

Australian Trade Policy After the Week of Big Diplomacy

by

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THE GREAT AUSTRALIAN DEBATE?

This session has been called "The Great Australian Debate". It might have been helpful for there to have been a great debate before now on the ways in which the recent shift from unilateral trade liberalisation at home and support for multilateral liberalisation and even-handed treatment of trading partners abroad, towards tit for tat negotiations on preferential trading arrangements with a limited number of partners, was likely to affect Australian opportunity and prosperity.

We should welcome now any signs of more widespread interest in these issues. The framework of trade policy in the Asia Pacific is changing dangerously for Australia. What had been the world's most open major trading region is drifting rapidly into preferential trade. Despite strong public relations about free trade areas with Singapore and Thailand, negotiations on an FTA with the US and now about a study on whether we should commence negotiations for an FTA with China, the drift is towards exclusion of Australia from the emerging preferential areas that are most important for our own economic future. The extent of the damage will depend on the length of the lags between the deteriorating reality and the perception of it, and between the perception and the policy response in Australia and abroad.

THE CONTESTED ISSUES

Supporters of the shift to preferential trade, in particular the FTA with the US, have argued that any improved access for Australian exports that can be achieved from such arrangements are net additions to whatever benefits might be available from the multilateral system. Some have argued that negotiation of FTAs actually improves the prospects for liberalisation in the multilateral system, through a process of "competitive liberalisation".

I have argued against this view. In an article immediately following the first public announcement of the Australian Cabinet's decision to seek a free trade agreement with the United States, in December 2000, I expressed four

concerns. The first concern was that it would become more difficult to hold together the intellectual and political coalitions that over the previous one and a half decades had allowed ours to become a relatively open economy. A second concern was that the new policy would damage the multilateral trading system, including through diminution of the prospects for a successful new round of multilateral trade negotiations. A third concern was that the new policy made it more likely that the traditional East Asian commitment to multilateral approaches to foreign trade would weaken, and that important trading partners, of Australia absorbing more than half our exports and an even higher proportion of future opportunities, would be encouraged themselves to enter FTAs that discriminated against exports from Australia. A fourth concern was that the new policy would increase the prominence of difficult and divisive trade policy issues in Australia's relationship with the United States, and in the worst of circumstances place unwelcome strain on the political relationship.

Over the past three years, the dramatic early claims by proponents of Australian benefits for the FTA have become much more modest and qualified. The results of economic modeling sponsored by the Australian Department of Foreign Affairs and Trade showed that the gains from an FTA would come mainly from liberalisation of American access to Australian services, notably telecommunications and banking, and of Australian access to American agricultural markets. Realisation of political constraints has whittled down perceptions of potential benefits in these and other areas — in the case of agriculture comprehensively, with the American refusal to contemplate the constraints on subsidies that would be necessary to give secure value to enhanced market access. There is now widespread recognition that the largest possible benefits from an FTA with the United States would be very small compared with those from a successful outcome from the Doha Round of multilateral negotiations within the World Trade Organisation (WTO).

Unfortunately, there are five compelling reasons why the proliferation of small-group FTAs is neither an alternative, nor a stepping stone on the way, to an effective multilateral system.

First, the FTAs that are currently under negotiation would provide poor models for trade agreements. Countries either avoid partners that would be associated with high levels of trade creation (the large potential for trade creation in agriculture rules out Japan-Australia and Japan-United States, for example), or seek to make exceptions for sectors that would involve high levels of trade creation (the United States refusal to include reduction of agricultural subsidies in bilateral FTAs). More generally, there are political economy reasons why progress in the hardest areas of trade liberalisation, including removal of agricultural subsidies, is inherently more difficult in a bilateral than a multilateral setting.

Second, the establishment of small-group FTAs changes the political economy adversely for subsequent multilateral liberalisation. Some beneficiaries from preferences resist their removal through multilateral liberalisation. Some exporters fulfill objectives in small-group FTAs, and withdraw from the policy contest over multilateral liberalisation.

