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Australia’s new terms of trade

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Mark began his career as an economist in the Bank of England’s international divisions, where he focused mainly on emerging market issues. He also spent some time in the Bank’s UK structural economic analysis division. He subsequently joined JP Morgan, where he was a vice president in the economic research department with responsibility for Central and Eastern Europe. Before joining the Lowy Institute, Mark was senior economist at the Australian Export Finance and Insurance Corporation from 1999 to 2003, where he worked on country risk issues, with a particular emphasis on East Asia.

Mark is the author of Lowy Institute Paper 01 *India: the next economic giant* and Lowy Institute Paper 07 *The new terms of trade*.

One of the key objectives of the Institute's International Economy program is to track and evaluate key trends in the international economic environment within which Australian policymakers and businesses have to operate. Lowy Paper 07 is intended to fit squarely within this remit: the aim is to paint a picture of Australia's current international trading environment, to ask how we got to where we are today, and to think about what some of the implications of current trends are for the future, and for trade policy.

The basic thesis of the Paper, and of this presentation, is that Australia's terms of trade have changed significantly in recent years. This is true in a strictly technical sense, in that there has been a dramatic run-up in the ratio of our export to import prices. But it is also true in a broader sense, in that the terms on which we engage with the rest of the world through international trade have changed as well. Specifically, the emergence of a new global economy is reshaping the international context for trade and trade policy. Moreover, Australian trade policy has undergone a significant shift of its own: when the Australia–United States Free Trade Agreement entered into force at the start of 2005, it signalled a fundamental adjustment to Australia's trade strategy.

For a more detailed version of the following argument, and supporting references, please see the Lowy Paper.

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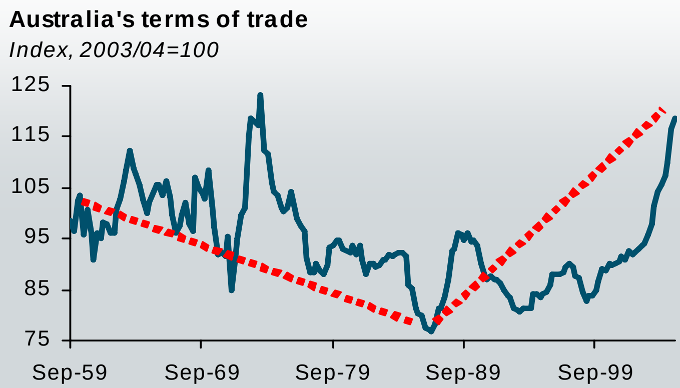
The new terms of trade v.1



Source: Australian Bureau of Statistics

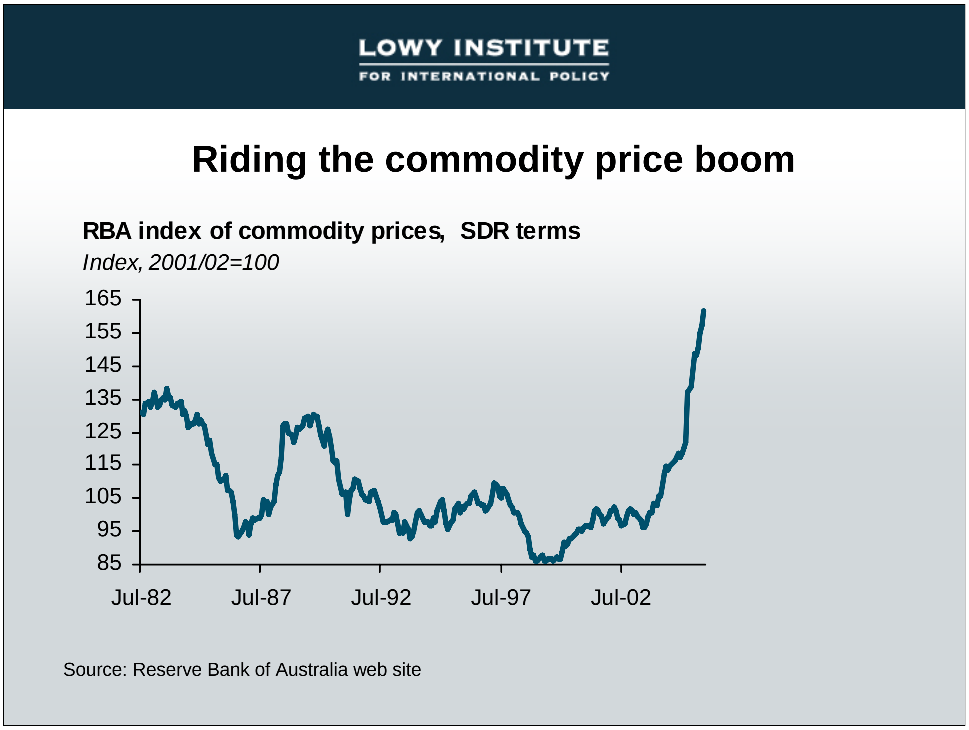
So what are Australia's new terms of trade?

Normally when economists talk about the terms of trade they are referring to a formal definition: the ratio of export to import prices. And there is evidence of a change here: between December 1999 and September 2005 (our most recent data point), the terms of trade have risen by more than 43%. In the past two years alone they have increased by about 25%. The RBA estimates that this has increased real incomes in Australia by about 1½ percentage points in each of these years.

Indeed, in recent years, Australia's terms of trade have risen faster and reached a higher level than at any time since the commodity boom of the early 1970s. (Then, higher commodity prices were associated with current account surpluses. Today Australia runs a current account deficit in excess of 6% of GDP.)

The Prebisch-Singer hypothesis (derived from work in the 1950s by economists Raul Prebisch and Hans Singer) posits that over time the prices of primary products will decline relative to the prices of manufactured goods. The implication is a secular decline in the terms of trade of commodity exporting economies like Australia. The chart suggests that Australia's terms of trade followed a declining trend between 1959 and 1987, but since then have been rising. (For a nice, detailed review of trends in the terms of trade, see the April 2005 RBA research discussion paper by Christian Gillitzer and Jonathan Kearns. They find that over a period of 135 years, Australia's terms of trade have declined by 0.1%pa.)

A look at the relative path of export and import prices shows that this improvement in Australia's terms of trade reflects a combination of falling import prices *and* rising export prices.



An important part of the export price story is the global increase in commodity prices.

The chart graphs the RBA's commodity price index.* The index has increased by more than 86% between December 1999 and December 2005.

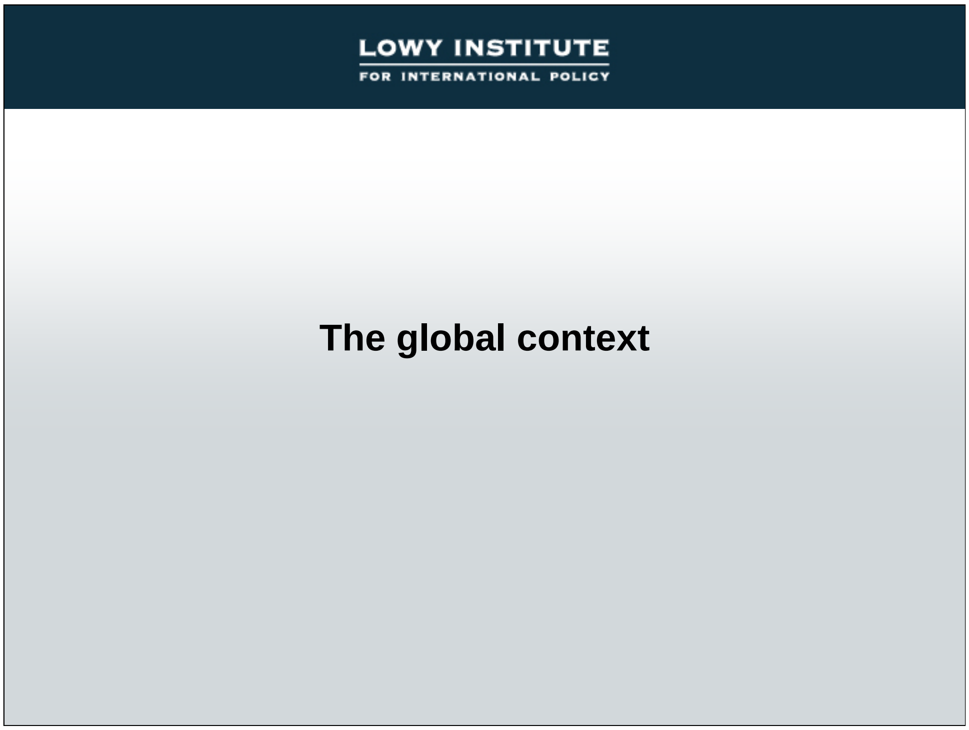
Since 1999, booming world demand – particularly from China – has pushed up the price of several commodities which are important elements of Australia's *export* mix, including coal and iron ore (our two largest exports by value in 2005/06). China is also an important part of the *import* price story. Competition from Chinese producers has exerted downward pressure on the price of manufactured goods.

