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JOINT STANDING COMMITTEE ON TREATIES

Reference: Australia-United States Free Trade Agreement

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JOINT COMMITTEE ON TREATIES

Monday, 3 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 Peter King and Mr Bruce Scott

Senators and members in attendance: Senators Kirk, Tchen and Mason and Mr Adams, 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 10.15 a.m.

CHAIR—I declare open this meeting of the Joint Standing Committee on Treaties. The public hearing today in Canberra is the sixth public hearing of the committee's review of the proposed Australia and United States free trade agreement. The inquiry was referred by the Minister for Trade, the Hon. Mark Vaile MP, on 9 March 2004. It was 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, chief ministers and presiding officers of the parliaments as well as to a list of people who have expressed an interest in being kept up to date with the committee's activity via an email bulletin. To date, over 170 submissions have been received. Submissions are available from the committee's web site. Details are available from the committee secretariat.

[10.17 a.m.]

ADAMS, Mr Keith Norman, President, Cattle Council of Australia

de HAYR, Mr Brett Raymond, Executive Director, Cattle Council of Australia

BARNARD, Dr Peter Oliver, General Manager, Economic, Meat and Livestock Australia

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?

Dr Barnard—We would like to make some brief opening remarks. These brief opening remarks will be aimed at highlighting three aspects of our submissions. The first aspect we would like to highlight is the importance of freer trade into the United States for the Australian beef and sheep meat industries. For our sheepmeat industry the United States is our largest export market, worth about a quarter of a billion dollars per year. The US is also our largest beef export market, worth between $1.3 billion to $1.6 billion a year. Our beef exports into the United States are currently quota constrained. Clearly, seeking alleviation from those quota constraints is a major objective of the Australian beef industry. That is the first point we would like to point out: the critical importance of freer trade into the US market.

Secondly, we would like to highlight our disappointment with the result of the free trade agreement negotiations. We went into these negotiations under the belief that a free trade agreement meant exactly what the words imply: eventual free trade between the two countries in all areas. We are also under the belief that the transition period to free trade should be relatively short. That is the second point we wish to highlight: our disappointment with the result.

Thirdly, we would like to state that, despite our disappointment, we are pragmatists: 70,000 tonnes are 70,000 tonnes. MLA therefore accept the agreement. We would also like to put on record our appreciation of the efforts of both the DFAT negotiators and the government in achieving what is, in our belief, the very best possible result under very difficult circumstances. I will now pass to Keith Adams to elaborate on some aspects of the opening statement.

Mr K. Adams—From the Cattle Council's perspective, our expectations leading into the free trade talks were quite high, taken in the context of an agreement negotiated between Chile and the US. We were led to believe that any agreement negotiated, as far as beef goes, between the US and Australia would be better than the Chilean agreement. The Chilean agreement covered access for beef over a four-year time frame. This agreement reaches full market access over a period of 18 years. When you examine it, you see that it is far less beneficial to Australia than the terms of the Chilean agreement were for Chile. Are we better off? Yes, we are, over a period of 18 years. There are so many unknown elements after that period of 18 years that it is hard to estimate to what degree we might benefit.

I would like to put on record the Cattle Council's appreciation of the process. We are of the strong belief that the negotiating team and the Australian government negotiated the best position possible for access, given the circumstances. I think I will leave it at that.

CHAIR—What sort of access were you expecting during the negotiations?

Mr K. Adams—The broad industry agreement was to put up a scenario of access of 90,000 tonnes over a seven-year transitional period with no permanent safeguard at the end of it. It had been discussed between the various sectors of the industry, and we thought that that was quite a reasonable position to put up.

CHAIR—Do you want to make any comments on the outcome on sheepmeat?

Dr Barnard—I think the outcome on sheepmeat is very satisfactory from an industry point of view. Small tariffs apply to our sheepmeat trade into the United States. Most of those tariffs will be eliminated from day one of the agreement. There are a couple of minor lines that will be eliminated over a four-year period. Apart from the tariffs, there are no other constraints to trade with the United States, so the elimination of those tariffs is a pleasing result.

CHAIR—Do you want to say anything about the sanitary and phytosanitary outcomes in the agreement?

Dr Barnard—The industry support a science based approach to SPS matters. As a major export industry, we quite often have difficulty with SPS measures in other countries. We have been resolute, both at home and abroad, in arguing the case for science based standards to arise. We found nothing objectionable in the SPS outcomes of the agreement and in fact supported specifically the side letter on BSE that advocates both countries working together in international fora to bring about a better trading regime with regard to that disease.

