FOREIGN
AFFAIRS AND
TRADE

REVIEW OF AUSTRALIA'S GENERAL TARIFF ARRANGEMENTS

Submission to the Productivity Commission by the Department of Foreign Affairs and Trade

28 January 2000

CONTENTS

KEY POINTS

- Trade is vital to Australia's economy. Taken together, exports and imports amount to 40 per cent of GDP ($12,600 per capita). The significance of trade has been growing for around three decades, with trade policy reform making a key contribution to this trend.
- The Productivity Commission's Review of General Tariffs is thus an important one. Its report is likely to influence the pace and direction of tariff reforms in the first decade of the 21^{st} century.
- The Review is being undertaken at a time when there is some domestic disenchantment with tariff reform. Paradoxically, this has occurred when the positive results of past reform are now very clear.
- Gains from trade liberalisation since 1986-87 has provided the average Australian family with more than $1000 extra per year
  - further liberalisation is likely to build on these gains substantially.

The Results of Past Tariff Reform

- The decline in trade barriers since the mid-1980s, coupled with extensive microeconomic reform, has helped to produce a more efficient and outward-looking economy
  - with a higher "speed limit" and much stronger productivity growth (1.7 per cent annually on average between 1993-94 and 1998-99, compared with the historical average of 1.0 per cent)
  - there are also more jobs as a result of tariff reform, both in non-protected sectors and overall (with many new jobs created in the exporting industries where wages are typically higher than elsewhere).
- Tariff reform has made a particularly strong contribution to export growth, partly by contributing to the diversification of Australia's export base
  - elaborately transformed manufactures (ETMs) and services have expanded rapidly as resources have flowed from more protected sectors (in nominal terms, ETMs expanded at 10.3 per cent annually and services at 8.5 per cent between 1990-91 and 1998-99)
  - previously highly protected sectors which had focused on the domestic market (such as the dairy and processed food sectors) are now expanding through exports as reform has boosted productivity
  - more traditional export sectors (including major rural and mineral exports) have improved their competitiveness, as tariffs on their inputs have declined

- a wider range of imported goods and services are available at competitive prices, including as inputs and capital goods for business and final goods for consumers.

- Modelling commissioned by the Department of Foreign Affairs and Trade (DFAT) in 1997 suggests that gains from trade liberalisation since 1986-87 have amounted to around 1.5 per cent of GDP (this is a conservative estimate, which does not include important dynamic gains from trade liberalisation).

Gains from Future Tariff Reform

- As a result of past tariff reform, Australia's tariffs are now low, with a simple average tariff of 4.5 per cent as at 1 January 2000, despite the relatively high tariffs applying in the passenger motor vehicle (PMV) and textiles, clothing and footwear (TCF) sectors
  - almost 41 per cent of Australia's tariff lines are at zero, and another 40 per cent have tariffs of between 1 and 5 per cent.

- Further tariff reform would nevertheless deliver significant gains to the economy. Modelling commissioned by DFAT suggests that over the longer term, further gains from a move to zero tariffs (including in PMV and TCF) would be around 1 per cent of GDP (this is again a conservative estimate)
  - in the short term, this work suggested that eliminating tariffs would create an extra 40,000 jobs, with increased employment in all but highly protected sectors.

- Exporting sectors, including in agriculture, minerals, less protected parts of manufacturing and services could expect to gain significantly from further tariff reform. Past experience suggests that more protected, import-competing sectors (for example, parts of manufacturing) might tend to contract in the short term, but would tend to increase their productivity as a consequence.

- Importantly, many of the industries which would benefit are mainstays of rural and regional Australia, suggesting that further tariff reform would provide a major boost to regional areas as diverse as rural and northern Queensland and the north west of Western Australia.

- The PMV and TCF sectors also would gain from reductions in general tariffs, as inputs for these sectors become more competitively priced. This would assist these sectors to adjust to lower tariffs in 2005, as well as to further tariff reform.

- Further reductions in general tariffs would provide more competitively-priced inputs and capital goods for Australian firms, and final goods for consumers, but the overall impact on imports would be small given the limited changes which can be expected to occur.

The Capacity to Adjust to Further Tariff Reform

- The capacity of industry to adjust to cuts in general tariffs has been assisted by an active program of microeconomic reform since the mid-1980s, including pro-competitive reforms in areas such as telecommunications, electricity, gas, water, rail, transport, ports and postal services, and labour market reform.
- Changes to tariffs and their impact on competitiveness are small compared with changes which occur through normal exchange rate movements (for example, between June 1997 and September 1998, the ABS import price index for manufactures rose by 14 per cent)
  - measures of the real exchange rate also suggest that Australia's competitiveness has fluctuated significantly. For example, in the past three years, competitiveness has improved by almost 20 per cent.
- Customs duty (including revenue from PMV and TCF imports not covered by the present Inquiry, but excluding the equivalent of domestic excises levied on imported products) is now only about 1.7 per cent of total Commonwealth revenue.

Trends in International Competitiveness

- Internationally, many of Australia's competitors are improving their efficiency and productivity, making the case for further tariff reform in Australia much stronger. For example, in many economies
  - tariff and labour market reform has boosted industry efficiency and productivity
  - deregulation, privatisation and greater private sector participation in sectors like mining, telecommunications and power generation has improved export competitiveness.
- The recent reforms introduced by East Asia's economies in response to the 1997-98 economic crisis, and further reforms being developed, are likely to improve their competitiveness in international product and services markets.

Trade Policy Issues: the World Trade Organization (WTO) and Asia Pacific Economic Cooperation (APEC)

- Trade liberalisation has been a major trend in the global economy, with massive reductions in tariffs in developed economies since the Second World War and in developing economies in our own region over the past decade.
- Australia has benefited substantially in the past from multilateral tariff reductions. Overall tariffs facing Australian exports were cut by an average of around 50 per cent on a trade weighted basis as a result of the Uruguay Round (1986-94)
  - the average bound tariff facing Australia's exports of industrial products is now less than 2 per cent on a trade weighted basis, while nearly 50 per cent of Australia's exports now have tariff-free access to significant markets.

- Australia has also benefited from rapid tariff liberalisation in the Asia Pacific region, where unilateral reductions in tariffs have often moved ahead of reductions negotiated multilaterally
  - for example, simple average tariffs fell from 17 to 9 per cent in Malaysia over 1988-97; from 28 to 11 per cent in the Philippines over 1988-98 and from 19 to 11 per cent in Korea over 1988-96
  - APEC has played a valuable role in encouraging liberalisation.
- The WTO Ministerial Conference held in Seattle from 30 November to 3 December 1999 was unable to achieve consensus on the basis for commencing a comprehensive new round of multilateral trade negotiations
  - however, WTO negotiations on agriculture and services are already mandated to begin under the "built-in agenda" established by the Uruguay Round and will commence in early 2000.
- Australia will continue to argue for a comprehensive new round, since the prospects for progress on trade liberalisation are strengthened when different economies can trade off gains across sectors
  - at the same time, Australia will seek to ensure that maximum progress is made in the negotiations on agriculture and services already mandated.
- Research commissioned by the Department of Foreign Affairs and Trade suggests that there would be major gains from a new round, with global welfare gains of around US$400 billion from a 50 per cent cut in tariff and non-tariff protection for agriculture, manufactures and services. This work suggested gains to Australia of around US$5 billion
  - a recent study by the European Commission found similar gains from global trade reform (US$385 billion from a 50 per cent cut in applied protection for agriculture, industrial products and services, combined with a multilateral agreement on trade facilitation).
- Further reductions in general tariffs would assist Australia's negotiating position in any future round, allowing us to go further in supporting broad cuts than otherwise
  - it is likely that any future WTO negotiations, including on tariff reductions, will accept credit for liberalisation taken outside the context of the negotiations (i.e. for autonomous liberalisation).
- A decision to eliminate general tariffs would also allow us to work in APEC for more ambitious liberalisation commitments by other APEC economies in the context of APEC's Bogor commitment to achieve free and open trade and investment in the region by 2010 for industrialised economies and 2020 for developing economies.

Implications for Preferential Arrangements

- Eliminating general tariffs would have some implications for existing preferential arrangements involving Australia, but DFAT's assessment is that this would not cause major problems for relations with the economies concerned
  - ➢ this is the case with the Australia New Zealand Closer Economic Relations (CER) Agreement, for example
    - ✓ implementing unilateral tariff reductions on a most favoured nation basis is consistent with the outward-looking trade liberalisation policies currently pursued by both countries, and New Zealand (1998) has declared its intention of moving to zero tariffs by 2006 (though this may be reviewed by the current NZ Government).
  - ➢ further reductions in general tariffs would similarly not cause major problems with the Forum Island Countries (benefiting from SPARTECA); Papua New Guinea (benefiting from PATCRA II) and for least developed economies and other small developing economies benefiting from the Australian System of Tariff Preferences
  - ➢ there could be some limited consequences under our trade agreement with Canada. Under the agreement (CANATA), either side is free to remove a preference, but it is open to the other to withdraw a substantially equivalent concession.
- Australia has indicated that it is open to considering new preferential arrangements which would give it substantial market access gains and which meet other relevant criteria (including consistency with the WTO)
  - ➢ Australia is currently participating in a study which seeks to assess the feasibility of achieving a comprehensive free trade agreement involving ASEAN economies, Australia and New Zealand by 2010.

Options and Conclusions

- Possible options in relation to general tariffs include:
  - ➢ reducing general tariffs (i.e. all tariffs of 5 per cent or less and excluding those relating to PMV and TCF) to zero by 2005
  - ➢ reducing general tariffs to zero by 2010
  - ➢ leaving general tariffs at existing rates and carrying out a further review in 2005, when tariffs for PMV and TCF will be reviewed.
- DFAT considers that a decision to eliminate all general tariffs ahead of the Bogor end-date of 2010 could bring significant economic benefits
  - ➢ a decision in principle to move towards elimination of general tariffs would also allow Australia to take a leading role in negotiations/discussions in any new WTO Round and in APEC.

1. INTRODUCTION

Trade is vital to Australia's economy. Taken together, exports and imports of goods and services amounted to 40 per cent of GDP, or around $12,600 for each Australian in 1998-99.

The significance of trade for the economy has been growing for around three decades,[1] reflecting Australia's increasing success in selling products as diverse as wine, fast ferries and software to overseas markets, and purchases by Australians of products and services from around the world. Tariff reform has played a significant part in the growing importance of trade.

The Productivity Commission's Review of Australia's General Tariffs is thus an important one for Australia. The outcome of the Review will be an early indicator of the pace and direction of tariff reform in Australia in the first decade of the 21st century. This in turn has significant implications for the efficiency of Australian industry and its capacity to maintain and develop new markets. It will also be a reference point for developing Australian strategies in any new WTO Round of multilateral trade negotiations, in the APEC forum and in discussions on new preferential trading arrangements.

The Review is occurring at a time when the climate for further tariff reform is more difficult than it has been for many years. Some members of the community believe that the tariff is no longer as important an issue as it was in the past, and that a new agenda needs to replace it as a focus of domestic policy debate. At the same time, concerns have emerged about the implications of globalisation, and with the need to ensure that the benefits of economic growth flow to all groups of Australian society, including regional Australia. Some believe that Australia's liberalisation efforts have moved ahead of those elsewhere in the world.

Paradoxically, domestic disenchantment has occurred at a time when the positive results of tariff reform (and economic reform more generally) have never been more evident. Through the most serious economic and financial crisis in East Asia's post-war history, Australia's economy has continued to grow rapidly. Productivity growth in recent years has been the fastest on record. Australia's unemployment rate has fallen appreciably. In spite of rapid economic growth, inflation has remained low. The new flexibility of the economy has been reflected in the capacity of domestic firms to compete with imports, and of exporters to find new markets for their products as old ones have shrunk.

The concerns with further tariff reform need to be seriously debated. DFAT's assessment, however, is that these concerns are not well founded. This Submission argues that further tariff reform, including to general tariffs, supports the key objectives of Australian policy. Tariff reform will add further momentum to the reform process, which has helped to transform Australia's economy over the past 15 years. It will help to strengthen Australia's export effort and will thus provide new opportunities for economic growth, jobs and living standards.

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[1] Total trade (exports plus imports of goods and services) rose from 27 per cent of Australia's GDP in 1968-69 to 40 per cent in 1998-99.

Tariff reform will also help Australia to exercise influence in advancing its economic interests internationally, which is a key element of the Government's approach to foreign and trade policy.[2] In particular, it will provide Australia with the basis to work for an ambitious outcome in any new WTO Round and to continue to work strongly for more open markets, both in APEC and bilaterally.

[2] See *In the National Interest: Australia's Foreign and Trade Policy White Paper*, Commonwealth of Australia, Canberra, 1997, p.vi.

2. ASSESSMENT OF AUSTRALIAN TARIFF REFORMS IMPLEMENTED TO DATE

Since the mid-1980s, Australia has progressively reduced tariffs and other barriers to trade. The effective rate of assistance on manufactured goods fell from 22 per cent to 6 per cent between 1984-85 and 1996-97 and will fall to around 5 per cent by 2000-2001.[3] The decline in trade barriers, coupled with extensive microeconomic reforms, has helped to produce a more efficient and outward-looking economy.

