AUSTRALIAN INSTITUTE OF INTERNATIONAL AFFAIRS

The AIIA is an independent, non-profit organisation promoting interest in and understanding of international affairs in Australia. It provides a forum for discussion and debate, but does not seek to formulate or promote its own institutional views. The Institute arranges programs of lectures, seminars, conferences and other discussions, and sponsors research and publications. It was established in 1933 and is the only nation-wide organisation of its kind in Australia. It is financed by members' contributions, a small government subvention and tax-deductible donations from individuals and businesses. For further information, contact (02) 6282 2133 or visit www.aiia.asn.au.

JR

TRADING ON ALLIANCE SECURITY

AUSTRALIA IN WORLD AFFAIRS 2001–2005

Edited by James Cotton and John Ravenhill

OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS

253 Normanby Road, South Melbourne, Victoria 3205, Australia

Oxford University Press is a department of the University of Oxford. It furthers the University's objective of excellence in research, scholarship, and education by publishing worldwide in

Oxford New York

Auckland Cape Town Dar es Salaam Hong Kong Karachi
Kuala Lumpur Madrid Melbourne Mexico City Nairobi
New Delhi Shanghai Taipei Toronto

With offices in

Argentina Austria Brazil Chile Czech Republic France Greece
Guatemala Hungary Italy Japan Poland Portugal Singapore
South Korea Switzerland Thailand Turkey Ukraine Vietnam

First published 2007

National Library of Australia
Cataloguing-in-Publication data:

Cotton, James, 1949–.
Australia in world affairs 2001–2005: trading on alliance security.

Bibliography.
Includes index.

ISBN 9780195550566.
ISBN 0 19 555056 0.

1. Australia—Foreign relations—2001—Textbooks.
2. Australia—Politics and government—2001—Textbooks.
I. Ravenhill, John. II. Title. (Series : Australia in world affairs).

327.94

Edited by Cathryn Game
Cover designed by Jenny Pace
Typeset in India by diacriTech, Chennai
Proofread by Tim Fullerton
Printed by Sheck Wah Tong

CONTENTS

TABLES, FIGURES, AND ILLUSTRATIONS

TABLES

FIGURES

ILLUSTRATIONS

CONTRIBUTORS

Roger Bell is Professor of History and Associate Dean, International, in the Faculty of Arts and Social Sciences at the University of New South Wales. He has published extensively on international history, focusing on the Asia–Pacific, Australian–American relations, American hegemony, and Americanisation.

Anthony Bubalo is a Research Fellow at the Lowy Institute for International Policy in Sydney, Australia. Before joining the Lowy Institute he was an officer in the Department of Foreign Affairs and Trade (1991–2003) and Senior Middle East Analyst at the Office of National Assessments (1996–1998). From 2002–2003 he was a director on the Australian Government's Iraq Task Force.

James Cotton is Professor of Politics, University of New South Wales at the Australian Defence Force Academy, and Adjunct Professor, Faculty of Asian Studies, Australian National University.

Lorraine Elliott is a Senior Fellow in International Relations at the Australian National University. She has held visiting appointments at the London School of Economics and at Balliol College, Oxford. Her publications include books and journal articles on the global politics of the environment, non-traditional security, global ethics and Australian foreign policy.

David Goldsworthy is an Honorary Senior Fellow at the Contemporary Europe Research Centre, University of Melbourne, and an Honorary Professorial Fellow in the School of Political and Social Inquiry, Monash University.

Murray Goot is Professor of Politics and International Relations at Macquarie University, where he holds a personal Chair; he is also a past President of the Australasian Political Studies Association. He co-edited *Australia's Gulf War* (1994) and edited the special issue of the *International Journal of Public Opinion Research* (2004) on the war in Iraq.

Ann Kent wrote her chapter as an ARC Australian Research Fellow and is currently a Visiting Fellow in the Centre for International and Public Law, Australian National University College of Law. She is the author of numerous works on international human rights, particularly in relation to Australia and China.

Michael O'Keefe teaches and researches at La Trobe University. His interests include Australia's international relations and defence policy, state fragility and the implications of transnational threats. His publications include 'Australian Intervention in its Neighbourhood: Sheriff and Humanitarian?', in *Righteous Violence: The Ethics and Politics of Military Intervention* (Melbourne University Press 2005), which he also co-edited.

John Ravenhill is Professor in the Department of International Relations, Research School of Pacific and Asian Studies, Australian National University.

June Verrier was Head of the Australian Parliament's Information and Research Service from 1993 to 2005. She is now Director, Democracy Building, John Kerin & Associates Pty Ltd, focusing on parliamentary capacity building and comparative parliamentary best practice.

David Walton is a Lecturer in the School of Humanities and Languages, University of Western Sydney. His current projects include 'Economic diplomacy in Australia–Japan relations, 1986–1990' (with Geoff Miller) and being guest editor of a special issue in 2006 of the *Australian Journal of International Affairs* (Australia–Japan relations).

Michael Wesley is Professor of International Relations and Director of the Griffith Asia Institute at Griffith University. He was Assistant Director-General for Transnational Issues in the Office of National Assessments in 2003–04. He is the Research Convener of the Australian Institute of International Affairs and a member of the Australian Research Council's College of Experts.

Hugh White is Professor of Strategic Studies at the Australian National University and a Visiting Fellow at the Lowy Institute for International Policy. He has worked extensively in the Australian Government, where from 1995 to 2000 he was a Deputy Secretary for Defence.

Jian Zhang is a lecturer in Politics in the School of Humanities & Social Sciences, University of New South Wales at the Australian Defence Force Academy, Canberra. In 2004 he published *Government and Market in China: A Local Perspective* (Nova Science Publishers, New York).

PREFACE

Since the era of the Vietnam war, foreign policy issues have seldom been as prominent on the political agenda as they were during the five-year period covered by this volume. The events of 11 September 2001, and especially the government's decision to align closely with the USA in the 'war against terror', brought security to the forefront of Australian foreign policy from 2001 onwards, while breaching many of the customary barriers between domestic and external concerns. Driven as much by politics and security as by economics, Canberra entered a controversial Free Trade Agreement with Washington in 2005, which was exemplary of the move that had occurred away from multilateralism to bilateralism in foreign economic relations. In response to the experience of coalition warfare in Afghanistan and Iraq, decisions were taken to equip the Defence Force with the capacity to operate in remote theatres. But at a time of uncertain US–China rivalry, Australia was also faced closer to home with the problem of managing the growing strategic power of Beijing, having to reconcile security concerns with the fact that China's sustained rapid economic growth increasingly underwrote the strong performance of the Australian economy. Instability in the Pacific generated a strong commitment to a new interventionism, ostensibly on security grounds. In the areas of human rights and the environment the government displayed a marked reluctance to engage with global institutions and regimes, notably regarding the Kyoto Protocol on global warming. Nevertheless, a government that had also previously been dismissive of regional institutions developed a new appreciation of their worth, aware that the terrorism issue required the closest cooperation with the Association of South-East Asian Nations (ASEAN) and individual South-East Asian states. An important outcome of the government's eventual and at times grudging reconciliation with the region was an invitation to the inaugural East Asia Summit, a foreign policy achievement that had eluded Prime Minister John Howard's Labor predecessors. This book charts the Howard Government's response to this unusually demanding environment.

