

Trade and Domestic Reforms: The Australian Experience

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Placing the interests of the consumer at the centre of policy thinking is a transformational notion. It goes to the heart of how our economic policies should be framed. And it is an important step in ensuring that resources are allocated in a way which is not only efficient but also meets crucial social policy objectives. Carrying the banner of consumer interests is rarely easy because it can cut across many vested interests. Today I'd like to speak about the links between trade and domestic reform.

Principally, I'd like to talk about the Australian experience of the past several decades, during which we've made much progress in opening our economy to the world. We've worked hard to build our competitiveness, and our prosperity. It is of course a never ending process: always a distant horizon. Economic reform, improved competitiveness, stronger innovation, better productivity – these are all crucial to the prosperity of our nation, as they are to the future of India.

The character of a trading nation

I'd like to start with Gurcharan Das and Donald Horne - an Indian businessman, and an Australian historian.

Das writes in an insightful, highly personal way, of the story of his country. For him, the modern history of India, since Independence, can be broken into three distinct phases: the hope of the post-Independence years, what he calls the lost generation of the late 1960s to the start of the 1990s, and the renewed optimism of the post-1991 economic reform period.

Das wrote this of India's lost generation:

India's leaders [blamed] foreign trade and foreign capital ... for our poverty, and closed our economy and pursued a policy of self-sufficiency. In the process, they wasted an opportunity. They forgot that India had a centuries-old tradition of trading before the British came, and that it had once enjoyed enormous prosperity through exports and imports. For these and other reasons, we became pessimistic about our ability to compete in the world economy and regain our historic pre-eminence as a great trading nation. We closed our doors. And our share of world trade declined from 2.4 per cent in 1947 to 0.4 per cent in 1990. We learned the wrong lessons from history.¹

Donald Horne, too, was critical of what he also thought of as a lost generation in Australia's history: then and now a controversial assessment.

Horne, writing in the 1960s, was a celebrated Australian journalist, social commentator and historian, most famous for coining the label "The Lucky Country" to describe the Australia of the 1960s.

It's a catching description. Horne meant it ironically but a generation of Australians has taken it literally.

Australia is at many levels a lucky country.

We are blessed with natural resources. We have a beautiful climate, a wonderfully clean environment. We have a stable, democratic system of government. We're miles from the conflicts of the world. We are prosperous - well-off, by the standards of almost any country.

But Horne saw the Australia of the 1960s as poorly run. He thought we were trading on our luck - our unearned natural resources, but also the luck of our historical origins: "British habits" which Horne claimed we had never earned.

Two countries and in different ways, arguably two lost generations.

And it is the place of trade and industry policy in each of our histories that I think is interesting to analyse – not usually seen as fundamental or defining – but perhaps incorrectly so.

I think for most people, trade, or international trade, at least, is something that happens somewhere else. It is not something that has a lot to do with their own life experience, unless they happen to work themselves as exporters or importers. That is changing with the ability to buy and sell goods and services on the internet; but still, I think, as consumers, we tend to think of that as shopping, rather than trading.

And I suspect industry policy is an even more opaque idea. Industry is probably seen, domestically, principally as a generator of jobs, maybe also as a source of government revenue, but not much more. Its capacity to shape the sort of economy a nation has - and therefore its capacity to shape the sort of people we are and the lives we lead - is probably not considered too often.

The reality is that you can change a country when you change its industry and trade policy. And Australia's trade and industry policy changed twice - by which I mean, changed 180 degrees twice - during the course of the 20th Century.

Australia as a trading nation

We started off, as a newly-forged nation in 1901, a relatively open, high-trading economy. The world was then, in the period before the First World War, in what we now understand as the first phase of globalisation - a colonial era during which global trade rose to historic volumes, shaped along the contours of empire.

Unsurprisingly, for a relatively small economy at one end of the world, Australia was a particularly high-trading country. We had the challenge of small domestic markets spread across a vast, largely unpopulated country.

Unlike places like the United States, we were not in 1901 defined so much by a distinctive national character, or by choices we had made during war or revolution, but by the products we exported: wool, wheat, gold, and so on.

As three former Department of Foreign Affairs and Trade (DFAT) colleagues of mine set out in a recent book launched by the Minister for Trade and Investment, Andrew Robb, for the first few decades after Federation in 1901, we were enthusiastic traders.

Minerals accounted for close to a quarter of our exports at Federation. We had high levels of foreign investment. In the early 1930s, the level of foreign investment in Australia was 160 per cent of GDP. We were successful - we had among the highest per capita GDP in the world, and the Australian standard of living stood out.²

Retreat to protectionism

But then we changed tack on industry and trade policy.

