

Free Trade Agreements

Costs and benefits

Briefing note

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Summary

The benefits of Free Trade Agreements (FTAs) are being promoted as Australia considers one agreement with China and another with 12 countries in the Trans Pacific Partnership (TPP). However, analysis and experience shows that FTAs over promise and under deliver.

Trade Minister Andrew Robb has claimed that FTAs with China, Japan and South Korea represent:

[A] landmark set of agreements [that] will see literally billions of dollars, thousands, many hundreds of thousands of jobs and will underpin a lot of our prosperity in the years ahead.

Modelling commissioned by the Department of Foreign Affairs and Trade (DFAT) contradicts such claims. DFAT's analysis estimates these agreements will:

- Increase GDP by 0.05 per cent in 2035, or an additional \$780 million per year in today's dollars.
- Increase employment in 2035 by just 5,434 jobs.
- Increase the value of Australia's trade by about three per cent:
 - Increase imports by 2.5 per cent.
 - Increase exports by 0.5 per cent.

While DFAT's analysis shows that the main result of these FTAs will be increased import growth, the Federal Government is promoting the agreements as "Free Trade Export Agreements."

Australia's trade agreement with the United States has been in place since 2005. Analysis of trade flows over the decade since then suggests that trade with the US has grown at the same pace as the wider economy. The agreement appears to have had little impact on trade. Further analysis by ANU researchers suggests that any increase in trade between the US and Australia as a result of this agreement has come at the expense of trade with other countries, with minimal change in net trade volumes.

Analysis of the TPP by the US Department of Agriculture does not anticipate any increase in Australia's national income by 2025 as a result of the parts of the agreement that relate to agriculture.

Australia already has low barriers to trade and agreements with most of our major trading partners. There are few important restrictions that remain to be removed.

Claims that these agreements will bring major economic benefit are contradicted by both government-commissioned analysis and experience with the US agreement.

Introduction

The Australian Government has recently negotiated a Free Trade Agreement (FTA) with China, often referred to as ChAFTA – the China-Australia Free Trade Agreement. ChAFTA is currently being debated in the Australian Senate as well as in public discussion and the media. ChAFTA follows other FTAs with Japan and Korea.

Minister for Trade Andrew Robb has endorsed ChAFTA, emphasising its economic potential:

By itself it's hugely significant but put the three together [China, Japan and Korea] and you really have got a set of trade agreements with over 50 per cent of our export markets.

Given what's going on in the region, the extraordinary explosion of people going into the middle class, this is a very I think landmark set of agreements and it will see literally billions of dollars, thousands, many hundreds of thousands of jobs and will underpin a lot of our prosperity in the years ahead.¹

In the above quote Minister Robb claims that the deal would generate billions of dollars. At other times he has claimed that it would add billions of dollars to the economy.²

The Trans Pacific Partnership (TPP), a FTA between Australia, Singapore, Brunei, New Zealand, Chile, the United States, Peru, Vietnam, Malaysia, Mexico, Canada and Japan, has also recently finalised negotiations and released the text of the agreement.

FTAs have traditionally over promised and under delivered. While their advocates talk about the economic growth and jobs that they might create, analysis and experience has invariably shown that FTAs have at best a marginal impact on jobs and growth. In this briefing note we summarise the results of economic studies on the Northern Asian FTAs, Australia's preferential trade agreement with the United States and a US government assessment of the TPP.

¹ Brissenden (2015) *China-Australia free trade agreement to be sealed today*

² Robb, A (2015) *Don't fall for union lies on China free trade deal*

North Asian FTAs

The Department of Foreign Affairs commissioned economic modelling to estimate the benefits of the FTAs with Japan, South Korea and China.³ The modelling estimated that by 2035 the combined effect of the three FTAs will:

- Increase GDP by 0.05 per cent, or an additional \$780 million per year in today's dollars.
- An additional 5,434 jobs by 2035.
- increased Australia's trade by about three per cent:
 - Increase imports by 2.5 per cent.
 - Increase exports by 0.5 per cent.

We see that DFAT's modelling estimates the North Asian FTAs will increase the value of Australia's imports by 2.5 per cent, but the value of our exports by only half of one per cent. Australia generally imports slightly more than we export, but both imports and exports are of similar magnitude. The increase in imports from the North Asian FTAs is almost five times larger than the increase in exports.

This result of DFAT's modelling is not emphasised in the commissioned paper and is not promoted by the government. In fact, the Federal Government has launched a taxpayer-funded advertising campaign which promotes Free Trade Agreements as Free Trade Export Agreements.⁴ As the majority of the increase in trade, about 85 per cent, will be imports to Australia, a more accurate description would be to call them Free Trade Import Agreements.

³ Department of Foreign Affairs and Trade (2015) *Economic benefits of Australia's North Asian FTAs*

⁴ Australian Government (2015) *Australia Open For Business*

Australia-United States FTA

In 2005 Australia signed an FTA with the United States. Since then, trade with the US has increased by \$11.5 billion or 26 per cent.⁵

However, this growth in trade volumes is almost identical to the growth in the overall size of the Australian economy, which has grown by 25 per cent over the same period. This means trade growth with the US was almost identical to the growth in the economy as a whole. This suggests the Australia-US FTA provided no significant boost to the volume of Australia-US trade, and as a result, very little in terms of economic growth and employment.

The composition of the increase in Australia-US trade is also worth examining. Since the signing of the Australia-US free trade agreement, exports to the US have increased by 11 per cent. This is less than half the rate of growth in the Australian economy over the same period. Imports from the US by comparison have grown substantially faster than the economy. Imports grew at 34 per cent compared to the economy at 25 per cent.