This volume, the tenth in this series, is again sponsored by the Australian Institute of International Affairs. The editors would like to record their thanks to the Institute and especially to Ross Cottrill, Charles Stuart and Melissa Conley Tyler for their interest in this project. The Department of International Relations at the Australian National University provided

10 Australia and the Global Economy

John Ravenhill

KEY TOPICS

- A retreat from multilateralism?
- APEC
- WTO
- Australia's foreign aid program

Australia's extraordinary economic boom continued throughout the period covered by this volume. By the end of 2005, the economy had enjoyed fifty-seven quarters of consecutive economic growth: Paul Keating's 'recession we had to have' was a distant memory. Unemployment fell to slightly more than 5 per cent, the lowest rate for three decades. The government's budget was enjoying record surpluses. Australia's economic growth rate in the period was substantially above that of the average for the Organisation of Economic Co-operation and Development (OECD), the grouping of leading industrialised economies. Australia's ranking in the OECD on *per capita* income rose from eighteenth in the early 1990s to eighth by 2005 (Henry 2005a: 8). Astute intervention by the Reserve Bank of Australia through the imposition of a marginal increase in interest rates in early 2005 appeared to have succeeded in deflating the housing bubble and in ensuring a soft landing for the economy.

The feel-good factor produced by the housing boom contributed, however, to some worrying trends in an otherwise upbeat economic situation. High levels of demand for imported consumer goods drove the balance of payments ever further into deficit (see table 10.1). By 2004 Australia's current account deficit as a share of GDP was exceeded among OECD economies

only by Hungary, Iceland, New Zealand, and Portugal. Australia's record was even worse than that of the USA. Australia's net foreign debt grew rapidly over the five-year period in absolute terms, and more slowly when expressed as a percentage of gross domestic product (GDP). Because exports kept pace with the growth in debt, however, the debt service ratio (the ratio of net interest payments to total exports) changed little throughout the five years, and at the end of 2005 was substantially below the levels of the early 1990s.

Table 10.1 Australia: Basic economic indicators

	2001	2002	2003	2004	2005
GDP growth (%)	2.6	3.8	3.6	2.9	2.5
Exports (% of GDP) (goods and services credits)	22.5	20.7	17.9	18.2	19.0
Current account balance (% of GDP)	−2.3	−4.2	−5.9	−6.4	−6.0
Net foreign debt (A$ billion end of period)	320.5	353.7	370.2	421.9	472.8
Net foreign debt (% of GDP)	46.3	48.0	47.1	50.3	58.0
Debt service ratio (%)	9.4	8.4	8.1	9.3	9.4
Terms of trade goods and services	99.2	98.2	100.0	107.0	122.0
Trade weighted index of A$ (May 1970 = 100) Period average	49.6	51.8	57.8	62.3	63.9
A$–US$ exchange rate (end of year)	0.52	0.54	0.65	0.74	0.73

Source: DFAT 2004a, 2005a.

The relatively low debt service ratio, coupled with the fact that all except a few per cent of Australia's foreign debt was privately held, gave the government little reason for concern with this indicator. Other trends were more worrying. Like the USA, Australia's savings rate languished at the bottom of the OECD ladder, households having engaged in net *dis*-saving from the June quarter of 2002 onwards (Reserve Bank of Australia no date a). And despite the boom in foreign demand for raw materials, the absolute value of exports actually declined during the years 2001–03 before resuming strong growth at the end of the period because of high prices for exports of coal and iron ore. Whereas the total value of merchandise exports rose by 15 per cent in 2005, their volume increased by only 2 per cent. Imports, meanwhile, grew at a rate more than six times that of exports during 2001–05; the consequence was that the trade gap widened substantially.

Unlike the period 1996–2000, when the Asian financial crises buffeted the Australian economy, the region made a significant contribution to the country's generally impressive economic performance. By far the most important influence was China's emergence as the workshop of the world. The significance of China's contribution came not just from its own demand for Australian exports, especially of raw materials, but also indirectly through China providing the motor for the regional economy. Much of the growth of the other North-East Asian economies in the period came from their exports of components to China (approximately 60 per cent of the value of China's exports is derived from imported components; two-thirds of these come from Hong Kong, Japan, Korea, and Taiwan (Gaulier, Lemoine & Unal-Kesenci 2004: 13)). In turn, their rapidly expanding exports to China laid the foundation for the increased demand from these North-East Asian economies for Australian exports.

China's rapid economic growth and the more general recovery from the economic crises in the region had two significant effects on Australia's trade. First, they drove a further redirection of Australian trade towards East Asia, which in 2004–05 accounted for 56 per cent of all Ausrralian merchandise exports. Trade with individual countries in the East Asian region reflected the growing importance of China. The growth in China's share of Australian exports over the period 1990–2004 has been matched by an equivalent decline in Japan's share (see figures 10.1 and 10.2). Over the same period, the shares of the USA and the European Union (EU) in Australian exports both fell by 3 per cent, an indication of the increasing dependence of the economy on Asian markets. Also noticeable in this period is the increasing significance of India as an export market for Australia (with non-monetary gold accounting for more than half of the total value of exports).

Figure 10.1 Geographical distribution of Australia's exports, 1990

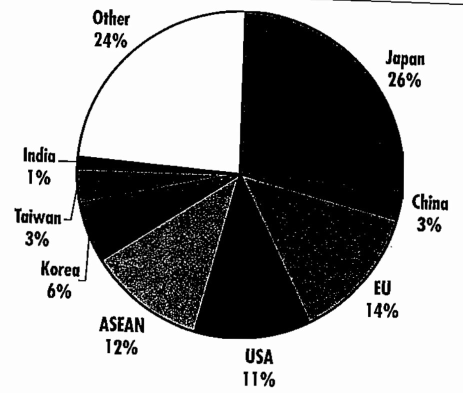
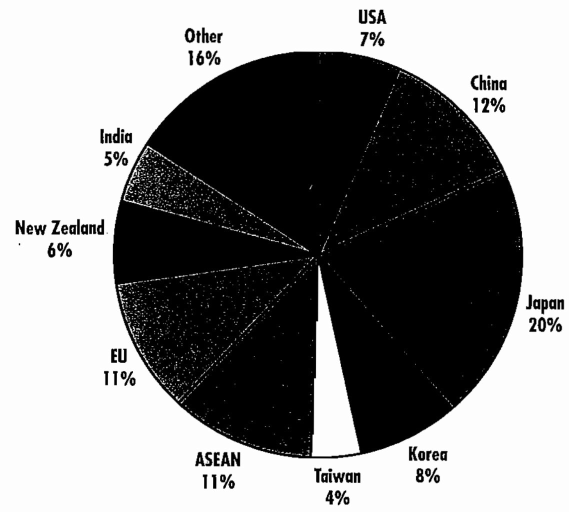


