



## 9. The regional dimension

### Australia's regional trade interests

A leading international policy interest of successive Australian Governments has been to secure closer engagement with Asia, including by economic integration. A principal vehicle has been APEC, largely an Australian initiative. There has also been interest in sub-regional trade linkages. Some concern has been voiced in Australia that seeking a trade agreement with the United States will diminish Australia's commitment to engage with Asia. This chapter looks at the implications of an FTA with the US for Australia's interests, both economic and political, in Asia.

### Attitudes in East Asia to trade liberalisation

Australia's trade policy has shown an enduring interest, and demonstration of interest, in advancing engagement with Asia on a regional and bilateral basis. However, while economic integration was a high priority for most East Asian Governments through most of the 1990s, it is clear that today, especially following the Asian economic crisis, trade liberalisation is a lower priority. This is despite the welter of proposals for new trade and regional agreements that continue to be put forward around the Asia Pacific region.<sup>1</sup>

While the term "free trade" is used to describe many of these proposals, the record of the East Asian region on trade liberalisation since the mid-1990s is patchy. Efforts to implement the proposed program of Early Voluntary Sectoral Liberalisation in APEC could not secure consensus at the APEC Summit in Kuala Lumpur in 1998, principally because of opposition from Japan. The process of trade liberalisation in the ASEAN Free Trade Area has all but stalled because of difficulties in implementing the agreed tariff cuts, including Malaysia's refusal to reduce tariffs for its automotive sector. Commitments to liberalise financial services among ASEAN countries likewise remain

---

<sup>1</sup> There are proposals by Singapore for bilateral free trade agreements with the US, Japan, Australia, NZ (completed); by Korea with Mexico, Canada, NZ; by Australia and the US, Singapore, and Thailand; and for a bilateral FTA between New Zealand and Hong Kong. There are proposals for FTAs/closer economic relationships between Japan and Korea, Japan and Mexico, and between NZ and Chile. There is a proposal for an FTA between China and ASEAN, proposal for Closer Economic Partnership between ASEAN and Australia and New Zealand and there is a proposal to examine an ASEAN plus Japan, Korea and China economic relationship.

unimplemented. And the proposal to create a free trade area between AFTA and ANZCERTA had to be substituted for a more modest goal of building a Closer Economic Partnership because ASEAN leaders could not agree to proceed with the idea.

There are two reasons for the fall in support for trade liberalisation. Economic recession in the region led industries to adopt more inward looking approaches, including through calling for trade barriers to be maintained. It also focused leaders on internal issues, such as reform of financial and administrative mechanisms. Secondly, it resulted in a general lack of leadership in East Asia to pursue ambitious international agendas. This has been compounded by political difficulties in some key countries of the region.

However, the need for market-based reforms has never been more relevant. They are at the core of what has to be done to restore economic stability and growth in the East Asian region. Yet the general response has been to defer taking necessary action or, in some cases, retreat from market based reforms. Only China, pursuing its membership of the WTO and domestic economic reform, Taiwan, also ready to accede to the WTO, and Singapore, which is building a network of bilateral agreements, show significant policy momentum in these areas.

## Australian policy

### *Policies for economic engagement in Asia*

Australia has been very active in trying to encourage greater market-based economic integration in the East Asian region. APEC has been the principal instrument for this over the last decade. Australia was an active supporter of the APEC program of Early Voluntary Sectoral Liberalisation (EVSL).<sup>2</sup> Australia has also pursued sub-regional and bilateral approaches. It strongly supported the proposal to bring the ASEAN Free Trade Area (AFTA) and the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) together. Australia has recently completed a joint study with Japan about promoting closer collaboration between the two economies, and has embarked on a similar project with the Republic of Korea. Australia is negotiating a free trade agreement with Singapore and has agreed to undertake a scoping study with Thailand on an FTA.