Mr de Hayr—As Dr Barnard has enunciated, we certainly see no pitfalls at all in the SPS arrangements negotiated under this agreement.

CHAIR—Just to clarify, from the point of view of Meat and Livestock Australia and the Cattle Council, what would you like parliament to do—to bring the free trade agreement into force?

Dr Barnard—From Meat and Livestock Australia's perspective, despite being disappointed with the agreement we do think that it was the best that could be negotiated under the circumstances and therefore support the ratification of the agreement.

Mr K. Adams—The Cattle Council will not oppose the ratification of the agreement. It falls far short of what our expectations were. We accept that the government has done the best deal possible under the circumstances and we will not oppose the ratification of the agreement.

Mr WILKIE—To what extent do the safeguards that are there for the US market undermine the free trade in beef?

Dr Barnard—We believe that they absolutely undermine the eventual transition to free trade. They are there for one reason: to thwart trade in beef between the two countries. They are very stringent safeguards. They have been deliberately designed by the United States to bite when they will hurt most. They are most stringent in the last quarter. Just as you want that increased access into the United States, they come in to bite really hard. And, of course, they only involve a 6.5 per cent movement in prices. We have looked at the last 10 years of data and concluded that those safeguards would have triggered in six out of 10 of those years. So clearly they will have a potentially significant impact on our objective, and the government's objective, of eventual free trade in beef from Australia into the United States.

Mr WILKIE—I believe you are totally opposed to the Japanese safeguards. Is that the case?

Dr Barnard—Absolutely. We are adamantly opposed to those sorts of safeguards. They tend to be arbitrary. They tend to distort trade enormously, as traders try to shuffle product around the safeguards. They will anticipate the safeguards coming on, therefore trade will increase greatly in the period leading up to the safeguards triggering. Then you get a dearth of product going in after the safeguard triggers, so they are just enormously disruptive. We are not convinced that in the case of Japan, or in other situations in which they apply, that they provide much assistance at all to domestic producers and they can be enormously frustrating from an exporter's point of view.

Mr de Hayr—One of the difficulties with the permanent safeguard is that after 18 years it is almost impossible to predict how this thing will actually impact on the marketplace. As Dr Barnard has pointed out, they are designed to restrict imports, and that is clearly what they do. In this case it is designed to restrict imports but, to protect domestic producers, we are not quite so sure. So it is really the safeguard mechanism in conjunction with the 18 years that makes that mechanism very difficult to analyse.

Mr WILKIE—So when you say that you are better off, in some ways you are not really sure because the safeguards may have a dramatic impact.

Mr de Hayr—I think we have to break this agreement into two parts: what happens within the next 18 years and post 18 years. We will certainly be marginally better off over the next 18 years. What we have said in our submission is that the situation post 18 years is impossible to predict. If it does in fact lead to free trade, that will be very good, but it is impossible to say that that is actually what will happen.

Mr WILKIE—But it is nowhere near as good a deal as other countries have achieved—an example I think you mentioned in your submission was Chile. The Cattle Council or the beef producers did some modelling about how they would be better off or worse off under the agreement. It has been mentioned in the submission that it would be one cow per year per producer over the 18-year life of the agreement. Where did that figure come from?

Mr de Hayr—Certainly, the three of us were in Washington during the negotiations. At the time, that was our back of the envelope estimate of benefits. Since then, some modelling has also been done by CIE which probably backs that up. It shows that the benefit over the next 18 years for the average producer selling about 600 head is about $600—that actually is not quite the

value of a cow at the moment; it is more like the value of a calf. Nonetheless, that is an additional $600.

Mr WILKIE—Just to clarify that, who did that modelling for you?

Mr de Hayr—The CIE, the Centre for International Economics.

Mr WILKIE—Are they the same people who have done the current modelling for the government?

Mr de Hayr—That is my understanding, yes.

Mr WILKIE—They are the ones who came up with one cow per year.

Mr de Hayr—No. The 'one cow' is our quote. That is certainly not CIE's quote.

Mr WILKIE—What was their take on it?

