

# 1. Introduction

Australia is interested in negotiating a Free Trade Agreement (FTA) with the United States. Australia is in good company. Global interest in using free trade agreements to expand trade, investment and other economic linkages between countries has increased dramatically in the last decade and a half. Even so, it is a significant step for Australia. To date Australia has a free trade agreement with only one other country – New Zealand. An agreement with the US would add an entirely new dimension to the bilateral relationship.

The proposal for a free trade agreement has stimulated some conferences and some debate in the media. The idea of an FTA is still relatively new so reactions to date have been generally positive. Arguments aired in favour so far suggest that an agreement would:

- Produce dynamic benefits from closer economic links with the world's biggest and most competitive economy and the heartland of the Information Economy
- Increase investment and trade between the two countries
- Give momentum to liberalisation in the WTO and APEC, and
- Strengthen the overall bilateral relationship.

The most commonly expressed reservations about an FTA are that it might:

- Undermine the credibility of Australia's efforts to strengthen relations with Asia
- Weaken the authority and effectiveness of the multilateral trading system based on the WTO
- Require Australia to take domestically sensitive measures action in sectors such as cultural industries to open them to increased US competition
- Fail to deliver significant improvements in access to US markets in key agricultural sectors with high barriers.

With anti-globalisation sentiment prominent, an FTA would also be likely to attract criticism as an instrument of trade liberalisation that intensifies the adverse effects of globalisation. The role of the US as an engine of the global economy, and the extent of its economic and cultural influence, will presumably add to the piquancy of such criticism.

As the debate so far has shown, there are significant potential benefits for Australia. An econometric analysis of the direct economic impact by the Centre for International Economics concluded that an FTA would expand trade and boost economic growth in both countries. This report has been commissioned to assess the broader implications that are less amenable to quantitative analysis. How will an agreement affect relations between the US and Australia, particularly trade and investment? How would an agreement affect Australia's global interests? Preparations are under way in the World Trade Organization to relaunch the next round of multilateral trade negotiations. How do the two activities relate? How would Australia's trading partners be affected? Australia is committed to engagement with Asia and development of APEC. What effect would an agreement have on those objectives? What would be the implications if Australia did not have a free trade agreement with the United States?

This introduction to the report will review the nature of free trade agreements, assess the global setting for trade liberalisation, consider the role of free trade agreements in international relations, and set out the approach taken in the report to assessing the implications of an FTA.

## What Free Trade Agreements do

Free trade agreements are legally binding agreements between two or several states to remove all, or nearly all, barriers to trade between countries. They are instruments for trade liberalisation and economic integration.<sup>1</sup> FTAs have also become touchstones for closer relationships among their members. The extent to which countries of the world have removed barriers to trade in the last half century is unprecedented.<sup>2</sup> The level of trade among countries has never been greater and the corresponding benefit is that standards of living around the world have never been higher.

Free trade agreements are usually differentiated from multilateral trade agreements which are managed by the World Trade Organization. The core agreement of the WTO is the General Agreement on Tariffs and Trade (GATT). The aim of the GATT is to standardise how countries regulate trade so that all countries can benefit, and to open up world markets by removing restrictions on trade. Using GATT rules, countries have progressively opened up world trade since 1948. This process of multilateral trade liberalisation is slow and difficult. All countries participate (today more than 140

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1 Free trade agreements need to be differentiated from general trade agreements. Countries often sign agreements to promote trade with each other. The commitments in these agreements are to facilitate and promote trade such as making customs procedures less bureaucratic or mounting joint trade promotions. They are generally not legally binding. Free trade agreements contain legally binding commitments to reduce controls on imports such as tariffs or quotas.

2 Many point out that the freedom to trade and invest between 1870 and 1913 was comparable. Comparisons can be taken only so far. The modern system of the nation state had not fully evolved and a significant amount of global commerce was conducted under Imperial rules.

countries are members of the WTO) and all areas of trade are covered so reaching agreement is difficult. In free trade agreements, liberalisation is easier. Fewer countries are involved. It is typical for parties in free trade agreements to agree to remove all barriers within finite periods. By contrast, in multilateral processes it is common to settle on more modest targets of agreeing to reduce, rather than eliminate, trade barriers.

Countries mainly join free trade agreements for the following reasons – to support domestic economic reform by engaging in trade liberalisation, to secure access to the markets of other countries, and to strengthen general economic relationships with other countries. To date, Australia has negotiated a free trade agreement with only one other country, New Zealand.

### *Multiple paths to liberalisation*

There are four main ways in which countries can reduce trade barriers –unilaterally, through bilateral agreements, through regional or plurilateral agreements, or through the multilateral processes of the WTO. Most countries are members of the WTO. Its multilateral processes are activated about once a decade when a global negotiation is held to reduce trade barriers. The last set of negotiations was the Uruguay Round which ran between 1986 and 1994.