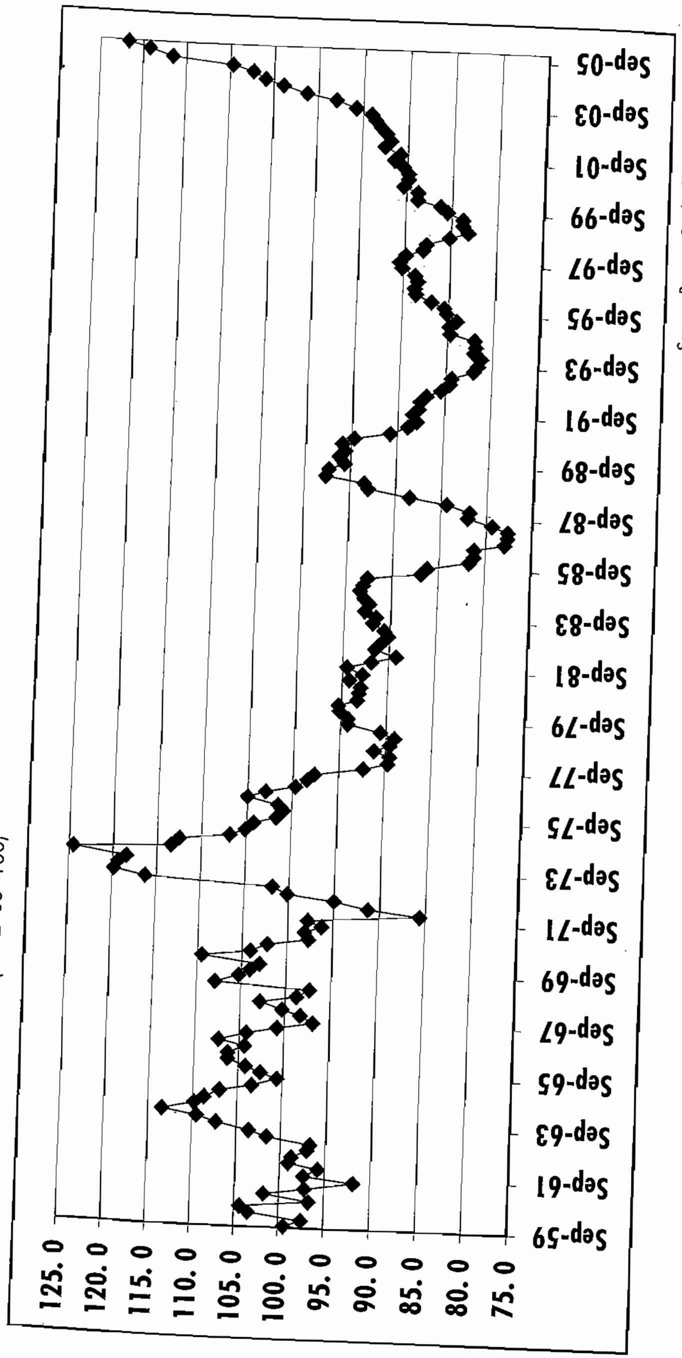
Figure 10.2 Geographical distribution of Australia's exports, 2005



Source: calculated from data in ABS 2006.

A second major effect of China's rapid economic growth was felt in the substantial improvement that occurred in Australia's terms of trade (in non-technical terms, the ratio of the prices of exports to those of Australian imports). After a long period in the doldrums following the end of the resource boom of the first half of the 1970s and a sharp decline with the downturn in economic activity in the region associated with the financial crises, the terms of trade picked up dramatically in the five-year period 2001–05, improving by more than a third (see figure 10.3). Unlike previous commodity booms, however, the increase in export prices and earnings did not feed through into the domestic economy to generate high levels of inflation. The principal reason why previous experience was not repeated was the greater flexibility afforded by the floating of the dollar in 1983. Higher prices for commodity exports drove the Australian dollar higher—by more than a third between 2002 and 2005. This appreciation in turn depressed the real price of imports (which had already fallen by 4 per cent in nominal terms, reflecting productivity gains in the manufacture of electronics and telecommunications), making these goods even more attractive to Australian consumers, and reducing the inflationary impact that the export surge would otherwise have had on the domestic economy (Henry 2005b).

Figure 10.3 Australia's terms of trade (2002–03=100)



Source: Reserve Bank of Australia no date b.

The growth in demand for Australia's minerals was the primary factor in changes in the composition of exports. Exports of primary products rose by an average of 5 per cent each year in the period, with increases in minerals and fuels being matched in 2004, following the easing of the drought, by gains in the value of exports of unprocessed and processed foodstuffs. As would be expected at a time when the currency was appreciating, exports of manufactures failed to keep pace with the growth in exports of primary products. By the end of the period, there were worrying signs that the currency appreciation that occurred from 2003 onwards, coupled with rising oil prices and increasing shortages of skilled labour in the domestic economy, was having a significant depressing effect on manufactured exports.

The absolute value of exports of elaborately transformed manufactures (ETMs) fell by more than 7 per cent over the period, with the consequence that the share of exports of ETMs in total exports fell from 22.9 per cent in 2001 to 20.3 per cent in 2004. The country's balance of trade deficit in ETMs widened in 2004–05 to a record $85.4 billion, a 13.4 per cent increase on the previous year (*Australian Financial Review* 2005c). The poor performance of manufactured exports led to exports overall contributing a substantially smaller share of Australian GDP—down from 22.5 per cent in 2001 to 19 per cent in 2005. Largely because of the export record, the openness of the Australian economy (measured as the ratio of its foreign trade to GDP) declined from 44.5 per cent in 2001 to 39.4 per cent in 2004.

Of Australia's ten most valuable export products in 2005, not one was an ETM (see table 10.2). By the end of the period, the annual value of exports of services was almost identical to that of manufactures—$37 billion—with transportation and travel services growing particularly rapidly.

Table 10.2 Australia's ten most valuable exports in 2005

Commodity	Value ($billion) and Share
Coal	$21.8(12%)
Iron Ore	$11.0(6%)
Travel	$10.9(6%)
Education Services	$7.5(4%)
Crude Petroleum	$6.3(4%)
Gold	$5.8(3%)
Bovine Meat	$4.7(3%)
Aluminium Ores	$4.7(3%)
Aluminium	$4.4(3%)
Passenger Services	$4.1(2%)
TOTAL	$176.7

Source: DFAT 2006, p. 4.