---

2 Under the EVSL Program, a set of liberalisation measures which APEC members were to implement voluntarily was negotiated. The project was fraught with difficulties. Mexico and Chile elected not to participate, the latter on the grounds that partial liberalisation was undesirable. The limited scope of the measures did not bear scrutiny. In 1997, the welfare effects on the Australian, Chinese Taipei and New Zealand economies were modeled in each country and reported to the annual APEC Study Centre Network Conference. The conclusions for each were that the net effect on economic welfare was negative. When the package was put to Governments to approve at the Kuala Lumpur APEC Leaders Summit, it was vetoed by Japan, not because it was an imperfect model of liberalisation but because the Japanese Ministry of Agriculture considered that it went too far.

Australia also demonstrated its support for the economies of East Asia during the Asian currency crisis. Australia generously funded balances of payments support for Indonesia, Korea and Thailand. Only Japan was more generous.

Despite Australia's willingness to strengthen economic relations in East Asia, its exports to the region have flagged since 1995, owing largely to the economic crisis. They appear to have recovered somewhat in 2000, but a significant amount of that increase can be attributed to increases in oil prices by OPEC (petroleum is a significant Australian export to East Asia) and to rises in world prices for beef and wool.

Despite this recent downturn, Australian policy-makers and governments have continued to emphasise the importance of the region to Australia. At the same time, Australia's successful avoidance of the effects of the crisis also reinforced the value of Australia's strong trade and investment links with the rest of the world.

Nevertheless, whether or not growth recovers in the short term or the long term, and whether or not East Asian economies recover the giddy growth rates of the early nineties, the reality is that in the long term countries in the region will remain major economic partners for Australia. It would be contrary to Australia's self interest not to foster close economic relations with East Asia nor to seek to maintain close political relations.

### *Asian engagement ahead of all other policy?*

One line of reasoning within Australia that has been given some airing in media opinion columns and at conferences is that Australia will diminish its capacity to pursue engagement in East Asia if it concludes an FTA with the United States. One argument appears to be that economic engagement in Asia should be the dominant priority of Australia's international economic public policy. Given the strategic importance of the region to Australia, the case for this can be understood.

However, this has never been the expressed policy of successive governments (all have been careful to avoid saying that one region is more important than other or that one country is more important than another). Although it is certainly true that engagement with Asia has acquired greater importance in Australian diplomacy over the last two decades. There are some implications in the assertion of Asian engagement as the policy interest to override all others that deserve consideration.

Suppose for a moment this is accepted as the dominant policy paradigm. Is this a policy to apply in all circumstances? Where Australia's willingness to engage in further economic integration did not match the policy settings of governments in the region, would the proponents of an "Asia first" policy contend that Australia should eschew opportunities to secure economic integration outside East Asia simply to pursue an apparent political objective?

To assert a political goal (integration with Asia) over an economic goal (allowing trade and investment to expand wherever businesses want to operate) has worrying and costly implications. The fundamental premise of economic integration based on open market economics is that countries should permit natural comparative advantage to work to allow trade and investment to flow wherever it will yield the best return for the nation.

Australia has imposed political objectives over economic self-interest in the past. It used the British Empire then Commonwealth System of Imperial Trade Preferences to ensure that Australia gave preference to British imports and directed its exports to Britain. This had the effect of diverting trade away from Japan and the United States and caused a loss of economic benefit to Australia. The lesson of this was well learnt by Australian farmers who refused all suggestions in the sixties that Australia should not sell wheat to Communist China because Australia did not recognize the People's Republic of China. It would be contrary to the national self-interest to pursue Asian engagement to the exclusion of all other policy and it would receive very little respect in East Asian countries, who themselves have not followed such a course.

There is no cause for Australia to cease doing what it has always done - building close relations without regard to considerations about whether or not strengthening a relationship with one country represented a diminution of interest in strengthening relations with others. This is a standard challenge for diplomacy in all countries.

If the suggestion is that Australia needs to consider any proposal for strengthening its relationship with the United States, such as negotiating an FTA, in the light of its possible impact on relations with countries in East Asia, that is an altogether different proposition. Other countries in the region do not feel so constrained (Singapore is negotiating an FTA with the US and South Korea is studying the idea.) And given that the strengthening of the relationship with the US is important to Australia's economic and political interests, to suggest that actions to strengthen ties should not be pursued for their own merit must surely be to subsume Australia's national interest to that of another country's.