Dr Barnard—They calculated the total benefits to be between $1.1 billion and $1.7 billion to the Australian industry over the lifetime of the agreement. When one brings it down to an individual producer basis, one cow does not seem all that much, but $1.1 billion to $1.7 billion is a sizeable benefit to the industry as a whole. One cannot think of too many initiatives that either the government or the industry could take that would yield that magnitude of benefit. It emphasises the difficulties we have with the agreement. It really should have been much more than $1.1 billion to $1.7 billion—it really should have been much more than one cow per producer—nevertheless those are benefits that cannot be easily dismissed.

Mr K. Adams—To put that $1.1 billion to $1.7 billion over the 18 years into context, the total value to the beef industry over that time is in the order of $100 billion. So that $1.7 billion of benefit is quite a small benefit indeed.

Mr de Hayr—The difficulty we have in comparing these figures is that we have a large benefit on an overall basis to the industry, but with 70,000 producers obviously you need a very large gain to have a significant impact on individual producers. It is those two.

Mr ADAMS—For growth into the future, that might be a bit restrictive. That is one steer per producer for 70,000 producers, so if you are talking about growth, it is not real growth, is it?

Mr de Hayr—Probably not on an individual perspective, no.

Mr WILKIE—I have some other questions but I will come back in a second.

Senator MASON—I understand you are not overjoyed about it, but I think Mr Adams said that you would not oppose entering into the treaty. Under the treaty, 378,214 tonnes can be exported to the United States without duty. How many tonnes do we currently export to the United States?

Dr Barnard—Last year, we exported up to that quota limit, so last year we exported—

Senator MASON—Up to limit. Have we been exporting up to the limit for the past few years?

Dr Barnard—No. We have exported up to the limit for the past two years. Prior to that time, we did not hit the quota under the new arrangements that were negotiated in the Uruguay Round. So between 1994 and 2001 we were beneath the quota limit, but in 2002 and 2003 we hit or exceeded the quota limit.

Senator MASON—Why were you below the quota from 1994 to 2001?

Dr Barnard—There were a variety of reasons but they mostly related to an increase in production in the United States. The United States cattle industry works on regular cycles that last about 10 years. The herd increases and then dips, and increases and then dips, as does beef production in the United States. We tend to supply that market when beef production, particularly lean beef production, in the United States is low, and that is the case at present.

Senator MASON—I raise the question only because your disappointment can be justified if we can export up to the duty free limit.

Dr Barnard—Yes.

Senator MASON—But your disappointment cannot quite be justified if we cannot. Do you understand my question?

Dr Barnard—Absolutely. I make two further points related to the strength of demand for our product in the United States. Firstly, Australia has now developed a chilled beef trade to the United States. I have to tell you that that is a bit like selling coals to Newcastle. It is of enormous credit to the Australian industry that we have developed a high-quality export trade to the biggest high-quality beef producer in the world. That high-quality chilled beef trade has gone from absolutely nothing about five years ago to 30,000 tonnes this year. It is a new trade that was not there five years ago. Secondly, there are a number of big food service customers in the United States that are now either using or trialling Australian product that were not using or trialling Australian product in the past. Of course the most notable of those is McDonald's.

Senator MASON—Do you think then that over the next 18 years the Australian beef industry will be exporting up to those maximums, duty free quota—

Dr Barnard—I cannot predict 18 years out but what I will say is that the modelling work over five years out has us hitting our quota each year. During that period we are likely to have an extra 400,000 tonnes or thereabouts of product coming on stream in Australia. Beef production in Australia has been affected by the current drought but, as we come out of drought, the herd and our beef production levels will increase. Certainly for the foreseeable future we will be bumping up against that quota, in our view. I must say that that is our biggest disappointment. Our No. 1 objective in this agreement was to try to take that quota out of play. The quota just distorts the market tremendously when it comes into play. Even if it is not hit—if it just looks like the possibility of its being hit—traders start taking positions on whether that quota will be hit.

Senator MASON—It still distorts the market potential.

Dr Barnard—Yes.

Senator MASON—Even if you do not reach it?

Dr Barnard—Absolutely. They tend to focus more on what is happening with quota and how they can make money out of quota rather than marketing and selling the product in the best possible manner.

Mr WILKIE—On quotas, I have heard some government members say that you have not been able to hit your targets and ask why bother increasing quotas if you cannot meet them. It is a very important point that you make: in the last two years you have reached quota and if you had greater access to the market you would be able to sell more to the US. Is that true?

Dr Barnard—Absolutely. We see enormous expansion in that market for Australian product, particularly over the next five years. As I say, beyond five years it is just very hard to predict. We do not know what is going to happen with the South Americans. We do not know what the state of US production is going to be. But over the period when one can reasonably readily predict market conditions we think that we will be bumping up against those quota constraints.