From the 1920s to the 1960s, Australia became a highly-protected economy. One which sheltered our manufacturing industries, hiding our domestic sectors from international competition.

Across perhaps the most challenging period in world economics and history in a century - the middle of the 20th Century, with Depression, War and recovery - the overall objective of our trade and industry policy was job-creation and security, particularly in the manufacturing sector. We argued that without protection, Australia's small domestic market, high wages and infant industries, Australian manufacturing would not be viable.

As Trade Minister McEwan put it in 1965: "Australian industrialisation has not yet reached the stage where our industries can compete on a free-trade basis."

In 1921, at the start of the period of protectionism, we created the Tariff Board - a body designed to consider the claims of industries wanting protection from the global marketplace.

In "The Lucky Country", Horne wrote this about protectionism and the Tariff Board in withering terms:

*"[The Tariff Board] was originally intended to protect young and inexperienced businesses but now everyone hops in for his cut. Once protection is dished out it usually stays. In the absence of any government plan for sustaining unemployed men over a retraining period or in assisting diversification, the political risks in allowing an inefficient industry to collapse are too great."*³

For several decades, Australia was trapped in this feedback loop of protectionism.

While it's true that protection might allow infant industries to begin, a protected industry also generates its own lobby groups and mutual protection societies, creating a perverse incentive against innovation, improved productivity and the growth of new sectors.

That political reality came to define Australian society.

As the 20th Century wore on, manufacturing rose, but Australia turned inwards, away from trade and global markets.

In our period of protection, minerals exports collapsed. That was, of course, partly to do with the First World War and Depression, but our high rates of tariff protection was the other major factor. Investment collapsed - by 1960, foreign investment in Australia was down to about 23 per cent of GDP.

Gary Banks, the former head of Australia's Productivity Commission has written that for many years, the economic costs of our period of protectionism were hidden by the success of our agricultural and mining industries.

"Until the early 1970s, Australia was still managing to 'ride on the sheep's back'," he wrote in 2005. The terms of trade favoured our primary commodities, and we had benefited from the world-wide expansion in demand following the War. Australians enjoyed close to full employment, with incomes still higher, on average, than those in most other OECD countries.

"But (wrote Banks) we were riding for a fall. During the 1970s, the prices we received for our commodity exports commenced a long decline, while the costs of imports began to rise. The resulting terms of trade deterioration would, in turn, expose the underlying problem of Australia's poor productivity performance." ⁴

As the world moved into the second dramatic phase of globalisation, from the 1970s through till now, Australia could only lose, if we remained inwardly-focused, uncompetitive, and out of touch with our time.

Return to the global economy

But a second U-turn in Australian trade and industry policy took place in the decades since the 1970s. It fundamentally reshaped our economy.

We moved from being an inward-looking economy to embracing the rigours and the benefits of globalisation. We turned our economy from being a parochial, protected shell and towards a more efficient and a more globally competitive one.

We carried out a sustained programme of trade liberalisation and structural reforms.

In 1973, the Government slashed tariffs by 25 per cent across the board, largely as a move that would help increase imports to contain inflation. Still - it marks, in a sense, the links between trade and domestic reforms. We started with trade liberalisation, and trade liberalisation remained a vital feature of the sustained domestic reform programme of later decades.

From the 1980s on, we started to make consistent changes towards becoming a more open and market-driven economy.

We floated the Australian dollar in 1983. Foreign-owned banks were allowed to compete with our own. We gave the Reserve Bank control of monetary policy, taking it out of government hands.

The Economic Statement of May 1988 cut a range of tariffs and industry assistance. Between the early 1970s and 2000, effective rates of assistance fell from 35 per cent to 5 per cent, and they have continued to fall.

Increased competition in our traded goods sector put new pressures on labour markets and public utilities to lower costs. Pressure mounted for reform of public institutions. All parts of our economy needed to become more efficient as they too were in effect competing in the global economy.

We began deregulating airlines, communications and transport infrastructure.

From the 1980s on, we began restructuring labour markets. In the late 1980s we began moving from centralised bargaining to enterprise bargaining, and later, from the mid-1990s, to further decentralisation of wage agreements and the use of individual contracts.

We increased the use of competitive tendering and contracting.

In 1995, we introduced the National Competition Policy reforms — and I know that India has closely modelled its competition policies on the Australian experience.

Across nearly three decades, we reformed the tax system. Capital gains tax was introduced in 1985, and the company tax rate fell progressively over the years through the late 1980s. The GST was introduced in 2000, with further cuts to income tax rates.

