

Priorities for Australian Trade Initiatives in 2005

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Introduction

Thank you very much for once again inviting me to be a part of the program for today's economic and political overview. When I spoke at this same forum one year ago, I said then that I welcomed the opportunity to discuss what was sure to be an exciting year. Well, I wasn't wrong. In 2004 we saw some very significant developments in international trade that contributed positively to this country's long-term economic prosperity.

Last year, and the Free Trade Agreement with the United States, look like a tough act to follow. But new trade agreements likely to be negotiated in 2005 have the potential to produce results that are equally significant. Realising the potential is going to require hard work and good decisions along the way.

This past July, as part of his Department's ongoing collaboration with our Institute, Trade Minister Mark Vaile came to Adelaide to kick-off a new series of annual policy speeches entitled "Trade Challenges for the Future". Minister Vaile spoke of the challenges and potential rewards of a successful conclusion to the multilateral WTO negotiation known as the Doha Round. He also drew attention to the gains that could be realised through FTAs and regional trade agreements.

This is a theme that I intend to pursue in my remarks today – much as I did one year ago. Today, I want to focus on three main topics:

- Australia's interest in a future FTA with China;
- taking advantage of the new FTA with the United States; and,
- what we can expect in the WTO trade negotiations in 2005.

China-Australia FTA

Since it joined the World Trade Organization in 2001, China has come a long way in a short space of time. The country's foreign trade volume doubled in just three years and exceeded \$1.3 trillion (US\$ 1 trillion) in just the first eleven months of last year.

China's trade surplus with the world for the month of December hit \$14.5 billion (US\$ 11.1 billion), but the picture isn't repeated automatically from one month to another. This is because China is not just an export powerhouse. Increasingly the country is a "balanced" trader, often importing more than it exports. For example, in the month of February 2003, China ran a trade surplus of \$884 million (US\$ 680 million) but a year later in February 2004, China saw a monthly trade deficit of \$ 10.3 billion (US\$ 7.9 billion). Exports were up by 40% but imports in the same period rocketed by 77%!

Australia can take some comfort from the fact that China is a net importer of agricultural products, running a sectoral deficit in 2004 of \$ 7.2 billion (US\$ 5.5 billion). Overall... China's trade surplus for 2004 was just \$ 42 billion – less than the annual surpluses it racked up in the late 1990's.

China's trade volume accounts for 60% of the country's GDP – an extraordinary figure. China is also a major engine of global economic growth. The United States and China taken together account for more than one-half of the growth in world trade. In the past two years, the growth in Japanese exports to China accounted for 80% of growth in the Japanese economy.

You could probably fill an entire speech with superlatives about China's position in the world economy. After absorbing \$ 65 billion (US\$ 50 billion) in foreign direct investment in 2002 and 2003, China attracted \$ 78 billion (US\$ 60 billion) in FDI last year. The Chinese economy consumed 50 percent of world cement production, 36 percent of steel production and accounted for one-quarter of global demand for copper and aluminium. Two-way bilateral trade between Australia and China has boomed.

The opportunities look too good to pass up. So why not negotiate a free trade agreement and make a good situation even better? Clearly, there is no objection in principle. China has recently concluded a free trade agreement with ASEAN. Australia's about to join with New Zealand and negotiate a three-way deal with ASEAN. New Zealand kicked off separate negotiations with China on an FTA in December and a so-called scoping study is under preparation by officials and academics in Canberra and Beijing. The results of the scoping study are due next month. With the two governments now having invested considerable political capital in the idea, it's hard to see how the scoping study could come out against the idea of a negotiation.

But why do we need an FTA with China? Where is the value added? China already enjoys excellent access to the Australian market – (Have you shopped at Bunnings lately?). Australia's tariffs on most goods made in China are less than five percent, with about fifty percent of all imports coming in free of duty now.

And we don't seem to need an FTA in order to sell greater quantities of mineral products to China. At first glance, it's hard to see how an FTA would substantially enhance competitive opportunities for either side.

At the same time, we need to acknowledge that there are some downside political risks associated with an FTA. Australian manufacturers are worried – and many of them probably should be. Much

of the manufacturing sector in this country is low and medium-value added and those manufacturers would be further threatened by eliminating existing protection. China is unbelievably price-competitive.

How competitive is China? In 2003, soft-sided luggage production shifted from South East Asia to China and in 2004 the Chinese share of that market in the USA went from 13% to 75% while the average price dropped by 60%. This is made possible in part by a minimum wage in Shenzhen of 610 yuan - the equivalent of \$ 96 (US\$ 74) a month.