Mr WILKIE—Is that one of the reasons why the Cattle Council is so disappointed that you got only an additional 70,000 tonnes?

Mr de Hayr—That is the primary reason. I think it is important to note that in 1994 we received an additional 75,000 tonnes access under the Uruguay agreement and we passed that within a decade. Any suggestions that we cannot produce an extra 70,000 tonnes over the next 18 years, especially in line with these projections, really do not hold up.

Mr WILKIE—Chances are you could have actually achieved a greater increase than your quota not through negotiating with the free trade agreement but through general negotiations.

Mr de Hayr—In the short term, I think we would have to agree that that is optimistic.

Dr Barnard—I do not think there would be any short-term mechanisms whereby we could have increased our quota to the extent that it has been increased in the free trade agreement.

Mr WILKIE—You guys were obviously in the US during all the negotiations. You would have seen our people at work, and you have praised them for their efforts. Do you think at any point they were disappointed in the outcome they were achieving for beef?

Mr de Hayr—I think it is impossible to tell what people were thinking. We were certainly disappointed. We probably all went into these negotiations with the same mind-set. I think that question is impossible for us to answer.

Mr WILKIE—It is fair to say that you were pretty disappointed, though. We mentioned the Japanese safeguards earlier. The government argued very strenuously against those safeguards

for the Japanese agreement, but they have actually agreed to them here. Why do you think that is?

Dr Barnard—I think it is due to pragmatism, and that is exactly the reason the Japanese safeguards were agreed to under the Uruguay Round. Japan said, 'We'll decrease our tariffs from 50 per cent to 38.5 per cent, but we will only do that on the condition that some safeguards apply.' You have to look at the deal in totality and say, 'Is that deal worth while for Australia?' In the case of Japan, the United States had to make the same decision. These trade negotiations get down to some very pragmatic decisions at the end of the day. That is why the Japanese safeguards were agreed in the Uruguay Round, despite the degree of distortion they introduced to the trade. I suspect that it was the same pragmatic decisions that led the government to accept the safeguards in the US free trade agreement.

Mr WILKIE—Obviously the agreement was hurriedly dealt with because of a political position in the United States—they had been trying to get it through before the election later this year—and there was a similar reason to get things through very quickly in this country. Do you think we could have achieved more? Others have said that we could have achieved a lot more had there been more time to sit down and discuss some of these sticking points. A lot of people have said that they believe that their industries would have been far better off had there been more time to negotiate on a lot of the different issues that were coming forward. Would that be your position?

Dr Barnard—I think it is impossible to tell. Who knows what the future holds. What I will say is that in the recent past the political climate in America has moved against freeing up trade. My suspicion is that that move in the political climate will occur for some time yet. My own view is that it is unlikely that, if this agreement were delayed six or 12 months, we would have faced a better set of circumstances—but, really, who knows.

Mr de Hayr—In hindsight, viewing some of the outcomes, you could make a number of calls. Certainly during the process in those last few weeks industry was in favour of ploughing ahead.

Mr WILKIE—Based on what happened with beef, would it be fair to say that in your view we did not really get a free trade agreement; we got a trade agreement that provided some benefits but it certainly is not a free trade agreement.

Mr K. Adams—We make that remark in our submission.

Mr WILKIE—Thank you.

Mr ADAMS—Mr Adams, you said that you thought Chile probably got better access in their agreement than we did.

Mr K. Adams—They got access over a transitional period of four years.

Mr ADAMS—It is better than what we get over the next four years.

Mr K. Adams—We are looking at an 18-year time frame. The transitional arrangements, viewed on their own, certainly make the Chilean agreement more attractive.

Mr ADAMS—If you are a producer aged 55, 18 years would make you 72 or something.

Senator MASON—That is still young, Mr Adams—still young!

Mr K. Adams—Any possible benefits will accrue to the next generation; as we know, the average age of cattle producers is around 60 to 62.

Mr ADAMS—Right; 18 years is a long time for a producer who is 60. As for the future of product, Dr Barnard has talked about the chilled trade, which we have extended into prime cut products, which is really about branding—getting your own brand and selling your product. In 18 years there could be a whole different set of circumstances affecting how we sell meat and how we sell product, whether we are actually packaging the product and selling it that way or whatever. Was there any discussion of that? You praised the negotiators, but I would have thought that there would be such changes in the way the world markets and brands products in the meat industry or the food industry that 18 years would be just beyond comprehension, with new ways of branding, packaging and exporting.