Third, one country's entering small-group FTAs with a proportion of the world's economies does not give that country anything like a corresponding proportion of the benefits of multilateral free trade. The first and sufficient reason for this is the presence of trade diversion. More importantly, to ensure that the preferential treatment goes to the parties for which it is intended, FTAs require the enforcement of rules of origin for inputs used in production. This increases transactions costs in trade — considerably for a single agreement, and increasing as the number of such agreements expands.

Fourth, some countries are unattractive partners in small-group liberalisation, because of location, small size, poverty, current political orientation or

historical relationships. These would be marginalized in a trading system that was fragmented into FTAs. The marginalized countries would include disproportionately the world's poor people, including countries in the difficult early stages of internationally-oriented economic reform. They would include essential allies and supporters in the struggle to constrain the use of terror as an international political instrument.

Fifth, when some countries seek advantage by joining small-group FTAs, others are led to seek alternative arrangements for defensive reasons, leading to proliferation and increasing costs for everyone. Even if a particular FTA were judged to confer advantages on its members, these could be negated and reversed if others entered arrangements that excluded the members of the original agreement.

A BIG WEEK IN AUSTRALIAN DIPLOMACY

It is just a few weeks since Australia managed successfully the most intense week of high level diplomacy of its history. Australia in this week demonstrated a capacity to be influential on both sides of the Pacific.

October's week of big diplomacy began with Prime Minister Howard participating in the APEC Leaders' meeting in Thailand. This is the one international event each year that brings the Australian Prime Minister into direct contact with the major leaders of the Asia Pacific region, and the world. This coincided with the signing of a bilateral FTA between Australia and Thailand. Then came the overlapping visits of President George W. Bush and General Secretary Hu Jintao, providing an unprecedented intensity of bilateral diplomacy.

There was one other major development in Australia's bilateral relations with significant partners in the week of big diplomacy. It is not closely related to the more famous events, but it should not be overlooked. After a period of tension in bilateral relations, ministers of the Somare Government in Papua New

Guinea responded positively to Australia's offer to provide a large number of Australian officials to play direct roles in the administration of law and public finance. The new Australian approach to development assistance and Papua New Guinea's response to them, while at this stage of uncertain consequence, holds out the possibility of more favourable development outcomes. This is a reminder of the geostrategic challenges to Australia, independently of the large issues of relations with Southeast Asia and the great powers of the Northern Pacific.

The Bush-Hu visits are important in themselves. The General Secretary of the Chinese Communist Party and the President of the United States brought with them a degree of Chinese and American interest in our country that is difficult to replicate in other circumstances. The exposure mostly revealed Australia in a favourable light.

Hu Jintao in his address to the Parliament provided Australians with a view of how China saw a multi-cultural and multi-racial global and Asia Pacific community working, in a way that gave a multi-cultural and multi-racial Australia a comfortable place. Hu told us that both China and Australia would fit best in a framework of international and domestic pluralism, based on mutual respect amongst people of different backgrounds. This fitted comfortably alongside the views of Australia in the world presented in the Parliament by the Prime Minister and the Leader of the Opposition. There were no signs of Australian exclusion from the political and economic life of its geographic region on racial grounds — favoured during the week by the then Prime Minister of Malaysia, without explicit contradiction from Southeast Asian colleagues. Hu's speech to the Parliament complemented a view put to journalists before his departure from China, that China saw Australia as a natural participant in East Asian regional fora. The hard edge was his additional comment that Australian inclusion in regional fora would require the support of other East Asian countries. China itself was positively inclined, but was not

going out on a limb against some Southeast Asian preferences for Australian exclusion.

There has been comment that the United States President did not make a similar effort to present a forward-looking view of the place of Australian-American relations in an international community. The New York Times went so far as to say that Bush had been overshadowed by Hu in the coincidental visits. Perhaps the United States President did take for granted our loyalty to his own perceptions of our shared interests. This is understandable: the Australian relationship with the United States is so well established that it needs less nurturing. And Australians, eager in the articulation of the values and interests we share with the United States, themselves have not been skilled in explaining to American friends the ways in which our values and interests differ.