How sustainable are these trends? To the extent that a key driver is China, then the scope for continued growth, industrialisation and urbanisation in that economy implies continued demand for many of the raw materials Australia exports. Much therefore will depend on the supply response, since high prices have already reportedly encouraged an increase in investment worldwide in resources.

*This covers some 17 commodities which account for about 60% of Australia's primary commodity export earnings. The index makeup is 29.1% rural commodities [including wheat (8.3%), beef and veal (7.9%) and wool (4.1%)]; 15.7% base metals [including aluminium (8.1%) and copper (2.0%)] and 55.3% other resources [including coking coal (14.7%), steaming coal (9.7%), gold (9.4%), iron ore (7.4%), alumina (7.4%) and LNG (4.8%)].

The proposition advanced here is that this change in the ratio of export to import prices can also be seen as a symptom (or reflection) of a broader change in Australia's international trading environment. In this broader sense, the 'new' terms of trade are those changes in the way in which Australia interacts with the rest of the global economy through trade.

In this sense, Australia's new terms of trade are those developments at the global, regional and national level that have transformed our international trading environment.



At the global level a (non-exhaustive) list of the new terms of trade would include:

- the growing importance of trade in the world economy;
- the rise of new trading powers;
- and the shifting policy environment, including the problems facing the multilateral system and the rise of preferential trade.

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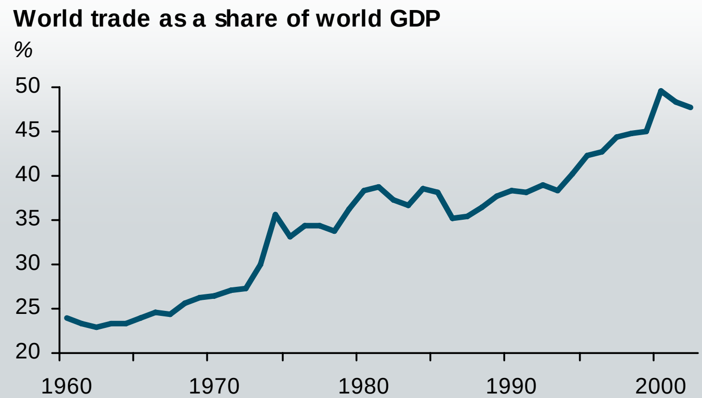
A new global economy?



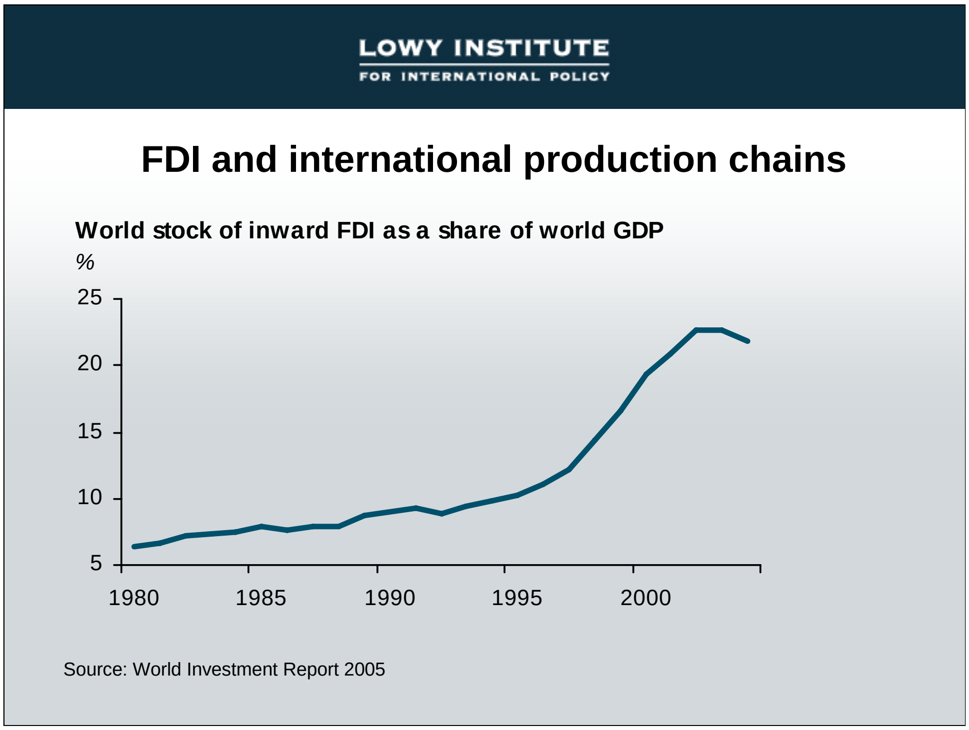
Source: World Bank World Development Indicators

An obvious starting point for describing the new terms of trade is the growing importance of trade in the world economy: the chart shows that trade (goods and services) as a share of world GDP had increased from one quarter in 1960 to one half by the start of the new millennium. This trend (together with the even more pronounced increase in international *financial* integration) is a defining characteristic of what is often called the new global economy.

This rise in the importance of trade relative to world output is a product of a whole series of factors, but in this presentation the focus is on just two :

• the growth of ‘international vertical specialisation’ / global supply chains;

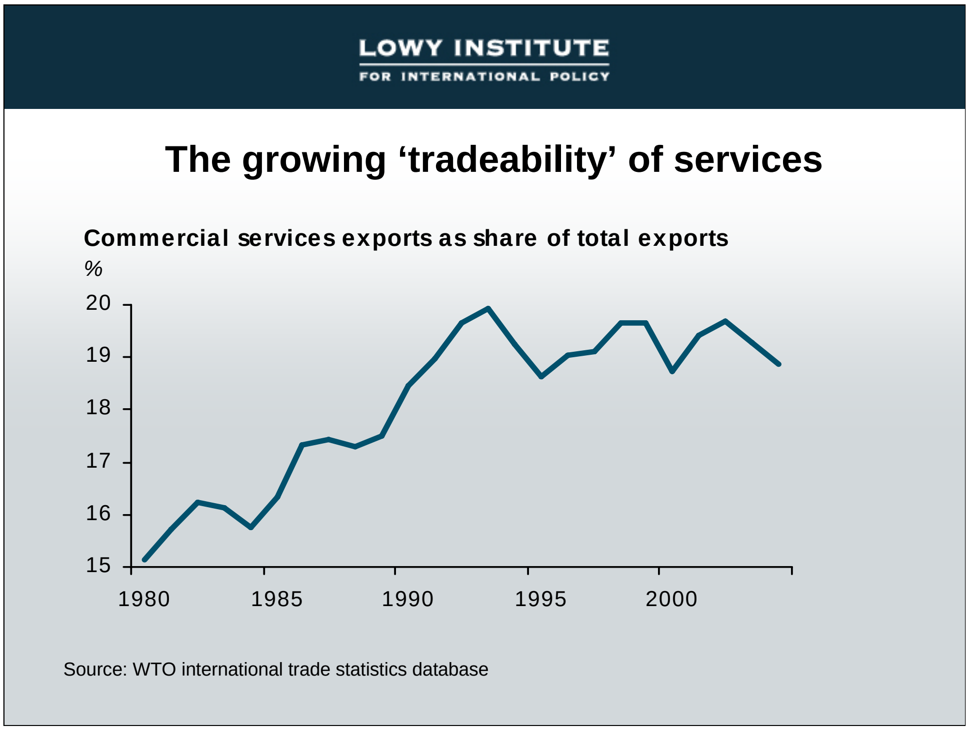
• and the spread of trade into new areas of national economies, in particular services.