And for a decade from the late 1990s, we engaged in a sustained package of fiscal reform.

Over three decades, we opened our economy to the world, and we made ourselves, again, a trading nation. The ratio of trade to GDP increased from 25 per cent to 37 per cent over the years from 1970 to 2004.

We've argued for greater economic transparency and integration across our region — from the inception of Asia-Pacific Economic Cooperation (APEC), through the conclusion of the Association of Southeast Asian Nations (ASEAN) Australia New Zealand Free Trade Agreement (FTA), and now the negotiation of the Trans Pacific Partnership and the Regional Comprehensive Economic Partnership.

As well, we've consistently pushed for more foreign investment. Australia was largely built on foreign capital - that was true at the time of the First Fleet, and true throughout the 20th Century, as British, American, and later Japanese investment fuelled the development and expansion of some of our most important industries.

Investment is an important part of our broader trade liberalisation agenda. We have used our growing network of comprehensive FTAs to improve Australia's attractiveness to foreign investors, as well as to seek greater access and protections for Australian investors abroad.

Our comprehensive agreements with New Zealand, the US, Singapore, Thailand, Malaysia, Chile, the ASEAN nations – and most recently Korea - have helped to strengthen two-way investment flows with each of these trading partners. This is also the approach we are taking in our current negotiations with other economic partners, like China, Japan, Indonesia and India. All of these efforts are aimed at positioning Australia at the leading edge of international economic reform.

Today, with an economy more exposed to global investment and competition, we are again one of the most prosperous people on Earth.

Our economy is the 12th largest in the world, even though our population size would put us somewhere closer to the middle of global rankings. We have enjoyed 22 years without a recession - even through the 1997-98 East Asian Financial Crisis and the 2008-09 Global Financial Crisis.

None of this is to diminish the challenges we still face and which are at the centre of the Abbott government's economic policies: challenges of fiscal consolidation, investment promotion, stronger innovation and better productivity.

In all of this we need to play to our strengths, rather than trying to shore-up our weaknesses. Mining and agriculture have of course a key role in this century of food and water security. But we also need to build a diverse, resilient economy with a range of strengths in services like education, health, finance and IT - all pivotal industries of the future.

Explaining the change of heart

How and why did we change? There are several reasons, but the first - and most fundamental - is that we recognised that we had to change.

The challenge of having a relatively small market has never left us - if we hadn't grabbed hold of a re-globalising world economy, it would have left us behind.

Australia's GDP per capita ranked 5th in the world in 1950. Over the next three decades our ranking fell and we ranked 14th in 1983. While the need to make a change was clear, it still needed a positive decision at Government level to effect that change. We would certainly not be in the position we are today, had we not shifted course on industry and trade policy from the 1980s to now.

A second reason that we were able to change was, in a sense, institutional and methodological. Over the period of reform, Australian governments, by and large, took an evidence-based approach to driving reform.

Strong evidence-based policy debate makes a critical difference. If the public understands the costs of doing nothing, and the benefits for the wider economy of doing something — it is possible to carry the debate forward.

Ironically the institutional beginning of our shift towards greater openness began at the heart of the architect of so much of our protection. As Gary Banks has written, from the 1960s on, the Tariff Board - the 1920s-era institution that essentially spent several decades deciding how much support to give Australia's protected industries - began to re-examine the costs of the long-standing practices of protection. It beefed up its analytical capability, and began publishing much more transparent real data on the costs of protection.

From the early 1970s, the Tariff Board morphed into the Industries Assistance Commission, the Industry Commission, and from 1998, the Productivity Commission.

Along the way, it became an organisation with a mission diametrically opposed to that of the old Tariff Board. The Productivity Commission now extends its work across all sectors of the economy - including in social, environmental and economic areas.

The work of the Commission has been crucial in helping demonstrate, and make the case for, reform of tariffs and other structural changes. Using evidence-based argument has been particularly powerful in agitating for change. Against the old arguments about loss of jobs or decline of communities in the face of the potential closure of a specific industry, the Commission has provided governments and the

public with well-researched advice on costs and benefits - both the costs of reform, but also the costs of doing nothing, or perpetuating the status quo.

The third ingredient for change was strong political leadership. This was not always bipartisan but during crucial periods, especially from the mid eighties through to the mid nineties, it did attract the support of both sides of politics. And this no doubt made the politics of economic reform easier.

The links between trade and domestic reforms - the Australian experience

Essentially, what Australia's last few decades show is that trade and domestic reform are intrinsically linked.