What of the more concrete outcomes from the week, that consultants and accounting firms might call deliverables? Today I will focus on the issues that had highest profile in the week of big diplomacy — the trade agreements, and some of their links into international political relationships — before returning to the Great Australian Debate on trade policy.

THE FREE TRADE AGREEMENT WITH THAILAND

The public announcements on the FTA with Thailand said that it would remove virtually all Australian border barriers to bilateral trade in goods by 2015 and Thai by 2025. The effects of the agreement may be profound in the several areas in which one or other partner has high protection: in Australia, cars, textiles and clothing and footwear. Each is a competitive supplier of some products in which the other has made substantial commitments to reduce trade barriers within the FTA, so there is a possibility of some welfare-enhancing "trade creation".

Neither Australia nor Thailand is the dominant supplier of the products that are currently the beneficiaries of the highest protection, so there is also a prospect of the new trade preferences generating welfare-reducing trade diversion. For example, after the long transition periods, some clothing of Thai origin will presumably expand its share of the Australian market at the expense of more competitive suppliers in China, India, Indonesia and elsewhere.

The agreement has less far-reaching effects on services trade, mainly binding current arrangements and placing some constraints on other countries being treated better. One significant element of the new arrangements for direct foreign investment is the lifting of the restriction on foreign ownership of mining enterprises in Thailand from 49 per cent to 60 per cent. The principal measures affecting investment and services trade are or could have been agreed on a most favoured nation basis, and so did not need the context of an FTA, built upon Article 24 of the GATT and Article 5 of the GATS.

The long transition to free trade in the FTA are inconsistent with WTO requirements for a plan and a schedule to reduce substantially all official barriers between members within ten years. In truth, the WTO requirements on FTAs are rarely honoured except in the breach, and this is not the most egregious of breaches.

The FTA would prevent the imposition of export subsidies in bilateral trade. It is silent on the much more important issue of subsidies to domestic production and to exports to the global economy. In this respect, the FTA does not go as far as WTO agreements in constraining trade-distorting economic policies. To this extent, the FTA is "WTO-minus". The silence on trade-distorting subsidies does not matter in this bilateral relationship. But it is a poor example for two agricultural exporting countries to set for others.

There have been no independent studies of the benefits and costs of the Australian-Thai FTA. The absence of transparent independent analysis prior to

policy decisions is a weakness in all Australian policy-making on the FTAs under discussion. In the best of circumstances, the assessment of benefits and costs in a bilateral FTA is difficult. The main potential costs of preferential trading arrangements are their effects on the political economy of trade policy in the bilateral partners and other countries, and on the quality of the international trading system and trade relations with other countries. In the nature of things, the assessment of these effects depends on judgements about complex relationships that are not amenable to precise calculation. They are nevertheless potentially of great importance, and I will return to them.

Next amongst the costs are the effects of the "rules of origin" that are necessary to ensure that the benefits of preferential treatment are confined to the party for which they are intended. These raise transactions costs and exacerbate costs of trade diversion even if designed to minimise distortions. The costs imposed by rules of origin are least when imports from the partner are allowed under the FTA even if they contain high proportions of foreign inputs, with the proportions being uniform across sectors and commodities. Even in these most favourable circumstances, the rules of origin would introduce costly bureaucratic intrusion into trade transactions, affecting export as well as import trade with third countries.