In this respect, there have been suggestions that strengthening the economic relationship with the US might spill over into strategic issues, such as current US interest in building an anti-ballistic missile defence system. Stronger ties with the US at this time, goes the argument, might be seen as siding with the US on an issue which has generated concern in the region, in particular with China. There is no automatic reason why this should be the case. It is part of the art of public policy and diplomacy to separate consideration of issues that are not and should not be joined. Managing these issues is a matter for the domain of diplomacy.

### *Is Australia being excluded from new Asian groupings?*

For some analysts, there is understandable unease about proposals for some form of economic integration arrangement between ASEAN and China, Korea and Japan (known as ASEAN plus Three). The concern is that a regional body in which Australia was not a member might be established. Before considering the question of what Australia could do about that, it is worth reflecting on the prospects for ASEAN plus Three and other proposed regional groupings.

Economic integration is not achieved by political declaration. Like trade liberalisation (which is part of the process of economic integration) it is difficult. It requires high levels of political commitment, formal legal commitments, changes to policies, structural adjustment and management of powerful domestic political interests. If the ASEAN economies cannot maintain their own timetable for liberalisation within AFTA and if Japan and Korea feel the idea of a fully fledged free trade agreement between the two countries is too ambitious, settling instead for a weaker agreement on economic cooperation on investment and services, what are the prospects in the short to medium term for some sort economic community among the ASEAN Plus Three group? This is an issue about which Australian analysts would be advised to bide their time before assuming that Australia is in danger of being excluded from meaningful regional integration.

### *Staying alert to opportunities*

Notwithstanding the above, it is also a diplomatic duty for Australia to remain alert to such developments in the region and continue to demonstrate preparedness to strengthen economic ties with any trading partner in East Asia. It should be ready to consider any proposal to that end and to implement such proposals when they are made, as in the case of the proposed free trade agreements with Singapore and Thailand.

It should be noted that East Asian Governments have not expressed a view about the appropriateness or otherwise of Australia's interest in an FTA with the United States. If Australia were to pursue such an FTA, it should not be difficult to assure East Asian governments that this in no way diminishes Australia's policy of engagement with the region.

## **An Australian US FTA and APEC**

What about APEC? Does an FTA diminish APEC's authority? Does it encourage the trend today in the region for a proliferation of bilateral and sub-regional agreements and does that harm the standing of APEC? There are two issues. What will this flurry of activity produce? How will it affect APEC?

It is already clear that some of these proposals for trade agreements will produce more significant results than others. As noted above, economic integration is always difficult to achieve. As a working rule of thumb, where economies are open, the likelihood of agreements with significant, legally binding commitments being struck is strong. Where economies are not open and governments are not pursuing a market reform agenda, results are likely to be modest; little more than political agreements to cooperate which make little if any contribution to economic integration.

Where agreements produce real commitments to liberalisation, there is no doubt this can be beneficial to the broad APEC Bogor goal of removing all barriers to trade and investment by 2010 and 2020. Agreements among any of the following – Australia, Chile, perhaps Hong Kong, Singapore, the United States, Canada and Mexico – could be expected, on the basis of established policies, to lead in that direction. The Bogor commitments are still 9 and 19 years out and remain realisable as broad targets. The rate of liberalisation required to achieve them is no less than the average rate of trade liberalisation among APEC countries, undertaken either unilaterally or within the disciplines of the WTO, over the last 10 to 15 years.

Bilateral and sub-regional agreements that achieve liberalisation can have a demonstration effect for the rest of APEC and can help to maintain some momentum for trade liberalisation among APEC economies. As argued in the previous chapter, an Australian–US FTA could serve to show leadership on economic integration among APEC economies, as can free trade agreements with Singapore and Thailand.

Furthermore, the trend towards extending free trade linkages across the Pacific can create a broader dynamic towards integration within APEC extending beyond the East Asian/Western Pacific region. Negotiations between Singapore and the US, and preliminary discussions between Chile and, respectively, Korea and New Zealand, and even exploratory talks by Japan with countries like Mexico and Canada, reflect an emerging trend.

