
1 Australia in the global economy

The 20th Century has seen historically unparalleled advances in global living standards and reductions in poverty. Greater economic integration among nations has played a role in underpinning increased prosperity. The benefits of liberalised trade and investment, as well as increased domestic competition, have been apparent in Australia's improved economic performance. Yet there are concerns and misconceptions evident in Australia and many other developed countries about aspects of 'globalisation', and particularly the rules governing the world trade system. These concerns threaten to erode community support for the policies and institutions needed for further improvements in living standards and reductions in poverty.

The performance of the Australian economy over recent years has been remarkable. Despite the crisis which enveloped a number of our major markets in Asia, Australia's GDP has continued to grow strongly, with per capita income growth averaging just under 3 per cent a year since late 1991. There has also been steady growth in full-time employment and even faster growth in the number of part-time jobs. The unemployment rate, while still higher than desirable given this period of growth, had fallen to a near 10 year low of 6.4 per cent in August 2000.

Good macroeconomic management has clearly played a key part, not least by keeping inflation historically low, thereby creating a stable environment for investment and consumer demand. But the acceleration in Australia's productivity growth in the 1990s — to rates rivalling the so-called 'golden age' of the early post-war decades — suggests more fundamental influences at the microeconomic level.

The timing, duration and dimensions of the productivity surge are such that it cannot be attributed in any significant measure to the business cycle or to wider international trends. Nor can it be explained simply by new developments in information and communication technology. Even in the United States, the role of these technologies, particularly the Internet, in stimulating productivity gains outside computer production remains contentious. In Australia's case, the increase

in productivity performance preceded any possible influence of the Internet by several years.

After considering other possible causes, it is difficult to reject the proposition that Australia's 'new economy' owes much to a series of policy reforms over the past two decades which have created better incentives in Australian workplaces to apply new technology and to be efficient, innovative and productive.

These reforms began with the progressive opening of the Australian economy to the pressures and opportunities of the world market. Reductions in barriers to trade and foreign investment have encouraged Australians to compete with and learn from the world's best. That challenge is being met. By a range of indicators, Australian firms have become much more productive and innovative, including through the adoption of new technologies. Rapid import growth has been broadly matched by export growth, with Australia's trade participation as a proportion of GDP now a third higher than it was in the mid-1970s. While the current account deficit was around 5.7 per cent of GDP in 1999-2000, Australia's external debt service requirement as proportion of export income is around half the peak of a decade ago.

Australia's economic transformation has also resulted from reforms in markets which do not compete directly with imports — such as in public utilities like electricity and gas — and reforms to the regulation of industrial relations. However, even in these important areas, pressures for improvements in efficiency have been strongly associated with the increased competition facing trade-exposed industries.

Given the pervasive influence on Australia's economic performance of its increasing integration into the world economy, the appearance of renewed efforts to stop or reverse this process is of concern. These have been caught up in a broader international backlash against the perceived adverse consequences of 'globalisation' and the role of the World Trade Organization (WTO) in particular. There is much at stake for Australia in this debate. It is important, therefore, to look carefully at the arguments and the evidence.

Globalisation: myths and realities

Here and in other countries, globalisation is portrayed by some as undermining national sovereignty, local values and standards and as working against a fairer distribution of income. These views reflect concerns about the pace of economic change and the costs of adjustment. But they frequently also involve misunderstandings about the real impact of globalisation — and the role of international economic institutions — on people’s lives. Differing perspectives on globalisation are presented in box 1.1.

The term globalisation is used to refer to a wide range of interactions across national borders (box 1.2). A key manifestation is the increasing involvement of people and firms in international trade and investment. The increase in short-term capital flows, the size and reach of multinational corporations, permanent migration and temporary labour flows, the standardisation of technology, and the speed with which events and ideas in one part of the world are conveyed elsewhere nowadays, provide other pointers as to how societies have become more economically integrated. In addition, a growing number of environmental issues — including ozone layer depletion, the maintenance of biodiversity, greenhouse gases and acid rain — have cross-border or global implications. Globalisation also has implications for culture, political systems, and defence and security.

Globalisation displays many different facets rather than constituting some monolithic force. International migration, capital flows, trade and foreign direct investment raise their own policy issues. For example, appropriate regulatory frameworks to obtain the most benefit from short-term capital flows are more contentious than for trade. A failure to distinguish between the various aspects of globalisation confounds popular understanding of the issues and can lead to simplistic policy advocacy.

What is driving globalisation?

The current extent and depth of economic integration is unprecedented but its underlying rationale is not new. Indeed, recent developments are a natural extension of people’s universal and age-old quest for trade and commercial opportunities beyond village, regional and national boundaries, limited only by the technology and capital available to them. Thus, except for a comparatively brief period embracing the two world wars, growth in world trade has consistently exceeded aggregate economic growth for two centuries or more (figure 1.1).

Box 1.1 Differing views on globalisation

Richard Trumpka, American Federation of Labor — Congress of Industrial Organisations Secretary Treasurer, Address to the ACTU Congress 2000, 26 June 2000:

... a global system is being created behind closed doors — a system whose purpose is to make all of us — in Beijing and Brisbane and Buenos Aires and Boston — work longer hours for less money — to pit us against each other — to put us under the thumb of global corporations — to reduce billions of living human beings to nothing more than an item on the cost side of an income statement.

Maude Barlow, Chairperson of The Council of Canadians, in a speech to a Conference on Globalization and the Live Performing Arts, Melbourne, 23 June 2000:

Dominated by American and Western values and lifestyles, driven by a consumer-based free-market ideology and carried through the massive US entertainment-industrial complex, the global monoculture has infiltrated every corner of the earth . . . In China, Latin America, the Pacific Region, South America, Africa and the industrialized world, young people want Nike sneakers, Gap clothes, the latest CDs, Michael Jordan t-shirts, baseball caps, Hollywood blockbuster movies, American television and mass-market books. Around the world, North American corporate culture is destroying local tradition, knowledge, skills, artisans and values . . .

Economic globalization is the creation of a single global economy with universal rules set by big business *for* big business in which a seamless global consumer market operates on free-market principles, unfettered by domestic or international laws or standards.