One key aspect of the growing importance of international trade has been the growth of so-called 'international vertical specialisation', or the emergence of global supply chains. That is, the ability of firms – typically via Foreign Direct Investment (FDI) – to choose different geographical locations for different stages of the production process according to comparative advantage. Perhaps the most often cited example of this is production of the notebook computer, with, say, the design work done in the United States, the memory chips produced in Taiwan, the disk drive in Singapore, the screen in Korea, and final assembly in China. As a result, production of an individual product often now involves a large element of cross-border trade.

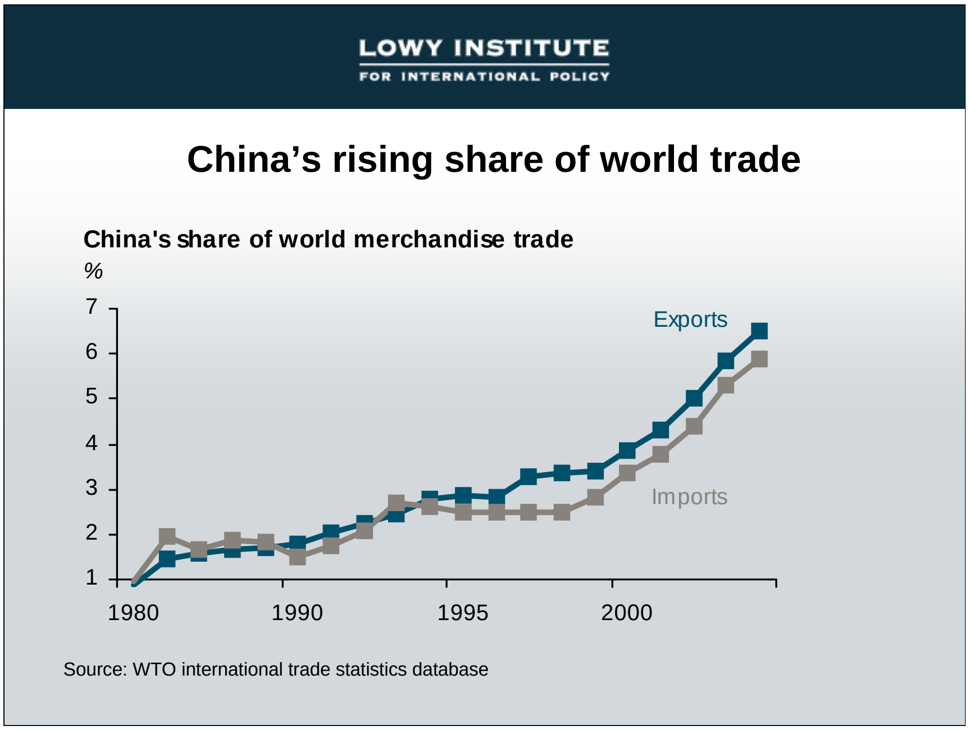
An interesting aspect of this is the linkage between trade and FDI. Some older theories tended to view the two as *substitutes* – a prime motive for carrying out FDI was thought to be to bypass trade barriers and access otherwise closed markets. But in an era of international production chains, the two are increasingly seen more as *complements*.

FDI is certainly a bigger part of the global economy: the chart shows the ratio of FDI to global output, which has risen sharply since 1995. By 2004 the global stock of inward FDI was US$9 trillion, and this formed the production base for about 70,000 Transnational Corporations (TNCs) with 690,000 affiliates generating sales of US$19 trillion.



The second of my two factors explaining the increased role of trade in the world economy is the growing ‘tradeability’ of services, increasingly as a product of offshore outsourcing. The outsourcing of some relatively low-skilled service sector jobs (call centres, for example) started in the early 1990s. But that has now been joined by more skilled white collar jobs in (for example) the IT and financial sectors, along with claims that anything that can be done remotely can be outsourced (from medical examinations to virtual classrooms).

Unfortunately, there are big limitations with the data on trade in services, so we probably don’t have a particularly accurate picture of this trend. Still, the data we do have show, for example, that in recent years exports of commercial services have accounted for roughly one in every five dollars of total export sales – a figure that is likely to be an underestimate.



Another feature of the new terms of trade at the global level is the rise of new trading powers, and in particular, the entry of the two billion-people-plus economies of China and India into the world economy.

Of the two, there is no doubt that China is the numbers story. By 2004 China had become the third largest trading nation in the world: 6.5% of world merchandise exports, 6% of world imports, 8% of world manufactures exports, 15% of office and telecommunications exports, 17% of textile exports, and 24% of clothing exports came from China. On the import side of the equation, China was the source of one-third of growth in world demand for oil and one half of growth in world demand for metals. Since the start of the current millennium, China has also been the single most important contributor to the growth in world trade.

China's emergence as a great trading power is also intimately connected to the growth of international production chains and the role of FDI. Since 1980, China has received roughly US$500b of FDI, and in 2004 more than half of all Chinese exports came from so-called foreign-invested firms.

See for example the Lowy Institute *Perspectives* piece on China*, Shaking the World?*

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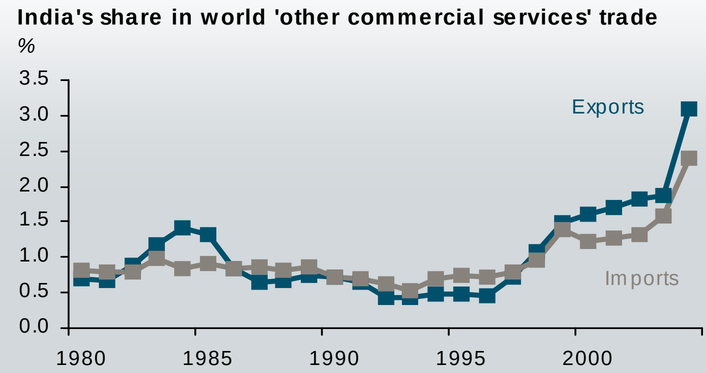
India and world services trade



Source: WTO international trade statistics database

While India's integration into the international economy to date has *quantitatively* been much more modest than that of China, the *qualitative* nature of the Indian push into global markets has been important. Here the 'new' feature is that a striking aspect of the current Indian development model has been the central role played by services.

India has seen its share of world services exports triple in the space of about a decade, and many of these gains have come in so-called new economy sectors like software, where India's share of the global market is around 17%, and where the growth of its exports has been double the world average. This has allowed Indian firms to compete in areas once thought to be the preserve of the developed world and to become a major force in the international outsourcing phenomenon: McKinsey estimates that Indian firms now control over half the global IT and back office outsourcing markets. The chart shows India's rising share of 'other commercial services trade' – the component of services trade that captures non-traditional services exports (i.e. excluding transport and travel).

Given the central importance of services in developed economies, in the longer term the Indian model has at least the potential to generate an even more fundamental shift in the international division of labour than the rise of China.

(For more on India, see Lowy Institute Paper 01 *India: the next economic giant*. For one comparison of China and India and their impact on world trade see an earlier presentation: *The changing geography of international trade*. Both can be downloaded from the Lowy web site.)