I don't think we need any further explanation of Treasurer Peter Costello's comment last December when he said there is no future for low-cost manufacturing in Australia.

But with or without an FTA with China, low value-added Australian producers are probably in trouble anyway. Chances are pretty good that most current tariff protection these firms now enjoy will disappear before long anyway as a result of the WTO negotiations.

The Australian Industry Group has objected to the idea that Australia should agree to treat China as a market economy for the purposes of antidumping actions. AIG thinks this would undermine its members' ability to protect themselves against predatory Chinese pricing. However, since China became a WTO Member, any added protection linked to China's "Economy in Transition" status is more illusory than real.

If you are still wondering where the substance is of an Australia-China FTA, I am about to get to what I believe is the point. The real benefit for both countries lies in the service sector. If bilateral services trade can be freed up in an FTA, both China and Australia will benefit importantly. If services are not a major part of an agreement, then the deal may not be worth doing.

Some background is in order. The Chinese authorities are becoming preoccupied by the fact that while the country has succeeded brilliantly at becoming the world's "factory", its service sector has lagged behind miserably. Earlier, I referred to current wages in the manufacturing sector. Those wages often look good to the sixty percent of the Chinese population that still works on the farm – at very low levels of pay and productivity. And the Chinese are always looking over their shoulder at India – where they can now see a burgeoning and internationally competitive service sector.

Today in Australia, the services sector accounts for about 80% of national GDP. The world average is slightly over 60 percent and services often represent 70% or more of GDP even in developing countries. In China, services account for only about 38% of GDP – and that share is falling. And where home-grown Chinese companies are services providers, they are often dismal performers.

One commentator observed the irony in the Chinese people having one of the highest domestic savings rates and then investing their money in banking institutions where it finances non-performing loans. It's a fact that Chinese state banks are struggling to transform their operations before the sector is liberalised in 2006 as a result of WTO commitments. The Chinese are right to be worried.

What steps should Beijing be taking? Unfortunately, so far, the Chinese reaction to the country's poor performance in services has led Beijing to exclude the service sector from regional trade agreements. The recent China- ASEAN free trade agreement only covers trade in goods. There

are a lot of reasons why we don't want to see that in the case of a Free Trade Agreement between Australia and China. And China should not want it either.

How do you make a services economy competitive? Through competition and the technology transfer that competition brings to the market place. This is where Australia and China have a real opportunity in the FTA. The Chinese can afford to expose their services sector to considerable competition from Australian services suppliers without fear of the potential competitive inundation that might result from full liberalisation vis a vis European or American services providers.

Australia has a lot to offer China, from innovative architects and experienced event planners to experts in ICT services and healthcare. Australian financial services firms can play a big role in helping to fix the Chinese banking sector. The enhanced – and preferential - access resulting from a comprehensive free trade agreement would be very commercially significant for Australian services providers. The Australian Services Roundtable strongly supports the negotiation of an FTA with China that would have an important services component.

The Roundtable and its members are well aware of the opportunities presented by the Chinese market and its directors and member companies are working at developing contacts with Chinese counterparts to build productive working relationships. Informed Chinese observers know that at the same time an FTA could benefit Australian services providers, competition in the Chinese market from world-class Australian companies would provide the impetus needed to upgrade the performance of existing Chinese services suppliers and induce new entrants into the market.

In speeches I made in China last December I emphasized the mutual gains Australia and China could reap from a comprehensive bilateral agreement that incorporates across-the-board services trade liberalisation. Because my audiences in Shanghai and Shenzhen understood the linkage between liberalisation and competitiveness, they were receptive to my pitch. This is also a message we need to deliver here in Australia. In Canberra, Australian negotiators need to appreciate the significance for both countries of making trade in services the centrepiece of a deal with China.

Implementing the AUSFTA

Australia's FTA with the United States is now in force. Last month we saw a lot of press releases and stories heralding the opportunities associated with the agreement and citing enormous figures on the size of new markets now open to Australian business. You might be tempted to think that now that the hard work of the negotiations is over, it's time to lay back and enjoy the benefits of free trade with the world's largest market.

But the real hard work has only just started. This is not a static agreement where all you get is what was on the table on 1 January. It's a living agreement where both the rules of the game and market access opportunities are designed to evolve and improve over time. But it will take work.

To their credit, Austrade experts proactively organised a series of seminars late last year to acquaint Australian exporters with how they could begin to take advantage of the newly-created opening to American government procurement markets. Selling to "Uncle Sam" can be lucrative, but it is often a complex business and Austrade is working with companies here to make sure they learn their way around the traps.

