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MESSAGE TO THE G20: DEFEATING PROTECTIONISM BEGINS AT HOME

WHAT IS THE PROBLEM?

On 16 November 2008, G20 leaders made a commitment to resist protectionism. When they meet in Pittsburgh, on 24 September 2009, they will have an opportunity to review that commitment and to decide how best to act on it. The advice they have received to date focuses on international monitoring and short-term responses to the global economic crisis. These measures do little to deal with the underlying causes of protectionism.

WHAT SHOULD BE DONE?

Protectionism results from decisions taken by governments at home, for domestic reasons. Any response to protectionism must therefore begin at home, and bring into public view the domestic consequences of those decisions. G20 leaders should sponsor domestic transparency arrangements in individual countries, to provide public advice about the economy-wide costs of domestic protection. The resulting increase in public awareness of those costs is needed to counter the powerful influence protected domestic interests exercise over national trade policies.

That is the response proposed in this Policy Brief. Those listed on the following page strongly commend it to G20 leaders when they meet in Pittsburgh, on 24 September 2009.

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The response to protectionism in this brief is supported by the following:

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Helping the G20 resist protectionism[1]

During their meeting in Washington last November G20 leaders made a public commitment to resist protectionism. In the few months since then they have confirmed by their own conduct that their commitment is far from binding. The World Bank reports that by the end of February 2009 seventeen of the twenty had 'implemented 47 measures whose effect is to restrict trade'.[2]

In a number of countries, including Australia, the global crisis has prompted recovery strategies that have involved supporting particular activities, sometimes single firms, against adjustment pressures that are shared by domestic economic activities generally.[3] In doing so they have transferred to taxpayers (and the domestic community) responsibility for the down-side of risks inherent in corporate management. Selective support of this kind can only exacerbate the long-term effects of other, more overtly protectionist, responses to the global crisis.

That issue aside, the actions of G20 leaders to date suggest that each has seen their commitment as an opportunity to limit *other* countries' protectionism, rather than a need to address their own. The US blames the EU for its reluctance to reduce tariffs on farm products. The EU blames the US for its reluctance to cut farm subsidies. The US and Europe both blame developing countries for not being prepared to lower their barriers to imports of manufactured goods and services. And developing countries are reluctant to do that unless Europe and the US concede more on farm trade. As a result, the commitment to resist protectionism remains just that—a commitment. G20 leaders have yet to focus collectively on how to *act* against the ongoing threat.

Leaders have received public advice from two sources. Neither, however, deals with the underlying causes of protectionism. The first came from WTO Director-General Pascal Lamy, who sees protectionism as a global problem, requiring a global solution. His view, that international governance is the answer, reflects the crucial difference between the world in which the WTO still operates and the real world, where decisions about protection are actually made.

The second advice came from seventeen international trade economists mentoring G20 leaders in the lead-up to their April 2009 meeting in London.[4] Advice from this group focused on a short-term response to the global economic crisis. The crisis may well have increased the temptation for governments to resort to protectionism, but it is not the underlying cause of it. The temptation to raise trade barriers will not go away when the global economic crisis ends. Experience over the life of the stalemated Doha Round confirms that protectionist impulses are alive in good times as well as bad: For most of that Round global economic conditions were normal, even buoyant. Any response must therefore be effective in the long, as well as the short, term. The absence of an effective and long-term response —one that addresses its ongoing causes—has left governments with no defence against the protectionist pressures that are contributing to the present crisis, and without a basis for dealing with them in the next.

Fighting protectionism needs to begin at home

This Lowy Institute *Policy Brief* provides G20 leaders with a third option. It recognises that protectionism results from *domestic* policy decisions made under pressure from *domestic* interest groups operating in their *domestic* political arena, and exercising power over *domestic* decision-making on protection. It therefore advocates a domestic response that can address those ever-present pressures, rather than continuing to rely solely on international processes that experience has shown conclusively cannot. Domestic policy governance is the basis for this response.

Our proposal is that G20 leaders should encourage individual governments to introduce a domestic transparency process to provide the information they (and their domestic constituents) need to reduce the political costs of resisting demands for protection — by raising community awareness of the consequences for their domestic economies of accommodating those demands. It would help domestic economic welfare to replace domestic political pressures as the driver of domestic decision-making on protection. The strength of this approach is that it deals directly with the problem facing G20 leaders at its source, while leaving national governments in full control of domestic policy.

Outline of the *Policy Brief*

The remainder of this *Policy Brief* explains why responsibility for responding to protectionism rests primarily with individual countries, and why a domestic transparency process is needed to underpin the existing international processes of the multilateral system.

What might such a process look like? The Annex to this *Policy Brief* provides an account of Australia's experience in developing a domestic transparency response to protectionism. The focus on Australian experience is not intended to convey a view that it provides the only, or even an appropriate, model for other countries. But there are elements of the experience that other countries are likely to encounter when considering their own response to protectionism. The relevance of Australia's domestic transparency arrangements is that they recognised, and responded directly to, the domestic causes of protectionism.

Understanding what causes protectionism

In order to meet their commitment to fight protectionism, G20 leaders need to come to grips with what causes it.

A recent WTO study has provided an important clue. After reviewing the experience of 45 member countries in the Doha Round, it concluded that outcomes from multilateral trade negotiations depend on decisions taken by individual governments at home, about their own trade barriers, and reflect the interaction between private interest groups and systems of national decision-making:

'This compilation of forty-five case studies… demonstrates that success or failure is strongly influenced by how governments and private-sector stakeholders organise themselves at home

…Above all, these case studies demonstrate that…sovereign decision-making can… undermine the potential benefits flowing from a rules-based international environment that promotes open trade.'[5]

The WTO study confirms that the major responsibility for resisting protectionism must reside in the domestic policy environment of individual countries. Many explanations have been advanced for the failure to deliver a conclusion to the Doha round — the size and diversity of WTO membership, the complexity of the issues, the growing importance of emerging market players in the negotiations, the expansion of negotiations to cover more controversial issues such as trade in agriculture and services. Fundamentally, however, multilateral trade negotiations in the Doha Round have stalled because pressure from protected domestic interests has dominated the negotiating strategies of their governments. While most market access requests were in response to domestic producers seeking external markets, the reciprocal offers of access to domestic markets were heavily influenced by protected domestic producers who felt threatened by the prospect of having their markets open to international competition.

