



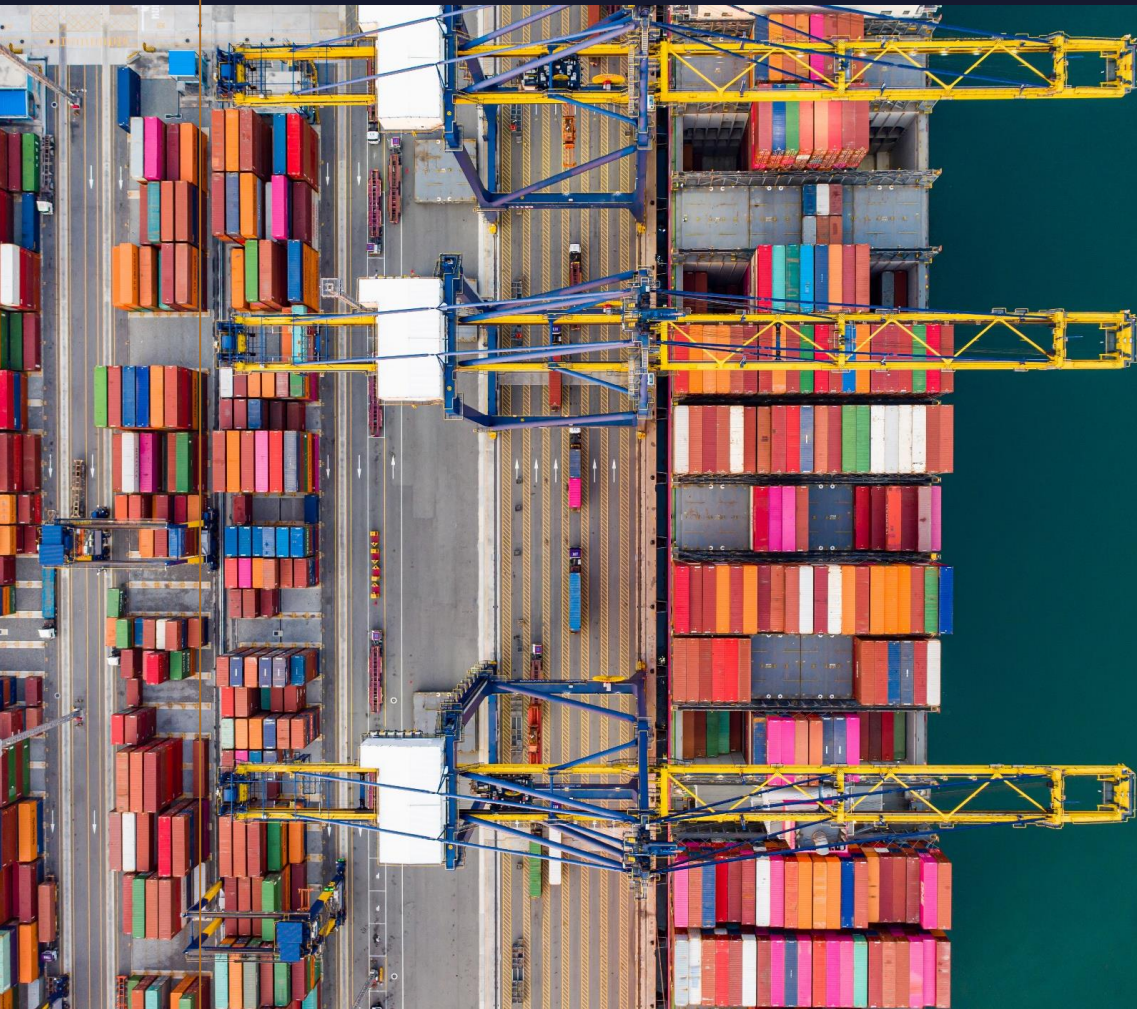
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Issues & Insights | May 2025

The changing global trade environment



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Key issues

- As a small open economy, Australia is reliant on trade to maintain and grow living standards for its citizens.
- In recognition of the benefits of free trade to Australians, governments throughout the 1980s and 1990s increased Australia's openness to trade, independent of the tariffs imposed by other countries.
- Recent decades have seen an increasing backlash against free trade, resulting in protectionist policies across the globe.
- There are economic downsides to increased protectionism, as well as some opportunities for Australia.
- Experts suggest maintaining free trade relationships and nurturing further growth in trade as the best available policy response to rising protectionism for Australia.