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The multilateral trading system in trouble

- **'Perhaps the most successful exercise of deliberate economic policy making in history . . .' Yet:**
- **Before Hong Kong, two out of the last three WTO ministerial meetings had ended in failure.**
- **Only one successful trade round concluded in the past quarter-century.**
- **Progress under the current Doha Round has been glacial: WTO report noted progress has been 'been painfully difficult and has raised questions about the process itself'.**
- **And of course, Hong Kong lived down to expectations.**

The final element of the new terms of trade I want to review at the global level is the changing policy environment. Here I want to emphasise two key developments: the growing stresses and strains on the multilateral system, and the worldwide expansion of preferential trade.

While there is still an ongoing academic debate about the precise contribution of WTO / GATT membership in promoting trade, most economists award the multilateral system a large share of credit for the post-WWII boom in world trade and the associated fall in trade barriers. Today, both the membership of the WTO and the share of world trade accounted for by WTO members are at an all-time high. From the original 23 signatories to the GATT in 1947, the number of member economies has risen to 149 (Saudi Arabia the latest in December last year). More are on their way, and the WTO is heading towards something approaching universal membership. This has been accompanied by a rise in the amount of world trade accounted for by members: currently over 95%.

Despite being possibly the most successful international economic policy initiative ever, the system is in trouble. The strictly limited progress made at Hong Kong is a good example of the difficulties in delivering further trade liberalisation, and I don't think you even have to be an advocate of the bicycle theory of international trade policy — the one which asserts that momentum is all, with the world either moving towards freer trade or towards more protectionism — to view this lack of progress as a source of real concern. As the WTO's own wise men have pointed out, since the WTO is basically a negotiating machine, to the extent it becomes unable to negotiate effectively, or even is perceived to be unable to do so, its position becomes precarious.

So why is the current system in trouble? Problems include:

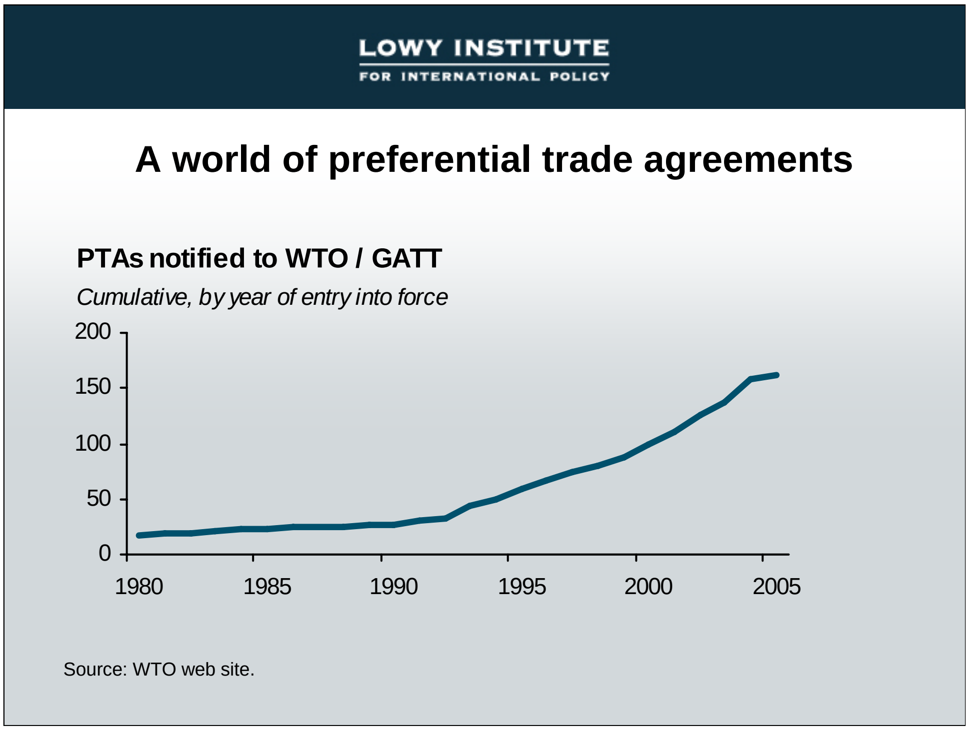
•The perils of success: reaching decisions among 149 members (and rising) is a difficult task, particularly with decisions made by consensus, with a one member one vote arrangement, and with the 'single undertaking' of the WTO regime requiring full participation by all members. At each successive trade round, it has taken more time for a larger number of members to reach an agreement (chart).

•Similarly, the increasing number and complexity of trade policy issues makes negotiations more difficult and time-consuming.

•The outcomes of negotiations have also become more sensitive for policymakers (and their constituents), as trade becomes a steadily more influential factor in national economies, and involves more (and different) people and jobs.

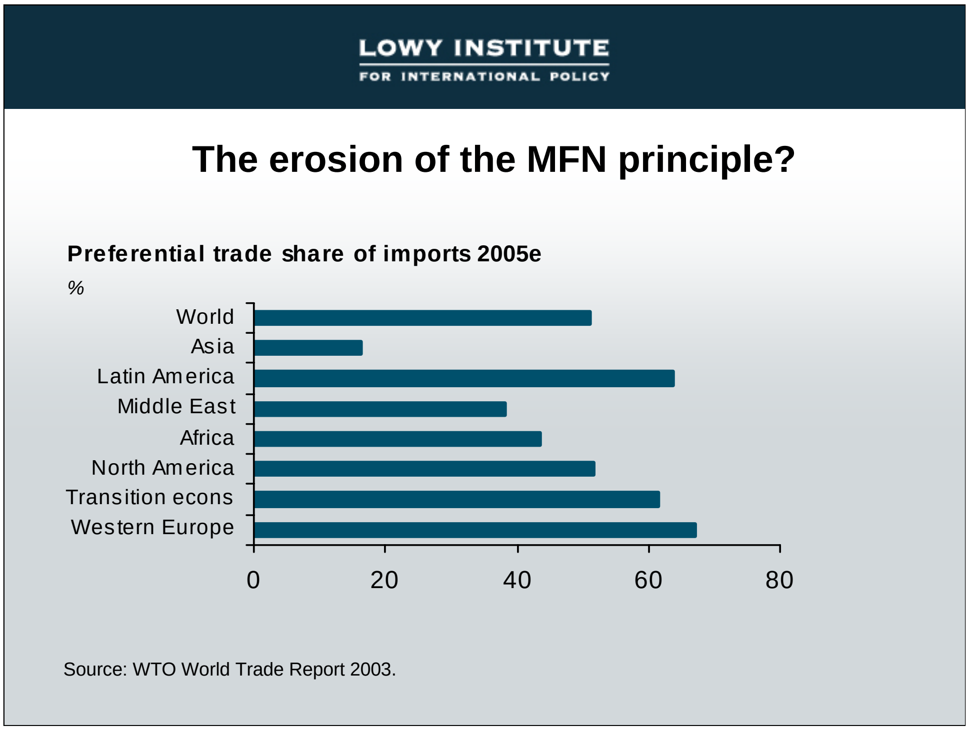
•The ability of a small group of developed economies to guide outcomes has been replaced by a growing degree of assertiveness on the part of developing countries: as they become more important players in the world economy, they naturally become more reluctant to sit back and let the big developed economies run the show. Meanwhile, for their part, the developed countries are no longer willing to let the larger emerging markets 'free ride' on the system: crudely put, the case for giving 'Special and Differential Treatment' to a trading giant like China is much harder to buy than for an impoverished African state.

• Past negotiations tended to shunt to one side the 'harder stuff' (such as agriculture). Now most of the 'low-hanging fruit' has been picked.



The increasingly problematic performance of the multilateral system has seen policymakers look elsewhere for trade policy initiatives. In particular they have turned their attention to preferential trade agreements (PTAs), typically in the form of bilateral free trade agreements (FTAs) and regional trade agreements (RTAs).