One important result of the influence exerted by domestic interests who depend on protection is that the means used to protect them have been moved further back into domestic policy, and away from the authority of the WTO. Their influence over national decision-making has swamped consideration of the economy-wide (national) interest in domestic decision-making about protection. And it is these larger, economy-wide, gains that provide the economic justification for opening domestic markets to international competition.

Changing forms of protection

International trade negotiations have been conducted by the GATT/WTO on the assumption that the resulting reductions in trade barriers would increase opportunities for trade, and hence for domestic development in participating countries, on the basis of what each does best. Negotiations in early GATT Rounds involved reducing tariffs, the main form of barrier operating at that time. The assumption was realistic then, because the resulting agreements to reduce barriers were effective. This was because of the relatively simple nature of the decision rules involved when tariff reductions were being negotiated. The proportional reductions of tariffs in the 1960s (under the Swiss Formula, for instance) automatically had the greatest impact on the most highly protected (least competitive) industries of each participant. In that environment international negotiations and agreements achieved a great deal. They were responsible for the very substantial liberalisation that took place among North Atlantic countries.

But non-tariff barriers (NTBs) have become increasingly important as the coverage of negotiations was extended to include agriculture and services. In these new areas the international processes of the WTO are struggling to make any progress. When governments individually seek to minimise adjustment for their own protected industries — for instance, by introducing non-tariff barriers to replace the tariffs bargained away — they cannot collectively (through

international negotiations to reduce barriers) increase export opportunities in their respective areas of economic strength.

Average industrial tariffs in OECD countries have been reduced from 40 per cent to 4 per cent through multilateral agreements. At the same time, however, non-tariff barriers (NTBs) have grown to the point where they now affect a substantial proportion of world trade. Many of these take forms that belong to domestic policy and, for that reason, are arguably beyond the authority of international rules and agreements. Governments introducing them have either made use of 'exceptions' in the rules for introducing protection (such as for emergency relief, or against 'unfair' practices); or exploited loopholes or ambiguities in the rules (such as 'domestic' production subsidies and regulations of various kinds); or they have simply occurred outside the international rules (such as 'voluntary' export restraints).[6]

As Peter Sutherland observed in 2002, based on his experience as director-general of the WTO:

'There is a side to the WTO that leaves in the hands of governments many tools of trade protection…There is no shortage of escape routes from international competition…In the end it all comes down to politics'.[7]

The response adopted to these developments in the Uruguay Round involved bringing all existing barriers into future multilateral negotiations, strengthening the international rules governing non-tariff barriers, international surveillance (through the Trade Policy Review Mechanism) to enforce compliance with agreements, and improved dispute settlement procedures.

That response could not overcome the problem facing the WTO system, and now exercising G20 leaders, for the following four reasons.

First, the approach operates only after the event. It catches up with today's non-tariff barriers only in tomorrow's multilateral negotiations.

Second, the scope for replacing the non-tariff barriers now in use with others, just as effective, is endless. As existing forms are brought under the authority of international agreements, pressure develops for new forms that fall outside their scope. Many of the new barriers are not only in non-tariff form, they are also in non-frontier forms and are therefore seen by governments introducing them as belonging to domestic policy—beyond the authority of international agreements. These barriers pervade markets for services, and have seriously limited the scope for opening markets for agriculture and services in the Doha Round.[8]

Third, the approach does not address the underlying problem—pressure at home from protected industries seeking to avoid the adjustment involved in liberalising their markets. It takes place in the international arena between trade officials, and not where decisions about protection are actually made. Backsliding from the Uruguay agreements confirms that this approach has not resolved the problem.

The use of non-tariff barriers to avoid WTO commitments has long been recognised by developing countries. It was confirmed by UNCTAD in 1992:

'Since the birth of GATT there have been a number of negotiating rounds that have dramatically reduced the level of tariff rates in the major industrial countries…It is generally agreed that tariffs do not constitute a significant barrier to imports into the OECD countries. As tariffs have come down, other restrictions on imports have appeared…There seems to be a movement towards less visible protectionist measures…'[9]

In providing protection in these forms, governments have demonstrated that the external discipline that international rules place on their conduct is no longer effective. And, as a result, progress in areas of special interest to developing countries has stalled as industrial nations—particularly the European Union, Japan and the US—have succumbed to pressure from their own protected producers to avoid the adjustment involved for them.

Fourth, and finally, the Trade Policy Review Mechanism (TPRM), introduced during the Uruguay Round to monitor the conduct of trade policy by national governments, has failed to address the problem. It cannot do so, because it is limited to international surveillance and is managed by trade officials—not by decision-makers responsible for promoting the national interest. It is a monitoring process and not an agent of domestic reform. That is how developing countries have seen it:

'The Trade Policy Review Mechanism…is not a national transparency mechanism… The ultimate aim of national transparency mechanisms…is to generate information about, and to promote a wider domestic understanding of, the economy-wide effects of protection in all its forms…'[10]

The need for a domestic response

Decisions about opening world markets are made in the domestic policy arenas of individual countries, under pressure from protected domestic producers seeking to avoid the adjustment involved for them. When governments succumb to those pressures, as they have in the Doha Round, they not only forego the unilateral gains (in domestic efficiency) available from reducing their own barriers. They also diminish the capacity of the WTO to deliver the additional gains (improved market access) available from liberalising in a multilateral context. The Doha Round has faltered because protected interests dominated the negotiating strategies of their governments, just as they have dominated many of the responses to the current crisis. Moreover, their negative influence is not limited to the Doha Round or the present crisis. Their threat to global prosperity is long term and ever-present, and will not cease when the present crisis ends. Any response by G20 leaders must therefore be effective in the long, as well as the short, term.

