



INSTITUTE FOR INTERNATIONAL BUSINESS, ECONOMICS & LAW

Ceda2004FINam

## The Emerging Outlook for International Trade

Andrew L. Stoler  
Executive Director  
Institute for International Business, Economics and Law  
The University of Adelaide

*CEDA Economic and Political Overview Conferences  
Adelaide, 9 February, 2004  
Melbourne, 10 February 2004*

### Introduction

Thank you very much for inviting me to be a part of your CEDA program today. I welcome the opportunity to discuss the emerging outlook for international trade in what is sure to be an exciting year. In the period since I took up my current job with the Institute for International Business, Economics and Law, we have strived to stimulate informed public discussion and debate on international trade and investment issues. As part of this effort we have cooperated in the development of a productive working partnership with CEDA. A concrete example of this partnership in practice was the highly successful trade conference we co-sponsored last June here in Adelaide.

I have to admit that when I first wrote this speech, just a couple of days ago, I had no idea what I was going to be able to say about the prospects for a deal in the Australia-US Free Trade Agreement negotiations. I learned only just before our first session in Adelaide that agreement had been reached. I think that the Agreement is very good news for Australia and for the USA. I will come back to the FTA in a few minutes.

### The Past is Prologue: 2003 in Review

2004 promises to be another extremely interesting year for trade. But the past is prologue and I think it is worthwhile spending a few minutes reviewing the more significant developments of last year since they set the stage for what's in store for us in 2004.

We had our fair share of good news and bad news in 2003. On the good news side, global trade expanded by around 3 percent. This achievement came on top of growth at about the same rate in 2002, following the steep drop in world trade that we saw in 2001. The improvement in the climate for world trade is important to Australia. Thirty years ago, imports and exports accounted for only around 14 percent of the country's GDP; today, international trade accounts for over 22 percent of GDP and is growing in importance.

The nature of the country's international trade is changing as well. Australia still leads the "Cairns Group" but agriculture is now relatively less important for the country and Australian exports of services are worth more than \$30 billion annually. The diversification of its trading interests reflects

Australia's transformation into a dynamic outward-oriented economy where Australians today are about 55 percent better off – in real terms – than they were in 1980.

The government recognizes this connection and Canberra pushed the envelope in 2003 through a combination of bilateral, regional and multilateral trade initiatives. More than \$5 billion worth of Australian goods is exported to Singapore each year. The Singapore-Australia Free Trade Agreement (SAFTA) signed just about a year ago, builds on this and opens important new opportunities in trade with this country's sixth-largest trading partner.

Only eight months after finalising SAFTA, Australia concluded a Closer Economic Relations Free Trade Agreement with another significant ASEAN partner, Thailand. This second FTA in our region is potentially more significant than the agreement with Singapore. Nearly 50 percent of Thailand's tariffs, covering nearly 80 percent of current imports from Australia, will be eliminated when the Agreement enters into force next January 1. Tariffs on automobiles with engines over 3 litres, now at 80 percent will be eliminated overnight. By some estimates, the Thai deal will boost Australian GDP by over \$12 billion over the next twenty years.

Last March, Australia embarked on the negotiation of a bilateral free trade agreement with the United States. At stake in this negotiation is the future growth of Australian exports of goods and services worth more than \$13 billion and Australian investment in the United States market valued at over \$90 billion. But if an agreement with the United States looks like a big deal, what about an FTA with China? China is Australia's third-largest trading partner and bilateral trade has been growing by 20 percent a year over the past five years. With their signature in October of the Australia-China Trade and Economic Framework, the two countries formally embarked on a two-year study of the feasibility of a Free Trade Agreement.

There was bad news too in 2003. While world trade grew, the rate of expansion was only about half the growth rate typical of the 1990's. On a very practical level, the 35 percent appreciation in the value of the Australian dollar has seriously challenged many exporters in their overseas markets. Our trade deficit in December was an eight-month high of \$2.6 billion, with imports up nearly 5 percent and exports off by slightly less than 2 percent. For the year as a whole the deficit hit \$23.6 billion.

On the trade negotiations front, the WTO Doha Round of multilateral trade negotiations suffered a near-death experience with the collapse of the Cancun Ministerial meeting in September. Consultations carried out in capitals and in Geneva in the final months of 2003 produced little in the way of evidence that major players in the WTO talks were prepared to alter their negotiating positions. At a time when we should have been entering the final twelve months of the Doha negotiations the Round appeared to be dead in the water.

#### Trade in Context – 2004 as a Complex Year

Trade negotiations will get a lot of attention this year, but our ability to stay focussed will be challenged by a whole series of external distractions. In May, the European Union will expand from 15 to 25 members as the Baltics, Central European countries, Malta and Cyprus join this increasingly complicated club. In June, the United Nations Conference on Trade and Development (UNCTAD) will hold its eleventh ministerial meeting in Brazil. At the end of October, the current European Commission will be replaced by a new team. The American elections will be a major distraction in the September to November period. We will also have an important election here in Australia.