It is becoming increasingly common for WTO members to liberalise unilaterally or to undertake bilateral or plurilateral liberalisation to complement participation in multilateral liberalisation. This is also Australia's experience. It unilaterally liberalized controls on imports to gain the benefits of making the economy more efficient and improve growth. And it negotiated a bilateral agreement with New Zealand. It did both while simultaneously negotiating multilateral reductions in the Uruguay Round.

Whereas the European Community has negotiated free trade agreements with a wide range of countries,<sup>3</sup> the United States did not negotiate free trade agreements until the late eighties. It relied on multilateral processes to achieve trade liberalisation. That changed with the negotiation of a free trade agreement with Canada in 1988, then the US and Canada negotiated agreements with Mexico to create the North American Free Trade Area (NAFTA). The US did not cease working the multilateral processes as it developed bilateral and regional trade agreements. It worked on both at the same time. US interest in regional and bilateral trade agreements has intensified. The US Administration has committed to negotiate a comprehensive free trade agreement covering all the nations of North and South America except Cuba and it has begun negotiations on free trade agreements with Singapore and Chile.

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3 The Agreements tended to provide preferential access for the other party to a limited range of products in the markets of the EC, rather than removal of all barriers, and they almost never provided access for agricultural products.

Interest in negotiating bilateral and regional trade agreements is now worldwide. Regional trade agreements have been negotiated in South-east Asia<sup>4</sup>, Latin America<sup>5</sup> and Southern Africa.<sup>6</sup> In East Asia, Japan, Korea, Singapore and New Zealand have all initiated discussions about a variety of bilateral agreements. For its part Australia has initiated negotiations with Singapore on a bilateral agreement and announced a joint scoping study with the Government of Thailand on a possible FTA.

There is also renewed interest in multilateral trade liberalisation. The global trade community is about to turn its attention once again to the multilateral trade process. Following the failure of WTO Ministers at the meeting in Seattle in November 1999 to agree to start a new round of global trade negotiations, a new Ministerial WTO meeting will be held in Qatar in November 2001 to try again. Preparations for that meeting have stimulated renewed debate about the impact of trade liberalisation and globalisation.

## The Global Setting for an FTA

It is sometimes said that the era of trade liberalisation and the process of globalisation which accompanied it is on the wane, evidence being the worldwide pattern of public protest against global economic conferences since the WTO meeting in Seattle in November 1999.

Anti-globalisation critics maintain that trade liberalisation widens the gap between rich and poor, favours large corporations and works against the interests of small and weak developing economies. The positions of the governments of developing countries suggest otherwise. In recent years the number of countries wanting to join the World Trade Organization has increased, not decreased. Thirty countries, are in the queue to join the WTO. The benefit that most seek is that membership will buttress their efforts to get the market economy functioning better inside their own economy. This was the avowed reason China applied to join the WTO and why Russia has applied.

The economic case to maintain momentum for trade liberalisation is very strong. It is the emphasis that trade liberalisation gives to using the market to direct allocation of resources in an economy that sets most anti-globalisation critics against it. Yet it is precisely the failure to encourage this that is causing growth to lag in Asia and why efforts to promote development throughout the developing world are languishing. It is no accident that the lack of support for trade liberalisation among a number of East Asian economies has occurred at a time when growth is lagging.

Despite the claims by anti-globalisation critics that globalisation has widened the gap between rich and poor, the record is that global standards of living have never been higher and the relative number of poor people in developing countries has never been

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4 The ASEAN Free Trade Area.

5 Mercosur, a common market between Argentina, Brazil, Paraguay and Uruguay.

6 SADC, the Southern African Development Community

lower. Countries, developed or developing, that have embraced open market policies and liberalised trade have on average raised the standard of living of their people much more than those that did not.<sup>7</sup> To damn now the only economic model that has been proven to address the problems of weak growth in developing countries is to discount the only effective strategy available to generate growth in poor and small economies.

Globalisation has brought great benefits to most countries. It has also altered the way in which international relations have been conducted and has given a new importance to trade agreements because of the economic integration they foster. An analysis of the importance of globalisation and impact of globalisation is set out in Annex 1.

Globalisation is a more important and more profound process than most criticisms of it suggest. It has altered the way in which nation states cooperate and created new opportunities for states to enhance prosperity and, in certain circumstances, improve national security.

One of the great innovations in international relations in the twentieth century was the common accord among nations to bind in international law the principles governing international trade. These rights have been established by the General Agreement on Tariffs and Trade as global rights in a multilateral trading system. They have also been created in regional agreements among groups of states and in bilateral agreements between states to remove barriers to commerce between those states. The extent to which states collaborate together for mutual advantage has been elevated to an entirely new plane.