Most of us have a limited understanding of what is at issue in decisions about protection. Our response to the prospect of opening domestic markets is influenced by the information available to us about the domestic consequences. In the absence of public information about the economy-wide gains at issue for the community as a whole, and in view of the more visible costs to prospective losers, the latter have naturally found support at home. As a result,

governments have had difficulty mobilising a domestic commitment to open domestic markets to international competition.

The domestic causes of protectionism and the domestic response needed to deal with them have been aired extensively since the early 1980s. The source of the problem was identified several decades ago by developing countries, by EU leaders, past Directors-General of the GATT and WTO, by the OECD, the World Bank, the IMF and by the Brookings Institution in Washington.

The then Vice President of the European Union, Leon Brittan, commented in 1988:

'The greatest challenge is to pursue… liberalisation in the face of domestic pressures in the opposite direction. I think we have to recognise that support for trade liberalisation is not automatic…We need to make the case. And it needs to be made again, again and again.'[11]

And more than a quarter of a century ago the GATT (predecessor to the WTO) itself identified the nature of the threat now facing G20 leaders:

'At present the GATT system is not adequately discharging…its ultimate function: to provide help to governments in withstanding…pressures from special interests. A major reason why things have gone wrong with the trading system is that trade policy actions have often escaped scrutiny at the national level…Clearer analysis and greater openness in the making of trade policy are badly needed…In each country, the making of trade policy should be brought into the open…Public support for open trade policies should be fostered.'[12]

The importance of transparency

In domestic decision-making about protection there will always be tension between the private interests of those who depend on it and the public costs their protection places on the rest of their domestic community. That provides the basis for the response to the G20 commitment proposed in this *Policy Brief*, which draws on work by the Australian and New Zealand industry and business organisations operating through the Tasman Transparency Group (TTG).

The proposal reflects a growing recognition that:

- the existing international disciplines of the WTO are not providing a persuasive domestic reason for lowering trade barriers;
- it is the positive or negative perceptions at home about the domestic consequences of liberalising that determine how much actually takes place;
- it becomes politically realistic to secure the gains from lowering domestic barriers (and resisting demands for new protection) only when pressure from protected domestic groups is balanced by a wide domestic awareness of the public benefits at issue.

Our proposal is that G20 leaders sponsor domestic transparency arrangements — developed, owned and operated by individual countries — to underpin the existing international processes on which the WTO relies.

The logic supporting the proposal is as follows:

- for individual countries the greatest gains available from liberalising come from

reducing the barriers protecting their own less competitive (most highly protected) industries, regardless of what other countries do;

- the residual gains available from liberalising in a multilateral context—those resulting from greater access to external markets—materialise only when other countries also reduce the barriers protecting their less competitive industries;
- both the major unilateral gains (from liberalising domestic markets) and the additional gains (*potentially* available from multilateral trade negotiations) depend on participating countries approaching the negotiating table with 'offers' consciously structured to secure the gains from liberalising their own markets;
- the role of the proposed domestic transparency arrangements is to counter the negative influence protected domestic interests now exercise over national decision-making on protection, including the market opening 'offers' governments take to Geneva;
- its contribution to resisting protectionism and to strengthening the multilateral system is to help decision-making on protection (trade barriers) by governments reflect the interests of their domestic community as a whole, rather than pressure from protected domestic interests;
- it will give substance to the G20 commitment by enabling member governments to raise community awareness of the domestic costs of maintaining their own trade barriers, and the economy-wide benefits from removing barriers to international competition;
- as a result, domestic interests relying on protection will find it more difficult to gain community support for resisting market opening commitments widely seen as nationally beneficial.

This response brings into account a reality that the existing international processes of the WTO cannot. The WTO is simply a set of rules and a negotiating forum, driven in both cases by what its member countries are prepared to agree to. It has no authority to deal with the domestic pressures threatening its future viability. That is the source of its present difficulties, and conveys a great deal about the options available to G20 leaders.

The strength of the domestic transparency response is that it addresses the source of the difficulties that have stalled progress in opening world markets, while leaving national governments in full control of domestic policy. By providing the public information needed for wider community understanding it enables governments, and their domestic constituents, to work out for themselves that the economy-wide (public) benefits from opening domestic markets to international competition outweigh the (private) adjustment costs involved for protected domestic producers. It simply adds a domestic process to give substance to the existing international processes of the WTO.

The relevance of this response is confirmed by Australia's experience. The domestic transparency arrangements put in place in the early 1970s enabled later governments to reduce Australia's barriers unilaterally in the 1980s and 1990s.[13]

And, once again, this is an idea that has a long history. The major international agencies now

advising G20 leaders on the present global crisis have in the past each pointed to the need for greater domestic transparency in national trade policies. For example, following its review of the Uruguay Round, the IMF concluded that:

'Governments can play a key role in helping to tip the balance of political forces in favour of trade liberalisation. They can do so, in part, by helping to lift the veil of complexity that often conceals the net social costs associated with protectionist trade policies. Mobilising political support for liberal trade can be facilitated by systematically exposing the implications of trade measures (which at times are effectively buried in the esoterica of trade legislation) and evaluating the associated costs for the economy as a whole.'[14]

Developing countries initiated a program of work during the Uruguay Round to examine the contribution greater domestic transparency could make in resolving the difficulties that had developed in the multilateral system. UNCTAD, for instance, concluded in July 1987 that:

'Governments should consider as part of the fight against protectionism…the establishment of transparency mechanisms at the national level to evaluate protectionist measures…and the implications of such measures for the domestic economy as a whole' [15]

And the US proposed early in the Uruguay Round that WTO members meet to examine trade policy procedures at home:

'Recognising that individual governments bear the primary responsibility for consulting with their own constituents when they formulate trade policy, the US…proposes that WTO Members discuss their respective consultation processes in Geneva to learn from each other how to ensure that the view of interested members of the public are taken into account.'[16]

How does a domestic transparency process fight protectionism?

The role of domestic transparency is to help governments give priority to the public (national) interest in decisions on protection. For instance, it is only by having a basis for giving priority to national over sectional interests in domestic preparations for the bargaining process that a closer match can be established between the expectation of national gains from international negotiations and the outcome of the negotiating process itself.