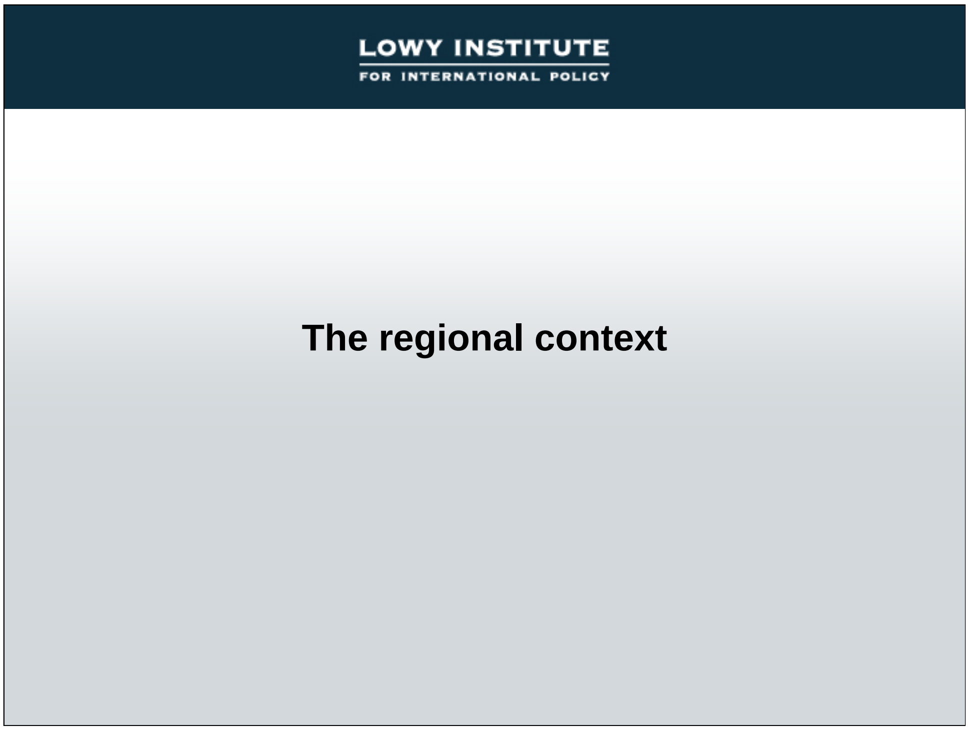
The number of PTAs being signed has increased markedly since the mid-1990s (chart) and by 2004 nearly every significant economy in the world — and virtually every WTO member — was involved in some form of PTA: the World Bank could find only 12 countries that did not belong to at least one such agreement, and virtually all of these were either islands or microstates. Indeed, on average, the Bank estimates that each country now belongs to six PTAs (although this hides substantial variations across regions and development levels).



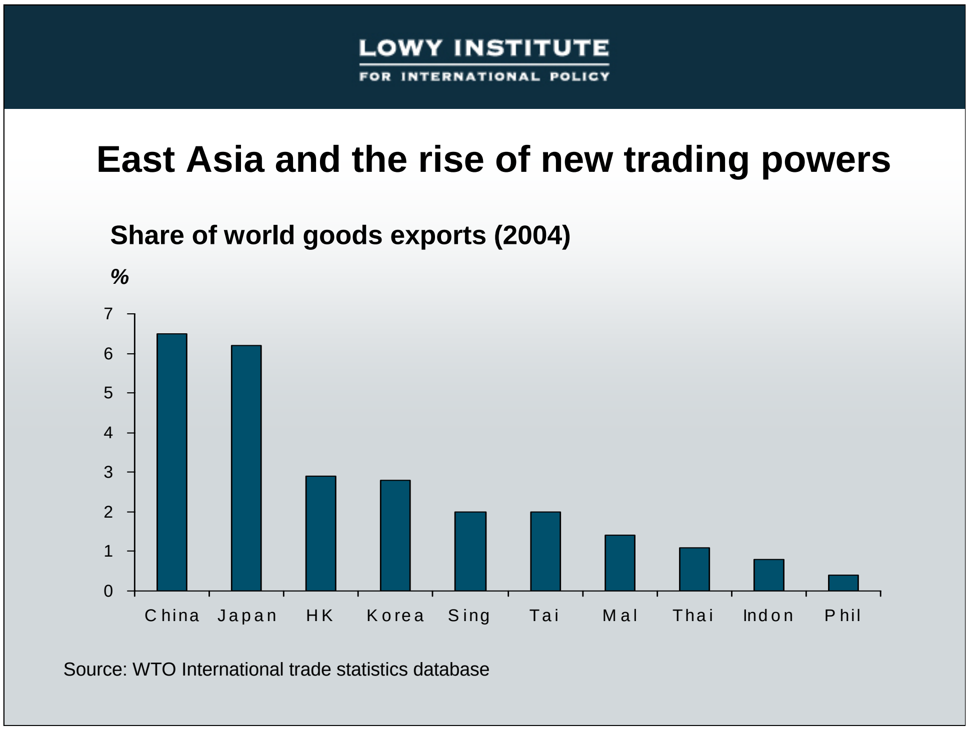
The WTO has estimated that, by 2000, around 43% of world merchandise trade was taking place within PTAs. By last year, the WTO expected that more than half of all world trade would take place on a preferential basis.

In fact, this estimate may be too high, since the value of total trade flows between PTA partners will tend to overstate the actual trade that takes place on a preferential basis (as the tariff schedules of many PTA members include MFN duty-free rates of zero). Taking this into account, the World Bank thinks that the amount of preferential trade among PTA members is probably around one fifth of world trade. Even so, the spread of PTAs has been such as to lead observers to fret that the most favoured nation (MFN) principle that anchors the multilateral system has become the exception, rather than the rule.*

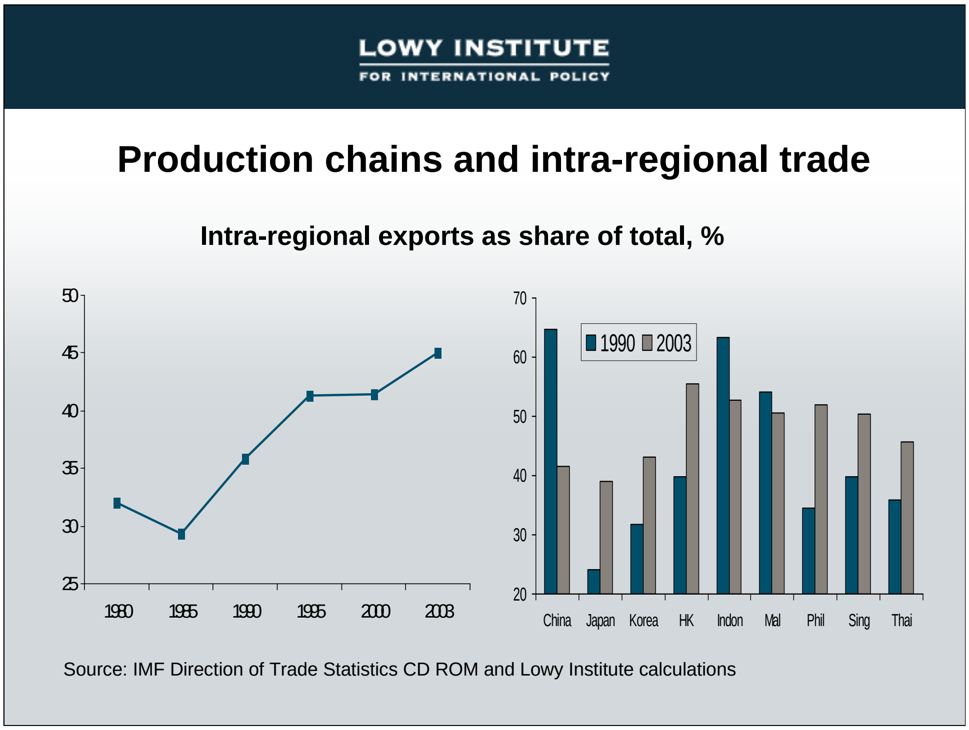
* The concept at the heart of the multilateral system is that of non-discrimination. This ideal is embodied in two guiding principles: MFN which says that a WTO member must treat all other members equally, and national treatment, which says that a member should not discriminate between its own and foreign products, once the latter have entered the national market.