Mr K. Adams—It is very difficult to predict what might be happening in 18 years, but the growth trends in the chilled sector of trade with the US are encouraging and, given a continuation of that trend, we will see that making up a larger and larger section of the allocation as time goes on.

Mr ADAMS—So there will not just be chopped-up cows in boxes; there will be some pretty good products getting the top-end dollar.

Mr K. Adams—Current trends suggest that that will be the case.

Mr ADAMS—Do we have enough lambs to export into that market—is our lamb trade big enough to increase its growth in the US market?

Dr Barnard—We have certainly got enough lambs to continue to supply the US market with increasing amounts. One of the encouraging and remarkable aspects of the last three or four years is that during a time of drought and high lamb prices—the highest lamb prices on record—our trade with the United States has continued to grow. That indicates that in the United States there is a willingness to pay for the sorts of lamb products that we produce in Australia, and we are confident that that market will continue to grow for us.

Mr ADAMS—And that is not at the expense of the beef market—it is a new market.

Dr Barnard—No, it is absolutely not at the expense of the beef market; lamb is just a tiny part of US consumer protein intake.

Mr ADAMS—What do they use the mutton for?

Dr Barnard—There is a large Hispanic community now in the United States, so they are one of the groups that demand our mutton.

Mr ADAMS—Is the goat meat trade going to increase?

Dr Barnard—I think it will, yes.

Mr ADAMS—Under the phytosanitary arrangements, part of the agreement is to set up a committee which has the aim of facilitating trade. This has to be about increasing the risks that we take. The simplistic thing to say is that this is about science, but it is really about risk and whether or not you are lowering the level of risk. What do your organisations think about that?

Mr K. Adams—Our understanding is that that is going to remain—the US has agreed to remain science based. The Cattle Council have no concerns about that particular clause that you are referring to. We have pursued this and gained assurances that the regimes will remain science based.

Mr ADAMS—If the protocols change it will mean there is an increase in what is termed the acceptable risk, because that is where quarantine has been going for every industry. Quarantine has been moving towards accepting the bigger risk. It is still based on science but it has a bigger risk, with all the extra costs that are associated with production if you get it wrong. But you accept that that is—

Mr K. Adams—We accept that there is no such thing as a nil risk, unless you want to completely close the borders and stop every tourist coming into the country. There is no scenario where you will have no risk. We are satisfied that the science based approach that has been enunciated will see those risks remain at acceptable levels for our industry.

Mr ADAMS—So you would accept part of a country that has foot-and-mouth disease, and you would accept that part of a country that has not had foot-and-mouth disease for the last 30 years could export product into Australia, based on a scientific statement?

Mr K. Adams—Are you referring to the removal of the 30-day rule?

Mr ADAMS—Yes, the 30-day rule.

Mr de Hayr—I think that scenario would depend entirely on the protocols that are put in place. It is impossible to talk about it on just a broad statement like that.

Mr ADAMS—I think it is a broad statement when you say that you set up a committee dealing with the science based scenarios on the way we could go, but the outcome of the committee's job is to facilitate trade. If you have a blockage in that one country cannot get its product in, it will be arguing for the other country to weaken and accept a broader risk in the product. That is the point I was trying to make. You are telling me that you accept the science based analysis of those protocols.

Mr de Hayr—My understanding is that the agreement allows each country to still retain their right of process, so it is more a consultative process than a binding process. That is my understanding.

CHAIR—I would like to ask you about section 201 of the Trade Act in the United States. Going back about four years, this did have an impact on the action that they took specifically on lamb. I note your comments that you are supportive of the intent. Did you want to say any more

on that? As I understand it, this now means that, unless Australia is responsible, we will be essentially immune from any United States action under section 201.

Dr Barnard—Yes. The point is that, in both beef and sheep meat, we are the major supplier to the market and are therefore not likely to be immune from section 201 safeguard cases if they are brought in the future. For that matter, it includes dumping cases and a whole range of other trade possibilities. We accept that those sorts of general provisions remain in place, but hopefully the closer economic relationships that will inevitably flow from this sort of agreement will mean that there is a lower possibility of those sorts of cases being brought in the future, particularly when they are brought unjustifiably, and that was clearly the case in the section 201 case against our lamb industry.