The rules of origin are most costly when they are negotiated commodity by commodity, allowing protectionist interests to constrain trade creation, and greatly compounding the costs of bureaucratic intrusion and transactions complexity. Like trade diversion, they are of least importance when the FTA members are "natural trading partners", likely to account for a high proportion of each other's foreign economic relations even in a world of free trade. The rules of origin for the North American FTA, covering the United States, Canada and Mexico, are notorious for their restriction, their complexity, and their exceptional incidence in sectors in which protectionist forces are strong. But while they impose high costs on each member's trade with third countries, for Canada and Mexico at least they have the saving grace that the NAFTA

partners account for most of their trade. Damage to trade with the rest of the world (and Canada's exports to East Asia, Europe and other non-NAFTA partners have fallen considerably since the NAFTA agreement) does not matter so much, for them.

The effects of rules of origin are not quantifiable in the current state of economic science, but in the assessment of economists who have studied them are very large. In the case of the Thai-Australia FTA, assessment of costs and benefits is made even more difficult at the time of preparation of this paper by the absence of any public announcement on the rules of origin. Are the rules of origin to allow relatively high and uniform proportions of third country value-added as in the Australia-New Zealand FTA? Or will they be highly complex and restrictive as in NAFTA? Much hangs on the answer to this question. For example, whether or not any Australian motor vehicles at all would be allowed into Thailand under the FTA, or Thai cotton or synthetic clothing into Australia, will depend on the rules of origin.

HU JINTAO AND THE CHINESE AGREEMENTS

The Hu Jintao visit was the occasion for the signing of a number of private commercial agreements. The greatest prominence was given to an agreement for a Chinese state enterprise to take equity in the Gorgon natural gas consortium on the Northwest Shelf, subject to the Gorgon partners being successful in bidding for a sales contract.

The highly publicized agreement was of a conditional, and preliminary kind. However, its execution in the presence of the two leaders raises the probability that the Gorgon field will be developed on the basis of large-scale sales to China.

The commercial agreements signed in the presence of the General Secretary of the Chinese Communist Party are in the spirit of the approach to bilateral economic relations with China that was established in the 1980s. Close and

productive relations between governments increase confidence in and facilitate commercial trade and investment arrangements. This approach to bilateral economic relations in the 1980s contributed to the emergence of annual sales in excess of a billion dollars per annum respectively for wool, non-ferrous minerals and iron ore. Its continuation in the early twenty first century will see the emergence of natural gas as the fourth billion dollar export commodity to China.

The intergovernmental Trade and Economic Framework executed during the Hu Jintao visit is also in the spirit of the established approach to bilateral economic relations. It involves facilitation of trade and investment without any element of discrimination against other trading partners. It expands the opportunities for two-way trade and investment if Chinese and Australian enterprises are competitive in each other's markets. In this, it is similar to and compatible with the Australia-Japan Trade and Economic Framework signed earlier in 2003.

One paragraph of the Australia-China Trade and Economic Framework foreshadows a joint study of something quite different: whether the two countries should enter negotiations on a bilateral FTA. Such an FTA had been proposed by Australian Prime Minister John Howard on his recent visit to China. The Chinese response had been less than enthusiastic at the time. The joint study is to be completed by October 2005. Hu Jintao was asked by an Australian journalist, at the joint press conference with the Australian Prime Minister, whether he expected the study to lead to an FTA. He responded that China was committed to trade liberalisation within the framework of the WTO.

Of more concrete and immediate importance, the two governments agreed that during the period of the study, Australia will not apply to China the "transitional economy" arrangements, under which WTO members can impose more severe anti-dumping measures. They also agreed that no negotiations would follow the study on an FTA unless by that time Australia had agreed to

treat China as a “market” and not a “transitional” economy for anti-dumping purposes.

An Australian decision to apply “market economy” and not “transitional economy” rules to China is in itself unexceptionable. The Australian application of anti-dumping rules generally and to China in particular have developed protectionist dimensions that would be less egregious under the “market economy” rules. However, the linking of the anti-dumping treatment to the study and negotiation of an FTA is curious and unfortunate.