This approach will be especially important in opening markets for services, where the barriers to entry are largely in non-border forms. As we have learned in the Doha Round, many of these non-border barriers are extremely difficult to identify. They are therefore unlikely to be included in domestic reform programs unless governments, in countries where they operate, recognise that trade barriers in this form also reduce their gains from liberalising. And, because they are in non-border form, they are seen by those who oppose their removal as belonging to domestic policy—beyond the reach of international surveillance, rules and agreements. A domestic transparency process, owned and operated by individual countries, provides the only means of bringing them into

account that also leaves governments in full command of domestic policy.

Unless G20 leaders can devise a means of dealing with the domestic political pressures responsible for the impasse in Doha negotiations, those pressures will continue to spill over into the international processes of the WTO—which are neither designed nor equipped to deal with them.

The clear message is that the antidote to protectionism, in all its forms, is a domestic discipline on national decision-making that promotes wide domestic awareness of its economy-wide costs.

Designing a transparency process

In our judgment it would be inappropriate to prescribe a standard form these transparency procedures should take in each country. It is achieving the *objective* of domestic transparency that is important, not the choice of particular institutional arrangements. What matters in dealing with the domestic influences generating protectionism is that the domestic response in each country gives priority to the public (national) interest, and supports a system of advice at arm's length from decision-makers.

We nevertheless have two suggestions for introducing them. These involve:

- encouraging individual countries to establish a domestic transparency process, independent of government, to provide advice about the economy-wide consequences of changes in protection under consideration;
- maintaining a clear distinction between responsibility for the advice going to governments from this process and governments' responsibility for decisions on protection.

These core features are crucial for maintaining the distance between government decision-making and the influence of domestic interest groups seeking special treatment at the expense of the domestic community. They also provide the underpinning and independence the advisory process needs. The importance of that underpinning is apparent from Australia's experience, both its successes and its failures, and is dealt with in the annex to this policy brief.

International agencies and policy institutes will always play an important role in drawing attention to the consequences of protection. But they are not a substitute for the domestic process advocated here. To be effective, the domestic transparency process must operate as a matter of routine each time a change in domestic protection is under consideration by government. It is therefore a discipline governments place on themselves, with the safeguards and charter needed to ensure the advice is provided as a matter of course when changes in protection are under consideration. As a result of bipartisan support for such a discipline, Australian governments gave up the ability to act without first receiving public advice about the economy-wide consequences of the changes they had under consideration.

The resulting enhanced public awareness of what was at issue for the Australian economy as a whole helped generate the community support needed for decisions reflecting the national,

rather than sectoral interests or the interests of particular industries.

How to build a domestic discipline into the G20 response to protectionism

The logic on which this response is based, while rock-solid, is counter-intuitive. It has been easier to believe that the national benefits available from multilateral negotiations depend on the skill of negotiators in gaining access to external markets while conceding as little as possible at home. The response we propose challenges the stranglehold that view has had on the conduct of trade negotiations. It recognises that the gains for countries participating in multilateral trade negotiations depend on what each takes to the negotiating table, not what they hope to take away from it.

There will be resistance to this response from protected interest groups and others comfortable with present arrangements. The case for it would therefore need to be pursued well beyond the Pittsburgh meeting of G20 leaders. And it will need to be argued outside the WTO, which has shown no enthusiasm for it. For instance, a similar proposal was introduced into the FOGS (Functioning of the GATT System) Group in the Uruguay Round twenty years ago. After considering it, negotiators in that forum introduced another international process instead—the Trade Policy Review Mechanism. When the idea was raised again, in March 2009, Pascal Lamy confirmed that there was 'not general support for the sponsorship of country processes within the WTO framework'.[17] As we noted earlier, the limited authority and international focus of the WTO makes it an unlikely forum to host a domestic response to protectionism. The case will therefore need to be argued in other meetings of world leaders—such as the World Economic Forum—and in international institutions such as the World Bank, IMF, OECD, and UNCTAD.

As a first step, and to demonstrate their resolve to resist protectionism, G20 leaders could provide a lead by introducing domestic transparency procedures into their own decision-making on protection. Indeed, some developing countries have already done so, or are contemplating it. Professor Hadi Soesastro, a prominent Indonesian economist, recently explained why Indonesia has introduced such a response:

'*…leaders must go beyond airing the right rhetoric…Concrete actions, which remain wanting, must follow…The Indonesian Trade Minister, for instance, has recently introduced domestic transparency procedures in the decision-making on protection to try to minimize the damage.*'[18]

How leaders of the major developed countries respond to the protectionist threat will send a very important message to the large number of developing countries that have been liberalising unilaterally, and to the many countries moving from command to market economies. These together represent the majority of the population of the developing world and constitute the major potential growth areas in world trade. Because developed and developing economies complement each other in the things they trade, that potential is crucial to world competitive producers in developed economies.

In the case of the United States the change required is minimal. It involves simply adding to the existing charter of the US International Trade Commission (USITC) a requirement that its public reports account for the economy-wide consequences of its recommendations on protection for individual industries. The fundamental deficiency of the USITC is that, while its procedures promote transparency, its role is to provide relief from international competition on the basis of criteria that focus on the problems import competition poses for individual industries. The broader effects of such competition, on the economy as a whole, are not brought into account in formulating advice about whether to provide relief. While its procedures make transparent the problems of ailing industries, the US President is left to decide whether to provide protection without public advice about the economy-wide consequences.

The action required to introduce this approach in the United States is therefore to add to the existing charter of the USITC a guideline requiring it to bring the economy-wide consequences into account when formulating advice and reporting on protection for domestic industries. And the challenge for developed countries generally is to build into their decisions on protection, including decisions about the reductions to offer in international trade negotiations, the economy-wide perspective and domestic commitment that are brought into play when countries liberalise unilaterally.

Conclusion: a response to the long-term challenge of protectionism

A domestic transparency response is needed to help underpin the future viability of the global trading system. We are drawing it to the attention of G20 leaders because of the need to develop a forward-focused response to protectionism now, in order to allay negative reactions about the future of world trade following the stalemate (after eight years of intensive negotiations) in the Doha Round.

