What A Free Trade Agreement Means for Australia and the United States

Thank you for your kind introduction. I am happy to have the opportunity to be a part of this Forum sponsored by the Institute for International Business, Economics and Law, and the Committee for Economic Development of Australia. I’d like to extend a personal thanks to both David Shetliffe and Andy Stoler for inviting me to speak here today.

Today I will outline the United States’ views on a U.S.-Australia Free Trade Agreement, briefly describe what we see as some of the main benefits, and then I’ll conclude with an appeal.

On November 14, 2002, US Trade Representative Robert Zoellick formally announced in Canberra the US’s intention of negotiating a Free Trade Agreement, or FTA, with Australia. This announcement launches the most important formal advance in U.S.-Australia relations since the formation of the ANZUS Treaty over fifty years ago.

The first round of FTA negotiations was held in Canberra in March. The second round was held in Hawaii in late May. President Bush’s recent statement that he wants to conclude these talks by the end of the year, so we can submit the FTA to Congress for approval, has energized these negotiations. I can report that the pace of the talks is consistent with the President’s deadline.

While it may have caught some by surprise, the FTA announcement was the culmination of a process that began a long time ago. The Australian Government had decided in 2000 to pursue an FTA with the US, and the supporters of this proposal have worked diligently ever since to make it a reality. But 2000 is not where the history of the FTA begins: the idea of eliminating substantially all trade and investment barriers between our countries is one that has occurred to many individuals, spanning several generations. The Australian Labor Party included in its 1998 policy platform the FTA idea. In its “A Better Plan for Trade” document of that year, Labor pledged to open new markets by “investigating the economic advantages in pursuing a comprehensive trade agreement with the United States.” Various U.S. officials had floated the FTA idea in the early 1990’s. We can find FTA-like proposals being proposed by Australian political leaders much earlier: on June 4, 1934, the Commonwealth Government approached the U.S. Consul-General in Australia, asking him to convey a request to the U.S. Department of Commerce to initiate negotiations on a bilateral trade agreement at an early date. The Australian request contained specific tariff reduction proposals that would form the basis of such negotiations. The U.S. reply, conveyed seven months later (communications were slower back then!), was a polite refusal, with the explanation that the press of business associated with negotiations for trade agreements with other countries precluded talks with Australia. Sixty-eight years later, it’s nice to see that Australia has moved up in the U.S. trade policy priority queue.

An FTA will build on an already solid bilateral trade and investment foundation. The U.S. is Australia’s largest foreign investor and employment generator. The destination for most Australian overseas investment is the U.S. The U.S. is Australia’s primary goods and services trade partner, and the largest customer for Australian manufactured
products. More significantly, trade and investment flows between Australia and the U.S. are growing much faster than the general growth rate of Australian trade and investment flows. Thus, our bilateral economic relationship is growing both in absolute terms, and relative to other countries such as Japan. In short, our economic partnership is becoming ever larger and more important to both of us.

Given this large and growing trade and investment relationship, what more could an FTA contribute? Before answering this, for the sake of full disclosure I must make a couple of confessions. First, I am a fervent believer in free trade, not for its own sake but for the effect it has on people’s lives. Free trade creates open markets that boost economic output and living standards, and increase people’s well-being and freedom by providing them with the power of choice. The unprecedented growth in world economic output and living standards we have witnessed since World War Two is due to many things, but perhaps the greatest cause is the growth of the international trading system. Countries that have integrated their economies into the world trading system—South Korea, for example—have experienced spectacular increases in living standards for their people. If you examine a list of the world’s poorest countries, you will notice that they trade very little. The lesson here is that countries are not poor because they trade, but because they don’t trade. Critics of the WTO and globalization will continue to struggle to explain away this basic, undeniable fact. I love to debate free trade because my opponents have to somehow convince all of us that old-fashioned tariffs—which are nothing but a flat, highly regressive tax—are wonderful things that somehow will increase society’s living standards.

My second full disclosure confession is that I’m an economist. Someone observed that in the eyes of a hammer, everything is a nail. Well, as an economist, I have tended to look at the FTA as an exclusively economic animal, and my pro-FTA arguments are all economic. I mention this because some regard the FTA as something motivated mostly by politics, and I’ll have a bit more to say about this later. We think there are several compelling economic arguments in favor of an FTA.

