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AUSTRALIA'S BILATERAL TRADE AGREEMENT WITH THE UNITED STATES: SIGNIFICANT DRAWBACKS, FEW GAINS?

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The character of regionalism in the Asia-Pacific has been changing significantly. Whereas up to the turn of the century most countries in the region concentrated on participating in the multilateral trade regime, today there is a marked shift. Almost all countries in the Asia-Pacific have embarked on a new course for their trade policy. Bilateral trade agreements are mushrooming all over the world, but the Asia-Pacific is the region with the most prolific supporters of bilateralism (Lloyd 2002: 1282). Frustrated with the lacklustre development of Asia-Pacific Economic Cooperation (APEC), and in view of the free trade agreement networks of the European Union and the USA, Asian countries are following the bilateral trend (Hufbauer and Wong 2005: 3; Ziltener 2005: 279). The implementation of discriminatory trade arrangements is arguably the most significant development in intergovernmental relations since the Asian crisis of 1997 (Ravenhill 2003: 300). This crisis exposed the weaknesses of existing institutions, such as the Association of South East Asian Nations (ASEAN) and APEC, and led to both monetary regionalism in finance and regionalism in trade (Dieter and Higgott 2003: 431).¹

¹ Ravenhill has suggested that it would be unfair to blame APEC for failing to resolve the Asian crisis (Ravenhill 2000: 326). Nevertheless, Asian policy makers in particular have been questioning the utility of economic cooperation that does not provide any input – neither liquidity nor advice – in the event of a financial crisis.

The wave of bilateralism in trade has been fuelled by the weakness of existing regional organisations for economic integration - APEC and ASEAN in particular (Camroux 2001: 7). Webber has convincingly argued that the Asian financial crisis has been the cause of both the decline of APEC and ASEAN and the rise of new forms of regional cooperation, ASEAN+3 in particular (Webber 2001: 342). He suggests that the inability to respond to challenges posed by the financial crisis has severely weakened ASEAN's credibility (Webber 2001: 350). In the crisis, ASEAN's fair weather cooperation lost its shine (Rüland 2000: 444).

The superficial explanation for this trend is that in bilateral agreements, countries agree on measures that liberalise trade much faster than in the multilateral regime, i.e. within the regulations of the World Trade Organisation WTO. At closer inspection, this explanation does not hold water. Bilateralism has to be evaluated not only in comparison with the multilateral regime, but also in comparison with unilateral liberalisation of a country's trade regime. I will demonstrate that preferential trade agreements are sometimes leading to third-best, rather than second-best, economic outcomes.

This paper analyses the benefits and disadvantages of the Australian-American agreement. The Australia-United States Free Trade Agreement (AUSFTA) is an interesting case not only because it is the first free trade agreement of Australia with another OECD-country apart from neighbouring New Zealand, but it is also the most important free trade agreement of the USA since the completion of the North American Free Trade Agreement (NAFTA) in the early 1990s. Although the United States have been negotiating a number of free trade agreements in recent years, the economies concerned are mostly relatively small, e.g. Jordan, Bahrain, Chile or Singapore.² By contrast, Australia is a relatively large, developed economy with 20 million inhabitants and a GDP of over 600 billion US-dollars (2004). The free trade agreement between Australia and the USA was controversial in Australia, but the concerns raised were barely considered in the final document. This agreement, an example of a

2 Gordon argues that Washington's turn to bilateralism is the major factor in explaining the change in trade policy in Asia (Gordon 2005: 9).

North-North agreement, will have repercussions not only for trade in goods, but also for trade in services. Furthermore, this agreement demonstrates that bilateralism can change the location of dispute settlement, which can be shifted from the multilateral level to the bilateral one.

AUSFTA has been in force since 1st January 2005. In the first eight months after the agreement's implementation Australia experienced a rather dramatic increase of its goods exports: they grew by 20.8 percent in the first eight months of 2005. However, Australian goods exports (excluding services) to the United States rose from US \$ 4.48 billion in the first eight months of 2004 to only US \$ 4.57 billion in the same period in 2005. This is an increase of 2.1 percent in nominal terms, a skimpy rate of export growth. Moreover, the rest of the world fared far better: American imports in the first eight months of 2005 grew to US \$ 1015.2 billion, an increase of 10.3 percent compared to the same period in 2004. America, by contrast, significantly increased the volume of exports to Australia: imports from America rose from US \$ 9.9 billion in 2004 to US \$ 10.9 billion in 2005, an increase of 10.7 percent.

Table 1: Australia's trade with the USA 2004 and 2005

	January 2004 to August 2004 (US\$ Millions)	January 2005 to August 2005 (US\$ Millions)	Change (%)
Australian exports (total)	55,247.1	66,757.9	20.8
Of which: Exports to the USA	4,483.3	4,578.1	2.1
Australian imports from the USA (f.o.b.)	9,918.4	10,978.5	10.7
US imports (total)	920,000.2	1015,000.2	10.3

Source: IMF, *Directions of Trade Statistics*, January 2006, own calculations.

Of course, one might argue that this data only gives a first impression of the development of trade between Australia and the USA after AUSFTA came into force. But it is striking that in the first eight months of 2005 Australia's export performance in relation to the rest of the world has

been so much better than in relation to the United States. At the same time, the rest of the world was able to export more to the USA than Australia: American total imports grew by 10.3 percent. These developments are no coincidence: as I will demonstrate in this paper, the asymmetric development – America benefiting more than Australia – can at least partly be explained by the fine print of the agreement, which favours American producers. AUSFTA does not provide a level playing field.³

For a medium sized economy like Australia that continues to rely substantially on exports of raw materials the shift to bilateral trade agreements results in – on balance – more economic disadvantages than advantages. There are good reasons to be sceptical about the benefits of bilateralism in general, but for Australia the balance is even less favourable than for larger economies like the EU, the USA or other countries that export primarily industrial goods, i.e. products which tend to be protected by higher tariffs than commodities, with the exception of agriculture. There is little to be gained by going bilateral; and, as a collateral damage of bilateralism, the multilateral regime is severely weakened.