Although this remains a very tentative trend, one can discern in it potential for broader consolidation of economic integration across APEC, and even beyond towards closer alignment of APEC as a region with the emerging Free Trade Area of the Americas. While such an idea might seem speculative, the 'pressures for inclusion' created by a spate of regional and inter-regional activity can build what has been described as a 'domino effect', drawing previously reluctant participants into integration and liberalisation processes.<sup>3</sup>

There is also something of a tendency, in Australian media commentary in particular, to see APEC as having passed its prime. This is a perception not held as strongly in the rest of the region. Such perceptions disregard the substantial institutionalisation of

---

3 See Baldwin, Richard E. "The Causes of Regionalism", *World Economy*; Vol. 20: Issue 7; 1997, for a discussion of domino theory.

APEC. With the annual Leaders' summit, regular meetings of Ministers and numerous technical working groups, no other organisation in the region apart from ASEAN is so well institutionalised. The ASEM (Asia Europe dialogue) process appears to be losing momentum and discussions about an ASEAN Plus 3 economic integration are simply at the point of study.

For so long as the United States remains a strategic player in the Asia-Pacific region, as an important market, a source of technology and investment, the largest export market for most APEC economies and the home of the information economy, there will be a logic for APEC. The dynamics of the annual APEC Summit are proof of that. There is no other occasion when the Heads of State of the United States, China and Japan can meet without the occasion of their meeting itself being an issue. APEC was not established to promote political stability. But the APEC Summit has come to play a leading role in managing trans Pacific relationships.

## Impacts on trading partners

The econometric modelling work by CIE for DFAT (see Chapter 5) suggests no trade diversion of any consequence for third countries as a result of an Australia-US FTA. The two small exceptions identified were related to the possibility of improved Australian access to the US dairy and sugar markets. In that case there might be some diversion of Australia's sugar trade away from one or two countries in East Asia and there may be consequences for New Zealand's dairy trade with the US. Generally, however, an AUSFTA was seen as having a likely positive, if small, impact on New Zealand, particularly through the flow-on of increased growth in the Australian economy.

Efforts have been made to establish guidelines to minimise the trade diversionary effect of sub-regional and bilateral agreements. These include provisions to enable others to adhere to agreements at later dates.

The low likelihood of trade diversion from an Australia-US FTA has been addressed several times in this report. However, in order to foster a positive attitude towards trade liberalisation among APEC countries, it would be in Australia's interests to seek such a provision in the FTA to facilitate membership by any other country, and in particular New Zealand, given the virtually complete integration of the Australian and NZ economies. This may be difficult to achieve. Securing the agreement of the US to structure a bilateral agreement so that third parties might subsequently join may be difficult. There is a long tradition of basing trade agreements on reciprocal terms in the US Congress. That is not a reason why Australia should anyway seek to craft an agreement that would serve such a purpose.



## Australia's strategic interests

As noted above, the US is a vital element of economic activity in the Asia Pacific region. It is the major market for most East Asian economies, the major supplier of capital, as well as the hub of the globalised IT manufacturing industry which has been such a vital part of economic development in East Asia. It is also a strong force for open market reform in the region. Its presence and economic engagement in the region is vital to strategies to secure economic integration among Asia Pacific economies.

While APEC may be institutionalised, its loss of momentum for trade reform and economic integration has diminished the standing of APEC in Washington. From the outlook in Washington DC, there is more momentum behind the idea of creating the Free Trade Area in the Americas than there is for realising the Bogor Declaration. At some point soon, APEC Leaders will have to confront this reality.

In the interim it is fundamental to Australia's interests in promoting open market integration among APEC economies to encourage US engagement in East Asia. An FTA between Australia and the US creates linkages that build such interests into US policy settings. It is a tangible way of encouraging continuing US interest in economic development in East Asia.

It is essential that Australia pursue its public policy interests in a way that demonstrates continuing interest in engagement with East Asia. It has done so already. Much, if not most, of the anxiety about being seen to diminish that interest by entering an FTA with the United States is over-wrought. Managing this requires the straightforward exercise of diplomacy at which Australian Governments are well practised. As with the question of whether Australia can pursue simultaneously an FTA and its interests in the WTO, the answer is the same: both can be done at the same time. Indeed, Australia's interests in advancing economic integration in East Asia are positively promoted by an FTA with the United States.