Australia's trade agenda - including our multilateral, regional and bilateral efforts - is essentially about continuing reform in the Australian economy, and pursuing similar reform in our trading partners.

I think it's fair to say that there is a widespread perception that trade liberalisation should only be pursued if it is reciprocated by trading partners.

While the Australian experience confirms the economics of trade liberalisation – that is, that the biggest benefits go to the liberalising country – the political reality for governments is that it helps to send that message if they can point to market opening and reform by our trading partners through trade negotiations.

While we've been active participants in the GATT and subsequently the WTO since the post-war period, our own approach has therefore been one that brings unilateral reform together with liberalisation by way of international negotiation.

In many cases, our unilateral reforms have been ahead of the multilateral trade effort – which is not to say that such reforms cannot, and have not, been used as "credits" in multilateral negotiations.

Our experience shows that liberalising one part of the economy can put pressure to liberalise other parts of the economy.

And that to get the full benefits of trade liberalisation, one may need to reform other parts of the economy.

But we've also understood that broader economic reform would be good for Australia and good for the region.

I should say something about innovation, as well, because I don't want to leave you with the impression that growth in our economy is driven by government. The private sector, of course, is the major engine of our growth – and the private sector is also a driver for innovation in our national economy.

Trade and Investment Minister Robb said this recently about innovation:

"For many people, innovation is something intangible; something very talented and bright people do. Yet innovation is simply a method, a new idea, a new product, a better process or a solution – it is within the power of everyone to innovate. This is something enlightened companies and enterprises strive to capture. Empowering people on the shop floor can ignite truly outstanding innovation and serious productivity gains."⁶

The OECD estimates that a 1 per cent rise in business R&D can increase multifactor productivity by 0.1 per cent – so the gains from innovation are significant.

Forward agenda

With that perspective, let me set out Australia's current priorities in trade policy, because the work we are doing now will help us deliver an even more open and competitive economy in coming decades.

We see global negotiations through the World Trade Organization as important to that effort.

The best liberalisation is liberalisation that opens the greatest number of markets for goods, services and investment that drives globalisation furthest, and removes distortions from the global economy.

But we recognise that we have to be pragmatic about how we can best achieve reform.

When the WTO Doha Round was launched in 2001, there were high hopes for an ambitious outcome.

We came close to concluding the round in 2008, and we harvested a subset of the negotiating agenda in December 2013, but a full, comprehensive agreement eludes us.

So we have kept ourselves open to alternative paths to progress.

Our G20 presidency in 2014 is a particular opportunity to advance Australia's trade policy priorities.

We intend to focus on both the importance of domestic reform to drive economic openness as well as the contribution the G20 can make to strengthen the global trading system.

A key element of our trade agenda is for each G20 country to identify actions they can take at home to increase trade flows and make it easier for business to trade.

These actions would form part of country-specific, comprehensive growth strategies (along with investment/infrastructure and employment), to be presented to the Brisbane summit.

The G20 also needs to provide strong support to the WTO. And we want to reinforce G20 Leaders' support for open markets and the WTO and to ensure bilateral and regional trade agreements strengthen global trade.

Bilaterally, we recently concluded an FTA with Korea, one of our most important trading partners. We are negotiating FTAs with China, Japan and Indonesia. With India, we are working on a Comprehensive Economic Cooperation Agreement.

We are also engaged in sector-specific negotiations, and regional approaches.

Let me mention four specific initiatives.

First, the Trans-Pacific Partnership. As its name implies, the TPP is a major regional trade negotiation, aimed at liberalising trade and investment across the Pacific.

The Government wants the TPP to be a vehicle through which we significantly improve market access around the region – something that makes a commercial difference for our business sector.

It will promote trade liberalisation throughout the region and advance the APEC vision of an economically integrated Asia-Pacific community.

It will cover more policy areas than any of our existing FTAs.

Second, Australia, along with India, is part of the negotiations for the Regional Comprehensive Economic Partnership - covering ASEAN's 10 member states, and ASEAN's other FTA partners: China, Japan, Korea and New Zealand.

RCEP is a significant undertaking.

Collectively, the participating countries account for almost half the global population, and 30 per cent of global GDP.

We want an agreement that is comprehensive, covering goods, services, investment and other issues. RCEP will build on ASEAN's existing FTAs, and will be inclusive - leaving the door open for other countries to join after negotiations have concluded.

Negotiating momentum will need to be maintained if RCEP is to be concluded by the end of 2015 – and if we are to secure agreement from our RCEP partners to a deal that delivers a credible and commercially meaningful agreement that contributes to regional economic integration.