While this response would be unlikely to achieve spectacular results immediately, its educative influence would progressively and irreversibly chip away the mystique and ignorance that has constrained national debates about the economic trade-offs involved in liberalising domestic markets. It would help correct the fundamental weakness of the present adversarial approach to international trade negotiations, in which domestic pressure groups exert the dominant influence on the negotiating stance of governments. It should consequently make it easier for G20 leaders to realise in their domestic policy conduct the worthwhile objectives about which they expressed collective agreement when they met in Washington and London. The test of its relevance is not whether it could quickly move all nations to the ideal situation, but whether they could generally do much better than at present.

Pascal Lamy's view, that international monitoring is an appropriate and sufficient response, is not supported by the study conducted by the WTO itself during the Doha Round. While monitoring may be of some help in the short term, simply relying on another international process does nothing to address the domestic source of

protectionism. When presenting his vision for the WTO over the next four years on the occasion of his re-appointment, he confirmed his view that 'No major overhaul of the system is required'.[19] And at a conference on 4 March 2009 he described the domestic transparency response as a 'perfectly legitimate, respectable and rational academic argument'[20], while leaving no place for it in his vision for the WTO. Two of his predecessors, Olivier Long and Fritz Leutwiler, chaired international study groups formed to review the performance of the WTO. Both concluded, nearly a quarter of a century ago, that its international disciplines needed the support of transparency arrangements at home.

If the G20 response is guided by Lamy's view, and thus limits itself to the international disciplines that have failed so dramatically in the Doha Round, governments will continue to insulate their less competitive (highly protected) industries against the adjustment pressures the present crisis places on all their industries. The cost of following his 'business-as-usual' advice will come later, when the crisis has passed. Instead of adapting to the changes occurring in their competitive strengths, their domestic industry structures will remain frozen in time. And that will seriously affect their domestic (and global) prosperity into the longer term.

The WTO system, in its present form, is clearly broke, and needs fixing. Without support at home, its international disciplines cannot deliver the national rewards participating countries expect from multilateral trade negotiations. To provide that support, we believe the G20 response to its commitment on protectionism must satisfy three conditions.

- It must encourage individual countries to develop domestic transparency processes as a basis for advice and decision-making on protection.
- It must encourage and enable them to address their own 'behind-the-border' barriers to trade.
- And it must leave them in full control of domestic policy.

The response we propose meets all three conditions. Its central message, confirmed by the failure to reach agreement in the Doha Round, is that an effective response to the difficulties now facing the global trading system must involve domestic processes that make the economy-wide consequences of existing and planned protection more transparent.

ANNEX : LESSONS FROM AUSTRALIA'S EXPERIENCE

The transparency arrangements that have provided the basis for advice to Australian governments on domestic protection (Australia's trade barriers) evolved over time, as have the institutional arrangements supporting it: the Tariff Board (1921–1973), the Industries Assistance Commission (1974–1990), the Industry Commission (1991–1998) and the Productivity Commission (1998–to the present).

This Annex focuses on the transition from the Tariff Board to the Industries Assistance Commission (IAC), because that transition generated policy tensions that other governments contemplating domestic transparency arrangements are also likely to encounter. It deals with why a domestic transparency institution (the Industries Assistance Commission) was established in 1974, and several important lessons from subsequent developments.

In explaining how Australia's domestic transparency arrangements helped to counter protectionism, it is important to know how decisions on protection were made in Australia before 1974 when the transparency arrangements were put in place.

Fragmented advice and policy information systems

Before 1974, the advice going to Australian governments focused almost exclusively on the needs of particular parts of the Australian economy. Governments received separate advice on policies for manufacturing (or parts of it), agriculture (or parts of it), the services and transport sectors (or parts of them) and the mining sector (or parts of it). The segmentation of policy advice produced a 'parts' approach to domestic development. Economic management was made up of two separate policy 'worlds'—the 'world' of the sectors and the 'world' of the whole economy. The focus was on the whole in macro-economic management, but on sectors when longer-term economic development—including protection and trade policy questions—were under consideration.

This segmentation of policy produced fragmented and closed systems of advice. Officials, with limited informational capacity, depended on the flow of information from their industry clients. Consequently, they were often unable to preserve the distance from their clients needed for independent analysis and advice. In this situation, individual sectors of the economy were able to 'privatise' advice going to governments on longer-term issues that had ramifications throughout the economy. Special interest groups had an incentive to exert covert pressure—both to influence the opinions of officials and to seek to have people sympathetic to them appointed to the positions responsible for formulating advice.[21] Vested interests developed inside government as well as out, so that a mutually supporting bureaucracy and industrial interests commanded a great deal of power over decision-making.[22] This interaction between special interest groups and those responsible for decision-making on protection was natural, indeed inevitable, in that environment. It caused government decisions on protection to reflect the needs of particular industries, rather than the economy-wide goals of national economic policy.

As a further consequence of this fragmentation of advice, protection policy was pursued separately from trade policy—as though these two areas of national economic policy were not tightly linked. Australia approached multilateral trade negotiations as though the only gains at issue came from access to external markets.

Tension between a protectionist policy and its economy-wide consequences

The Tariff Board, which preceded the Industries Assistance Commission, was established as an independent statutory body, charged with recommending assistance to 'economic and efficient' industries. It was required to hold public hearings on the matters referred to it by governments and to provide its advice in public reports.

It had two avenues for conveying its advice on protection: in reports on the particular matters referred to it by governments and in its annual reports. Until the mid-sixties its recommendations reflected the established 'needs-based' approach—that is, the level of protection needed to enable each industry to compete against international competition. Although its statute required it to report on 'the operation of the Tariff and the development of industries', its annual reports offered little insight into the economic consequences of the protection it recommended, and were generally limited to a description of those recommendations. The depth of its general reporting on its 'economic and efficient' guideline was conveyed in an annual report during the 1950s, which famously observed that the Board 'was impressed by the efficiency of Australian industries generally, and was particularly impressed by the efficiency of some'. It had not yet recognised the difference between technical and economic efficiency.