The emergence of a global community makes the twentieth century a watershed in human history. Global markets have been created. Producers are now able to sell their products almost anywhere. The application of information technology to the global market place has resulted in the creation of the Information Age, which will be a new driver of growth for decades to come.

This new system of economic relationships bound by international legal rights has emerged in parallel with the traditional system of managing relations among states to promote political goals and advance national security. The building of economic linkages and the attendant interdependence that it creates is a new tool in international relations. Where economic interdependence between states is deep, it can directly enhance national security.

### *How globalisation benefits Australia*

Globalisation has delivered significant benefits to Australia. Globalisation is fundamentally about open societies and freer movement of goods, services, capital and

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<sup>7</sup> A comprehensive resource on the statistics on the impact of globalisation and the arguments in favour and against is available on the APEC Study Centre website [www.apec.org.au](http://www.apec.org.au).

people. These are threatening to some societies. But in Australia's case they are a deep part of the tradition of economic development in Australia since European settlement.

Australia has already reaped the benefit of opening up its own economy. Record levels of growth in recent years are testimony to that benefit. Australia has a great deal to gain from seeing others open their markets for trade and increased flows of investment. Markets for many farm products in the European Union, Japan and the United States remain closed to Australian exports. There are significant barriers to Australian exports of automobiles and processed food in the East Asian region. Trade liberalisation will bring down those barriers, the result being more business for Australian companies and more, well-paid jobs for Australian workers.

## The new role of Free Trade Agreements

As noted above, Free Trade Agreements in international affairs are now seen as instruments for achieving closer economic relations as much as mechanisms to remove trade barriers.

There is still apprehension on economic grounds about use of FTAs for trade liberalisation because they have traditionally been considered second best instruments for trade liberalisation. It has long been understood by economists that if all countries participate in a global market in which each is able to trade what each is best at producing, the economic return to each economy is optimised. In contrast, agreements among small numbers of countries to remove barriers between themselves and not other trading partners can distort trade and damage economic interests.<sup>8</sup> Broadly speaking this is why the multilateral trading system, established by the General Agreement on Tariffs and Trade (GATT), is regarded as the best system for trade liberalisation. Most countries participate in it.

Such concerns about trade diversion are reduced greatly if barriers to trade in the countries entering the agreement are low, as in the case of Australia and the United States.<sup>9</sup> It is very unlikely the interests of other countries would be damaged by trade diversion from an Australian US FTA. The analysis by the Centre for International Economics on the impact of removal of all trade barriers between Australia and the

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8 The concern about agreements between pairs or small groups of countries is that if they remove trade barriers between them but not with other trading partners, the result could be diversion of trade towards the parties inside the agreement at the expense of parties outside. The arrangement could even be to the long-term disadvantage of the parties inside the agreement. Such an arrangement over time might result in less growth and accumulation of wealth than if they liberalised instead through the multilateral system. The touchstone of whether a free trade agreement contributes optimally to total net wealth is whether or not the effect of the arrangement is to create more trade than is diverted.

9 They also disappear if the members of an FTA lower trade barriers with third parties at the same time as they are lowering trade barriers between themselves. The Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) was not considered as having diverted trade because both countries unilaterally reduced their trade barriers with other trading partners in parallel with the ANZCERTA program to eliminate all trade barriers between the two countries.

United States<sup>10</sup> shows that overall an agreement would not result in trade diversion. Moreover, there is now a widespread view among economists that generally liberalisation between pairs or small groups of countries gives momentum to global liberalisation rather than undermining it.

In this era of unprecedented, deeper economic interdependence, free trade agreements typically span a wider range of issues than removal of barriers to trade in goods. They now can encompass services, intellectual property, investment, harmonisation of technical standards, harmonisation of business law and trade facilitation.

Free trade agreements have become new instruments for demonstrating close relations with other countries, as well as for securing the economic benefits of greater economic interdependence. The implications of a free trade agreement between Australia and the United States need to be assessed in this broader context as well as in the more traditional one of directly enhancing trade and investment flows.

## Approach to the Study

Chapter 2 of the study will provide an overview of the trade and investment relationship between Australia and the United States.

The study will then review the impact on the Australian economy. It will begin (Chapter 3) with a discussion of the advantages and disadvantages of FTAs. Chapter 4 will cover what an FTA between Australia and the US might look like and Chapter 5 will assess the impact on Australia's trade and investment. It will conclude with a review of the other dynamic impacts, particularly on the Information Economy and Business culture (Chapter 6).

The study will consider the broader implications for Australia's international policy, first on bilateral relations (Chapter 7), then on Australia's global interests (Chapter 8) the implications for Australia's regional interests (Chapter 9).

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<sup>10</sup> Centre for International Economics, *Economic Impacts of an Australia - United States Free Trade Agreement*, Canberra, 2001. See [http://www.intecon.com.au/reports\\_list.htm](http://www.intecon.com.au/reports_list.htm)

