COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT STANDING COMMITTEE ON TREATIES

Reference: Australia-United States Free Trade Agreement

FRIDAY, 14 MAY 2004

CANBERRA

BY AUTHORITY OF THE PARLIAMENT

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

To search the parliamentary database, go to:
http://parlinfoweb.aph.gov.au

JOINT COMMITTEE ON TREATIES

Friday, 14 May 2004

Members: Dr Southcott *(Chair)*, Mr Wilkie *(Deputy Chair)*, Senators Bartlett, Kirk, Marshall, Mason, Santoro, Stephens and Tchen and Mr Adams, Mr Bartlett, Mr Ciobo, Mr Martyn Evans, Mr Hunt, Mr King and Mr Bruce Scott

Senators and members in attendance: Senators Marshall and Tchen and Mr Adams, Mr Ciobo, Mr Martyn Evans, Dr Southcott and Mr Wilkie

Terms of reference for the inquiry:

To inquire into and report on:

(a) matters arising from treaties and related National Interest Analyses and proposed treaty actions presented or deemed to be presented to the Parliament;

(b) any question relating to a treaty or other international instrument whether or not negotiated to completion, referred to the committee by:

  (i) either House of Parliament; or

  (ii) a Minister

(c) such other matters as may be referred to the committee by the Minister for Foreign Affairs and on such conditions as the Minister may prescribe.

WITNESSES

Committee met at 9.04 a.m.

CHAIR—I declare open this hearing of the review of the proposed Australia-United States free trade agreement by the Joint Standing Committee on Treaties. The inquiry was referred by the Minister for Trade, the Hon. Mark Vaile, on 9 March, advertised on the committee's web site on 10 March and advertised in the *Australian* on 17 March. The committee wrote to some 200 organisations, advising them of the inquiry and inviting submissions on issues of concern to them. Following usual practice, the committee also wrote to all state and territory premiers and chief ministers and to the presiding officers of the state and territory parliaments, as well as to a list of people who had expressed an interest in being kept up to date with the committee's activities via an email bulletin. To date, 204 submissions have been received, and submissions are available from the committee's web site. Details are available from the committee secretariat.

Before we commence taking evidence this morning, the committee requires that submission No. 117 and submission Nos 119 to 204 be received as evidence and authorised for publication. There being no objection, it is so ordered. The committee is still accepting submissions and would like to remind individuals and organisations that have already prepared submissions that any additional comments they may wish to add to the evidence received at public hearings are welcome. The committee has also received several exhibits, most of which have been authorised as the inquiry has progressed. The committee would also like to authorise the remaining exhibits received today—exhibit Nos 14 to 16. There being no objection, it is so ordered.

During the process of the inquiry the committee has heard evidence in Sydney, Melbourne, Hobart, Adelaide, Perth, Brisbane and Canberra. The committee has been interested in the opinions and concerns of Australians, both individuals and organisations, who have provided written submissions or appeared as witnesses before it at these public hearings. The committee hopes that the evidence received today will complement the information and advice it has received to date. Further, it hopes that today's evidence will assist the committee as it concludes its program of public hearings and proceeds to complete its report concerning the proposed free trade agreement between Australia and the United States.

[9.07 a.m.]

HUMPHREYS, Mr John, Research Economist, Centre for International Economics

STOECKEL, Dr Andrew, Executive Director, Centre for International Economics

CHAIR—To commence the day's proceedings I welcome Dr Andrew Stoeckel and Mr John Humphreys from the Centre for International Economics. On behalf of the committee, I thank you for appearing again to give evidence today, to supplement that given on 3 May. Although the committee does not require you to give evidence under oath, I should advise you that the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House and the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. I understand that Dr Stoeckel does not wish to make any further introductory remarks, so we will proceed to questions. Is that correct?

Dr Stoeckel—I have already made my introductory remarks so, in the interests of time, please go to questions.

CHAIR—Thank you.

Senator MARSHALL—Can I take you to table 7.2. One of the things that jumps out at me that I would like you to expand on is the figure you give for employment in the leather products area. That is on page 85. Am I right in assuming that, under the employment heading, you predict a six per cent increase in labour employment in leather products as a result of the agreement?

Dr Stoeckel—Correct. That is an outcome of the modelling.

Senator MARSHALL—This just does not seem to fit in. I do not have any studies to back this up, but my own experience in these sorts of manufacturing industries is that leather is actually significantly on the decline in terms of employment and the growth of the industry. That is one of the things that actually jumps out at me and just does not seem to sit with what I expect to be the reality in the workplace. Could you explain where those figures come from?

Dr Stoeckel—It is driven, first of all, by the barriers that we are removing. If you also have a look at table 3.3, the outcome of any model is driven, first of all, by the inputs to the model—the shocks.

Senator MARSHALL—What page is that on?

Dr Stoeckel—It is on page 13. That is one thing, and then also there are the parameters and so forth of the model. As a point of clarification, first, just keep in the back of your mind the fact that those changes in 7.2—you have six per cent—are changes from the baseline. So, supposing the leather industry was declining at, say, 12 per cent—supposing there was a 12 per cent decline in the leather industry happening over the next 20 years anyway—what this is saying is that the decline would now be only six per cent. So this does not mean to say that the industry is

necessarily going to expand or contract or whatever: that depends on the baseline. Now go to table 3.3 and have a look again. What is happening here is that we have a very large—9.1 per cent—tariff on leather products in the United States.

Senator MARSHALL—Okay. At 7.2, when you add all that up there—

Dr Stoeckel—So, going to 7.2, that is quite a large change, and if we see the removal of a large tariff then that is the sort of change we may get in leather products—and it would reflect also the fact that Australia has a comparative advantage, potentially, in leather products, particularly on the supply side. It would also partly reflect the linkages between that—notice also that bovine meat products expand, so we will end up producing more cattle in this country so there will be a greater supply of leather as well.

Let us just go through the mechanisms here. Even if we did not do anything on leather, supposing we did something advantageous or America tomorrow woke up and said, 'Look Australia, you can have free and open access to the beef market.' That is our single biggest item of merchandise trade with America. That would be great news for our beef farmers. They would get busy, and we would supply and grow more beef in this country. Apart from our live cattle—which is a significant part of it—most of our beef is processed here, and so we would produce more hides and so forth. So as we produce hides, we are going to produce more leather. Some of this would be shipped off and processed offshore and some would be processed onshore and so forth. But—even if there were no change in the leather products industry—with the greater supply of leather, that industry would expand anyway, because in these models they are all linked. You cannot have one change in one area and no change in another area. That is particularly why we use these models where we capture all these linkages and flows between them.

On top of that we also have the removal of a barrier in leather products, and that would tend to lead to an expansion of trade. So there are favourable things happening on the supply side and on the demand side—on both sides of the equation—and they are working together. Keep in mind again that this shows change from the baseline—change from what would otherwise be the case. So this does not necessarily mean that the industry will expand six per cent, if the industry is already contracting.

Senator MARSHALL—Then what is the cumulative effect of this table? The reason it jumps out at me is that six per cent is the second highest figure on that table, and it is significantly higher than the average, and the only other one that beats it is the 8.4 per cent for other manufacturers. So how is the cumulative effect of this table then used to make other assumptions? Because, if the figure for leather, for instance, was wrong, and you took away that six per cent, that would actually impact significantly on the cumulative effect of that table.

Dr Stoeckel—Are you worried about the cumulative effect of the output or the employment?

Senator MARSHALL—Primarily what I have missed in this study, which I thought we were going to get when we talked about this last time—and it is not your fault; DFAT indicated that they would ask you to do this detailed work—is what I am very interested in, particularly in the manufacturing sector, which is the impact on jobs in regional industries: to know what we can expect and what we might have to do to accommodate those skills needs et cetera.

Dr Stoeckel—Right. First of all, in that employment column the cumulative effect of all those employment changes is zero, because in 20 years time it is still assumed that there will be full employment. There is what you might call a natural rate of unemployment, so full employment to an economist is a number like 5.5 per cent or whatever.

There is always unemployment, but there is a natural rate of full employment, if you like. If I am working as a wheat farmer I cannot be working as a leather products processor, or I cannot also be simultaneously working in the tourism industry. So, what happens when we do a change is that resources move around an economy and it is the more efficient use of those resources, people working in more productive areas, that is where the gains come from—that capital and labour are used in those areas where Australia has a very good advantage. By taking off and removing a barrier to leather products and also having a greater supply of raw material, because the beef industry simultaneously expands for other reasons, that has an advantageous effect on the leather industry and more people would be engaged in leather products.

Senator MARSHALL—But the reality is that it is not a seamless transition.

Dr Stoeckel—It is not a seamless transition.

Senator MARSHALL—That is what I am concerned about. It is okay to have the economic model that assumes full employment, but if you have an automotive parts worker, for instance, in the northern suburbs of Melbourne, they do not seamlessly work into greater employment opportunities in the—we will not say the sugar industry—beef industry in northern New South Wales. That does not happen without lots of government assistance and training. They are the things that I am interested in: the actual real impacts and what we may need to do and consider.

Dr Stoeckel—I understand, Senator. A better representation of the real impacts would then be on chart 6.7. As you now become, perhaps, a bit familiar with this, we have used two economic models or frameworks—that is on page 79. The reason we use two frameworks is because we do not have the ideal framework that captures everything. The results in table 7.2 that you were just looking at were from the GTAP model. That is a model that has a very large degree of disaggregation for a lot of sectors and so forth, but it is a real model. It has no finance sector, it has no borrowing or lending behaviour—which is kind of real world stuff—and it has no time. Therefore, we can take only a snapshot view in 20 years time, after all the changes and everything has worked its way through and all adjustments have been made. Do not worry about how you got from A to B; that is the long-term answer. You start to think, 'That is not that good, is it?' In some ways it is not, but that is the best world standard that the World Bank and other people use.

On top of that, though, we use this other framework called the G-cubed model, developed by Professor Warwick McKibbin, and Peter Wilcoxson. That model takes into account the dynamic path. It models a financial sector, borrowing and lending behaviour, and it fully integrates it with the real sector. Because it then models time it is capable of capturing the adjustment costs and what might happen to employment, so it incorporates that real issue that you cannot just go from A to B without cost. There is an adjustment cost in that model. Also, it can reflect the fact that, in the real world, if things are growing and we do something advantageous to the economy and things expand and businesses want to hire more workers, initially they just put on more people and this unemployment pool just dips a bit and we, possibly, have more participation. But, then,

what happens over time is that people say, 'We are in high demand. I am going to ask for a slightly higher wage.' So over time real wages start to increase, which is a good thing. The whole purpose of an economy is so that benefits go to people. That is the only reason why we have an economy.

Senator MARSHALL—Is that right?

Dr Stoeckel—Absolutely. That is the whole purpose of it and that is why wages are such a big issue. What else do we do all this activity for? In chart 6.7 there is this more aggregated lot with only 12 sectors. It has got agriculture, energy, mining, services, construction and so forth. The chart shows—in that little tiny dip, which is infinitesimal—that there is in fact this tiny, little drop and there is not that much gain in the initial period because there are adjustment costs.

In the first year of this agreement you would not see an enormous amount of gain because there are adjustment costs, but there are also some immediate benefits as well. They kind of cancel each other out a fair bit. That grows over time. As people move, adjustment costs become less over time and more investment takes place, the economy expands and grows. There is a gain to employment—initially not much—but then that gain dissipates as real wages start to catch up over time. Businessmen say, 'It has got more expensive to hire workers,' and you go back to your natural full-employment rate. The economy settles down over 20 years back to some sort of natural rate of unemployment.

Senator MARSHALL—Does the information at 7.2 feed into 6.7?

Dr Stoeckel—No. A bit of information in 6.7 feeds into 7.2. Because that model does not have as neat an investment story, we use the information we have got from the G-cubed model, which is by far the neatest and more theoretically correct and advanced model. The trouble is that we have to solve things for 50 years because, once you have time, you have to have expectations because that affects behaviour. If we expected the price of toothpaste to double next week, do you know what we would do on the way home from work tonight? We would go to the shop and buy a few tubes. Expectations of the future affect today's behaviour as well. We have to solve this over very many time periods. Then the model becomes very large, which makes it very hard to get that detailed sector information, and so we have to resort to the second model to get that detailed sector information. The problem is that we do not have the ideal framework. That animal does not exist. It probably will and we will probably have it in six months time, but it does not exist today.

Senator MARSHALL—All right. I will ask one more question on the graph. Coming back to what I said earlier, I accept what you did say about how, if the industry might have been in decline and this slows the decline, that will be seen as a growth. That may well be the case but, if that six per cent in employment was substantially wrong, would that figure have corrupted any of the information or general outcomes, or would it have only been a minor change?

Dr Stoeckel—Then you have to consider how big that leather industry is and how many people that is. I do not have that information off the top of my head but, if that has changed from a small base or a small industry, that can also give you large numbers sometimes because the industry is not that large. It will have an impact, but only to the extent that it is a significant industry. If it is a minor industry in Australia, which is only 1,000 people or something like that,

and if you had a six per cent change, then you have only an additional 60 workers hired in leather products. Those 60 workers can be employed throughout the rest of Australian industry. Leather is going to be a very small industry compared to some of those industries down the bottom such as insurance, finance, business services and so on.

Senator MARSHALL—So they are there as headings because of the tariff treatment in the agreement rather than the size of the industry. You would not pick up every possible player within the industry.

Dr Stoeckel—No, you cannot. And, as you say, it is still aggregated. To know what actually happens in the leather products industry, the best thing to do if you wanted that would be to go along and measure the leather industry specifically, look at it and build its own separate model, accounting equations and so forth. There is trouble with that approach. Firstly, to do that for every industry becomes an enormous task and, secondly, those partial models assume that everything else is held constant. The trouble is, everything else is not constant. With an agreement like this, the whole purpose is to change a whole lot of tariffs and prices and so forth—so everything else changes.

So the price of motor vehicles and utilities is going to change, and that has an impact on leather products. The price of hides is going to change because there is going to be more beef produced. That has an impact on leather products. The price of accountancy services will change. There are lots of changes. They are all very small effects—you can see from some of those price effects in the right-hand column 'Local price'. Everything starts to change, and one has repercussions for another sector. The cleverness of these models today is that they do encompass and incorporate all those interactions. Where we are not so confident is in specific parameters and specific circumstances of the leather industry and so on where we are still capturing things at a pretty broad level.

Senator TCHEN—I have a couple of short questions. You have described your models, which are very comprehensive. It is a very comprehensive matrix of cross-sector relationships. Would you say that the outcomes of your projections are always as expected, or do you quite often have outcomes that are unexpected?

Dr Stoeckel—Sometimes you do get unexpected results. For example, a good one would be the result we got on investment. It is not unexpected in the direction of the effect. Everyone here knows that the economy is going to grow and expand, so that is okay. But, initially, we thought the size of the effect looked large. Whenever you get an effect like that that you do not expect, standard professional procedure is to go back and explain it, and that is what we do. So, first of all, we had a particular box and detailed an intuitive explanation of why a small change in the equity risk premium could give such a large effect in the economy—and it was because we reduce the price of capital. So in chapter 6 on the results we gave a little intuitive explanation of this.

For example, you could explain the Asian boom and the miracle years in Asia as happening because the equity risk premium people decided it was safe to invest in Asia. Money poured into those economies. Then the Asian financial crisis happened when people said, 'Hang on. This is not sustainable,' and investors took fright and the equity risk premium changed by 500 or 800 basis points. It was a very big change and then there was a huge drop. They started using the 'D'

word around Asia—depression. We had 40 per cent drops in GDP in some countries and so forth. So small changes in that cost to capital can have very large repercussions. So that is at an intuitive level. The third thing we did was to go back to the model and say, 'Can we explain it in terms of the equations in the model behaviour?' And that is appendix C.

Economists say, 'Let's forget all the complications and wrinkles. Can we just work our way through a simple example here on the back of an envelope and explain whether it is a reasonable effect and whether the model is working correctly?' That is what we have done in appendix C. We are now satisfied that we do have that effect. That gives us an insight. It comes back to whether we believe removing those restrictions on investment will lead to a change of 0.05 percentage points and whether we get that change in the equity risk premium in the cost of capital in Australia.

If you are not familiar with modelling, you then have to use your intuition and think it through from first principles. You look at the inputs to that bit of analysis, look at chart 4.1 on page 26 of the CIE report and think, 'Gee, Australia is the fifth most protective, restrictive country in the OECD area on foreign investment. On this graph, we are shown as nearly 10 times more restrictive than the United Kingdom.' That is recent information. You then think, 'Australia's Productivity Commission methodology, which is an advance on the World Bank's methodology, is being used here to measure these restrictions and get an index of them. That's okay. Why has the OECD gone to the trouble of measuring these things in the first place? Do they matter or not?' That is where we pull up a bit short.

There are very few analyses of the removal of these restrictions on foreign investment because, again, there are not really any models and so on. To integrate a financial sector with a real sector there is only really one framework on the frontier, and that is that G-cubed model. It is a world-class framework and it is used by reserve banks and so forth around the world. We are using that framework. You have to ask, 'We have all these restrictions, but do they matter?' The intuitive answer is that we would not have been looking at them and the OECD would not have been looking at them if they did not matter in the first place.

You then have to start to work through how big this cost of capital could be. You give a line of reasoning there and start to trawl through the literature and the research to see what the spread is between Australia's return on capital and that of other places like America, which is the largest investor in Australia anyway. You then argue, therefore, that we will see a very small reduction in the cost of capital. It is tiny, but economies are sensitive to small changes in the cost of capital because it affects everything. I would not want to die in the ditch and stake my whole professional reputation on five basis points being the reduction we might see. Some people could argue it might be as high as 20 points; other people could argue it would probably be as small as two points.

So you do sensitivity analysis between that range, weighted and biased towards the two points and the five points end, where you think it could be. You think it will probably be very small and probably be down that end. Then you report all results. You present them all and present the arguments. People think, 'Does that sound reasonable? What do we think? We think it is smaller than this,' so you will get a smaller number. That is the fundamental chart. As I said before, one of the key charts in this whole report is chart No. 3, that diagram of where the most probable

effect of this agreement on the Australian economy will be. That is the kind of procedure and thought process we go through.

Senator TCHEN—Thank you, Dr Stoeckel, that is certainly a very comprehensive, very well-traced process. Given that you test your model outcome that way, can you tell us whether the laugh test is reliable?

Dr Stoeckel—You dismiss that, because we followed standard procedure here. We gave a back-of-the-envelope estimate and so on. The point about that is that people say there is no effect, that it is zero, but zero is a number, as I explained before. This clearly shows that it has a big effect. If you were going to argue that the effect will be zero—and I am happy to have that debate but I am yet to see anything concrete written down on why there will be no effect at all—you would want to make sure that you were very clear on that as well, because you could be making a very large mistake on that side. That would not pass the laugh test either.

But, if I were philosophically opposed to this agreement or whatever—I did not like it—then the strategy would be to try and, first of all, look at the big components and knock them off, and then start to debate specific little effects and try to highlight a whole lot of little effects that you have not measured yet and so forth. We have not captured everything. We have not captured all the benefits and we have not captured all the costs either. That would be the strategy. But I am pretty confident that in time we will get a considered professional response to this. It will be forthcoming from somewhere. There are a lot of very good professional economists in Australia and that debate will ensue.

Senator TCHEN—Thank you, Dr Stoeckel.

CHAIR—We got Dr Stoeckel back at Mr Adams's request. Do you have any questions, Mr Adams?

Mr ADAMS—Yes, I have, but not just at the moment.

Mr MARTYN EVANS—I am happy to defer to Mr Adams, but I have a point that relates to this very issue that we are just touching on. I want to go back to the point that Senator Tchen was raising, which I assume relates back to page 155, where you have that back-of-the-envelope calculation. That was the point you were discussing with Senator Tchen, wasn't it, Dr Stoeckel?

Dr Stoeckel—Yes—well, it was a more general point. What happens in professional procedure is that, when you get a result, you have to go and explain it. Somebody went to the effort, and in fact this basically comes from some comment from Treasury. Again, you get a result. You first of all show the result and the modelling to the author of the model, who repeats it on his version and everything, so you make sure that everything is working. You repeat it all there. Secondly, you also show it to the Foreign Investment Review Board and Treasury. One of the comments was: 'Gee, that has a big effect. You need to be very clear and give some good intuitive explanation of why you get that effect.' It is one thing to put in a whole lot of equations and mathematical formulae—and there is that help—but we also try and give a more intuitive explanation, again to be helpful, in box 6.2 on page 74.

Mr MARTYN EVANS—It all comes down, in that sense, to the impact that the reduction in the cost of capital has because of the reduction in the risk premium that you impute to the removal of things like the FIRB restrictions under the FTA.

Dr Stoeckel—That is correct.

Mr MARTYN EVANS—That is relatively small, but it is hard to pinpoint exactly what it might be, which is why you offer a range of values but posit a certain figure in the middle as the most likely potential outcome from that. But of course that then implies a certain potential reduction in interest rate premiums that would flow. You have that in the equation on page 155, which appears in those figures in the denominator of the equation. But, where you have the risk premium in the denominator, then of course you also have the figure for the real interest rate—R—in the denominator and I suppose that, in some ways, a similar effect would be achieved if one were to vary the real interest rate.

Dr Stoeckel—Yes—the real interest rate permanently.

Mr MARTYN EVANS—Why permanently?

Dr Stoeckel—Because, with this risk change, we have assumed that if we take some barriers off—a bit like a tariff reduction; the beef market is now open to Australia for all time and we have done that change, so that is the only basis we can do it on—and if we make these changes here, we get a reduction in the risk and that is for all time. The real interest rate has the same effect—if it is a permanent change and there is a difference between the real interest rate and the nominal interest rate. Mostly what is happening in an economy is that the nominal interest rate goes up but it is in response to the inflation rate rising. So the real interest rate hardly changes. It does not change very much at all. But if something happened and we had a permanent change in the real interest rate it would have much the same effect as a change in the risk premium. So it has got to be permanent.

Mr MARTYN EVANS—So you are suggesting that the real interest rate is not changing over time by more than—

Dr Stoeckel—It does not change as much as people think.

Mr MARTYN EVANS—But surely the real interest rate is changing by numbers like 0.05?

Dr Stoeckel—Yes, it does change. We do see economic growth. We see recessions and economic growth from recession to four per cent and even higher. Exactly.

Mr MARTYN EVANS—We have seen significant shifts in interest rate changes—

Dr Stoeckel—These are significant shifts.

Mr MARTYN EVANS—to which you are attributing the same kind of impact over time as you would attribute to the 0.05 per cent shift.

Dr Stoeckel—Yes. The model tends to track that. A lot of other things happen in a model besides just those simple equations. This is just an extrapolation of part of it. Can we work our way through and can you believe big effects? There are big effects from permanent changes in the real rate of interest.

Mr MARTYN EVANS—But is not your view of 0.05 per cent based on market sentiment to some extent? This is a removal of restrictions.

Dr Stoeckel—Correct.

Mr MARTYN EVANS—The removal of restrictions is based on what people think. Apart from when the Treasurer knocked off Shell in relation to Woodside, there is very little action by FIRB to routinely reject foreign investment.

Dr Stoeckel—Correct.

Mr MARTYN EVANS—Australia may have a number of restrictions, as you have correctly pointed out, and I understand that that has an effect, but Australia is not in the business of routinely rejecting foreign investors.

Dr Stoeckel—No.

Mr MARTYN EVANS—Therefore, this must be a perception effect.

Dr Stoeckel—There is a perception effect, yes.

Mr MARTYN EVANS—The Reserve Bank has frequently moved interest rates, so why do the perception effects of changes in interest rates not—

Dr Stoeckel—But most of those interest rates are in the nominal rate.

Mr MARTYN EVANS—But we are talking about the market and perception.

Dr Stoeckel—Yes, but the Reserve Bank changes are in the nominal interest rate. Mostly, they are in response to changes in inflation and inflationary expectations.

Mr MARTYN EVANS—And the market is factoring those out?

Dr Stoeckel—We can never really observe the real interest rate because the real interest rate is defined as a nominal interest rate discounted for the expected inflation. Mostly what we take is the nominal interest rate less the actual, observed inflation. But we never really observe that. The Reserve Bank is adjusting that nominal interest rate in response to changing expectations and actual and expected inflation. So, as that rises, the nominal interest rate goes up and the Reserve Bank tightens monetary policy. But one offsets the other. There is little change, really, in the real interest rate.

Mr MARTYN EVANS—I understand. I believe that. But given that we are hypothesising a change here that is almost exclusively due to market perception about the impact of FIRB—

Dr Stoeckel—Correct. There is a political risk.

Mr MARTYN EVANS—I just find it hard to believe that they are so sensitive to that hypothetical restriction and yet, when the Reserve Bank shifts the actual nominal interest rates, and occasionally real interest rates move, the market is so insensitive to that perception.

Mr Humphreys—It is the perception of risk that matters here. When the RBA changes the nominal rate by 50 basis points, you have to consider what changed perception of risk exists in the market. It is pretty much zero. The risk has not changed.

Mr MARTYN EVANS—But before there is an interest rate move there is a real risk it will move. The market does not know what is going to happen to—

Mr Humphreys—We are talking about risks to the economy and political risks, and these sorts of things do not change when the RBA change their rates. They may, but we have not seen it before.

Mr MARTYN EVANS—But people are not going to say, 'Gee, I won't invest in Australia.'

Mr Humphreys—Fair enough. You have advanced—

Dr Stoeckel—In many ways, it may make Australia more attractive. We think that the Reserve Bank is right on top of this and is doing a good job. The market may well observe that Australia is now a better place to invest in because of very good and clear macromanagement.

Mr MARTYN EVANS—It seems to me your argument is that the market perceives the Reserve Bank to be expert managers of the economy with no political risk but the parliament to be less than that and therefore—

Dr Stoeckel—Correct, and this is why—

Mr MARTYN EVANS—a high political risk.

Mr Humphreys—It does not mean that there is no risk; it means that the risk is not changing. When we see the RBA increase the rate by 50 basis points, if people assume that that means that the RBA is now captured by the government then you will see a change in the perception of risk. But I do not think anyone here would argue that—

Mr MARTYN EVANS—Which would see dramatic changes in the GDP under your model.