Individual firms have responded to cuts in tariffs and other forms of protection by increasing productivity and by internationalising their operations. Some previously focused almost exclusively on the domestic market (such as the processed food industries) have not only survived cuts in tariffs and other forms of protection, but have expanded exports significantly. With a more competitive domestic economy and cheaper imported inputs, many Australian manufacturers have become internationally competitive for the first time. The automotive industry offers an example of the way in which domestic industry has responded, with significant improvements in productivity and in the quality of Australian motor vehicles.

Partly as a result of tariff reform, the Australian economy now appears to have a higher growth potential and a more favourable climate for investment. ABS data show multifactor productivity growing at an average of 1.7 per cent per annum between 1993-94 and 1998-99, compared with the long-term average of 1.0 per cent.[4] While much of this change would appear to be due to reforms in government enterprises (for example, electricity, gas and water), tariff reform has also contributed to productivity growth. There is also some evidence to suggest that that the NAIRU (the rate of unemployment at which inflation does not accelerate) has declined. The Reserve Bank has calculated that the underlying rate of inflation is only around 2 per cent, in spite of very rapid economic expansion and an unemployment rate currently around 7 per cent.

Tariff reform has contributed to rapid growth in exports, with much of the expansion occurring in the manufacturing and services sectors. Traditional Australian exports of minerals and fuels and agricultural products still form a relatively large share of Australia's merchandise exports (29 and 27 per cent respectively), but have fallen as a proportion of exports due to stronger growth in exports of elaborately transformed manufactures (ETMs) and services. Between 1984-85 and 1998-99 ETMs exports increased from 11 per cent to 23 per cent of merchandise exports. Over the same period, services exports grew from 16 to 23 per cent of total exports of goods and services.

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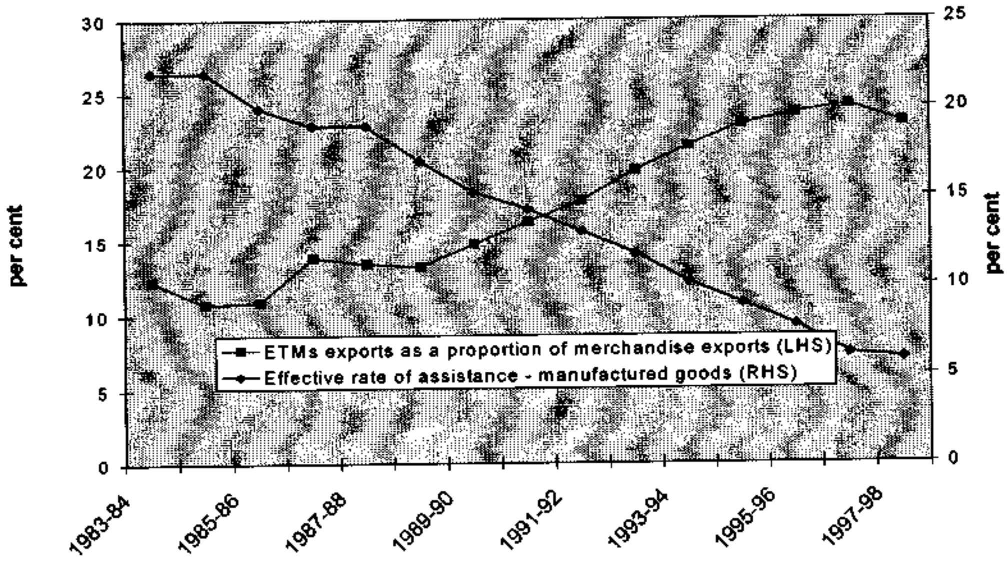
[3] Data are from the Productivity Commission. The effective rate of assistance essentially measures the net assistance conferred by tariffs and subsidies (taking into account the impact on both outputs and inputs).

[4] See Australian Bureau of Statistics, *Australian System of National Accounts, 1998-99*, Catalogue 5204.0. Multifactor productivity seeks to measure productivity taking into account inputs of both labour and capital. Given the difficulties involved in this area, estimates should be employed with caution.

Falling import protection has stimulated increased export orientation in the manufacturing sector.[5] Chart 2.1 below shows the relationship between falling protection levels and growth in exports of ETMs in graphical form. The relationship reflects the increased international competitiveness of Australian made ETMs which require imported and domestic inputs that are now substantially cheaper, as well as a trend towards increasing the level of value adding to Australia's raw material exports. Services exports have also benefited from tariff reform.

Chart 2.1
ETMs Exports and Protection



Sources: Productivity Commission, DFAT STARS Database.

While some jobs have been lost over the past decade in sectors which have been subject to higher levels of import competition, new areas of economic activity in sectors of the economy with lower levels of protection are creating new and more highly paid jobs for Australians. Many of the new jobs created over the past decade are in the services sector, where growth has been assisted by cuts in tariffs elsewhere. At the same time, there has been substantial growth in higher paying jobs in niche manufacturing areas. Many new jobs have been created in the export sector, partly as a result of tariff liberalisation. Productivity Commission estimates show that between 1983-84 and 1993-94, exports led to the creation of over 400,000 Australian jobs.[6]

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[5] For econometric evidence on this point, see A. Marks and M. Sadeghi, "Testing the Olson Hypothesis Within the Australian Context", *The Australian Economic Review*, Vol. 31, No. 2, June, 1998, pp.130-144.

[6] Data supplied by the Productivity Commission. For an earlier study setting out the methodology underlying this estimate, see C. de Laine, K. Lee and G. Woodbridge, *Microeconomic Reform and Structural Change in Employment*, Industry Commission Staff Research Paper, Australian Government Publishing Service, Canberra, 1997. The estimates take into account losses in jobs associated with increased imports.

3. THE INTERNATIONAL CONTEXT OF TARIFF REFORM: THE WTO, APEC AND REGIONAL TRADE ARRANGEMENTS

The GATT/WTO

Tariff liberalisation has been a central focus of international negotiations for the past 50 years. Since the Second World War, there have been 8 rounds of multilateral trade negotiations, beginning with the Geneva Round (1947). These have played a major part in cutting tariffs in the postwar period – from an average of around 40 per cent to 3.8 per cent on industrial goods in developed economies after implementation of all the Uruguay Round reductions.[7]

In the initial rounds, tariff reductions were based on request and offers involving the negotiating parties. Starting with the Kennedy Round (1964-67), however, formula approaches were used to cut tariffs across the board, supplemented by more traditional negotiating procedures.

The two most recent rounds of multilateral trade negotiations – the Tokyo Round (1973-79) and the Uruguay Round (1986-94) both achieved major cuts in tariffs for industrial products. The Tokyo Round delivered overall tariff cuts on industrial products of 33 percent, while the Uruguay Round outcome was a fall in industrial tariffs for developed economies of around 40 percent.[8] Both Rounds also broadened the multilateral negotiating agenda. The Tokyo Round developed a range of new disciplines on non-tariff barriers, ranging from import licensing to technical barriers to trade. The Uruguay Round – the most comprehensive and broad-ranging set of multilateral negotiations ever undertaken – resulted in some limited disciplines on agriculture and textiles. It also extended the multilateral agenda to new areas such as services and trade-related aspects of intellectual property.[9]

By opening world markets and setting predictable and stable rules for trade, the General Agreement on Tariffs and Trade (GATT) and the World Trade Organisation (WTO) Agreement have been major factors in an eighteen-fold growth in international trade over the past 50 years.

Australian industry and the economy as a whole have derived substantial benefits through negotiated tariff reductions. Australian negotiators have succeeded in obtaining significant improvements in access for products of interest to Australian industry. In particular, substantial cuts obtained from high tariff countries have opened up new areas of access, while requiring only limited adjustment for our own industry.

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[7] WTO Secretariat estimates. They apply to most-favoured-nation (MFN) tariffs.

[8] Both figures are on a trade-weighted basis. See B. Soderstein and G. Reed, *International Economics*, MacMillan, London, 3rd ed., 1994, p.364, and GATT Secretariat, *The Results of the Uruguay Round of Multilateral Trade Negotiations*, Geneva, 1994, p.12.

[9] See M. Kreinin, *International Economics: a Policy Approach*, Dryden Press, Fort Worth, 7th ed., 1995, pp.195-201.

Box 3.1
The World Trading System: Fundamental Principles[10]

The World Trade Organization (WTO) is the international body that deals with the rules of international trade. The WTO agreements provide the legal ground-rules for international commerce.

The Organization's overriding purpose is to increase global economic welfare through the expansion of international trade. One of the WTO's most important functions is to provide a forum for multilateral trade negotiations. The WTO's dispute settlement system is also vital in respect of its framework of rules.

According to the underlying principles of the WTO agreements, the world trading system should be:

- without discrimination – a country should not discriminate between its trading partners (they are all, equally, granted "most-favoured-nation" or MFN status)[11]; and it should not discriminate against foreign products and services (they are given "national treatment").
- freer – with trade barriers and other distortions coming down through negotiation.
- predictable – foreign companies, investors and governments should be confident that trade barriers (including tariffs, non-tariff barriers and other measures) should not be raised arbitrarily; more and more tariff rates and market opening commitments are "bound" in the WTO.
- competitive – by discouraging "unfair" practices such as export subsidies and dumping products at below cost to gain market share.
- more beneficial for less developed countries – by giving them more time to adjust, greater flexibility, and special privileges.

Australia also benefits from the framework of rules the WTO provides (see Box 3.1). Our interest as a middle economic power generally lies in strengthening these. They help to protect us and other medium and small economies from unilateral and bilateral actions by other economies, particularly the major trading powers. In the case of tariffs, for example, concessions negotiated bilaterally must be applied to members multilaterally because of the MFN principle. The WTO rules limit the scope for economies to raise tariffs bound in WTO Schedules. Agreements under the WTO also set out rules for the imposition of special import restrictions when domestic industries face import competition. In some cases, these rules limit the scope for Australian Government action and in some cases less than comprehensive coverage of

[10] Adapted from information at www.wto.org
[11] Exceptions to this principle are permitted under certain conditions. Preferential trade agreements (discussed below) are the most notable exception.

the rules is not ideal from an Australian perspective. But the more important effect they have is to preserve access for Australian exporters.

APEC

Australia has played a leading part in promoting trade liberalisation as an issue in the APEC forum since it was established in 1989. This partly reflects the direction of our own trade, with some 70 per cent of our exports destined for APEC economies in 1998. It also reflects Australia's strong interest in reducing tariff barriers in some developing economies in the region, which have traditionally been reluctant to make major commitments in the WTO.

Trade liberalisation became a central focus of APEC at the Bogor Leaders Meeting in 1994. At that meeting, APEC Leaders agreed to achieve free and open trade and investment in the Asia Pacific, with industrialized economies reaching this goal no later than 2010 and developing economies no later than 2020. APEC Leaders also agreed to pursue these objectives in a manner which would encourage and strengthen trade and investment liberalisation globally. Since 1996, APEC members, including Australia, have prepared Individual Action Plans (or IAPs) showing how each would move towards the Bogor goals. Issues in implementing the Bogor objectives are discussed further below.

The Australian Government has made it clear that it has a strong commitment to APEC - for reasons which include, but also go beyond its role as the pre-eminent economic institution in the Asia Pacific. According to the 1997 White Paper on Australia's Foreign and Trade Policy:

> [APEC] is among the strongest forces for further regional integration and so promotes strategic stability. It promotes cooperative approaches among the major powers of the Asia Pacific. It is the only forum which brings together leaders from across the Asia Pacific. These meetings contribute to habits of consultation and dialogue, and the development of personal relationships, which are necessary to the strengthening of trust and confidence ... .[12]

Preferential Regional Trade Arrangements

In recent years, there has been a substantial increase in the number of preferential regional trade arrangements (RTAs). Almost 120 RTAs have been notified to the WTO, including 75 since 1995. The WTO estimates there are a further 60 RTAs which have not been notified.

Around 50 per cent of world trade is now carried out under preferential agreements. The EU and the US have been particularly active negotiating preferential arrangements with newly developing East European and Latin American countries, aimed at securing favourable conditions of access for EU and US products. The failure to launch a new round of multilateral trade negotiations at the Seattle WTO Ministerial Conference may prompt greater interest on the part of some countries in regional approaches to trade liberalisation.

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[12] See *In the National Interest: Australia's Foreign and Trade Policy White Paper*, p.41.

RTAs are permitted under the WTO Agreement in recognition of the desirability of fostering closer integration between economies by facilitating trade. Such arrangements are subject to the requirement that in facilitating trade between the constituent territories, members should not raise barriers to trade with other members. Furthermore, customs unions and free trade areas are subject to the requirement that duties and other restrictive regulations of commerce should be eliminated on "substantially all the trade" between the constituent parties for goods, subject to certain qualifications or have "substantial sector coverage" for services.[13]

The spread of RTAs has given rise to concerns that they will undermine the benefits of global MFN treatment and entrench trading blocs. This is because preferential RTAs are discriminatory, diverting trade and investment away from non-members. That said, RTAs have generally tended to encourage economic growth and development, which in turn generates dynamic benefits and greater trade opportunities for others. Net damage to non-members can be avoided if trade diversion is outweighed by new trading opportunities from increased economic growth in RTA markets and/or by the simultaneous lowering of trade barriers.