Third, we are negotiating in sector-specific arrangements, like in services.

Services is an area where there has been dramatic economic reform in recent years in many countries because of the huge role services now play in many domestic economies, and Australia is no exception.

Services is one of the least developed areas of international trade reflected in a low level of international commitments in trade agreements. Given the proportion of our economy that relies on services - about 70 per cent - Australia has a strong interest in improving global services trade reform, which currently represents less than 20 per cent of our exports. Hence Australia's joint leadership of the 23-party Trade in Services Agreement negotiations in Geneva- the TiSA - a services only agreement.

We are also using trade negotiations to reduce behind-the-border regulatory barriers for our services providers - including in professional services - to facilitate more open trade.

For example, the decision to liberalise our professional services sector has helped grow a \$4 billion export industry for Australia.

And fourth, we are involved in procedural reforms that make it easier for trade to flow across our borders.

One example of that is the trade facilitation agreement struck in December at the WTO meeting in Bali. That agreement will improve customs procedures, reduce the number of forms that need to be filled out during border movements, allow for electronic reporting and streamlined reporting timeframes. It represents the first multilateral agreement achieved under the WTO.

Implementation of the agreement within Australia will complement domestic reforms that are already being considered by the Australian Customs and Border Protection Service.

For example, the Trusted Trader Programme aims to provide enhanced border clearance privileges for a range of trusted entities engaged in the import and export of goods.

India

Before concluding let me say a few words about India which is also going through a significant period of change, even if some of India's partners would like to see the pace of that change quicken.

Australia's ability to trade with and invest in India will inevitably be driven in part by decisions the Indian Government makes on economic reform and financial opening.

Businesses would know only too well that India's economy has undergone a protracted slowdown since March 2011, marked by a slump in investment and industrial output.

GDP growth fell to 4.4 per cent in 2012-13. It is forecast to remain somewhere in the 4.5 to 5.5 per cent range over 2013-14 and many businesses are adopting a 'wait and see' approach in the lead-up to national elections due later this year.

Finance Minister Chidambaram and RBI Governor Rajan have taken positive steps to address key concerns, including curbing the fiscal and current account deficits and shoring up capital flows.

The short term outlook may be below par but India's strong medium-term fundamentals give cause for more optimism.

Favourable demographics, prevailing trends of urbanisation and industrialisation, and room for productivity gains should enable India's economy to achieve growth outcomes of 6-7 per cent over the next 20 years or more.

Reaching a high growth trajectory will depend on India getting its domestic policy settings right and investing in infrastructure, skills and institutions.

Australia is well placed to partner with India on both the infrastructure and skills agenda and to share lessons learnt on policy reform. Our key energy exports also provide the necessary drivers for further economic development in India, and we are committed to a long-term, broad based energy supply relationship.

Encouragingly, there are signs that India's federal system is working to show that good policy can also be good politics, as more dynamic states compete to create a more favourable environment for private and foreign investment.

Efforts by these states to cut through regulation and bureaucracy, address infrastructure bottlenecks, introduce tax incentives, and provide easy access to land and power are leading to above-average growth in some states.

Conclusion

Let me conclude with these observations.

Domestic industry policy and trade liberalisation are two sides of the reform coin. These are, often, technical economic discussions.

But if they seem arcane from the outside, they are not irrelevant to the success of our national life – far from it.

Indeed, they are, in large part, determinative of the sort of society we live in, and the role our society can play in the wider world.

The same processes are at play on a regional level, too.

If domestic trade liberalisation and industry policy reform shape the kind of successful, open nation we aspire to be, then regional economic integration and liberalising reform will shape a more successful, open region in the same way. Our liberalisation agenda will have long-lasting benefits in helping realise the regional and global society we would like to see.

Reform is a permanent challenge, but for me, the ingredients for successful reform remain the same: recognising the need to adapt; policy that is anchored in clear evidence, and a political leadership willing to make the case for change.

Endnotes

¹Gurcharan Das, "India Unbound – From Independence to the Global Information Age", pp. 68

²Mike Adams, Nicolas Brown and Ron Wickes, "Trading Nation", pp 60-61

³Donald Horne, "The Lucky Country", pp 134

⁴Gary Banks, "Structural Reform Australia-style: Lessons for Others?", 2005, pp 3

⁵Gary Banks, "Structural Reform Australia-Style: Lessons for Others?" (2005), pp 16-18

⁶Speech – "Innovation and the digital economy", San Francisco, 15 January 2014