Dr Stoeckel—It is a very good point that you are raising. There is a lot of emphasis that goes around financial markets on the independence of the Reserve Bank to make clear that it does not have this political component to it, because it is so important. I suppose you have to think of it generally. I do not know if you have seen that good book by Thomas Friedman, *The Lexus and the Olive Tree*. He describes these foreign investors as sort of like wildebeest grazing over there on the plains of Africa. If there is a little rustle in the leaves, they are off; they go. That is sort of the way it is. People can get a fright very easily. That is an important component of it.

The fact is that the FIRB has only rejected four in five years. They are doing a great job; there is no criticism here of FIRB or anything. But why are those arrangements still there? We had the opportunity to get rid of them all. Why aren't we down there with the United Kingdom? Why are they there? The answer that you have to come to is that foreign investment is politically sensitive.

I mentioned in my first appearance that we were invited to do a study on foreign investment. We called it *Trojan Horse or More Horsepower*. Why? Because the MAI—the multilateral agreement on investment—had been rejected and there were antiglobalisation protesters in the street and so on. The mere presence of those restrictions is kind of like a flashing red light that maybe foreign investment is politically sensitive in this country. A foreign investor in America might say, 'Gee, if we go and invest in Australia who knows what might happen? We might get a government-subsided "Buy Australia" campaign et cetera. Or multinationals might be on the nose. Or we might have adverse rulings and rules changing against us.' That matters.

Mr MARTYN EVANS—But that might all happen without FIRB.

Dr Stoeckel—It can happen without FIRB but—

Mr MARTYN EVANS—Surely the rule of law is a stronger disincentive.

Dr Stoeckel—the advantage of the WTO and all these trade agreements is that it gives it another layer of surety. It ties the hands of politicians and prevents them from changing rules so that they become adverse to business and so forth.

Mr MARTYN EVANS—I understand that point. But what about the ratio of investment covered by FIRB to non-FIRB? Surely the non-FIRB investments are of the order of magnitude, if not double it, of the FIRB investments.

Dr Stoeckel—We looked at that.

Mr MARTYN EVANS—Aren't they? It seems to me—

Dr Stoeckel—It is the rules. There are still the rules and the perception of it.

Mr MARTYN EVANS—But it does seem to me that 'FIRBable' investments are $5 billion and 'non-FIRBable' investments are $70 billion or $80 billion—from foreign sources.

Dr Stoeckel—We have allowed for the proportion of how much investment is caught up in the FIRB in those categories. Those are the adjustments on page 60 or whatever it is.

Mr MARTYN EVANS—Sure. But I do not see how that can have that kind of impact on GDP.

Dr Stoeckel—It is like this: you cannot say that, just because only a small proportion is caught up with FIRB, it has no effect. It is like those wildebeest saying, 'Why are we so frightened? Only four of us got eaten by a tiger last year. Why are we rushing at the first little sound of a rustle?' The facts are that foreign investment is still politically sensitive. There is still

a lot of xenophobia out there. Foreign investors know that and that is one of the criteria they look at. What we are computing here is a very small effect. It is 0.05. The second thing is: how come, over time, that accumulates into such a big amount of action? But then I would equally have to be convinced, if someone wants to argue zero, why—

Mr MARTYN EVANS—But if you are a large fund manager and your investment is 'non-FIRBable', why would you look for a risk premium when you know—and everyone else knows—that 100 per cent of your investment is not subject to FIRB? Why would anyone give you a risk premium if they know that it is not subject to FIRB—when there is no risk?

Dr Stoeckel—I was in Sydney yesterday, invited by a merchant banker to come and talk about this very thing. They informed me that the phone is now ringing, that there is greater interest about investment in Australia since the announcement of the FTA. Their view was that they agreed with this—they think that is important.

Mr MARTYN EVANS—I can understand that in a lot of areas where there is FIRB there would be some relevance in that, yes. My questions are not designed to deny that. Given the opportunity, I would like to see less restriction on some of those areas in a broader context, but my questions are designed to elicit some explanation of why this back-of-the-envelope calculation, as it is—

Dr Stoeckel—Hang on, it is not—

Mr MARTYN EVANS—I am trying to find out more information to explain—

Dr Stoeckel—With respect to the back-of-the-envelope calculation, there are two things. One is that a lot of those variables are changed. 'Back of the envelope' is just intuitive. It is not a back-of-the-envelope calculation; it is from a very sophisticated level of modelling.

Mr MARTYN EVANS—I am a science-background person, so I understand back-of-the-envelope calculations about the universe. I think it is a good idea; I am in favour of those things. That is my theory of how things should be done. But I just have difficulty when I see that FIRB is $5 billion and non-FIRB is $70 billion. Why would people demand risk premiums for an investment which is not subject to FIRB? If I were a merchant banker and involved in an investment and somebody said to me, 'I want a risk premium for an investment that is not subject to FIRB, because of the FIRB risk,' I would say, 'Excuse me, but—'

Dr Stoeckel—It is not just FIRB; there is the effect of the FIRB and its transactions and the perception of it. But, again, it is this whole perception of: 'Are foreign investors really welcome in this country?' That is the key thing.

Mr WILKIE—US foreign investment always has been. I do not think any has been knocked back. There has been a lot of concern expressed—

CHAIR—Hold on.

Dr Stoeckel—We have Invest Australia. We have groups out there promoting investment in Australia and so forth. I accept all that. But it is still undeniable. Foreign investors have different

alternatives and they look at the expected return on their investment. They look first of all at the growth and those sorts of things—and that is a very big issue; that is why there is a lot of interest in China—but they also look at the amount of political risk that exists.

Mr WILKIE—We are specifically talking about the United States.

CHAIR—Mr Humphreys just wants to say something.

Mr Humphreys—One very important point is that we are talking about marginal changes. When we say the political risk is coming down, we do not mean to imply that we have a high political risk vis-a-vis many other countries in the world; we do not. But the fact that we have a low one does not mean that it cannot be lower. We are talking about a marginal change. We are a country that has accepted lots of investment; no-one is denying that.

Mr MARTYN EVANS—And I would support the statement that, because it is low, that does not mean it cannot be lower. I agree with you: yes, it could be lower.

CHAIR—Who would like to ask questions now?

Mr ADAMS—I think you said I asked these witnesses to come back. I do not know if that is actually so.

CHAIR—I thought you were very keen.

Mr ADAMS—It does not matter; I am quite pleased. It is always good to hear Andrew. He has had this 'enormous amount of money that we are going to have invested in Australia' approach to this agreement and the changes that it will drive. But I really wanted to get to the basis of trade agreements—and I know that Andrew is an expert in this—and what drives trade agreements. I think we would take it as given that it also drives domestic change, and one of the reasons for having a trade agreement is for forcing domestic change as well. Is that a given now, in most quarters, politically?

Dr Stoeckel—That trade agreements drive change?

Mr ADAMS—Yes, domestic change within their own economies.

Dr Stoeckel—Change is fundamental to be able to get gains.

Mr ADAMS—You have got to do it to get the gains, and it sometimes forces change.

Dr Stoeckel—If there is no change, there are no gains.

Mr ADAMS—Dairy farmers in my electorate in Tasmania have said to me that, with deregulation of the dairy industry, they lost $25,000 a year. This was about the dairy industry being market driven and having no problem saying to the world: 'We can sell. We are market driven. We want to export.' They are telling me that the only gains they can get out of this agreement are $2,500 a year. What sort of change is this driving in that industry? Where does that industry go in the longer term?

Dr Stoeckel—We have got to work hard on the whole WTO for the dairy industry. Dairy products are one of the very highly protected products in global markets. It is terribly disappointing that the Doha Round is going slowly et cetera, and we cannot seem to convince the French and Germans, who are pretty key groups in Europe, to change. We cannot convince the Japanese to lower barriers to that, and we have found it very hard to convince the Americans to go even harder than what they did on dairy products.

Dairying is an age-old area of sensitivity. Since Australia's dairy industry has become one of the most efficient in the world—which it now is, along with New Zealand's—the only place to go is to get those barriers down. Bilateral agreements are one way that they can come down. Far better still is a multilateral agreement, because a multilateral agreement allows you to attack domestic subsidies, which are also part and parcel of the dairy problem. That is where they have to go; they will either look for new and expanding markets that can exist in China or wherever—

Mr ADAMS—Or our industry will wither.

Dr Stoeckel—No, it will not. Our industry is very efficient and will tend to prosper. Over time, those barriers have tended to come down—far too slowly for our liking—but the industry stands its best chance of prospering if it is most efficient and if we work hard on getting access to those other markets.

Mr ADAMS—All they are doing at the moment is getting bigger—250 cows, 500 cows, 1,000 cows. There is a limit to that.

Dr Stoeckel—There is, but a lot of other firms can do that. You are quite correct—if you and I were going dairying today, we would go out to the block and buy some water licences. We would have a 1,000-cow operation and buy the grain and—

Mr ADAMS—We would corporatise it, wouldn't we—the old family farm?

Dr Stoeckel—No. It would not be like a mum-and-dad operation. We would have a very large, highly automated operation. We would go into a grain area and buy lots of feed grain. This is why the Australian industry, potentially, will do quite well relative to New Zealand. New Zealand does not have the same scope for large-scale operation, nor do they have a large grain based supply industry. That is going to be very interesting, but it is not particularly germane to this free trade agreement.

Mr WILKIE—In chart 7.1, would you agree that you have got trade diversion greater than the welfare effects on trade creation?

Dr Stoeckel—No. In chart 7.1, the relevant numbers are in the right-hand column. What we have done is shown the effects of what would happen if Australia removed its barriers to America. What we provide in all those numbers in the columns—and they are not independent—is a decomposition of the effects.

So what we are doing is this: the first two columns on trade creation are the volume effects alone. They do not incorporate the price effects. So you are only looking at part of the equation. It is just the same as, for example, if I were to say, 'The United States will take an extra $200

million worth of beef exports.' I could break that down and say, 'That is $150 million worth of volume effect, in terms of sales, and $50 million worth of price effect. The price is going to go up because they take a tariff off.' So we just tried to decompose it as a point of understanding of what is actually going on and recognition of the fact that there is some trade diversion. But you have to look at the totality of it.

Looking at that table you can ask whether it would be in Australia's interest to say, 'Hey, America, we think you are a great country and we are going to just remove, on a preferential basis, our barriers against your trade and you do not have to do anything in return.' That would be silly: we would be worse off. But then, if we could convince America, without us doing anything—if we could say, 'America, look, we are a great country,' et cetera, 'why don't you just take all your barriers off for us?'—we would be unambiguously better off. You need to look at a combination of those two things, because that is the trade deal—those first two rows—and that gives you $200 million worth of annual gain, 20 years out.

Mr Humphreys—So, for your benefit, we are looking at the negative $231 million and the positive $431 million on the right-hand side.

CHAIR—I see.

Dr Stoeckel—That is just on the merchandise trade side alone. On top of that, we have some services trade liberalisation. You can see there what that is worth. We have estimated that at $131 million. Also we have achieved some access to the government procurement market, and that is worth $28 million per year. So the really relevant number is that $359 million, rounding to $360 million, per year of merchandise trade liberalisation, as represented by that model. That includes no dynamic effects and no investment effects; that $360 million per year is just from the highly detailed GTAP model.

What does that depend on? You can see that there, I should hastily add, in that sensitivity analysis on page 97, table 8.1. What we have done, as we change parameters and model just how responsive Australia is to different markets and so forth, is grid them all, and table 8.1 shows again where our 95 per cent confidence band is. You can see there in the top left-hand corner that that figure of $365 million is different from the figure of $359 million, because this is basically the mean—an average figure—whereas that $359 million is a point estimate from a particular set of parameters. So there is a slight difference there, because the mean and the mode do not perfectly line up. But you then have that 95 per cent confidence interval. We are 95 per cent sure that, just on the merchandise trade alone, forgetting investment—if you do not like the controversy leave it out and if you do not like dynamic productivity leave it out—that it is between $322 million and $408 million, for the GTAP model.

CHAIR—Thank you. One of the arguments that is sometimes voiced against preferential trade agreements or bilateral trade agreements is that there is some trade diversion involved.

Dr Stoeckel—Yes.

CHAIR—I think it is important that in this table 7.1 when we look down the columns we see that it does say that trade creation is $100 million and trade diversion is $119 million.

Dr Stoeckel—Yes, in terms of part of that—the volume effects—that is what it says.

CHAIR—In terms of the volume effects?

Dr Stoeckel—Yes.

CHAIR—Are those the two numbers that we should be comparing to decide?

Dr Stoeckel—No.

Mr Humphreys—No, you need to have price effects. Maybe it would have been more helpful if we had had a price-included version of that. That would have shown net creation. The terms of trade—the positive $99 million—is higher than the difference between $119 million and $100 million. If you want to pretend that investment does not change—and I do not understand why you would make that assumption either—you can just add up the creation diversion in terms of trade numbers. That would be your basic starting point. Of course, investment does change, so you add in the capital accumulation number. Then you have to take off the foreign income flows. But you cannot just look at the first two columns without considering the terms of trade—otherwise, they mean nothing.

Dr Stoeckel—It is incorrect, and that is wrong.

CHAIR—It is $199 million minus $119 million. Is that right? Trade creation plus terms of trade, minus the trade diversion factor.

Dr Stoeckel—Yes.

Mr Humphreys—Yes, but that assumes that investment does not change at all.

CHAIR—I understand that. Thank you.

Dr Stoeckel—You are looking at $80 million there. The columns are not independent; each one of those rows is separate. You can choose to add or ignore a row but you cannot ignore all the columns of a component because, the minute you take off some tariffs, taxes are involved, there is tariff revenue, the economy grows, there are tax changes and so forth. You have to take account of those as well. In terms of the effects, the right-hand numbers in those rows are very important. But you can say, 'If we didn't do this and we didn't do that, that would be the effect.'

Mr Humphreys—I would like to make one more clarifying point. The capital accumulation we have been talking about in this table is not the investment story we have been talking about previously. This table does not include dynamics. That is also included separately. It has been previously stated that this has dynamics in it, but it has not.

Mr WILKIE—As you know, we took evidence from Professor Garnaut, and you probably read what he had to say. I want to refer to part of the transcript and get your feedback on it. Talking about your modelling, he said:

In that $5.6 billion, the biggest hunk by far is the Foreign Investment Review Board tweaking, the second biggest gain is the billion dollars from trade liberalisation and the third biggest is what is called dynamic effects, which flow from the trade liberalisation. But the dynamic effects depend on the trade liberalisation gains being positive. If in fact the GTAP results in table 7.1 are the accurate reflection of the reality and the trade liberalisation gains are zero or slightly negative, then the dynamic effects are likely to be zero or slightly negative as well, within the logic of the modelling that is applied. So if you have worries about the Foreign Investment Review Board numbers, if you think it is a few tens of millions rather than billions, if you think that the GTAP model, which is better for these purposes, is right about the net gains from trade liberalisation and if you follow through the implications of that for dynamic effects, then—and I am just using the logic of these models, and you can work through the logic in the report, as I did over the weekend—you come up with gains of not $5.6 billion but approximately zero.

Mr Humphreys—I want to say very specifically that Garnaut makes two errors of economics in that—not errors of opinion but errors of economics. Firstly, he says that diversion exceeds creation. We have just gone through that. For some reason, he ignores price. You cannot do that. The second error he makes is part of what you have just mentioned. Table 7 1 looks at the allocative benefits. If the allocative benefit is negative, it does not follow that the dynamic benefit is therefore negative. The allocative benefits and the dynamic benefits are functions of different things; different things determine them. Even if diversion exceeded creation—which it does not—you would still have dynamic benefits.

I think what has happened is that Professor Garnaut may not have actually read our section on dynamics. If he had not read what we have written then what he is assuming would be a very reasonable thing to assume. He thinks that by 'dynamic' we mean 'over time'. That is not what we mean. When you have more import competition, two things can happen. Firstly, in areas where import competition is strong, you shift resources to other areas where you are better. That is a typical gain from trade; this is very standard in every model. Secondly, where you have import competition, you get better at what you are doing. That is what the dynamic productivity story is about.

There is ample anecdotal evidence—Andy and I can each cite a couple of examples of that—but increasingly there is also econometric evidence, and that is what we use for our dynamic productivity gains here. We take it most specifically from the Productivity Commission. I brought this report, just in case you asked, in which Chand and his associate—whose name I have forgotten—make an estimate for the increased productivity that is caused by decreased protection, which is totally different from the allocative gains on table 7.1, and that is what we use to get our dynamic gains. So the short answer is that they are functions of different things; therefore they do not necessarily move together. So he is just wrong there.

Dr Stoeckel—So it is important to realise that, in the real world—let us think about it—if we take off a tariff and then the costs come down in Australia, the local industry has a choice. It can do one of three things: (1) go out of business, (2) cut its costs or (3) differentiate its product and try and command a price premium. What happens mostly is (2) and (3). They cut costs, they change and so forth, and that is the dynamic. This extra competition leads to that.

You would have observed changes. Mr Adams was referring to the dairy industry and going back to closer economic relations with New Zealand. I remember at the negotiations being heavily involved with that and personally directing a lot of the research behind it all. It was all, 'Dairy, dairy, dairy!' It was only when that MOU was signed in that part of the agreement that

the whole agreement got going, but then it was a major stimulus to the Kerin plan and all the other subsequent events in the dairy industry. Dairying in Australia today is one of the most productive, efficient industries in the world, and New Zealand dairy farmers come over here to practise dairying. So that is the dynamic efficiency gain. The industry was highly protected, and the reason it was so sensitive, with the closer economic relations negotiation, was that New Zealand at the time was the lowest cost, largest exporter in the world. The dairy industry here could see a lot of product coming in and flooding and so on. But that was partly the stimulus for that industry to really get its straps together. You have heard evidence from the dairy industry, I am sure.

CHAIR—I am very interested in this area, because I think that looking at how the Australia-New Zealand closer economic relations have developed over 21 years gives us some ideas of perhaps—

Dr Stoeckel—How this might go.

CHAIR—how this one may develop in the future. I would be interested in your comments on what involvement you have had in CER and how you have seen that evolving over 21 years. That is really what I would be interested in. We are also going to be speaking to the department, just for a bit of an overview on ANZCERTA.

Dr Stoeckel—I was involved at a very high level. At the time, I was the head of the Bureau of Agricultural Economics and, of course, we were the chief government research body looking at all the agricultural issues. As I mentioned, dairying was fundamental. Plus, we could see this coming, and we had a whole section just doing this analysis and research.

Over time, and looking at other agreements, the CER is typical. First of all, the agreement was accelerated. There are some things here that are phased in generally, but if you were a betting person you would say that things would probably accelerate. There will be annual meetings and so forth about how this agreement is going et cetera. That is typical. It happened in ASEAN and the AFTA—the ASEAN free trade agreement. Basically, things have got deeper and more integrated, and they have tended to accelerate and lower barriers, and so forth. That has been the tendency for a lot of these agreements, and I suspect that that will happen in this case. But your observations are as good. We have not assumed any of that here. We have assumed that this is what we have got and what we get. And that would put you on the sensitivity analysis. You would think, 'Actually, frankly, we're going to do better than this. This is just one side of it here.'

CHAIR—If we looked at CER, at what it was in 1983 and what it is now, there is obviously much greater liberalisation now compared to 21 years ago.

Dr Stoeckel—Yes, and integration and so on. They are studying it. There is a ministry—I have forgotten which one—that just in the last year has had a report commissioned on that. My advice is that one of the findings is that integration begets more integration. As you integrate, it encourages yet more integration. So I would expect that to be an outcome.

Mr WILKIE—I understand that you did not model the dynamic gains in the first work you did, but you said that you have been able to this time. What has been the change there?

Dr Stoeckel—In the first round, two reports were commissioned. One was a report that we did—and you may be familiar with it—but a second report was commissioned by Alan Oxley at DFAT. It was to do with the relationship, the dynamics and so forth—it was just qualitative. In the meantime, people have started to study these dynamic effects more and they have started to be more confident about how big they might be. My colleague John Humphreys indicated the study from our own Productivity Commission on micro-reform and productivity growth. The World Bank, using the GTEC model and so on, incorporates dynamic productivity effects. The World Bank does this—so it is not unusual; we are not inventing things. But we are not 100 per cent sure of the size of the numbers. We have a bit of a feel for it but, like simple scientists, we would like more information and more research. We look at the research and put in what we think it could be from our own intuitive observation of what has happened in, say, dairy.

I mentioned last time the Japanese beef market. It is the same deal. They liberalised. They went from a 70 per cent tariff in 1991—as part of the Uruguay Round—down to a 38.5 per cent applied rate. Their bound rate is still 50 per cent. That is nearly halving the tariff. Wagyu beef was a big component of their domestic beef production, so what do you think happened when Japan halved their tariff from 70 per cent to 38.5 per cent? That is a big change; it is a big tax to take off. Firstly, you would think that Australia, New Zealand and America would send a lot of beef to Japan—and that is true. But what do you think happened to domestic Wagyu beef production? Did it go down? It actually rose. Over the last decade or more, it has risen. How on earth could it go up? They were getting a lower price, lower tariff protection. So how did it go up? They cut their costs; they adjusted. Small farms went out and big farms came in. They also differentiated their product. They have been able to command a price premium over imported product. They have been able to say that Japanese beef is better. Even though you pay more for it relatively—although the price has come down a bit—the premium, the wedge, between the Australian and the domestic product has risen a bit.

Mr ADAMS—But they also grow it in Tasmania.

Dr Stoeckel—That is right. But that would not be counted as domestic production. I am referring to domestic production.

Mr ADAMS—Actually sending the cows from Tasmania up to Japan?

Dr Stoeckel—Yes, they can send live cattle. All these adjustments happen. Think about that enormous gain in productivity as a result of the removal of protection.

Mr ADAMS—Competition.

Dr Stoeckel—John can tell you the story of New Zealand sheep meat—lamb. We all know the New Zealand sheep jokes. There was a huge reduction in sheep numbers. Sheep numbers came down with the removal of subsidies but lamb production actually went up—bigger animals et cetera.

Mr Humphreys—Productivity moved from one per cent to six per cent at a time when their dollar was appreciating, interest rates were on the up and they removed protection.

Dr Stoeckel—So then you go to your own intuition—have you seen enough examples of this. Even our car industry was protected once. How come it is still surviving when there is less protection? The point is: people adjust. It is picking up that effect. People are reasonably confident. You just have to trust your own intuition. Does the effect exist? We would not want to die in a ditch over the specific number, but you are making a bigger error to say it is zero. Remember always that zero is a number. If Professor Garnaut says there is no such thing, you would very clearly want to have a lot of evidence that there is no effect—that people do not adjust in response to higher competition—and show some evidence why that is the case.

Mr WILKIE—You probably would have read the article in the *Australian* on Tuesday when Christine Wallace made the comment that DFAT's views about the changes to foreign investment are different to the figures that you have provided in the modelling. Why do you think DFAT did not use your figures?

Dr Stoeckel—You will have to ask DFAT that. I think that is also a misreading of what DFAT have produced. It is just taking something out of context. You are obviously talking to DFAT and I would ask them to tell you that. It just illustrates how independent our report is of DFAT.

Mr ADAMS—I want to come back to the chair's point about the closer relationship with New Zealand which works very well with the exchange of people. These things sometimes work well because of proximity. So New Zealand's economy, where they are going, their connection to Australia and our whole constitutional connection in the early days of white settlement and how we developed have all played an important role in that too, haven't they?

Dr Stoeckel—Yes. Certainly, geography is very important and economists do look at gravity models. You will trade more with your closer neighbours than your more distant ones. I should also note that that is why that government procurement gain is so low. Even though it is a very successful and important component, we have basically looked at the Canadian experience and then heavily discounted our experience because we are that much further away than Canada and we said that we are not going to do as well as Canada has been able to. Partly we have been very cautious on that point. It would be easy to find one or two industries in Australia where their gains alone are more than we have estimated there.

Mr ADAMS—The cultural, geographical and historical links we have with New Zealand have also played a very important role in our agreements with them and how they have come together.

Dr Stoeckel—Yes, they have. Culture is always there. That is why England and America are also the biggest investors in Australia: the cultural links and so forth are there.

Mr ADAMS—It is about 50 per cent of our investment, isn't it?

Dr Stoeckel—I think 29 per cent is from America alone. That number is in here.

CHAIR—There being no further questions, I would like to thank you very much for your attendance once more before the committee. The secretariat will forward a copy of the proof transcript of evidence to you as soon as it becomes available.

Dr Stoeckel—Thank you.

Proceedings suspended from 10.23 a.m. to 10.33 a.m.

CHAIR—I believe that the Bundaberg Distilling Company wish to withdraw their submission from the committee's consideration, and that DSICA, which they are a member of, has also made a submission.

Mr WILKIE—Can I suggest that, in light of their request and the reasons outlined in their letter, we withdraw their submission?

CHAIR—We require a resolution that the committee rescinds the motion which authorised—

Mr WILKIE—We should include the words 'in light of their request and the reasons outlined in their letter'—I think it is worth stating that in the motion—before we move on to agreeing to the request to have the submission removed from the evidence.

CHAIR—So the motion is: 'That, in light of correspondence received by the committee and the reasons outlined therein, the committee rescinds the motion which authorised the publication of submission No. 33, from the Bundaberg Distilling Company, and orders that the submission be returned to the author.' That is moved by Mr Wilkie and seconded by Senator Marshall. There being no objection, it is so resolved.

[10.35 a.m.]

DONALDSON, Mr Patrick Joseph, Senior Policy Analyst, Australian Pork Ltd

PLOWMAN, Ms Kathleen Ann, General Manager, Policy, Australian Pork Ltd

CHAIR—Welcome. On behalf of the committee I would like to thank you for appearing to give evidence today. Although the committee does not require you to give evidence under oath, I should advise you that the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House and the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. Do you wish to make some introductory remarks before we proceed to questions?

Ms Plowman—Yes, thank you. First I would like to state that Australian Pork Ltd actually broadly supports the move towards improving our trading arrangements with the US, but we do have a number of reservations regarding recent activities and comments relating to the draft free trade agreement. These include: the implied link between US trade representatives, between the FTA, and changes to Australia's quarantine standards, which are favourable to US exporters, including specifically pig meat; indications that the final import risk assessment for pig meat, released by Biosecurity Australia, was potentially influenced by negotiations with the USA about quarantine outcomes in the context of the free trade agreement and, in particular, the timing and release of the final IRA report; the potential for de facto dispute resolution via the SPS technical working group; and the inclusion of trade representation on the proposed SPS committee and related technical subcommittees.