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Introduction

Global trade has surged since the Second World War, driven by technological changes and an increasingly favourable disposition towards trade. The establishment of multilateral institutions such as the World Trade Organization (WTO) further promoted global trade.

Australia embraced trade liberalisation in the 1980s and 1990s, reducing tariffs and deregulating industries. This openness has led to lower consumer prices and stronger economic ties, particularly with China and the US. For small economies like Australia, trade remains crucial for accessing a broader range of goods and services.

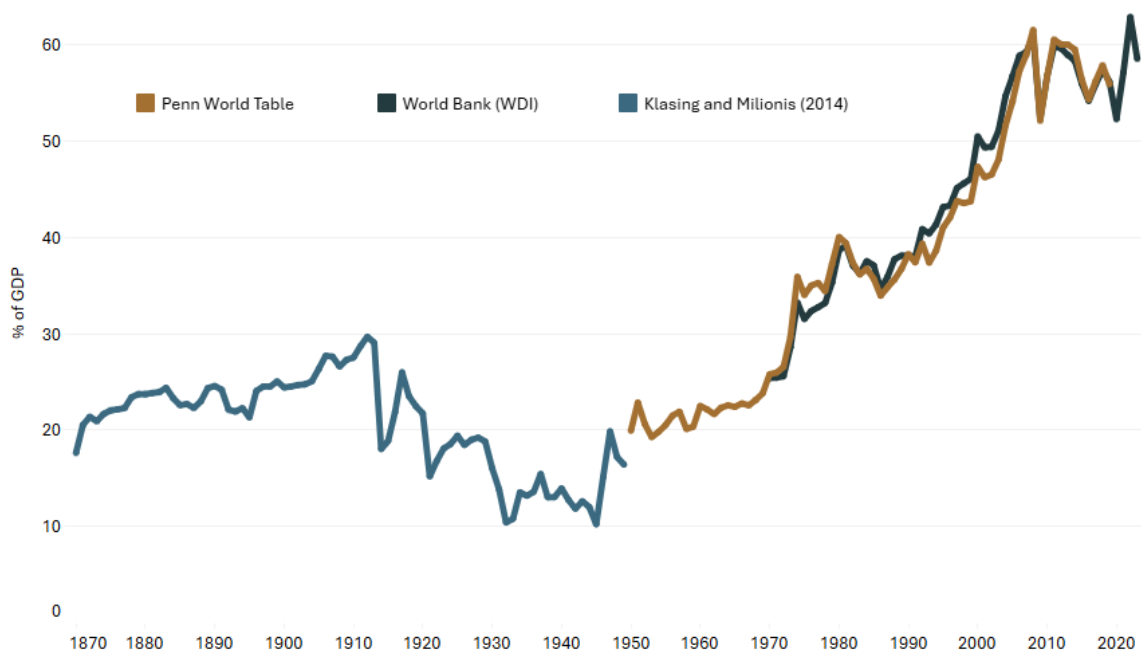
While the concept of free trade has long been a cornerstone of global economic policy, free trade has also faced significant criticism from various quarters, leading to a growing backlash and policies that restrict trade.

This article considers the specific impact of these changes on small open economies like Australia, which are particularly vulnerable to shifts in global trade dynamics. It outlines some of the responses that institutions have suggested for Australia in order to safeguard economic growth and living standards.

Trade in recent history

Taking the long view, global trade has increased over time. There are good reasons for this: trade enables access to goods and services that people want but might otherwise be unable to buy, and it generally lowers prices for goods that can be traded. Figure 1 shows how trade has trended upwards since the end of the Second World War.

Figure 1 The long view on trade



Source: Klasing and Milionis (2014); World Bank and OECD (2025); and Feenstra et al. (2015), Penn World Table (2021) – with processing by [Our World in Data](#).