Australia is one of a limited number of significant economies which does not have a free trade agreement with any of the major world economies or with emerging trade and economic associations[14] such as the ASEAN Free Trade Area (AFTA) or the Southern Cone Common Market (MERCOSUR).[15] Australia is currently, or potentially, subject to relatively high tariffs in many markets, competing against trading partners which may enjoy preferential tariff rates and/or be moving to free trade.[16]

It is in Australia's interest to ensure that there is an effective framework of disciplines in place on RTAs. At the same time, Australia needs to be open to considering free trade agreements with other economies under certain conditions. In particular, such agreements should deliver faster and deeper liberalisation than the multilateral process, with the objective of gaining better market access for our exporters, faster economic growth and stronger employment growth; and be consistent with the WTO. Australia's approach to existing or potential RTAs involving Australia is discussed further below. Our approach to the broader systemic issues raised by RTAs is examined further in Attachment A.

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[13] See Article XXIV:8 of the GATT and Article V of the General Agreement on Trade in Services (GATS).

[14] Others include New Zealand, Japan, Korea, Hong Kong, China, India and Pakistan. Australia does, of course, have a free trade agreement with New Zealand, which is a major trading partner for us. This is discussed further below.

[15] MERCOSUR includes Argentina, Brazil, Paraguay and Uruguay.

[16] One important counterbalance to this is that under many regional arrangements, key agricultural commodities of interest to Australia are excluded due to domestic industry sensitivities. For example, in the case of the EC-South Africa Trade and Cooperation Agreement, beef, sugar and most dairy products are excluded from preferential tariffs.

4. AUSTRALIA'S CURRENT TARIFF ARRANGEMENTS AND INTERNATIONAL COMMITMENTS

Australia's average tariff level is quite low by world standards, standing at a simple average of 4.5 per cent on 1 January 2000.[17] This includes the relatively high tariffs applicable in the TCF and PMV sectors.

On 1 January 2000, 40.8 per cent of Australia's tariff lines were at zero and 39.9 per cent had tariffs between 1 and 5 per cent. A further 4.5 per cent had tariffs between 6 and 10 per cent; 7.9 per cent between 11 and 15 per cent; 0.2 per cent between 16 and 20 per cent and 6.4 per cent were over 20 per cent.

The main sectors which are protected by tariffs are textiles and clothing (average tariffs of 12.7 per cent), leather and rubber (average tariffs of 6.9 per cent) and transport equipment (average tariffs of 5.4 per cent). Tariffs in the PMV/TCF sectors are being reduced in line with industry restructuring plans. Tariffs on PMV are to be held at 15 per cent from 2000 to 2004 and reduced to 10 per cent in 2005. Tariffs in the TCF sector are to be held at current levels (i.e. between 5 per cent and 25 per cent) from 1 July 2000 to 1 January 2005, then reduced to a maximum rate of 17.5 per cent for clothing. These tariff reductions are linked to broader packages of restructuring measures (details are given in Attachment B).

Table 4.1
Australia's Tariffs: 1 January 2000
per cent

	Duty Free	Simple Average	Import-Weighted
Agriculture, excluding fish	69.3	1.3	1.6
Fish	99.1	0.0	0.4
Minerals	62.1	1.9	1.1
Petroleum	100.0	0.0	0.0
Wood, paper, paper products	28.3	3.7	3.6
Textiles and clothing	13.3	12.7	17.4
Leather, rubber, etc.	18.6	6.9	10.8
Metals	25.6	3.7	5.0
Chemicals	53.1	2.4	3.4
Transport	26.6	5.4	7.6
Non-electrical machinery	38.9	3.5	2.4
Electrical machinery	32.5	3.8	3.0
Manufactures nes	54.6	2.4	1.8
All Products	40.8	4.5	4.5

Source: TNAS Database. This table is derived from a broader table prepared as part of Australia's submission to APEC on our Individual Action Plan. It relies on data available as at July 1999. Some figures may have changed as a result of subsequent amendments to the Australian tariff. The textiles and clothing sector in the above table is not the same as TCF for industry policy purposes.

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[17] This figure is derived from DFAT's Trade Negotiations Analysis System (TNAS). The simple average will be around 4.4 per cent from 1 January 2001.

In comparing average tariffs, account needs to be taken of the fact that Australian tariffs are predominantly ad valorem (i.e. a constant proportion of the value for duty). Many countries, such as the United States and the European Union have a high proportion of either specific duties (expressed as fixed monetary amounts per physical unit or per unit of weight of the imported product), or compound duties (a combination of ad valorem tariffs and specific duties). As it is not always possible to calculate the ad valorem equivalent of specific duties, simple average tariffs do not accurately reflect the full level of protection.[18]

Out of a total of 5,757 lines in the Australian tariff as at 1 January 2000, 5544 - over 96 per cent of the tariff lines – are bound under Australia's WTO Schedule of Commitments.[19] All agricultural tariffs are bound at rates ranging from 0 per cent to 29 per cent, in line with the requirement of the WTO Agreement on Agriculture for all agricultural tariffs to be bound. The industrial tariff lines that are bound (over 4500 lines) range from 0 per cent to 55 per cent. The 213 tariff lines that are not bound include certain leathers, TCF items, ceramic and glass products, metal products including tools, machinery, transport equipment, photographic equipment and other electrical components and equipment. For a number of these items, China is the major supplier and the question of binding the tariffs has been set aside pending finalisation of negotiations on China's accession to the WTO.

[18] A useful discussion of the complexities of the tariff regimes of OECD countries and factors which need to be taken into account in calculating and comparing tariff levels is contained in a 1996 study by the OECD which examined the patterns of tariff and non-tariff barriers to trade in member countries. See ECO/CPE/WP1(96)4

[19] Bound rates are maximum tariff rates and may exceed the rates countries actually apply. Since they are included in WTO Schedules, they provide traders with a greater degree of certainty on access than applied rates, which can in some cases be changed more easily.

5. THE ECONOMIC AND TRADE IMPACT OF GENERAL TARIFF REFORM

(a) Economic Implications

The implications of tariff reductions for the Australian economy have been examined extensively over the past two decades. The strong, broad consensus has been that overall Australia has gained handsomely from trade liberalisation, including by liberalising in Australia without waiting for others. The Productivity Commission's own work in this area over a number of years has typically suggested worthwhile gains from tariff liberalisation, as well as from broader microeconomic reform.

Research published by DFAT in 1997 suggested that gains from trade liberalisation since 1986-87 had amounted to around 1.5 per cent of GDP, equivalent to providing the average Australian family with more than $1000 extra per year. This work also suggested that further liberalisation would be likely to deliver short-term gains in jobs, with all industries increasing jobs except the most highly protected sectors. Over the longer term, further gains from a move to zero tariffs would be around 1 per cent of GDP, well in excess of gains to Australia from liberalisation by other economies in our major Asia Pacific markets.[20]

These results generally understate the gains. Most modelling work which has been undertaken does not fully take into account the dynamic gains from trade liberalisation, particularly the way in which heightened competition can induce increases in productivity. As suggested already, experience with trade liberalisation suggests that industries often adapt to cuts in protection much more successfully than would have been predicted, lifting productivity sharply in the process. Some estimates suggest that these "dynamic gains" could be many times the gains measured by conventional economic models.[21]

DFAT's assessment is that reducing or eliminating general tariffs subject to this review would generate further, worthwhile economic gains. These tariff reductions would contribute to a more productive economy, with higher incomes and more job opportunities, more appropriate use of resources, lower prices and better quality choices for consumers and for business.[22]

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[20] See Department of Foreign Affairs and Trade, *Trade Liberalisation: Opportunities for Australia*, Canberra, 1997. This work, carried out by the Centre for International Economics, drew on the results of three different models – the Orani Model, Monash-MR and APG-Cubed.

[21] On the basis of cross-country regressions for OECD economies, the former Economic Planning Advisory Commission (EPAC) concluded that dynamic gains from trade liberalisation could be as much as 10 times "static" gains. EPAC estimated that the fall in Australia's average tariff on imports between the mid-1980s and 2000 would add around 15 per cent to Australia's GDP in the longer term. See EPAC, *Tariff Reform and Economic Growth*, Commission Paper No. 10, Australian Government Publishing Service, Canberra, 1996. A more recent discussion of the importance of dynamic gains is A. Stoeckel, K. Tang and W. McKibbin, "The Gains from Trade Liberalisation with Endogenous Productivity and Risk Premium Effects", Paper for Seminar on "Reason versus Emotion: Requirements for a Successful WTO Round", Seattle, 2 December 1999.

[22] It is noted that stronger gains would flow from reductions in assistance to the more highly protected sectors of PMV and TCF, which are outside the terms of reference of the Inquiry. It should also be noted that dispersion of rates of assistance among industries can be as important as the average rate of assistance industries receive, since this encourages capital and labour to move into less efficient

Reductions in general tariffs are likely to increase exports overall. As noted already, firms experiencing tariff cuts tend to respond by increasing their own productivity and efficiency. This and the availability of cheaper imports would reduce the costs of inputs for other firms, including exporters. With a somewhat higher level of imports, Australia's exchange rate could, at least initially, also tend to be somewhat lower than would otherwise have been the case, providing extra revenue for exporters, and encouraging the flow of resources into export activity. Export-oriented firms would also tend to benefit from easier access to capital and labour as industries subject to tariff cuts are restructured.

DFAT's assessment is that elimination of general tariffs would encourage, rather than discourage, foreign direct investment in Australia. For many industries – particularly high technology industries – there is now a global production chain, with inputs for production obtained from a number of different sources from around the world. Firms often aim through investment to serve the global market rather than a small domestic market. A high-tariff regime can discourage investment in this type of production. For this reason, foreign direct investment is now more likely to associated with openness to trade, rather than with restrictive trade barriers as in the past.

Industry sectors which are export-oriented and which receive little by way of tariff protection, can expect to gain from further reductions in general tariffs. New or emerging industries that do not receive protection can be substantial beneficiaries from tariff cuts which allow them to benefit from lower input costs and attract resources which might otherwise have flowed to the protected industries. Sectors that are principally import-competing and receive tariff protection will need to adjust, but are likely, on past experience, to emerge stronger and more outward-looking as a result, and with a stronger future based on the world market.

(b) Implications for Exports by Sector

Food and other Rural Exports

Australia's agricultural industries are, for the most part, not protected by tariffs. Products with zero tariffs include the major agricultural exports, among them beef, wheat, wool, sugar, and cotton (see Table 5.1). Imports in the non-protected rural sectors are generally low, reflecting Australia's strong comparative advantage in them, and in many cases, limited possibilities for intra-industry trade for the relatively undifferentiated products involved.

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sectors. In the case of the Australian manufacturing sector, dispersion of rates of assistance across the manufacturing sector is likely to decline as assistance for PMV and TCF falls. The Productivity Commission expects the standard deviation of effective rates of protection to fall from 10 percentage points in 1996-97 to 7 percentage points in 2000-01. Disparities in assistance nevertheless remain substantial.

Box 5.1
Adjusting to Lower Protection: Australian and International Cases

Reductions in protection have often resulted in significant adjustments in the affected industries, but just as typically they have emerged more efficient, with an international future as a result. A number of case studies, both in Australia and internationally, illustrate this general point.

The Canadian Furniture Industry: Prior to the Canada-US Free Trade Agreement (CUSTA) signed in 1989, the Canadian furniture industry relied on tariff protection of 12.5-15 per cent to compete in the domestic market, with small-scale industry and limited production runs. Tariff liberalisation under CUSTA was widely believed, including by the domestic industry, to threaten its existence. Between 1989 and 1994, the industry underwent a painful restructuring process with the effects of tariff cuts compounded by recession and appreciation of the Canadian dollar. From 1992, however, recovery commenced. Although the number of firms declined and the industry employed fewer people as a result of restructuring, the nominal value of output in 1998 was 54 per cent up on 1989 levels. Exports rose strongly from less than $CDN 800 million to almost $CDN 4.4 billion in 1998, reaching 58 per cent of output. Labour productivity rose strongly. The Canadian industry has shifted towards more specialised, higher value-added operations.

The New Zealand Wine Industry: The New Zealand wine industry initially developed behind prohibitive tariffs, supplying the domestic market with low quality wine. A small domestic market and high transport costs made its economic future uncertain by the late 1970s. Since the 1970s, the industry has moved, with Government enouragement, towards higher quality production geared towards exports. Imports have grown as tariff protection and tariff quotas have fallen, rising to just under half of domestic consumption at peak. But the growth in imports has been more than offset by a surge in exports, based on premium wines. Although the volume of New Zealand wine production has increased only modestly, the shift towards high quality wines has brought about a big increase in the value of wine production.

The Australian Dairy Industry: The Australian dairy industry has traditionally been one of the most heavily assisted agricultural sectors in Australia. Production of market milk remains very heavily assisted. However, under the "Kerin Plan" (1986-92) and successor industry plans, production of manufacturing milk and dairy manufactures has been made much more responsive to market forces. The adjustments undertaken by the industry initially gave rise to fears that there would be an adverse impact on exports of manufactured dairy products. However, exports have grown strongly. Cheese exports grew at a trend rate of 13.5 per cent over 1993-98 and butter at 9.5 per cent per annum, both well above the rate for Australian exports generally. Dairy manufacturers have built up substantial and growing markets on the back of investment in high-technology plants and close attention to market needs, and have good prospects of further expanding sales.