John Micklethwait and Adrian Wooldridge, authors of *A Future Perfect: The Challenge and Hidden Promise of Globalisation*, argue in *The Spectator*, 24 June 2000:

Globalisation is always illustrated by pictures of the Spice Girls, never the Guggenheim in Bilbao; always a Big Mac, never Chilean Sea Bass with Moroccan couscous and fresh Javan papaya.

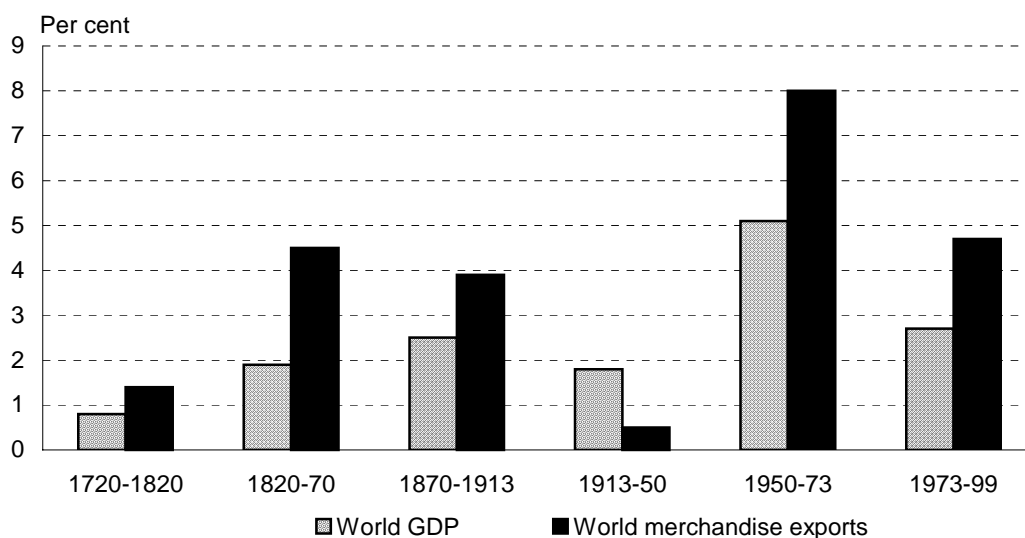
Donald Johnston, Secretary-General of the OECD, 'Globalise or fossilise!', *OECD Observer*, No. 219, December 1999:

Globalisation is not a policy; it is a process which will affect all aspects of our lives. We may not always like it; after all, it can compel us to give up cosy habits. But to stand against it would be sheer folly. Still, some believe they can somehow resist the powerful tide of globalisation. Take those who cling to protectionism to preserve jobs. Their thinking is fossilised. They forget that by their actions they drive up prices and actually destroy jobs, as well as choke off similar jobs in the developing world.

Mike Moore, former Prime Minister of New Zealand and current Director-General of the WTO, Address to the International Union of Socialist Youth Festival, 26 July 2000:

We on the Left have a lot to be proud of. We built the Welfare State that looks after people when they are sick, poor, or old. We fought for the equality of women and of minorities. We argued passionately for internationalism, for solidarity between workers in Sweden and those in Africa. So it is odd that some in the Left have sometimes opposed free trade. If international solidarity means anything, surely it means helping people around the world who are less fortunate than us. And surely that means buying coffee from a Ugandan grower and T-shirts made in Bangladesh as well as demonstrating against apartheid. The contradiction of the Left is that in church on Sunday we give generously to flood victims in Bangladesh. Then on Monday we petition the government to stop the Bangladeshis selling their garments in our country.

Figure 1.1 **World GDP and merchandise exports, 1720 to 1999**
Real average annual growth



Data sources: WTO (1998, 2000).

Technological change, reductions in government barriers to international trade and investment, and the development of the institutional arrangements necessary for global transactions have been the key drivers of this sustained trend towards globalisation.

Advances in *transport, communication and information technologies* have been powerful forces in reducing the effective distance between markets.

- Railways reduced the costs of trading goods by 85 to 95 per cent in the 19th Century. Steamships reduced maritime transport costs significantly, and containerisation and bulk shipping continued the trend. The unit cost of sea freight declined by almost 70 per cent in real terms in the last 10 to 15 years.
- Rapid technological advance has seen the price of computing power fall by more than 99 per cent in the past 45 years. The cost of a three minute telephone call from Australia to the UK fell from about \$350 in 1926 (in today's prices) to \$13 in 1980 and to around 65 cents today. An e-mail via the worldwide Internet is possible for not much more than the cost of a local telephone call, whereas a sometimes-muddled 20 word telegram to the UK cost the equivalent of about \$1200 in the 1890s.

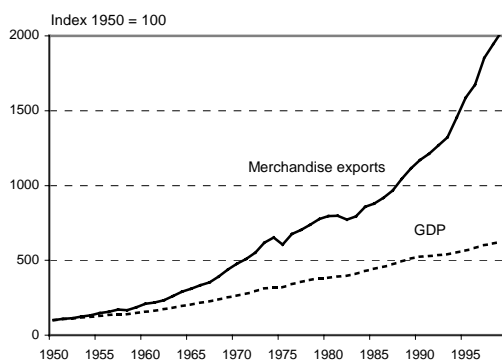
Box 1.2 Dimensions of globalisation: trade, money and people

The trend in growing worldwide inter-connectedness is illustrated by the following indicators.

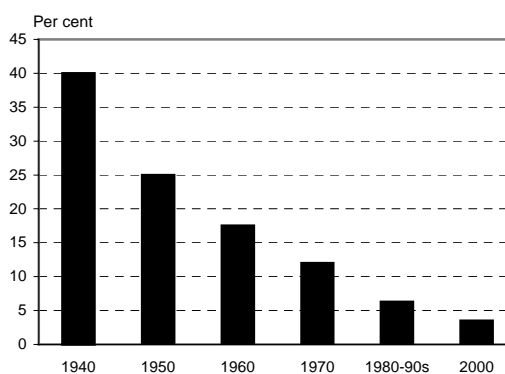
Trade

Countries have become increasingly engaged in international trade. World trade in goods and services has expanded at nearly double the pace of world real GDP between 1950 and 2000. In this period, world trade in goods and services (exports and imports) rose from barely one-tenth to about one-third of world GDP. Falling tariff barriers have facilitated trade growth.