The Australian Government has commissioned an assessment of the FTA, and the U.S. International Trade Commission soon will release its own study of the effects of an FTA. The Australian study indicates that an FTA with the U.S. would boost Australian GDP by about 0.4 percent, or about A$3.6 billion per year. U.S. GDP would also grow, amounting to an annual increase of about A$3.7 billion annually. An interesting conclusion of the Australian study is that, even though this is a bilateral trade agreement, net global exports will increase as a result of the FTA. This means that the FTA will have a beneficial effect on other countries. This can be explained by the fact that both the Australian and U.S. economies expand faster under an FTA, which boosts demand for imports from all trading partners. While the impacts on third countries are relatively small in many cases, the effects are nevertheless consistently positive. In the language of trade policy, a U.S.-Australia FTA will be, overall, trade creating, not trade diverting.

These econometric studies, while useful, are limited by their methodology. They can only measure what is precisely, quantifiably measurable, and must exclude other, less quantifiable dimensions of trade liberalization that are highly beneficial. For example,
the enormous opportunities in non-defense government procurement are not even mentioned in the study. Government procurements account for around 20 percent of the GDP of both Australia and the U.S. Right now, these markets present many obstacles to each other’s suppliers, a situation we hope to address in our FTA. We also hope to incorporate the procurements of the U.S. and Australian States and Territories in the FTA.

Let me describe a few other benefits.

One effect we have seen with other FTAs, such as NAFTA, is dramatically increased U.S. investment flows to the partner country. That investment creates productive capacity that leads to greater trade flows. Our FTAs have also increased investments from other countries as well. The chief reason for these increases is that an FTA puts a highly publicized imprimatur on the partner country’s business climate. Australia’s basic economic structure – a large, underdeveloped landmass with a relatively small population – dictates that it will be a net capital importer. If history is a guide, there is every reason to believe that Australia will receive the positive investment benefits we’ve seen with other FTA partner countries. This sort of high profile, positive advertising about the attractions of Australia as a place to invest in and do business with cannot be bought at any price.

Another important benefit – and one that I credit Allen Oxley of Monash University’s APEC Study Centre for first advancing – is what I call international benchmarking. Firms are increasingly competing globally while adapting to local markets. Successful firms are doing this by sourcing globally and adopting internationally recognized “best practices” in product development and marketing utilizing cutting edge IT operations and business models. Many large firms aim to establish world class operations in a core market comprising North America, Europe, and China. Australia will benefit if it is part of this central network. Australian businesses need to be benchmarked with the best worldwide – to avoid falling behind. The link to U.S. businesses through an FTA offers Australian companies and workers that opportunity.

When the British economist Ricardo first talked about comparative advantage in the early 19th Century, he seemed to have natural endowments – good harbors, minerals – in mind. Today, countries largely create their comparative advantage by fostering innovation, access to and use of information, and the creation of knowledge to add value. The only answer to the challenge of low wage countries is product innovation: businesses must constantly strive to avoid the fierce pressure of commodity pricing by adding value to a service or product. By removing artificial barriers between the U.S. and Australia, an FTA would enhance Australia’s ability to compete anywhere.

A recent Economist Intelligence Unit survey rated the U.S. and Australia first and second in terms of the propensity of our national economies to utilize information technology. The effective use of IT has been the main factor responsible for the U.S.’s ability to grow the economy and boost living standards without creating inflation. The productive power of a U.S.-Australia FTA would be especially enhanced because of the bonds it would foster between our IT sectors and businesses using IT to increase productivity and service.
I've listed just a few of the benefits likely to accrue from an FTA. Most of these benefits are not quantifiable. We have every reason to suspect that there are many more that are not even predictable, let alone quantifiable. Our experience with other FTAs is that open borders foster a diversity and scale of human enterprise that dwarfs our ability to forecast using econometric models. Given that experience, I regard the available FTA analyses as a bare minimum estimate of the economic benefits we can reasonably expect.

In order for the benefits of open markets to be available to everyone, we must have global ambitions for trade and investment liberalization. That explains our longstanding leadership of and commitment to the GATT, now called the WTO. We founded the GATT in 1947 (the actual language of the GATT text is borrowed from 1930’s-era U.S. domestic law), and have led it through every round, including the one launched in Doha last year. Going forward, we attach top priority to the WTO talks. This round must include meaningful agricultural reform, and must commit itself to bringing the poorest countries into the world trade and investment process.