A RETREAT FROM MULTILATERALISM?

The most significant development in Australia's foreign economic relations during the first five years of the new millennium was the shift to bilateralism in trade negotiations. This marked the most dramatic change in Australia's trade policies since the early 1950s, when Canberra had lost its enthusiasm for imperial preferences and had committed to multilateralism (Capling 2001). As discussed in the previous volume in this series (Ravenhill 2001), the emphasis in the Coalition Government's 1997 Foreign and Trade Policy White Paper on bilateralism (DFAT 1997) had not been fully articulated in the trade sphere by the turn of the century. Elements within the Department of Foreign Affairs and Trade (DFAT) remained strongly committed to the non-discriminatory approach to trade of the World Trade Organization (WTO), believing that this was the correct path to pursue not only from the perspective of economic theory but also from that of power realities. As a relatively small player in international economic relations, Australia was unlikely to win significant concessions from more powerful partners in bilateral negotiations.

Moreover, in the late 1990s the potential partners available to Australia for bilateral negotiations appeared limited in number and significance. To be sure, Chile and Singapore, two early enthusiasts of bilateralism, were keen to broaden their network of bilateral agreements. But the Association of South-East Asian Nations (ASEAN) as a whole, led by Indonesia (smarting from the Australian-led Timor intervention) and the predictably hostile Dr Mahathir Mohamad of Malaysia, had indicated that it was not interested in pursuing a proposed link between the ASEAN Free Trade Area (AFTA) and the Australia–New Zealand Closer Economic Relationship (CER). The major North-East Asian economies at this time were still wary of going down the bilateral path and in any event were unlikely partners in a trade agreement with Australia given their desire to maintain high levels of protection for their domestic agricultural sectors. China was concentrating its energies on its accession to the WTO, which was not achieved until the end of 2001. And the capacity of the USA to negotiate bilateral or regional trade arrangements was hamstrung by the failure of the Clinton administration in 1997 to gain congressional approval of a 'fast-track' trade bill (legislation that enables an administration to negotiate trade treaties that are subject only to yes-or-no votes in Congress with no amendments allowed, thereby assuring trade partners that any deal reached would not be unpicked by domestic interests in the USA).

Several developments in the late 1990s dramatically improved the prospects for bilateral negotiations. The failure of the Seattle ministerial meeting of the WTO in December 1999 reinforced concerns held by governments of many industrialised countries about the likelihood of significant progress in a new round of global trade talks. For governments determined to continue the momentum of trade liberalisation, bilateral deals appeared to offer a viable

way forward. And governments in the East Asian region were increasingly worried, first, that regionalism in Europe and the Americas was affording the rivals of their domestic firms a competitive edge and, second, that they were depriving themselves of a significant foreign policy instrument by maintaining a multilateralism-only approach to trade negotiations (the most comprehensive official argument in support of a change in trade policies was provided by Japan's Ministry of Economy, Trade and Industry (METI) in a paper advocating a 'multilayered' approach (METI 2000)). Despite domestic opposition from traditional protectionist forces (most notably in the Ministry of Agriculture, Forestry, and Fisheries) and from committed multilateralists, the Japanese government responded sympathetically to initiatives from Singapore and Korea to establish study groups to investigate the feasibility of bilateral trade agreements.

John Howard's government had already indicated that it was willing in principle to negotiate bilateral trade deals before the failure of the Seattle WTO ministerial. In a joint statement in August 1999 with the then New Zealand Prime Minister Jenny Shipley on a review of the trans-Tasman bilateral economic partnership, the prime ministers announced: 'New Zealand and Australia are willing to consider free trade arrangements [FTAs] 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. Such arrangements would need to reflect the principles underpinning CER, including WTO consistency' (Howard 1999).

Whether the agreements that Australia was subsequently to negotiate met the criteria laid down in this communiqué became a matter of considerable controversy.

Australia goes bilateral: The Singapore–Australia Free Trade Agreement

Singapore has been the pioneer in East Asia in the negotiation of bilateral free trade agreements (despite the early objections of its partners in ASEAN). The reasons for its enthusiasm for such arrangements are not difficult to discern. As an economy with very few border barriers to merchandise trade, Singapore has to make relatively few concessions to free its trade completely. Moreover, as the world's most open economy (measured by the share of foreign trade to GDP), one whose manufacturing sector is dominated by export-oriented subsidiaries of multinational corporations, and one with negligible agricultural production, the Singaporean Government faces little protectionist opposition in attempting to negotiate free trade agreements that would further its ambitions to be a regional hub.

Much to the surprise even of members of his own administration, US President Clinton, in the last days of his term of office, accepted an invitation from the Singaporean Government at the Brunei Asia–Pacific Economic Cooperation (APEC) Leaders' Meeting in November 2000 to begin negotiations for a bilateral FTA. Australia followed suit, and a joint announcement was made at the APEC meeting between Prime Ministers Howard and Goh Chok Tong regarding the launching of negotiations—Australia's first foray into bilateral negotiations outside its longstanding relationship with New Zealand. Ten rounds of negotiations were held between April 2001 and October 2002 before agreement was finally reached, with the treaty being signed in February 2003 (entering into force following parliamentary consultation in July of that year).

The agreement with Singapore proved to be relatively non-controversial—an ideal starting point for the Howard Government's move to bilateralism. Singapore, as a strong supporter of global trade liberalisation, was regarded as an ally. As a high-income economy, specialising in the export of sophisticated manufactures, many of which already entered the Australian market duty-free under the terms of the Information Technology Agreement, Singapore was not expected to cause any significant disruption to the Australian market (84 per cent of Singapore's existing exports enjoyed duty-free access to the Australian market before the signing of the FTA). On the other hand, the gains from the agreement were also likely to be limited. Because Singapore already had zero tariffs on most products, the only significant improvement in access for Australian merchandise exports was to eliminate tariffs on Australian beer and stout. More significant were concessions that Singapore made on services, including easing the existing restrictions on banking licenses, on establishment rights for Australian law firms in Singapore, and on national treatment for Australian educational providers in Singapore. But the study that the government commissioned from the consulting firm Access Economics on the expected costs and benefits of the FTA concluded that even in educational services, the likely primary area to benefit from the agreement, gains would amount only to additional exports of approximately $50 million per year (Access Economics 2001). Not surprisingly, the official review of the agreement conducted a year after its entry into force found it difficult to point to any concrete gains that it had generated (DFAT 2004h).