A post-war trade boom

The prevailing trade ideology stems from the period following the Second World War, when trade came to be viewed as a vehicle for peace. Soon after the war, France and Germany established shared coal and steel markets where trade provided mutual benefits and made war between the nations economically less feasible. Because of the integration through trade, damaging one country would also harm the other, leading to greater stability and cooperation between the historical rivals. This same logic led to the broader growth in trade that emerged post-war, with multilateral institutions and agreements promoting global cooperation in trade and other areas.

As the global trade system evolved, this philosophy of economic interdependence extended to incorporate more of the globe, with organisations such as the WTO and the US advocating for the integration of China and other emerging economies into the world trade system.

China's changing role in the world economy

China's integration into the global trade system was marked by sweeping economic reforms and participation in international trade forums. In 2001, China joined the WTO, opening its markets to the world and embedding itself in global supply chains.

Over the past few decades, China has transformed from a peripheral player to a dominant force in global manufacturing. This seismic shift is evident in the increase in China's share of global manufacturing production, which surged from [a modest 5% in 1995 to 35% by 2023](#).

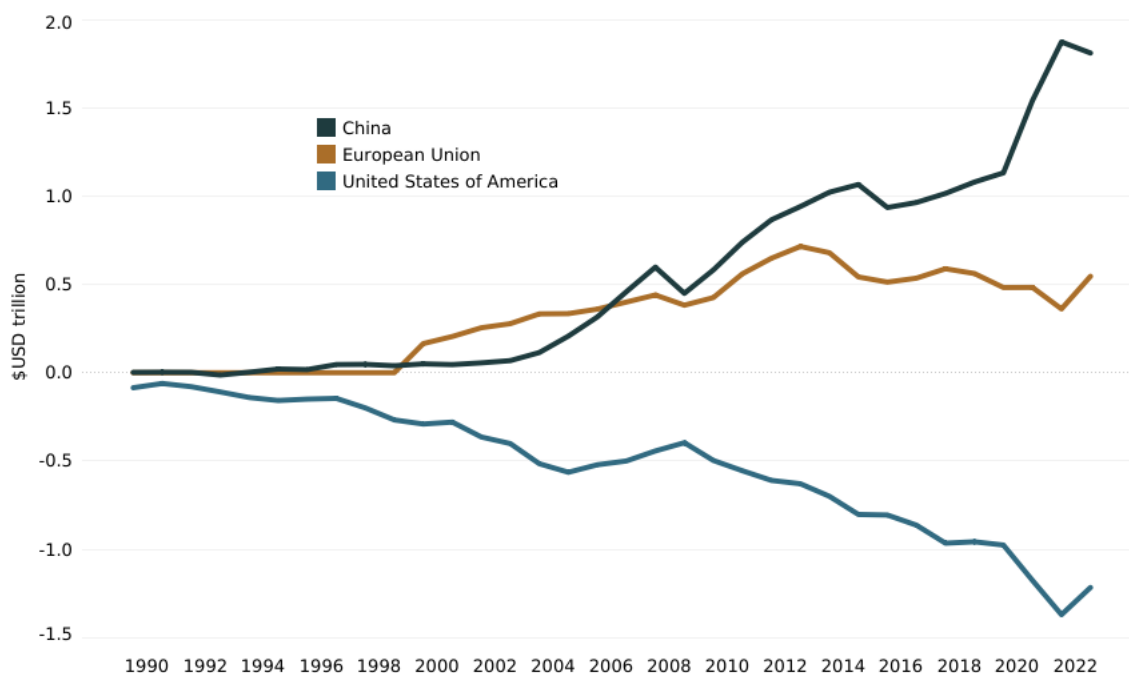
Initially, China's manufacturing was concentrated in relatively low-value-added goods, such as clothing and textiles. Over time, it expanded its capabilities in more complex products such as machinery and electronics. In recent years, China has increasingly focused on renewable energy and green technologies.