Box 5.2
Responding to Import Competition by Exporting: the Pigmeat Industry

The pigmeat industry offers an example of responding to import competition by developing exports. Over the past three years the industry has been changing rapidly, following a serious import challenge, mainly from Canada, in 1998. Exports of pigmeat, at $112 million in the first 11 months of 1999, were almost double imports of $60 million for the same period. This compares with exports of $52 million and imports of $27 million in the corresponding period in 1998.

The industry's export success followed the dramatic development of a new market in Singapore in 1999, building on strong growth in the Japanese market. In less than 12 months, Australian exports of fresh or chilled pork to Singapore grew from virtually nothing to over 2000 tonnes per month, with exports in the first 11 months of 1999 reaching $47 million. Australian industry was able to develop the new market partly because there was an outbreak of the nipah virus in Malaysia, which had previously supplied Singapore. Ensuring that Australia could meet the new demand also involved intensive efforts, including a strong collaborative effort between the private and public sectors.

Rural industries which currently receive no protection would typically expect to be significant beneficiaries of further reductions in general tariffs. They would gain added revenue (in Australian dollar terms) if the exchange rate is lower (though this would be partially offset by an increase in the cost of some inputs, like fertilisers which generally enter duty free already).[23] Many of these industries also depend quite heavily, directly or indirectly, on inputs from manufacturing industry. They would therefore benefit from lower costs for both inputs and for capital goods, as well as from easier access to labour and capital as industries relying on tariffs restructured. This would make a useful contribution to their capacity to maintain existing markets or expand into new ones.

There are some important agricultural and food products which continue to receive tariff protection. They include cheese, certain vegetables (such as spinach and mushrooms), some oilseeds, and various processed foods (such as ham, breakfast cereals, jams and orange juice). In the case of vegetables and processed foods, the Australian Government has been seeking to encourage much stronger export efforts. The future of these industries essentially lies in serving a broader export market, along with the domestic market, with high-quality food and agricultural products. Both Australian and overseas experience of tariff cuts suggests that the industries concerned would emerge as more efficient and outward-oriented industries from gradual steps to remove tariffs.

[23] In the case of agriculture, the Productivity Commission's research indicates that the implicit tax on inputs due to tariffs fell from $106 million in 1992-93 to around $60 million in 1997-98. Changes in tariffs also led to a decline in taxes on plant and equipment used in the agricultural sector.

Minerals

Like rural industries, Australia's mining industry does not depend to any appreciable degree on tariffs. The two biggest mineral products exported - coal and iron ore – have no tariff protection. These two products alone contributed $13.1 billion to export revenue in 1998-99, or about half of all mineral exports. Crude oil, refined petroleum, petroleum gas, alumina, and ores of copper, zinc, and lead are other major minerals which receive no tariff protection (Table 5.1).

Australia's mineral industries are highly efficient by world standards. Export industries in the mining sector nevertheless face strong pressures to cut costs, either from major buyers or because of depressed prices on world markets. The increasing efficiency of other suppliers, partly as a result of privatisation and reduced regulation of minerals industries in other economies, has placed added pressure on Australian mining industries (see Section 6(c) below). Strong pressures on costs have underpinned a drive by the industry over more than a decade to rationalise operations, including by reforming work practices.

Table 5.1

Trade in Major Primary Commodities with Zero Tariffs: 1998-99

$A million

HS	Commodity	Exports	Imports
	Rural		
0201	Beef, fresh or chilled	1,177	5
0202	Beef, frozen	1,758	1
1001	Wheat and meslin	3,399	1
1003	Barley	698	0
1701.10	Cane or beet sugar	n.a.	0
5101	Wool, not carded or combed	1,998	47
5201	Cotton, not carded or combed	1,559	0
	Minerals		
2601	Iron ore and concentrates	3,845	85
2603	Copper ores and concentrates	988	0
2607	Lead ores and concentrates	228	0
2608	Zinc ores and concentrates	690	4
2701	Coal, briquettes, etc.	9,265	13
2709	Petroleum oils, etc., crude	1,600	3,603
2710	Petroleum oils, etc., other than crude	1,487	706
2711	Petroleum gases and gaseous hyrdocarbons	1,726	70
2818.20	Aluminium oxide, other than artifical	2,843	14
	corundrum		

Source: DFAT STARS Database.

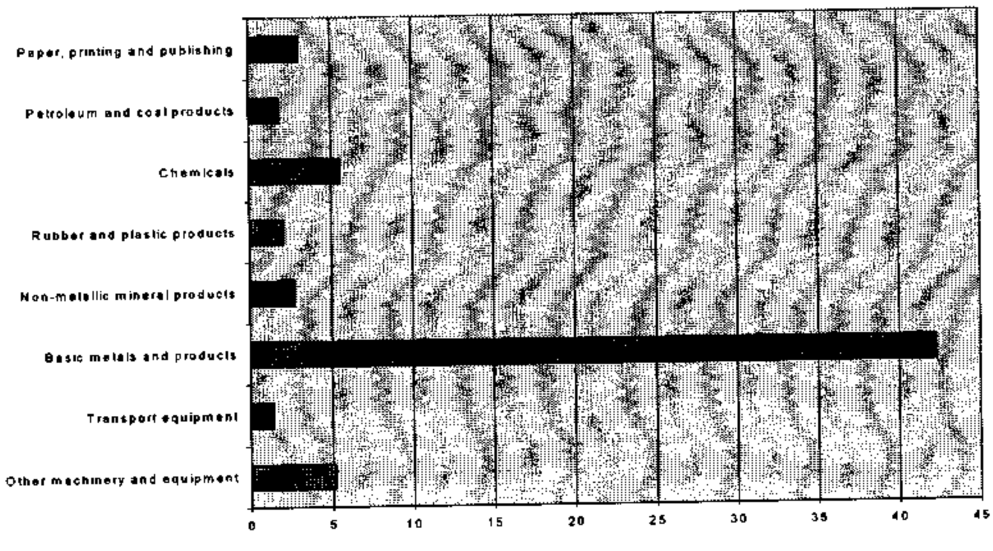
The mining industry would gain in competitiveness as a result of tariff reductions in other sectors. Input-output tables show the industry to be highly dependent on inputs from manufacturing industry, partly through purchases from other industries with more direct links to manufacturing.[24] Capital goods used by the industry also depend heavily on manufacturing. Although wages are not a high direct component of industry costs (less than 14 per cent according to the 1994-95 input-output tables), the industry would also benefit from lower pressures on wages which would flow from further reductions in general tariffs.

Manufactures

The Australian manufacturing sector has undergone major changes over the last decade, with trade liberalisation playing an important part in achieving this outcome. Manufacturing is still much less export oriented than agriculture or mining. However, firms in a diverse range of manufacturing industries have succeeded as exporters, with particularly strong growth since the mid-1980s in exports of ETMs.

A feature of the manufacturing sector is the high level of interdependence among sub-sectors. Reductions in protection for some parts of manufacturing tend to lower input costs at other stages in the manufacturing process. Chart 5.1 illustrates this, showing final requirements for the fabricated metals sector from other key manufacturing sectors (with $100 in output for fabricated metals requiring $42 of Australian output or imports of basic metals and products and over $5 of other machinery and equipment). Manufacturing industries also draw heavily on other manufacturing industries for the supply of capital goods.

Chart 5.1
Total Requirements: Fabricated Metal Products



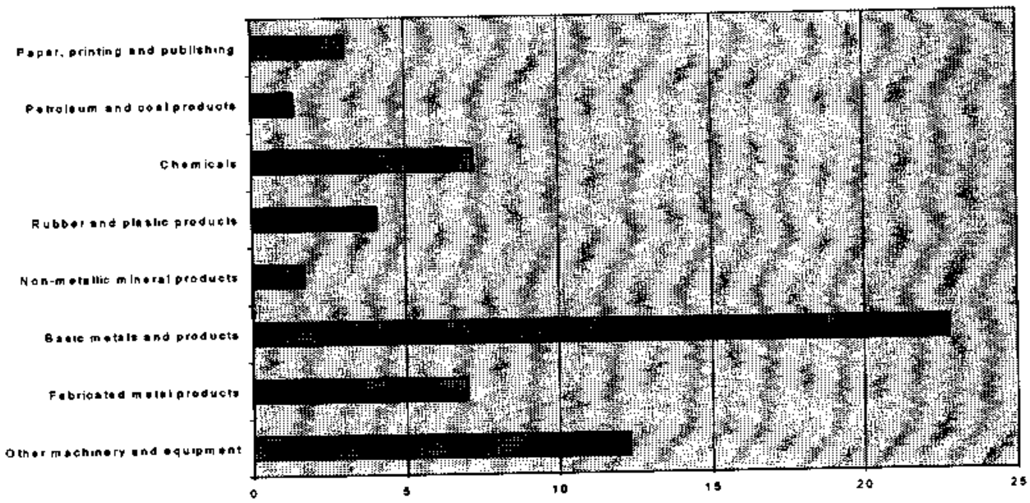
Source: ABS, *Input Output Tables 1994-95* (Catalogue Number 5209.0). The chart shows the ultimate requirements in terms of intermediate goods (either Australian or imported) for $100 of output for the fabricated metal products sector, when this output is sold into final demand (for example, for final capital goods or to consumers).

[24] Input-output analysis traces interdependencies between different sectors of the economy, focussing particularly on those which result from sales and purchases of intermediate goods.

Reductions in general tariffs would be likely to lead to some restructuring of the manufacturing sector. Import-competing areas might tend to contract, at least initially, under the impact of heightened competition from overseas suppliers. But they would tend to lift their own efficiency as a consequence. Other sectors of manufacturing would benefit from lower input costs as a result. The sector would tend to become more export-oriented, with a greater degree of specialisation by individual firms. Prospects for growth based on the world market would increase.

Reductions in general tariffs would assist the PMV and TCF sectors to adjust to lower rates of protection which will enter into force on 1 January 2005. These sectors depend heavily on Australian production or imports in other key manufacturing sectors for intermediate inputs. Chart 5.2 illustrates this with the example of transport equipment, showing that a $100 increase in output for this sector, when sold into final demand, ultimately requires an increase in Australian output or imports of almost $23 for basic metals and products, and over $12 for other machinery and equipment. As the price of imported products falls, and the productivity of domestic manufacturing increases in these sectors, the benefits would tend to flow through to downstream manufacturers.

Chart 5.2
Total Requirements: Transport Equipment



Source: ABS, *Input Output Tables 1994-95* (Catalogue Number 5209.0). The chart shows the ultimate requirements in terms of intermediate goods (either Australian or imported) for $100 of output for the transport equipment sector, when this output is sold into final demand (for example, to consumers).

Services

Australia's services industries have been a strong area of export growth, with exports rising in volume terms at an annual average rate of 7.4 per cent between 1990-91 and 1998-99. The bulk of growth in services exports has come from tourism and travel services (including expenditure on goods and services by overseas tourists, business visitors, and overseas students). There has also been a substantial expansion of transportation services and a variety of other services (such as financial services, insurance and business, professional and technical services).

The international market conditions under which services are sold vary considerably. The bulk of travel services and a significant part of transport services exports are linked closely to the inflow of foreign tourists to Australia, which is perceived by industry to be quite sensitive to prices of travelling to and staying in Australia compared with alternative destinations. In the case of more complex services, price considerations are likely to be less significant than the quality of the service provided. For some services, such as finance and telecommunications, restrictions on market access or the absence of national treatment (either at the establishment stage or post-establishment) may be more significant barriers to exports.

Australia's service industries would gain competitiveness from reductions in tariffs on imported goods. However, the extent of these gains would vary widely. Reductions in tariffs could have an appreciable positive impact on our competitiveness as a destination for tourists and students, by lowering the cost of goods and services purchased in Australia. They would have a smaller impact on exports of more complex services which may not be highly sensitive to price or where barriers to access are a major impediment to increased trade.

(c) Implications for Imports

Further reductions in general tariffs are likely to have only a limited impact on Australia's aggregate imports. This is partly because over 40 per cent of tariff lines are already duty free. Furthermore, many imports enter at reduced tariff rates, either because they are subject to concessional entry or because they originate in economies to which Australia accords tariff preferences.

Table 5.2
Estimated Long Run Price Elasticities for Australian Imports

Author	Period	Elasticity
Wilkinson	1974:3 to 1989:3	-0.49
Bullock et. al.	1974:3 to 1992:4	
including computers		-0.45
excluding computers		-0.42

Source: M. Bullock, S. Grenville and G. Heenan, "The Exchange Rate and the Current Account", in A. Blundell-Wignall (ed.), *The Exchange Rate, International Trade and the Balance of Payments*, Reserve Bank of Australia, 1993, p.102.

Econometric work also suggests that aggregate import volumes are not highly sensitive to changes in prices. Wilkinson's 1992 estimates suggested that the price elasticity for Australian imports was around -0.5 in the long run (indicating that a fall in import prices relative to domestic prices of 1 percent would lead to a rise in imports of 0.5 per cent). Subsequent estimates by Bullock, Grenville and Heenan are of a comparable magnitude (see Table 5.2), but also indicate that capital goods and consumption goods are much more responsive to price changes than intermediate products. The impact on imports of any general reduction in tariffs could be offset to some extent by a fall in Australia's exchange rate as imports expanded.