World trade and output trends, 1950 to 1999



Average tariffs in industrialised countries



Technological change is increasing the intensity of competition and opening new avenues for trade in services. Drucker (1999) goes as far as to argue:

In the mental geography of e-commerce, distance has been eliminated. There is only one economy and only one market. . . . One consequence of this is that every business must become globally competitive, even if it manufactures or sells only within a local or regional market. The competition is not local anymore — in fact, it knows no boundaries.

The Internet is redefining business-to-business commerce with, for example, e-procurement systems offering access to competitive sources of supply and cost savings through lower transactions costs. Natural barriers to trade in services are also being broken down, with technology providing alternatives to temporary or permanent migration. Indian software developers and data processors on-line to firms around the globe are oft-cited examples.

Capital

A similar picture of intensified international interaction is evident in world capital movements. While foreign investment flows were large relative to GDP a century ago, they were directed to a narrower range of sectors and activities and, in contrast to today, mainly took the form of long-term investment.

- Foreign direct investment can substitute for trade — building factories abroad has been a way of jumping high tariff barriers — or it can complement and facilitate trade by establishing a commercial presence close to customers. In the case of some

Box 1.2 (Continued)

services such as fast food, a domestic presence is a prerequisite for selling to foreigners. Annual outflows of foreign direct investment expanded 17 times to reach US\$800 billion at the end of the two decades to 1999 and the stock of such investment in relation to world output has more than doubled in the last 20 years.

- Short-term capital movements have increased dramatically — the average daily turnover in foreign exchange markets increased from about US\$200 billion in the mid-1980s to well over seven times that in 1998, much larger than the value of world trade and long-term capital flows.

Multinational companies

Another sign of global integration is the increasing prominence of many goods and services that are provided by the same companies to markets almost everywhere. As Bordo et al. (1999, p. 11) note: 'Production and exchange by multinational firms has been a force in global trade since the days of the East India Company. There has been a quantum leap, however, in the importance of multinationals from the pre-World War I era'.

- In addition to being major drivers of investment flows, multinational corporations accounted for an estimated 25 per cent of the value of global output in 1998 and their intra-firm trade for a third of world trade.
- Multinationals play a key role in disseminating technology around the world: 70 per cent of all international royalties on technology involve payments between parent firms and their foreign affiliates.

Migration

The expansion of the international economy that took place during the 19th Century until the outbreak of World War I was accompanied by largely unfettered migration. Around 45 million people emigrated from Europe between the beginning of the 19th Century and World War I in search of land and opportunities for a better life. Levels of global migration were subdued in the interwar period but resumed with the massive population displacements following World War II. In addition to flows of migrant labour, a range of other people movements have developed, encompassing international tourism, temporary workers, business travellers, students, refugees and asylum seekers. Castles and Miller (1998, p.103) comment:

... international migration has become a crucial part of global transformations. It is linked to the internationalisation of production, distribution and investment and, equally important, to the globalisation of culture. Even countries like Japan, which have tried to close themselves off from foreign influences, are finding that participation in the international economy brings migration and cultural change.

Sources: Mussa (2000), WTO (2000), Stoeckel et al. (1990), UNCTAD (1999 and 2000), BIS (1998), Held et al. (1999).

Greater *openness of economies to international trade and investment* in the post-war period has also facilitated market integration.

- Notwithstanding the remaining high levels of assistance for agriculture, textiles and clothing, average tariff levels on manufactured goods in major industrialised countries have fallen by 90 per cent since the end of the World War II. Restrictions on direct investment in manufacturing have been reduced substantially over the past decade in nearly all OECD countries, but controls on foreign investment in service sector activities remain common. Many developing countries in Asia and Latin America had moved from inward to outward-looking trade and investment policies in the 1980s.
- Australia, which had amongst the highest tariffs of any OECD country and was a late comer to trade reform, has opened its economy substantially. Summary measures now place Australia amongst the more open of OECD countries to trade and investment (OECD 2000).

Increased cross-border activity has also depended on growing confidence in the broader *institutional and regulatory frameworks* which govern market exchange. Enforceable contracts and property rights, and transparent regulation reduce the riskiness of trade and investment in foreign countries. At the international level, commerce has been facilitated by post-war cooperative efforts to build a network of core market-supporting institutions including the GATT/WTO, the International Monetary Fund and the World Bank.

Globalisation and national living standards

Globalisation is not, as often portrayed, a ‘race to the bottom’ (box 1.3). One of the oldest and most enduring fallacies, for example, is that competition from low-wage countries threatens overall living standards in developed economies. In practice, by ensuring that an economy plays to its comparative strengths rather than tying up resources in activities with poor returns, trade supports higher living standards in both developed and developing countries. Trade enables access to cheaper, better and different goods and services. It also provides access to new technology, and to larger markets that allow specialisation and productivity improvement and keeps domestic producers ‘on their toes’. The market opportunities provided to poorer countries enable them to grow faster and to increase their purchases from developed countries. While low wages in some less developed countries can provide a competitive advantage in standardised labour-intensive products, low wages can also reflect low productivity — arising from a lack of skills and equipment, and inadequate market institutions. Wage levels alone are not decisive in determining where goods and services are produced.

The fact is that there has been a remarkable transformation in average living standards over the course of the 20th Century. At a time of unprecedented population growth, not least because of increased infant and childhood survival rates, real output per capita grew five-fold — with the bulk of the gain occurring in the period since 1950. The richest quarter of the world’s population became almost six times richer. The poorest quarter became almost three times richer (IMF 2000). A broader measure of living standards would also take account of improvements in life expectancy, literacy and other social indicators. Life expectancy in India, for example, rose from 36 years to 61 years in the second half of the Century.