We believe that the quarantine concessions that have been negotiated in the US FTA are significant and have serious implications for Australia's pork industry and other food-producing industries, and we believe that they will inevitably be extended to other countries. APL are concerned that, combined, these factors could contribute to a reduction in Australia's conservative quarantine standards, a potential outcome the Australian pork industry views as particularly troubling, with far-reaching implications. We also wish to express our support for the proposed measures regarding safeguards, particularly in relation to the requirement that WTO safeguards and bilateral safeguards cannot be applied at the same time. However, we note that within the FTA there is an allowance for safeguard price mechanisms to trigger for US beef and horticulture, in spite of the fact that this is contrary to Australia's own policy position regarding this trade measure. These safeguards are an unfortunate precedent to be set by a committed agricultural trader and leading light of the Cairns Group of free trading nations such as Australia. We therefore urge the Senate committee to take into consideration our concerns. Thank you.

CHAIR—Thank you very much.

Ms Plowman—My apologies: I amend that to 'joint house' committee.

CHAIR—Can you point to anything in the agreement which does affect the risk assessments that Biosecurity Australia will be doing?

Ms Plowman—In the actual agreement, we are concerned that there is trade representation on an SPS committee. Our principal concern is that Australia has always advocated that our quarantine assessments are based on science risk analysis, so our question is: why do we need to have trade representation on that committee? We believe it is unnecessary.

CHAIR—The guide to the agreement, produced by the Department of Foreign Affairs, says that the SPS chapter reaffirms:

> … that decisions on matters affecting quarantine and food safety will continue to be made on the basis of scientific assessments of the risks involved in the commercial movement of animals and plants and their products.

Would you support that principle?

Ms Plowman—I certainly do support that principle. In supporting that principle, what we would be looking for within this agreement, as noted in our submission, would be clarification of those technical issues, but also we would want to have a better understanding of the processes involved. If a product comes up for discussion within that committee, we believe that there should be notification to those industries. We also believe there should be some consultation and communication processes. I believe that would provide better assurance than as it currently stands.

CHAIR—The National Farmers Federation, the Australian Dairy Industry Council and Meat and Livestock Australia do not seem to be too worried about the quarantine sections of the free trade agreement. How does Australian Pork respond to these other peak groups?

Ms Plowman—With respect to the other peak groups, very few of them have undergone a rigorous import risk assessment process recently and I do not believe they have the same depth of understanding as, say, the Australian pork industry or the Australian chicken meat industry. I would also direct the committee's attention to the submission that was provided by the Federation of Australian Scientific and Technological Societies, which raised very similar concerns to ours.

CHAIR—Are you saying that the NFF do not have a depth of understanding of quarantine issues?

Ms Plowman—Obviously when you have been working on an issue as closely as our industry has, you have a much greater appreciation and understanding of the processes involved.

CHAIR—Thank you.

Mr ADAMS—The NFF is made up of bodies such as yours and other groups, isn't it?

Ms Plowman—We are an associate member of the NFF. We do engage with them through a quarantine and animal health technical task force.

Mr ADAMS—We have not imported into Australia any red meat that has come from countries with foot-and-mouth disease, have we?

Ms Plowman—And definitely not BSE.

Mr ADAMS—We would think the red meat industry would play a pretty vocal part when that starts to happen. I want to touch on some of these issues, including the setting up of these technical committees. I think you say in your submission that you believe industries should have an opportunity to look at what those committees are doing. If those committees are making recommendations to change the risk assessment process, you believe that your industry should have an opportunity to be a part of that.

Ms Plowman—I believe that should be the case because of our import risk assessment process. We have a handbook. We have a transparent process apparently within the import risk assessment process. If we were to ensure that continues, I would imagine that would be a necessary function of this particular committee.

Mr ADAMS—I should imagine that the pork industry of Australia is very concerned about wasting disease.

Ms Plowman—We are extremely concerned about wasting disease.

Mr ADAMS—Wasting disease is in America and I understand they have enormous problems with wasting disease.

Ms Plowman—The problem with this disease, referred to as PMWS, is that it will increase your cost of production from, say, 15 to 20 per cent with significant mortalities in your weaners. So, yes, it does add a lot to your cost of production. Australia is one of two countries that are free of this disease.

Mr ADAMS—So we would be in a worse trading and producing position if we ever had this disease in our country?

Ms Plowman—It would certainly make us uncompetitive.

Mr ADAMS—I understand that New Zealand, who have changed their quarantine laws to some degree and now let pig meat be imported, have about 25 pig farms with wasting disease.

Ms Plowman—They identified 26 pig farms in the North Island recently. One of the potential ways to manage this disease—and this is not even agreed—is to slaughter out your herd. Even then that is not guaranteed.

Mr ADAMS—I understand that that has occurred in the last two to three years.

Ms Plowman—That is actually a direct result of their quarantine protocols and swill-feeding arrangements, as I understand it. There is dispute about that.

Mr ADAMS—The concern is that these committees lead to the potential for de facto dispute resolution through the working groups. These groups are trying to work out scientific fact to facilitate trade. Is that how you see these working?

Ms Plowman—I would hope that that was the principal and overarching aim of such a group, but our experience, particularly in relation to this import risk assessment for pig meat which has just been finalised, is that we have concerns that Australia's conservative approach to quarantine is slowly being watered down and that priorities over and above risk analysis are given more attention than is necessary. I believe that the report from the Senate inquiry into pig meat which was released yesterday confirms those views.

Mr ADAMS—That is the Senate Standing Committee on Rural and Regional Affairs and Transport.

Ms Plowman—That is correct.

Mr ADAMS—They found that the disease risk posed by pig meats imported from countries such as the United States and Mexico was too great to import them, I think.

Ms Plowman—That is correct.

Mr ADAMS—So it will be interesting to see. We do not really have much detail about whether these committees have criteria or whatever, as yet.

Ms Plowman—That is our point in our submission: what are their criteria? What are their terms of reference? What are the processes of consultation? What assurances do we have that they are consistent with our own transparent import risk assessment process—and that those processes are based purely on science?

Mr ADAMS—I also just wanted to draw out—because I have had this from several industries—the numerous unsubstantiated claims throughout the FTA negotiation process that Australia's quarantine standards are not based on science. Has your industry association felt that coming through from those negotiations?

Ms Plowman—From those specific negotiations? There has been some concern that they perhaps would not be based on science, if you are referring to the US FTA—

Mr ADAMS—I am.

Ms Plowman—but we have always looked to the government, and principally the Department of Foreign Affairs and Trade, to provide advice and assurances that, in effect, that is not the case. We have to rely on that advice. We are not party to those negotiations, and we can only look, therefore, to statements that have been coming from the US before, during and after these negotiations about Australia's quarantine arrangements. We can look also at the import risk assessment for pig meat process, where we have a final report being handed down before the Senate has made its recommendations.

Mr ADAMS—In your submission I think you have put to us that the final indications are that the final import risk assessment for pig meat released by Biosecurity Australia—in particular, the timing of the release of that report—was potentially influenced by negotiations with the US about quarantine outcomes in the context of the free trade agreement.

Ms Plowman—Yes, we are very concerned about the timing and release of that report. We are also very concerned that the policy determination for the pig meat import risk assessment was made within hours of the appeal panel's finding and before the Senate committee recommendations—even though there was knowledge that this Senate committee was about to make public its recommendations. So these are troubling events for us.

Mr ADAMS—We have started to export more pork out of Australia, haven't we? In Malaysia and other places we had some—

Ms Plowman—Our principal markets are in Singapore and Japan. From 1998, I think, to 2003 our exports have grown from three per cent to 20 per cent, and we are often held up as an industry that is leading the way in agriculture in terms of its competitiveness.

Mr ADAMS—Good. Thank you.

Mr WILKIE—It is a very important industry. I used to have a little piggery, many years ago. I actually studied animal physiology and pig husbandry—not that I married a pig! What I am worried about is this: quarantine is obviously a very serious issue for piggeries because the intensive nature of the business means that if you get a disease in there it is very hard to get rid of without wiping out the entire herd. Did the disease that got into New Zealand come from the United States? How was that brought in there?

Ms Plowman—It is very difficult to verify where it came from. My understanding from my discussions with the New Zealand Pork Industry Board, which is managing this particular disease and looking to slaughter out, is that it is their belief that there was a window of opportunity between where their protocols once stood in relation to disease and swill feeding.

During this time, they have been importing product from overseas, including, I believe, from the US, and that it was swill feeding of cooked product, in the form of pies et cetera, that was fed to pigs. That is one of the windows that has been identified. I believe that the New Zealand MAF may have alternative views, but from my understanding and examination of this I believe that is the most feasible option.

Mr ADAMS—Is swill feeding under review?

Ms Plowman—Although that is under review, I understand that that has been under review for the last two years, because we put in a submission, I believe in January 2002, about our concerns about swill feeding.

Mr ADAMS—And we have no swill feeding in Australia, do we?

Ms Plowman—No. We need to congratulate and acknowledge ourselves for the fact that we do not have swill feeding. It is legislated in the states.

Mr WILKIE—Yes, we banned that years ago. In relation to competition from United States pork, is it true that the United States industry is very heavily subsidised?

Ms Plowman—While the pork industry is not directly subsidised, those subsidies would come through indirect subsidies.

Mr WILKIE—Could you go through those for us? I think it is very important.

Ms Plowman—As you would appreciate, pork is really a value added grain, and grain represents 60 to 70 per cent of our cost of production. When you subsidise your grain imports to the extent that the US does through its farm bill—through corn, soya and wheat—you are obviously going to get a competitive advantage on that particular product. When we talk about pork exports, we are really talking about value added grain exports. You are competing on grain.

Mr WILKIE—Can you expand on that? I want to put that into context. I remember, when I had my little operation, at one stage I think it was Canadian pork that was coming into the country at a lower rate than we could afford to produce it for. So it is very important when you are looking at our market trying to compete with overseas people who are receiving very heavy subsidies.

Ms Plowman—Our problem with the EU, in particular Denmark, and the US—less so Canada—is the fact that they get indirect subsidies. It is unfortunate for us that, when we try to track those subsidies and put value on them, it takes an incredibly long time and a lot of money to collect the data. We are undertaking such analysis, though, because if you want to undertake any countervailing actions you need to have an understanding of those price differentials and why they occur on like goods. Unfortunately, my understanding of countervailing duties as they currently stand is that, if you want to proceed with such an action, it is far easier to do so on direct subsidies. One of the reasons we mentioned the farm bill in our submission was that there has been no account of the benefit and advantage that that provides to US farmers as compared to Australia. Australia has a very low PSE for pig meat. I believe it is around four per cent.

Mr ADAMS—Were those matters raised in the negotiations by our negotiators?

Ms Plowman—My understanding is that that was off the table because you cannot negotiate on your domestic subsidies. Nevertheless, you could still have some real-time monitoring and evaluation of those subsidies, and it should not necessarily be left to industries such as ours to undertake such analysis.

Mr ADAMS—That was my next question—about whether the department is assisting in that to build our case to be able to say, 'We believe these are subsidies going into your industry. We want those removed if we are going to have any free trade as a part of this agreement.' Do you not get that assistance?

Ms Plowman—No, we do not get that assistance at this stage, although I will commend the Department of Agriculture, Fisheries and Forestry—because of the potential crises now facing the pork industry, we are working to look at those areas.

Mr ADAMS—So that is something that could come in the future?

Ms Plowman—Yes, and I certainly urge the government to undertake such analysis of any market anyway because, while we continue to pursue a free trade agenda and while that free

trade agenda influences our own policy with regard to safeguard measures and protection, we need to have a better understanding, as an industry, of where our competitiveness lies.

Mr ADAMS—That is right, but I understand that the Canadian transport system helps the grain in some way as well.

Ms Plowman—One of the reasons they are so efficient is their transport system.

Mr ADAMS—It is subsidised in some way, I understand—there are processes.

Ms Plowman—I cannot directly comment on their subsidies. I have never looked at those.

CHAIR—Was Australia consulted during the negotiations?

Ms Plowman—Yes. I would like to congratulate the Department of Foreign Affairs and Trade for their consultations. We were involved directly with them. We believe that they were very understanding and keen to hear our point of view. We were also involved through the National Farmers Federation consultations as well.

CHAIR—Given that we are now considering the draft text of the free trade agreement, does Australian Pork have a view on whether it should be ratified?

Ms Plowman—If it were to be ratified, we would like to see our concerns regarding the SPS committee examined and included.

CHAIR—On page 4 you have very helpfully made a number of suggestions. There are seven things that you have requested—for example, the APL 'requests that the FTA cover the issue of domestic support'. Based on what you have said, would that involve renegotiation of the treaty?

Ms Plowman—You would have to renegotiate the treaty.

CHAIR—But there are other things that would be consistent with chapter 7 of the agreement?

Ms Plowman—Most certainly. I believe you can include those. I also believe that perhaps a recommendation could go forth with regard to this examination of domestic agricultural support programs.

CHAIR—We have not taken much evidence specifically on tariff lines on pork products. Are they being abolished on day 1 of the agreement when it comes into force?

Ms Plowman—I cannot remember if it was day 1, but we were happy—

Mr Donaldson—That is my understanding.

CHAIR—Is it day 1 for both Australia and the United States?

Ms Plowman—Our tariff lines are so small anyway that they are non-existent. We were very happy with that arrangement, but our point in the submission was that, while we have limited

market opportunities in the US at this stage, we are examining them very closely and that any kind of competitive advantage we might have is negated by the farm bill and the subsidies they provide to grain.

Mr WILKIE—Given that you are concerned about quarantine issues and would support the free trade agreement if they were taken care of, what about the subsidy issues? I would have thought that they would have the equal potential to damage the industry as quarantine. If you cannot compete with people bringing in product cheaper than you can produce it for, surely that is going to be of concern.

Ms Plowman—We would like to see the subsidy issue addressed, but I am also a realist and understand the parameters in which these negotiations can take place. We would therefore be looking to the government for direction in terms of assistance in the analysis that I was talking about and the real-time monitoring of the subsidies programs and, in particular, at the government's view with regard to safeguard mechanisms. It was willing to provide those to the US but not to consider them for its own industries.

Mr WILKIE—That is why I am asking about this. You are agreeing that you can include the concerns you have in one area but not the other. I am suggesting that both should be included because it is an equally important issue. You may be a realist, but if you do not ask, you do not get; you have to ask in order to achieve something down the track.

Ms Plowman—In that case, I would be asking the committee to include those. I would also ask the committee to have a close look at the safeguard mechanisms that are being provided.

CHAIR—Thank you very much for your attendance before the committee today. The secretariat will forward a copy of the proof transcript of evidence to you as soon as it becomes available.

Ms Plowman—Thank you.

[11.03 a.m.]

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

GOSPER, Mr Bruce, First Assistant Secretary, Office of Trade Negotiations, Department of Foreign Affairs and Trade

MACLEAN, Mr Alistair, Assistant Secretary, New Zealand and Papua New Guinea Branch, Department of Foreign Affairs and Trade

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

CHAIR—I would like to welcome officers from the Department of Foreign Affairs and Trade. On behalf of the committee, I would like to thank you for appearing to give evidence today. In order to familiarise itself with the proposed treaty the committee received a briefing from the department on 2 April. The committee is currently in the process of authorising a transcript of this briefing and hopes that this may be able to be finalised later today or in the near future.

Since 2 April we have taken a lot of evidence. We have received over 200 submissions and had 10 days of public hearings. So committee members have certainly been well briefed on the agreement. We have set out a program for the areas that we particularly want to focus on. Time will be limited, so we would ask members and witnesses to keep the questions and answers short as it will be a fairly full program.

Although the committee does not require you to give evidence under oath, I should advise you that the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House and the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. As DFAT have advised that they do not wish to make any introductory remarks, we will proceed to questions. Firstly, I was particularly interested to receive some evidence for the committee on the history and evolution of the Australia-New Zealand Closer Economic Relations Trade Agreement. I have been fairly involved in the health area, and certainly in the food and therapeutic goods areas it seems we are always considering bills addressing closer integration between Australia and New Zealand. I would like to hear some evidence on how that agreement has evolved from when it was first negotiated, when it came into force in 1983, and the steps along the way.

Mr Maclean—As you know, the agreement had its 20th anniversary in 2003. The CER agreement was originally built on a series of preferential trade agreements between Australia and New Zealand, including the 1966 free trade agreement between the two countries. By the late seventies that free trade agreement and its predecessors had led to the removal of tariffs and quantitative restrictions on about 80 per cent of trans-Tasman trade. In March 1980 the concept of closer economic relations—CER—between the two countries was introduced in a joint

communique by then prime ministers Fraser and Muldoon. Then you had the negotiation of the free trade agreement—the CER—which culminated in its entry into force on 1 January 1983.

CER has developed quite considerably in the years since. There have been a number of changes, not just to the CER agreement but also to a number of other agreements that have developed as a result of the CER. The most important was a protocol called 'the acceleration of free trade and goods', which sped up the phase down of tariffs and quantitative restrictions five years ahead of the original schedule. The phase down was completed in mid-1990 and the agreement was signed in 1988, so it brought the whole process forward. That agreement also brought services into the CER from January 1989.

So since July 1990, some seven years after it initially entered into force, all goods meeting the CER rules of origin have been free of tariffs and quantitative restrictions, and there are now very few restrictions on services. Whilst CER is the principal agreement that supports the trans-Tasman economic relationship, there are a number of other agreements and arrangements which have been developed since, some of which I can outline for you now, if you wish.

CHAIR—Yes, please.

Mr Maclean—Of course, there is the CER itself and its protocol of 1988, which I have just outlined. Another very important agreement was one made much more recently, in 1998, called the 'trans-Tasman mutual recognition arrangement'. That is an agreement between the two governments and the governments of the Australian states and territories which provides that goods that can be legally sold in one country may be sold in the other country and that a person who is registered to practise an occupation in one country is entitled to practise an equivalent occupation in the other country. That has been quite an important development in deepening the economic relationship.

An open skies agreement was signed in November 2000 by transport ministers in a memorandum of understanding. It allows Australian and New Zealand international airlines to operate across the Tasman and beyond to third countries without restriction. In addition, international airlines of both countries are able to operate dedicated freight services using what are known as 'seventh freedom rights'. These rights allow a New Zealand dedicated freight carrier to operate services directly from Australia to third countries without operating out of New Zealand, and obviously vice versa for Australian international airlines.

In 1996 there was a customs cooperation arrangement between Australia and New Zealand. It provides for cooperation to harmonise customs policies and procedures, cooperation in criminal offences to do with customs offences and cooperation in resolving issues in administration. That has been quite an important development, especially in terms of the administration of the rules of origin, which underlie the CER trade arrangements.

They are some of the arrangements. I think the Trans Tasman Mutual Recognition Agreement is one of the most important. Right now we are focusing on what we are referring to as third generation trade facilitation issues. We are advancing CER issues like business law reform and tax imputation. Progress has also been made in the regulatory area with the introduction of a joint food standards code and an agreement to establish a trans-Tasman therapeutic products

agency, and you alluded to both of those earlier. There are also other areas of cooperation in science and technology, biosecurity, quarantine, industry, competition issues et cetera.

The Productivity Commission is now reviewing the Trans Tasman Mutual Recognition Agreement, including an assessment of its benefits and possible advantages from greater harmonisation and where we can improve the agreement. As you would be aware, the two governments have signalled their commitment to the further development of a single market between Australia and New Zealand. We will see continuing developments in terms of the cooperation, protocols and arrangements in the future. That in particular is going to take place in the area of competition policy. There is a lot of work under way at present. There is also considerable work under way at the moment to review the rules of origin that underpin the CER. So that will be another area of focus for both the department and the government over the coming months.

CHAIR—Does the department have an estimate of what the benefit has been to Australia and New Zealand over the 21 years?

Mr Maclean—We have consistently observed the fact that the CER remains one of the world's most open free trade agreements. I think the figures point to it having been extraordinarily fruitful in improving and extending trans-Tasman trade and investment links. Since 1983, two-way trade with New Zealand has expanded about 500 per cent, with annual growth of around nine per cent over the past decade. So it outstrips total growth in trade. Obviously the difference in the size of the economies means there are some differences in the relative profiles of Australia for New Zealand, and alternatively of New Zealand for Australia. New Zealand, despite the difference in size, is still Australia's fifth largest market. It takes 5.9 per cent of our total exports—that includes goods and services—and total bilateral trade with New Zealand was more than $16.2 billion in 2001-02, including $3.8 billion in services.

CHAIR—We are considering the Australia-United States free trade agreement and what the figure may be 10 years down the track. Given that we are now looking at a historic period going back 20 years, do you have an estimate of how much the CER has added to the GDP of Australia and New Zealand?

Mr Maclean—Not offhand. No, I could not answer that question at this stage. But I will take it on notice and get back to you.

CHAIR—Thank you very much. Many years ago—perhaps eight years ago—I had a briefing from the Department of Foreign Affairs and Trade and they did have some figures on the increase in trade and also what the increase had been to the economy. Former foreign minister Gareth Evans, writing in his book on Australian foreign policy and giving an overview of CER, talked about the liberalisations that you mentioned but said that it had not included investment because of the treaty of Nara. The treaty of Nara had precluded Australia from including investment. This may be a more general question, but if the treaty of Nara has precluded investment liberalisation between Australia and New Zealand why is it part of the Australia-United States free trade agreement?

Mr Deady—It is probably better that I try and answer that question for you. The issue here, without commenting on Mr Evans's comments there, is that we certainly have taken on

obligations in the investment chapter in the free trade agreement with the United States. We will obviously now be looking to implement those commitments. In any implementation of those commitments, very clearly the government would look at all its international obligations and fully reflect those—the WTO, obviously, but also other trade agreements, such as the Singapore agreement, which is already in force, and the obligations we may have under the Nara agreement. But I do not want to particularly comment on the Nara agreement as such and what those obligations may be. That is something that certainly the government would look at and take into account in implementing the commitments that we have made to the United States.

CHAIR—Does anyone want to ask anything more on Australia-New Zealand?

Mr ADAMS—The evidence that has been given to us is that it is a great thing but we have not got any evidence to show the increase in either economy.

CHAIR—That would be an important figure, principally because we are looking at a proposed free trade agreement with the United States. The Australia-New Zealand free trade agreement is obviously our longest and most integrated one. So in order to give a prospective opinion we are seeking to perhaps draw some evidence from what we know about the Australia-New Zealand agreement.

Mr MARTYN EVANS—That is particularly relevant in view of the evidence we had earlier this morning. The modelling showed—from this morning's evidence from Dr Andy Stoeckel—that the biggest anticipated effect is the reduction in the risk premium. An increase in our GDP would flow from that reduction in the risk premium—as perceived by foreign investors coming into Australia—which therefore would reduce the cost of our capital. This would enhance Australia's GDP in the opinion of the modellers and therefore lead to a large increase over time in Australia's GDP and so to an enhancement in Australia's overall economic welfare.

In the case of the New Zealand relationship that benefit has not flowed because there has been no reduction in the inherent risk premium. One could impute, based on the evidence we had this morning, that there would have been no benefit at all flowing from the CER agreement because the same condition would not have existed. So if one were to examine the evidence from this morning one would have to assume that there had been no benefit whatsoever because there has been no inherent reduction in the risk premium.

CHAIR—Do you have a question?

Senator CHRIS EVANS—My question, based on that evidence from this morning, is that, if you took the assumptions based in the model that the government has commissioned for the US free trade agreement and applied them to the 20-year history of the CER, why would you not therefore assume that the CER has not led to any increase in Australia's economic welfare?

Mr Deady—I certainly do not see that you can draw that parallel from the negotiation with the United States. If you go back 20 years and look at the relative tariffs of Australia and New Zealand at that time, the deregulation and liberalisation that has occurred in that period would certainly be a factor in any sort of modelling that you had to do.

The fact is that we do have now in Australia in 2004 a much more open economy than we had 20 years ago, in 1983, so very clearly the trade impacts of reducing those tariffs in Australia—the impacts that would have fed through, through liberalisation et cetera—I think would be much more substantial, just on that basis alone. So I do not think you can draw that sort of conclusion from the fact that we have taken on some commitments in relation to investment in the US. Investment was not specifically part of the CER 20 years ago. I do not think that is a conclusion you could draw.

Mr MARTYN EVANS—But aren't we then using totally different bases for our assumptions about the benefits that flow from the two agreements? Aren't we conveniently using totally different sets of assumptions about why benefits will flow from the two sets of agreements?

Mr Deady—I do not believe so. We are looking at the drivers of these models, and I think one of the attractions of the work of the CIE was that it did identify effects in those three categories, if you like: the trade liberalisation effect, the direct effect of the tariff cuts in both countries; then these dynamic gains that the modellers believe also can be generated as part of that; and then—the third element—the reduction in the risk premium and what that would mean, in the modellers' views, for future investment in Australia. But, again, I would have thought that the very size of US investment is also a factor in these things.

I think it is very hard to draw a comparison 20 years on between the tariff, the trade profile and the industry profile we had in this country at the time and what we have now and say that there would be no gains for New Zealand because investment was not part of the agreement. Again, I do not think there is any evidence of that. The gains are very clear in terms of the very significant integration of the two economies and the 500 per cent growth in trade that Mr Maclean talked about. I think they are very significant outcomes.

It is very difficult. As Mr Maclean said, I am not sure either what, if any, precise modelling or economic analysis type work has been done on the CER. But, again, stating the obvious, when you are looking back like that there are so many other factors that impact on the economic relationship and the developments in both countries in that time. As I say, we will certainly look and see what work, if any, has been done that we can share with the committee.

CHAIR—Before we go to any further questions, I think we might move on to economic modelling.

[11.22 a.m.]

BROWN, Mr Nick, Assistant Secretary, Trade Analysis Branch, Department of Foreign Affairs and Trade

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

GOSPER, Mr Bruce, First Assistant Secretary, Office of Trade Negotiations, Department of Foreign Affairs and Trade

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

LEGG, Mr Chris, General Manager, Foreign Investment Policy Division, Department of the Treasury

PARKINSON, Dr Martin, Executive Director, Macroeconomic Group, Department of the Treasury

CHAIR—I welcome the witnesses who have come to the table.

Mr Legg—By virtue of my position as General Manager, Foreign Investment Policy Division, I am also the executive member of the Foreign Investment Review Board. Unfortunately, I am not the expert on the modelling. My modelling colleagues are on their way and should be here within a few minutes.