China's large manufacturing trade balance (shown in Figure 2) can be attributed to several key factors. Firstly, the country leveraged its vast labour force, providing a competitive advantage through lower production costs. This attracted significant foreign direct investment from corporations looking to minimise costs.

The Chinese Government also implemented a range of subsidies that provided favourable conditions for manufacturing activities, including improved infrastructure and reduced regulatory hurdles, further boosting China's manufacturing capabilities.

China's focus on education and skill development has also played a crucial role in helping its manufacturing sector to 'climb the value chain' and move to manufacturing higher value products. The government invested heavily in technical and vocational training, ensuring a steady supply of skilled workers capable of handling advanced manufacturing processes.

Figure 2 Trade balance in manufactured goods



Source: WTO statistics

At the same time that China was increasing its manufacturing capacity and integrating into the global trade system, other countries (including Australia) were also increasing their openness to trade, providing them with access to the growing Chinese market.

Australia’s trade liberalisation

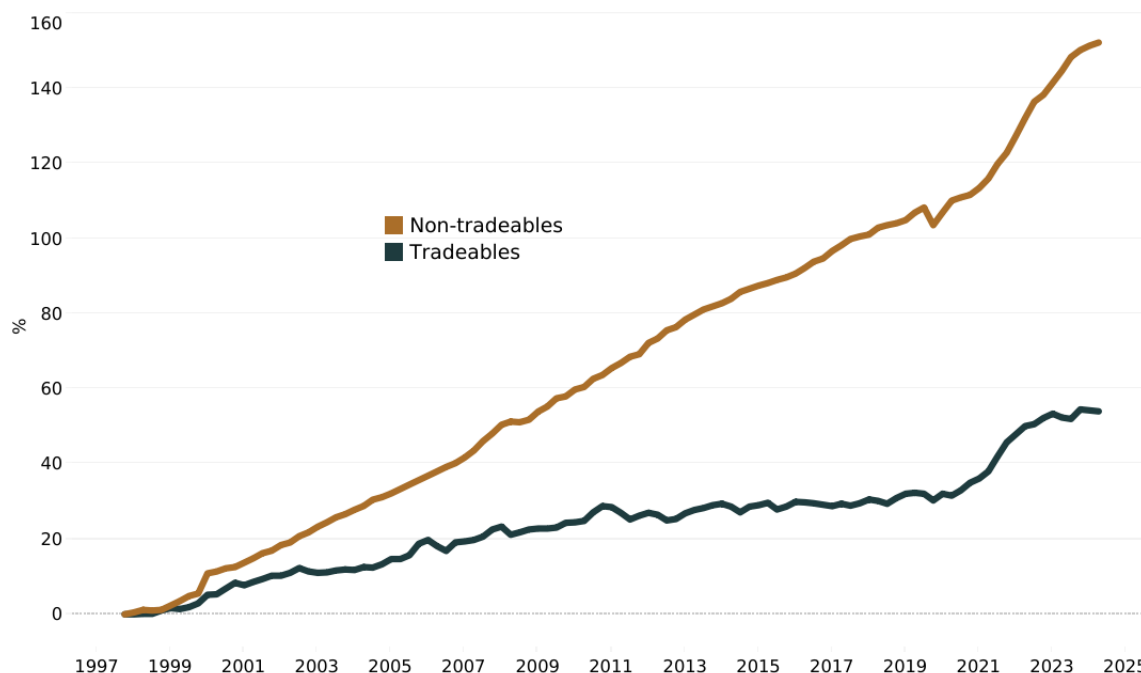
During the 1980s and 1990s, Australia increased its openness to trade, as it lowered tariffs, deregulated the financial sector, entered into trade agreements and reformed some industries.

Explaining the rationale behind these reforms, the then prime minister, Bob Hawke, [spoke about tariffs](#) resulting in:

Inefficient industries that could not compete overseas; and higher prices for consumers and higher costs for our efficient primary producers. Worse still, tariffs are a regressive burden – the poorest Australians are hurt more than the richest.