Howard's war dividend: The Australia–US Free Trade Agreement

Shortly after the Howard Government announced that it would begin negotiations with Singapore, the Australian Ambassador to the USA made a speech to the American Australian Association in New York on the mutual benefits of a free trade agreement between the two countries, a first indication that the Australian Government was intending to approach Washington for a preferential trade agreement. In the first half of the following year, the government commissioned two studies on the economic impact and broader implications of a free trade agreement between the two countries. Following talks between foreign and trade ministers, the Prime Minister, in

August 2001, confirmed that the government intended to pursue a free trade agreement with the USA. Further movement awaited the administration of George W. Bush gaining 'fast-track'—now renamed 'trade promotion'—authority. Three months after the passage of the Trade Act 2002 provided Bush's administration with this authority, the US Trade Representative Bob Zoellick and Prime Minister Howard announced that negotiations would start on an FTA. Five rounds of negotiations were held before agreement was reached in February 2004 (the agreement was signed in May of that year and was implemented from 1 January 2005).

Like Canberra, Washington had been reluctant to go down the path of discriminatory trade during the first forty years of the postwar trade regime. Concern that its exporters were the victims of discriminatory policies—by the EU and as a consequence of the protectionist policies of individual North-East Asian countries—prompted a change in attitude in the first half of the 1980s, at a time when US domestic economic mismanagement generated a widening trade gap. Washington's first preferential arrangement was with Israel; of far greater significance was the free trade agreement with Canada, which took effect at the beginning of 1989 and paved the way for the North American Free Trade Agreement (NAFTA) (implemented from 1 January 1994). Although it was clear by this time that Washington saw FTAs as a valuable instrument of US foreign economic policy, further negotiation of FTAs was stymied by the domestic protectionist backlash to NAFTA, reflected in the 1997 congressional refusal to renew the Clinton administration's fast-track authority.

The US academic Richard Feinberg, a former special assistant to President Clinton for national security affairs, has provided a succinct statement of the principal interests of the US Government in negotiating FTAs. He suggests that these are:

- 'asymmetric reciprocity' that advantageously opens markets for US traders and investors
- establishing precedents or models or serving as catalysts for wider trade agreements (competitive liberalisation)
- rewarding and supporting domestic market-oriented reformers, and
- strengthening strategic partnerships (Feinberg 2003: 1020).

The Howard Government clearly believed that it could capitalise on the last of these elements to make Australia only the second industrialised economy after Canada to conclude an FTA with the USA. There seemed to be potential political advantages from doing so: to receive positive payback for the loyalty shown to the USA over key foreign policy issues including Afghanistan and Iraq, to cement the 'strategic relationship', and to exploit the electoral vulnerability of the Australian Labor Party (ALP) to accusations that it was anti-American and unable to manage relations with Australia's most important ally. These political considerations appeared to blind the government to the first of Feinberg's points: that, in negotiating FTAs, Washington has single-mindedly pursued the interests of US exporters through imposing asymmetrical agreements on weaker trading partners.

It was largely the concern that a bilateral agreement with the USA would be highly asymmetrical in its obligations, with the US Government unwilling and/or unable to deliver free access to its market for Australian exports of products considered politically sensitive, that had caused Canberra to reject Washington's earlier FTA overtures (Snape 1986, 1989). The initial studies commissioned by the government on the impact of the proposed FTA on the Australian economy pointed to the potential difficulties ahead. The Centre for International Economics in its 2001 study (CIE 2001) concluded that the largest gains to Australia would occur in the politically sensitive sugar and dairy sectors, in which exports were subject to tariff rate quotas (which provided access to the US market for specified quantities at a reduced tariff; beyond these quantities, the tariff is set at a prohibitive level, for instance, between 60 and 65 per cent for dairy products). The study indicated clearly that significant benefits to Australia from an FTA would come about only if its starting assumption—that the USA *fully* liberalised access to its market to negotiate a clean, comprehensive agreement—was realised.

The subsequent negotiations demonstrated that the fears of sceptics about what was politically feasible in a bilateral trade deal with the USA were fully justified. Contrary to statements from Australia's Trade Minister Mark Vaile and colleagues that everything was open to negotiation because the USA had committed itself to a 'comprehensive' agreement,[1] it soon became apparent that this was not the case. In particular, better access to the US market for Australian sugar was simply non-negotiable because of the strength of the US sugar (and sugar substitutes) lobby. On agricultural issues in particular, Australia ended up negotiating a deal inferior to that reached in other US bilateral agreements, most notably those with Canada and Chile. And entirely consistent with Feinberg's argument, US negotiators, backed by an army of Washington-based trade lawyers, pushed strongly for an agreement that advantageously opened Australia's market for US exporters and investors—forcing concessions on such issues as quarantine and the pharmaceutical benefits scheme (PBS), which the Australian Government had previously declared off limits. Although the Australian Government itself spent more than $1.5 million on US lawyers and lobbyists in the course of the negotiations (NineMSN News 2005) it was no match for the well-honed skills of the US lobbyists, particularly on such issues as intellectual property rights, which had been pursued aggressively in Washington's previous negotiations, for example, with Singapore (on the centrality of intellectual property to new trade talks see Drahos and Braithwaite 2002).

So asymmetrical are the agreement's provisions that Australian negotiators, including Trade Minister Vaile, were prepared to walk away from the talks in February 2004 before Prime Minister Howard intervened and ordered them

to accept what Washington was prepared to offer (Capling 2005: 57). With an election to be faced later in the year, it appeared that domestic political considerations had much to do with the Prime Minister's bargaining strategy: a desire to achieve a war dividend and to put the ALP on the defensive. Ultimately, the strategy nearly backfired when Opposition Leader Mark Latham insisted on politically popular amendments intended to preserve quotas on locally produced media content and to punish pharmaceutical companies that made spurious patent claims.[2]

The decision to negotiate with the USA deeply divided the academic and policy communities in Australia. Arguing against the proposed agreement was an unlikely coalition that ranged from pro-liberalisation economists, who argued that Australia's move to discriminatory trade agreements would undermine its efforts to push for broader trade liberalisation through the WTO, to anti-globalisation activists. Having a particular impact on the public debate were academic lawyers and members of the medical profession who provided detailed critical commentary on the likely negative impact of an FTA on the PBS. The 'globalists', who were sceptical of discriminatory arrangements, continued to have significant influence within DFAT but ultimately lost the debate in the face of a government determined to pursue its political agenda.

The principal source of support for the proposed agreement came from AUSTA, the Australia United States Free Trade Agreement Business Group, founded in September 2001 and coordinated by the trade policy consultant Alan Oxley. The coalition included Australia's two peak business associations, the Business Council of Australia and the Australian Chamber of Commerce and Industry, major Australian corporations including BHP, Commonwealth Bank, News Limited, Telstra, Western Mining, and Westfield Holdings, and Australian subsidiaries of leading US corporations including Esso, IBM, Kelloggs, and Mobil. Also represented in the coalition were leading Australian agricultural lobbies, including the Australian Dairy Council and the Australian Meat Council.