Each of these events has the potential to serve as an important distraction for a significant number of players in the ongoing trade negotiations. Some interest groups and governments will seek to use them as excuses for inaction. One can imagine certain Europeans arguing that further reforms of agricultural subsidy regimes need to await analysis of the effects of the eastern expansion of the Union. India and other developing countries that have dragged their feet in the Doha Round may well delay adjustment of their negotiating positions until the post-UNCTAD XI period.

Trade policy has been an issue in the Democratic Party primaries in the U.S., but it's too early to say whether it will be a debating point in the Presidential election. The only avowedly protectionist candidate, Dick Gephardt, has now dropped out of the race. But this year's election will bear on next year's trade decisions. In the course of 2005, the US Congress will need to vote on the extension of trade promotion authority – without which the American Administration would be severely handicapped in the WTO and bilateral talks.

### The Challenge of China

No discussion of the emerging outlook for international trade can be complete without reference to China and the increasingly important place China occupies in the global economy.

In 2003 Chinese GDP grew by 9.1 percent, following on growth in 2002 of 8 percent. Trade is a huge part of this, with the ratio of exports to GDP hitting nearly 31 percent and imports to GDP ratio of 30 percent. China replaced France as the world's fourth largest auto producer. This year, auto production is estimated to rise to 5.15 million units and China will move into the number three slot ahead of Germany. Per capita GDP in 2003 stood at over US\$ 1,000 – no small feat when we consider the 1.3 billion person base.

China is committed to implementing a set of sweeping reforms designed to implement the WTO's market access, national treatment and transparency standards; to protect intellectual property rights, to limit the use of trade-distorting measures; and to make numerous changes to bring its legal and regulatory system into line with those of other WTO members.

In 2003, the government began to take steps to correct what had been systematic problems in the administration of its import regime for bulk agricultural commodities. In response to outside pressure, it also reduced unreasonable capitalization requirements in certain financial services sectors and opened up the motor vehicle financing sector to outside competition.

But institutionalisation of market mechanisms is incomplete and intervention by Chinese officials in the market is still all too common. The greatest problem areas are those relating to WTO-mandated reforms affecting agriculture, trade in services and enforcement of intellectual property rights. Counterfeiting is not just an issue for Rolex watches: over 100,000 Chinese reportedly died last year as a result of their use of fake pharmaceuticals. There are also signs of increasing resort in China to industrial policies encouraging domestic industries at the expense of imports from overseas or foreign business operating in China. These issues are especially problematic in the rapidly growing automotive sector.

China's WTO membership represented a watershed in policy, but the country isn't putting all of its eggs in one basket. Beijing has recently begun to explore seriously the notion of bilateral and regional trade agreements. China concluded a free trade agreement with Hong Kong that entered into force at the beginning of this year and has agreed with ASEAN member governments to

progressively lower barriers to each others' exports with a view to achieving an FTA in ten year's time. As a part of the Australia-China Trade and Economic Framework, Beijing and Canberra announced agreement to conduct a feasibility study of a possible FTA, with the study due to be completed by October, 2005.

Studying a bilateral FTA with China certainly makes sense from an Australian standpoint. China is Australia's third-largest trading partner and fastest growing export market. Two-way trade has trebled in recent years and was worth more than \$22 billion in 2002-03. Nearly 200,000 Chinese visited Australia last year and 35,000 Chinese students are enrolled in schools in Australia. It's worth paying attention to the progress in these talks as Austrade economists estimate that China will overtake Japan as Australia's top export destination by 2012.

### WTO's Doha Round

As important as China is, the biggest potential economic gains from trade are found in the multilateral trade negotiations at the World Trade Organization. The World Bank has estimated that a new round of market opening would raise global output by between \$290 billion and \$520 billion by 2015. If industrial tariffs could be reduced by this round to average levels of one percent in the developed world and 5 percent in developing countries, the economic gain to developing countries alone could be as much as \$108 billion in increased exports

A recent initiative by the United States Trade Representative seems to have put new life in the Round – mainly because the USA has now distanced itself from its pre-Cancun position on agriculture subsidies. The reaction to the US initiative has been positive but will this be translated into concrete progress in agriculture and other difficult areas? Meetings of key negotiating groups, suspended in the aftermath of Cancun, will begin again in the March-April timeframe and we will need to see additional flexibility in country positions if the small amount of momentum that now seems to characterize the Geneva talks is to be maintained.

Building and maintaining momentum for these important negotiations will require more than just additional flexibility in government negotiating positions. It will also require initiatives by the business community in support of the Round.

Clearing goods through customs continues to take far more time than necessary and accounts for a significant portion of the overall cost of shipping products internationally. One important example of planned international business cooperation in support of the Doha Round is a new global Trade Facilitation Alliance. The new Alliance will work on behalf of private business interests to achieve concrete international rules that will reduce the costs of international trade.