Another area where Australia's FTA with the USA provides for important follow-up work is in the agreement's provisions on mutual "recognition" agreements. Where two countries have different standards and/or qualification procedures there are generally three options.

A first option is for the business to pass the two different tests in both jurisdictions. But this can be costly and time-consuming. A second option would be for one government or jurisdiction to harmonize its procedures or standards with those in the other jurisdiction. This is often politically impractical and in any event might not take account of differences in the country that explain the differing rules.

The third and clearly the best option would be for the governments concerned to find a way of recognizing the other country's standards or qualification procedures as equivalent in effect to its own rules. From a commercial standpoint, the value of a mutual recognition agreement is obvious. And here's where there's hard work ahead of us in the FTA. The Agreement establishes institutional mechanisms to promote bilateral mutual recognition arrangements. The work of the FTA's Professional Services Working Group could eventually give rise to recognition in the United States of the qualifications of lawyers graduated from Australian law schools or facilitate work in Australia by U.S.-trained architects and accountants.

Professional services providers have a lot to gain, but so too do the Universities and other schools engaged in providing professional services education. Similar trade-facilitating provisions are found in the Agreement's chapters on technical regulations for industrial goods and for quarantine issues arising out of trade in animals or food products. This can be a very big deal for business.

While the FTA was under negotiation, there was a considerable amount of conjecture, much of it based on economic modelling, as to whether and to what degree this agreement would be likely to benefit Australian businesses and consumers. My own view has always been that four or five years from now we should look back at what has actually happened and in particular whether the rewards realised were commensurate with the effort put into getting the most out of this agreement. Much of that effort is required now – in 2005.

The Doha Round of WTO Negotiations

Now, turning to the important WTO negotiations. The bad news is that we lost a lot of time in this negotiating in 2003 and 2004. 2004 was not a total write-off, however. The negotiating climate was improved by WTO Members' agreement last July to drop three problematic topics from the negotiating agenda. And the July Framework agreement also provided for the start of long-stalled negotiations in the genuinely useful area of trade facilitation.

Now we have a new overall target to aim for in the Round. Another Ministerial meeting will be held in December this year in Hong Kong. It is generally expected that a successful Ministerial meeting will set the stage for the last lap of the Doha Round and the conclusion of negotiations by late 2006 or early 2007. If the Hong Kong meeting is to succeed, 2005 will need to be an active and productive year in the negotiations.

There is cause for some encouragement in the outcome of a trade ministers meeting that took place on the fringes of the Davos World Economic Forum last month. Trade ministers from close to two dozen key countries agreed to focus their efforts in 2005 on five key areas where progress this year will need to be made for the Hong Kong meeting to succeed. Geneva Ambassadors have been mandated to focus on:

- agreeing the structure of the final package for agriculture, including the date for elimination of export subsidies;
- forging an understanding on a formula for cutting tariffs on industrial products;
- developing a critical mass of market opening offers for trade in services;
- realising significant progress in strengthening antidumping and other trade remedy rules; and,
- reaching agreement on specific measures to promote trade facilitation.

Over the next ten months, negotiators in Geneva need to build on this ministerial understanding and set target dates for smaller agreements that will collectively move the bigger negotiation forward. Many linkages have been drawn between seemingly unrelated areas like trade in services and agriculture. Diverse negotiating groups need to be seen to be moving forward in tandem. The call for new and revised services trade offers by May is sure to go largely unheeded if agriculture is not seen to be moving.

Progress in the WTO Round is important because it is only in the WTO negotiations that we can deal with the major distortions to world trade in agriculture. The US FTA demonstrated the limitations of the bilateral route for agriculture. The Doha Round is also the negotiation that offers the brightest hope for developing countries to realise big gains from trade. Last year I gave you some numbers estimating the gains that could flow to the global economy from a significant outcome in the WTO negotiations. Those numbers have not changed but we are not too much closer to reaping the gains than we were 12 months ago.

At the start of this week, WTO Members met in 2005's first meeting of the Doha Round's Trade Negotiation Committee. They agreed to work toward an "endgame" document for the Hong Kong meeting and to aim for development of a first draft by July. These are the kind of targets that will have to be met if the negotiations are to keep to a reasonable schedule.

We need to do whatever we can to bring about an on-time end to this Round. This has to be an Australian priority, alongside negotiating a comprehensive FTA with China and working hard to implement the American trade agreement.

2005 promises to be a very important and a very interesting year.

Stay tuned.

For now, I hope that I've made a useful contribution to your conference.

Thank you very much for your attention.