As in Conan Doyle’s *Hound of the Baskervilles*, perhaps the most significant trade policy element of the Hu visit was the dog that did not bark. The dog in this case was serious discussion on the Doha Round of multilateral trade negotiations at a critical time. China was a major player in the Group of 21 developing countries which closed down discussion of the Chairman’s text at the Cancun ministerial meeting. It is highly influential in the WTO at present, as a result of its spectacular growth in trade — contributing virtually the whole of the growth in world exports and the major part of the growth in world imports since late 2000. The Howard-Hu exchange was an opportunity to explore and to advance the joint Sino-Australian interest in the success of the multilateral trading system.

THE FTA WITH THE UNITED STATES

The United States President came to Australia at an advanced stage of official negotiations on a bilateral FTA. He expressed strong personal commitment to completion of an FTA with Australia, but also drew attention to the constitutional and political difficulties.

The visitors left no doubt that an FTA would contain no constraints on the use of subsidies on agricultural production or export to global markets. The various American agricultural lobbies took the occasion of the visit to announce that they would accept no liberalisation in a bilateral FTA with

Australia. By contrast, the Australian National Farmers Federation generously, one might say tamely, accepted exclusion of constraints on subsidies. The visitors and the Prime Minister conditioned the Australian community to acceptance that any market access conditions on agriculture would be phased in over lengthy periods.

The dampening of expectations on issues of importance to Australia contributed to the perception that the United States leader's visit had been less important than the Chinese. This was not a reasonable perception, since given the inherent difficulties in negotiating an Australia-US FTA, it followed more or less inevitably from the differences in the two economies' structures, growth trajectories, complementarity and competitiveness with Australia, and domestic political contexts.

Again, the dog didn't bark. The meeting of the Australian and United States Heads of Government in Australia, like that in Crawford Texas a short while before, gave great prominence to the bilateral FTA, and none to the Doha Round of multilateral negotiations which had recently broken in crisis at Cancun.

THE APEC AGREEMENT

The publicity from the APEC Leaders meeting in Thailand, at the beginning of the week of big diplomacy, was dominated by the security agenda and the corridor discussion of bilateral FTAs and Sino-American issues.

Away from the media attention there was substantive progress on the old APEC multilateral trade agenda. The steady APEC focus on reducing transactions costs in international trade and investment was taken further. Most importantly, APEC members unanimously supported a return to the Doha Round of WTO trade negotiations on the basis of the Chairman's text from the Cancun ministerial meeting. This text had been decisively rejected, leading to

the meeting ending in disarray, only a few weeks before. European Union Trade Commissioner, Pascal Lamy, commented on the change of heart of APEC leaders:

“I am left to wonder, rather, what magic dust has been sprinkled over a text so roundly rejected in October.”

The APEC consensus embraced four members of the G21/22/23 of developing countries that had been the immediate instrument of destruction for the Cancun meeting. It included the largest and most influential member of the group. It included representatives of three governments — the United States, Thailand and Australia — which had declared after Cancun, that they would elevate bilateral relative to multilateral negotiations. It included Japan and Korea, which after Cancun were expressing relief that the days of real pressure for agricultural liberalisation through WTO negotiations may be over. And it included the Cancun Chair, Mexico, that some had thought excessively eager to bring the ministerial meeting to a premature and unsuccessful end.

The APEC agreement could provide a foundation for re-establishing momentum in the multilateral discussions. For it to play this role, some influential members, including Australia, would need to promote it vigorously.

THE WEAKNESS IN THE TRADING SYSTEM

I regret that each of the damaging consequences from Australia’s shift in trade policy priorities that I foreshadowed three years ago, has already been realised to an uncomfortable extent.

The Australian focus on negotiation of bilateral FTAs since late 2000 has been accompanied by a comprehensive loss of interest in domestic liberalisation. Our community has been encouraged to think that liberalisation at home is a “concession”, to be “paid for” by reciprocal liberalisation in a specific partner. This self-defeating approach contradicts the lessons drawn from economic analysis and Australia’s own experience over two decades of internationally-

oriented reform: that by far the main benefits of reducing trade barriers are received by the liberalising country itself.