All of these changes to the terms of trade at the global level also have their counterparts at the regional level. Indeed, East Asia is at the heart of many of the global trends — the emergence of new trading powers and the proliferation of PTAs — described earlier. And while global developments are of critical importance to Australia, trends in East Asia are of particular interest, since the region now accounts for roughly half of all our merchandise trade.



East Asia has been at the centre of the emergence of new trading powers, beginning with the (re-)emergence of Japan as a major trading nation in the 1960s and 1970s. Japan was followed by successive waves of regional economies, first the newly industrialising economies (NIEs) of Hong Kong, South Korea, Taiwan and Singapore, then the 'Tigers' of Southeast Asia (Thailand, Malaysia, Indonesia and the Philippines), and of course most recently by China.



The region has also seen the rapid expansion of international production chains. This in turn has contributed to very strong intra-regional trade growth: in emerging East Asia, for example, intra-regional trade has been growing at a rate roughly double that of world trade overall since the 1980s. This is a far faster pace than intra-regional trade in either NAFTA or the EU.

For several of the region's economies, intra-regional trade now accounts for more than 50% of exports, although China is seeing *extra-regional* exports grow in importance.

Note also that a large proportion of this expansion in intra-regional trade reflects cross-border movements of intermediate products. In terms of *final* demand, East Asia remains dependent on markets outside the region, including the EU and (particularly) the US.

An important element of the growth in intra-regional trade and production networks has been the increasingly central role of China. During 1995–2001, emerging East Asian exports to China grew at an annual average rate of 11.5%, compared to a growth rate of less than 4% for world trade. The result has been a rapid increase in the rest of the region's interdependence with the Chinese economy (chart).

There has also been an element of rising 'third market' competition between Chinese and other regional exporters, however, leading to the 'China as comrade or competitor' debate.

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East Asia is now a convert to PTAs

Selected regional PTAs, actual and proposed

ASEAN / AFTA
ASEAN – China
ASEAN – India
ASEAN – Japan
ASEAN - Korea
China - Australia
China – HK
China – Macao
China – New Zealand
Japan – Indonesia
Japan – Mexico
Japan – Philippines
Japan – Korea
Japan-Singapore
Korea – Chile
Korea – Mexico
Malaysia-Australia
Singapore – Australia
Singapore – Canada
Singapore – Chile
Singapore – EFTA
Singapore – Mexico
Singapore – US
Thailand – Australia
Thailand – US

Another global trend apparent in the region is the spread of PTAs – indeed, their arrival in East Asia arguably marked the fall of the last multilateralist left standing, as until recently the region had been notable for its reluctance to head down the preferential trade route.

In fact, the new wave of regional integration initiatives was initially more apparent in terms of *financial* than trade policy. The idea of closer regional monetary and financial cooperation was given a boost by the Asian financial crisis which breathed life into 'blue-sky' ideas like an Asian Monetary Fund (an idea first raised by Japan in 1997) or a common Asian currency. But more concretely, the aftermath of the crisis also saw: regional central banks put in place the Chiang Mai Initiative of currency swaps; ASEAN establish regional surveillance procedures, along with the Asian Bond Markets Initiative; and the negotiation of several agreements on technical matters and information sharing.

Increasingly, however, it is trade policy initiatives that are starting to make the running when it comes to regional economic initiatives. In particular, the last few years have brought a plethora of new and proposed trade agreements which have at least the potential to fundamentally reshape the regional trading environment

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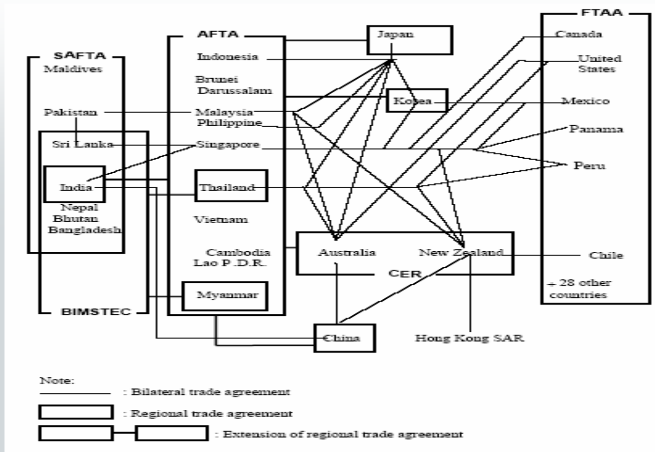
The result: a ‘noodle soup’ of agreements



Source: Figure 3 in Feridhanusetyawan, Tubagus, 2005, "Preferential Trade Agreements in the Asia-Pacific Region," IMF Working Paper 05/149 (Washington: IMF).

East Asia’s opinions on PTAs probably started to turn at the end of the last century. Proposals or studies for several PTAs were announced at the Auckland APEC economic leaders meetings in September 1999. These included the Singapore–Japan, Singapore–Chile, Singapore–New Zealand, South Korea–Chile and Japan–Mexico agreements. More followed at the November 2000 meeting, with announcements including the Singapore–US and Australia–Singapore deals. At the same time, Beijing proposed an FTA between China and ASEAN, a move swiftly followed by news of a planned Japan–ASEAN agreement.

The result is what looks like (in the words of the Economist magazine) a ‘noodle soup’ of overlapping agreements – a regional counterpart to the ‘spaghetti bowl’ of agreements seen elsewhere in the world economy.

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Why has East Asia joined the bandwagon?

1. **Asian financial crisis created sense of growing regional identity and awareness of economic interdependence. Trade policy now a tool for advancing regionalism.**

2. **Growing relative importance of intra-regional trade.**

3. **Defensive response to proliferation of PTAs elsewhere (negative demonstration effects), along with positive demonstration effects from successful regional PTAs in Europe and North America.**

4. **Concerns about direction of trade policy in US and EU.**

5. **Disappointment with alternative routes – APEC as well as the WTO.**

6. **A means of managing / reacting to China's rise – economic and foreign policy aspects.**

The list identifies several possible explanations for East Asia's deciding to jump on board the PTA bandwagon. The last of these points is one of the most interesting, as one of the most striking factors about regional trade developments has been the way in which the mounting economic and political weight of China has exerted a gravitational pull on the rest of East Asia, influencing both regional trade flows and institutions.

Towards an East Asian trade bloc?

- **Limitations of existing agreements (AFTA experience).**
- **Economic logic of an expanding bloc – winners and losers.**
- **Political competition between Beijing and Tokyo.**
- **The imperative of being (an economic) part of the region.**

So what does it all mean? One response is 'perhaps not very much'. It's possible that the current swathe of agreements will prove to be more about sending political signals and delivering the diplomatic equivalent of public relations coups than about economic substance. A look at AFTA – ASEAN's own free trade agreement and the only PTA operating in East Asia before the recent flurry of activity – provides grounds for scepticism. Under AFTA formal trade integration has been largely limited to tariff reductions – many of which were arguably happening anyway with unilateral cuts – and the agreement also allowed for significant exceptions. Meanwhile non-tariff barriers have remained significant. Anecdotal evidence suggests that the actual proportion of trade making use of AFTA's Common Effective Preferential Tariff could be as low as 5%.

The other – much more interesting – possibility is that these various agreements accrue substance over time, and start to effectively shape the regional trading environment in what becomes an evolutionary process. Economic modelling suggests the presence of a potentially strong motive for *region-wide* agreements, as several studies find that the benefits of an agreement rise strongly in line with membership, while the economic costs of not being a member for those regional economies left out are also increasing sharply with the size of agreement.

A key question then becomes how far economic logic will drive membership decisions as opposed to other factors (politics, security issues etc). Which particular motivation triumphs could mean the difference between a comprehensive East Asian trade bloc, and a region splintered into competing trade blocs. The latter scenario would be bad news for everyone, including Australia. The former would *potentially* be good news for Australia, *provided* that we were in it, or that we had suitable side-agreements in place, and dependent on the nature of the bloc.