Critics of globalisation point to the growth of inequality between people in rich and poor nations and the continuing extent of poverty in the world. Measures of inequality are sensitive to the methodology and time period used. For example, the growth in inequality is particularly pronounced if income divergence is measured by comparing countries, but significantly less so when, more properly, counting people (World Bank 2000). Indeed, the average per capita income growth of 70 per cent of the population of developing countries exceeded that in industrialised countries over the last three decades — reflecting economic growth in China, East Asia and India. As Castles (2000a, 2000b) notes, inequality in the average income of people living in the poorest fifth of the world and the richest fifth narrowed in the 1990s. Nevertheless, at the end of the century there were still some 1.2 billion people in developing countries and the transitional economies of Eastern Europe living in absolute poverty.

But it is clear that globalisation has not caused or worsened poverty. Indeed, openness to trade and investment and greater access to the markets of developed countries are important parts of the solution. The clear policy lesson of the past century is that those countries which shut themselves off from the rest of the world have done so at the expense of the living standards of their own people — including access to basic healthcare, education and other community services.

- When countries retreated into protectionism in the interwar period, compounding the international financial crisis, growth in world per capita income was almost halved.
- Openness is not a sufficient condition for economic development, but it is an essential ingredient. The series of in-depth country case studies sponsored by the World Bank and others from the late 1960s to the early 1980s found that ‘self-reliance’ (or import-substitution) strategies performed very poorly compared with export-oriented strategies. Much of Africa and Latin America has suffered from poor growth rates while East Asia has prospered with the largest and most rapid reduction in poverty in history, notwithstanding the temporary setback caused by the recent financial crisis.

Box 1.3 **Globalisation myths**

Will globalisation make us all paupers?

The argument that competition from low-wage countries threatens living standards in developed countries currently finds expression in: 'it's impossible for Australia to compete with countries paying workers 60 cents a day'. Leaving aside strong counter-arguments to do with productivity and comparative advantage, what evidence is there for this perceived threat?

- Over the past 20 years, developing countries increased their share of Australia's merchandise imports from 24 to 35 per cent. However, Australia's exports of goods to developing countries grew just as fast. Developing countries as a whole now take 46 per cent of Australian merchandise exports and purchase more from us than they sell to us.
- Despite claims about 'deindustrialisation' and a decline in the share of manufacturing in GDP, the real output of the Australian manufacturing sector is now 50 per cent larger than at the time of the 25 per cent tariff cut in 1973 and manufacturing exports have increased four times in real terms. Exports of elaborately transformed manufactures have increased even faster and accounted for two-thirds of Australia's total exports of manufactures in 1998-99.
- Protection does not preserve existing levels of employment, as the Australian experience shows. In the decade to 1984, the effective rate of assistance to the TCF industries increased by 12 per cent a year while employment fell by 3 per cent a year.

This is not to deny that many Australian workers in trade-exposed industries have been displaced from their jobs as a result of import competition. And there is an ongoing debate about how extensive an impact imports from developing countries have on wage levels in developed countries. Most overseas studies suggest that trade may play a small role in increasing wage disparities within a country but that the influence of technology on rewards for skill is by far the dominant factor (Cline 1997 and Williamson 1997 survey the literature). In Australia, Murtough et al. (1998) found that reduced trade barriers had not been a major contributor to the increasing inequality of earnings or to unemployment over the last decade and a half. The wage and employment effects of changes in trade barriers have been overshadowed by technological change (requiring more high skilled labour) and by other developments such as adverse shifts in international trading conditions for primary commodities. More recently, de Laine et al. (2000) showed that increasing imports are not leading to widespread change in the relative demand for skilled workers in Australia, although exports appear to be spurring the demand for skilled workers.

Globalisation and rapid change inevitably have significant impacts on some people who are the proper focus of policy concern. The provision of an adequate social safety net and targeted assistance to address concentrated adjustment difficulties can help people adjust to change better and increase community confidence that the gains from change are widely shared (PC 1998, 1999a, 2000e).

Are labour standards being undermined?

If investment flows to developing countries and openness to trade are undermining labour standards in developed countries, conclusive evidence is difficult to find. Empirical investigation of the claim that multinational companies are attracted to countries with lower labour standards to take advantage of lower costs suggests, if anything, that low labour

Box 1.3 (Continued)

standards deter rather than attract foreign direct investment (Aggarwal 1995, Rodrik 1996). Recent surveys of the literature find little statistically significant support linking low labour standards with enhanced export performance (OECD 1996, Brown 2000).

An environmental race to the bottom?

So far, most of the empirical studies of different countries, industries and periods conclude that environmental standards have hardly any impact on trade patterns. Pressures on firms to lower their environmental standards in order to keep otherwise uncompetitive industries in developed economies or to relocate dirty activities to 'pollution havens' in developing countries, do not seem to loom large in firms' locational decisions. Pollution abatement costs are typically a small proportion of a firm's total costs and, while there are exceptions, production technologies tend to be standardised for high environmental performance rather than adjusted for different parts of the world (WTO 1999, Harris et al. 2000). Moreover, the 'race to the bottom' argument ignores the fact that the demand for environmental protection in developing countries generally increases as income levels rise. Perhaps the greater risk to the world environment is the political pressure to close some polluting industries in developed countries, bringing a consequent expansion of similar but more polluting activities in developing countries with more harmful outcomes for the world environment.

Weakened national autonomy in policy making?

Some of the most highly charged aspects of the globalisation critique concern national sovereignty. Are nations constrained in pursuing their own monetary and fiscal policies in a world of capital mobility? Is their ability to choose tax rates and systems and to set social welfare expenditures undercut?

Market integration necessarily sets some limits on policy action, though the extent varies. In a world of integrated financial markets, for example, countries which eschew financial stability as a policy goal and fail to ensure adequate prudential supervision expose themselves to greater risks. Similarly, tax competition between countries creates pressures for efficiencies in government expenditure. Yet as trade has expanded in the post-war period, the share of government expenditure in GDP in industrialised countries has increased. While decisions on where to locate investment are complex, numerous studies show that tax rates alone are not the determining factor — influences related to market demand provide the major impetus (IC 1996).