Mr WILKIE—I have a question on foreign investment, then.

CHAIR—We will ask a question and, when they do arrive, we will move to economic modelling.

Mr WILKIE—I just need to find the question that I had.

Mr ADAMS—The modelling that we have seen from Dr Stoeckel and the Centre for International Economics has this enormous plus from investment that will flow from the changes to our present arrangements. How much growth would that be? What would that give the Australian economy—five or 10 per cent growth?

Mr Legg—That is a question in regard to which my colleagues who are coming are probably more expert. They come from the macroeconomic side of Treasury; my role is in implementing foreign investment policy. I could make one observation, though, on the conversation I came in halfway through, which is this issue: if there is no risk premium effect of the CER, is there no impact on investment? I will just make the additional observation, if I may, that, whilst there

may not have been a risk premium impact directly in the way that is being measured in the CIE study, one would expect there to be impacts on investment as a result of investment related to the broader trade relationship. So there would be other ways in which an agreement which did not explicitly mention investment would have an impact on investment decisions and would therefore be expected to have an impact on economic welfare.

CHAIR—Thank you.

Mr Deady—That is a very good point—I should have mentioned that earlier. I would add that the Singapore agreement would again be a good example of that. We are making commitments to Singapore on investment and vice versa that improve the certainty for investors and all those things that go along with these free trade agreements.

Mr ADAMS—We have a situation where any country investing in Australia has the weight of our law behind them. What is their risk now and when did we last knock something back—Shell and Woodside or something? Why is this great tendency of their not investing now and with the change, this big flood that is going to come from the US?

Mr Legg—I think this issue goes to whether or not we believe the CIE report. I guess that is what you are asking, and I would like to answer it in this way: we have always believed that the Foreign Investment Review Board processes and the screening arrangements have to impose a cost. There must be a compliance cost associated with this. There must be some impact on the risk premium, to the extent that investors have great uncertainty as to, first of all, whether they will be able to get in and, also, if they want to sell that investment later, whether they will only be able to sell it to Australians or other foreigners would be able to buy it. So there must be some impact. I am not aware that we have ever tried to measure that.

Both sides of politics in government have tried to strike a balance between minimising those costs and being still able to protect the national interest. I guess we had reached the view prior to having the benefit of the CIE study that we had got that as well-balanced as we could, so we were comfortable that we were treading the right path there. I would be untruthful if I said I was not surprised by the CIE study, but I am surprised in the positive sense in that it is something I do not want to dismiss. I think reasonable assumptions have been made by highly respected economists using a reasonable model, so we have to take this seriously and consider that maybe we had understated where we were, if you like, in that balance. It gives us a little more comfort.

We were always comfortable that the agreements we had reached in this were in our interest, but it gives us a bit more comfort that there is clearly a positive benefit from this. One may want to debate the assumptions the CIE have made as to exactly the size of the risk premium and how much of that is due to the Foreign Investment Review Board processes and how much is due to other things. That is a healthy debate. You may say, 'What if they are still being not sufficiently conservative?' and that is possibly the case, but the outcome still seems to be that you will get a materially positive benefit. That is the important conclusion that I reach from this.

Mr ADAMS—Under that modelling it gives us enormous benefit, and maybe Dr Parkinson can comment. Is he the expert now?

CHAIR—We might ask the new witnesses to identify themselves, and then have questions from Mr Adams and then Mr Wilkie.

Mr ADAMS—I was asking about the analysis and assumptions by the Centre for International Economics and that they give Australia this enormous flow of capital post the changes that will come about from the agreement. How big a growth will that give to the Australian economy?

Dr Parkinson—You can use different models and get different—

Mr ADAMS—I know that. We have one that has been given to us. This has been put up as the model—using two models. Everybody accepts the models; everybody says their assumptions are okay and they have put it in there, but it is saying, 'This is what makes this agreement worthwhile for Australia.' The majority of it is to do with investment. That is big bit in this modelling that we have before us. I am asking you how much growth that will give Australia.

Dr Parkinson—I was actually in the process of answering the question.

Mr ADAMS—Sorry; I did not mean to be rude.

Dr Parkinson—You can use different models and get different outcomes, but the very clear message is that, if you liberalise investment and get a change in the risk premium—whether it is five, two or 10 basis points—you are going to generate fairly significant benefits for the economy. On the modelling that CIE has done, you are getting around 0.3 of a percentage point GDP, very roughly. You are getting total benefits of around $6 billion in net present value terms, and 60 per cent of that is a function of investment liberalisation.

Let us step away from the numbers for a minute and ask ourselves: does that seem plausible? As Mr Legg said, we in Treasury have never said that we do not believe the foreign investment rules are costless. We have always tried to strike a balance. This is saying that there is a cost and it attempts to quantify it. We can argue about the assumptions underlying that, but, if they did not have an effect, they would not have a cost. If they did not have an effect, why would we have them? There must be some benefit from removing them.

It is essentially a decision about weighing up whether or not Australia is better off with investment liberalisation as against any increased foreign investment in Australia. It seems to me that foreign investment brings with it huge benefits. You do not have to buy the specific modelling that CIE has done or the specific quanta that they have come up with, but it is very clear that we as a society believe foreign investment is very valuable. Indeed, globally we believe foreign investment is very valuable because that is, in fact, the sort of message that we keep giving to developing countries: open up and engage in freer trade; make yourself more inviting as a place for foreign investment and that will help generate your growth. Developing economies that have done very well are those that have pursued an outwardly oriented approach to development, including investment.

Mr ADAMS—I have not got a problem with that. I am trying to get some sort of idea of where that investment would go in the Australian economy. We talk in generalisations, but we can never get down to saying: 'This is what will happen. It will go into this area.' There is this

assumption that a great amount of money will flow to us because we have changed, and I am finding it difficult to say how it is going to affect the Australian economy—other than for the good, as you say. Motherhood is good as well.

Dr Parkinson—That is a fair comment to make, and it is an issue that—

Mr ADAMS—It is what my constituents ask me.

Dr Parkinson—That is exactly right. It is an issue that the public asks all the time. In a sense, it reveals a problem that we confront when we talk about these issues. Economists cannot identify how particular firms will change their behaviours, and that is really what is going to happen. We know, in aggregate, that there will be changes and that they will be beneficial, but we cannot say that company X will increase its investment in Australia by Y dollars.

If you go back and reprise the tariff debate of the late eighties, we had exactly the same sorts of issues. People said, 'Where will the jobs come from?' and we saw dramatic job growth. This is a far more dynamic, productive and competitive economy than what we had in the 1980s, and it is a consequence of the reforms that were pursued by the then government and have been pursued subsequently. But to ask us, as economists, to identify where specific jobs will be created is, in a sense, very similar to asking us, 'Into which firm or industry will investment go?' You can see that there will be some industries which may be more attractive places to invest because American firms can use them as a stepping stone into other areas. Equally, you could change modelling assumptions and get a different set of outcomes. All I am doing is saying that I can't answer the question.

Mr ADAMS—That is fine. The issue is that, when those changes come, the people who get displaced here—those of us who deal with those issues—need retraining to go there. It is not easy. My colleague made this point very well this morning with an example. It is very difficult to do that unless you have some idea of what is actually happening. We do not seem to get that. We are asked to accept something without knowing exactly the impacts that it will have and how we will deal with these impacts or whether government is going to endeavour to deal with these impacts or not.

Dr Parkinson—This is, in a sense, going to take me away from the CIE modelling per se, but you have actually touched on a quite important issue, which is: when we put in place transitional arrangements, whether it is in the face of structural reform in the eighties or anything else, should governments be trying to identify what industries people should move into? The track record says that we should not because we cannot. What we are much better off doing is helping people get generic skills and then letting them make the decisions. But that is an argument that does not say that you do not have transitional arrangements; it just says that you do not overengineer the transitional arrangements. Your point is exactly right, though. You can identify people who are affected negatively much more easily than you can identify the people who benefit.

Mr ADAMS—Aged workers in Australia are a prime example. There is the issue of identifying them and retraining them—and we have not retrained them into many new industries.

Dr Parkinson—And that is a group that is clearly an area where we have to enhance participation going forward, because of the demographic challenges alone.

Mr ADAMS—We wish Treasury would help us a bit more in that area sometimes. Thank you.

Mr WILKIE—I want to talk to the DFAT group first of all. Christine Wallace put out an article in the *Australian* on Tuesday where she stated that DFAT had a different view of the gains from changes to the Foreign Investment Review Board to the CIE study. Why was that?

Mr Legg—I am actually from Treasury, from the foreign investment policy division. I am conscious of the article that you are referring to. She was quoting a reference in the regulation impact statement, I think. Mr Deady can qualify this or add to this but, essentially, the first cut of that was written before we had the CIE report and it was really in line with what I was saying before: it reflected our established view that we had tried to balance the application of foreign investment policy in a way which would minimise the cost. We felt comfortable that we were doing that and so we were reluctant to claim great gains from this, although we thought the gains would be positive. We then got the CIE report, which was then added into a further version—for procedural regions we did not go back and rewrite it but we put the CIE findings into the report in boxes—and there is an apparent contradiction between those two statements. I guess the point I was making earlier was that we took the CIE study as being an interesting new piece of information which we were not prepared to dismiss. We took it seriously. It said that it was going to be higher than our first inclination might have let us to believe, and we said, 'That is interesting. We will take that on board and say that we are even more comfortable now that the changes we are making are good changes to make.'

Mr WILKIE—But do you think it is valid? We have had CIE firmly say that their modelling is right—as, obviously, they would—but we have had other noted economists say that there may be some increase in foreign investment but nowhere near the degree which is in the model. In fact, Professor Garnaut said that if you looked at the Foreign Investment Review Board gain it would not even pass the laugh test. Then Mr Cutbush came in the next day and said it would not pass the eyebrow test. Those are my words; he said that it raised a few eyebrows. Given that we have other noted economists saying the models are fatally flawed in certain areas, what credence does Treasury then place on the models? Surely Treasury would have done its own analysis?

CHAIR—On that, I distinctly remember Professor Garnaut saying the models were very good.

Mr WILKIE—The models were good but the assumptions were wrong.

Mr Legg—I do not have much to add to my perspective on that, but Dr Parkinson may want to say something about models and assumptions.

Dr Parkinson—I heard Professor Garnaut's comments on the laugh test. He is right that if things do not look and smell sensible one should be very suspicious. But, if you are gaining enhanced access to the world's most dynamic, most competitive economy and to a market of 300 million people, it is very hard for me to think that anybody who says there are no benefits is not failing a laugh test.

Mr WILKIE—In fairness to Professor Garnaut, I think he said there probably would be some benefits but they would not be anywhere near the—

Dr Parkinson—I am actually not thinking of Professor Garnaut in that sense. For the record, Professor Garnaut is a noted economist and a person for whom I have great personal and professional respect. When he says things, I always listen. On this particular issue, though, I think we would agree to disagree. He was making a series of points about the benefits of multilateral liberalisation as against bilateral liberalisation. I think the important issue is really that, if you cannot engage in multilateral liberalisation at the moment, should you work away from benefits—which may or may not be as large as estimated—when they are on the table? That to me has a pretty straightforward answer: you should not. That is not to say that you should not be continuing to focus on multilateral liberalisation; clearly, that is where the biggest gains are going to come about. On the modelling, I go back to the point I made before. The impact of investment liberalisation may be the equivalent of five basis points off the risk premium, it may be more or it may be less. The point is it is going to give you some benefit. In one sense, no matter what the actual number is, the real issue is: if you are ahead of the game, do you want to walk away from it?

Mr WILKIE—You have talked about 0.3 per cent for gains. The budget came down on Tuesday night and I could not find in the budget documents anywhere in the forward estimates any estimates of future gain to the country based on the free trade agreement.

Dr Parkinson—This issue came up at the last Senate estimates hearing. I was asked when we would factor any such estimates into our forecasts. Firstly, I will not do it before parliament and the US Congress has passed the agreement and we know exactly the timing of how it is going to be introduced. Secondly, given the way that we forecast the macro economy, we are never going to identify specific gains that are going to show up from investment liberalisation or trade liberalisation. We are talking about an economy that is likely to grow in the next 12 months by 3½ percentage points. We forecast in a very aggregated sense. We will never be able to, and we will never attempt to, forecast what the economy would look like without the FTA or with the FTA over the next 12 months. You are asking us to count the number of angels on a pinhead. It is just beyond our capacities, and it is not the way in which we would go about forecasting. That is quite different to what CIE was asked to do, which was to take the economy as a benchmark and then see what happens if you add this FTA to it. CIE is not doing a forecast of the Australian economy next year and the year after and the year after that.

Mr WILKIE—You made the comment that, obviously, it has not passed through the House or the Senate yet, nor through the US Congress. I would argue that we factored in the sale of Telstra before that had gone through, but that is another point.

CHAIR—Mr Evans?

Mr MARTYN EVANS—One thing that I related to Dr Stoeckel this morning and which we discussed at some length—and I would like to get your brief comments on this area—and one of the largest factors that he incorporated into his benefits analysis in his modelling, as you would be well aware, was this issue of the reduction in the risk premium and therefore the reduction in the cost of capital and so on to the Australian economy from reducing the perceived risk of foreign investors to the Australian economy and our political risk here. He makes the point that

because it is low it can still get lower, which is certainly an obvious point to make. But, of course, one would observe that clearly there are also significant reductions in interest rates here, and in that denominator of his—the back-of-the-envelope calculation/equation—he also has real interest rates as well as that reduction in the risk premium.

Whether you change that real interest rate factor or whether you change the reduction in the risk premium, mathematically the two are equivalent: you still affect his model in the same way. Of course, we often see changes in interest rates. He makes the point that real interest rates do not change that much over time, but of course they do and he concedes that there is a change periodically—and we are only talking about a very small change here which needs to occur. It is my observation that we are talking about a market perception here, because Australia is not a country that rejects foreign investment frequently anyway, especially investment from the United States. So it is market perception. Given that interest rates change significantly from time to time—the Reserve Bank has changed them in living memory frequently—and given that 'FIRBable' investments are a small fraction of total foreign investment, why is this tiny change in FIRB rules, rather than interest rates which change anyway, going to make such a massive difference in perception? I do not think he really gave us a total answer to this point. I just wonder if you agree with him that this is actually so dramatically significant.

Dr Parkinson—You have me at a disadvantage because I did not hear what Dr Stoeckel said, but when we see the sorts of variations in nominal interest rates that we in Australia have experienced, often what you are seeing are cyclical changes—that is, in a sense the equilibrium, long-run, real interest rate is not actually changing. If you change people's perceptions and change the risk premium through policy change, whether it is through FIRB liberalisation or pursuing a more open, outwardly oriented sets of policies of the sort that, say, we pursued during the 1980s, then that is a reduction that is going to be there irrespective of what is happening to nominal interest rates on a day-to-day basis. So to the extent that you change the risk premium you will actually have a real benefit that goes on irrespective of the level of nominal interest rates today or, indeed, irrespective of the level of real interest rates. For whatever level of real interest rate you would otherwise have, if you can lower the risk premium even if only marginally, you are still better off.

Mr MARTYN EVANS—Even though FIRB impacts on only a small proportion of total capital inflows? FIRB is approximately $5 billion and the total capital investment coming from overseas is in an order of magnitude much greater than that.

Dr Parkinson—I go back to the point that I made in Senate estimates: you have got to make some assumptions. Models are indicative of the real world; they can never capture the full richness. All they can do is sort of lead you in the direction in which things are likely to change. Does that mean that CIE have captured it accurately? Whether it is a reduction of five basis points or a reduction of one or two basis points, you are still going to be better off than you would have been otherwise. It seems to me the additional issue that you have raised that is interesting is the extent to which the existence of FIRB actually leads people to self-censor; it is not so much the extent to which you are able to look at FIRB applications and say, 'We only knocked back X;' the really interesting question is: would there have been more applications without the FIRB arrangements there? Going back to what Mr Legg said earlier, we have always tried to find a balance between the costs that FIRB imposes and the benefits that society believes

that FIRB gives us. The CIE numbers, taken at face value, suggest that they are a different set of numbers than many of us may have believed.

Mr MARTYN EVANS—Surely they suggest that you have been seriously wrong, don't they? Surely they suggest that we have been seriously misled by Treasury over a decade and that it has taken a USA free trade agreement to awaken us to this horrible error, that Treasury have been misleading the parliament and the government of the day and that we should have jumped at this a decade ago, and it has all been a horrible error.

Dr Parkinson—I could take that, but I think Mr Legg might want to say something first.

Mr Legg—First of all, in terms of the amount of the value of foreign investment proposals considered by FIRB related processes in 2002-03, it is actually $85 billion, not $5 billion. It is a significant number.

Mr MARTYN EVANS—Billion?

Mr Legg—According to our annual reports, proposals considered by foreign investment arrangements during 2002-03 value $85 billion, so it is a large number. I think you are exactly right that perceptions are what the risk premium is all about. One practical observation to make in that regard is that the US clearly thought this mattered, because in these negotiations this was one of their biggest targets and what was negotiated fell a long way short of what their ambit claim was at the start of this process. They would have liked to have seen all foreign investment screening relating to any US investment cease, and they argued very strongly that businesses were coming to them saying that this was very important to them. So, there is a perception. We could argue—and we did argue to them—that, in fact, we have a policy which is very friendly to foreign investment, but there are genuine community concerns which governments over a number of periods have endeavoured to manage through this process and that was important for us in building a consensus in favour of foreign investment. That is the role of the FIRB in some ways: being able to deal with the small number of cases that raise national interest concerns and to reassure people that those issues are looked at while still genuinely welcoming foreign investment. We argued that to them, but they were very strongly saying, 'Actually, it really matters to us.' So their perception was that this matters—and, in a sense, their perception, to the extent that it is influenced by their investors, is an important issue.

Your last point is perhaps more rhetorical. I think foreign investment screening has always been an issue of balancing community concerns against the economic impact of those issues, to some extent. We have tried to get that balance as right as we could. I am not saying—and I did not say earlier—that I necessarily think the CIE number is 'the' number—and I would be open to the possibility that they overstated it—but what that analysis tells me is that it is a positive number, therefore, we should take that seriously. We have always assumed it would be a positive number and this reassures me that it probably is.

Mr MARTYN EVANS—Really the benefits of the agreement that we are being told about publicly are fairly dependent on that number in many ways, aren't they? It is a big part of the plus sign and it is somewhat dependent on that. If Treasury is fairly confident that the foreign investment fear factor is actually that high then really Australia has missed out on an awful lot over the last 10-plus years and we should have been alerted to this an awfully long time ago

because Australia has missed out on billions and billions of dollars worth of GDP if these people are right. I suspect there is an awful lot of negligence involved in this—because we should have been alerted to these huge numbers, billions of dollars. Alternatively, the assumptions are wrong and the FTA is worth an awful lot less. One of those two is true.

Mr Legg—There is a third possibility—that is, the model is not a complete and accurate picture of all of the benefits or all of the costs.

Mr MARTYN EVANS—In which case the FTA is worth a lot less.

Mr Legg—No, the model may well not be able to measure some benefits that are real. Models have their limitations. I do not know what was said this morning by the CIE, but there would be a number of dynamic benefits in this agreement which would have a positive benefit—but one they have not tried to qualify. That may well offset some of the things that may have been overstated.

Mr MARTYN EVANS—But then it could have negatives as well and we would not know them—in which case it is not worth knowing about.

Mr WILKIE—If you are saying that some of the assumptions may vary and could give entirely different results—and that really we need to look at a lot more—wouldn't we have been better off having the Productivity Commission do a thorough analysis?

Dr Parkinson—I would like to come back to Mr Evans's point first. I think we need to be very careful in making the sorts of comments that Mr Evans has just made. The OECD has, for a long time, thought that Australia is at the restrictive end of international investment regimes. That might just be perception; it might be that they are totally wrong, but you have a respected international institution saying to Australia, 'You have an investment regime that is restrictive relative to the rest of the developed world.' What we were saying is that we have always understood that the investment regime was not put in place—let me be very clear on this—by the Treasury; it was put in place by governments and has been maintained by governments because governments made a decision that it was appropriate to have that regime. What the OECD has said is that Australia's regime is at the very restrictive end. What the CIE have said is, 'If you change it, this might be a reasonable indicator of some of the benefits that you'll get.' What the Americans have said is, 'There is a perception amongst our firms that your regime is deterring investment.'

Mr MARTYN EVANS—Yes, I am using you as a proxy for the government because I cannot get the Treasurer to sit where you are sitting.

Dr Parkinson—Let us go back. When was the foreign investment regime introduced? It was introduced in the 1970s.

Mr Legg—There was something that preceded it, but the current legislation is from 1975.

Mr MARTYN EVANS—Yes.

Dr Parkinson—It was driven by fear. I remember at the time that it was driven by a fear that we were selling off the farm. This is a world, 30 years later, in which there is not that same sense.

Mr MARTYN EVANS—That is right. Times have changed.

Mr Legg—That, of course, may be a measure of the success of the policy.

Mr MARTYN EVANS—FIRB. Exactly.

Mr WILKIE—I would like you to comment on Professor Garnaut's evidence on FIRB. I will quote him. He says:

I would quite like to get rid of the FIRB; I think it would have gains. The gains might be in the millions or tens of millions of dollars a year, but they are not in the billions. The gains will not be $4 billion from a partial removal of FIRB regulation and the lifting of the threshold for consideration of US investments from the current $40 million capital value of the asset being purchased to $800 million. If you follow the logic of the CIE-DFAT report and if you got rid of approval requirements for all foreign investment between $50 million and $800 million—and not just American—you would get gains of over $15 billion a year. If you got rid of the approvals beyond $800 million it would be twice that again—and that is without touching the sensitive industries where we actually do something about foreign investment, like media, broadcasting, civil aviation, banking and Telstra, because the modelling is done on the assumption that none of those things will be touched. I do not think that you can say there are $4 billion gains from the little bit of fiddling around with the American things or four times that from getting rid of all approvals up to $800 million or twice that again from getting rid of all FIRB approvals from non-sensitive ...

He said, 'I don't think you can talk about $4 billion, four times that and eight times that and not laugh.' That was in the context of his not passing the laugh test. What are your comments about that?

Mr Legg—There are a lot of ideas in there, and I think there are probably three things. One is whether the CIE is overstating it, and I have already commented on that so far as I can. The second point is: should we get rid of the FIRB and, related to that, should we get rid of it in its entirety; and, related to that, should we extend these benefits to other countries? All I can say on that is that I cannot comment on what future government policy should be. We have an agreement with the US that retains foreign investment screening but raises the thresholds. That is something which I am starting to do the work to implement if the parliament passes it. I think there will be positive gains from doing that, and I think a genuine government concern is to be able to deal with community concerns about foreign investment. There is no decision as to whether we should do this for others, and it is not for me to speculate beyond that.

CHAIR—Mr Legg, could I ask you a question: if we do ratify the free trade agreement and we have the liberalisation involved with the FIRB, do we have an obligation to offer that same liberalisation to Japan under the treaty of Nara?

Mr Legg—My understanding is that that is an issue for debate, basically. The Japanese may well claim that; but, on at least some interpretations of the Nara treaty, it would be debatable as to whether that is really binding. I am not an international lawyer, but this is my understanding of the situation. Others could perhaps add to or qualify this if I get it wrong. Essentially the Nara

treaty is somewhat dated now, so the language used then to define what is now called the most favoured nation clause is different and somewhat less precise than the sort of language used now. What you have in Nara is actually a national treatment clause which also includes something about non-discrimination. It is arguable that that clause does not extend to pre-establishment arrangements. The FIRB is about pre-establishment arrangements. It is what happens before investors get to set up. So the wording of that clause could well mean that it was never intended to apply pre-establishment but only post-establish.

Then there is a second set of issues which relate to subsequent agreements both parties have entered into which would override that agreement. I am thinking in particular of the GATS, where there is a much clearer most favoured nation clause—of the type we are more familiar with now and where there are clearly agreements as to the limits of that most favoured nation clause. As I understand from the lawyers who tell me those things, the one key principle of the Vienna convention on the treatment of treaties is that a subsequent treaty overrides a previous one if it is dealing with the same thing. We could well have a claim made that the Nara treaty would require it, and we would sit down and talk that through, but I do not think it is unequivocal at this point that that just happens mechanically. I should also note that, as far as I am aware, we have not had that claim made by Japan officially.

CHAIR—Thank you. Are there any further questions on economic modelling?

Mr WILKIE—I have one quick question. You were talking about Japan. We have just received the Thailand free trade agreement. What is proposed in there for foreign investment?

Mr Legg—It is a slightly different structure. There is a positive list and we are not bound to change anything in our foreign investment arrangements for Thailand—beyond the current arrangements. The structure of the agreement is quite different anyway, because it is a positive list as opposed to a negative list, so the structure looks quite different.

We are certainly not agreeing to do anything beyond the current arrangements that we have for Thailand. This was not a big part of the debate for Thailand. As I understand it, the Thai agreement was much more about access in the goods markets. That was the area both parties were interested in discussing. I think many of the normal obligations of most favoured nation status, national treatment and others are in there, but we have reserved, as we have in the past, to protect our ability to undertake foreign investment screening.

Dr Parkinson—Can I go back to Mr Wilkie's point earlier. I think there is one thing we need to be very careful not to lose sight of. I have to be completely honest and say it worries me when we end up having discussions about whether the benefits are 0.3 per cent of GDP or 0.1 per cent or 0.5 per cent. That misses the point. The real issue here is whether there are benefits and whether you want to walk away from them if there are positive benefits. We have our own experience from the 1980s and subsequently to show us that countries that unilaterally liberalise are the ones who gain the bulk of the benefits.

You do not have to go into a trade negotiation process to actually improve your welfare. If you liberalise, you are able improve your resource allocation within your economy and you are able to generate better outcomes. Our history over the last decade shows the benefits of doing that. There is a reason we have among the best performances of any developed economy in the world,

we have had about the best productivity growth and our productivity growth has been at least as good as the miracle productivity performance of the United States. It is because under successive governments we have pursued policies of liberalisation.