Of course, supporters of AUSFTA could argue that this agreement supports the security alliance with the United States. This may be the case, but I will refrain from analysing this potential effect of the agreement and concentrate on the economic dimension.

It is also pertinent to note that some observers have argued that, by pushing for a closer alliance with the United States, and the AUSFTA being one instrument for more intensive partnership, Australia has upgraded its position in global politics.

3 On 1st January 2005, the Australia-Thailand Free Trade Agreement (TAFTA) also entered into force. Trade has expanded much more rapidly: There was an increase of Australian exports from US dollar 1266.6 million to 2154.5 million (during the first eight months 2004 and 2005), an increase of 70.1 percent. In the same period, Thai exports rose by 28.5 percent, from US dollar 1773.4 million to 2278.1 million (IMF, *Directions of Trade Statistics*, January 2006). Without analysing TAFTA in greater detail, it is clear that bilateral trade liberalisation can contribute to an increase in trade volumes.

Prime Minister Howard's grand strategy has improved Australia's geopolitical position. By embracing the United States in a tighter alliance, Canberra has become a global power player ... It no longer has to 'beg' for a seat at the table in Asian economic forums, it has secured an FTA with the United States and will probably do so with the PRC ... In addition, it can rightly claim to exert considerable influence over the world's sole superpower (Blumenthal 2005: 6).

These claims are not convincing. First, the stronger alliance with the United States has not turned Australia into a superpower. The United States continues to forge alliances with many countries, some of them temporarily close, but the power and influence of America's partners is not enhanced by those alliances.

Second, Australia's participation in Asian economic forums happened *despite* the strong ties with America, not because of them. Both the East Asian Summit in Kuala Lumpur in December 2005 and the emerging monetary cooperation in the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) are forums that were specifically designed to exclude the United States. In EMEAP, a request of the Federal Reserve Bank to be included in the process was rejected by the Asian members (Dieter 2006: 39). Consequently, it seems far fetched to assume that the strengthened alliance with the United States improves Australia's position in the region at a time when Asia is trying to reduce its reliance on America.

One further clarification: all free trade agreements require rules and certificates of origin. Without a certificate of origin, no product qualifies for duty-free access in a bilateral free trade agreement. Although there is considerable debate on this issue, I will not deal with it at great length here, but rather explore the structural weaknesses of bilateral trade agreements in a paper forthcoming in the next issue of *JAPE*. Nevertheless, it is important to bear in mind that preferential trade agreements cause substantial administrative costs for producers in order to qualify for duty-free trade.

The Limited Utility Of The Australia-US Free Trade Agreement (AUSFTA)

The Australian-American Free Trade Agreement was agreed upon in February 2004 and formally signed in Washington on 18 May 2004. In 2003, Australia had been supporting the US invasion of Iraq, and Prime Minister John Howard wanted to benefit from the backing he had provided to George W. Bush's government. Australia got a free trade agreement, but surprisingly the deal is asymmetric in favour of America, not Australia. Rather than benefiting from the good political relationship between the two governments, Australia got a lopsided deal. The richer country, the USA, got superior access to the Australian market, whilst Canberra accepted some important restrictions.

The Debate on AUSFTA in Australia

In previous years, the United States had approached Australia twice before with the proposal to establish a free trade area (Weiss *et al.* 2004: 6). In 1997, today's Prime Minister John Howard had rejected an offer by the Clinton government, citing the unwillingness of the USA to open its markets for sugar, dairy products and state-of-the-art ferries as reasons (Capling 2004: 7f). The Howard government emphasised the importance of the multilateral regime for a small, relatively open economy such as Australia's. In a white paper on Australia's foreign policy, aptly named 'In the National Interest', the government of John Howard openly criticised preferential trade agreements in 1997.

Of particular concern is the potential fragmentation of the non-discriminatory trading system which could arise from discriminatory arrangements ... The government will also seek to make the multilateral system ... move faster to reduce the incentive for discriminatory regional solutions to market access (*Australian Government 1997: 42*).

The same government that saw the dangers arising from preferential trade arrangements in 1997 pushed such an agreement in 2004. In contrast to the previous approach, Australia is moving fast to create a

dense network of bilateral arrangements, *inter alia* with China, Japan, South Korea and the ASEAN countries.⁴ The explanation given by the Howard government in 2003 stresses the advantages of bilateralism.

The Government is determined to pursue pragmatically the advantages the free trade agreements offer to Australia. Such agreements can deliver important market access gains faster than a multilateral round ... The free trade agreements that the Government negotiates will be comprehensive, not leaving out areas that our partners might find difficult, such as agriculture (*Australian Government 2003: 58-59*).

Evidently, John Howard's government did not initiate the policy with regard to bilateral trade arrangements, but it did not oppose the about turn on bilateralism either.⁵ In contrast to most other bilateral trade agreements, there has been a substantial debate in the Australian public on the merits and disadvantages of the bilateral deal with the US. The Department of Foreign Affairs and Trade had commissioned the Centre for International Economics (CIE) to prepare a study on the effects of AUSFTA, which was published in 2004 (CIE 2004).