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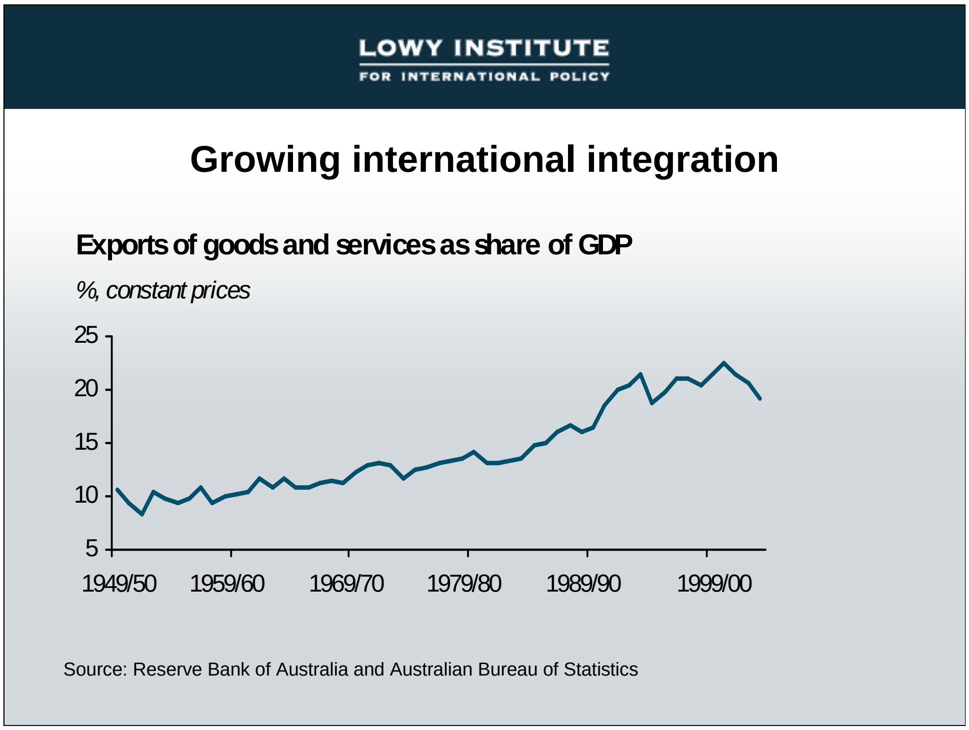
The national context

These changes at the global and regional level have also been reflected in Australia's own trade and trade policy profiles:

• The share of trade in output has risen over recent decades (to about 40% as of 2003) and services have become a more important part of our trade mix (23% of total exports and 20% of total imports in 2004, for example);

• China has become a key bilateral trading partner (in 2004/05 our second largest merchandise trading partner);

• And Australia has joined the worldwide shift to preferential trade, with three agreements signed since the start of 2003 and several more currently under negotiation.

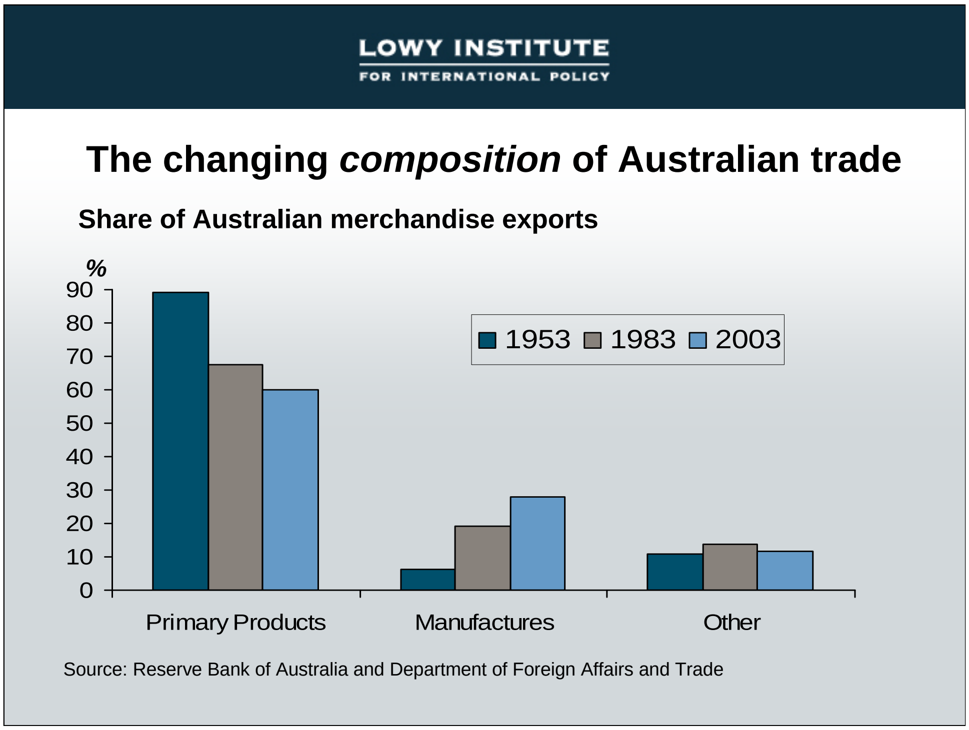


I began by suggesting that one feature of the new global economy is the growing importance of trade. The same sort of measurement confirms that Australia has also become a more open economy, in line with the global trend. For example, a look at the ratio of exports of goods and services to GDP since 1949/50, reveals a fairly steady rise in openness, particularly after the 'paradigm shift' in the 1980s (chart).*

Despite this rise, Australia's share of trade in GDP looks relatively low when compared to many other developed economies. Work by two economists at the RBA suggests that this is largely explained by Australia's relative remoteness from other major trading partners and its larger land mass.**

*Using current prices rather than constant prices would show that Australia today is still less integrated with the global economy than it was in 1949/50. Why the different results? In today's economy, GDP is dominated by services, which still tend to be less traded than goods. Since at the same time there has been a fall in the price of goods relative to services, this leads to the different trends in the two ratios.

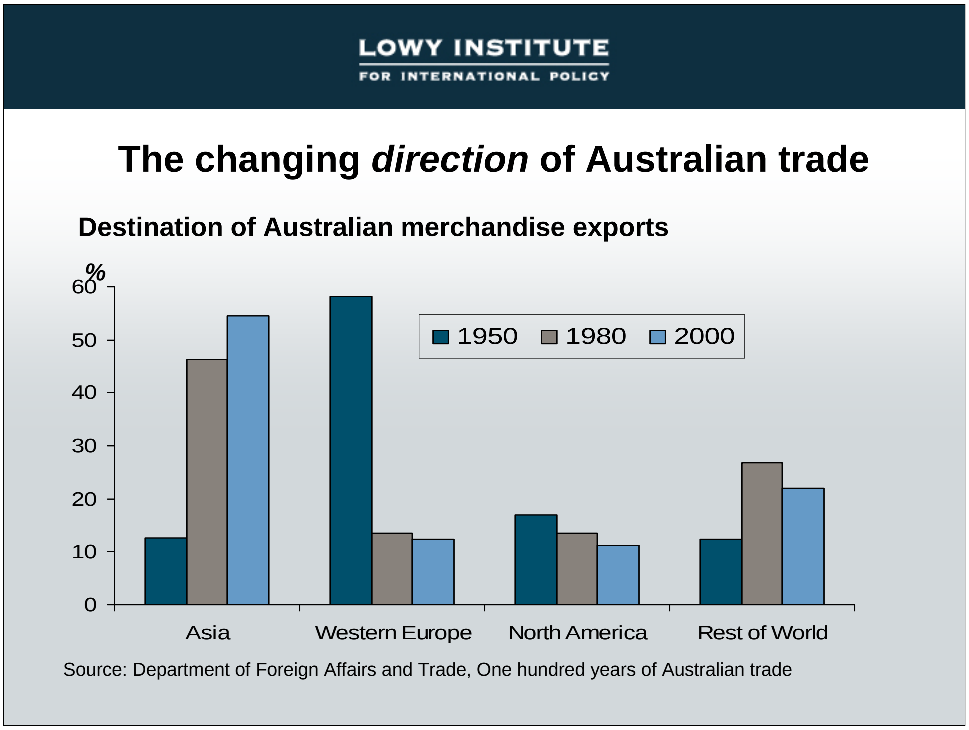
**See the December 2004 RBA research discussion paper by Simon Guttman and Anthony Richards.