Views on the agreement that resulted from the negotiations ranged from Alan Oxley's (2004) statement that 'This is Australia's most important trade agreement since it acceded to the GATT [General Agreement on Tariffs and Trade] in 1948 ... this agreement underpins Australia's economic security for the next 50 years' to arguments that the FTA would devastate the Australian economy (Weiss, Thurbon & Mathews 2004). The undertakings made by the two governments in the agreement clearly were asymmetrical, especially in the area of agriculture where fully a third of Australian agricultural exports do not enjoy duty-free access, and even where duties were cut, these would be phased in over a period of four to eighteen years. In contrast, Australia immediately eliminated duties on all US agricultural exports. For proponents of the FTA, having an imperfect agreement with the world's largest economy was better than having no agreement at all, with some exporters bound to benefit from reductions in tariffs. (The Prime Minister argued that the deal was the 'best we could get in the circumstances'. See *Sydney Morning Herald* 2004.) For critics of the FTA, the potential gains were minor and would be more than offset by welfare losses caused, for instance, by changes to the patent system and the PBS. Efforts to assess the costs and benefits of the agreement are discussed below.

A network of FTAs?

The government's enthusiasm for bilateralism soon led to a proliferation of negotiations for further FTAs, primarily with Asian countries, but also extending as far as the United Arab Emirates. Such a strategy was logical once a bilateral approach to trade relations was adopted, despite the transactions costs of negotiating multiple agreements—both because it minimised the risk of costly trade diversion to preferred partners and because it laid the grounds for Australia establishing itself as a hub in a network of FTAs.

The next cab off the rank was Thailand, ASEAN's second largest economy and another country with aspirations to carve out a position as a regional hub, this time for manufacturing in South-East Asia. In July 2001 a joint scoping study was undertaken. Negotiations began in May 2002 and culminated in the signing of the agreement in July 2004. Thailand—Australia's twelfth largest export market—is a country that continues to maintain relatively high tariffs on imports of manufactures and consequently is an apparently attractive partner for an FTA. Nonetheless, the total value of exports to Thailand constitutes less than half of one per cent of Australia's GDP, so the benefits from an agreement would be expected to be small (especially as raw materials dominate Australian exports to Thailand and already enter the Thai market at zero or low rates of duty). A study commissioned by the government from the CIE (2004a) estimated that the agreement would increase Australia's GDP by just 0.01 per cent. Any enthusiasm that the Australian business community had for the agreement was tempered by the timetable under which Thailand would reduce its tariffs, with sensitive items not being liberalised until 2020 (which ironically is the deadline to which less developed APEC economies had committed themselves in the Bogor Declaration for complete liberalisation of their trade).

From a political perspective, the most unlikely development on bilateral FTAs was the launch in May 2005 of negotiations for an agreement with Malaysia. Dr Mahathir had not only been hostile towards Australia but also outspoken in his criticism of other ASEAN countries undertaking free trade negotiations with non-ASEAN members, with Singapore being his principal target. His successor, Abdullah Ahmad Badawi, proved to be keen on building improved relations with Australia and on catching up with other states in the region in pursuing bilateral agreements. Malaysia's

change of heart was also crucial for the revival of proposals for a link between the CER and AFTA, negotiations for which began in 2005. Also commencing in 2005 were negotiations with China, with informed commentators forecasting difficulties because of China's concerns over the potential political problems caused by any significant increase in Australian agricultural and service exports.

From an economic perspective, the most unlikely development was the announcement that Australia and Japan were to commence a feasibility study to 'examine the pros and cons' of a bilateral free trade area (DFAT 2005b)—unlikely because of the continuing reluctance of Tokyo to liberalise access for agricultural imports. Tokyo may have been encouraged by Canberra's willingness to sign off on an agreement with the USA that excluded Australia's most significant agricultural exports. On the other hand, bowing to domestic sensitivities, the Japanese Government insisted that the project was not a 'scoping study' as normally understood in these negotiations; that is, as a quantification of the benefits and costs of an agreement, with the expectation that negotiations would open quickly thereafter. Even this vague feasibility study was enough to prompt adverse reaction in Japan: in a statement in August 2005 the Agriculture, Forestry and Fisheries Minister, Mineichi Iwanaga, asserted that 'Japan has no intention of concluding a free trade agreement with Australia' (AAP News 2005).

Clearly any aspiration that the Howard Government might have to achieve something that no other country to date has managed—to negotiate FTAs with the world's three largest economies—would not be easily realised no matter how loosely Canberra was willing to interpret 'free trade'. And by the middle of 2005 the strains that the new strategy of bilateral negotiations were imposing on the depleted resources of DFAT became evident when the government told Indonesia's Trade Minister, Mari Pangestu, that it could not at the time consider entering negotiations with ASEAN's largest economy because of other negotiating commitments (*Australian Financial Review* 2005a).

Evaluating the costs and benefits of the new bilateralism

In a world in which barriers to trade in manufactured goods have been substantially reduced, bilateral trade agreements would be expected *a priori* to generate at best modest benefits for the participants. This is particularly likely to be the case when governments take advantage of the vagaries of the WTO's rules on preferential trade agreements to exempt sectors of particular domestic political sensitivity from the agreements (the WTO's rules prescribe that FTAs must cover 'substantially all the trade' between the parties, but members have failed to reach agreement on what this phrase means in practice). Many of the agreements do go beyond traditional border barriers to address issues relating to 'deeper' integration, such as investment, intellectual property rights, and government procurement. But the potential economic impact of agreements on such issues is particularly difficult to measure. Besides the direct economic impact of the agreements themselves, any assessment of costs and benefits must raise broader issues relating to the opportunity costs of the agreements for other dimensions of foreign economic relations, particularly for negotiations at the regional and global levels.

Turning first to the direct economic impact of the agreements: their recent entry into force, the fact that some provisions will be phased in over a period of years, and the fact that Australian merchandise exports continue to be dominated by primary commodities that already enjoy free access to foreign markets make it impossible to reach any conclusion at the time of writing about the effects of the agreements. The triumphalism of critics of the US agreement over the fact that Australian exports to the USA fell during the first twelve months of the agreement was simply misplaced. (Australian exports to the USA fell by 4.7 per cent in the first twelve months after the implementation of the agreement, whereas Australian imports from the USA rose by 5.7 per cent; see *Age* 2006). But attempts to estimate the potential costs and benefits of the Australia United States FTA (AUSFTA) through economic modelling have served largely to demonstrate that everything depends (as in the original CIE study) on the initial assumptions that modellers make—although the widely varying estimates that such exercises produced at least served a political purpose from the government's perspective in confusing the general public.

Certainly some studies, such as a second paper commissioned by the government from the CIE after the details of the US agreement were known, seemed to follow the GIGO (Garbage In, Garbage Out) principle. Recall that the original CIE study estimated that the principal benefits to the Australian economy from an FTA would accrue to the sugar and dairy sectors. When the FTA produced little improvement in access to the US market for these products, the CIE generated a new model that concluded that the Australian economy after a decade would gain $5.6 billion annually from the agreement, primarily through increased investment and through the benefits of greater competition (CIE 2004b). In contrast, a study by a former Productivity Commission economist, Philippa Dee (2005), estimated that the annual gains to Australia would amount only to a paltry $53 million, once various welfare losses imposed by the agreement were taken into account.