To suggest that we will not gain additional benefits from further liberalisation seems to me to fail the laugh test. The question then becomes, as a second or third order issue: what is the actual number? Is it six, is it four, is it 12—who knows, in one sense? You can feed things into different models and get out different results. I think the very strong message is that the CIE modelling uses a respected model. The assumptions are transparent and explicit, and you can vary the assumptions and get different results. The CIE report puts in a range. That range runs from—and correct me if I am wrong—about $1 billion upwards. The debate is circulating around whether it is six, four or some other number. I think the very clear message is that engaging in this way with the world's largest, most dynamic economy, which has 291 million people and 25 per cent of global GDP, is going to have benefits for Australia. Could we get additional—

Mr WILKIE—In relation to that statement, that may be true, but that is what we are here to find out. We are here to look at all the evidence and make a recommendation to the government as to whether we believe that that is a valid argument. We are hearing different evidence. We are hearing evidence that multilateral is better than bilateral. We are hearing that there is a whole range of inputs that we as a committee need to look at before we can make the decision whether we believe this agreement is or is not in Australia's best interest. We have had evidence, for example from Mr Cutbush—no, sorry, I mean Professor Garnaut—who disputes the model. Using the logic in these models, you can work through the logic in the report, as I did over the weekend, and come up with gains not of $5.6 billion but of approximately zero dollars. So there are a whole range of different assumptions being made that we have to consider.

Dr Parkinson—With all due respect, I have been around this game for a long time. I do not know Mr Cutbush; I do not know what he said.

Mr WILKIE—Sorry, this is Professor Garnaut.

Dr Parkinson—I do know Professor Garnaut and I have great respect for him. But I think that, if we get into a debate about whether multilateral or bilateral is the best approach, we are actually missing the point. I am a firm believer, along with Professor Garnaut, that multilateral yields better global outcomes, but if we cannot actually advance multilateral at the moment, the real issue for a small country like Australia is: does engaging in this bilateral agreement make us worse off? I think the answer is indisputable: it does not make us worse off. Does engaging in this bilateral agreement mean that somehow Australia has eroded progress towards multilateralism? We are too small. The extent to which we are not making progress in the multilateral arena is really in one sense neither here nor there from our perspective. Much as we can try, if we cannot get the US, the Europeans and the Japanese to bite the bullet on the big issues for us, there is not much we can do. For a small, open economy, there may be benefits in pursuing a regional approach, even if from a world perspective we all agreed that a multilateral approach was better. That is, in a sense, the dilemma that the committee has to grapple with.

CHAIR—Thank you for that.

Senator MARSHALL—I want to comment on your point that it does not really matter what the figures are because it is access to the biggest economy and there will automatically be benefits. That is a fine argument that economists may use and we have figures on bits of paper that say everything is fine, but I think as parliamentarians we have a greater responsibility and obligation to actually look down the track at the practical and real impacts. We now have 2.2 million casual jobs, and I want to know what it means to skills and to quality jobs. People working in high-skill growth areas actually provide a skills base that can flow on to other industries and that might be abolished or removed, creating lots of part-time jobs in the tourism industry and some sectors. I do not think that necessarily is a great result, but people say, 'It's still a full employment model. It's wonderful. Don't worry. Look at the overall figure.' But the discrepancy between the growing numbers of working poor and the growing numbers of people at the other end has social impacts that we also have to consider.

I think it is important to actually understand what it means in practical terms, because that is what people on the street ask us. They do not really care about the two basis points or five basis points because they do not really understand what that means. They want to know about their employment prospects and the employment prospects for their children. I think we have to take the next step and say, 'What does it mean to people in real terms? What is the impact?' We have to actually spend a lot of time looking at what skills we need in the future. Again, we cannot leave those things up to the market.

I have been involved in industry training boards for most of my working life and we spend a lot of time actually trying to work out what skills we will need based on information that economists give us for a whole range of industry groups, because those skills just are not there already. There is a long lead-in time. We need to understand where this agreement potentially takes us in terms of industry, industry development, the positives, guessing what jobs might be created and also identifying the losers. We have seen huge efforts made to accommodate the losers out of the agreement in terms of the sugar industry, which lost from the point of view that they were not included.

CHAIR—Senator Marshall, are you coming to a question?

Senator MARSHALL—Yes, I am coming to the question. There is no limit on questions, is there?

CHAIR—We want short questions and short answers.

Senator MARSHALL—This is actually quite a short question relatively. What do we need to put in place for other areas that may be directly impacted? There is no question really, but I just wanted to respond in some way and say that we need more and that that is why we need to push you on figures and what it actually means to real people. I invite you to comment on that if you like, but you do not necessarily have to.

CHAIR—You can take that on board.

Dr Parkinson—Very briefly, I think you have touched on one of the big challenges for public policy going forward—that is, how do you actually get an education and training system that delivers skills that people are going to need and are going to be able to use when you do not have

a crystal ball that tells you exactly what the world is going to look like tomorrow? That raises real issues about whether or not our education system is sufficiently flexible and responsive, about whether we have the right sorts of incentives in place for people who acquire skills.

Those issues are germane to Australia's future irrespective of whether or not we have a free trade agreement with the United States. They are not issues—I believe—that should be seen through the prism of a particular trade agreement; they are at the very heart of the issues that Treasury and the Treasurer have been trying to get onto the public record. How do we prepare ourselves for the looming demographic changes? How does one enhance work force participation or at least sustain participation of people at different levels of intensity as they age? How does one actually enhance Australia's aggregate productivity? It comes back to really fundamental questions about education, training and a range of other areas. That is not specifically about this free trade agreement, but I agree with you entirely about the importance of those issues.

Senator MARSHALL—I agree with what you have just said too, except that this agreement does shape the future. Let us accept that. We can argue about how much, but surely it is going to make a difference, because that is what everyone has told us: it is going to make a difference. So we are trying to work out what the actual difference is—how big it is and how small it is. I do not disagree with what you have said either.

Mr WILKIE—The reason the figures are very important for us is that we have a Treasurer out there telling the world that it is wonderful, it is $6 billion, whereas we are getting conflicting reports saying that it could be zero, that it could be a lot less than that. It is important for us to determine whether those figures are accurate or the modelling is flawed in any way, so that when we report to the Australian public they are getting a well-considered and rounded position.

CHAIR—Thank you for that. We will now move on to the intellectual property section.

[12.18 p.m.]

CRESWELL, Mr Christopher Colin, Consultant, Copyright Law Branch, Attorney-General's Department

MACKEY, Ms Gabrielle, Principal Legal Officer, Copyright Law Branch, Attorney-General's Department

CORDINA, Mr Simon, Acting General Manager, Intellectual Property Branch, Department of Communications, Information Technology and the Arts

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

GOSPER, Mr Bruce, First Assistant Secretary, Office of Trade Negotiations, Department of Foreign Affairs and Trade

HARMER, Ms Toni, Lead Negotiator, Intellectual Property, Office of Trade Negotiations, Department of Foreign Affairs and Trade

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

TUCKER, Dr Peter, General Manager, Business Development and Strategy Group, IP Australia

CHAIR—Welcome. In the submissions that the committee has received, and also in the public hearings that have been conducted, there are several issues that have been raised in the chapter which relates to intellectual property. The first issue is that of copyright term extension from 50 years to 70 years. A common theme running through those submissions is that the balance has been tilted in favour of copyright owners and against people who wish to use this copyright material in the public domain and so on. In terms of your answers, this is a very important point that needs to be addressed.

One thing that has been suggested to the committee is that, by taking on obligations for a copyright term extension but without something like the United States' fair use provisions, we have tilted the balance one way, but we do not have the fair use provisions here. Concern has also been raised by people in the software industry and people who use open source software. The concern especially relates to the status of process patents within Australian patents law. This is something that the committee really does need departmental evidence on. I think they would be the major areas: copyright term extension, fair use provision and whether that could be incorporated in the review that is going on at the moment in copyright, and the concern about process patents and what it means for people who are users of open source software. Who would like to address those issues?

Ms Harmer—In terms of the issue of copyright term extension tilting the balance, particularly the issue of fair use, which I understand has been raised by some users, one of the things we were very keen to make clear today—I must say this does not just relate to copyright term extension but to some of the other areas where we may have strengthened copyright—is that we have not just agreed in the text to do that, we have also preserved our ability to make exceptions. We have not specifically adopted US exceptions in the text. We have done something which we actually think is a better outcome for Australia—that is, to have preserved our ability to access exceptions that meet internationally agreed standards.

With respect to copyright there is the Berne three-step test, which is in the Berne convention and the TRIPS agreement. Providing our exceptions meet that standard, we can put in Australian specific exceptions so they may look something more like the US-style exceptions, or we may indeed choose to do something different that we think is better for Australia and the Australian market where we perceive that there is a need to provide more balance. In that way, we actually think that is a more preferable outcome than having just taken exceptions that have been designed for the US market and putting them in place in legislation. In the context of implementation, the process that we are going through now of looking at translating the treaty into domestic legislation, we are certainly looking at the balance and how that will fit within the Australian context and what we consider to be appropriate.

CHAIR—On the issue of patents, there is concern out there and a lot of people have picked up on the idea that we are harmonising. There seems to be a misconception that harmonisation on IP does include adopting US patent law. How would you address those concerns?

Ms Harmer—I understand there has been some concern with our use of the word 'harmonisation'. I think we used harmonisation more closely in our fact sheet, and that seems to have given rise to a concern that we actually mean to adopt US law and practice, word-for-word completely. I want to make it very clear, particularly in terms of the issue of patents and what will be patentable in Australia, that the FTA text is completely consistent with our current law. We will not be changing what it is that can be patented in Australia as a result of the FTA. There will be only one minor change to the Patents Act relating to the grounds for revocation. I think the concerns that some people have had in the open source software industry, particularly with respect to software patents, are actually quite unfounded because it will be pretty much business as usual for IP Australia in terms of the kinds of patents that they grant now and how they go about doing that.

CHAIR—When we explored this a bit more, they seemed to be concerned that our Australian patent law would allow for process patents as well. That seems to be the source of their concern, and I think article 17.9 does include language which could be construed as that.

Ms Harmer—We currently allow for process patents in Australia. The language in article 17.9.1, from memory, very closely reflects the language that is in the TRIPs agreement relating to the scope of patentability. In that sense, it does not require any change to our law. I am not sure if Peter has anything he would like to add, but we do already grant patents for those things.

Dr Tucker—That is correct. Business processes are patentable in Australia and have been for some time. There will be no change there.

Mr WILKIE—Part of the concern was that if they were using software that was patented in the US they would not be able to have access to that without paying for a licence if we harmonised. That was part of the concern as well—it was not just what happened here but if what they were using was patented over there and they then had to pay licence fees for that that they are not paying now.

Ms Harmer—If something is subject to a patent in the US, I am not sure that the situation differs at all under the FTA. If they have some sort of right that applies in Australia, they would have to have a licence for that now.

Mr WILKIE—I understood they were saying that under the open access software arrangements now they use products online to help develop other products that they can then sell. In using those products, they are worried that they may end up being caught up in US patent law to do with those products which they can currently access.

Ms Harmer—And that they may infringe a US patent?

Mr WILKIE—Yes.

Ms Harmer—It is probably important to clarify that patent rights are granted on a national basis. If someone has a US patent and they want to patent in Australia, they will still have to come here and apply for the patent—

Dr Tucker—Yes, that is right.

Ms Harmer—and meet the requirements of the Australian Patents Act. I think some of the concerns may relate to the US patent office and how they may grant patents, but we are not required to take on board any of those practices in Australia.

Mr MARTYN EVANS—The concern about open source software related to the Digital Millennium Copyright Act. If we adopt provisions of the Digital Millennium Copyright Act, that will actually lock up those open source users when they are dealing with what are now products they can freely reverse engineer. At the moment Australia does not have a Digital Millennium Copyright Act. The concern is that under the FTA we will adopt an equivalent of the DMCA. If we adopt an equivalent of the DMCA, then they will no longer be able to legally reverse engineer any product, because of the DMCA. It is contemplated that under the FTA we will adopt an equivalent of that.

CHAIR—Do you want to address that?

Ms Harmer—Let me clarify. Currently we have digital agenda legislation. What the FTA requires us to do is adopt certain elements of the US Digital Millennium Copyright Act, but I think it would be incorrect to say that the FTA requires us to adopt the Digital Millennium Copyright Act. With regard to the elements of that legislation that are contained in the FTA, as I said earlier we have also ensured that there are appropriate balances that we can make domestically. The other point I want to make is that the treaty is not legislation as such. We will be translating that into our own domestic legal framework, and that will need to happen in the context of our own domestic copyright regime. So we will not end up having something which

word for word mirrors the Digital Millennium Copyright Act. I do not know whether Mr Creswell has anything to add specifically.

CHAIR—Which elements of the Digital Millennium Copyright Act are we adopting?

Ms Harmer—There are elements relating to Internet service provider liability—

Mr MARTYN EVANS—That is the take-down provisions?

Ms Harmer—Yes, the notice and take-down regime; and technological protection measures. They are probably the two main areas, and perhaps rights management.

CHAIR—The enhanced measures against copyright infringement?

Ms Harmer—Yes; that is anticircumvention.

CHAIR—Does anyone want to add anything more on that?

Mr MARTYN EVANS—I think the concerns are: are you taking into account the concerns of the open source industry about the inability to take into account those kinds of products and are you intending to address them? Those are the concerns they have.

Mr Cordina—As Ms Harmer said, the obligations do not require Australian to cut and paste the Digital Millennium Copyright Act. They do provide us with a sufficient amount of a flexibility so we can take on board Australia's own legal and regulatory environment and also the interests of our domestic stakeholders. In relation to the area of technological protection measures, as Mr Evans pointed out, we have under the obligations a specific exception which allows for reverse engineering of computer software to develop interoperable products. In addition to that, there is actually an ability to implement our own exceptions, which we would be looking at after a consultation period with various interests. In relation to the technological protection measure part of the obligation, we were given a two-year time frame after the agreement comes into force in which to conduct that type of consultation and to look at achieving the appropriate balance between the rights of owners and users.

Mr MARTYN EVANS—What are the consequences if the US is not ultimately satisfied with the legislation Australia adopts? Say we adopt legislation which ultimately the US feels is not appropriate for some reason. What occurs as a result of that?

Ms Harmer—I think there is a difference between them thinking something may not be ideal and us breaching one of the obligations. The issue really is whether we have implemented those obligations consistent with the FTA, and that is very much what we will do.

Mr MARTYN EVANS—We could presumably implement it, as Australia would intend to do; I do not imagine that we would not intend to implement it. But if at some point after the parliament had finished with it the US felt that the provisions of our adapted copyright DCMA equivalent were not quite what they envisaged they would be—let us say a recalcitrant upper house ultimately amended it in a way which the US felt was not quite what it should be—what dispute mechanism would resolve that?

Mr Deady—There is a dispute mechanism under the agreement. The US would have to allege that we had breached an obligation—that is, that we had put in a place a measure that is inconsistent with the obligations and commitments we had entered into under in this case the IP chapter. That dispute settlement mechanism is a government-to-government process. It would start with consultations. The first thing the Americans would do in a situation like that would be to put their case to us. We would put our case back. If it did go to a dispute process there is a chapter that deals with the mechanism that would deal with that dispute. That dispute settlement mechanism process covers the whole of the agreement.

Mr MARTYN EVANS—So it would fall back to the overall dispute settlement mechanism process, even if it were part of that legislative change?

Mr Deady—Yes. Again, without a precise example it is hard to comment, but if the Americans believed that we were not meeting an obligation under the agreement then they could take that to dispute. As I say, that is the process—consultations first.

Mr WILKIE—Before it got to that stage, would we be including the US in consultations about the framework of our legislation?

Mr Deady—We will be implementing the commitments under the agreement and consulting with stakeholders domestically as part of putting together the legislation required, but there is no obligation on us to consult with the Americans as part of that process.

Mr WILKIE—So the process is, if they do not like what we put in—

Mr Deady—It is a domestic process where we implement the commitments that the government has entered into.

CHAIR—It sounds like most of the concerns, and certainly those relating to the software patents and so on, can be met and explained. On the concerns about the copyright term extension, we do have existing power to legislate for our exceptions. I understand there is a review of copyright going on at the moment. Is the shape of the exceptions—as long as it is consistent with what we have agreed to—something that would be incorporated in that review?

Ms Harmer—Are you referring to the review that is currently under way regarding the digital agenda legislation?

CHAIR—I understand a review of copyright has been announced by the Attorney-General.

Mr Creswell—Mr Chairman, are you referring to the digital agenda review and the report by Phillips Fox?

CHAIR—Yes.

Mr Creswell—I will ask my colleague Ms Mackey to answer the question.

Ms Mackey—The digital agenda review was something that was committed to by the government when the digital agenda amendments were first introduced into the parliament. That

review commenced early last year. As part of that review we engaged an independent consultant, Phillips Fox. They have prepared a report on key aspects of those reforms. That process has occurred independently of the free trade agreement negotiations. There are aspects of overlap between the two processes. To the extent that they are inconsistent, the free trade agreement commitments will prevail over what has been recommended in the Phillips Fox report. The Phillips Fox report is feeding into the broader government review of those reforms. That will have to take account of our free trade agreement commitments as well. So the review that we have committed to under the free trade agreement, in terms of technological protection measures and what exceptions may be able to be put in place under that provision, is a separate process.

CHAIR—Which copyright materials does the digital agenda review encompass?

Ms Mackey—It is written works and other works—

CHAIR—So it does encompass books, paintings, music and films?

Ms Mackey—It covers all works that are covered by the Australian Copyright Act.

Mr MARTYN EVANS—I want to ask about retrospectivity. I can understand the argument about extending the period of copyright; one can always argue about life plus 50—or 40, 60 or 70. It is going to be an arbitrary figure, whatever you pick—one period is as valid as another, I suppose. My question is: having picked a certain period when an artist made the decision to create the work and thus created the economic and cultural values, having defined that period in law, we have now created that economic right. If we arbitrarily extend that period, what is the view, especially in the context of the free trade agreement and the deal we have negotiated with the United States, in terms of our legal obligation to extend that retrospectively to works that are already in existence and already enjoying a copyright period? It is one thing to extend it for works that are created from tomorrow; what about works that are already in existence? Are we obligated under the agreement to extend it for works that already exist?

Ms Harmer—We are obligated to extend protection to works that currently enjoy copyright protection in Australia but we are not obligated to claw back material that has already entered the public domain.

Mr MARTYN EVANS—Where does it say that in the agreement?

Ms Harmer—The provision relating to application to existing subject matter.

Mr MARTYN EVANS—So it specifically covers existing—

Ms Harmer—It is at the beginning of the agreement.

Mr MARTYN EVANS—I accept what you are saying. I remembered the provision about extending it but I was not aware that it actually explicitly covered existing works. So the US was quite explicit about wanting to cover existing works, were they?

Ms Harmer—I will ask Mr Creswell to comment because there are some specific rules relating to copyright.

Mr Creswell—The idea of the application of a new or extended form of protection to existing works is a familiar principle in international copyright treaty making. Most of the treaties and specifically the Berne convention have this principle where a country joins the treaty for the first time. I would also note that the obligation is not to make infringing past acts, so it is not retrospective to that extent. While existing works will acquire the benefit of the extended protection, it will be in respect of future acts.

Mr MARTYN EVANS—Right. And will we also take into account in our preparation of domestic law, when we say we are formulating our own exemptions, that the period that will be extended here will principally affect older works? I am concerned here about universities in particular and educational institutions and the question of location and identification of the people involved. From the representations we have had from universities and libraries, this is going to add significantly to their costs, isn't it, for students and the works that will be involved? It seems to me it will add significantly to their costs in identifying the works involved by people they thought would be now falling into the public domain, so there will be an additional impost on them. Will we be looking at that in terms of adding to our domestic exemptions because we do not have that US fair use policy? I do not know if applying that is really worth a huge amount to our people, but one is concerned about the additional costs to universities and educational institutions. Especially when you look at Australia's history and creative history, that 20-year period could be quite consequential here.

Ms Harmer—Firstly, in terms of the increased costs—and I understand you have had some evidence to that effect from libraries and educational institutions—

CHAIR—We have had evidence, for example, from the Australian Vice-Chancellors Committee. They say that Australian universities spend about $20 million a year on copyright. We have had people representing libraries and quite a lot of academics in the area of IP.

Ms Harmer—I am sure you are familiar with the CIE report, which talks about the possible costs as well. It certainly does not suggest they are necessarily significant, particularly for educational institutions where perhaps a lot of textbooks are actually quite new.

Mr MARTYN EVANS—This obviously is not relating to the copying of textbooks; it is relating to cultural works—poetry and works like that—which would have fallen into the public domain and now will not. They now have to be identified as being copyright and the authors have to be identified, people paid and so on.

Ms Harmer—As I mentioned at the beginning, we are looking at the balance in terms of exceptions as well. Any exceptions we have would apply to those works just as the exceptions that we currently have in our law apply to libraries and educational institutions in those situations. That would be the appropriate way to balance that increase in rights.

Mr MARTYN EVANS—Okay.

Mr Creswell—Can I add that there are statutory licence limitations. I mention this to address Mr Evans's question about the difficulty of tracing right owners. The operation by educational institutions under the statutory licences means that they are able to copy within the limits of the licences and then the effort of tracing is transferred to the collecting society, which has to send

the remuneration to the owner of the copyright concerned, whether that is the original author or a publisher or some assignee.

CHAIR—There are no further questions on the intellectual property chapter. Thank you very much for your evidence on that. As I said in my opening remarks, we have had a lot of submissions so it is important that we deal with it comprehensively in our report. I am sure that in your prior consultations and your travels around the country you would have encountered many of the same issues.

Proceedings suspended from 12.45 p.m. to 1.24 p.m.

[1.24 p.m.]

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

LOPERT, Dr Ruth, Medical Adviser, Pharmaceutical Benefits Branch, Department of Health and Ageing

SMITH, Ms Carolyn, Assistant Secretary, Targeted Prevention Programs, Department of Health and Ageing

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

CHAIR—I welcome our new witnesses. Please state the capacity in which you appear before the committee.

Dr Lopert—I am a medical adviser representing the Pharmaceutical Benefits Branch of the Department of Health and Ageing.

Ms Smith—I am an assistant secretary for the Department of Health and Ageing, but I was a secondee to DFAT during the FTA negotiations.

CHAIR—This is the committee's 10th day of public hearings. We have received over 200 submissions and travelled all around the country. Some of the submissions relate to the Pharmaceutical Benefits Scheme and the review process, so it is important that we address those issues. Would you like to make some opening comments?

Dr Lopert—I have some very brief comments. I have read a number—most, in fact—of the submissions that have been made to the committee and, indeed, the transcripts of some earlier hearings. I am aware of the very broad interest in the review mechanism. I could say at the outset that the nature of the review mechanism has not been established yet because there is a consultation process that has commenced. I will wait to see what particular issues arise in questioning beyond that, if that is all right.

CHAIR—Certainly. In terms of the pharmaceuticals section and the area relating to transparency and so on, will it be up to Australia to shape the review process consistent with what is in the draft text of the free trade agreement?

Dr Lopert—That is correct. There has been some criticism that the text in relation to the nature of the review mechanism is ambiguous, though I would characterise it as indicating a degree of flexibility in that, in developing the way in which we will implement this obligation, it would not be appropriate to define within a treaty level obligation in the document the precise nature of the implementation of that obligation. It is a matter for Australia to develop in

consultation with key stakeholders as a domestic issue, as long as we meet the letter of the obligation contained in the text.

CHAIR—Could you inform the committee about the review process—what sort of time frame is involved, who will be consulted, that sort of thing?

Dr Lopert—I can, although not in great detail. Timing is a matter for the minister to determine. What I can say is that the process has commenced and there has already been some consultation with key stakeholders. It is anticipated that after some degree of consultation with key stakeholders a paper will be developed and circulated for further comment from a broader range of interests. So far there has been preliminary consultation with Medicines Australia, the industry peak body, and the Pharmaceutical Benefits Advisory Committee. There has been some discussion with the AMA; there have been some stakeholder briefings held by the Department of Health and Ageing in which a range of interested parties have expressed views as to what issues they thought were important in developing the implementation of the review mechanism. However, this is very much the beginning of the process and the time frame is not entirely clear at this stage, but it is happening.

CHAIR—If the agreement does enter into force on 1 January 2005, is the review process something that we should have up and running by then?

Mr Deady—Yes, I believe we should have it up and running by then. It is a matter that I think carries an obligation on us to have a review mechanism, so I think the expectation would be that we should have that in place by entry into force.

CHAIR—That means we have seven months for the consultation, the draft and the draft paper. As I understand it, there is no change in legislation required; it can be done within existing legislation.

Dr Lopert—That is correct. There is no intention to change the National Health Act for the implementation of the review mechanism; it will be done administratively.

Mr WILKIE—When you say there is no fixed format for the review process at this stage, what parameters are you looking at within the confines of the consultation? You must be asking people to put forward something. What are you doing with them?

Dr Lopert—There is nothing proposed at this stage. We are collecting the views of the various stakeholders on what sort of form this mechanism should take—what the scope of it should be and what sorts of procedural rules it should operate under. These are things that we believe it is important for our stakeholders to contribute to the development of the paradigm that will operate when the review process is implemented. It is not possible at this stage to pre-empt the outcome of that process; it is still very early.

Mr WILKIE—The committee have a real problem in relation to the evidence we have received because we are getting people who are saying that, if we do not get this review process right, the Pharmaceutical Benefits Scheme could be severely damaged as a result of signing up to the free trade agreement. I am a little concerned that there is no framework for us to look at in terms of how the review process might operate. Pharmaceutical Benefits Scheme board members

have advised me privately that, if we have an open and accountable process, it may actually benefit the Pharmaceutical Benefits Scheme. If we have a process where all the facts and figures that are being put forward are not open and accountable and a decision is made one way or the other, then that decision could be taken by a pharmaceutical company and publicly used to bash the government or the Pharmaceutical Benefits Scheme for not listing a particular product. So it is very important to the agreement that the review process is done right.

Dr Lopert—You have raised a number of issues there, and I will try to address each of them. I accept there is concern that the shape of the review mechanism become known but, as I said, it is important that we do not attempt to pre-empt the input or outcome of the consultative process. It is important that stakeholders feel that they have a role in shaping what the review mechanism looks like.

I have also heard arguments that the implementation of a review mechanism will place additional pressures on the PBAC and PBS. I would argue that pressure of that kind occurs already. When a drug is rejected for listing on the PBS, there is often intense lobbying that is applied to that situation. What this process does is formalise and institutionalise a channel for that. It is important to recognise that there is an opportunity for a review mechanism to enhance the transparency and accountability of the process. I also reiterate the fact that the review mechanism does not in any way undermine the PBAC's role as the only body that can recommend to the Minister for Health and Ageing whether a drug can be listed on the PBS.