There can be no doubt that the high priority that many countries — first of all the United States — are giving to bilateral FTAs has weakened support for the WTO and the Doha Round of multilateral negotiations. Influential Japanese economist and policy adviser, Takahashi Ito, told an Australian National University seminar on November 7, 2003, that Japan now had no interest in multilateral negotiations (in which it was constantly under pressure on agriculture) and was focusing only on FTAs. The distraction of FTA negotiations seems to have played an important role in the failure of diplomacy to deliver a successful outcome from the WTO ministerial meeting in Cancun, despite large progress on the most difficult substantive issues. The potential leaders of WTO liberalisation in the Asia Pacific region, include the US, China and Australia, have used all of the time available for high-level exchange on trade policy for bilateral FTAs.

Australia has no trade policy interest as important as non-discriminatory access to expanding East Asian markets, especially for the agricultural products the trade in which has been prone to greatest distortion. Recent developments on the matters have been strongly in a direction that has as its end point the exclusion of Australian agriculture from many of its most promising opportunities. Since October, 2003, China has granted tariff-free access to ASEAN fruit and vegetables as part of an “early harvest” on an FTA, and will extend it to a wider range of agricultural products from early 2004. Japan, Korea and India have begun to negotiate preferential arrangements with ASEAN. The talk of an East Asian FTA has intensified and become less implausible.

One cannot define with certainty the extent to which Australian policy and actions have contributed to these unfortunate developments. Alter all, this has been a period during which the United States (with encouragement rather than

caution from Australia) has changed its trade negotiations priorities from multilateral to bilateral liberalisation. It has been a period (with encouragement rather than caution from Australia) during which Japan has abandoned its long standing commitment to non-discriminatory multilateral trade. And it has been a period during which China, with reluctance deriving from recognition that the scale of its trade expansion requires integration into global markets, (with encouragement rather than caution from Australia), has been prepared to enter preferential arrangements, so far only with Hong Kong and the ASEAN countries.

What can be said with confidence is that Australia has used whatever influence it has to support rather than to resist the new tendencies towards the emergence of discriminatory trading arrangements in the Asia Pacific region. This contrasts with the strong leadership that Australia provided in the Western Pacific and the United States for non-discriminatory liberalisation during and after the Uruguay Round of multilateral trade negotiations.

My own judgment is that Australia's change of sides in the contest between multilateralism and trade discrimination was influential and possibly decisive. The success of our week of big diplomacy is a reminder that we are not necessarily an unimportant country on either side of the Pacific, despite protestations to the contrary by senior Australian officials.

THE POLITICAL DANGERS OF TRADE BILATERALISM

Negotiations on the FTA have brought trade issues to the centre of US-Australia relations, without providing new means for reconciling conflicting interests. The result has been Australian disappointment at what has been seen as inadequate US political commitment to the relationship. There is a danger that the disappointment will grow in the course of US Congressional consideration of an FTA proposal from the Bush administration.

Australia's eagerness to negotiate an FTA with China has qualified its policy-making autonomy over whether to treat China as a "market" or a "transitional" economy for anti-dumping purposes. Australia would not have been under such pressure if it had been managing market access through multilateral mechanisms.

The exchange of statements in the Australian Parliament between Bush and Hu, on the contrasting roles that the United States and China want Australia to play in relation to conflict in the Taiwan Straits, is a reminder of the risks of politicising bilateral trade relations, as inevitably occurs if the main framework of trade is bilateral rather than multilateral. Australia may one day face fateful choices in the Straits of Taiwan, that affect Australia's chances of survival as a sovereign entity. The management of trade relations with the United States and China principally through bilateral agreements, rather than multilateral processes, reduces Australia's capacity to make these choices autonomously, on the merits of assessment of its national interest in the strategic issues.

WHERE DO WE GO FROM HERE?