In the mid-sixties, following a wide-ranging review of economic policy commissioned by the then Australian government, the Board began to consider how it should respond to the quite limited policy guidance provided in its statute.[23]It was becoming aware of the economic consequences of the established 'needs-based' approach to protection. In 1967 it outlined a new approach, developed to ensure that its recommendations were consistent with the settled goals of national economic policy.[24]This included a systematic public review of the structure and levels of protection, focusing on industries with high levels of protection, rather than the past focus on particular industries or products.[25]It nominated levels of protection that indicated low, medium and high cost production (using 'effective rate', a measure of the protection accorded a process or industry rather than their outputs, developed by Professor Max Corden).[26]It foreshadowed its intention to use the effective rate concept (measuring the net protection accorded an industry as a result of the opposite effects of protection on its inputs and outputs) in deciding which industries were highly protected and thus most in need of review.[27]It also foreshadowed improvements needed in the policy information system supporting its work.

These foreshadowed changes challenged the prevailing 'needs-based' approach to protection, an approach to which both the Department of Trade and its Minister were strongly committed. The tension that developed between the Minister and the Board, and within Cabinet between

the Trade Minister on the one hand and the Prime Minister and Treasurer on the other, stimulated intense public interest and discussion about the roles of advice and decision-making on protection.[28]The Trade Minister and his departmental advisers regarded the changes proposed by the Board as a matter of policy, beyond the authority of the advisory body. The Board saw it as exercising its statutory responsibility for making public the criteria it used in formulating its recommendations, and in relating them to the settled objectives of national economic policy. The resulting tension was inevitable, and became very public. The chairman of the Tariff Board was at one point warned by the Minister for Trade against providing a public explanation of the proposed changes on the grounds that he would be in breach of his authority in expressing a view that may not be consistent with government policy.

The final act in the Board's struggle to clarify its role came when the Minister for Trade sought Cabinet approval, in December 1970, to direct it how it should form its recommendations. He proposed the Board be instructed that, when deciding whether an Australian industry was 'economic and efficient' and therefore worthy of protection, it should compare local production costs with those in 'mature economies' in Western Europe and North America. When establishing the appropriate level of protection, however, it should be required to recommend the level needed to protect local production against the cheapest source of international competition. The Minister did not gain Cabinet support, and the separate roles of advice and decision-making remained unresolved until the Industries Assistance Commission was established in 1974.

The statute creating the Industries Assistance Commission (IAC) signalled the government's (and Parliament's) wish to ensure that:

- the economy-wide perspective quite consciously taken in formulating budgets was carried over into policy on longer-term protection and trade policy issues;
- the Commission's mandate covered all forms of assistance to all economic activities, in all sectors of the economy;
- it had authority to initiate its own public inquiries;
- governments had an obligation to seek public advice from the Commission before responding to requests for new or increased assistance, although they were not obliged to follow that advice.

A clear distinction was thus established between the transparency institution's responsibility for *advice* and the government's responsibility for *decisions* on protection.

The Commission's charter

The reason for establishing the Commission was to extend to all Australian industries the system, already applying (through the Tariff Board) to import-competing industries, of governments receiving public advice from an independent authority following a public inquiry.

When introducing the legislation creating it the then Prime Minister said:

'The Commission will be a single institution, with responsibility for advising on the assistance

which should be given to industries in all sectors of the economy. It will therefore be very conscious of the need to develop a rational and consistent approach to all industries.'[29]

This approach was embodied in the legislation, and reflected a bipartisan commitment to distinguish future arrangements from those it replaced. It was supported by the major political parties in both houses of the Australian Parliament and subsequently reaffirmed by successive governments of differing political persuasions.

It provided the IAC with the charter and independence required to ensure that its advice to governments would be disinterested, open to public scrutiny, and formulated from the perspective of *national welfare* rather than the needs of particular producer groups.

This involved:

Independence: The transparency agency was created as an institution independent of both the political process and of any industry-specific branch of government. In explaining its role, the Prime Minister said:

'The…Commission will ensure public scrutiny of the process whereby governments decide how much assistance to give to different industries…Such a process must be independent and impartial, and seen to be independent and impartial…'[30]

In explaining why the institution would be given authority to initiate its own inquiries, the Prime Minister said:

'It is a safeguard against the indefinite continuation of assistance to particular industries long after it is needed. It is necessary because structures of assistance, like some of the activities they support, can become obsolete.'[31]

Its statute committed Australian governments to seek its advice about the economy-wide effects before acting on requests for protection. The Prime Minister observed that this was:

'an essential safeguard to the integrity of the system…If some industries, particularly those which stand to lose most from public exposure of their claims, can avoid the process of public inquiry the fundamental purpose of the Commission will be frustrated.'[32]

This bipartisan approach was put in place to safeguard the integrity of advice and decision-making on protection. The IAC was, however, established as an advisory body only—with no judicial, executive or administrative functions.

Economy-wide charter: It was given a mandate to inquire and report on all forms of government assistance to economic activities in all sectors of the economy, and to evaluate these in terms of their economy-wide effects. The legislation establishing the IAC required it to give priority in its recommendations to the *public* gains or losses at issue for the community as a whole in changing protection, rather than the *private* gains or losses at issue for particular groups of economic agents.

The legislation also required it to research, and report annually on, how overall developments in the evolving structure of protection were related to these general objectives.

Openness: To facilitate community participation in the advisory process, its charter required it to hold public hearings and to make its advice to government available in public reports.

The legislation establishing it thus drew a distinction between the transparency agency's responsibility for *advice* and governments' responsibility for *decisions* on protection. While governments were required to seek advice from the Commission before taking action on protection, they were not required to act on the advice. This preserved the autonomy of governments over policy, while introducing transparency and an economy-wide perspective into the advice going forward to them.

It would, of course, be misleading to give the impression the Commission's analysis and advice would always be adequate or complete. If (or when) this was not the case, the scope for public scrutiny included in its procedures ensured that any blemishes would be brought to governments' attention. That provided a powerful discipline on its performance.