A globalised culture?

While some claim that an homogenisation of culture is sweeping the world and nations are powerless to stop it, others point to openness to ideas and values as the hallmark of a liberal society and view any restrictions on freedom of expression as an anathema. Where governments seek to meet cultural objectives, it is important that they find efficient and effective means of doing so without forsaking the benefits of diversity. The Commission's report on broadcasting argued that diversity of media ownership, sources of information and Australian content were more likely to be promoted by treating foreign investment in the media in the same manner as foreign investment in other industries (PC 2000a). Messerlin (2000) argues that the complicated and costly system of protection provided to the French audiovisual industry has had perverse cultural outcomes: promoting clones of Hollywood films that have accelerated the Americanisation of the French film industry while making French cultural film production sterile.

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- Moreover, many of the poorest countries — for example, Myanmar, Sierra Leone, Rwanda, Guinea-Bissau, the Republic of Congo, Chad, Burundi, Albania and North Korea — are not in that state because of globalisation. Rather, responsibility lies with internal institutions and policies and other factors inimical to economic growth such as political instability, poorly defined property rights, civil unrest and disease.

Despite the demonstrable benefits of a more open trading system, the role of the WTO as a ‘rule setter’ for global trade liberalisation has come under fire. It is important that this strand of globalisation is not undermined by misunderstandings of its role and contribution.

Australia’s stake in the WTO system

The Seattle Ministerial Meeting of the WTO in December 1999 focused world attention on the role of the WTO in the globalisation process. Similar issues were evident at the World Economic Forum summit in Melbourne in September 2000. The WTO has been charged variously with being an undemocratic world government, anti-small country, driven by the interests of corporations, and insensitive to labour and environmental standards and cultural values. For some, the WTO is seen as having too much power; for others, too little. Within Australia, there is frustration over lack of access to some foreign markets and perceptions about ‘adverse’ findings on Australian quarantine controls on fresh salmon and assistance to automotive leather products.

The WTO is in fact a forum where governments voluntarily agree to abide by a set of principles to preserve and develop an open trading system (box 1.4). The WTO itself does not write trade rules. Its members — sovereign states — do this through negotiation and consensus. Countries voluntarily agree to abide by the ‘rules of the game’ because it is in their overall interests to do so. They have agreed to constrain their own behaviour in return for other countries constraining theirs. Countries are free to withdraw. Few did so from the GATT, and then for political rather than trade considerations. In fact, GATT/WTO membership has continued to grow.

Governance arrangements based on consensus mean that small countries have a voice and that large trading nations and trading groups cannot altogether ignore the interests of smaller nations, especially if these nations can agree amongst themselves. The Cairns Group of agricultural exporting nations, in which Australia has a leading role, is an example of such a like-minded grouping which has played a significant negotiating role within the WTO.

Box 1.4 **The World Trade Organization**

The WTO provides a framework of rules for international trade. This framework was established in 1947 by 23 countries signing the General Agreement on Tariffs and Trade (the GATT). It has evolved through eight successive rounds of negotiations to cover goods, services and trade-related aspects of intellectual property. There are currently 138 members of the WTO and a further 30 countries — including China and the Russian Federation — are waiting to join.

The main functions of the WTO are to:

- administer and implement the trade agreements which together establish the WTO;
- provide a forum for multilateral trade negotiations;
- monitor national trade policies;
- assist in resolving trade disputes; and
- cooperate with other international institutions involved in global economic policy making.

Rather than being the centre of a ‘global conspiracy’ as its detractors claim, the development of a rules-based trading system overseen by the GATT/WTO has best been described as one of ‘accidental success’. The GATT had a somewhat shaky start — a supposedly interim arrangement pending wider agreement to form an international trade organisation — but ended up providing the framework for multilateral trade until the establishment of the WTO 47 years later. Negotiating rounds can be difficult and protracted — the Uruguay Round took eight years — and the Seattle Ministerial meeting was not the first time that ministerial meetings aimed at advancing trade negotiations have failed.

The benefits of a rules-based trading system

Key WTO provisions require members to apply their trade rules in a transparent and non-discriminatory manner. This helps to protect those with limited bargaining power.

The most-favoured-nation rule means that all WTO members have to be accorded as favourable access to a particular country’s market as any other country (with limited exceptions for free trade agreements, customs unions and preferential arrangements with developing countries). The benefit to small countries is illustrated by the outcomes achieved from the series of bilateral negotiations China is undertaking as part of its accession to the WTO. Australia negotiated reduced Chinese tariffs, for example, on wine (down from the current 65 per cent to 20 per cent) and butter (down from 50 per cent to 25 per cent). The European Union negotiated even lower tariffs (14 per cent on wine and 10 per cent on butter). Application of the most-favoured-nation rule means that the most favourable

concessions negotiated by each of China's trading partners will automatically become available to all WTO members.

Other key provisions provide a measure of certainty and protect smaller nations from arbitrary and discriminatory changes in the application of trade rules.

- The requirement to accord 'national treatment' means that, once foreign products have passed quarantine and customs, they must not be treated less favourably than domestically produced goods. This means, for example, that the European Union could not apply quality or health-based standards to imports of Australian grains that it did not apply to its own producers. As a result of telecommunications negotiations, foreign telecommunications companies have the same conditions of access to domestic networks as national companies.
- Once a country's tariffs have been agreed with other WTO members, the rates are 'bound' and cannot be increased unilaterally without offsetting compensation.
- Special mechanisms to suspend or void these general provisions — such as safeguard measures against increased imports, antidumping measures and countervailing action against subsidies — are available to all WTO members, but are prescribed and monitored.

Even strong supporters of the WTO system would acknowledge deficiencies in the coverage of its rules. The growth of regional trade agreements which override the most-favoured-nation principle and provide preferential treatment within groups of countries is a cause for concern in many quarters. The virtual exclusion of many textile and agricultural products from significant barrier and subsidy control has been another. Nonetheless, the foundations for agricultural liberalisation were laid in the Uruguay Round. Much rests on reducing these barriers in the next WTO round of trade negotiations. The recent setback in initiating a new round of trade negotiations at the Seattle Ministerial meeting, and challenges to the WTO itself, should thus be of particular concern for Australia's rural industries, as well as developing countries dependent on agricultural exports.