Mr Deady—The final point that Dr Lopert mentioned is key, as is the fact that it is a matter for the government of Australia to establish this review. Yes, concerns are being expressed and people are reading a lot into the wording but, if you look at what is there, the government is committed to providing the opportunity for this review, and it is for the government of Australia to establish that.

Mr CIOBO—This ties in with some of the evidence that we heard from the Doctors Reform Society. It is perhaps not a mainstream view, but I think it is important that there is a robust position to answer critics such as that. I take it, Dr Lopert, that you have had a chance to look at the testimony that came from that group, because it ties in with what Mr Wilkie was talking about. I feel that some substance is probably still lacking in how we address concerns such as those that have been raised. On the face of it, they are legitimate concerns to a certain extent.

Dr Lopert—I am sorry; I am not clear what the question is.

Mr CIOBO—I feel we are lacking substance in the way in which the review committee will operate and the parameters that will be in place. Assertions that are put forward by groups such as the Doctors Reform Society need to be more adequately addressed.

Dr Lopert—It is difficult to satisfactorily address those concerns when we are at the beginning of a consultative process that will take on board views of interested stakeholders as to how they believe the mechanism should operate. It is important that we do not attempt to pre-empt that process. It is also important to recognise that some of the concerns that have been reflected in some of the submissions—and I cannot say specifically whether this is one of the ones raised by the Doctors Reform Society—have been about the scope of the review mechanism in terms of who will be able to seek a review and what will be the nature of those

things that may be reviewed. I can say that the review will only apply to those applications where the PBAC has failed to recommend that a drug be listed. That is an important point. The other thing is the issue about who can apply for a review. The text is very clear that a review will be made available to an applicant, and an applicant 99 per cent of the time is the pharmaceutical company sponsoring the application, although in rare cases applications have been submitted to PBAC from other bodies.

Mr CIOBO—So you do not have a preconceived notion? I use the phrase 'merits review' but, given that one of the witnesses raised the issue about the need to specifically look at R&D costs, would you see that being envisaged as part of a review of a decision that it not be listed? Would that be one of the arguments brought in or are they quite separate matters?

Dr Lopert—Sorry, I am a little unclear as to what you mean.

CHAIR—I think what Mr Ciobo is saying is that the evidence we had in Brisbane—it may have been from the Doctors Reform Society—

Mr CIOBO—No, think it was someone else.

CHAIR—They were saying that things like looking at R&D should not be part of the Pharmaceutical Benefits Scheme process—that what they should be looking at is basically the cost-benefit analysis that they do now.

Dr Lopert—That will not change and is not part of the consideration that PBAC applies when considering an application for listing on the PBS.

Mr CIOBO—That is what I am saying. So it is very definitely two separate issues?

Dr Lopert—Yes.

Mr CIOBO—And you would not see that being caught up as part of the review process?

Dr Lopert—No, I do not believe so. What I perceive the review process to be is a second look, if you like—a fresh pair of eyes applied—where the PBAC has made a recommendation of, as we put it, 'failed to recommend' that a drug be listed on the PBS. While not wishing to pre-empt the outcome, my understanding is that it would not be appropriate for a review to consider any facts other than those which had also been put before the PBAC in its original consideration of the matter. The PBAC is not empowered, for want of a better word, to consider the cost of R&D as one of the facts that it considers. Very explicitly—and paraphrasing, if I may, the act—the PBAC may only recommend for listing a drug which is significantly more expensive than a therapy already listed where it provides an increment in health benefit. That is, if you like, the fulcrum on which the whole interpretation of the application pivots and that will still be the case.

Mr CIOBO—That is very important, good to know and reassuring. I understand your point that you do not want to pre-empt what perhaps will be the process of the review and therefore may not be able to provide an overview of what would be incorporated into the review process. Are there examples of witnesses raising with the committee issues that you can say definitively

will not be embraced by a review? The point that you just raised is one such example. Witnesses have said to us, 'Issues such as pricing to incorporate R&D we believe will be subject to review.' Do you understand the point that I am making there? You are saying, 'No, that is not going to be encompassed within this,' and that is actually quite an important point to leave out to the side.

Dr Lopert—As I said, I am reluctant to pre-empt the outcome of the consultative process, but I think it is reasonable to say that the review process will apply a fresh pair of eyes to the issues considered by the PBAC and may perhaps draw a different interpretation from some of those issues. However, the basis on which a review assesses the application must be based on what is in that application, and the guidelines for what is presented to the PBAC and the basis on which an application is made are very clear. It is about comparative clinical benefit and comparative cost-effectiveness, and those are the issues that are considered.

CHAIR—In some of the evidence we have received, they have picked up on being committed to the following principles, in annex 2-C:

1. Agreed Principles

… … …

(b) the importance of research and development in the pharmaceutical industry ...

The concerns seem to be that this is something that should not be considered by the PBS. However, one witness that we had before us said that if it was done the within the industry portfolio, fine, but it is not really something to be done within the PBS. Would you care to comment on that?

Dr Lopert—It is a matter for the industry portfolio to consider the costs of R&D. The PBS is not used as an instrument of industry policy. As I said, the PBS processes confine themselves to considering comparative clinical benefit and comparative cost-effectiveness of therapies as precondition for listing them on the PBS. The PBAC is charged with ensuring that a drug proposed for listing on the PBS represents value for money as it delivers health benefits; it is about outcomes. The R&D component, if you like, should be reflected in the incremental benefit that the drug actually delivers, and that is the extent to which the PBAC would consider that aspect of an application. One of the concerns raised in a number of submissions has been in relation to the emphasis on innovation and R&D in those principles. I would draw the committee's attention to the final principle, which talks about maintaining procedures that value the objectively demonstrated therapeutic value of the product. That is what the PBAC does: it assesses the objectively demonstrated therapeutic value. It is consistent with the current PBAC processes.

Mr CIOBO—It was on this point that I had the debate with the witness in Sydney, whose name escapes me. What you say is reassuring—and I think that most members of the committee are glad that that is the situation—but it is important to get that point across, because there are those in the community, who have appeared before us as witnesses, who have the view that the review process enables factors that are not previously incorporated as part of the PBS but are listed as the objectives of this free trade agreement to then be brought into the review process. To paraphrase you, and as I understand it, it is still confined to what the PBAC looks at. So if the

only way in which R&D, for example, comes into play is by looking at the innovative side of new drugs in terms of the health consequences, and that is the scope with which the review would concern itself and not the pricing side—am I clear on that; is that correct?

Dr Lopert—The review is about when a drug is not recommended for listing—whether or not a review should be applied to whether, in fact, there were issues that could be interpreted in different ways or looked at with a fresh set of eyes.

Mr CIOBO—But effectiveness, not pricing?

Dr Lopert—Yes. It is important to understand that the price of the drug is nominated by the applicant when applying to the PBAC. The question is not whether the price should be lower or higher; it is whether the PBAC considers that it represents value for money at the price proposed. It might be an issue of whether there is a different view as to whether the interpretation of 'value for money' reflected the broader community standard, for example—not whether or not the price was or was not acceptable per se.

Mr CIOBO—It would be exceptionally unlikely that, if a drug were rejected on the basis of it not being value for money, you would have an applicant seek to have the price increased and reapply and use the review process as the mechanism to try to get a price increase. That would be exceptionally unlikely, wouldn't it? In fact, I take it it probably would not even get before the review committee.

Dr Lopert—I think that is a bit speculative, with respect; I cannot—

Mr CIOBO—That is a concern that witnesses have raised. It is not a concern that I have; that is a concern of witnesses such as Ms Ballenden from the Australian Consumers Association.

Dr Lopert—I think it is important to recognise that the review is looking with a fresh set of eyes, as I said, at what the PBAC looked at.

Mr CIOBO—I understand.

Dr Lopert—Generally speaking, where an applicant makes a change, wishes to present new data or wishes to present a change in the price or a change in the proposed restriction, the appropriate avenue to further that is through resubmission to the PBAC, not through seeking a review of a recommendation that the PBAC has already made. That would not be appropriate. The appropriate mechanism is to seek a resubmission.

Companies often resubmit. A submission which is not successful on the first application to the PBAC may very well be successful in a subsequent application because more information has been provided, there has been a change in price or there has been some change in the proposed restriction. It is important to recognise that, where a proposed restriction is very broad, the intended use may be well beyond the scope of the population in which the use of the drug is cost-effective, but by identifying more closely the appropriate patient population you may be able to define a patient group in which the use of the drug represents appropriate value for money. That is a process that goes on now.

CHAIR—We have had a number of submissions already on this. You have had the opportunity to look at those submissions. Obviously there will be the opportunity as part of this review process for those groups to have input. I think the Australian Medical Association, for example, has said that they support the agreement but there are five things that they would like to see in the review process. I hope you will be able to take that on board. There will be the opportunity for all the groups that we have seen to have input. They already have their views on the public record anyway through the submissions and the public hearings. Is there anything further that you would like to add?

Dr Lopert—No.

CHAIR—Thank you. If there are no further questions, we will move on to the next witnesses.

[1.50 p.m.]

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

GOSPER, Mr Bruce, First Assistant Secretary, Office of Trade Negotiations, Department of Foreign Affairs and Trade

MARTIN, Mr Andrew, Negotiator, Agriculture, Department of Foreign Affairs and Trade

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

GREVILLE, Ms Virginia, Special International Agricultural Adviser, Department of Agriculture, Fisheries and Forestry

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Ms Greville—I was involved throughout the FTA negotiations as the representative of Agriculture in both the agriculture negotiations and the SPS negotiations.

CHAIR—Thank you very much. The committee felt it was important to speak to departmental representatives on the quarantine issues. We have found in our public hearings broadly, I think it is fair to say, that most of the peak agribusiness groups are satisfied with the quarantine measures. We did find, when speaking to Tasmanian apple and pear growers, that they had some concerns about the way they understood the quarantine measures, and they also had concerns about the way Biosecurity Australia operates currently with its risk assessments. We had a submission and heard evidence this morning from Australian Pork Limited, and they have raised a number of concerns. We also heard evidence in Sydney from FASTS, the Federation of Australian Scientific and Technological Societies. We are really interested in hearing the departmental response to the concerns that they have raised—so over to you.

Ms Greville—If it suits you, I will make some brief introductory comments which hopefully will cover some of the concerns that I have heard being raised, and I guess we can take it from there. You may have heard other concerns that you want to talk about specifically. From the view of the Department of Agriculture, Fisheries and Forestry and Biosecurity Australia, we are comfortable with the agreement and the provision that it makes for discussions between Australia and the US on quarantine matters as a natural part of our trading relationship. As I think you know, the agreement reaffirms the commitment of each party to the WTO SPS agreement and is very clear that it imposes no new SPS obligations and creates no new SPS rights for either party with respect to quarantine.

Australia and the United States are very important to each other as trading partners, and agricultural trade in each direction is an important part of that trading relationship. I guess it is fair to say that one of the functions of a free trade agreement is to create and manage a closer trading relationship, and that is what this text is about. For a range of reasons, quarantine matters have from time to time been a source of irritation between Australia and the US. This text formalises some arrangements that we have been building up and working with over the last several years which have helped us to better manage those issues.

The agreement establishes two bodies through which the parties will pursue closer cooperation. The SPS committee, which has clear terms of reference in the text, provides a forum for high level policy discussions and facilitates cooperation between agencies. The standing technical working group on animal and plant health actually formalises the arrangement that Biosecurity Australia has already with its counterpart competent authority, the Animal and Plant Health Inspection Service, which is part of the United States Department of Agriculture.

The annex to chapter 7 spells out in some detail the agreement about how this working group will operate. We are very aware that there has been a degree of concern expressed by the community, however defined, about the agreement. This has largely come about, I have to say, because of a lack of understanding about how our arrangements currently work and the extent of WTO members' obligations to each other currently and/or a misunderstanding of what the text actually says. For example, the arrangements do not mean that the US will participate in our quarantine risk assessment policy or decision-making processes, rather they recognise that the interests of both parties—when you are dealing with a technical market access request—are best served if there is early access to the best scientific information available. The working group is a means to facilitate exchange and cooperation to that end.

One of the other concerns that has been expressed is about the involvement of trade officials in this working group. I guess there are a lot of ways you can answer that question. The first is to say that the SPS agreement is actually a trade agreement and, if you were not trading, you arguably would not need to be talking about quarantine. The SPS arrangements within the FTA, as I said before, are based on the SPS agreement and are about managing—as does the SPS agreement—two important objectives: firstly, to support the right of a country to protect its human, animal and plant life and health and, secondly, to ensure that the measures in support of that objective are not applied in a manner which is a disguised or unwarranted restriction on international trade.

In my opinion, it is fair to say that a disconnect between trade officials and scientists can sometimes result in quarantine issues escalating unnecessarily into trade disputes. The inclusion of both in a consultative body can help each to understand better the rules by which the other operates. So if trade officials, for example, do not understand the nature or scale of a particular unresolved scientific issue or the steps that need to be taken before some scientific certainty can be reached on an issue then they may leap to an unfair conclusion that the delays in quarantine decision making are disguised trade barriers. To be frank, Australia is sometimes accused of this in the US and elsewhere, and it may not be in our best interests for such a view to continue to be held. The more trade officials who understand the basis for our conservative quarantine regime—the way that our process works and the rigour with which we assess risks—the better our reputation is likely to be.

CHAIR—Thank you very much. It is my view as well that certainly, as I said, most groups are satisfied. I have the submission from Australian Pork Ltd and I will ask you to respond to some of the things it says. The submission says:

1. APL seeks clarification with regard to the 'technical issues' referred to by US authorities and the details of the framework, including the nature of the trade agency representation and the list of specific products.

Ms Greville—I must say that when I read this I was a little confused about what they meant when they said 'technical issues referred to by US authorities'. Certainly the text talks about technical and scientific issues as being the subject matter of these two bodies, and if that is what they are referring to then I can talk about that a bit. Of course I need to make the point that that is not a reference by US authorities; that is text that has been negotiated and agreed between both parties. The sorts of technical issues we are talking about are the scientific and technical issues which come up in the context of a technical market access request—for example, the range of pests and diseases which are present or likely to be of quarantine importance and the methods of amelioration for those kinds of risks, from a high-level scientific end right down to the most practical way of inspecting or containing product as it crosses the border. So those are the sorts of technical and scientific matters that are likely to be the subject of conversation between the competent authorities on each side—that is, Biosecurity Australia and APHIS.

CHAIR—You have also said that they propose that the role of trade representatives on bilateral SPS bodies be clearly articulated and closely monitored. I will not go on there. Do you have any comment on that?

Ms Greville—As I was saying just a moment ago, it has been raised with us on a number of occasions that some people see it as anomalous that trade officials are involved in these bodies. Our point, as I said before, is that it is really not anomalous at all—what we are talking about are trading arrangements. While they may be present for those conversations and it may facilitate understanding, that is not to say that those trade officials will in any way contribute to or affect the outcome of discussions on matters of science. That is very clearly understood between both parties. I would also like to make the point that neither party—that is, neither the US nor Australia—has any interest in having the scientific and technical matters resolved by anyone other than people with scientific and technical expertise.

Mr Deady—The point Ms Greville is making is a very good point. These are mutual obligations. We have a large number of quarantine issues with the United States. We have set up a process here that I believe has mutual obligation on both sides. It gives us the capacity to deal with access issues that are of concern to Australia in the United States market.

CHAIR—Several of their concerns seem to relate to the technical working group. They propose that, when discussions by the technical working group relate to a certain industry or products, the industry be notified of such discussions. Is that anticipated?

Ms Greville—Probably the best way to answer that is to make the point in the first instance that the arrangements in this agreement about how Australia and the US will consult and cooperate are in every respect in addition to—not instead of—the existing import risk assessment process that Biosecurity Australia goes through, which has at various points significant opportunities for consultation with all interested stakeholders and a very high degree

of transparency in terms of exposure of technical issues papers, documents on the public file and explicit consultation on matters of technical and scientific interest. There will be discussions as a result of this agreement between the competent authorities on technical and scientific matters, which may be of interest to the pig meat industry, the apple industry or whoever. To the extent that those discussions are crystallised into something that is germane or useful to the IRA process, that will be injected into the IRA process and will be subject to the same transparency arrangements and the same consultative mechanisms that the rest of the process is subject to.

Mr MARTYN EVANS—I understand why it is very important that we engage the US on these quarantine issues, I understand the importance of the science based process and I understand the importance of enhancing trade relationships with them based on that and the significance of our existing relationship in promoting the quarantine issues. But if these committees are not going to matter, why do we have them? If they do matter, they are going to do something. If they are going to do something, it is very important that the processes are open and transparent. That is the difficulty that I am grappling with.

We are saying that it is not going to be that significant because all the other processes will still be there and all the transparency that goes with the existing processes will be what matters, so the industry will feed into all the existing processes and all the transparency they get with that will be fine. So the fact that these committees will not be transparent will not matter. But then these committees are clearly important because they are in the agreement. We think they are important enough to put in the FTA and do something with them. If they are not that important, why are they in the FTA? If they are that important, surely they are important enough to have openness and transparency and involve the industry.

Ms Greville—I will answer that by going back one step and saying that exporting and importing countries can and regularly do query with each other the basis for quarantine decisions or they seek to engage each other in discussion about the technical issues that go towards those decisions. In that sense, while the formalisation of the process through this agreement and the articulation of the parameters of that consultation are explicit in the agreement, that is not to say we were not doing it already. Yes, it is important; it was clearly important as part of this agreement, it is an important part of our trading relationship and it is important that we articulate the level of commitment we have to having those sorts of conversations with each other.

My personal view is that the corollary of that is not necessarily that that conversation has to be a multilateral conversation, if you see what I mean. The competent authorities regularly engage each other in scientific and technical discussion, and that is what this is about. The fact that it happened already and it will continue to happen does not take away from the importance of it. The fact that it is articulated here and has not been articulated before does not either increase or decrease the importance of it. The point I was trying to make was that the issues we will be talking about with the US under these arrangements are, without a doubt, in some instances the same issues we will be talking about with our domestic stakeholders. It is not necessary for us to have those conversations together for them to be important to the process. I am not sure whether that is answering your question.

Mr MARTYN EVANS—You are saying the back channel has now been formalised under the treaty but it will still be the back channel.

Ms Greville—I do not agree with the characterisation of it as a back channel. Our trading partners are also stakeholders in our import risk assessment process. If you look at the import risk assessment handbook that articulates the number of times and occasions when Biosecurity Australia consults with stakeholders, that can be international as well as domestic stakeholders. A lot of international stakeholders register with Biosecurity Australia and are routinely updated on the progress of either specific import risk analyses or all of the import risk analyses. So there was already the capacity for us to consult with stakeholders. This is an articulation of how we are going to do it in this case based on the experience we have had with the US in the last two or three years when we have been able, through that process, to manage the discussion on scientific issues in a more productive way.

Mr MARTYN EVANS—But it will not be a formal decision-making process.

Ms Greville—No, the text is very clear that the place where Australia makes its quarantine decisions is at the end of an import risk analysis process. That is articulated in this handbook and remains, in every respect, the same after this agreement. To the side of that there is a consultative process that we have with trading partners—and, in this case, we have articulated it in this way with the United States—which runs in parallel to allow each of us to have a useful exchange on matters of interest. In the same way, this arrangement will allow us to engage with the United States during their process of pest risk analysis for Australian exports to the United States.

Mr MARTYN EVANS—But in the case of the pig meat decision recently—I am looking at the *Financial Review* of 14 May where there is an allegation from the industry; I do not assert this—there was a drift towards a trade maximisation strategy rather than a risk aversion strategy. It suggested the decision was biased to some extent in favour of trade maximisation rather than reducing risk because that would increase the level of trade. My colleagues will know that I do not normally favour the precautionary principle but those who assert this in relation to the pig meat industry favoured a more precautionary approach. In a group like this formed under the FTA, the industry might consider that negotiations similar to those that formed the FTA would perhaps take place where offsetting considerations might be entered into which were not of a formal nature but where trade maximisation discussions might occur, and Australia and the US might look at how to maximise the trade between the countries while looking at the biosecurity as well.

Is that the kind of thing that industry might be concerned would be occurring at these kinds of discussions where trade maximisation might be on the agenda at the same time as biosecurity? Because, in the context of biosecurity, what the industry is alleging in today's *Financial Review* article is that trade maximisation was the strategy, not necessarily a precautionary approach in relation to biosecurity. I am simply reflecting the industry's viewpoint here, because I think it is essential for the committee to test that evidence from the industry which we had today against what the department wishes to counter that with.

Ms Greville—There are a lot of things that could be said in response to that. I might confine myself to a couple of them. I think it is true to say that some industry representatives have expressed concern that, in the context of FTA negotiations, there may have been some discussion about quarantine standards or some pressure to compromise quarantine standards. I can assure you that the FTA negotiations were not at any stage concerned with individual technical market access requests. Neither the Australian government nor the United States government could

possibly contemplate confusing the negotiation of a cooperative consultative arrangement with the technical discussions on specific commodities that are part of technical market access processes. Nor would either jurisdiction have any interest in trading off its quarantine standards for an FTA.

Mr MARTYN EVANS—I think it is more about the future of these consultative committees—not the original FTA but the future activity of the consultative committee.

Ms Greville—One of the other things I should say, and I think I have alluded to it before, is that under the SPS agreement we have dual responsibilities—all WTO members do—to protect our plant and animal health and life and to ensure that, in the process of doing that, we do not use those as unwarranted or unjustified trade restrictions, so I think it is fair to say that there always has to be some consideration of your level of risk and the least trade restrictive measures in order to both support your appropriate level of protection and the acceptable level of risk while not impeding trade any more than is necessary. It is not appropriate, I believe, for me to comment specifically on the pig meat IRA, which I think was actually what prompted that particular article that you are referring to.

Mr MARTYN EVANS—That was just an example.

Ms Greville—But I can say that the government has provided repeated explicit assurances, and it is very clear in the text, that this consultative arrangement is about science and technical issues; it is not about the level of protection which is appropriate, the level of risk which is acceptable or the fundamentals of the balance between trade and quarantine.

Mr CIOBO—One of the witnesses raised their belief that the review committees should have independent scientists on them. We were querying whether in fact this was going to be a reality. I am not sure whether it was part of an elaborate conspiracy theory that the government was willing to trade off quarantine for increased access. I think we even had a witness put it to us that, if we could get extra wheat or something in, we could happily forgo salmon and all these things. I just want a response with respect to the need for or whether it will envisage independent scientists.

Ms Greville—There is already a capacity in our process and, as far as I am aware, in the American equivalent process for the competent authority—Biosecurity Australia in Australia or APHIS in the US—to engage outside expertise if they need it. Biosecurity Australia can and sometimes does, if it does not have the resources or the particular expertise, engage scientists from outside its own organisation. That is the first step.

Also, within our process we already have the capacity at various stages to consider whether the development of the scientific basis for our quarantine policy decision would benefit from independent peer review. We have that already in our process. We give it consideration at various stages about whether peer review of a particular scientific paper or a particular step in the scientific process would be useful. We can do that, and we sometimes do. The Americans can do that, and they sometimes do.

Within the discussions on this free trade agreement with the Americans, independent peer review was discussed. We had a discussion with each other about how each of us can already do

that. There is a provision in the agreement, in the annex to chapter 7, which articulates the fact that one of the things we talk to each other about in this consultative process might be whether an issue arises that we agree between us would benefit from an independent scientific peer review. The text actually says that the working group shall consult on 'matters that may be referred by either party to an independent scientific peer review or for other independent scientific input'. It is quite feasible under these arrangements that one of us might say to the other, 'I think it would be a really good idea if you got independent peer review on paper X.' The other party would consider it, and, if it was appropriate, they would do it.

The other point I should make that sometimes escapes commentators on the quarantine policy currently in place is that, once the basis for our quarantine decisions is released, either in a draft IRA or a final IRA, all the scientific thinking that has gone into that is public. There is nothing to stop anybody—a domestic stakeholder, an international stakeholder or anybody else—to then review that or to submit it to independent scientific review, if that is what they want to do. I suspect that quite a lot of our trading partners do do that when we release an IRA on some commodity that they are interested in.

Mr CIOBO—I guess my focus is more on domestic industry than on government to government. I understand what you are saying about the opportunity to do that. Is there opportunity for industry to seek independent review internally?

Ms Greville—I guess we are straying now into discussion of the way that our quarantine policy works rather than the impact on that of the FTA, but if I—

Mr CIOBO—On that point, it is only insofar as one or two witnesses raised concerns about Biosecurity Australia. I think it would be fair to characterise it that way. I am not seeking your comment on that. But, given concerns that were raised in that regard, that obviously has an impact, from an industry perspective, on the safeguards that they believe are in place for industry stakeholders. That is really what gave birth to the notion of saying, 'We should have independent scientists sitting on these committees.' Hopefully that puts in it a bit more context for you.

Ms Greville—I understand what you are saying. I come back to my point that the debate generated by the FTA has broadened a bit. I agree with you: there is some discussion going on out there about the way our quarantine processes work. It is probably as much to do with the fact that Biosecurity Australia has recently released a number of big import risk analyses, which have of course occasioned great interest in the industries that are affected by them. The only thing that it is appropriate for me to say at this point is that, as I understand the process, because our process is so consultative and so transparent and because, as they are generated, technical issues papers and various documents are made available to stakeholders, either directly or on the public file, there is the capacity for stakeholders—whether they are industry or whoever—to seek views on those. If that process results in a scientific opinion that differs from what is being promulgated then there is ample opportunity for those people to inject that opinion back into the process and to have that considered.

Mr CIOBO—How do they do that? Is it just through raising it in the public domain or is there a more formalised process?

Ms Greville—Again, I am not really a great expert, I have to say, on the IRA process in the sense that Biosecurity Australia knows much more about it than I do.

Mr CIOBO—What about in terms of the FTA and then a government-to-government review?

Ms Greville—Perhaps we were talking at cross-purposes, though I suppose it applies both ways. Once an IRA process is under way there are, as I said before, significant transparencies and the capacity for either domestic or international stakeholders to be engaged. At any stage there are both formal and informal mechanisms via which they can seek more information or inject information. There is usually a technical issues paper and people are invited to comment. In some cases we invite them again and again to comment if people who we know have significant interest in a subject have not yet come forward. So we actively seek comments in some instances from people at that stage. Then the process goes on and there are papers—sometimes it is a draft import risk analysis; there are other ways that information is promulgated. Again, either domestic or international stakeholders then have an opportunity to comment and to seek independent comment and pass it on.