One important consequence of the arrangements put in place for the operation of the IAC is that the public was engaged directly in the process by which advice on protection was formulated. The Commission's contribution in helping Australian governments open domestic markets to international competition therefore involved more than simply raising the visibility of particular domestic barriers to trade; it also raised community awareness of their economy-wide effects. Its role was to provide the information domestic constituents (and the incumbent national executive) needed to reduce the political costs of liberalising, by making the consequences for the Australian economy more transparent.

Some lessons from Australia's experience

While advocating a domestic transparency process as a response to protectionism, we recognise that it would be inappropriate to prescribe a standard form that transparency arrangements should take in each country. Instead, it is a matter for each country to choose and develop its own arrangements. There are nevertheless elements of Australia's experience that other countries may also encounter when contemplating how to structure their own transparency arrangements.

Safeguards for the operation of the transparency process

Recognising that protection has long-term consequences for the performance of the economy, the Australian Parliament included two safeguards in the legislation creating Australia's transparency arrangements. One gave the transparency institution power to initiate its own inquiries. The other committed governments to seek its advice before changing protection.

It is worth repeating the explanation of the then Prime Minister, when introducing these provisions in the legislation establishing the transparency institution (the IAC):

'If some industries, particularly those which stand to lose most from public exposure of their claims, can avoid the process of public inquiry the fundamental purpose of the Commission will be frustrated.'[33]

These safeguards, agreed by the major political parties in both houses of the Australian Parliament, were put in place to ensure the transparency process would operate as a matter of course whenever changes in protection were in prospect—rather than only when it suited particular incumbent governments. They underpinned bipartisan support for protection reform, by providing an agreed basis for subsequent Australian governments to account for the consequences of policy decisions they take during their time in office. Public confidence in government decisions on longer-term micro-economic policy issues, the effects of which are felt beyond the life of the government responsible for particular decisions, was enhanced by this process.

Subsequent developments have confirmed the need for those safeguards, which were removed over time. There was, from the outset, uncertainty about whether the provision committing governments to seek advice from the transparency institution before introducing or increasing protection was legally binding. Its contribution in underpinning Australia's transparency arrangements is therefore uncertain. The existence of the other safeguard, which gave the transparency institution power to initiate its own inquiries, provided a basis for expecting individual governments to respect the bi-partisan commitment to seek its public advice when contemplating changes in protection.

This power to initiate its own inquiries was removed in 1983 after a review, commissioned by the Minister then responsible for its operations, recommended that it was no longer needed because it had not been used. The review did not recognise that the *existence* of that power provided the safeguard needed to ensure the system operated as the Australian Parliament intended it should. The inevitable consequences of removing it were subsequently described by the Minister for Industry, who had commissioned the review and was then responsible for removing the safeguard:

'In Cabinet the transport minister…rejected an inquiry into 'his' industry. He…appointed an inquiry of his own. Nothing seemed to happen. Gareth Evans as minister for resources said the mining industry didn't want to be inquired into. So nothing happened there either.'[34]

He confirmed these consequences to the then chairman of the Commission who, following removal of the Commission's power to initiate inquiries, had sought approval to conduct those inquiries:

'It might be desirable for industries such as mining, sectors of transport, business sources, etc, to be examined by the IAC, but there was no particular 'will' in government, industry or administration for this to be done…I am personally willing to pursue the question of further work being done in the services sector, but do not anticipate much progress in the immediate future.'[35]

Advice and decision-making on protection consequently returned to the 'sectoral' or 'industry' focus and processes that existed before the transparency institution was established. Ministers responsible for each sector of the economy made their own arrangements, with predictable results.

The transparency process was by-passed again quite recently, in reviews of Australia's most highly protected industries—its car and clothing and textiles industries. In establishing these reviews, responsibility for advice was placed in the hands of industry insiders. The industry-centric focus of the reviews meant that the subsequent advice and decisions reflected what was required to ensure their survival, rather than their contribution to national economic welfare. The economy-wide consequences of those decisions will emerge later—perhaps a decade down the track—beyond the life of the government responsible for them.

The lesson from this experience is that, without safeguards to underpin the transparency process, governments will always be under pressure to meet the demands of particular domestic groups who profit from protection. Later governments, and future Australians, will be left to deal with the consequences. It is precisely for this reason that the transparency process was put in place — to provide an agreed and enduring basis for public advice, at arm's length from government, about the economy-wide consequences of changes in protection under consideration by incumbent governments.

Ministerial responsibility for the transparency process

The consequences of placing responsibility for the transparency process in the hands of an 'industry' minister, depending on other 'industry' ministers to support an approach that gives the highest priority to national economic welfare, has been described above. Progress in pursuing that objective was subsequently restored when ministerial responsibility was transferred to the Treasurer—an 'industry-neutral' minister, with economy-wide responsibility for domestic economic policy. The then Treasurer established a forward program of inquiries for the Commission—one part of the program dealt with protection; the focus of the second was on other major impediments to improved national efficiency. The move from an 'industry' minister (responsible for the manufacturing sector) to the Treasurer thus restored an economy-wide perspective to protection policy. But, without the safeguards that had underpinned the agreed transparency arrangements, the public discipline of receiving advice from the transparency institution before changing protection could be sidelined by any government wishing to do so. That was confirmed by the recent reviews of the car industry and clothing and textiles.

A Work In Progress

Another important lesson from Australia's experience is that opening domestic markets to international competition, like the transparency procedures underpinning community understanding and acceptance of it, is an ongoing and evolving work in progress. This is reflected in the developments leading to the expanding remit, over time, of Australia's transparency institution. The Tariff Board focused entirely on frontier forms of protection, principally for the manufacturing sector, and without guidelines that enabled it to report on the economy-wide effects of changing protection. Near the end of its life, in 1973, a one-off 25 per cent reduction in

tariffs was initiated outside the Tariff Board system without any systematic understanding (within government or the community) of its economy-wide consequences. The outcome demonstrates the crucial role of transparency in enhancing public understanding and confidence in decisions to reduce domestic trade barriers.