Another notable feature of the Australian trade data is a shift in the composition of trade. Traditionally, Australia has been a major commodities exporter and a substantial importer of manufactures, effectively relying on the sale of rural and mineral resources to pay for manufactured goods. While this description continues to capture a large part of the current reality, there have nevertheless been significant compositional shifts in the export profile. Thus the share of primary products (energy and minerals) had fallen from almost 90% of merchandise exports in the 1950s to about 60% by 2003 while the share of manufactures rose from 6% to 28% over the same period.

There have also been important changes within these sectors. For example, in the 1950s, manufacturing exports virtually all comprised so-called simply transformed manufactures (basically metals). By 2004, roughly two-thirds of manufactured exports comprised elaborately transformed manufactures such as mechanical and electrical equipment along with scientific and medical equipment. Again, within primary product exports the share of rural goods (particularly wool) has declined, while that of metals and resources has increased.

By 2004, manufactures (22%) and services (23%) between them accounted for approaching half of total Australian exports. In the same year resource exports accounted for a bit over one-quarter of total exports (27%), while rural exports comprised almost one fifth (19½%).



There have also been substantial changes in the *direction* of Australian trade. Back in 1950/51, for example, the UK alone was the destination for roughly one third of Australian exports. By the start of the current millennium, the UK's share of Australian exports had fallen to a little less than 4%.

The big medium-term trend in Australian trade has been the rise in the relative importance of (East) Asia as a trading partner, reflecting the growing economic weight of the region. Historically, Japan has played a central role in this process. In 1950/51 Japan was the destination for just 6% of Australian exports; by 1980/81 that share had risen to almost 28%, before falling back to a little under 20% by 2000/01.

By 2004 roughly 54% of Australian exports went to the region, compared to 11% each for Europe and the Americas. East Asia also dominated Australia's goods imports, accounting for 49% of the total, compared to 24% for Europe and 17% for the Americas

The more recent component of this change is the rise in the importance of China as a bilateral trading partner.

While Japan remains by far the most important destination for Australian merchandise exports, China has rapidly become a major buyer, overtaking the United States to become Australia's second largest export market in 2004. China was also the second largest source of merchandise imports in the same year and Australia's third largest trading partner overall.

By FY2004/05 China had become Australia's second largest merchandise trading partner overall, accounting for almost 12% of total trade, with values growing by roughly 30% over the course of the year (Japan remained our largest trading partner, accounting for about 15% of total merchandise trade).

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Trade policy evolution or devolution?

1930s	Member of the Imperial Preference scheme – based around the Ottawa Agreement of 1932 – era of preferential trade.
1948	Australia one of the founding signatories of the GATT. But initially a somewhat reluctant convert to the benefits of multilateralism.
1956	Ottawa Agreement renegotiated, indicating retreat from Imperial Preference.
1957	Commercial Treaty with Japan signed: followed by Australia-Japan Treaty in 1963; Japan overtakes UK as most important trading partner in 1967.
1983	Floating of A$; signing of CER with New Zealand; paradigm shift?
1988-91	Period of unilateral trade liberalisation; era of 'open regionalism'.
2004-5	Australia-United States Free Trade Agreement signed in 2004, enters into force in 2005: back to preferential trade?

I noted earlier that one of the main features of both the global and the regional trading environment now facing Australia is the proliferation of PTAs. Australia last participated in preferential trade in a big way when it was part of the Imperial Preference scheme that originated in the 1930s. Subsequently, with the exception of the CER agreement with New Zealand and its predecessor arrangements, Australian trade policy between 1956 and 1996 basically refrained from preferential arrangements, instead sticking to the policy framework provided by the multilateral system and augmenting this either with efforts at non-discriminatory regionalism or at unilateral liberalisation.

This period of Australian trade policy arguably ended in 1996 with the election of a Howard government committed to a more 'aggressive' and 'results-oriented' trade policy, and the new approach was set out in the 1997 White Paper on Foreign and Trade Policy, which stated that '[e]xisting bilateral and multilateral approaches to trade policy . . . have served Australia well. For the future, however, Australia will keep an open mind about new approaches, including preferential free trade arrangements.'

When the Australia–United States Free Trade Agreement entered into force at the start of 2005, it signalled the end of a fierce policy debate and confirmed a fundamental adjustment to Australia's trade strategy.

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Australia now on the PTA bandwagon

Partner	Date announced	Start of negotiations	End of negotiations	Date signed	Date entered into force
Singapore	Nov 2000	April 2001	Oct 2002	Feb 2003	July 2003
United States	Nov 2002	March 2003	Feb 2004	May 2004	Jan 2005
Thailand	May 2002	Aug 2002	Oct 2003	July 2004	Jan 2005
China	Oct 2003	May 2005			
Malaysia	July 2004	May 2005			
ASEAN (w. NZ)	Nov 2004	Feb 2005			
UAE	March 2005	March 2005			

Note: Feasibility study for possible FTA with Japan announced in April 2005

Since the change of policy signalled in the 1997 White Paper, Australia has completed negotiations with Singapore, Thailand and the United States, and all three PTAs have now entered into effect. In addition, negotiations are already under way on an agreement with United Arab Emirates (UAE), on an ASEAN–CER deal, and on deals with China and Malaysia. Canberra and Japan have also agreed to launch a feasibility study into a bilateral PTA.

Of the agreements actually signed to date, the deal with the United States (AUSFTA) has undoubtedly been the most significant, involving the most important trading partner: in 2004 the United States was Australia's third largest merchandise export market, its largest source of imports, and its second largest trading partner overall. Moreover, the United States was also Australia's most important partner in services trade, as well as both the largest source of foreign investment into Australia and the biggest destination for Australian investment overseas.

Between them ASEAN, China and the US would account for about 37% of merchandise trade (2004 data).

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Conclusion:
Managing the new terms of trade

What do all of these changes in the terms of trade mean for trade policy?

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Challenges for trade policy

1. **Reinvigorating the WTO:**
   i. **Delivering on Doha.**
   ii. **Institutional reform.**

2. **Influencing the regional environment:**
   i. **Worrying about the endgame: three scenarios.**
   ii. **Bilateral initiatives to deal with the noodle soup.**
   iii. **Getting a regional approach: resurrecting APEC?**

3. **Managing a PTA trade policy:**
   i. **Which countries?**
   ii. **What are the objectives?**
   iii. **What should be included . . .and what shouldn't?**
   iv. **The case for regular review.**

The most pressing issue for policymakers is safeguarding the international trading system. The immediate challenge is to ensure that the current Doha Round of trade talks does not end in ignominious failure. In the longer term, reinvigorating the trading system requires two more things. First, it means restoring the effectiveness of the multilateral system as a negotiating forum; that is, pushing ahead with reforms to ensure that trade rounds can once again deliver results, and do so in a reasonable time frame. Second, and in practice closely related, it involves convincing a sceptical public that the system itself is in fact worth saving.

The geographic concentration of Australia's trade means that developments in East Asia are particularly crucial. Here the challenge is to work to ensure, as best as possible, that the ongoing process of regional trade integration and the associated policy initiatives unfold in ways that are beneficial both for Australia and for the region as a whole. This means making sure that we have a voice in the emerging regional architecture (such as the East Asian Summit) and then using that voice to continue to push for open and comprehensive regional trading arrangements. It is possible that there may even be a role here for the Asia–Pacific Economic Cooperation (APEC) forum.

Finally, with Canberra's trade policy now committed, in the near term at least, to following the preferential trade approach in tandem with the multilateral route, another important policy objective is to maximise the net economic gains from that policy switch, and minimise any associated risks. This should be accompanied by a process of submitting completed agreements to a rigorous and regular review in order to gauge their ongoing economic impact, to stress test the efficacy of the new trade strategy.