In any case, any increases in imports which would result would bring benefits to the Australian economy. They would provide cheaper goods to Australian consumers and more competitively-priced inputs and capital goods for Australian firms, including exporters.[25]

[25] There would also tend to be some changes in the source of imports, as countries with duty free access to the Australian market (such as New Zealand) experienced a small loss in price competitiveness. Removing distortions on this kind would add to economy-wide efficiency. The consequences of these changes for Australia's relations with other economies are analysed further below.

6. SELECTED ISSUES IN CONSIDERING FURTHER REFORM TO GENERAL TARIFFS

(a) The Impact of Microeconomic Reform and Pace of Structural Adjustment on Australian Industry

Since the mid-1980s, there has been an active program of microeconomic reform by the Commonwealth, States and Territories across a range of areas. In addition to tariff reform, increased labour market flexibility and prospective changes in taxation arrangements, there has been substantial progress in the reform of areas of the economy traditionally characterised by government ownership. More competitive structures have been introduced in areas such as telecommunications, electricity, gas, rail transport, ports and postal services.

These reforms have been aimed at improving cost structures in the economy and, with this, increasing productivity growth. They have been undertaken against a background of low productivity growth rates which Australia experienced in the 1970s and 1980s, relative to previous decades and to those of other developed countries. The reform initiatives have had a role in the improvement to productivity and growth experienced in recent years. They have made possible reduced prices and increased flexibility in resource use in a number of areas. For example, there have been price declines and improvements in the quality and range of services offered in the supply of electricity and gas, and in telecommunications and rail freight services.

Reforms within the economy have helped make it more flexible and responsive to change. They have served Australia well during the contraction of Asian export markets stemming from East Asia's financial crisis. Exporters were in a position to find new markets rapidly in countries throughout the Middle East and South America, as well as in traditional European and North American markets. Likewise, the increased flexibility and responsiveness to change have enhanced the ability of Australian industries to adapt to further tariff reductions in an environment of global oversupply in many commodities as a result of the regional financial crisis.

The areas subject to most of the non-tariff reforms have been in non-traded areas of the economy - predominantly in service industries such as utility services, telecommunications and transport. By reducing costs for a wide range of other industries in the traded sector, these reforms have made adjustments to past tariff liberalisation much easier. For example, lower prices for utility services and transport has assisted a broad range of import-competing industries for which they are significant inputs.

Similarly, further, ongoing microeconomic reform is likely to ease adjustment to future tariff reform, including reform to general tariffs.

(b) Recent and Prospective Progress in Regional and International Trade Liberalisation of Interest to Australia

Multilaterally Negotiated Tariff Reductions

Australia has benefited substantially from multilateral tariff reductions, especially from the most recently completed comprehensive round, the Uruguay Round. Overall tariffs facing Australia's exports were cut on average by around 50 per cent on a trade weighted basis as a result of the Uruguay Round. More than 86 per cent of Australia's exports gained more secure market access through bound tariff commitments by most of our major trading partners.

As a consequence of the Uruguay Round, the average bound tariff rate facing Australian exports of industrial products is less than 2 per cent on a trade weighted basis. Nearly 50 per cent of Australia's exports now have tariff-free access to significant markets. In return, Australia has been able to meet virtually all of its commitments under the Uruguay Round within the framework of the 1988 and 1991 programs of phased tariff reductions.

In the case of agriculture, the Uruguay Round outcome provided for a simple average cut on all agricultural tariffs of 36 per cent for developed economies (24 per cent for developing economies), with each tariff line to be cut by a minimum of 15 per cent (10 per cent for developing economies). All tariffs were to be bound. Non-tariff measures (such as quantitative import restrictions) were to be tariffied – that is, converted into tariff equivalents - with reductions in the resulting tariffs. Implementation of these commitments has brought a much greater level of security and predictability to trade in agricultural products. Other key commitments on agriculture included a 20 per cent cut in trade-distorting domestic support (13.3 per cent for developing economies) and a reduction in export subsidies. The latter aimed to reduce the value of export subsidies to a level 36 per cent below the 1986-90 base period and the quantity of export subsidies to a level 21 per cent below the base period level. For developing countries, reduction commitments on export subsidies were two thirds of these rates.

In the case of industrial products, exporters made highly specific gains in access across a wide range of industries. For example, the Round delivered tariff reductions of some 32 per cent for aluminium, 43 per cent for copper and 70 per cent for zinc. Other gains included building materials (an overall cut in tariffs of more than 30 per cent), leather and leather goods (also average cuts of over 30 per cent); and wood and wood products (tariff cuts averaging over 61 per cent).

Post-Round negotiations on specific sectors have similarly resulted in substantial market access gains. The Information Technology Agreement (ITA I) which was concluded in 1997 established bound tariffs at zero for a defined product coverage to be implemented through four equal reductions by 1 January 2000. Provision was made for some participants to take a longer implementation period up to 2005 but only for a very small number of products. Further negotiations to expand the product coverage of the agreement have been stalled since July 1997, however.

Australia would be a significant beneficiary from new multilateral trade negotiations. Research commissioned by DFAT estimates that the gains in terms of global welfare from a 50 per cent cut in tariff and non-tariff protection for agriculture, manufactures and services would total some US$400 billion annually.[26] Of this, Australia would expect to gain around US$5 billion. Importantly, these are conservative estimates which do not take into account a range of dynamic effects of trade liberalisation. The research showed that more extensive liberalisation would result in bigger gains, with global gains of over US$750 billion from eliminating barriers.

These estimates are in line with a recent study by the European Commission, which found gains of US$385 billion from a 50 per cent cut in applied protection for agriculture, industrial products and services, combined with a multilateral agreement on trade facilitation.[27]

Progress with Tariff Reductions in the Asia Pacific

There has been substantial progress with tariff liberalisation in the Asia Pacific region over the past decade. In part, this has occurred through negotiated tariff reductions. But much has also come from unilateral tariff reforms as economies have recognised the gains in terms of economic growth from trade liberalisation. Applied tariffs have declined faster than tariff commitments bound under the WTO.

Table 6.1 draws together World Bank estimates of changes in tariff rates in some regional economies. The Table shows very substantial tariff reductions since the late 1980s/early 1990s for a number of economies. For example, simple average tariffs fell from 17.0 to 9.1 per cent in Malaysia over 1988-97; from 28.2 to 11.2 per cent in the Philippines over 1988-98; and from 18.9 to 11.1 per cent in Korea over 1988-96. Tariff reductions were smaller, but still appreciable for Japan and the United States.

Trade liberalisation, including in areas of key interest to Australia, has continued in difficult circumstances following the onset of the East Asian economic crisis in July 1997. In Thailand, for example, tariffs on cotton and wool (major Australian exports) were completely removed following a comprehensive review of tariffs in August 1999. In Korea, tariffs on a number of items were reduced, including industrial inputs and foodstuffs. Indonesia cut tariffs on most food items to a maximum of 5 per cent. Box 6.1 provides further details.

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26 See Department of Foreign Affairs and Trade, *Global Trade Reform - Maintaining Momentum*, Canberra, 1999.

27 See N. Nagarajan, "The Millennium Round: an Economic Appraisal" *Economic Papers*, No. 139, November 1999. Released by the European Commission on 23 November 1999. Both the Australian and European Commission estimates are also broadly in line with results in A. Stoeckel, K. Tang and W. McKibbin, *op. cit.*, showing an increase in global consumption of around US$630 billion from full liberalisation. The Stoeckel, Tang and McKibbin results take into account endogenous gains to productivity (for example, arising from additional competitive pressure on industries) and reductions to risk that flow from greater openness.

Table 6.1

Changes in Average Regional Tariffs

per cent

		Simple	Weighted
China	1992	42.9	40.6
	1998	17.5	18.7
Indonesia	1989	25.2	23.6
	1996	13.0	13.8
Japan	1988	7.1	3.7
	1998	5.7	2.0
Korea	1988	18.9	17.1
	1996	11.1	9.5
Malaysia	1988	17.0	12.6
	1997	9.1	9.4
Philippines	1988	28.2	27.2
	1998	11.2	9.3
United States	1989	6.3	4.4
	1998	5.2	2.8

Source: World Bank. The averages are calculated for applied MFN ad valorem duties and do not include specific duties. The Bank calculates weighted averages use world imports rather than the economies own imports since averages based on the latter may be biased downwards.

APEC has played a valuable role in encouraging economies to move in a direction which is generally pro-liberal and reformist. Even during the recent regional economic downturn APEC exerted a positive influence on trade liberalisation and economic and financial reform in regional developing economies. Planned improvements to the Individual Action Plan (IAP) mechanism and greater emphasis on peer reviews of IAPs should help to inhibit backsliding and provide a focal point for spurring reform by APEC economies.

The IAPs of APEC economies provide an indication of further liberalisation which is in prospect in the region. Among commitments:

- Brunei has agreed to progressively liberalise towards zero tariffs by 2020 (excluding some items)
- Chile is reducing its applied tariff to 6 per cent by 2003 and has committed to reduce most tariffs to zero by 2010 (excluding some sensitive sectors)
- Chinese Taipei has undertaken to reduce its average tariff to 6 per cent by 2010.
- New Zealand has stated that it intends to eliminate all tariffs by 2006 (however, this may be reviewed by the current New Zealand Government)
- the Philippines has targeted to uniform tariff rate of 5 per cent by 2004, except for sensitive agricultural products
- Singapore has committed itself to bind all tariffs at zero by 2010.

A 1999 report commissioned by APEC and produced by the Pacific Economic Cooperation Council (PECC) confirmed a previous PECC assessment that APEC members continue to make overall progress in reducing tariffs and generally remain on track towards achieving the Bogor goals in the area of tariffs. The PECC study notes, however, that the assessment covers three years during which APEC's WTO members were implementing their Uruguay Round commitments and that a number of tariff peaks remain in the agricultural, automotive, textile, clothing and footwear sectors.

Box 6.1
Trade Reforms Since the Onset of the East Asia Crisis

Indonesia: tariffs on most food items cut to a maximum of 5 per cent; all tariffs, import controls and domestic subsidies eliminated on wheat, sugar and soyabeans; reduction of tariffs and removal of tax incentives linked with the level of local content in the automotive industry; and a commitment to phase out all remaining quantitative import restrictions and other non-tariff barriers.

Korea: progressive phasing out of the Import Diversification Programme banning importation of certain goods; reduction of tariffs on a number of items including industrial inputs (to zero or near-zero levels) and foodstuffs.

Malaysia: a range of tariff reductions announced in November 1999 on food and manufactured/industrial products, including fruit, vegetable, dairy and seafood products of significant value to Australian exporters.

Thailand: tariffs on cotton and wool completely removed following a comprehensive review of tariffs in August 1999. Tariffs on lupins reduced from 35 to 5 per cent; on plywood, veneered panels and laminates from 60 to 20 per cent. Other tariff reductions. A 10 per cent surcharge, which had applied to most imports, also removed.

Some trade within the region is being liberalised through regional trading arrangements. The ASEAN Free Trade Area (AFTA) aims to reduce tariffs on intra-ASEAN trade for most products and members to 0-5 per cent by 2003. Many of the reductions made towards this goal have been on a non-discriminatory basis either as implementation of Uruguay Round undertakings or as part of subsequent unilateral liberalisation and economic reform packages.

Non-Tariff Barriers

Tariffs are, of course, not the only barriers affecting market access. The proliferation of non-tariff measures (NTMs) applied by trading partners including in Australia's major markets and competitors can significantly undermine, if not negate, the value of tariff reductions and bindings. Price controls, import licencing arrangements and technical standards are among the major forms of non-tariff barriers.

Since the Tokyo Round of GATT negotiations, considerable progress has been made in introducing disciplines on a range of non-tariff barriers. During the Uruguay Round the previous codes on non-tariff barriers in areas such as anti-dumping, technical barriers to trade, customs valuation, subsidies and countervailing measures, and import licensing procedures were strengthened and these new arrangements extended to all members. New disciplines were introduced on sanitary and phytosanitary measures.

Further efforts to address NTMs are being pursued in APEC. Its work on trade and investment facilitation targets impediments which increase exporters' costs, cause delays, create inefficiencies and deny access to markets. Good progress has been made in addressing differing national standards, customs procedures, investment regulations, restrictions on business travel and other administrative and regulatory barriers.

(c) Other International Economic and Trade Developments

The outlook over the medium to longer-term is for greater competitive forces in most regions of the global economy. Globalisation is bringing new players into international markets, feeding greater economies of scale, increasing competition, and squeezing margins. A number of specific changes have led to substantial advances in productivity and the use of technologies in many economies, among them Australia's major trading partners and a growing list of emerging markets. Thus:

- tariff reduction programmes in many economies, often associated with multilateral, regional and bilateral trade negotiations, have enhanced the efficiency of economies where tariff regimes had formerly limited growth potential

- deregulation and privatisation in a number of key industries, including mining, telecommunications and power generation, are opening them to competition and raising their efficiency. Private sector participation is introducing commercial best practice to these and other areas

- growing flows of foreign direct investment (FDI) are encouraging domestic companies to perform against international benchmarks in order to compete

- the increasing trend toward capital raising in equity markets (as distinct from debt financing) is placing added pressure on companies to improve productivity and profitability

- labour reforms are being implemented globally, including in emerging markets. In addition, rising education levels are improving the stock of human capital

- technology is improving organisational management and delivery of both products and services, contributing to more efficient production processes, as well as more efficient supply processes such as Just-In-Time

- increased global competition is evident across all areas of economic activity. For instance, developed economies, and even some emerging economies, are becoming increasingly services-oriented, introducing an increasing level of supply and competition in services trade.