Australia’s increasing openness, combined with burgeoning exports from China and other countries, led to reductions in the prices of consumer goods that could be traded. For example, the price of clothing and footwear has decreased by around 55% in real terms over the past 3 decades, making these items more affordable for Australian consumers. The difference in nominal price growth for tradeable and non-tradeable products is shown in Figure 3.

Figure 3 Price increases for tradeable and non-tradeable consumer products



Source: ABS consumer price index and Parliamentary Library calculations.

China has been Australia’s biggest trading partner since 2007, with Australia exporting vast quantities of raw materials to fuel China’s industrial growth, while importing a wide range of manufactured goods. The [China Australia Free Trade Agreement](#) (ChaFTA) has led to [benefits on both sides](#). In 2023, China was Australia’s [top export and import partner](#), receiving 32.6% of exports and providing 20.5% of imports.

The importance of the US-Australian economic relationship, underpinned by the [Australia-United States Free Trade Agreement](#) (AUSFTA) is understated in the trade figures, which show the US receiving 5.0% of exports and providing 12.4% of imports. Accounting for the [2-way investment relationship](#) between the US and Australia, valued at US\$1.6 trillion, the US becomes Australia’s largest economic partner. Including the free trade agreements with China and the US, Australia has [18 FTAs in force](#).

Small open economies like Australia have the most to gain from trade. They lack the economies of scale and market depth found in larger countries, making international trade crucial for accessing a broader range of goods and services.

The global backlash against free trade

There have long been criticisms of free trade, with scepticism emerging for a range of reasons spanning the political spectrum. These criticisms mean that political arguments and identities against free trade have landed on fertile ground, leading to [a backlash that has manifested in changing policies across the globe](#).

Some of the reasons for scepticism towards free trade that have led to the backlash are outlined below.

Perceptions of an uneven playing field

Two competing companies operating within a single economy generally operate under the same conditions. Both are required to adhere to the same regulations on, for example, labour or environmental standards. Both may have the same level of access to subsidies from their government.

But regulatory standards and levels of subsidies differ across borders, which can create a sense of unfairness when competing internationally.

Constraints on sovereignty from international institutions

One of the ways policymakers and international institutions seek to alleviate the uneven playing field concerns is to regulate across jurisdictions. For example, the EU requires its member countries to regulate to ensure its supply chains do not have [human rights abuses](#). The EU also has a series of [standards across products](#) that companies are required to adhere to. This has led to some businesses and people opposing these perceived constraints on their national sovereignty.

Inequality in the gains of trade

Trade has most likely reduced global inequality overall. In recent decades, around [one billion people were lifted out of extreme poverty](#), in part because of the benefits associated with the increase in global trade. However, access to additional markets affects different groups of society differently.

The gains associated with free trade tend to be incremental and dispersed across many people in the form of increased choice and lower costs for consumers. The costs of free trade, on the other hand, are highly concentrated for specific industries and workers, leading to unemployment and regions that become economically depressed. As [academic and author Dani Rodrik](#) points out ‘the consumer price effects of trade can never fully compensate the losers’.

Policies from the backlash

The backlash against free trade has led to a steady increase in trade restrictive policies globally. The International Monetary Fund found that the number of new trade restrictions being imposed has increased over time, with the number of new restrictions in 2022 being [6 times higher](#) than in 2013.

The most direct form of trade restriction is through import tariffs. There are also import and export quotas, which can artificially adjust domestic prices, and tariffs once certain quotas are reached. But there is also a suite of [industrial policies](#) that have a similar effect, in that they give cost advantages to domestic production to make them more competitive. These include:

- market based instruments like direct grants, tax credits, interest rate subsidies, loan guarantees and R&D incentives

- direct provision, which includes tax incentives; export subsidies; government procurement; product standards; state investment funds; infrastructure development and other government programs.

As the [Productivity Commission](#) has said:

These [non-tariff] measures – which can include subsidies, stronger anti-dumping protections or local content rules – also tend to distort economic outcomes and raise prices for consumers and costs for producers.

How the changing environment affects Australia

The downside to the changing trade environment

Small open economies, such as Australia, have the most to gain from free trade. They are also vulnerable to general global declines in free trade and to tariffs on Australian exports.