The actual impact of the agreement will depend in large part on the response of firms. And here economic modelling may provide little guidance in a world in which multiple considerations determine where multinational companies decide to conduct their operations. The computable general equilibrium models used for such exercises rest on standard assumptions from neoclassical trade theory, such as the presence of perfect competition, which seem more appropriate to trade in the nineteenth century than to today's globalised economy. Take one example: the *Australian Financial Review* reported that Holden decided not to pass on to customers the savings

it gained when tariffs on a car model sourced from Thailand were reduced to zero as a consequence of the new free trade agreement that Australia had signed with that country. A Holden representative asserted that 'the company's pricing was extremely competitive before the tariff cuts' (*Australian Financial Review* 2005b).

The reference to the Thai auto industry raises another issue in evaluating the effects of FTAs. One source of gains from FTAs comes from their providing preferential access to Australian exporters over those of other countries. But the proliferation of these arrangements may quickly erode any preferential access negotiated. In the AUSFTA, for instance, much was made of the new opportunities for the Australian auto industry because the agreement removed the 25 per cent tariff that the USA imposes on imports of light trucks—pick-ups or 'utes'. Yet, at the time the AUSFTA was signed, Washington was also negotiating a free trade agreement with Thailand, the world's second largest exporter of pick-ups after the USA, and a potentially formidable competitor to Australia as a source of these vehicles.

The actions of firms will be crucial to the impact of the agreements in other areas. Much of the concern expressed about the AUSFTA relates to the provisions on intellectual property rights and how these will affect the PBS. Here the key issue may be how aggressively the US 'pharmas' use the dispute resolution provisions of the FTA to challenge the PBS. On this dimension, the AUSFTA includes an unusual provision—a non-violation nullification or impairments of benefits clause—that allows dispute procedures to be initiated when the actions of a party while complying with the strict letter of the agreement allegedly contravene its spirit and the reasonable expectations of other parties to the arrangement (Weiss, Thurbon & Mathews 2004 provide a detailed discussion of the potential threat to the Australian economy from the agreement).

The broader impact

For many commentators, Australia's move to bilateralism was of concern as much for its impact on other dimensions of foreign economic relations as for its direct effects on the domestic economy. Some commentators believed that the decision to negotiate with the USA sent the wrong message to Asia—that Australia's priorities lay in the trans-Pacific relationship—and that Canberra was willing to give preferential treatment to US exports as a means of shoring up the security relationship (see for instance Garnaut 2002). Of the various objections to the arrangement, the debate on discriminatory trading sending a hostile message to Asia was among the least persuasive. With all other East Asian countries jumping on the bilateralism bandwagon, they were not well placed to complain that Australia was pursuing similar policies—not least because Canberra was also seeking to negotiate free trade deals with them. Indeed, a senior official in Japan's Ministry of Economy, Trade and Industry told this author that Tokyo had been pleased with the conclusion of the FTA between

Australia and the USA because it demonstrated that Canberra had abandoned its 'purist' attitude to trade negotiations (author interview April 2004).

Of arguably far greater concern was the impact that the new emphasis on bilateralism had on Australia's role in existing regional institutions and in the WTO. At both levels, progress in trade negotiations during the 2001–05 period was disappointing. Although the government maintained that in trade negotiations 'it could chew gum and walk at the same time'—that is, operate effectively in multiple forums—the evidence seemed to suggest otherwise.

APEC

As noted in the previous volume of *Australia in World Affairs*, the Howard Government initially had little enthusiasm for APEC, identifying it with the policies of Bob Hawke and Paul Keating's governments from which it wished to distance itself and as an institution whose *modus operandi*—based on unilateral trade concessions—was at odds with the government's emphasis on pursuing Australian economic interests through obtaining reciprocal 'concessions' from its trading partners.

APEC's contribution to trade liberalisation had largely stalled with the failure of the negotiations for Early Voluntary Sectoral Liberalisation at the Kuala Lumpur Leaders' Meeting in 1998. Although APEC continued to do useful work on issues of trade facilitation, it was generally of a highly technical character and not the type of activity likely to attract the attention of political leaders.

APEC did take on a much higher profile after the events of 11 September but mainly as a venue for the discussion of counter-terrorism measures. On one dimension—the securitisation of trade—this new role for APEC did reinforce existing economic collaboration. New requirements for security measures for ports, container inspections, and airports and so on threatened to erect barriers to the free flow of goods and people among APEC member economies. Collaboration to reduce the disruption that security concerns would have on interstate commerce was very much in line with APEC's trade facilitation agenda, and the institution appeared to draw on lessons learned in its first decade in fashioning a reasonably coherent response to the new challenges (Ravenhill 2006).

On the issue of trade liberalisation, however, APEC became primarily a venue at which leaders reached and announced agreements to negotiate bilateral trade deals. APEC continued to make ritualistic declarations in support of global trade liberalisation, but the key issues dividing the WTO also split leading APEC economies. There was no evidence that Australia played an active role in attempting to promote APEC's trade liberalisation agenda: there was little enthusiasm in Canberra, for instance, for proposals made at the 2004 Leaders' Meeting in Santiago, Chile, for the creation of

an APEC-wide free trade area. And Canberra's commitment under APEC to free its trade by 2010 was largely ignored in Australia's bilateral trade negotiations.

WTO

Australian governments have consistently stated that negotiations at the global level through the WTO are the main game as far as trade liberalisation is concerned. For most trade negotiators in Canberra, the turn to bilateralism was a second best option, a direction initially taken because of the slow progress in trade talks at the WTO. For many commentators, however, an increasing worry in the first five years of the new millennium was whether the enthusiasm for bilateralism had begun to impede Australian efforts at the global level. Two issues figure here. The first is whether Australia had damaged its credibility as a committed 'free and fair trader' by accepting agreements that failed to bring any significant progress on liberalisation of agricultural trade (for further discussion see Capling 2005, chapter 5). The second was whether the preoccupation with bilateralism was diverting attention and resources from the global talks.

Estimating the extent to which any government commits attention, energy, and resources to various negotiations is inherently difficult—and comparisons across time even more so. Moreover, in negotiations that are continuing, anecdotal evidence is often all that can be offered. But what evidence is available does seem to suggest that Australia has played a less active role in the Doha Round negotiations than in the previous Uruguay Round. For instance, the Cairns Group, which Australia founded and chairs, and which did much to keep agricultural issues high on the agenda of the previous round, has been largely sidelined in the Doha Round. Similarly, reports from Geneva suggest that Australia has simply not been as active in the current round of negotiations as in the past (again Capling 2005 provides a useful discussion).