Some prominent Australian economists, namely Ross Garnaut, former advisor to the Hawke and Keating governments and an economist at the Australian National University, denounced that CIE study (CIE 2004) as "not passing the laugh test". In an interview with the ABC, Garnaut suggested that any econometric modelling should be presented to a person that knows the real world described by the modelling exercise. If that person does not laugh, the test is passed.⁶ Others, such as Melbourne

4 These countries have also changed their trade policies after the Asian crisis (Lee and Park 2005: 23).

5 However, Australia followed the trend quickly. In May 2000, Prime Minister John Howard suggested a free trade agreement between South Korea and Australia during a visit to Seoul (Harvie 2004: 13). At that time, not many other bilateral agreements were negotiated.

6 ABC online, 4 May 2004 (<http://www.abc.net.au/am/content/2004/s1100916.html>). The CIE study was commissioned by the Department of Foreign Affairs and Trade. The assumption was that all sectors, including agriculture, would be included in the trade deal. Since the final agreement has not provided that outcome, the results – suggesting an increase of Australia's GDP by 0.7 percent – are questionable. The assumed big increase of automobile exports to the

economist Peter Lloyd, were less critical. He argued that Australia should push both bilateral and multilateral regulation of trade.

A small trading country such as Australia can proceed on both fronts since what happens at the multilateral front is very largely out of our control and influence. The main reason for pursuing bilateral agreements is the possibility of our being excluded from major potential markets in the sense that we have conditions of access worse than those of major competitors who have concluded bilateral/regional agreements. In my view, the fear of exclusion is the major reason why bilateral/regional trade agreements have proliferated since the early 1990s (Lloyd 2003: 5).

Lloyd rehearses arguments that sound plausible, but after scrutiny they are not, in particular for a country with Australia's export profile. First, although Australia probably cannot determine the outcome of multilateral trade negotiations, it nevertheless has had an influence. The Cairns Group, discussed in greater detail later, was driven by Australian initiative and had a major influence on the outcome of the Uruguay Round. Second, by going bilateral Australia enables the United States to give the multilateral negotiations reduced relevance. As mentioned in the introduction, AUSFTA has been the greatest recent success of American trade policy: Australia is a significant OECD economy. AUSFTA has set a precedent for other countries. Therefore, it appears that Australia has both neglected its role in the Doha Round and provided an opportunity for the USA to defect from multilateralism. Third, the exclusion scenario does have some significance for countries that primarily export products that compete with domestic production, e.g. manufactured products. However, Australia continues to export a substantial proportion of commodities. In 2004, major merchandise exports to the Americas were beef and veal, alcoholic beverages, crude oil, coal and passenger vehicles. Major exported services were transportation services and travel

US is also uncertain. First, why should US companies export to their home market from Australia? Second, which products would be marketable in the United States? Perhaps some Australian utilities could be exported, but they would cannibalise the sales of US-made General Motors and Ford light trucks – not entirely likely.

services.⁷ Commodities, however, have to be divided into two categories: agricultural products and raw materials. Whereas the latter typically attract very limited trade barriers, agricultural products often do. Australia is excluded from many markets with regard to agricultural products, but not with regard to raw materials. Why should any country stop importing, say, iron ore from Australia? The exclusion scenario is not convincing for an economy like the Australian.⁸

The negotiating team itself was surprised by the deal the American government was suggesting.

Australia's trade negotiators knew how difficult a negotiation with the United States would be, but even they were shocked at the lousy deal Washington offered Australia. Yet their recommendation that the deal not to be signed was overridden by the prime minister, who clearly was of the view that a bad deal was better than no deal at all (*Capling 2004: 73*).

Against this background, several questions have to be asked. First, is the agreement as bad as its critics suggest? Second, what might have been the motives of the Howard government to agree to this deal? Third, is this new strategy providing Australia with the appropriate trade regime for the 21st century? In particular, are bilateral deals enabling Australian companies to intensify their integration into the Asian markets?

Some Australian observers, namely Linda Weiss *et al.*, have argued that the agreement is "killing the country" (Weiss *et al.* 2004). These authors

7 Department of Foreign Affairs and Trade: Australia's Trade with the Americas 2004: 2. The USA represented by far the largest market in the Americas with a share of 77 percent.

8 This assessment is even more plausible when trade with major Asian economies, e.g. South Korea, is taken into consideration. In 2003, the top five Australian exports to South Korea were coal, crude oil, non-monetary gold, iron ore and aluminium. The share of commodities in exports to South Korea, including other commodities such as wool, wood, zinc ore, steel, wheat, sugar and beef, was 75 percent in 2003 (Harvie 2004: 4). Closing the South Korean market for imports from Australia would deprive South Korean industry of essential raw materials. Also, an FTA would not reduce the price of Australian commodities in South Korea very much: On mineral products, the average tariff has been as low as 3.6 percent in 1998 (Harvie 2004: 15). Agricultural products, however, are a different story.

argue that the agreement does not contribute to free trade, puts Australia at a disadvantage and even endangers a cornerstone of Australia's health system, the Pharmaceutical Benefit Scheme (PBS). Others, like Ann Capling, have been very critical of the contract without using a language as drastic as that of Weiss *et al.* But are there substantial shortcomings?