Whatever the cause of the unhappy state of trade relations in the Asia Pacific region, questions remain about where we go from here, albeit from a much less propitious position than the one Australia occupied a few years ago. Three points should be made at once.

First, Australian prosperity will be affected much more by the policy decisions that we take in relation to imports of goods and services into Australia, than by other countries' decisions on trade liberalisation or restriction.

Second, Australia benefits greatly from a relatively open multilateral trading system as it is at present, whether or not it is enhanced by successful new rounds of multilateral negotiations. It is hard to imagine gains from bilateral FTAs with currently contemplated partners that could compensate for the losses that would be associated with a significant weakening of that system.

Third, the potential gains from a successful outcome from the Doha Round of trade negotiations would be many times larger than from the most favourable of FTAs with currently contemplated partners, and there are still good prospects for an outcome that would be highly advantageous for Australia.

These three propositions suggest a way forward for Australian trade policy.

The way forward would have three steps. The first two would build on the success of the week of big diplomacy, and the third on Australia's happy experience with unilateral trade liberalisation over the past two decades.

Step one would be for Australia to enlist China, Thailand and the United States as co-champions of the APEC Leaders' unanimous support for advancing the Doha Round negotiations on the basis of the Chairman's text rejected at Cancun. This action would have the support of the European Union, the joining of which with the APEC members makes up an overwhelming proportion of the weight of the international trading community.

Step two would be for Australia to extend to all of its trading partners, the most favourable of the terms of market access for each category of goods and services that it had agreed with any of its FTA partners. It would encourage each of its FTA partners and potential partners to do the same.

Step three would seek as part of the Doha Round outcome, the establishment within the WTO of a Commission for independent and transparent analysis of the extent and distribution of costs and benefits of possible trade policy changes in individual WTO members and the world as a whole.

On the first step, the Cancun ministerial meeting was in sight of an outcome that, while falling short of global free trade, would be an immense improvement for agricultural exporters in developing countries and Australia.

There may be opportunities for small advances on what was on offer from the European Union and the United States at Cancun — and the United States will need to be persuaded to do more on cotton. But the reality upon which we should act is that the available Doha Round outcome is greatly superior to the sum of the potential gains from bilateral FTAs that Australia has in recent times agreed or entered negotiation.

The successful conclusion of the Doha Round would reduce enthusiasm for new FTAs in East Asia, which had been greatly enhanced by the failure of the Cancun meeting.

The second step would itself deliver larger benefits to Australia than, on the most generous attribution of value to FTAs, all of the Australian FTAs that have recently been completed or are the subject of current negotiations. It would avoid the damage to relations with non-members that would otherwise be associated with discrimination in favour of FTA partners. And it would remove the need for rules of origin on the Australian side in any FTAs that we had entered.

The first and second steps would be accompanied by a more realistic approach to completion of negotiations on the FTA with the United States. The political difficulties of the FTA — including the risks of embarrassment to the Bush administration and to US-Australian relations in the US Congress — could be avoided by executing instead a Trade and Economic Framework of the kind that Australia has reached earlier this year with Japan and last month with China. It could embody the main migration, investment and trade terms that might have been included in an FTA. It would contain no trade discrimination against non-members.

The third step would change the universe of possible trade liberalisation in future, much more effectively than tit-for-tat negotiations in FTAs or the WTO. It would help all countries to move away from the wrong and damaging

perception that trade liberalisation is a “concession” to others. The Australian Prime Minister recently confirmed his view that liberalising through international trade agreements “will only succeed if communities in each country believe that it is in their interests to liberalise”. These views reflect an emerging realisation that international commitments are not providing a persuasive reason for lowering trade barriers. It is the positive or negative perceptions at home about the domestic consequences of liberalising that determine how much actually takes place.

These three steps alone will not arrest the momentum in East Asia, and especially in our crucial Northeast Asian markets, towards preferential arrangements that discriminate against Australia. They will, however, build alternatives to East Asian FTAs that in practice will be recognised as having many advantages over the continued fracturing of the international trading system.