There can be little doubt that this action set back public acceptance of protection reform in Australia. It followed a report prepared secretly, with no public input. That did not fit the Tariff Board model, of an open inquiry system as the basis for public advice on changing protection. And it created public uncertainty about how reform would be conducted in future. Reflecting that uncertainty, and in response to pressure from those who stood to lose most from the action, the government quarantined Australia's most highly protected industries from the general reduction. While the 25 per cent cut in tariffs lowered the general level of protection, the government's subsequent action (again taken without knowledge of its likely economy-wide effects) increased the disparity in the structure of domestic protection. This greatly reduced the potential national benefits.

Following that experience the statute creating the Industries Assistance Commission extended its remit to include all forms of assistance to all industries in all sectors of the economy, and required it to report on the economy-wide effects of its recommendations. The Productivity Commission's work has been further extended to cover structural reform issues across all sectors of the economy, including regulatory impediments to domestic efficiency—an area of special relevance in opening world markets for services. The progression in the scope of Australia's transparency function evolved from an initial preoccupation with border protection, and one sector of the economy, to now cover all impediments to international competition (and improved domestic efficiency) throughout the economy. In the absence of the safeguards introduced at the outset, however, progress now depends on the preparedness of particular governments to expose its decision-making to public scrutiny and to seek independent advice about the future economy-wide consequences of changes in protection they have under consideration.

Public awareness and interest in the issues involved in protection

Before the Tariff Board began to question the then prevailing orthodoxy, in the mid-sixties, most Australians had only a passing interest in the dry arguments involved in discussions about protection and trade policy. Australians found it easy to accept that lowering domestic barriers to international competition simply hurt protected Australian producers for the benefit of foreigners. That view was supported by a matching, and equally erroneous, view that trade negotiations provide an opportunity to win access to external markets while giving away as little as possible at home. Competent economic journalism played a major role in helping turn those popular perceptions on their head, and in exposing the spin generated by both private and official interests opposing any change to the established 'needs-based' approach to protection policy.

The positive contribution to reform, and the enhanced policy transparency that resulted, is dramatically illustrated by how the struggle throughout the 1960s (between the Tariff Board and the protectionist Minister for Trade) finally played out.[36]

NOTES

[1] Several of the contributors to this *Policy Brief* are members of the Tasman Transparency Group (TTG) and this paper is based on the work of the TTG. The TTG was formed in 2005, by Australian and New Zealand business and industry organisations, to help strengthen the ability of the WTO to open world markets.

[2] Elisa Gamberoni and Richard Newfarmer, *Trade protection: incipient but worrisome trends*. Trade Note Number 37. Washington DC, World Bank, 2 March 2009.

[3] In Australia, for example, measures taken include the announcement on 16 June 2009 by the NSW State Government of a new, 'Local Jobs First' scheme covering government procurement. See www.budget.nsw.gov.au/_data/assets/pdf_file/0019/14374/NSW_jobs_first_NSW_Budget_2009-10.pdf

[4] Richard Baldwin and Simon J Evenett, *What world leaders should do to halt the spread of protectionism*, VoxEU 4 December 2008.

[5] WTO website : 'Managing the Challenges of WTO Participation—45 Case Studies', December 2005.

[6] In the markets for services these are generally of long standing, and many were initially introduced for reasons that had nothing to do with trade or protection.

[7] Peter Sutherland, former Director-General of the WTO, in *The Australian*, 18 March 2002.

[8] In that context, recent World Bank studies on the potential gains from the Doha Round concluded that the great bulk of gains from global liberalisation would have come from opening markets for services.

[9] UNCTAD, Trade Policies, Structural Adjustment and Economic Reform, Geneva, 17 July 1992.

[10] *Ibid*.

[11] Reported in *The Australian*, 24 June 1988.

[12] Fritz Leutwiler et al, *Trade Policies for a Better Future*, GATT Secretariat, 1985.

[13] See Dean Parham, *Microeconomic reforms and the revival in Australia's growth in productivity and living standards*, Productivity Commission, Canberra, 2002, Dean Parnham *Benefits of Trade and Trade Liberalisation*, Department of Foreign Affairs and Trade, Canberra, 1 June, 2009 and Ross Garnaut, *Briefing to Joint Standing Committee on Foreign Affairs, Defence and Trade*, Canberra, 12 November 2008.

[14] International Monetary Fund, 1994.

[15] UNCTAD V11, July 1987, Final Act, para.105 (4).

[16] Press Release, United States Trade Representative, 10 October 2000.

[17] Productivity Commission: *Trade and Assistance Review 2007/08*, p123.

[18] Professor Hadi Soesastro: *What Should World Leaders Do To Halt Protectionism From Spreading?* East Asia Forum, 10 December 2008.

[19] WTO website, *Strengthening the WTO as the global trade body*, 29 April 2009.

[20] Address to 'Outlook 2009', Canberra, 4 March 2009.

[21] Rattigan observed that this was the basis for his own appointment as chairman of the Tariff Board. Rattigan, G.A., *Industry Assistance: The Inside Story*, Melbourne University Press 1986.

[22] *Ibid*, p 23.

[23] *Ibid*, pp 24–25.

[24] Tariff Board Annual Report 1966–67, pp 4–11.

[25] Two safeguards were subsequently included in the legislation establishing the IAC, to ensure it had the power to proceed with the review begun by its predecessor.

[26] Discussed by Henry Ergas, 'Economic Certainty', in the *Australian Financial Review*, 30 January 2009.
[27] Tariff Board Annual Report, 1966–67, pp.11–12.
[28] Rattigan, pp 103–104.
[29] Parliamentary Debates, House of Representatives, Parliament of Australia, 18 October 1973.
[30] *Ibid*.
[31] *Ibid*.
[32] *Ibid*.
[33] *Ibid*.
[34] John Button, *As It Happened*, Sydney, Griffin Press, 1998, pp 264–265. It is not being suggested that Button was himself protectionist, but simply that he was unable to maintain an economy-wide perspective from his restricted 'industry' portfolio.
[35] In a letter to the chairman of the IAC, 22 December 1986.
[36] The intense public interest generated by the attempt to prevent the Tariff Board from explaining publicly how it interpreted the guidelines in its charter was reviewed by Nigel McCarthy, in the *Australian Journalism Review*, December 2000.

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