate how it plans to meet APEC Bogor target of zero tariffs by 2010 makes it difficult for Australia to pursue strategies to get others to adopt programs to implement the targets. All that is left is to argue for greater market access.

Policy in APEC

The EVSL debacle has been an unfortunate adventure for APEC. It has needlessly damaged the credibility of the organisation and diminished the influence it did have to promote an open economic system among APEC economies.

¹ It is worth noting for the record that two APEC countries did not associate themselves with the original EVSL package -Chile and Mexico

All APEC economies adopted the Bogor targets of elimination of all barriers to trade and investment among industrialized economies by 2010 and developing economies by 2020. This was a powerful political commitment. It did shape policy formulation of trade and industry policy in APEC Governments.

The error in APEC was to attempt to create an operational program of liberalisation among APEC economies to realize these goals without creating an effective framework for the program. No trade agreement has been successful without making commitments to reduce barriers legally binding. The only real options in APEC were to create legally binding commitments to meet the Bogor target in a formal trade agreement or to agree to pursue the goals in the WTO. The former was not a practical possibility, but instead of adopting the latter strategy, the ill-fated program of voluntary, unilateral liberalisation was developed. When that produced very few new commitments to reduce barriers, the idea of EVSL was spawned, with the results already discussed.

The pity of the outcome of EVSL is that the APEC Governments shifted the wrong piece of APEC policy to the WTO. Rather than dispatching the economically illiberal EVSL program to the WTO, APEC Governments should have agreed instead to use the next WTO round to realize the Bogor liberalisation targets. It is not too late to adopt such a strategy.

The strategic credibility of APEC is at stake here. If liberalisation in the WTO does not result in general elimination of trade barriers to zero by industrialised economies by 2010, the Bogor commitments become empty rhetoric from which the developing country members of APEC can walk away.²

Evidently Australia cannot argue either in APEC or the WTO that reduction of all trade barriers to zero by 2010 is a workable target unless it regards this as a viable commitment which it can meet itself. This is potent reason that Australia should commit to cut trade barriers from five percent to zero by 2005 and lay down a program to bring PMV and clothing and textile barriers down to zero by 2010.

With such domestic policies setting a clear strategic direction for trade liberalisation in Australia, the broader settings can be put back around trade policy. This would enable Australia to resume leadership on trade liberalisation issues in APEC and argue for adoption of the Bogor targets as strategic targets for liberalisation in the WTO.

² At some point as well, we are going to have to recognise that the Bogor targets will not apply to trade in agriculture or clothing and textiles. It is an impossible idea that the industrialised economies (the US, EU and Japan in the case of agriculture and the US and the EU in the case of clothing and textiles) could agree to remove all barriers to trade in those sectors by 2010. However general targets of reducing tariffs to averages of zero or near zero by 2010 are practicable. They are already at 6 percent by average for the industrialised economies. In the same vein, it is not impracticable for developing economies to reduce average trade barriers for industrial products to zero or near zero by 2020.

Policy in the WTO

The forthcoming trade round in the WTO presents Australia with the best opportunity it has to secure better access to Asian markets. Australian companies face significant trade barriers in the Asian region. Yet Australia is not positioned to press for effective strategies in the negotiations to secure reduction of trade barriers in Asia.

Australia has adopted "market access" as its strategic objective for the forthcoming WTO round. Australia has two options in the WTO to secure improved market access - either by securing comprehensive agreement to reduce barriers across the board, or in one-to-one bilateral negotiations with individual Asian economies. There is always a process of bilateral negotiating towards the end of all WTO rounds.

Australia has little reason to assume that it can secure much in the bilateal processes. It has little bilateral political leverage and efforts at bilateral leverage rarely result in significant reductions of trade barriers. Countries mostly reduce trade barriers when they realize it is their national interests to do, or (as the recent case of the Asian currency crisis) liberalisation is required as a condition for financial support from the international monetary community, or when they accept that it is a worthwhile endeavor to do so in concert with others, such through liberalisation programs negotiated in regional trade agreements or during the regular rounds of WTO global trade negotiations.

The optimum strategy for Australia to adopt in the WTO is work for comprehensive liberalisation which would oblige all countries to reduce barriers across the board. In negotiations such as this, it is the prospect of greater access to the world's markets which creates incentives for developing countries to accept commitments to reduce their own barriers. This opportunity presented is pressing for adoption by the WTO of across the board commitments to reduce tariffs, based on the formulae used for cutting tariffs in the past where rates of cuts are greater where tariffs are higher.

It is evidently difficult for Australia or anyone else to work for such a strategy unless they are in a position to accept such commitments themselves or, better still, have adopted such objectives as national policy. A commitment to reduce tariffs to zero by 2005 would enable Australia to work with other countries who also have open economies to press for strategies of comprehensive global liberalisation. This is a difficult objective, but it is not outside the experience of the WTO. Any idea that Australia could go into the negotiations with relying on use its political bilateral leverage to win access or seek to trade access to the Australian market in return for access to others as its principal negotiating strategy overlooks the reality of the limits of influence and disregards the principal opportunity for global liberalisation which only the WTO can offer.

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