Mr CIOBO—Is there a formalised process for that passing on of comment?

Ms Greville—At various stages there are comment periods. Once a technical issues paper, for example, or a draft import risk analysis has been released, stakeholders are notified and there is a formal comment period, whether it is 60 or 90 days. I think it differs and, to be honest, I cannot claim to be absolutely accurate on that. During that period, comments are sought in the same way as for submissions to parliamentary inquiries. There is a comment period, people make submissions and those comments are considered. If they include matters of science—and they do not always—then those scientific issues must be considered in the process as it goes on.

Mr CIOBO—I am trying to think of a hypothetical: you might have a Tasmanian apple grower concerned about the import risk coming from foreign apples who says, 'We might say we're not going to allow those foreign apples to come in because of quarantine concerns.' That is then taken to review—again this is just hypothetical—and as part of that review process they say, 'We have in fact changed our mind; we don't think that the risk is real enough, so we are going to allow the foreign apples to come in.' All I am seeking is an assurance, I guess, that as part of that review process the domestic stakeholder has the opportunity to provide input into that review and thereby seek to have the original decision upheld, in this hypothetical.

Ms Greville—Bearing in mind that my area of particular expertise is arguably not the import risk analysis process, I will try and be not too specific. I think probably the best answer to your question is that, before we would have reached the first decision that you referred to in your hypothetical, which is to not allow the foreign apples in, under our current arrangements there would be a process to arrive at that decision. The domestic apple grower would have had opportunity to comment at several stages about what the pests and diseases are, whether or not they are of quarantine concern, whether we have them here, whether they have them there and what the impact would be domestically if a particular pest or disease entered the country via trade. So there would have been that process and the domestic constituent would have had a lot of opportunities.

When the report comes out, whether it is a 'yes' or a 'no' finding, there is a comment period. That is the draft report. All of those comments are then factored into a final report. When the final report comes out there is a comment period. If people appeal against the finding, as they sometimes do, there is then an independent import risk analysis appeals process with a panel of independent experts who were not the original decision makers. They reconsider the issues where appropriate and then release their decision.

Mr CIOBO—So Biosecurity Australia is part of the original review process?

Ms Greville—Biosecurity Australia is the competent authority responsible for the import risk analysis—for dealing with technical market access requests from trading partners.

Mr CIOBO—What is our position with regard to the composition of the independent panel to which you refer?

Ms Greville—I think it is probably best if I take that question on notice; it is essentially a matter for Biosecurity Australia, of which I am not a member.

CHAIR—I would like to thank you very much for your evidence today.

[2.26 p.m.]

CAMERON, Mr James, Chief General Manager, Broadcasting, Department of Communications, Information Technology and the Arts

YOUNG, Mr Peter, General Manager, Film and Digital Content Branch, Department of Communications, Information Technology and the Arts

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

CHURCHE, Dr Milton, Lead Negotiator, Services and Investment, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

VENKATARAMAN, Mr Rajan, Negotiator, Services and Investment, Department of Foreign Affairs and Trade

CHAIR—Welcome back. In the submissions—and also in some of the public hearings—we have received evidence regarding the local content rules for audiovisual broadcasting and we felt it was important to speak with the department as well. Generally the concern seems to be that there will not be enough Australian audiovisual content—on television, principally. Perhaps you would like to address some of those issues to begin with and then we will ask a few questions.

Mr Deady—Maybe I should say a couple of words and then let the experts take over. This is, of course, an area that was subject to very detailed negotiations with the United States. It was an area where the United States certainly had a high objective and it was a high priority for them in the negotiations. We have taken commitments in this area. It is the first trade agreement where we have taken commitments in the audiovisual area. We have previously made limited commitments in our Geneva and Singapore agreements.

We have negotiated a very good outcome for the Australian industry. The current local content requirements are fully preserved under the agreement and we have also ensured a large amount of flexibility for future governments to make sure that there is adequate Australian content in all forms of potential new media. This was a big issue. We had a lot of discussions and consultations with the industry right through the process last year and I believe that we have negotiated something that meets the concerns of the industry. We are certainly happy to explain that further. It is a complicated area of the negotiations. These negative lists and these reservations are very complicated.

As I said, we have preserved the local content requirements on free-to-air television—the 80 per cent advertising and 55 per cent local content on the commercial stations. We have

introduced the capacity to extend those local content requirements as we move into a new era of perhaps multichannelling on free-to-air television. We have some existing constraints on pay television. We have flexibility for future governments to extend those requirements on pay television quite substantially in the future. In the area of the so-called new media, the things that we perhaps do not know about as fully, we have a capacity here for the government of Australia to make a finding. If it is a determination that there is inadequate Australian content in some of this new media in the future, then a future government can introduce measures to ensure there is adequate local content on that technology. So we do think we have addressed the concerns of the industry.

Another aspect that was talked about was the capacity of Australian governments to provide subsidies and other concessions to the audiovisual industry. They have been fully preserved under the agreement. There are no changes there at all. In the area of public broadcasting—the PBS and the ABC—again there is nothing in the FTA that affects the capacity of the government or future governments in relation to those public broadcasters.

Mr CIOBO—Mr Deady, on that point I just want to query a couple of things. You said that you had comprehensive consultation with the industry. I think the Australian Coalition for Cultural Diversity claimed—and I am just going from memory here—that they had been spoken to only once and that what was put to them was quite distinct from their original impression of what was going to be the Australian government's position. I also think they claimed that they were never invited, unlike other industry groups, to participate actively by actually going across for the negotiations. I am interested in your response to those comments.

Mr Deady—Mr Ciobo, I certainly stand by my comments about the amount of consultation we had with industry in this area. We could check the records, but we consulted with a very wide cross-section of the industry, a large number of groups—the Australian Screen Directors Association, the Screen Producers Association of Australia, the Australian Writers Guild, the Australian Film Commission. Dr Churche and colleagues from DCITA could certainly add to that list. I believe we did have very extensive consultations with all groups.

Mr CIOBO—What does that involve, when you say 'extensive consultations'?

Mr Deady—That certainly involved a number of sessions where we invited the industry to Canberra for consultations. I think we met with them on a large number of occasions, usually at least immediately after one of our negotiating rounds, and we would normally meet with them prior to heading off to one of these negotiating rounds. I think some of our material has provided an indication of the consultations we have held, but we could certainly identify the specific cases when we have met with this industry. We have had a large number of telephone conversations and other informal contacts. I recall that Mr Vaile held a meeting with the industry here in Parliament House at least once through the course of last year, and again we invited a large number from the industry to that. I remember meeting once, certainly specifically in Melbourne, with the Australian Coalition for Cultural Diversity. I know they have lot of members, but many of them would have been part of the consultations that we held throughout the year. And, as I said, we had consultations with the Australian Film Commission and the Australian Writers Guild.

Mr CIOBO—Mr Herd, from the SPAA, said:

We just wanted to get on the record that, despite the fact that the national interest analysis talks about the consultation that was undertaken with the sector, we agreed that there was a lot of talking, but what we saw at the end of the agreement is way past what the sector was consulted about. In fact the deal that was done in Washington earlier this year is not what the sector supported and it was not discussed with the sector at all by the Department of Foreign Affairs and Trade.

Then Mr Wilkie asked:

Were sector representatives invited to Washington to be part of the negotiations?

Mr Herd replied, 'No.' That, as we say in our submission, stands in stark contrast with what we believe the level of consultation was with the American cultural sector. Mr Wilkie asked:

Did the sector ask to be invited? A lot of industry groups went to Washington and were part of the negotiating process. I do not know whether the government invited them to go.

Mr Harris replied:

We asked to be involved as much as we possibly could. We did not specifically ask to go to Washington.

It goes on.

Mr Deady—Just on that, we would have had no problem whatsoever if the industry had wanted to go to Washington. We did not formally ask anyone to come or not to come.

Mr CIOBO—So they never expressed to you a desire to go?

Mr Deady—They never said to us at the end, 'Should we come?' or, 'Could we come?' We would not have had a problem at all if they had been there. I am sure that we made it clear to them in various meetings that we had with them that we had no difficulty with them being there, if that was their choice. But we did not ask any group to come. We said the same thing basically to other groups, the agricultural groups. We certainly said, 'We're happy for you to be there, but the decision is yours.' We neither encouraged nor discouraged them. There was no selective—

Mr CIOBO—Marshal?

Mr Deady—No.

Mr CIOBO—And no clear enunciation of their desire to attend?

Mr Deady—No. We met with them quite close to the period just before we left for the final round. It was not raised by them. I thought they might have raised it, because they have expressed through the year an interest in perhaps coming to some of these sessions. Again, we did not discourage them. We certainly pointed out that these were government-to-government discussions and they would have spent their time like the people from the agriculture industry who were there—and it was not just the people from the agricultural sector, but they were mainly agriculture people there at the end. Those people were not involved in the negotiations and they spent a lot of time in hotel rooms in Washington. But we did talk to them regularly, of course, once they were there.

Mr CIOBO—What about the allegation that what was agreed upon went far beyond what the sector supported and that what was agreed upon was not discussed at all with the sector by DFAT?

Mr Deady—Again, I do not know what they mean there. There was a wide range of discussions with them, as I said, and we certainly understood that parts of the industry in particular were looking for commitments that were much less than the government signed on to in the end. But we certainly talked to them seriously about a whole raft of issues: about how we would handle new technology, if we were to go down the path of taking on commitments here. There was a lot of discussion through the course of the year. The US lead negotiator made a comment quite early in the process that the United States was 'comfortable', or words to that effect, with the current arrangements. So that then generated a lot of interest amongst the industry as to what precisely that meant. Would Australia agree to a standstill? But a standstill would not be sufficient, because of their concerns about whether we could adequately then address new technology. These are the sorts of issues. I do not agree with that criticism. I think that we negotiated a structure that the industry well and truly understood: the nature of the positive list and therefore the nature of reservations, the concerns over the 55 per cent local content, whether we are protected fully for existing media, the subquotas that we fully protected and the move to digital television and multichannelling. These are the sorts of things that we talked about right through the process—the new media.

As soon as we got back to Australia, the precise nature of the commitments at the end of the day were made public as soon as we could. We put out these fact sheets very early. We got the information out. I think Dr Churche and colleagues very quickly drafted a note to try to give a fuller picture to that industry about what precisely we had agreed to. We then of course, as you know, got the draft text out for full transparency purposes as quickly as we could. So this information was out there very quickly. We certainly explained to the industry, again face to face, what the reservation meant. We answered a number of questions at the time, and I am sure colleagues have continued to talk to the industry. We are certainly open to talking to them every time they ring us, but we have not had a formal meeting, I do not think, since the one just prior to when we first appeared before you.

Mr CIOBO—On another point, there was a significant amount of discussion about one of the new protections that you brought in with regard to pay TV. A criticism that was levelled was that it is 10 per cent of expenditure, and that expenditure may in fact be very low and that it did not represent much of a protection at all. I am just wondering in terms of the negotiations, with the process there—the 10 per cent expenditure rule or protection that is now afforded versus a 10 per cent of total broadcast or something like that—what were the factors at play?

Mr Deady—Just to be clear on the status quo of today and additional requirements that a future government could impose: we have a 10 per cent expenditure requirement now on drama channels on pay TV, as you know. We have the capacity under the agreement to double that—so 20 per cent on drama channels—and we also now have a capacity to establish completely new expenditure quotas; that is, up to 10 per cent of programming expenditure on four additional services: children's television, documentary, educational and the arts. So that is a significant increase—the current arrangements allow for just the 10—and that is building in flexibility for future Australian governments to ensure Australian content on those pay TV platforms.

Mr CIOBO—Just in terms of the measure though: did you ever receive from industry the argument that they were seeking 10 per cent of total broadcast time quotas or anything like that?

Mr Deady—Again, I am not sure precisely. There was certainly some discussion about this. As I said, parts of the industry did not want Australia to take on any commitments in this area. Anything was too much. In the context of the negotiations, yes, we have taken on obligations. Dr Churche and others could correct me, but I do not recall a specific proposal that we apply 10 per cent on all pay TV broadcasting. I do not personally recall—

Mr CIOBO—The argument as I understood was that they were saying that, for drama, 10 per cent of expenditure may not represent too much.

Mr Deady—Sorry. Certainly, yes, they made that point to us, and there is this flexibility to double that under the agreement. Also I think that, as expenditure on drama, if it increases the number of drama channels, then you are building a base for higher expenditure and therefore potentially higher funding. That was a point they made—that this 10 per cent did not in their view translate to a great amount of money, but others might be able to comment.

CHAIR—This is what they are saying; this is in a submission from the Writers Guild and the Screen Directors Association. They said:

> We have verified that the current 10% Australian drama spend requirement only amounts to 3.8% of total transmission time.

So they are talking about the difference in free to air, where it is transmission time, as I understand it, but in pay TV it is actually an expenditure which, because of different costs, works out much lower. That is their basic argument.

Mr CIOBO—You said the Americans are very aspirational in this area; in the negotiations would they not entertain at all the idea of 10 per cent of total transmission? I am just trying to get an idea of some of the discussions, if appropriate.

Mr Deady—These negotiations certainly went right through the process, and the Americans were looking for, as I said, a more substantial commitment out of Australia. It was a negotiation and this was the outcome that was reached which I believe does go well beyond the current arrangements and does provide this additional flexibility for future governments. I think there was a lot of discussion with the industry—much more, in my view, in relation to the new media—the things we did not know—beyond broadcast television. The multichannelling and pay television were important. They were all important, but I think there was a big concern that perhaps we could, because of the things we know about, make commitments here, but future governments would be very heavily constrained in what they could do in terms of new media. That is where I think we have crafted here a very good outcome in that regard, because a future Australian government has the capacity to introduce measures to ensure there is adequate Australian content on this new media.

Mr CIOBO—If there were four drama channels, would the 10 per cent expenditure apply across all four channels or just to one channel?

Mr Deady—If there were four drama channels on pay television—on Foxtel, for example?

Mr CIOBO—Correct.

Mr Deady—Yes.

Mr CIOBO—So the 10 per cent is the aggregate amount?

Dr Churche—Yes. The point about our pay television obligations is that we can place expenditure requirements on each service provider. For example, if you had two pay TV providers and each of them had, say, 10 drama channels, then the expenditure requirement could be imposed on each of the drama channels on each of the pay TV providers. I think that is very important to emphasise. I think that it is true that at the moment under our existing pay TV, there are about 14 drama channels, so we can impose that expenditure requirement on all 14 drama channels. In the future, as pay TV expands in the Australian market, as one would expect, and as we see more channels being provided, and as we know that is happening with digital plans, we would expect that this 10 per cent—and certainly if we move to 20 per cent—would be quite a significant amount of money.

Mr CIOBO—It is exceptionally significant, isn't it? I did not realise that. Presumably, as pay TV operators offer a broader and broader array of channels, you will cream 10 per cent or up to 20 per cent across every single one of those that fall into those four categories.

Mr Deady—That is right.

Dr Churche—In terms of this general point that the industry has raised about transmission time, it is important to note that it is very difficult to compare what we do on free-to-air TV, where we have a single channel and therefore a known quantum of the hours which are being transmitted, with pay TV, where no-one has any idea of what that quantum will be. At the moment we have a certain number of channels, but we could find ourselves in a situation in the future where there might be 500 channels or 1,000 channels. We have no idea of the amount of hours there will be at the time.

If we had gone into this negotiation saying to the Americans, 'We want to put a percentage number there'—say, 20 per cent of total transmission hours—when we have no idea of what that will be in 20 years time, I think we would have been very much in a situation where the Americans would have said, 'You can have no more than five per cent,' working on the assumption that in 20 years time the amount of transmission hours is going to be infinitesimal. Our DCITA colleagues can talk about this much better in terms of our policy approach. Of course, Australia has adopted this approach on pay TV because it is a very different medium. We certainly do not see that as the most effective tool—to try to use transmission hours—first, because the amount of hours is so much greater; and, second, because there are a lot of reruns and things like that.

The whole point about the expenditure requirement is that it is an expenditure requirement in relation to new programming. So it is new money going into the making of new production. It is not about saying 10 per cent has to be Australian produced at some time in the future. It is no good showing *Skippy* or whatever to fill in. It has to be new money generated into the industry.

That is why it is very important. That is why we think what we have here is a very good outcome.

Mr WILKIE—We also heard evidence from Mr Herd from the Screen Producers Association of Australia in the same presentation. He raised a number of concerns:

... they relate to another significant area of the government's support for the cultural sector—that is, through measures such as grants, subsidies and investment—and support through the national broadcasters, the ABC and the SBS.

There are no reservations in the treaty for any of those organisations, so they are subject to more general exemptions in the treaty, particularly the Film Finance Corporation and the Australian Film Commission, which are the principal agencies through which the government provides development support and investment in Australian film and television production. Those organisations are subject to prohibitions under the agreement on making performance requirements. For example, they can invest only in film and television programs that are made in Australia by Australians and under the control of Australians. The practical effect of the text of the agreement is that America can object to the existence of those agencies and that an American producer, because investment is subject to national treatment under the current text, can apply to the Film Finance Corporation, for example, for funding and it would not be permissible for the Film Finance Corporation to discriminate against an American producer. So, in a practical sense, government funding would be available to non-Australians and therefore would defeat the purpose of the existence of those organisations.

Dr Churche—We have seen the submissions, and there is no basis in any of those concerns. There are really two elements there. The first one is that, when the government or government agencies—such as the Film Finance Corporation or the Australian Film Commission—give tax concessions or grants in any of these areas they can continue to limit this to Australians. In the services and investment chapters, there is a carve-out for subsidies in relation to the national treatment obligation. So there is no obligation here that we have to give any of that money to any American producers who want to have access to it.

On the second issue, which is really about performance requirements, that is a situation where we say to a producer or director that, as a condition for getting a grant or tax concession, there have to be certain limits on the way in which they go about producing a particular film, and it has to meet certain requirements about Australian content. We actually have a reservation which fully covers that situation. There is certainly nothing in the agreement which will in any way affect what we do at the moment or our capacity not only to keep the grants tax concessions that we have but also to introduce new ones.

Mr WILKIE—Specifically in relation to the ABC and SBS, he went on to say:

… the text of the agreement provides that where government is providing services it cannot do so in competition with the private sector. For example, while the SBS gains some of its revenue from advertising, the ABC, as well as providing film and television services, is a significant publisher of books, music and online material. Under the current text of the agreement it would be permissible for America to object to the ABC and the SBS providing those services.

Dr Churche—I think this is a very important point, because it is something which is very often misunderstood. For example, in the cross-border trade in services chapter, we do have a carve-out for services provided in the exercise of government authority, but there is nothing in any of the chapters which in any way limits government's ability to provide public services. So the first part of the statement is totally wrong where it says that in some way there is something

which precludes government or government agencies or bodies from providing services in competition with the private sector. There is certainly nothing in the agreement that in any way precludes or affects that.

If indeed you did have a particular government entity providing a commercial service on a fully commercial basis in competition with the private sector, then the commitments might actually be relevant. However, they would only be relevant in the sense that, if we are providing certain advantages to the government entity in that competitive relationship, then we might, under the national treatment obligation, have to extend it to US competitors. That would be the only situation. But there is certainly nothing that says that government, or government agencies, cannot continue to operate or provide public services.

Mr WILKIE—Mr Deady, you talked about the consultations that you had. Would you mind checking the records to see how many? Obviously we are getting one view here—

Mr Deady—I would be very happy to do that. I am very happy with the amount of consultation we had with the industry.

CHAIR—In terms of the free-to-air section, the principal argument against this seems to be that it is subject to standstill and wind-back provisions. You would be familiar with those arguments. Would you care to respond?

Dr Churche—I think it is very important in terms of the final outcome. It goes partly to the earlier question, in terms of the concerns the industry have raised about how the final outcome is perhaps a little bit different from what we started with in the negotiations. Our initial position was that everything should be in annex 2 of this structure. Essentially, annex 1 is a standstill for existing measures. It is also subject to a ratchet mechanism, which is what the industry have raised concerns about. This essentially means that, where we liberalise a measure in those annex 1 reservations, that liberalisation is locked into place. Our position was always in favour of going for an annex 2 reservation on audiovisual which gave us greater flexibility not only to maintain existing measures but to introduce new measures, and that annex 2 would not be subject to a ratchet mechanism.

At the end of the day, virtually all of the things that we have got on audiovisual are in annex 2. Not only do we have the flexibility to maintain the existing measures that we have; we have within certain limits, the ability to introduce new measures, and none of that is in any way subject to a ratchet mechanism. The only thing that we have in annex 1 which could be subject to the ratchet mechanism is the existing requirements in relation to the free-to-air TV—both analog TV and single channel digital. If indeed we do see a move to a multichannel environment on free-to-air TV, then that annex 1 reservation will become irrelevant.

CHAIR—There also seemed to be an argument that, perhaps, having now set 10 per cent expenditure limits in the pay TV area for certain categories and 20 per cent for drama, this might somehow be inferred back to the free-to-air stuff, even though it is not in the agreement and we are just talking about a hypothetical. You would be familiar with that argument as well. Would you like to respond?

Dr Churche—I think it is important to emphasise that all we have here is a certain capacity for governments in the future to intervene. None of this involves a roll back or a limitation on what we do at the moment. In fact all of this is about creating flexibility for governments to increase their degree of intervention and increase their requirements in the future. Whether any government in the future will do that, I cannot comment on—and I would that my DCITA colleagues probably cannot comment on that either. That is an issue for future governments. None of this may ever happen. We may indeed have no increase beyond 10 per cent on drama on pay TV. I certainly cannot forecast what might happen and what the market dynamics would be. One would imagine that any government making decisions about what the requirement should be in this area would actually take those sorts of issues into consideration in making its judgments and thinking about a reasonable equivalency for the burden being imposed on the pay TV sector compared to the free-to-air TV sector. My DCITA colleagues may wish to comment on that.

Mr Cameron—I think the only comment I would make in addition to Dr Churche's is to remind you of his indication before that the nature of the pay TV television sector and the free-to-air broadcasting sector is quite substantially different. Comparisons between those sectors are difficult to make and that is one reason why we currently have different arrangements. Whether those comparisons could be made in the future as technology changes is something that we could only speculate on.

CHAIR—Another concern that was raised in this same submission related to the Film Finance Corporation and the Australian Film Commission. They were concerned that Australia will be constrained in its ability to discriminate in favour of qualifying Australian films that meet the significant Australian content test currently part of the trigger for Film Finance Corporation investment.

Dr Churche—We think that is fully covered, and we have had discussions with the industry on this. We certainly appreciate that when we looked at this there were some concerns. We have spoken to them and we think there are no issues there. We have explicitly covered that in our reservation. I think it is important to emphasise that, as Mr Deady commented on earlier, at an early stage in the negotiations the Americans made it quite clear that they had no problems at all with what we do in this area. They were quite happy for us to carve that out.

CHAIR—There was also a concern raised about the ABC and SBS. Although there is no specific reservation for the ABC or SBS, there is a reservation for a service supplied in the exercise of government authority. They have gone on to ask would the ABC news service be in competition with that provided by CNN or Microsoft, for example.

Dr Churche—It is a public service. We often hear this—it is an issue which comes up time and time again when one talks about services. Certainly I do not think there is any question at all. The ABC and SBS provide public services and we do not see an issue there at all.

CHAIR—They provide public broadcasting services.

Dr Churche—Yes.

Mr CIOBO—We had a fascinating discussion with ACCD about the free-to-air channels and multichannelling. I was re-reading the transcript before. Dr Churche, am I correct in my understanding that we have three free-to-air channels and if or when we change to digital TV we can have up to five multichannels per free-to-air channel, which is up to 15 and therefore a total 15?

Dr Churche—I think it is very important to understand particularly the relationship between the annex 1 and annex 2 reservations. As soon as we go to digital multichannelling, annex 1 is irrelevant and what we look at is the annex 2 reservation. In terms of the way in which we approached the negotiations, the reality is that we do not know if we have multichannelling how many channels there are going to be for each service provider.

Mr CIOBO—Is there a technological limit though? I thought there was a maximum of five.

Mr Cameron—Under the current technology the amount of spectrum which is used by a single analogue television channel can be used to broadcast around four or five standard definition digital television channels. That may be where that comment comes from. The number of channels that a free-to-air broadcaster would be able to broadcast would depend on the commercial decision about the number they wish to broadcast but also the number of blocks of spectrum that they have allocated to them. In the current environment, broadcasters have a single channel and they have a single block of spectrum allocated in order to broadcast that channel. The scenarios in the future would depend on the decisions taken by government at the time.

Mr CIOBO—As the agreement operates at this point, when we go to multichannelling, we can have up to two additional channels that carry the 55 per cent local requirement per free-to-air broadcaster. Is that correct?

Dr Churche—It is two channels per service provider, not two additional. If we go to multichannelling, irrespective of the number of channels each service provider provides, we can impose local content requirements on at least two of those channels. So if, for example—

Mr CIOBO—On only two or at least two?

Dr Churche—At least two. For example, say we have Channel 7, Channel 9 and Channel 10 as they are at the moment. They all become digital multichannels and, if each of them has two channels, we could impose local content requirements on each of those two channels—in other words, six channels in total.

Mr CIOBO—Let us say that Channels 7, 9 and 10 each multichannel five channels, so there is a total of 15 channels being broadcast on digital TV. How many can we impose Australian local content rules on?

Dr Churche—In that situation, what you have to look at in terms of these commitments is how many channels each individual service provider has. If they have five, two of those channels could be subject to local content requirements.

Mr CIOBO—So where was your ‘at least two’ reference? Is that in regard to the aggregate?

Dr Churche—There are two parts to what we have done. We have said, 'You can have at least two channels, or you can impose the local content requirement on 20 per cent of the total number of channels.' That really only kicks in when you reach 10 channels for each service provider. If Channel 7, for example, had 10 channels, two channels equals 20 per cent. If they go beyond that and they get to 15 channels, you can go to three channels.

Mr CIOBO—Per free-to-air broadcaster.

Dr Churche—That is right. The point is, if we had a situation where Channel 7 had 15, then you could say three of those channels—

Mr CIOBO—No, I am talking about 15 aggregate—five each.