These trends are changing the environment in which the Australian economy operates. In particular, the recent reforms introduced by East Asia's economies in response to the 1997-98 East Asian economic crisis, and further reforms being developed, are likely to improve their competitiveness in international product and services markets. While the extent of reform varies across the region, the economic environment in post-crisis East Asia will foster much greater economic efficiency compared to the pre-crisis period.

In the increasingly dynamic world economic environment, ongoing economic reform will be necessary in order to achieve the flexibility required to remain competitive. Only internationally competitive Australian firms will be able to take advantage of commercial opportunities that emerge in the global economy. One practical implication is that Australian businesses will need to minimise their cost of inputs, including imported goods now attracting tariffs, in order to maintain competitive pricing.

It is also important to note that the momentum of globalisation, and many of the other changes outlined above, will not be held back by any one economy or group of economies resisting liberalisation and reform. Moreover, the benefits that globalisation has to offer will be delayed for countries that resist.

(d) The Impact of the Floating Exchange Rate on the Competitiveness of Australian Industry

The value of the Australian dollar has fluctuated appreciably since it was floated in December 1983. Changes in the exchange rate have played an important part in transmitting price signals, and in encouraging industries to adjust to changing international market conditions.

The exchange rate appears to be much less volatile now than it was immediately after the float. Even so, it is still not uncommon for the average value of the Australian dollar in terms of US dollars to change by 3-6 per cent from one quarter to the next. Over a number of quarters, movements in the value of the dollar can be much bigger. Between December 1993 and December 1994, for example, the Australian dollar appreciated by 13.4 per cent against the US dollar in nominal terms. Between December 1996 and September 1998, it depreciated by some 24.7 per cent.

The extent to which exchange rate changes "pass through" to changes in prices at the wholesale and retail level has been the subject of some discussion, both in Australia and in other economies. In Australia's case, econometric work suggests that import prices charged by foreign suppliers adjust fairly quickly and fully to changes in the effective exchange rate. However, local importers and retailers may absorb a somewhat higher proportion of changes which they experience.[28]

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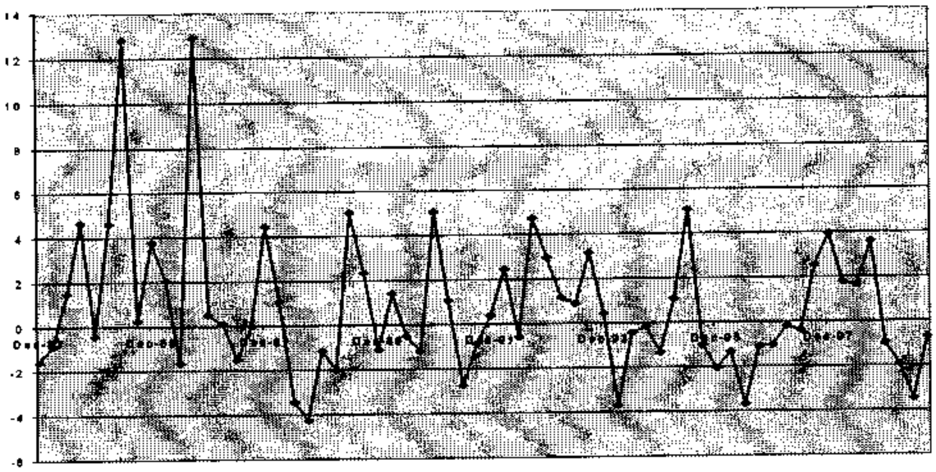
[28] See R. Philipps, "Exchange rate pass-through and import prices", in C. Hamilton (ed.), *The Economic Dynamics of Australian Industry*, Allen and Unwin, North Sydney, 1991, pp.30-46.

Chart 6.1
Import Price Fluctuations: Manufacturing
percentage change, quarter on quarter



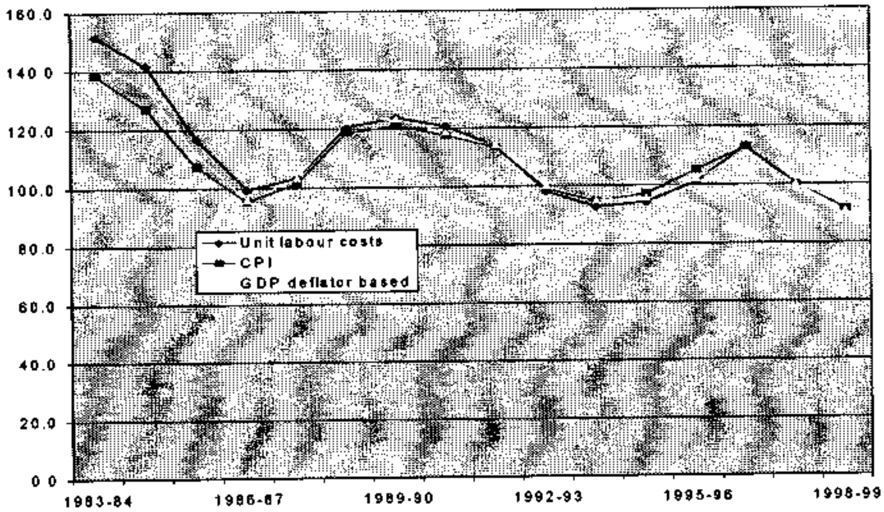
Source: ABS

ABS data on import prices shows big short-term fluctuations. In the case of prices of manufactured imports, for example, changes of around 3-4 per cent from one quarter to the next are quite common. Over a number of quarters, much bigger movements can occur. Between June 1995 and June 1997, for example, the ABS import price index for manufactured imports fell by 10.3 per cent. Between June 1997 and September 1998, it rose by 14.2 per cent.[29] The changes which industry faces as a result of the normal operations of the market are thus very large compared with the tariff.

Changes in the competitiveness of Australian industry over the medium term are affected by movements in domestic and foreign costs of labour and other inputs to production, as well as by changes in exchange rates. The Department of Treasury publishes three measures which track changes in costs and prices in Australia and four economies, adjusted for exchange rate changes. The four economies - the United States, Japan, UK and Germany – account for about 45 per cent of Australia's imports. The measures used are respectively based on the GDP-deflator, consumer prices and unit labour costs. While they need to be employed with some caution, they provide a broad measure of changes in the competitiveness of Australian industry relative to imports from major suppliers.

[29] Since the import price index measures prices f.o.b. (free on board) and may not take into account the way in which importing agencies and retailers absorb fluctuations, the actual changes may be somewhat less for the final user or consumer, as well as less marked for competing domestic manufacturers.

Chart 6.2
Competitiveness Indicators
1997-98 = 100



Source: Department of the Treasury. A fall in the indicators shows an improvement in Australia's competitiveness. The indicators are based on movements in Australian costs relative to the geometric averages of exchange rate adjusted costs for Australia's four major import sources – the US, Japan, UK and Germany. The text provides further details.

Chart 6.2 shows that the three measures are quite closely correlated, and have tended to move together over time. Competitiveness, as measured by these indicators has improved since the dollar was floated, with the overall improvement between 1983-84 and 1998-99 between 34 and 40 per cent. However, most of this change occurred between 1983-84 and 1986-87. All of the indicators suggest appreciable fluctuations in the competitive position of Australian industry vis-a vis major import sources, with major changes in competitiveness of the order of 20 percent over as little as 1-3 years. Between 1996-97 and 1998-99, for example, all three measures showed an improvement in competitiveness with respect to major import sources of 18-19 per cent.

(e) Implications for Trade Negotiation Strategies, Including How the Timing of Any Reductions in General Tariffs Would Best Assist Australia's Negotiating Position in the Next WTO Round

<u>A New Multilateral Round</u>

The WTO Ministerial Conference held in Seattle from 30 November - 3 December 1999 was unable to achieve consensus on the basis for commencing a comprehensive new round of multilateral trade negotiations. At this point prospects for progressing to a comprehensive round of negotiations are unclear. However, negotiations on agriculture and services are mandated to begin under the "built-in" agenda of the Uruguay Round and will commence in early 2000.

At the Seattle Conference, Australia argued strongly for a round which would be centred on the key market access areas of agriculture, services and industrial products. On market access for both agricultural and industrial products, substantial progress was made in Seattle towards agreement on the basis for negotiating reductions in both tariff and non-tariff barriers. It remains to be seen whether this can be retained in future negotiations on arrangements to launch a comprehensive round of negotiations. However, Australia will be seeking to ensure the results of the Seattle discussions in this area are maintained.

Tariff reductions have historically been an important element of multilateral trade negotiations. There is considerable scope for further reductions in tariffs on both agricultural and industrial products, including especially the elimination of "tariff peaks" and tariff escalation in certain sectors. Tariffs are therefore likely to be an important part of any future WTO negotiations, in spite of the progress that has been made in reducing them in the last fifty years.

Early reductions in general tariffs would have implications for our negotiating position in any new WTO Round. This is partly because liberalisation taken outside the context of multilateral negotiations can be recognised. Credit of this kind - for so-called "autonomous liberalisation" - was the subject of extensive debate during the Uruguay Round when participants (including Australia) became concerned that there would be no recognition of trade-liberalising actions taken outside the context of a round. Acceptance of credit for autonomous liberalisation was acknowledged during that Round as a mechanism through which economies could be encouraged to undertake trade-liberalising measures on a regular basis rather than saving "negotiating coin".

The General Agreement on Trade in Services (GATS) formally makes provision for liberalisation in the services sector undertaken autonomously by WTO members since previous negotiations. In the preparatory talks for the WTO Seattle Ministerial Conference, the issue of credit for autonomous liberalisation was pursued by Australia and other countries, notably the United States. No formal decision on this was taken in Seattle, but with the precedent of the Uruguay Round and acceptance of the principle in the GATS, it is likely that any future WTO negotiations will accept credit for autonomous liberalisation, including for tariff reductions. Australia will continue to press strongly for full credit for autonomous tariff liberalisation prior to or during the course of any new comprehensive round of multilateral trade negotiations.

More importantly, multilateral negotiations on tariffs are normally carried out on the basis of *bound* tariffs rather than *applied* tariffs. If this is the case in future negotiations, then early reductions in Australia's applied tariffs could strengthen our negotiating position rather than weaken it. For example, reducing our applied tariffs might make it possible for Australia to go further in supporting across the board (or formula) reductions in bound rates than otherwise - in the knowledge that this would not require any further changes to applied rates.

Reductions in general tariffs would not affect tariffs on PMV and TCF. DFAT's assessment is that, in future negotiations, these sectors are more likely to be targeted by our trading partners than the items covered by the terms of reference of this Inquiry. TCF is likely to be a particular priority for least developed economies.

Accelerated Tariff Liberalisation

As a means of progressing the APEC Bogor goals, APEC Ministers agreed in 1997 to consider early voluntary liberalisation which would have a positive impact on trade. This became an important focus of APEC's work in 1998. However, at the Kuala Lumpur meeting in November of that year, APEC Ministers transferred the package of tariff reductions established through the Early Voluntary Sectoral Liberalisation process to the WTO, where it is known as Accelerated Tariff Liberalisation (ATL). The package covers environmental goods, energy, chemicals, fish and fish products, forest products, medical and scientific equipment and instruments, gems and jewellery, and toys.

In preparatory discussions and at the WTO Seattle Ministerial Conference, there was only limited interest in making any commitment to processes involving sectoral liberalisation in the WTO. Priority was given to ensuring a mandate for comprehensive negotiations on industrial/non-agricultural products. A critical mass of support for the package in the WTO would be required if the ATL package were to be implemented. Not all APEC members are prepared to commit themselves to implementation of the full package.

Preferential Regional Trade Agreements

Australia is willing to consider free trade arrangements with other significant individual economies or regional groupings, where they would deliver faster and deeper liberalisation than the multilateral process, with the objective of gaining better market access for our exporters, faster economic growth and stronger employment growth. As noted in the Joint Communique by Australian and New Zealand Prime Ministers on 4 August 1999, such arrangements would need to reflect the principles underpinning CER, including WTO consistency. At the same time, Australia has indicated that it accords the highest priority to achieving broad trade liberalisation though the WTO.

Currently, Australia is participating in a study which seeks to assess the feasibility of achieving a comprehensive free trade agreement involving ASEAN economies, Australia and New Zealand by 2010. The decision to undertake this work was made in October 1999, at a joint meeting of Ministers from ASEAN, and from the Australia New Zealand Closer Economic Relations (CER) Agreement. The study will be carried forward by a taskforce, on which Australia is represented by former Deputy Prime Minister and Minister for Trade, the Hon Tim Fischer MP. The Task Force is scheduled to meet three times over the course of the year, prior to presenting its report to the next meeting of ASEAN and CER trade ministers in Thailand in October 2000.