It is interesting to consider the developments in the last days before the deal was struck. Australian politicians had publicly raised the expectation that agricultural products, including sugar, would be freely tradable under the FTA. As it became clear that the US government was unwilling to grant market access in that segment, the Australian trade negotiators wanted to walk away from the negotiating table. On 7 February 2004, Mark Vaile, the Australian Minister for Trade, called Prime Minister Howard and suggested not to sign the deal. Howard single-handedly overruled that, and the following day Mark Vaile and Robert Zoellick, the US Trade Representative, agreed to sign the Australia-United States Free Trade Agreement (Capling 2004: 56; and personal communication in Canberra).

The proximity of the negotiations to the election partly explains why the deal was struck. The agreement did not receive much support from the Labor Party, which is not surprising when considering the weaknesses of the deal. Howard used any move by the Labor Party against the agreement as evidence of Labor's Anti-Americanism as well as Labor's inability to consider Australia's future economic prosperity. Furthermore, Howard argued that Labor would be an unreliable partner of the US (Capling 2004: 74). Whether or not the FTA played an important role in the 2004 elections is difficult to say, but it evidently did not cause a shift of the voters away from John Howard's government.

An interesting effect of AUSFTA is the inclusion of labour rights, which has set a precedent for other FTAs with Australian participation. When the intention to negotiate a free agreement was made public in 2001, the heads of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and of the Australian Council of Trade Unions (ACTU) issued a joint statement in which they emphasised the need to observe minimum rights of workers as identified by the International Labour Organisation (ILO) (Nyland and O'Rourke 2005: 462).

When the American Congress provided George Bush's government with the so-called fast-track authority in 2002, one condition was that labour standards had to be included in any free trade agreement in which the USA participates.⁹ For the Howard government, this turned out to be a serious problem, because Howard aimed at both strengthening the alliance with the United States and weakening the trade union movement at home. During the negotiations it became clear that there would be no agreement with the United States unless a chapter on labour rights would be included that strengthens the position of workers. Faced with that choice, the Howard government agreed to sign Australia's first ever trade agreement that included a chapter on workers rights (Nyland and O'Rourke 2005: 468).¹⁰ With this precedent established, it will be difficult to fall back to a position that ignores labour rights. For Australian trade unions, the negotiations on free trade agreements with Asian countries, China in particular, will provide an opportunity to stress this point. A government that signed a free trade agreement with the United States that acknowledges labor rights will have to explain why such provisions have less relevance in a potential agreement with China or other countries.

Asymmetry In The Details

Australia and the United States have agreed to eliminate most tariffs from day one of the commencement of the agreement. Tariffs on textiles and clothing, some footwear as well as some other items will be phased out by 2015. Australia's tariffs have been reduced to a level of five percent in general, with peaks of 15 percent for textiles, 25 percent for clothing and 15 percent for passenger cars and 5 percent for four-wheel-drive vehicles (Dee 2005: 4). US tariffs vary much more: many tariffs are zero or very low, but tariff peaks result in substantial protectionism. On

9 In essence, trade promotion authority means that Congress waives the right to change the details of any trade agreement the government has negotiated. However, it retains the right to reject the entire treaty.

10 Chapter 18 of AUSFTA deals with labour issues. In article 18.7, the agreed principles and rights are laid down. They include the prohibition of child labour and the right to organize and bargain collectively (AUSFTA, article 18.7 (1)).

some textile clothing and footwear items, tariffs are as high as 37.5 percent (Dee 2005: 4). The protection for cars is either very low or very high: vehicles primarily designed for the transportation of people attract a negligible tariff of 2.5 percent, whereas vehicles primarily designed for the transportation of goods attract a steep tariff of 25 percent (Dieter 2005b: 176).¹¹

The benefits of tariff cuts in preferential agreements are difficult to evaluate, in particular when compared with unilateral liberalisation (Dee 2005: 16f). Take, for example, a radio that is both manufactured in Japan and in the United States, costing 100 dollars for the Japanese one and – due to higher production costs – 110 dollars for the American radio. Before the preferential agreement, the radio would be sourced from Japan and the price would be 115 dollars (production costs plus 15 percent tariff). With AUSFTA, the radio would be sourced from the United States at a cost of 110 dollars. If tariffs were scrapped unilaterally, the radio would be sourced from Japan at a cost of 100 dollars. Unilateral liberalisation would provide a cheaper radio to Australian consumers. Preferential liberalisation delivers a slightly cheaper radio than under the old regime (110 dollars), but Australia loses 15 dollars in tariff revenue. On balance, preferential liberalisation is – in this example – inferior to both unilateral liberalisation and the former tariff based trade policy. Of course, this example does not consider the advantages that Australian producers may benefit from, but it shows that preferential liberalisation can have uninvited side-effects.

The disadvantages for Australia are most visible in agriculture. Sugar, which can be produced competitively in Australia's tropical regions, is excluded from imports into the United States, apart from a quota of 87,402 tons per year which existed before the AUSFTA. For beef and dairy products there are surprisingly long transitional periods of up to 18 years before Australian producers will have unrestricted access to the American market.

11 Tariff position 8703 is applied for cars, and 8704 for light trucks. See the US customs database at <http://dataweb.usitc.gov/scripts/tariff2002.asp>. The high tariff for light trucks has its origin in a curious trade dispute between Germany and the United States in the early 1960s. For details see Talbot 1978 and Dieter 2005: 174-181.