The benefits of a strengthened dispute settlement system

The WTO dispute settlement system keeps large and small countries alike accountable and provides a forum in which treaty rights can be defended. WTO members are committed not to take unilateral action against perceived violations of their rights. If conciliation is unsuccessful, the parties in dispute must instead argue their case before an independent panel. The rulings of this panel (often as amended on appeal) are binding unless rejected by consensus of the Dispute Settlement Body,

itself constituted by all the members. Even then, the party found to be in breach of its WTO obligations has choices. It can choose to remove the measure or to adjust the measure to bring it into WTO conformity. Failure to comply with the rulings risks WTO-sanctioned retaliation.

A strengthened dispute settlement system — particularly the increased difficulty for members to block findings adverse to them — was arguably a major advance over previous arrangements under the GATT. There is, however, a need (discussed in the concluding section below) to reduce the risk that the increased legal decisiveness of dispute rulings could harm the international political consensus and diplomacy on which the GATT/WTO system has depended. There is also the risk that the power and success of the dispute settlement process will encourage countries to bring disputes of issues to the WTO that are essentially political, the settlement of which is not appropriate for a trade organisation. Such political disputes could unravel the dispute settlement processes of the WTO.

Nearly 200 disputes had been brought to the WTO between 1995 and May 2000. Fifty of these were initiated by developing countries. The US and the European Union have registered the most complaints — 60 and 50, respectively — but they are also the most frequently cited for not complying with WTO rules. Of the 77 disputes resolved, 41 were resolved without going to adjudication by a panel. Australia has been involved, or had an interest, in 32 disputes, including five as a respondent (two of them involving salmon quarantine and two involving automotive leather).

Some claim that the WTO is flawed because, as they see it, trade interests prevail over environmental objectives in disputes. Specific provisions in the WTO charter provide exemptions from its general rules and allow members to impose trade measures ‘relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production and consumption’ or which are necessary for health and safety. Nevertheless, a ‘green’ folklore has developed around a series of high profile trade disputes — involving dolphins caught in tuna nets, chemical standards for reformulated gasoline and turtles netted with shrimp — that went against particular US trade measures. In each case, however, the rulings found that the US had breached its obligations to other WTO members not because it had set environmental standards, but because of the *discriminatory way* in which policies were implemented.

There is insufficient recognition of the direct benefits from the dispute settlement mechanism. Australia and other smaller countries, for example, have gained from:

- *a faster opening of markets* — for example, India, having lost a case taken by the US in the WTO, agreed to remove quantitative restrictions on agricultural,

textile and other industrial products two years earlier than previously negotiated with other members, including Australia;

- *countering market-closing measures* — for example, the US, having lost the case brought against it by Malaysia, Thailand, India and Pakistan, altered its shrimp import regulations thereby allowing Spencer Gulf prawns access to the US market previously denied because Australia did not mandate turtle-excluding devices on fishing nets despite the extremely low incidence of sea turtles in that fishery;
- *the opportunity to challenge marketing restrictions* — for example, Australia's claim that Korean regulations discriminate against Australian beef by confining sales of imported beef to specialised stores and limiting the manner of its display has been upheld, as has a similar claim made by the US;
- *requiring large countries to abide by the rules* — for example, the findings against the US tax treatment of export income and the European Union banana import regime demonstrate that even powerful countries are not 'above the law' even if, as in the long-running banana saga, they delay bringing their arrangements into conformity with their treaty obligations; and
- *securing the interests of Australian consumers, producers and taxpayers.* Notwithstanding recent controversy over imports of fresh salmon, it is in Australia's overall interests for the dispute settlement system to require science-based quarantine protocols. Such protocols help to prevent Australian exports being discriminated against in foreign markets (as they have done with the finding that Japan's testing requirements for different varieties of some fruit were inconsistent with its treaty obligations). And they mean that Australia cannot use its quarantine system as an economic protection device — which would impose costs on consumers and other Australian industries. Similarly, apart from the domestic implications of subsidy assistance, Australia's interests would not be well served if other countries had unchallenged rights to emulate the subsidies paid to the automotive leather producer, Howe Leather.

The WTO dispute mechanism is encouraging the observance of agreed obligations and supporting the openness of the world trading system. Paradoxically though, the ultimate sanction available to parties in dispute is trade retaliation which restricts market access and hurts both parties (Robertson 2000).

Sanctions are a feature attractive to those who seek to impose labour and environmental standards on other countries. They see the WTO as one of the few international systems with 'teeth'. However, proposals to link trade retaliation with these issues have significant implications for the functioning of the WTO system.

Labour standards, the environment and the WTO system

Demands by a variety of non-governmental organisations (NGOs) for the WTO to be changed to promote and enforce core labour standards and strong environmental policies reflect a variety of motives, from altruistic concern for the plight of people in developing countries to thinly disguised protectionism. There is also concern that WTO rulings weaken environmental protection. Despite claims that the WTO has too much power, some NGOs want to be represented in it and give it even more responsibility.

Labour standards, in particular, have also been a concern of US administrations since the early GATT days. The indication that the Clinton Administration would move to link trade sanctions to labour standards was one of a number of factors scuttling the Seattle meeting. There is clearly no universal agreement on the general applicability of human rights standards beyond the prohibition against slavery. The linkage proposal is strongly resisted by most developing countries who see it as an invasion of their sovereign right to determine their own standards and a threat to their trade prospects and economic development (box 1.5). A Commission study under way is looking at these linkage issues in detail. Some of the emerging findings are highlighted below.

Box 1.5 **An objection to linking labour and environmental standards to the WTO**

Around 100 Third World academic and non-governmental organisations issued the following statement in the lead up to the Seattle Ministerial meeting:

... we declare our unambiguous opposition to Linkage of Labour and Environmental Standards to WTO and to trade treaties. We also wish to disabuse the media and the governments in the developed countries of the notion that those who oppose Linkage are corporate interests and malign governments ...