It is too early to predict possible outcomes of the study, or the scope of an eventual free trade area.

(f) Interaction with the Various Tariff Concession Arrangements Including the Manufacture in Bond and Tradex Schemes

The TRADEX scheme is an initiative which arose from the Prime Minister's 1997 *Investing for Growth* statement. It aims to allow for the importation of goods, without payment of customs duty or taxes, provided the goods are subsequently exported or incorporated in other goods that are exported. TRADEX replaces the Tariff Export Concession (TEXCO) Scheme, incorporating improvements designed to make it possible to re-export goods, reduce compliance and administrative costs and increase industry utilisation (estimated at only 50 per cent under TEXCO).

DFAT considers that the improvements introduced under TRADEX will help to improve export competitiveness. Even the streamlined arrangements being put in place involve some compliance costs for industry however, and there may be practical difficulties in utilising the arrangements when goods are transformed a number of times. DFAT considers that eliminating general tariffs will help to address these remaining problems, by providing duty free access for a wide range of goods for exporters. For the same reason, it would provide the benefits of duty free entry for goods affected at a lower cost to industry, and under much less restrictive conditions, than the Manufacture in Bond scheme.[30]

(g) Budgetary Implications, Including the Effects of Any Changes in Domestic Economic Activity Flowing From Tariff Reductions

The stimulus to economic activity resulting from tariff cuts can generate additional revenue from a number of sources. These include income and corporate taxes, as well as broad-based taxes on consumption, where revenue is likely to be closely linked to growth. Eliminating tariffs can also reduce the cost of customs administration to some extent (although in Australia's case, it would still be necessary to administer the tariff for statistical and other purposes). At the same time, customs revenue itself will fall.[31] The overall impact of tariff reductions on revenue is not necessarily clear-cut given these conflicting tendencies, but can be positive if the more broadly-based taxes generate sufficient revenue.

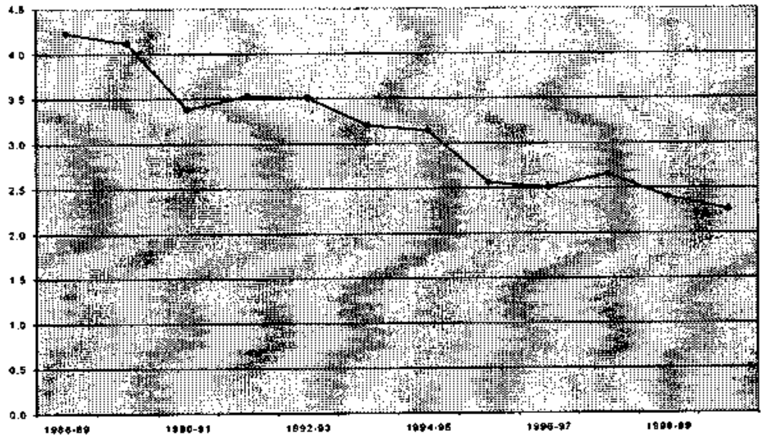
In Australia's case, customs duty has declined appreciably as a share of total Commonwealth revenue, falling from around 4.2 per cent of the total in 1988-89 to an estimated 2.2 per cent in the current financial year (see Chart). The nominal dollar amount of duty collected has remained fairly constant, however. An appreciable part of duty collected (an estimated $890 million of the total customs revenue of around $3640 million in 1999-2000) consists of duties imposed on imported petroleum products, tobacco, beer and spirits which are the equivalent of domestic excise duties. This would not be affected by any change to general tariffs.

[30] The Manufacture in Bond scheme allows firms to import goods into a warehouse licensed by the Australian Customs Service, free of duty and sales tax, provided the goods are re-exported in their original or in manufactured form.

[31] Another offsetting factor, if tariffs are reduced rather than eliminated, is the increase in import volumes resulting from lower tariffs.

Customs duty excluding these excises is about 1.7 per cent of total Commonwealth revenue. Part of this includes duties on PMV and TCF products not covered by the current review. The impact of any further reduction in general tariffs on revenue would therefore be quite limited, even without considering offsetting factors such as greater revenue resulting from increased economic activity.

Chart 6.3
Tariff Revenue as a Percentage of Total
per cent



Source: Commonwealth Government 1999-2000 Budget Paper No.1.

Studies undertaken by the European Commission on the development of the Single Market suggest that administrative and related costs to *firms* from tariffs (including delays and business forgone) are much bigger than the administrative costs for *governments*. Moreover, the Commission's work suggested that costs were much higher for small firms rather than big firms, with customs costs up to 30-45 per cent higher for companies with less than 250 employees.[32] It is not clear how far this experience applies to Australia. Moreover, costs have almost certainly declined with computerisation of customs procedures.

Work published by the International Monetary Fund suggests that taxes on international trade should play a minimal role in best practice taxation policy (Box 6.1). Additional costs from the distortions resulting from tariffs ultimately flow on to consumers, providing a burden which adds to the quite substantial tax which tariffs themselves impose.

[32] See P. Cecchini et. al., *The European Challenge: 1992; the Benefits of a Single Market*, Wildwood House, Aldershot, 1988, pp.8-10.

Box 6.1
Tariffs and Taxation

Tariffs are typically a major source of tax revenue when economies are at an early stage of their development and lack the administrative instruments and economic base required for a more broadly based taxation system. The contribution of tariffs tends to decline with further economic development.

Research published by the International Monetary Fund suggests that, for developing economies, best practice in taxation policy should focus on taxes which minimise distortions in resource allocation, are equitable and are simple to administer. According to the Fund research, this means that "Taxes on international trade should play a minimal role. Import tariffs should have a low average rate and a limited dispersion of rates, to reduce arbitrary and excessive rates of protection. Exporters should have duties rebated on imported inputs used for producing exports". The authors also suggest that a broad-based consumption tax should also be introduced or strengthened.[33] These principles are also applicable to more developed economies.

Like other taxes, tariffs encourage efforts by the private sector at minimisation. These efforts may range from outright evasion to attempts to reclassify goods in order to obtain lower tariff rates or to use preferential arrangements to import goods at a lower cost. These efforts can result in added costs/distortions for the economy, but are less likely to be significant when tariffs are low and relatively uniform.

(h) The Economic, Social, Environmental and Regional Policy Objectives, Including Employment Objectives, of Australian Governments

Employment

The elimination of general tariffs is expected to have only small implications for aggregate employment. DFAT's assessment is that it is quite likely that the overall impact would be positive in the short term.

As tariffs are reduced, employment in protected sectors may well contract, at least in the short term. But removing tariffs creates new jobs. Output in less protected sectors is likely to expand, generating new jobs in other parts of the economy. For example, reductions in tariffs on consumption goods gives consumers more money to spend in other parts of the economy. Because jobs lost are highly visible, and those gained elsewhere much less so, tariff reform is often wrongly equated in the popular mind with job losses.

Even for protected industries, the impact of tariff reductions is frequently exaggerated. Short-term job losses in specific industries are often driven by such

[33] L. Ebrill, J. Stotsky and R. Gropp, *Revenue Implications of Trade Liberalization*, International Monetary Fund, Washington, D.C., 1999, p.8.

factors as rapid technological change, structural adjustment, cyclical economic factors and firm level strategies to lift productivity. These are often of far greater importance than changes in tariffs and may lead to job losses in particular industries even if tariffs are maintained or increased. In the highly protected PMV and TCF industries, for example, employment has declined even during periods of rising tariffs.

The modelling discussed in Section 5 suggested that removing all remaining tariffs (including for PMV and TCF) would create around 40,000 additional jobs in the short term (within 2 years), with increased employment in all industries except PMV and TCF. All occupation groups would see employment growth except plant and machine operators (prominent in the PMV and TCF industries). Groups that would gain less included less skilled workers, such as labourers and clerks.

One important way in which tariff reductions can contribute to employment is through their impact on exports. A 1996 survey of Austrade's exporter clients showed nearly 60 per cent had either increased employment or expected to do so as a result of exporting. Sixty four per cent expected improved profitability as a result of exporting. Similarly, a 1996 Australian Bureau of Statistics survey of the growth and performance of small and medium-sized enterprises showed that a higher proportion of exporting businesses increased employment than non-exporting businesses. Manufacturing surveys by the ABS show that employees in export related jobs are paid more, and that the pay gap between exporters and non-exporters increased during the 1990s. Average wage and salary payments by exporters in 1997-98 were nearly 30 per cent higher than for non-exporters.

Rural and Regional Policy Objectives

Rural and regional Australia has been a major policy focus of Australian governments in recent years, reflecting concern with the social and economic gulf dividing regional and urban Australia. The priority the Government has accorded to rural and regional Australia was reflected in the Regional Australia Strategy announced in 1998, and more recently in the Regional Australia Summit held in Canberra from 27-29 October, 1999.

Regional and rural communities have undergone massive changes in the last few decades, but for reasons which have often been beyond the capacity of Government policy to influence. According to the Productivity Commission's own study on *Impact of Competition Policy Reforms on Rural and Regional Australia*:

> Broad long-term economic forces which are beyond the control or influence of governments have been key drivers of the economic and social changes of particular relevance to country Australia. These include: changing technology and increasing productivity; rising incomes and changing lifestyles; and declining world agricultural and mineral commodity prices.[34]

Changes in tariffs and other forms of industry assistance have had an uneven impact on rural and regional Australia. Overall, however, there is no doubt the impact has been positive. Export-oriented industries forming the economic base of major parts of rural and regional Australia – agriculture, mining and tourism – are major beneficiaries of tariff reform (see Section 5 above). The agriculture, mining and

[34] Report No. 8, AusInfo, Canberra, 1999, p.78.

services industries would also benefit from further reductions in general tariffs. Tariff reform would assist the development of new manufacturing industries based in regional Australia which aim to serve the global market.

Environmental Objectives

The environmental impact of reductions in general tariffs is complex, since tariff reductions will affect both total output and its composition. DFAT's assessment is that further tariff reform, backed by sound environmental policies, would be consistent with the promotion of ecologically sustainable development. Tariff reform is expected to contribute to greater efficiency in resource use as well as improving access to new technologies, including those that have environmental benefits. Given the generally low level of most Australian tariffs, however, it is unlikely that there would be significant environmental impacts associated with either the retention or removal of these tariffs.

There is considerable public interest in the environmental impacts of trade liberalisation. The international community agreed at the 1992 UN Conference on Environment and Development to make trade and environmental policies mutually supportive in promoting sustainable development. There is a broad international consensus that trade liberalisation, when complemented by appropriate environmental policies, will contribute to sustainable development. In particular, there is strong support for the view that further trade liberalisation that improves the economic opportunities of developing countries is a necessary requirement for sustainable development.

(i) Existing Preferential Trade Arrangements

Australia has preferential trading arrangements of varying scope with a number of economies. The Australia New Zealand Closer Economic Relations – Trade Agreement provides for reciprocal free trade between Australia and New Zealand. Agreements with the members of the South Pacific Forum (SPARTECA) and Papua New Guinea (PATCRA II) also provide for duty free entry into Australia for goods meeting relevant rules of origin. Tariff preferences are provided under the Canada-Australia Trade Agreement (CANATA) for some products.[35] In addition, under the Australian System of Tariff Preferences, many goods originating in developing countries attract preferential (i.e. reduced) rates of duty.

The Australia New Zealand Closer Economic Relations (CER) Trade Agreement

The CER Trade Agreement is one of the world's most comprehensive bilateral trading arrangements. The objectives of the Agreement are to develop closer economic relations between Australia and New Zealand through a mutually beneficial expansion of free trade under conditions of fair competition and through the gradual and progressive elimination of barriers to trade between the two countries. All tariffs and quantitative import or export restrictions on trade in goods originating in the Free Trade Area are prohibited under the CER Agreement.

[35] Australia's 1958 Trade Agreement with Malaysia included four schedules listing Australian and Malaysian goods on which preferential tariff rates were applicable. However, these are not included in the new Trade Agreement with Malaysia which entered into force on 1 January 1998.

The preferential access which Australian goods gain under CER is now modest. New Zealand's remaining applied tariffs are generally low (the only exceptions are in the TCF sector). In 1998, New Zealand implemented a tariff reduction program to achieve zero tariffs by 2006 (see Table 6.2). New Zealand's new Labour-Alliance Government has signalled that it will review this program. Prior to the November 1999 election, the NZ Labour Party was proposing to freeze remaining tariffs at year 2000 levels for at least five years, or until trading partners match those levels, while promoting transitional measures to allow industries to prepare for the lower tariffs.

Table 6.2
New Zealand: Tariff Removal – Indicative Program

Goods	2000	2001	2002	2003	2004	2005	2006
(a) Textiles, clothing and accessories, carpets, headgear, footwear	15% 10% 5%	15% 10% 5%	15% 10% 5%	15% 10% 5%	10% 8% Free	5% 4%	Free Free
(b) Motor vehicle components	10%	5%	Free				
(c) Other products	5%	Free					

Notes: The rates detailed above "ad valorem" duties (calculated on the basis of value). The phase-out program uses ad valorem rates as its basis. 1 July will be the date of tariff change. From 1 July 2006, no tariff duty will be payable at all on any goods imported.