China is Australia's biggest trading partner, so policies that impact on its economic growth (such as tariffs on Chinese exports) also affect Australia.

The Reserve Bank of Australia (RBA) has [modelled the impact of China-US tariff scenarios](#) on Australia's economy, finding that even in its 'escalation scenario' where the US applies a 40% tariff on Chinese imports, the impact on Australia's economy is a modest 0.2 percentage points over 12 months. It did also note there are downside risks to the scenario results.

The [RBA noted](#) that Australia's floating exchange rate acts as a buffer on some negative demand shocks from overseas, explaining that 'if there is a downturn in the global economy and activity starts to weaken generally, the exchange rate will depreciate and that supports our net exports'.

The silver lining

When tariffs are applied, supply lines across the globe adjust to find the lowest cost suppliers given the new set of constraints.

For tariffs applied directly to Australia, exporters may find other markets to sell their products to as a way of limiting the economic damage. This previously proved to be the case for many Australian industries when faced with [China's trade restrictions](#) that began in 2020 and ended in 2024.

For tariffs applied between other countries, there could also be opportunities for 'bystander' countries to increase exports. After the US-China tariffs were applied in 2018, some countries were able to [increase their exports](#) to the rest of world for products that were subject to the tariffs.

The possibility of benefiting from trade reallocations was also raised in a [Treasury brief](#):

On the other hand, as global supply chains adjust, countries can benefit from trade diversion – the reallocation of trade away from exporters affected by tariffs to those not affected. (p. 3)

How experts say Australia could respond

Governments in Australia initially removed their own tariffs in order to [improve the living standards](#) of Australians. According to the Productivity Commission (PC), ‘modelling suggests that it is not in our national interest to participate in any global tariff war’:

Increasing our direct barriers to trade and investment – even if we did so in retaliation – would come at a high cost to our economic growth and living standards. For example, we estimate that if Australia and other countries introduced a 10 per cent tariff in response to a general 10 per cent tariff from the US, then Australian prices would rise 0.2 per cent.

Further, in the PC’s 2017 research paper on [rising protectionism](#), it concluded:

In the event of a global rise in protection, Australia is likely to face intense political pressure to follow suit and lift its own barriers to trade and foreign investment. Working with a coalition of countries to keep their markets open is a strategy that would make it easier for Australia to resist protectionist pressures. (p. 6)

Free trade agreements, particularly for small open economies like Australia, can be beneficial to Australian living standards. The PC has also stated that better outcomes and public confidence in open markets would be helped by ‘prioritising regional and sector-specific agreements, rigorous upfront due diligence on the impacts of prospective agreements and their net benefits, and better consultation processes’ (p. 92).

Conclusion

In recent history, global trade has been a powerful driver of economic growth, consumer benefits, and international cooperation. Countries like Australia have embraced trade liberalisation, resulting in lower consumer prices and stronger economic ties with major trading partners such as China and the US.

As Australia navigates the uncertain global trade environment, it is crucial for policymakers to understand the historical context of trade and its benefits. Despite the challenges posed by protectionism and shifting global dynamics, the principle of improving living standards for Australians through trade remains.

Further reading

- Dani Rodrik, ‘[A Primer on Trade and Inequality](#)’, *Oxford Open Economics* 3, no. 1 (17 July 2024).
- Alexander Al-Haschimi and Tajda Spital, ‘[The Evolution of China’s Growth Model: Challenges and Long-term Growth Prospects](#)’, *ECB Economic Bulletin* 5 (2024).
- Vu Lam and Ian Zhou, [Australia’s Engagement with Indo-Pacific Economic Initiatives](#), Research paper, (Canberra: Parliamentary Library, 26 August 2024).

- Ian Zhou and Tessa Satherley, '[Global Trade Risks and Opportunities](#)', *Briefing Book – Key Issues for the 47th Parliament*, Research paper, (Canberra: Parliamentary Library, 23 June 2022).
- Stefanie Walter, '[The Backlash Against Globalization](#)', *Annual Review of Political Science* 24 (May 2021): 421–42.

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