The demand for Linkage via a social clause in the WTO (and corresponding preconditions on environmental standards for WTO-protected market access) ... is the result of an alliance between two key groups: *Politically powerful lobbying groups that are 'protectionist'* and want to blunt the international competition from developing countries by raising production costs there and arresting investment flows to them; [and] *The morally-driven human rights and other groups* that simply wish to see higher standards abroad and have nothing to do with protectionist agendas ...

The former groups are not interested in improving the wellbeing in the developing countries; they are actuated by competitiveness concerns and are hence selfishly protective of their own turf ...

On the other hand, there are also *morally-driven groups* that genuinely wish for better standards for labour and the environment in the Third World; and they must be fulsomely applauded. But their demands for Linkage ... while not deceptive and self-serving, are nonetheless mistaken and must also be rejected. Superior ways of advancing these objectives and agendas exist, which lie outside of the trade context and can be pro-actively pursued instead. (TWIN-SAL 1999)

The most basic difficulty in using trade instruments to raise labour and environmental standards is that trade is usually unrelated to or not the major factor in the activities and outcomes to which people object. Trade sanctions are at best a blunt instrument and may actually work against the outcomes desired by their advocates. Sanctions are seldom effective unless they enjoy widespread multilateral support. Even then, most of the worst abuses by undemocratic governments have proved intractable in the face of sanctions (Hufbauer 1998).

Most impacts on the environment arise not from trade itself, but from the production or consumption of goods and services. Problems like the rampant conversion of forests to other land uses (such as cattle ranches in the Amazon or palm-oil, coffee, cocoa and rubber plantations in West Africa and South East Asia) and illegal logging can be tackled effectively only at the source of the problem, by countries fixing their property rights regimes and enforcing regulatory controls. The imposition of trade sanctions against countries with inadequate environmental protection may, for example, have little effect on forest clearing, much of which occurs as part of land-use change, with the sale of wood merely defraying the costs of clearing. Indeed, sanctions could perversely increase the extent of deforestation if lower export timber prices undermine the commercial viability of those forests which could be managed sustainably, hastening their conversion to other land uses. More generally though, unless deficiencies in property right regimes are taken into account in a trade liberalisation strategy, opening markets to trade may lead to the overexploitation of environmental resources.

Similarly, sub-standard labour conditions have more to do with poverty in third world countries than international trade. The capacity of developing countries to improve their labour conditions depends on their rate of economic development and income growth, as well as social and cultural values. Trade restrictions imposed by other countries because these labour conditions are unacceptable by the standards of developed countries would weaken the ability of developing countries to trade their way to higher incomes. Access to export markets, imports and technology were key means by which today's developed economies began to prosper and enabled improvements in their working conditions and living standards to be sustained.

Trade sanctions against the exports of developing countries do nothing to increase the real resources available to poor countries to address their pressing social and environmental priorities and may well be counterproductive. Wages and conditions in the more export-orientated sectors of these economies are typically better than in their non-traded sectors. Trade restrictions — whether to compel the implementation of existing commitments on labour standards or to improve them — would limit export opportunities, close down firms dependent on exports and force workers back into lower paid or subsistence activities and would not improve conditions for the vast majority who work in the non-traded and informal sectors.

According to World Bank estimates, less than 5 per cent of working children are employed worldwide in the export manufacturing and mining sectors and only 1 per cent to 2 per cent in export-oriented agriculture (Fallon and Tzannatos 1998). The International Labour Organisation (ILO) has acknowledged that developed country boycotts against the use of child labour have sometimes perversely forced children into even worse predicaments, including prostitution (box 1.6).

Box 1.6 Child labour

The ILO has estimated that, in developing countries alone, 120 million children (mainly in Asia and Africa) aged between 5 and 14 are involved in full-time work, and that work is a secondary activity for another 130 million children. About 40 per cent of African children work. Although poverty is a prime reason why children work, cultural and social norms can also play a role.

A number of widely-ratified ILO Conventions — most recently, the Worst Forms of Child Labour Convention 1999 — have sought to prohibit and eliminate the use of child labour and are seen by many people as constituting a core labour standard. Nevertheless, as the (then) Director-General of the office of the ILO observed:

The last few years have witnessed the proliferation of campaigns against child labour carried out by consumer organisations, trade union organisations or non-governmental organisations in the developed countries. These campaigns have taken on various forms; but those which have been most in the public eye have been campaigns to *boycott* products made totally or partially by children and to promote *labels* guaranteeing that the product or service, bearing the label, has not been produced from work carried out by children. In both cases, the idea is either to encourage the consumer not to buy a boycotted product or to prefer a product or service bearing a label over another for ethical reasons — as the exploitation of child labour is morally reprehensible.

However, these movements might, depending on their origin or methods used, risk being arbitrary or being put to improper use. By attacking a product or a category of products, the labelling or boycott campaign aims at a sector geared to export and overlooks the fate of the majority of children working on other products or for the domestic market alone. Moreover, labelling and boycott campaigns do not involve any accompanying measures for the children themselves who, as a result, might find themselves without a job. Even worse, they might result in children being transferred from one sector of activity to another, which is more or better hidden, and even more hazardous for the children involved.

This situation occurred in Bangladesh in 1994-95: following a threat of boycotts, employers in the textiles industry abruptly dismissed children under 15 years of age working in this sector. Given the lack of adequate education and training infrastructures and accompanying measures, many of these children had no other choice but to work in the informal sector, in workshops subcontracted for the textiles enterprises, under working conditions that were much more precarious and dangerous than those under which they had previously been working. A good number of these children found themselves on the streets of Dhaka, forced to beg or enter prostitution (Hansenne 1998).

Environmental issues with worldwide ramifications are appropriately handled by multilateral environmental agreements (MEAs). The Montreal Protocol on Substances That Deplete the Ozone Layer, for example, has been successful in limiting fluorocarbon emissions. Only a minority of these MEAs incorporate trade restrictions, in order to encourage compliance with their widely agreed environmental objectives. In these instances, it is difficult to envisage a problem in regard to WTO rules where all signatories are WTO members and agree to forgo their rights. While no trade disputes have arisen to date, there is, however, a potential for conflict between MEA-sanctioned trade restrictions and WTO rules were a member of the WTO to use such sanctions against another member which was not a signatory to the relevant environmental agreement (Sampson 2000).