Reductions in Australia's general tariff would weaken New Zealand's price advantage for some goods in the Australian market relative to competing economies. However, DFAT's assessment is that it would not adversely affect bilateral relations with New Zealand or the strength of CER. Implementing unilateral tariff reductions on a most-favoured-nation basis is consistent with the outward-looking trade liberalisation policies currently pursued by both countries.

<u>The South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)</u>

Australia's (and New Zealand's) trade and economic relations with the Forum Island Countries (FICs) are conducted under the aegis of SPARTECA.[36] SPARTECA provides a framework for assisting FICs with their economic development and trade performance and, subject to meeting a 50 per cent local or area content rule, FIC

[36] Palau has not yet ratified the Agreement.

exporters are eligible for free and unrestricted access to the Australian (and New Zealand) markets for virtually all products.[37]

SPARTECA's value to FICs has been diminishing because the overall decrease in tariff rates in Australia has been removing the marginal preference which is its main benefit. Even with further reductions in general tariffs, however, it would still be of value because of the preferential access it provides for TCF and PMV items. TCF products, in particular, are major imports from Fiji. DFAT's assessment is that further reductions in general tariffs would not cause problems in our relations with the FICs and that there are other, alternative approaches which could provide a more effective means of promoting the development of these economies.

At the Pacific Island Forum in October 1999, Leaders endorsed a recommendation by the Forum Trade Ministers that a Pacific Regional Trade Agreement (PARTA) be negotiated over the next two years. Australia and New Zealand, as members of the Pacific Island Forum, will be included in the agreement "in appropriate ways" reflecting their level of development. Negotiations are expected to commence in June/July 2000.

<u>Agreement on Trade and Commercial Relations between the Government of Australia and the Government of PNG (PATCRA II)</u>

PATCRA II seeks to strengthen trade, investment and private sector cooperation between Australia and Papua New Guinea, in the context of the close trading and commercial relationship. It aims to ensure the commercial relationship is mutually beneficial and and takes account of the capacity, resources and development needs of both countries. Under it, PNG receives duty free entry into Australia for goods meeting relevant rules of origin.

As in the case of SPARTECA, reductions in Australia's general tariff would be unlikely to have a negative impact on the bilateral relationship.

<u>The Canada-Australia Trade Agreement (CANATA)</u>

CANATA, which was negotiated in 1960 and amended in 1973, provides for preferential trade access for bilateral trade between Canada and Australia on a range of specified goods. While it continues to provide benefits to both countries, its significance has declined as a result of sweeping reductions in tariff rates in both countries and as patterns of trade have changed since the items of merchandise covered by preference were first agreed.

Today, Canada is eligible to receive CANATA preferences on nearly 450 tariff lines. The value of the preference over the MFN rate varies from 1 per cent (for some fruits and vegetables and lumber) to 15 per cent (for car batteries). The margins of preference and the number of tariff lines affected are summarised in Attachment C.

The 1973 Ministerial Exchange of Notes amending CANATA established a 30 day notification and consultation procedure whereby either party could reduce or

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[37] In the case of some PMV products, the FICs receive a 5 percentage point preference.

eliminate CANATA tariff preferences. The procedures are summarised in Attachment C. In the event that one party proposes to reduce tariffs on goods covered by CANATA, that party should provide 30 days advance notice, during which time (depending on the category of good) the other party is entitled to consult. If the proposed reduction goes ahead, the other party would be entitled to withdraw "substantially equivalent concessions". If changes in the Australian general tariff were to negate Canada's preferences under CANATA, Australia's preferential access to the Canadian market could also be affected.

The Australian System of Tariff Preferences

Preferential tariff arrangements for developing countries were formalised in the GATT through a decision of 25 June 1971 which granted a waiver to preference-giving countries in accordance with the Generalised System of Preferences (GSP). In that decision, it was recognised that the principal aim of a preference to developing countries should be to promote their economic development. It was noted that the grant of preferences did not constitute a binding commitment and that it should be a temporary measure.

The Australian System of Tariff Preferences (ASTP) was introduced in 1965. It was one of the models on which the GSP was based. A tariff preference of 5 percentage points was applied to imports of all goods from any developing country. Over time, the ASTP has been modified to reflect the improved prospects for economic growth and development among developing countries. It now applies only to 48 countries identified by the United Nations as the Least Developed Countries (LDCs) and a number of other small island developing countries and territories.

For most products (about 85 per cent of tariff lines), this results in duty-free and quota free access for these beneficiary countries, either because the general tariff rate is zero or through the 5 percentage point tariff preference. The preferential tariffs are higher than zero for textiles, clothing and footwear, the automotive sector and cheese. Australia also provides duty free access for virtually all exports from Forum Island Countries, most of which are not LDCs.

The value of trade covered by the ASTP is limited. TCF products are of particular interest to developing/least developed countries and this is an area where, even with preferential treatment, the tariffs rates faced by these countries remain high.

The progressive reduction of general tariffs on a global basis has reduced the benefits derived by developing and least developed countries under the GSP. There is recognition amongst developed and more advanced developing countries of the need to assist the further integration of LDCs into the global trading system. These countries remain marginal participants in world trade and generally face significant obstacles to promoting their economic development and improving the low living standards of their populations.

In the lead up to the WTO Ministerial Meeting in Seattle, there was significant pressure on developed countries to agree to improve access for LDCs by agreeing to grant them duty free access on all products. Some LDCs pushed for such tariffs to be bound rather than granted on a voluntary basis. Most developed countries appeared ready to agree to a commitment to provide duty free access for 'essentially all products' from these countries. Although Seattle did not achieve an outcome on this or other issues, the proposal for duty free - and possibly quota free - access from LDC is likely to receive continuing profile in coming months. Although, as noted above, Australia already provides duty-free access for these countries for 85 per cent of tariff lines, there could be pressure for us to look at ways to improve this. Further reductions in general tariffs (i.e. all tariffs of 5 per cent or less and excluding those relating to PMV and TCF) will not increase the number of zero tariffs faced by LDCs.

(j) The Government's Commitment to the APEC Goal of Free and Open Trade and Investment in the Asia Pacific by 2010 for Industrialised Economies and 2020 for Developing Economies

The Bogor commitment to free and open trade and investment (see Section 3 and Attachment D) has been reaffirmed by APEC Leaders on a number of occasions, including in Vancouver in 1997, against the background of serious financial crisis in the region. The Bogor goal was reiterated most recently when APEC Leaders (including Prime Minister Howard) met in Auckland in September 1999.

The Bogor commitment to free and open trade is comprehensive. In Osaka in November 1995, APEC Leaders endorsed a broad framework for achieving the Bogor commitments. The focus of this framework (the Osaka Action Agenda) was on broad principles and procedures for implementation. It provided for the development of a plan (the Individual Action Plans referred to previously in this Submission) for achieving free and open trade and investment. The Osaka Action Agenda indicated that APEC economies were to achieve the goal of free and open trade, among other ways, by progressively reducing tariffs and non-tariff measures.

IAPs have normally been updated annually by APEC economies. In many cases, they continue to focus on near term liberalisation achievements and objectives. In some cases, however, APEC economies have provided long-term commitments. As already noted, New Zealand's IAP includes a commitment to achieve zero tariffs by 2006. Singapore and Hong Kong have agreed to bind all tariffs at zero by 2010.

Australia has a strong interest in achieving more open markets in the region and in maintaining the Bogor commitments. As noted already, around 70 per cent of our exports go to the region. A decision to eliminate general tariffs ahead of the Bogor date of 2010 for industrialised economies would allow us to work with like-minded economies for more ambitious commitments by other APEC economies. DFAT notes, however, this would also require Australia to move towards further liberalisation of PMV and TCF when these sectors are reviewed again in 2005.

7. FURTHER REFORM OF NUISANCE TARIFFS

On 8 December 1999, a proposal for the elimination of "nuisance" tariffs on 268 items was tabled in the House of Representatives, with a date of effect of 15 December. This followed an extensive process of public consultation on items to be included in the package, commenced by the former Minister for Industry, Science and Tourism, the Hon. John Moore in 1998. In the consultations which developed the package of 268 items, "nuisance tariffs" were defined as items for which annual customs revenue was less than $A100,000; for which there was no significant local production; and for which the tariffs were between 1 and 5 per cent.

DFAT considers that the elimination of tariffs on these items would contribute to strengthening industry competitiveness, since they tax inputs used in production in Australia, in some cases where the end product enters duty free. At the same time, experience has demonstrated that identifying nuisance tariffs is a difficult process. DFAT's assessment is that there would be much stronger gains from an across-the-board elimination of general tariffs.

DFAT considers that if further work to identify nuisance tariffs is undertaken, the criteria used to identify them should be modified. In discussions on trade policy the usual definition of a "nuisance" tariff is one where the costs of collection are greater than the revenue derived. It would be more appropriate to focus on items where costs of tariffs (particularly to business) are high relative to the revenue received, rather than on those where there is no significant local production.

8. THE TARIFF CONCESSION SCHEME AND PROJECT BY-LAW ARRANGEMENTS

The schemes under this heading allow goods to be imported at concessional rates under certain circumstances. The Tariff Concession Scheme thus allows goods to be imported duty free (for consumer goods) or at 3 per cent duty (other goods) where no substitutable goods are produced in Australia, provided a Tariff Concession Order (TCO) has been approved. Some classes of goods are not eligible for a TCO. Project By-Law arrangements allow for duty free entry of imported goods and certain materials in specified circumstances.

DFAT's assessment is that these schemes continue to benefit Australian industry and consumers. However, eliminating general tariffs would provide duty free access for imported inputs and capital goods affected, without the restrictions and compliance costs associated with the Tariff Concession Scheme and Project By-Law arrangements.

In the event that general tariffs are to be phased out, there would be value in maintaining the Tariff Concession Scheme and Project By-Law Arrangements for as long as they continue to provide appreciable benefits, after taking into account the administrative costs involved. There could be merit in modifying the Tariff Concession Scheme to reduce the concessional rate of duty for goods other than consumer goods to zero while general tariffs are phased down.

9. OTHER ISSUES

(a) Import Data for Tariff Negotiations

As Australia's tariffs are changed, it will be important to retain access to statistical data on imports relating to WTO bound tariff items.

Tariff offers in multilateral negotiations are usually assessed on import levels over the most recent three year period for each tariff line subject to negotiation. A large number of Australian WTO tariff concessions (or "bindings") relate to 8 digit tariff lines or to ABS statistical codes at the 10 digit level. The current practice adopted by the Australian Customs Service is to close up 8-digit tariff lines as applied tariff rates converge. This sometimes results in the ABS closing up 10-digit statistical codes, reflecting the cost of maintaining highly detailed statistical codes for both industry and government administration.

However, failure to maintain ABS statistical codes at the 10-digit level relating to WTO bound tariff items would mean that it would not be possible to identify import levels relating to Australia's WTO tariff commitments and future tariff negotiation offers. It would have implications for Australia's ability to conduct future tariff negotiations in the WTO. DFAT considers that due recognition needs to be given to the importance of maintaining the statistical information needed for these negotiations given the significant economic benefits derived from tariff negotiations.

10. OPTIONS FOR FURTHER GENERAL TARIFF REFORM

A number of possible options could be considered in relation to general tariffs. Three possibilities would be:

a. to reduce general tariffs (i.e. all tariffs of 5 per cent or less and excluding those relating to PMV and TCF) to zero by 2005

b. to reduce general tariffs to zero by 2010

c. to leave general tariffs at existing rates and carry out a further review in 2005, when tariffs for PMV and TCF are again reviewed.

DFAT considers that eliminating all general tariffs ahead of the Bogor end-date of 2010 could bring significant economic benefits. A decision in principle to move towards elimination of general tariffs would also allow Australia to take a leading role in negotiations/discussions in any new WTO Round and in APEC.

Given that general tariffs are at most 5 per cent, the Department considers a program to eliminate general tariffs ahead of the Bogor end-date to be quite manageable.

Elimination of general tariffs before 2005 would assist the PMV and TCF industries to adjust to lower rates of protection which will enter into force on 1 January 2005.

Within the scope of option (a) and (b), it would be possible to stage reductions in a variety of ways. For administrative reasons, however, it might be preferable to reduce tariffs from 5 per cent to zero with at most one intermediate staging point.

DFAT notes that the views of specific industries towards further tariff reductions are mixed. A number of major industry groups see the advantages, internationally and domestically, of tariff reductions. However, others remain preoccupied with the domestic impact of further tariff reductions, particularly in relation to their competitiveness in the Australian market. Some may seek adjustment support programs as well as improved market access in return for tariff reductions. In considering arrangements for adjustment support, consideration needs to be given to current WTO disciplines, including those relating to subsidies. It will also be important to ensure that the gains achieved through tariff elimination are not negated by other trade distorting non-tariff measures.

DFAT notes that in general, a more ambitious program of reform can ease adjustment problems. For example, cuts in general tariffs can lower adjustment costs imposed on non-traded sectors from microeconomic reform. Tariff reductions in the PMV and TCF sectors prior to 2000 will reduce the impact of cuts in general tariffs for firms which use their inputs. Similarly, reductions in general tariffs will reduce costs for the PMV and TCF sectors assisting them to deal with further tariff cuts post-2005.