These are ambitious goals. The great advantage of the WTO is that it includes everyone. The great disadvantage is that its large membership and consensual operating style frequently lead to lengthy delays and a lowest common denominator approach. The challenge before us is to find a way to spur the WTO toward timely, ambitious outcomes. We aim to achieve this by initiating a series of ambitious regional and bilateral trade agreements, including an FTA with Australia. By setting a high bar early on, these agreements will create a competitive dynamic, encouraging timely and far-reaching results within the WTO talks. This idea of competitive liberalization is not just a theory for me – it is an observation based on personal experience. Having been involved in the Uruguay Round of multilateral trade talks, which began in 1986 and finally concluded eight years later, in 1994, I am convinced that we would still be meeting in Geneva if it had not been for the impact of NAFTA and APEC on those talks. An historical dialectic of our time is that free trade begets more free trade: our FTA with Canada begot our agreement with Mexico, which will beget our Central American Free Trade Agreement, which will beget our Free Trade Area of the Americas initiative. Besides begetting a good result within the WTO, a U.S.-Australia FTA will beget a much-needed reinvigoration of regional trade liberalization within APEC and other fora. There are encouraging signs that this is already happening with some of Australia’s Asian trading partners. For the U.S., bilateral, regional, and multilateral talks are coherent components of a unified, global trade liberalization strategy.

The WTO recognizes the value of bilateral and regional trade agreements. Specifically, the WTO text states that WTO members “recognize the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to free trade agreements.” The WTO defines an FTA as an agreement that eliminates restrictive regulations of commerce with respect to “substantially all the trade” between the affected countries. This is what we aim to achieve – a comprehensive, world class FTA that will set new standards for trade agreements.
There has been some speculation in the media and elsewhere about what might or might not be covered in an FTA. I have already stated that we want the FTA to be as comprehensive as possible. In considering the practical meaning of this, I commend to you something I learned during my several years working in the GATT/WTO. In the preamble to the General Agreement and in several other WTO agreements, the concept of “rights” and “obligations” is introduced. In the WTO Government Procurement Agreement, for example, the preamble “(Recognizes) the need for an effective multilateral framework of rights and obligations with respect to laws regarding government procurement...” It goes on to recognize the need to “maintain the balance of rights and obligations at the highest possible level.”

A balance of rights and obligations: this is as good a way to view a trade agreement as any I’ve heard. An effective, politically viable trade agreement must embody for all parties a balance between rights — access to other markets, and obligations — providing access to one’s own markets. If one side removes an obligation from the table, the other side could remove a right in order to balance the agreement. I appeal to all of you to bear in mind this unbreakable link between rights and obligations, particularly as you consider the wisdom of those in both of our countries who might advocate the a priori removal from negotiations of this or that measure which restricts trade or investment. Giving up an obligation inevitably means giving up a right. We aim for a comprehensive trade agreement, which means we aim to maintain the highest possible level of rights and obligations. We are, of course, conscious of the need to be aware of sensitive sectors in both of our economies, which may warrant special consideration. The overall comprehensives of the FTA will in large measure depend on how successful we are in persuading our publics of the benefits of open trade and investment markets.

As promised, I have concentrated on the economic benefits of an FTA. What about the claims that this is primarily a political creation? Perhaps this issue should best be taken up with those making these claims, which would exclude me. One thing I can personally testify to is that the two-year effort to sell the FTA to Washington policymakers was made a whole lot easier by the enormous amount of good will and positive attitudes that people in Washington have toward Australia. Our efforts have been aided by our close friendship, which manifests itself in areas of defense and intelligence. We are good friends — for that I make no apologies — and an FTA will make us better friends.

I believe that the FTA provides an historic opportunity to transform relations between our countries. In addressing this opportunity, we recognize that the negotiation of an FTA poses many challenges. Both the U.S. and Australia have domestic interest groups that resist openness and fear change. Both have stubborn barriers that must be tackled at home. We cannot hope to work through these issues effectively unless we have a broad base of public and political support. And so I come to the last part of my message to you today, which is an appeal. I’ve tried to speak as plainly as possible in explaining what we are about:

-- We aim to craft a comprehensive FTA that will boost living standards for the Australian and American people;
-- we aim to craft an FTA that will provide a competitive spur to the WTO talks and regional trade liberalization, and inspire timely and ambitious goals in those fora;

-- and, finally, we aim to craft an FTA that will bring our people closer together.

I appeal to you to join us in supporting this effort. Thank you.