On one dimension of WTO activities, Australia was far more active in the period 2001–05 than in the previous five years (which coincided with the first five years of the WTO). Before 2001 Canberra had been criticised for its failure to make effective use of the WTO's Dispute Settlement Mechanisms (DSMs), one of the most significant changes in the global trade regime introduced in the Uruguay Round negotiations. Despite its relatively clean record in international trade, Australia anomalously had found itself on the defensive as a respondent in several suits in the WTO's first five years. In contrast, the government failed to take advantage of the DSMs to pursue Australia's own grievances against its trading partners. In response to criticism, the government established a WTO Trade Law Branch in DFAT in early 2001 to engage more effectively with the new WTO mechanisms.

In the period under review, Australia has been a complainant in two significant cases before the WTO: on EU usage of geographical names for foodstuffs and other products, and on EU export subsidies for sugar. The outcome of the first case was somewhat equivocal; of the second, however, Australia and other sugar exporting countries, such as Brazil, won a major victory when the WTO deemed European export subsidies to be illegal.

Meanwhile, Australia continued to be a target of other countries' complaints. In particular, the EU, supported by seven other countries including China, the USA, and Canada, took action against Australian quarantine regulations on the import of pork and poultry, and the Philippines lodged a complaint about Australian regulations on the import of fresh fruit and vegetables. Neither case had been decided at the time of writing.

AUSTRALIA'S FOREIGN AID PROGRAM

For most of the period under review, the foreign aid program continued much as before, with the government maintaining the aid to GDP ratio at the low level of 0.25 per cent (AusAID 2005b). In accord with priorities established in the 1990s, emphasis in the aid program was given to Australia's immediate region (indeed, this trend further developed in this five-year period with the share of aid given to the three largest recipients of the program—Papua New Guinea, the South Pacific islands, and Indonesia—increasing from 45 per cent to more than 65 per cent).

A major ministerial statement in 2002, *Australian Aid: Investing in Growth, Stability and Prosperity*, argued for a 'more robust' approach that would lead to better coordination among various Australian government agencies in promoting good governance in the region. Governance subsequently became the major focus of Australian assistance programs (see chapter 7 by Michael O'Keefe).

The major developments in the aid field came at the end of the period. The first was the government's generous response to the tsunami tragedy of Boxing Day 2004. The government immediately extended $60 million in humanitarian assistance to support relief efforts in Indonesia, the Maldives, Sri Lanka, and Thailand, and provided Australian Defence Force and Australian Federal Police teams to assist in the emergency response. Two weeks after the tsunami struck, the Prime Minister announced a new Australian–Indonesia Partnership for Reconstruction and Development under which Australia will contribute $1 billion over five years. If fully committed, this will amount to the largest single aid contribution the country has ever made. The government has pledged that this program will be in addition to existing aid commitments (AusAID 2005a). Together with the response of the Australian public, non-governmental

organisations, and the business community to the tsunami tragedy (which contributed a combined total of more than $280 million in response to public appeals), the government's actions did much to improve the image of Australia in Indonesia and helped to erase the bitterness over the East Timor intervention. The generous aid response appeared to be a significant factor in the good relationship established between Howard and the new Indonesian President, Susilo Bambang Yudhoyono.

The impact of Australia's response to the tsunami appeared to convince the government of the effectiveness of aid as a foreign policy tool. The generous turn on aid issues was extended when Howard addressed the United Nations (UN) summit in mid-September 2005. He announced that the government planned to double Australian aid by 2010 to 'about $10 billion' annually, which would represent the most significant boost in Australia's aid to GDP ratio for many years (although it would still fall well short of Australia's commitment to the UN target of 0.7 per cent of GDP) (Howard 2005f). The aid increase, however, would be dependent on recipients pursuing approved policies on governance and on trade and investment liberalisation. A new White Paper on aid would be prepared in 2006 to examine (again) the effectiveness of the program and the priorities for the future.

CONCLUSION

The buoyancy of the Australian economy in the years 2001–05 underpinned the two election victories the Coalition enjoyed in this period. The growth of the US economy in the same period pulled other economies along in its wake; Australia also benefited from the capacity of the Chinese economy to sustain expansion at historically unprecedented rates. The likely continued high rates of economic growth in China, now coupled with similar rates for India, promised a healthy outlook for the Australian economy for the medium term. Booming commodity prices bolstered state and federal coffers but simultaneously fuelled a real estate bubble and an increasingly worrisome balance of payments deficit. It was this deficit, combined with the poor export performance during the five-year period, that constituted some of the few clouds on an otherwise sunny horizon.

The move to bilateralism during the period considered in this volume marked the most significant change in Australia's trade policies for half a century. By the end of the period, it was far too early to judge whether the new free trade agreements would have the positive economic impact that some of their proponents argued. What was clear, however, from the negotiation of the agreement with the USA, was that political considerations were paramount and would triumph over principles of economics should the two be in conflict.

NOTES

1 See, for instance, Truss (2002). The minister also commented that 'Entering into negotiations with the US will in no way compromise Australia's conservative approach to quarantine', another prediction that proved false. The government had listed 'the removal of tariff rate quota restrictions on Australian exports to the United States, including those affecting exports of beef, dairy products, sugar, peanuts and cotton' as the second of its 'specific objectives' for negotiations with the USA. See DFAT (no date a).

2 Despite declaring in February 2004 that Australian farmers had been 'dudded' in the negotiations, and that the deal 'was not in Australia's interests', Latham committed the ALP to supporting the agreement, again apparently because of concern at the adverse electoral repercussions if Labor opposed the FTA. See chapter 13 by Murray Goot for public opinion on the USFTA. For Latham's comments, see australianpolitics.com 2004.

11 Pragmatism, Prosperity, and Environmental Challenges in Australia's Foreign Policy

Lorraine Elliott

KEY TOPICS

Conceptualising environmental foreign policy
The global policy context
The Coalition's environmental foreign policy
Foreign policy in practice

In conventional institutional terms, Australia's role in world environmental affairs is the product of its foreign policy on regional and global environmental issues and its domestic implementation of formal treaty obligations and other commitments. Australia's ecological profile provides good reason for governments of whatever political hue to take a keen interest in international negotiations to manage transboundary and global pollution, protect the world's species and ecosystems, and advance the cause of sustainable development. Australia has one of the world's most variable climates and is, with the exception of the Antarctic, the world's driest continent. As the drought conditions that beset the country in the first half of the period under review demonstrate, the country is susceptible to water stress. Australia is one of the few industrialised countries that suffers from severe desertification, and it is the only developed country among the ten in the world that qualify as mega-diverse in their fauna and flora. As a country 'girt by sea', protecting the oceans from pollution and resources therein from over-exploitation is a key policy objective. As well as the important contributions that primary production and resource extraction make to the