The significance of business groups like the Alliance was demonstrated in the last WTO Round of negotiations when cross-border private sector initiatives led governments to conclude sectoral tariff agreements in a dozen key areas, including steel, pharmaceuticals, chemicals and construction equipment. Strong business support, backing concrete objectives, will make it more likely that the Doha Round will advance meaningfully in 2004.

### Australia – USA Free Trade

The news that the USA and Australia have successfully completed their negotiations on a Free Trade Agreement is very good news indeed. The bilateral trading relationship between Australia and the United States reflects a healthy exchange of goods, services and investment characteristic

of two countries whose national economies have already undergone a large degree of economic integration. The two countries sell each other just about everything in both directions: transportation equipment, manufactured food products, computer and electronic products, chemicals and fabricated metal products.

And the numbers are sizeable. In 2002, two-way trade in goods amounted to US\$ 18.7 billion. Two-way services trade that year came to US\$ 8.9 billion. In 2001, Americans invested just over US\$34 billion in the Australian economy and Australians put US\$23.5 billion into the United States. Relatively speaking, Australians invest considerably more in the United States than Americans invest here. The total value of Australian assets in the USA at the beginning of the decade was just over US\$69 billion, while the book value of US investments in Australia was slightly more than US\$103 billion. Little wonder then that investment facilitation and protection issues are important in the context of the FTA negotiations.

Last year, I wrote a short article in CEDA's Chief Executive magazine on the subject of the value of an FTA with the USA to Australian business. I noted then that perhaps most importantly, FTAs tend to be implemented through bilateral institutional arrangements that give special and ongoing attention to problem-solving and proposals for additional or accelerated liberalisation. Issues related to product standards or certain tests for health and safety reasons are good candidates for discussion and problem resolution through such bodies. The implementation mechanisms can, for example, facilitate the negotiation of mutual recognition arrangements that make it unnecessary to harmonize differing national regulatory systems. We don't have the text of the FTA yet, but from what I know of the agreement, it will contain elements along these lines.

Turning to the substance, let's look at what's in this new agreement with the United States: I think it's pretty impressive:

On the first day of the agreement's entry into force, tariffs on over 97 percent of Australian exports to the USA will go immediately to zero. This includes \$310 million in auto parts exports and \$140 million in seafood exports. Also getting immediate duty free treatment will be wheat and cereal flour mixes, horticultural products like oranges, mangoes, mandarins, tomatoes, strawberries and macadamia nuts. We will see the immediate removal in the US market of a 35 percent duty on canned tuna and a 25 percent duty on utes. Sixty-six percent of all Australian agricultural exports will get immediate duty-free treatment.

Australian goods and services producers will gain access under the agreement to government procurement markets in the United States worth \$270 billion a year. Australian providers of educational services will benefit from greater recognition in the USA of Australian degrees. The FTA includes a framework to promote mutual recognition of professional services and enhances access to the US market for a range of services providers, in particular financial services institutions.

For its part, Australia has successfully preserved its ability to review incoming foreign investment to ensure it is in the national interest, although review limits have been relaxed in some cases. Similarly, Australian content restrictions on broadcast television are not called into question. The PBS will not be changed in its basic operation, although Australia did undertake to make a number of improvements on PBS procedures that will enhance transparency and accountability in the PBS.

A lot has been said about agriculture and in particular the difficult negotiations on beef, dairy and sugar. Access for beef will increase over a transition period and the amount of dairy products allowed in to the US market will be allowed to rise as well. There is no increased access for sugar,

but that is hardly surprising when you understand what makes the American sugar market work. OK, so these results are not so great, but we need to keep a proper perspective.

The American tariff rate quota on beef has never actually restricted Australian shipments to the US market. According to the Australian dairy industry, while enhanced access to the US market would be welcome, there is a limit to Australian producers' capacity to shift supplies to that market due to commitments in other areas. Sugar exports would certainly increase if the market were liberalised, but only for so long as the US continues to bar access to producers like Brazil that are forty percent more competitive in cane sugar production than Queensland farmers.

Overall, the negotiators and politicians on both sides are to be commended for a job well done. This is an important agreement that will produce many economic benefits for both countries, while at the same time accounting satisfactorily for the political and social sensitivities both sides had to deal with in reaching the compromises that are in the final deal.

### Conclusion

Last year was an important year for international trade. This year presents us with great opportunities as well: in China; on the bilateral and regional front; and, most importantly, in the WTO. The negotiation might be finished, but there is still a lot of work to do on the FTA with the United States. The texts need to be cleaned up and the agreement needs to be submitted for Parliamentary and Congressional approval. A lot of important benefits will flow from this FTA, so it's important that the job is finished properly.

If the WTO negotiation can cut global import duties by 50%, the Australian economy could benefit by up to \$7 billion a year. Even if estimates like this of potential gains from trade liberalisation are off by 50 or 60 percent, it's clear that the remaining trade-inspired growth in the global economic envelope will provide many thousands of new business opportunities. Well worth the effort.

Thank you for your attention.