There are alternative international forums with oversight roles in relation to labour standards — most notably, the ILO. Indeed, ILO Conventions form the basis for the core labour standards — such as freedom of association and freedom from child labour — most commonly proposed for inclusion in WTO trade rules, in a manner similar to the exception already made for the products of prison labour. While these ILO conventions have been widely ratified, it is probable that many countries would not have signed them had they known that trade sanctions would be used for enforcement. At the 1996 Singapore Ministerial meeting of the WTO, member governments committed to the observance of internationally recognised core labour standards and agreed that the ILO was the competent body to set and deal with these standards (WTO 1996). However, members rejected the use of labour standards for protectionist purposes and asserted their belief that economic growth and development fostered by increased trade and further trade liberalisation contribute to the promotion of these standards.

In view of the outright opposition of much of the developing world to linking trade and labour standards in particular, attempting to embed these issues in the WTO would at best be unwieldy and might make the WTO unworkable. It would certainly divert the WTO from its core business of reducing trade distortions — to the detriment of developing countries which are seeking better access to developed country markets for their agricultural, textile and other labour-intensive manufacturing exports. It could also erode WTO disciplines on trade policy and lead to the escalation of retaliatory measures which hurt all parties.

Shoring-up national support for the international trading system

Dispelling community misconceptions about the GATT/WTO system is difficult when some of the language of trade negotiation — ‘concessions’, ‘negotiating coin’, and ‘retaliation’ — conveys the impression that trade is a zero-sum game rather than a source of mutual advantage. And in denying claims by domestic

interest groups for special treatment, national governments are prone to blame ‘WTO rules’ rather than cite national interest grounds.

The GATT/WTO bargaining approach to trade negotiations, based on the reciprocal exchange of concessions, allows governments to sell the benefits to particular domestic constituencies, such as exporters. The downside is that this can reinforce a mercantilist view of the gains from trade liberalisation — that increased exports are good for a country whereas imports are not.

As Krugman (1997, p. 113) put it:

The compelling economic case for unilateral free trade carries hardly any weight among people who really matter. If we nonetheless have a fairly liberal world trading system, it is only because countries have been persuaded to open their markets in return for comparable market-opening on the part of their trading partners. Never mind that the ‘concessions’ trade negotiators are so proud of wresting from other nations are almost always actions these nations should have taken in their own interests anyway; in practice, countries seem willing to do themselves good only if others promise to do the same.

Concerns about the GATT/WTO have arguably been reinforced as governments have collectively agreed to extend the influence of its rules beyond tariff and quota barriers in merchandise trade to include trade in services, rights to provide services from within foreign countries and regulation to do with domestic subsidies, quarantine and intellectual property. These expanded areas of commitment have also been accompanied by more robust dispute settlement disciplines, as already noted.

Yet, as Hudec (1999, p. 12) has observed, the heightened international obligations have not been matched with greater resolve at the national level:

The new WTO system asks for a stronger political commitment because it sets the bar higher. Yet it is difficult to identify any major changes in national political life in the major WTO countries that will make their political systems more receptive to WTO legal discipline than they were in the decade or two before the WTO came into being.

Events in Seattle were a reminder that pressure group politics remain a potent force, domestically and internationally, which could impede further international liberalisation of trade and investment and the resultant improvement in development prospects and living standards.

If there is a deficiency in responding to the concerns of various interest groups, it lies primarily in domestic democratic processes. Some of the more responsible critics have a point when they argue that corporations often find it easier than consumers and many non-governmental organisations to attract the ear of national governments. It is important that the legitimate concerns and agendas of interest

groups be addressed at the national level. If they are not, those groups who feel disenfranchised nationally will continue to target the WTO itself, which is neither designed nor equipped to accommodate them directly in negotiations. That said, some governments include non-governmental groups in national delegations to WTO meetings. In addition, the expertise of these groups can be drawn upon by dispute panels, and there may be informal means by which interactions between these groups and WTO members could be expanded.

There is a range of governance issues in the WTO which needs to be addressed. For example, resource constraints impede the ability of many of the poorer developing countries to identify and defend their interests and participate actively in WTO activities. Such countries also face large compliance costs and difficulties in meeting commitments. The growth in WTO membership means that more inclusive ways of structuring negotiations need to be found. These and related issues, which have been raised by the Director-General of the WTO, as well as his designated successor (Panitchpakdi 2000), constitute a substantial action agenda for the WTO.

Ultimately, the future of the WTO system depends on achieving a better understanding within each member country of the benefits and costs of its own liberalisation. That requires political leadership to articulate the benefits of freer trade and that the adjustment consequences be addressed. In most countries, those groups who benefit from protection and other anticompetitive arrangements have been a dominant influence. As the Australian experience shows, greater domestic transparency of the costs of protection (and who bears them) can be a powerful counterweight, promoting wider public understanding of what is at stake in trade reform. Indeed, Australia could be said to have had the best of both worlds — it has mainly taken the unilateral route in reducing its trade barriers, yet effectively obtained ‘credit’ for this in subsequent trade negotiations (PC 2000c).

The role of domestic transparency in underpinning liberal international trade was recognised in the first stages of the Uruguay Round through the work of the negotiating group on the Functioning of the GATT System. As the Round progressed, the question of agreed institutional arrangements to achieve greater transparency was placed on the ‘backburner’ and the Trade Policy Review Mechanism was established instead. This vehicle for international surveillance of member countries’ trade policies has generally been regarded as a significant advance. Nevertheless, it remains a mechanism that is largely external to the policy debate within member countries and further initiatives are required at national levels. Reviving consideration of this issue within the WTO could play a useful role in shoring-up support for the WTO system itself. A rules-based trading system is still the surest way of promoting global economic growth through trade and the associated rising standards of living.