Australian trade negotiators apparently were unable to open up the US market for sugar. The Australian Government, which had campaigned for the free trade agreement, citing agriculture as a potential benefit for Australia, subsequently had to provide compensation to the domestic sugar producers that will receive 444 million Australian dollars,

Table 2: Some Asymmetries In The Australian-American Free Trade Agreement

Consequences for Australian Producers	Consequences for American Producers
<p>Agriculture: Tariffs, quotas and seasonal restrictions remain; tariffs continue to exist for wool (10 years), wine (11 years), dairy products, beef, cotton and cut flowers (18 years, conditions for application required)</p> <p>Sugar continues to be excluded from free trade indefinitely</p>	<p>Agriculture: No restrictions for imports from the USA from the day the treaty becomes effective; no seasonal restrictions; sugar imports unrestricted</p>
<p>Manufacturing: In general, no restrictions on exports to the USA, but the same rules of origin apply, which are more difficult to comply with for Australian manufacturers</p> <p>Restrictions on the use of Australian-made ferries in the US continue: the Jones Act of 1920 requires the use of American-made ferries for national shipping (passengers and freight)</p> <p>Cancellation of all "Buy Australian" campaigns</p> <p>Exceptions for small companies (less than 200 employees)</p>	<p>Rules of origin are more easily comply with due to the larger supplier base</p> <p>Public procurement may contain minimum US-content requirement</p> <p>Exceptions for small companies (less than 1500 employees)</p>
<p>Consular Affairs: Australian citizens have no right to be granted a US visa if that is necessary for foreign direct investment</p>	<p>Consular Affairs: American citizens have the automatic right to be granted an Australian visa if that is necessary for foreign direct investment</p>

Source: Weiss et al. 2004: 7-13.

comprising a rather hefty sum of 70,000 Australian dollars for each of the 6,500 sugar farmers in Australia (Capling 2004: 67; Weiss *et al.* 2004: 147).

The acceptance of the deal on sugar is particularly disturbing when previous proposals are considered. In 2003, the European Union and the United States made a joint proposal for the reform of agricultural subsidies which would have improved market access and would have reduced production subsidies. During the Ministerial Meeting in Cancún, Australia rejected this proposal, only to accept a worse deal in AUSFTA (Dee 2005: 13).

Equally problematic is the deal on beef. The US can stop Australian imports if American farmers are threatened by this competition. For more than 30 years, Australia fought a similar approach of the European Union, only to accept it now in the case of the United States (Capling 2004: 82). Both the exclusion of sugar and the arbitrary regulation of beef imports are violations of the principles that Australian governments had been publicly supporting for decades.

Garnaut and Vines have emphasised that the avoidance of liberalisation in agriculture that would result in trade creation is a characteristic of the current wave of preferential agreements:

An example ... is the complete exclusion of sugar and the gradualism to the point of imperceptibility in other major agricultural exports in the US-Australia FTA (Garnaut and Vines 2006: 9).

Both Australia and the United States have retained major reservations in financial services, education, but also maritime and air services. The regulations on maritime services are harmful for Australian producers. The United States continues to apply the Jones Act of 1920. This act requires that all vessels used for shipping between to US ports have to be built in the United States. Australia, which has developed a competitive industry for fast ferries, does not benefit from free trade in this sector. The irony is that Australian-made fast ferries may be imported duty-free

into the US, but they may not be used, neither for the transportation of goods nor of people.¹²

The Tasmanian company INCAT has been supplying a ferry for travel between Canada and the United States – which is international traffic and consequently not covered by the Jones Act. The fact that there has not been more of a campaign by INCAT can partly be explained by the fact that it has been supplying catamaran ferries to the US Navy, which uses them *inter alia* as troop carriers in the Iraq war.¹³

The rules of origin in the AUSFTA are as complex as those in many other FTAs. They can contribute to the circumscribing of market opening. The rules are tailor-made, tariff line item by tariff line item, and in general require significant transformation of a product (Dee 2005: 9). For the first time, Australia has accepted rules of origin that are complex and can be used as protectionist devices. Hitherto, Australia's FTAs used relative simple rules of origin based on regional value added (Dee 2005: 13).

In principle, a combination of methods is used. A change of tariff classification is needed for textiles and apparel or a list of products that are specified in Annex 5-A of the agreement (AUSFTA, article 5.1.(i)). For products that require a minimum local content, the thresholds are 35 percent (build-up method), 45 percent (built-down approach) and for some footwear the minimum percentage is 55 percent (Dee 2005: 10). For cars the threshold is 50 percent, the only permitted method being the so-called net cost method.¹⁴ Particularly problematic – both from an economic as well as from an ethical perspective – are the regulations on textiles and clothing, where all yarn must either come from Australia or the United States - the yarn-forward rule (Dee 2005: 10). Yarn produced in Asia cannot be used if the finished product shall be imported duty-free

12 During the weeks following hurricane Katrina, President Bush suspended the Jones ACT to permit the use of Mexican and Canadian fuel tankers for coastal shipping in the USA.

13 See the company's website at <http://www.incat.com>. For a description of the military use of these ships see http://www.incat.com.au/news/interest.cgi?caller=archive&news_task=DETAIL&articleID=63484§ionID=202.

14 For details see the agreement and explanations at http://www.dfat.gov.au/trade/negotiations/us_fta/guide/5.htm.

into the United States, or Australia. But the more disturbing rule is the one on cotton and man-made fibres: there, the requirement is fibre-forward. This means that cotton from African producers cannot be used or duties have to be paid. The issue of American (and to a lesser degree European) cotton subsidies had been a major issue in the failed Ministerial Meeting of the WTO in Cancún in 2003.¹⁵ Using rules of origin to exclude African producers from both the Australian and the American market is a less visible, but equally efficient method. It undermines decades of efforts of African producers to participate in a global division of labour. These are unfair practices in international trade that disadvantage the poorest.¹⁶

The only cumulation of origin that is permitted is the diagonal variety, i.e. inputs must be sourced from either Australia or the US to qualify for duty free treatment. For textiles, there are separate regulations. The complexity of the rules of origin in AUSFTA does not differ from NAFTA or other agreements with US participation. Rather than facilitating trade, these measures are making trade more complicated. Even if there is some reduction of costs due to lower tariffs, this cost-saving is probably more than compensated for by an increase in administrative expenses.