Dr Churche—That is not how the commitments work. You are actually looking at the individual service provider because you might have the situation where one has 15 channels and one has 10, so the way this works is that you look at the individual service provider.

Mr CIOBO—That does clarify one point. They talk about pay TV and the 10 per cent expenditure issue and they say it is up to 20 per cent for drama only. Is that correct?

Dr Churche—That is right.

Mr CIOBO—So the other three categories are 10 per cent.

Dr Churche—It is an additional four.

Mr CIOBO—That is it for me. Thank you.

CHAIR—I do not have any further questions. As there are no further questions on the cultural stuff, thank you very much for your evidence.

[3.06 p.m.]

MATHESON, Mr Scott, Assistant Secretary, Economic and Labour Market Analysis Branch, Department of Employment and Workplace Relations

BROWN, Mr Nick, Assistant Secretary, Trade Analysis Branch, Department of Foreign Affairs and Trade

BUSH, Mr Richard, Assistant Secretary, Lead Negotiator on Rules of Origin and Government Procurement, Department of Foreign Affairs and Trade

CHESTER, Mr Doug, Deputy Secretary, Department of Foreign Affairs and Trade

DEADY, Mr Stephen, Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

MORETTA, Mr Remo, Lead Negotiator on Non-Agricultural Market Access, Standards, Technical Regulations, Textiles, Trades, Remedies, Department of Foreign Affairs and Trade

SPARKES, Mr Philip, Deputy Chief Negotiator, Australia-United States Free Trade Agreement, Department of Foreign Affairs and Trade

MILEY, Mr Ken, General Manager, Trade and International, Department of Industry, Tourism and Resources

CHAIR—Welcome. Would anyone like to make an introductory statement on this section?

Mr Deady—No; we would prefer to answer any questions.

CHAIR—I am happy to do that. We have not received much in the way of submissions or much in the way of the public hearings on the rules of origin. The manufacturing companies and industries that have come before us, like the FCAI, Holden and Ford, for example, have not raised it as issues of concern, from memory. Mr Bush, what are the differences in the rules of origin in the Australia-United States Free Trade Agreement compared with the Australia-New Zealand one?

Mr Bush—It is a different model. It is based on a change of tariff classification. In the case of the Australia-New Zealand Free Trade Agreement, origin is determined on a cost basis. If you can demonstrate that 50 per cent of your value added was accounted for by Australian labour and materials and other costs then you are over the threshold for determining Australian origin. Under the free trade agreement negotiated with the United States, we had adopted the model that the Americans first introduced for NAFTA over a decade ago. It is a change of tariff classification approach. Under that approach, you have to demonstrate that any imported material—and it is only imported material that you have to worry about—which comes in under a certain tariff item is transposed as a result of the manufacturing process you undertake, so that

when it is incorporated in the finished product it is classified under a different tariff item. That is the rule in the case of 85 per cent of tariff items.

We have to examine this carefully because it is a fundamentally different approach from the one that our industry is used to. So we embarked on a major consultative process with Australian industry to see what they thought about it. This went on during the negotiations. That process revealed that, after the initial shock of having to face up to a different model, when we explained it to industry, they came to the idea that this was actually better.

The main reason that they thought it was better was that it does not involve any cost calculations. The cost calculations are always a burden for them in terms of time and costs and also in demonstrating to Customs that they have been accurate in their costings, especially on the portioning of overheads, which is always a controversial matter when trying to demonstrate that you have achieved a 50 per cent level of content. So the idea that you could demonstrate origin just by showing that your manufacturing process transformed the input of raw materials according to the rule that we specified for the finished product had a lot of appeal.

I should also say that in the chemical sector there is an overriding rule that if you can demonstrate that you have undertaken a chemical reaction then the finished product is classified as originating. That has lots of attractions for the chemical industry, especially where they are using imported petrochemical or oil based materials where the price is fluctuating quite a lot. Often they would find that through no fault of their own but through changes in the price of the imported materials they may be above or below the 50 per cent threshold under the old cost basis way of determining origin whereas under this new model it is just their manufacturing processes that determine whether or not their product is originating.

I should also add that for many products in our trade with the United States the rule of origin will not be an issue. All the agricultural product manufacturers know that their products originate in Australia. They are using Australian raw materials. It will not be an issue for them. The additional cost will not be an issue. Also, the rule that we have agreed to with the United States has what is called a 10 per cent de minimis. That means that 10 per cent of the finished product can be from imported raw materials that do not have to undergo the change of tariff classification test. That injects quite a lot of flexibility into the whole machinery. If our manufacturers are only using a small proportion of imported raw materials and they know it is less than 10 per cent of their final price, they do not have to worry about complying with the rule of origin.

Mr MARTYN EVANS—Overall the issue which our colleague is particularly concerned about in relation to the manufacturing industry is the impact on jobs in Australia. That is where most of the concern has been in some of the evidence we have heard, which, I must say, has been minimal, generally speaking. It was particularly in Sydney in relation to the union evidence. That has been the concern—that is, when our American colleagues took the view that there was going to be a significant impact on the manufacturing industry in the United States, there was a view that there would be a contrary impact in Australia. It might not necessarily be a win-win scenario here. It would be a win in the United States but not necessarily a complementary win here. It would be a significant export led gain in the US that they import here, but there would be a loss of Australian jobs as a result. I do not know what view you have taken of the positive

impact for the US manufacturing industry which flowed from the announcement in the US of this and the consequences it would have here.

Mr Deady—Perhaps I should start off. We certainly saw the comments going right back almost to the first day. I remember the press conference Ambassador Zoellick and Mark Vaile gave after the negotiations were concluded. United States Ambassador Zoellick made the point that they did see this as a very good outcome for US-manufactured exports. Of course, the US is already a major supplier of manufactured products to Australia and has a large trade surplus with us in manufactured products, as I know you know. They do see that as a significant outcome and welcome the agreement in that regard.

The first point I would make is that it does not follow that, because there is an increase in jobs in the United States from increased exports of manufactured products to Australia, there is a corresponding loss of jobs in this country. We look at the vast range of factors that I think you have to take into account here. The first is that we do have low levels of protection in this country already. The Americans have that trade surplus with Australia largely because we want to import those products. They are competitive suppliers in the market, and many of them do not compete with existing Australian production. To the extent that there are any tariffs on those, they will actually be a benefit to Australian manufacturers and lower the costs of Australian industry.

I was interested in your comments that there have not been a lot of concerns expressed in this area since the agreement. That was really our experience throughout the processes last year. In our consultations we had a lot of issues with various manufacturing industries—the rules of origin that you talked about and various other matters—but there was not huge concern about competition from the United States and tariff reductions that might flow from the free trade agreement. In a couple of sectors we have maintained some tariffs beyond the entry into force—in particular, the passenger motor vehicle industry, where we have a five-year phase-out of tariffs—parts of the industry were certainly looking for some sort of time frame or transition period.

In the textiles area, in talking to the industry, the Australian industry was fully prepared to go to duty-free tariffs from day one in competition with the United States if we could have talked about the rules of origin. As you would have heard, the one area where we were disappointed with the rules of origin outcome was textiles, where unfortunately we were not able to get the Americans to move off what is a very protective approach. In the end we phased out the tariff cuts on textile, clothing and footwear over 10 years. So again there is a transition period for the domestic industry. There will be some advantage to that industry from the FTA, but we acknowledge that it is not as great as we and the industry would have liked. But neither Australia nor the US are major textile suppliers to either of our respective markets. So we do not see a great outcome there.

I have said this in some of my presentations around the country, and I think this is a significant point: the average tariffs in both countries are very low. I think three or four per cent are the latest numbers that Dr Stoeckel talked about on average. However, the profile of the US tariff is different from that of Australia. It does have tariff peaks. It has tariff peaks on light commercial vehicles—the 25 per cent tariff that we talked about; 35 per cent on canned tuna; a number of tariffs well above five per cent, which is our peak tariff, effectively, apart from the motor vehicle

and textile sectors, in the metals and minerals area. So there are real gains to Australian industry as a result of those tariff cuts. I think that is certainly acknowledged in the discussions I have had and, from what you are saying, some of that has certainly come through to the committee.

Mr MARTYN EVANS—I must admit that, in the majority of the areas, I can understand the point that you are making. In my area, for example, in the case of Holden, there are some real opportunities there in the area of exports. The one issue that concerns me is that, say in the case of tuna, it is obvious that we can export canned tuna and the opportunity is relatively safe. In the case of Holden, though, for example, if that market took off quite well it would always be quite feasible to relocate that particular manufacturing opportunity back into the United States. So in some cases you can see how the opportunity can be developed; in other cases, you can see an opportunity for the United States to relocate, particularly where you have multinational companies operating in these areas. If it were successful, you could simply take a decision to shift industries back home to the US.

Mr Deady—I suppose that is a good point, but of course they are decisions that may be taken in the context of corporate decisions. There would be nothing stopping that decision being taken now, still with the protection behind a 25 per cent tariff wall. So I am not quite sure that that follows as an outcome of the free trade negotiations. What I think has happened with Holden and the other car producers is that, with the great advances that those companies have made in design and in other features, these vehicles are just so attractive now, and I think that they do see the platforms they have developed there in being able to supply what are not huge numbers of cars. Obviously the US market is very significant for our industry and certainly from my discussions—and I am sure you have had even fuller ones with Holden—that is the message I am hearing from them: this is a real opportunity.

Mr MARTYN EVANS—It is a hugely attractive product.

Mr Deady—Yes.

Mr MARTYN EVANS—Thank you.

Mr WILKIE—In the first meeting we had—and I understand that we are going to be authorising for publication the text with certain corrections, which will not be a problem—Senator Marshall was referring to economic modelling. Unfortunately, he could not be here this afternoon, but he has pointed out that there was a commitment made by the department to look at job impact in the manufacturing sector and have it done on a regional and sectoral basis. He is very adamant that that should have occurred, and he is wondering where that would be at the moment. Has it been completed?

Mr Deady—I recall that conversation. I think we were talking about the modelling that we had at that stage asked the CIE to undertake. Senator Marshall asked: would that modelling work look at manufacturing jobs? I answered that, recognising then that, as much as they know about modelling, there are limitations to what they can and cannot do, we were clear to the CIE that we wanted them to do as much as they could in this area, looking at regional impacts, but again by that we really meant states and territories. I think we asked them to do some work there because in a lot of our discussions with state and territory colleagues that is something that they were looking for: what are the impacts on regional levels.

We certainly wanted some sectoral outcomes and we wanted as much as they could give us on employment. I think I said at the time that, while there were limitations on the models, with those three elements—the regional, the sectoral and as much as they could do on employment—could we pull it together and provide as full a picture as we could on the impacts on employment. I know you have had discussions with Dr Stoeckel. He has outlined, in fact, the two different models that they needed to try and do those things. We asked him whether, going through the process, there was more that they could do in that area, but the outcomes that we have in that modelling exercise are the best that we can do. We have the GQ model, which shows the overall employment gains over time from the outcome and the real wage increases that result there. We have sectoral outcomes that give quite a lot of detail about the impacts on various sectors and industries, which again provides the best picture the modelling was able to give of the outcomes on particular sectors—exports and other things—and then the state outcomes. It is those three things together, really, that I think give us the best picture we can provide, certainly in the modelling that the CIE could do, on employment impacts and therefore the impacts across sectors and regions.

We have not commissioned any further work on specific employment in specific sectors or regions. But we did raise that with Dr Stoeckel to see what they could do, and, as I say, the two models were employed to try and give us that picture. At least in part of that he talks about some of the employment impacts, such as the impacts in the dairy sector in Victoria that might result from the strong growth in employment. But the fact is that, with the nature of the models—I think he went through this for some of you this morning—the more you get down into sectoral outcomes then you have to close the model, you have to assume there is full employment at the beginning and the end. Increasing output in one sector draws down resources from another, so you do not get really a dynamic picture in that GTAP model of just what are the real implications, I do not believe, of employment outcomes.

Mr WILKIE—Have we done anything in relation to looking at trade diversion and the impact that may have on some of our manufacturing sectors?

Mr Deady—No, we have not done anything like that. The modelling identifies trade diversion numbers, and I was watching some of the discussion this morning so I know you have been through that, in the modelling sense, with Dr Stoeckel. But, no, we have not done anything in that regard.

Mr WILKIE—I will try to paraphrase what we have received so you can comment on it. Professor Garnaut talked about how there would be a massive trade diversion. He quoted as a possible example the situation where vehicles made in the United States, because of their tariff-free status coming in may favourably compete—although we pay more for them, technically—with cars made by a Japanese manufacturer in Asia. Therefore, instead of going and buying them from a Japanese manufacturer in Asia, we would buy them from a Japanese company—basically, the same company—manufacturing those vehicles in the United States. Then you look at South Australia, with Mitsubishi having all sorts of problems at the moment. If Mitsubishi were to move offshore we would end up losing 12,000 to 22,000-odd jobs. I think that is one of the reasons why Senator Marshall was looking at getting some feedback on whether there had been any studies done as to whether there would be job losses and in which areas, because it may have a significant impact on Australia if some of those trades are diverted.

Mr Deady—That thing you described about diverting potential imports from Japan to the United States certainly is, as I understand it, a classic trade diversion, in that sense. However, if you look at the work that Dr Stoeckel has done in the manufacturing sector broadly but in the auto sector in particular, it shows very strong gains for the Australian industry as a result of the free trade agreement. In fact, it shows increased two-way trade with the United States, certainly showing increased imports from the United States in autos but also in auto parts. They go on to explain that they think most of those increases would be in components, trucks and vehicles other than passenger motor vehicles—where they do not really see competitive pressure from the United States—but also significant growth in Australia's exports and output of autos. That seems to be an area where the FTA delivers significant gains to the manufacturing sector, and the auto sector in particular. The reason that that is a good example is that it does then lead you to at least to make some reasonable conclusions about what that means for Victoria and South Australia in particular, where that part of the industry is heavily based. That is the best we could do with the modelling and the work that Andy Stoeckel could do for us.

CHAIR—Are there any further questions, not just on jobs in manufacturing but on general discussion of the FTA?

Mr MARTYN EVANS—I have one final issue in this regard. As an FTA, this does seem to have an extraordinary level of detail in it about general policy—though we have not had a lot of these bilateral FTAs, obviously. Apart from the issues that we are going to have to confront with the Nara treaty, and so on—which is obviously another issue to be discussed generally with the Japanese—and then also the extent to which we have to deal with this in relation to investment issues with New Zealand, how seriously do you think we have to start considering this question of policy issues which are being confronted in free trade? We are prescribing a whole series of questions on broadcasting policy, copyright issues and IP issues.

Throughout this treaty is a series of policy prescriptions that not only go, to some extent, to domestic law but will interact with other trade agreements we might want to make, multilaterally and bilaterally, as well as what parliament might want to do domestically. We will now have to be conscious of this with all other agreements we might want to strike. What if Britain wanted to do a free trade deal with us and they said, 'We want to have 30 per cent access to your free-to-air broadcasting—we do not think 20 per cent is high enough—and we think copyright ought to be life plus 80 years'? By going to such detail in these agreements, on what are basically policy questions, to what degree are we starting to tie ourselves down in areas where we are minimising our freedom, even if one agrees with the majority of the things proposed?

Mr Deady—Again, I am not quite sure I can give an adequate answer. These would be policy decisions for future governments—

Mr MARTYN EVANS—In individual areas they are.

Mr Deady—I think it is a good question; it does raise a number of issues in my area of expertise, the trade field, about what this agreement means. The government has said one of the advantages it sees from these free trade negotiations, if they are comprehensive and done properly, is that they will contribute to our ongoing pursuit of trade liberalisation around the world. In these free trade negotiations, you can touch at some depth a wide range of issues that

give Australia the capacity to approach other negotiations with a greater degree of freedom and to extract from other countries additional commitments and further liberalisation.

Some of these things have an 'automaticity', if you like. A good example is copyright. Our commitment to change it from 50 years to 70 years is a commitment to the United States. That is multilateral; everyone benefits from the outcome. But we have placed no obligations on any country other than the United States to keep it at 70 years. In a trade sense, that is valuable coin when we sit down in Geneva in those broader negotiations on TRIPS or other areas. We can say to Japan or the EU that we are prepared to bind this obligation to them if they are prepared to do certain things for us in other areas—for example, agriculture. I think that can complement and build on trade. US Trade Representative Zoellick and Minister Vale talk about competitive liberalisation, and I feel there is a real element of that in these free trade agreements. We have an open market in Australia, so that gives us a significant leg-up as we start these negotiations. The fact that we have liberalised and further deregulated as part of an FTA with the United States strengthens our hand in other negotiations.

Mr MARTYN EVANS—I was not questioning liberalisation so much. Many of these things are not so much liberalisation as constraint—where we have actually tied ourselves down. In the copyright area, we have said that we will pick up the US's DCMA—not literally. We are agreeing to have the take-down provisions about ISPs. We are picking up specific highly focused provisions in this agreement, which mean we cannot have other provisions in relation to take-down notices about information on the Internet, for example. We are not just liberalising trade—which is, I agree with you, a very good idea—but picking up very specific items in these agreements. We are not just going to the US and saying: 'Let's liberalise trade. It is a great idea. It would be a generally liberating thing to do, and it would be ammunition to use with other countries.' What has come with that is this baggage, not of liberalisation but of highly specific constraints.

Mr Deady—In relation to intellectual property, it is about balancing the rights of IP owners and consumers. With regard to having an IP regime that achieves that balance in taking on additional commitments to strengthen the obligations or the rights of the IP holders, yes, that is a concession, if you like, that we made. But certainly the IP holders, the creative industries in Australia, will benefit from these things. There is certainly an aspect, if you like, of—

Mr MARTYN EVANS—I am not arguing against the principle of that as an issue. I am saying it is unfortunate that that has to then become part of the baggage of a free trade agreement. Assuming you want to go out and use these things as part of a free trade agreement, you are then locked into these highly specific conditionalities. If you want to go to Japan or some other country, you then have all these other highly specific and focused deals locked into that, because you now cannot agree some other Internet provision with Japan or Turkey.

Mr Deady—I suppose it is a bit hypothetical. The fact is that we could. We have obligations to the United States which we have to respect, but that does not preclude us from taking on commitments that may go further.

Mr MARTYN EVANS—But not inconsistent.

Mr Deady—That are not inconsistent. I believe you could certainly negotiate outcomes in separate negotiations but they would have to be consistent with all obligations, including existing ones.

Mr WILKIE—You mentioned that we got certain concessions and we can use those against others when we are doing trade deals, but it is a two-edged sword, isn't it? We gave up quite a lot that we did not want to give up that may be used against us in some trade negotiations in the future as well.

Mr Deady—In the sense of negotiations, we have not given up anything to anyone other than the United States. We have made bindings and commitments to the United States, and in negotiations we now come to the table with those and they may be concessions we are prepared to make to other countries in a binding, legal form through trade negotiations. I do believe it strengthens our hand in many areas. I will use a specific example, and this is again hypothetical. We have made commitments to the United States on investment that go beyond the commitments we gave to Singapore, for example, on investment. There is a large amount of Singapore investment in this country now. Singapore may be interested in obtaining those same concessions. That means we then have a capacity—and we have this capacity under the Singapore agreement—to have an ongoing, built-in agenda, as we call it, to see if we can further develop the Singapore agreement, just as we did with the New Zealand one. A future government could say to Singapore, 'Yes, we are prepared to extend this firm commitment to you, Singapore, to bind it to you, if you are prepared to do more for us on education services, legal services or financial services.' We have some coin to bring to the table in those negotiations, and that is very real. Until we make that binding commitment to Singapore we have no trade or legal obligation to Singapore. We could change the thresholds tomorrow in relation to Singapore. So it is real. If you are moving down a liberalising path in these FTAs, if they are comprehensive, then I think it does strengthen your hand in other negotiations.

Mr WILKIE—I have a couple of industry specific questions. We were in Brisbane the other day and we heard from the peanut farmers of Kingaroy.

CHAIR—The Peanut Company of Australia.

Mr WILKIE—They were hoping for 12½ thousand tonnes of access and they got only 500. What was the stopping point for them not getting more than 500 tonnes? It seems such a piddling amount.

Mr Deady—From memory, I do not think they were ever asking for 12,000 tonnes.

Mr WILKIE—They gave a submission that they were asking for 12½ thousand tonnes.

Mr Deady—I would have to check. The question is still valid. We were certainly aware of an interest in improving the access of peanuts and other agricultural products into the United States market. That was on our priority list of access requests of the US through the process. The negotiated outcome was the one that is in front of us—500 tonnes. I think that tariff quota does grow somewhat over time, and that is the market access gain we were able to achieve as part of the outcome. Again, that is not as much as the industry wanted, just as it is not as much as the

beef industry wanted, as you have heard. Nonetheless, these are real access gains that we have as a result of the FTA and that we would not have without it.

Mr WILKIE—We talked to representatives from the sugar industry in the same hearing. They pointed out—and this was after they had received the package of government assistance, I might add—that they were expecting to get something, really fought for something right up until the last minute and then did not get it. They gave evidence that they were not really expecting anything even though they were fighting for it. I put to them that the reaction they had afterwards was one of such outrage and anger that it would have appeared that they were expecting in real terms to get something and were let down. Do you think they were entitled to be so outraged at the end of the day?

Mr Deady—I certainly think that they were very active right through the process. We had a lot of consultations with the sugar industry, and I do not say that to exaggerate our role, it is just a reflection of the level of interest they had. They were there in Washington for three weeks. They sat there with really no joy on any day. They realised that these negotiations were an important opportunity to try and get some improved access into what is a very high-priced market in the United States. It was a very important issue for them. I certainly think they were justified in being disappointed that they got nothing from the negotiations. I think I have said before that the whole team—and, I am sure, the government—feel disappointed that we were unable to achieve anything on sugar as part of the agreement. The US sugar program is highly protected. It is something that Australia has been pursuing, including through GATT cases, for the last 40 or 50 years. We certainly were looking to achieve at least some improved access for that industry. I think they were justified in being disappointed that we were unable to achieve any improvement in access in that sector. That was the only ag sector that got no improvement in access.

CHAIR—Speaking to Queensland Sugar and the cane growers in Brisbane last week, they did say that they were very satisfied with the consultation and negotiation process. They were satisfied that we continued to demand on sugar right to the end. They were obviously disappointed—understandably disappointed—but they still felt that, regardless of sugar not being part of the agreement, the agreement should not be held up. That is a summary of what they said.

Mr WILKIE—Like I said, that hearing was after the package of government assistance had been handed down.

Mr Deady—I saw them in North Queensland too as part of my little trip. I was wondering what their reaction would be, but I must say that I had some very good discussions up there with them. They were realistic. They were disappointed, and rightly so. They know that the problem they face, as much as they would have liked access to the United States market, is the bigger problem of the distortions in world agriculture, particularly in sugar, that make it so difficult. They are things that have caused the problems for this very efficient industry in Australia. It is about the WTO and those processes. They have always been very supportive of all governments and officials in pursuing those liberalisation objectives. They have worked very hard for a number of years to achieve that. Again, I can certainly understand their disappointment at having gotten nothing from yet another trade negotiation.

CHAIR—One thing they did say was that it seemed to be easier for developing countries to gain increased access for sugar than for developed countries. Do you think there is a sense of that in terms the way it is viewed in the United States?

Mr Deady—Bob Zoellick made some comments, I cannot remember them exactly, but the US did make some concessions to developing countries on sugar in the CAFTA agreement. Again, if you look hard at the nature of that commitment, you will see that the reason they were able to give that concession to the CAFTA countries is that they also included in that a clause that said, 'We might not actually take the sugar, but we'll pay you as if we did.' I think that is what they mean when they say it seemed easier for the US to do that rather than give access to developed countries. The other side of your question is that, of course, the big protection occurs in the developed countries—Japan, the United States and the EU.

Mr WILKIE—This is no reflection on the negotiating team at all. I take the view that the government misled them in some respects, given that the Deputy Prime Minister said, 'No sugar, no deal' and that without sugar a trade deal would be un-Australian. So I think there was an expectation given to the industry by government that they may achieve something because they would hang out for them—and then they ended up hanging them out to dry. That is no reflection at all on you or your group. Just to finish on a positive note, we heard from the canned tuna people in South Australia, didn't we?

CHAIR—The tuna boat owners.

Mr WILKIE—Yes, the tuna boat owners—and they were actually stunned that they achieved anything because they were not expecting it, so that was a positive. They were particularly surprised, given that they felt that the tuna industry there has a very strong lobby group and that, if they had got wind in the US of the fact that they were likely to be getting anything at all, they might have carried on in the same way that sugar did. Sorry, I should not have said that, but well done on that. Thank you.

Mr Deady—Thank you.

CHAIR—As there are no further questions, thank you very much for coming back before the committee today. This is the 11th day that the committee has sat and received evidence on the Australia-United States free trade agreement. I am sure that virtually all members of the committee have participated at some stage in the public hearings. It has been a fascinating process considering subjects such as peanuts, sugar, tuna, intellectual property copyright laws, beef, the Pharmaceutical Benefits Scheme and what we watch on television—as you would be well aware, having been involved in this process for over a year. So thank you very much for coming back before the committee. This is our final scheduled public hearing, so we will now be writing the report and deliberating on that. Thank you very much.

Mr Deady—Thank you.

CHAIR—I would also like to thank all the witnesses—departmental witnesses and all of the other witnesses—that we have had before us, all the people who have made submissions, all members of the committee and the committee secretariat as well, for providing support—and also Hansard, for getting the reports back so promptly. I require a resolution to authorise

submission No. 15.2, which is the supplementary submission from AusAID for the treaties tabled on 2 March.

Mr WILKIE—So moved.

Mr MARTYN EVANS—Seconded.

CHAIR—We have received supplementary submissions from Professor Garnaut, so I require a resolution to authorise for publication submissions No. 160.1 and 160.2.

Mr WILKIE—So moved.

Mr MARTYN EVANS—Seconded.

CHAIR—The secretariat will forward a copy of the proof transcript of evidence to witnesses as soon as it becomes available.

Resolved (on motion by **Mr Wilkie**, seconded by **Mr Martyn Evans**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Resolved (on motion by **Mr Wilkie**, seconded by **Mr Martyn Evans**):

That this committee authorises publication of the proof transcript of a briefing given before it by the Department of Foreign Affairs and Trade on 2 April 2004.

Committee adjourned at 3.48 p.m.