This means that exports contributed 15 per cent of the growth in trade while imports contributed 85 per cent of the increase. These results are almost identical to the findings of the government modelling of the three north Asian FTAs.

A 2015 study of the Australia-US FTA by a researcher at the Crawford School of Public Policy at the Australian National University assessed ten years of economic data from the beginning of the FTA.⁶ The study concluded that US and Australian trade with the rest of the world was lower because of the FTA, that is there was trade diversion. It also found that after controlling for country specific factors trade between Australia and the US fell because of the FTA. That is the Australia-US FTA was not even good for trade between Australian and the US.

Concern that FTA costs might be greater than benefits is shared by the Productivity Commission which in June attacked the latest series of FTAs.⁷ The Productivity Commission felt that the costs of FTAs were not being properly considered. They also had concerns about the ISDS provisions and the added costs on business for complying to these complex FTAs.

⁵ Calculations in this section based on: ABS (2015a) Table 1, ABS (2015b) Table 14a & 14b, ABS (2014) Table 5 & 7

⁶ Armstrong (2015) The economic impact of the Australia–United States free trade agreement

⁷ Productivity Commission (2015) Trade and Assistance Review 2013-14

Trans Pacific Partnership

Unlike the studies of the North Asian FTAs and the Australia-US FTA discussed above, no modelling of the TPP has been done from the Australian perspective. However, the United States Government Department of Agriculture has assessed the impacts that the TPP's reduction in trade restrictions would have on member countries' real GDP by 2025. It found that after the TPP has been in place for 10 years it is expected to increase Australia's real GDP by 0.00 per cent.⁸

This result is broadly similar to the expected impact of the three north Asian FTAs and the US FTA. The slightly smaller result for the TPP could in part be explained by the fact that Australia already has FTAs with the large economies involved with the TPP, including the two biggest, the US and Japan. This reduces any benefit that Australia might see from reduced trade restrictions under the TPP.

⁸ Burfisher et al. (2015) Agriculture in the Trans-Pacific Partnership, see Table 8, p21

FTAs – rhetoric and reality

Clearly the rhetoric of trade ministers and the results of FTAs are quite different. The small size of the benefits delivered by FTAs is not surprising, however, when considered in the wider economic context.

The final impact of a FTA will depend on many factors, but the most important is the number and significance of the trade barriers being removed. If the FTA removed large and significant trade barriers then the economic impact will be significant. If the trade barriers removed are small then the economic impact will be small.

Australia has relatively few trade restrictions. Over the last 30 years both sides of politics in Australia have pursued a free trade agenda. This has resulted in the removal of most trade restrictions.

Furthermore, Australia already has FTAs with most of our major trading partners. There are few important restrictions on trade remaining. This is currently the case with China. According to the Department of Foreign Affairs China is Australia's largest trading partner with around \$670 billion in two way trade in 2014. It would be very difficult for this amount of trade to occur if the two countries had significant trade barriers.

This means that any FTA between Australia and China will have only a marginal change in the trading relationship. Most of the trade that could occur between Australia and China is already occurring.

Given that the FTAs are only changing the trade rules in a marginal way then it is not surprising that the benefits are only marginal. The fact is that the three north Asian countries that we have recently signed FTAs with are countries in which few trade barriers exist.

Wider issues and public concern

The problem with FTAs is not all economic. A wide range of governance, social and environmental impacts could arise from these agreements.

In particular, FTAs can include Investor-State Dispute Settlement (ISDS) provisions. Under ISDS provisions an international company whose profits have been negatively impacted by a change in government policy could sue the Australian government for damages.

For example if Australia were to sign up to the TPP and a future government was to introduce a carbon price that negatively affected the foreign owned brown coal fired power stations, then those companies could potentially sue the Australian government for any loss of profit. Similar concerns relate to other health and environmental regulations. ISDS clauses can leave a democratically elected government in a position where it faces significant payouts to foreign companies in order to do what is in the best interests of its citizens.

More concerns surround the lack of transparency around how FTAs are negotiated. Negotiators claim that secrecy is necessary to get the best deal possible. They claim that if details were public vested interests could lobby for their own advantage and weaken a country's negotiating position. For this reason governments and negotiators claim the negotiations need to be conducted in secret.

However, the negotiations are not being conducted in secret. At each round of talks the governments consult with lobbyists for various special interest groups. The government claims this is because the trade deal impacts on them. But this means that the voices of business are well represented but the voices of other groups in our society remain silent.

Conclusion

Free Trade Agreements (FTAs) generally over promise and under deliver. Governments and interest groups invariably talk up estimates of the economic growth and jobs FTAs could bring, but analysis and experience suggests that they fail to deliver.

Economic theory predicts that free trade brings benefit to both buyers and sellers. However, the benefits of free trade predicted by economic theory are generally not achieved by our FTAs because, despite the name, FTAs do not actually facilitate the 'free trade' that economists envisage. The current round of FTAs, including the Trans Pacific Partnership (TPP) and the China-Australia Free Trade Agreement (ChAFTA) have very little to do with free trade and are more about locking Australia into agreements that have nothing to do with trade and are not in Australia's national interest.

Australia should have a debate about the benefits and costs of each FTA. This cannot occur if one or both sides exaggerate the benefits or costs. Unfortunately the free trade debate in Australia has become meaningless and this has resulted in low levels of understanding and engagement by the general public.

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