These rules of origin are discriminating against Australia. Its inefficient car industry of the past has been successfully modernised and transformed into an exporting industry.¹⁷ A major factor in this success has been the sourcing of components from Asian suppliers. Under AUSFTA, sourcing from Asia becomes significantly more difficult (Garnaut and Vines 2006: 11). The minimum value added requirement for cars is 50 percent, and if complex components are not sourced from either Australia or the USA, this threshold value is difficult to comply with. Of course, this is much less of a problem for producers in America

15 In 2002, the subsidies added up to 4,000 million dollars in the United States and 700 million in the EU. *Frankfurter Allgemeine Zeitung*, 10 September 2003, p. 3.

16 For details see Dieter 2005: 192ff.

17 In 1983, the Minister for Industry, John Button, had introduced an industry policy which aimed at increasing exports and used programmes such as the "Export Facilitation Scheme" (Dieter 1994: 149ff). Today, six-cylinder engines made by Holden in Melbourne are used in Alfa Romeos, Saabs and Opels.

since the number of competitive suppliers is much larger there.¹⁸ Furthermore, two of the four car producers in Australia, GM-Holden and Ford, have their largest production facilities in the USA and their willingness to cannibalise their American-made model range with cars made in Australia can be called into question.

For years, American governments have complained about the Australian regulations on quarantine. The authorities in Australia have been very restrictive with the importation of fruit, vegetables and meat because of the fear of an import of diseases. For instance, foot and mouth disease does not yet exist in Australia. Agricultural authorities are trying to prevent the importation of the disease, which can affect most animals that are commercially held in Australia.¹⁹ The USA had – without success – tried to weaken the Australian regime by having it evaluated by the WTO, which declared it in conformity with WTO regulations (Weiss *et al.* 2004: 34). With the introduction of the bilateral AUSFTA, new institutions have been created. Sanitary and phytosanitary measures will be negotiated in either the “Australia-US Committee on Sanitary and Phytosanitary Matters” or the “Australia-US Standing Technical Working Group on Animal and Plant Health Measures”. All bilateral conflicts are supposed to be dealt with in these two groups. The conventional procedures will be that the Committee will ask the Working Group to provide a consensual solution to the conflict within 60 days. From the Australian perspective, there has not been any reason to introduce these two forums that exist parallel to the WTO procedures (Weiss *et al.* 2004: 55f).

Elements of the bilateral agreement that received a lot of attention in the Australian debate have been the regulations on the Pharmaceutical Benefit Scheme (PBS). For many Australians, this is a model health care institution that provides low-cost access to most important medicines. For American pharmaceutical companies, the PBS is a trade barrier. The scheme was founded in 1953 and subsidises medication that has been

18 Of course, Australian producers could draw inputs from American producers, too. At least for bulkier products, transportation costs would matter, though.

19 These are mainly pigs, cattle and sheep. For further information on import restrictions see the website of the NSW Department of Primary Industries at <http://www.agric.nsw.gov.au/reader/6543>.

listed in a catalogue, which in turn had been agreed upon by a group of medical advisors, the Pharmaceutical Benefits Advisory Committee (PBAC). In 2004, some 2,500 medications were available under PBS, and the Australian Federal Government has provided subsidies to PBS in the order of 6.2 billion Australian dollars. PBS could be described as a wholesaler that negotiates directly with pharmaceutical companies. It also selects the drugs that receive a government subsidy. Other medication, i.e. which is not on the list, can be sold in Australia, but without the subsidy component (Weiss *et al.* 2004: 60).

The PBS is now directly attackable by American Pharmaceutical companies that do not agree with the decisions of the advisory committee. If PBAC decides that a certain medicine will not be subsidized under PBS, under AUSFTA a review mechanism has been established. This review is conducted by medicines experts who are external to the PBAC. This review process potentially enables pharmaceutical companies to overturn the PBAC decisions. This could result in the listing of more highly priced medicines, even if they are not more medically effective. This new avenue for dispute settlement reduces the independence of the health policy of the Australian government.

It has become apparent that what is most important for the US in this deal is not really "more and freer trade" but, instead, the inflicting on Australia – and through this example eventually on others – of an economically indefensible extension of the protection of US monopoly power over intellectual property, particularly in the drugs, film and publishing industries. There is already significant upward pressure on the price of drugs in Australia, as a result of the agreement (Garnaut and Vines 2006: 10).

Intellectual property rights are covered in Chapter 17 of the AUSFTA. The provisions of the agreement are rather complex and cover 29 pages. Kim Weatherall has described them as "breathtakingly long, detailed, and opaque" (Weatherall 2004: 19). The reason for this convoluted deal is not that intellectual property was previously badly protected in Australia. Rather, the USA had been unsuccessful with attempts to raise intellectual property rights through the WTO. Faced with opposition

there, as well as in other multilateral forums dealing with intellectual property, like UNESCO, the US has gone bilateral.²⁰ It has moved to impose its preferred standards through a template approach – the chapter on intellectual property is negotiated according to a template used in previous agreements, with the same provisions in all of them (Weatherall 2004: 19).

The downside of the new regulation is that the regime has become more complicated. Further, adopting US standards implies adopting an important element of US economic policy, which may not suit the interests of Australia. The tightening of intellectual property rights in Australia, which is a net importer of intellectual property, is resulting in additional cost to Australian consumers and producers alike (Weatherall 2004: 20).²¹ America, by contrast, benefits. There will not be significant additional costs to American consumers, but American innovators selling their products abroad will reap the reward.

The copyright term has also been extended, to the life of the author plus 70 years. This innovation, pushed by the EU in 1998 and subsequently adopted by the US, is applicable to new and old literature. It does not create new incentives, because, as Kim Weatherall observes, ‘dead men do not write poetry’ (Weatherall 2004: 22). Again, as Australia is also a net importer in literature, this is an additional cost to Australia.

As mentioned in the introduction, one of the most disturbing aspects of bilateral trade agreements is that they contribute to a weakening of the dispute settlement mechanism of the WTO. This applies to AUSFTA as well. Article 21.4 stipulates the following.

- Where a dispute regarding any matter arises under this Agreement and under another trade agreement to which both Parties are party, including the WTO Agreement, the complaining Party may select the forum in which to settle the dispute.

20 See, for instance, the speech of the US ambassador to UNESCO, Louise V. Oliver, on 17 October, 2005, on the convention of UNESCO on Cultural Diversity, in the web at http://www.amb-usa.fr/USUNESCO/texts/GenConf33_Amb_Intervention_CD_Amendments.pdf.

21 In 2002-2003, Australia has spent 1.82 million Australian dollars on royalties, but has only received \$ 618 million from abroad (Weatherall 2004: 20).

- Once the complaining Party has requested a panel under an agreement referred to in paragraph 1, the forum selected shall be used to the exclusion of the others (AUSFTA, article 21.4).

The consequences are far-reaching. There is a possibility to use the bilateral dispute settlement even for cases that affect the participation of the two countries in the multilateral regime. Although the weaker country has a choice of forum, in practice there will be considerable pressure by the more powerful country to use the bilateral mechanism. If this were not the case, it is hard to understand why the choice of dispute settlement has been suggested in the first place. Weaker countries do not have a motive to provide a choice between bilateral and multilateral, for it is those countries that benefit most from a rules-based multilateral dispute settlement mechanism.

One of the most damaging aspects of the AUSFTA is that it has dramatically reduced Australia's credibility in multilateral negotiations. From the beginning of the 20th century up to 1983, Australia was one of the most protectionist countries in the West, but change had become inevitable. At the time, there were comments that Australia had shown the "death-bed repentance of a tariff junkie" (Dieter 1990).²² However, since 1983 Australian governments, notably those led by Bob Hawke from 1983 to 1991, showed a commitment to bring tariffs down substantially. Simultaneously, Australia increased its efforts to promote free trade in agriculture.

In 1986, Australia and 13 other competitive producers of agricultural products, e.g. Brazil and Canada, founded the Cairns Group. Ever since, this group has been able to increase awareness for the negative consequences of protectionism in agriculture (Capling 2004: 23). Moreover, the Cairns Group has been described as a model of group activity that smaller states can utilize to foster change in specific areas of the global economic order (Higgott and Cooper 1990: 592). But the Australian-American preferential trade agreement has resulted in severe damage to Australia's integrity. After all, if American protectionism with

22 For instance, the tariff on motor cars was as high as 57.5 percent.

regard to sugar is acceptable to Australia, what is wrong with Japanese protectionism in rice or European protectionism in cheese?

The Limited Attraction Of Bilateral Trade Agreements

In this article, I have worked with two assumptions. First, I have implicitly assumed that trade liberalisation is beneficial for an economy. This assumption, however, is somewhat unrealistic. One cannot ignore the negative effects that free trade can have for a society and its citizens. As the American economist Paul Samuelson has emphasised in 2004, the validity of David Ricardo's theory of comparative advantage can be called into question. Samuelson argues that productivity gains in less developed countries could lead to a situation where developed countries are losing their comparative advantage via the change in terms of trade. The result is that free trade can negatively affect a range of groups within an industrialised country, not primarily unskilled labour (Samuelson 2004).²³

Samuelson's argument is not entirely new. He made the same argument way back in 1947 and in 1972 (Samuelson 2004: 136). The interesting point is that in 2004 this argument attracted widespread attention. One of the reasons for that attention is that mainstream economists have stubbornly denied negative effects of free trade, but these outcomes have become more obvious. As Samuelson points out:

Policy aside and ethical judgements aside, mainstream trade economists have insufficiently noticed the drastic change in mean U.S. incomes and in inequalities among different U.S. classes. As in any other society, perhaps a third of Americans are not highly educated and not energetic enough to qualify for skilled professional jobs. If mass migration into the United States of similar workers to them had been permitted to actually take place, mainstream economists could not avoid predicting a substantial drop in wages of this native group while the new immigrants

23 For a detailed discussion of the benefits and disadvantages of trade openness see Dowrick and Golley 2004 and Lutz 2001.

were earning a substantial rise over what their old-country real wages had been (Samuelson 2004: 144).

Samuelson has been rehearsing his argument on factor price quasi-equalisation through free trade that he had made in 1947. Free, unrestricted trade will lead to equal factor costs between the free trading countries. The effects of free trade on labour markets will be the same as if free migration were permitted. Consequently, for unskilled labour, free trade is bad news, because there is a vast pool of unskilled labour in countries like China; and this competition will – other factors unchanged – lead to lower wages in high-wage countries. What Samuelson has been pointing out in 2004 is that in the 21st century, this effect reaches skilled labour. Since the pool of skilled workers, say software-engineers, is growing rapidly outside of OECD-countries, this puts pressure on high-wages labour markets. The beneficial effects of free trade will often reduce these negative effects, but not always and – particularly important – only over time.

Second, I have also assumed that the multilateral regime is superior to the bilateral regulation of trade. This implies a preference for trade policy formulation through the World Trade Organization (WTO). The WTO provides central functions, not supplied by any other international organization, for the regulation of international trade of goods and services. It is an important cornerstone of what is known as “global governance.” The WTO operates by consensus. Each country has a seat and can theoretically veto any proposal. In no other relevant organization do developing and emerging countries have such wide-reaching power of creation and obstruction. All 149 members of the WTO have a veto. This clearly makes the negotiation process more difficult, but at the same time, it gives the organization’s decisions a high level of legitimacy. The extremely important dispute resolution mechanism is a significant step forward in comparison to the regulations of the GATT (out of which the WTO was born in 1995): whereas in the GATT the introduction of a claim could be blocked by the affected party, this cannot be done in the WTO. In increasing numbers, developing and emerging countries, led by Brazil, have made sure, through complaints in Geneva, that the international trade rules, which were agreed to by all of the WTO members, are in fact enforced.

Of course, the WTO can be criticized for a range of negative developments. However, we have to differentiate between (unwarranted) consequences of free trade and the regulation of trade in the WTO. Even when considering all the shortcomings of the multilateral regime, it should not be overlooked that international trade of goods and services should preferably be regulated by a global regime that is the same for all regions of the world. Too many levels of regulation – national, bilateral, regional, global – make it more difficult for less efficient actors, in particular, to participate in possible welfare gains achieved through the international division of labour.²⁴

Conclusion

It has been demonstrated that the Australian government has made a remarkable policy shift between 1997 and 2003. However, the government's earlier approach continues to be more convincing. Australia, as an exporter of raw materials and agricultural products, cannot benefit very much from free trade in manufactured products unless dynamic effects would lead to an increase in competitiveness of Australian manufacturers. The country would benefit from free trade in agriculture, but the agreement with the USA has set an unfavourable precedent for other FTAs.

Australia's policy shift is rather unfortunate, because it depends on the rule of law in international relations. Australia is a country that is not closely affiliated to any large bloc. Consequently, the country vitally depends on a functioning multilateral trading regime. Of course, if one concludes that the multilateral regime is already collapsing, then bilateral trade agreements would offer a second best solution. Australia is certainly not the main culprit for a collapse, but the country's trade policy shift has contributed to a disturbing trend. Further, the limited resources that the Australian government – and most others – can provide for trade negotiations have an effect on the country's ability to push

24 For a more detailed discussion of this issue see Dieter 2005a and Dieter 2005b: 171-222.

multilateral negotiations. It is an illusion to assume that both approaches can be pursued with equal vigour.

The AUSFTA does not enable Australia to enjoy the best of both worlds. Both the analysis of the details of the agreement and the development of bilateral trade in the first eight months of its implementation have shown meagre advantages, but substantial disadvantages. The country's credibility in trade negotiations is weakened, its sovereignty reduced, and the potential for Australian companies to integrate themselves in international production networks weakened. Whether the AUSFTA has contributed to a strengthening of Australian-American security ties has not been the topic of this paper. But, in any case, this perceived support for the military alliance has resulted in disadvantages for Australian companies and workers.

The bilateral agreement shows very few benefits for Australian commercial interests, but it has damaged the reputation of the country in international groupings. The Cairns Group is now relatively weak, and major players within that organisation, Brazil in particular, are today using other forums to promote their cases, e.g. the G-21 founded during the failed WTO ministerial round in Cancún. Bilateral trade agreements in general and the deal with the United States in particular are not in Australia's national (economic) interest. This conclusion is also drawn by Philippa Dee:

It is often claimed that preferential trade agreements can achieve faster progress than multilateral negotiation in difficult areas. This appears not to be the case with AUSFTA. On a strict cost-benefit calculation, the agreement is of marginal benefit to Australia, and possibly of negative benefit given some of the pernicious but unquantifiable elements of the intellectual property chapter (Dee 2005: 38).

Australia has joined the movement towards bilateral trade agreements. This trend, particularly visible in the Asia-Pacific, is difficult to comprehend. These preferential agreements are often not liberalising trade comprehensively, cause great administrative burden to producers and undermine the multilateral regime.

By and large, it is quite unlikely that Australian companies will benefit from bilateral trade agreements with other countries in the region, namely with China and Japan. For decades, despite substantial liberalisation efforts, the weakness of Australian manufacturing has not been reduced. It is hard to envisage the emergence of Australia as a manufacturing centre for Asian and world markets due to, say, a free trade agreement with China. FTAs tend to liberalise trade in manufactures but today, manufactured products constitute only 25 percent of Australian exports. Raw materials, the largest component of Australian exports, have usually not been affected by import tariffs, and are therefore largely unaffected by free trade agreements.

The situation might be somewhat different in services, a sector in which Australian financial companies are competitive and can probably benefit significantly from free trade. This would be particularly the case if Australia and ASEAN would agree on comprehensive free trade in both goods and services. However, some ASEAN countries, e.g. Thailand, are unwilling to open their financial sectors to foreign competition after the devastating experiences of the Asian crisis.

Proponents of bilateralism often assert that simply relying on the WTO is like doing nothing. This is not the case. Multilateralism continues to function and to represent a superior form of regulation compared to bilateral regulation like in AUSFTA. In trade policy, pushing preferential agreements is a second-best solution, if that.

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