CHAIR—It gives the President the discretion not to apply the safeguard against Australia if Australia is found not to be a substantial cause of injury?

Dr Barnard—Yes, that is right.

CHAIR—The United States did not give this treatment to Chile in their free trade agreement.

Dr Barnard—I am not aware of that.

CHAIR—They did not.

Mr WILKIE—You mentioned the benefit that we achieved over the life of the agreement for beef. Have you done any modelling to determine what benefit you may have achieved had you obtained what you wanted—free trade?

Dr Barnard—Yes, we did some modelling. I just cannot remember the figures off the top of my head but we would have done some scenarios around completely free trade between Australia and the United States.

Mr WILKIE—I would not mind getting that on notice if possible, because obviously we are saying we got $1.1 billion to $1.7 billion over the life of this agreement, but I would like to put that into some sort of perspective and see how much we would have achieved if we had got free trade as an outcome.

Dr Barnard—Okay.

Senator TCHEN—You said earlier to Mr Wilkie that in your opinion the outcome of this free trade agreement is generally better than you could have achieved through continuing separate trade negotiations with the United States. Is that correct?

Dr Barnard—Absolutely. In my view, the only other scenario that would have brought about a relaxation of our beef quota constraints into the United States would have been a successful conclusion to the current WTO round. I do not think that there are other bilateral mechanisms that would have resulted in a relaxation of that constraint.

Senator TCHEN—You are aware that this agreement provides for amendment and review, subject to further progress in the WTO negotiation. It also sets up mechanisms for further review independent of WTO progress.

Dr Barnard—We are certainly aware that there are review mechanisms under this agreement and that the way this agreement works will vary depending on the outcome to the Doha Round negotiations—as it should.

CHAIR—Thank you for your attendance before the committee today. You have that question on notice from the deputy chair. The secretariat will forward a copy of the proof transcript of evidence to you as soon as it becomes available. Thank you.

Proceedings suspended from 10.58 a.m. to 11.32 a.m.

HAIKERWAL, Dr Mukesh Chandra, Vice President, Australian Medical Association

O'DEA, Mr John F., Director, Australian Medical Association

SHAW, Mr Bruce Victor, Senior Policy Adviser, Australian Medical Association

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

Dr Haikerwal—Mr Chairman and members of the committee, thank you very much for the opportunity to give evidence to you, further to our written submission, on the Australia-United States free trade agreement. The scope of the FTA is widespread and its impact will be felt in many sectors of our society. The AMA's main area of interest in the FTA lies in the possible impact on the Pharmaceutical Benefits Scheme. We do have some interest in other chapters that could impact on our health system, including intellectual property, work force, investment and quarantine.

The AMA opposed the inclusion of the PBS in the FTA. Australians' access to health services in general, and pharmaceuticals in particular, is enviable. Our system provides a clear pathway for all Australians to access medications they need for preventative care, disease treatment and modification, palliative care and maintenance of a lifestyle which would otherwise be curtailed or indeed ended in the absence of such medication. The PBS allows a subsidy to apply to pharmaceuticals, with copayments expected of health care card holders of around $3.80 and copayments of $23.70 for the rest of the population. Once thresholds are reached, there may be no expected out-of-pocket copayment for the remainder of the year in which the threshold has been exceeded.

The level of subsidy to the citizens of Australia range from nil to very substantial for the chemotherapy agents for cancer care. Access is also widened to Indigenous Australians in remote locations through innovative schemes under section 100 arrangements. The most prescribed item by volume on the PBS, lipid lowering agents, cost in general $70 to $80 a month—an individual paying between $3.80 and $23.70 or nil. For this category alone, a $1 increase in cost would amount to $14 million per month in expenditure to government.

In a real sense, the PBS does not simply purchase pharmaceutical products on behalf of the Australian community, but health outcomes—what the products provide. Australian government assurances that the draft FTA will not lead to overall increases in the prices of drugs on the PBS is basic to our support. The AMA remains concerned at suggestions, for example, at a meeting on 9 March 2004 of the US Senate Finance Committee, that Australian PBS prices for patented drugs would increase as a result of the FTA.

There are concerns around the listing of products on the PBS and the conditions applied to those medications under 'restricted benefits' or 'authority required' provisions. The best way of resolving many of the concerns from industry, the profession and the Pharmaceutical Benefits Advisory Committee would be to ensure that the PBS is in no way diminished, that the level of subsidy that Australians receive is maintained and that the best and fairest price is agreed to such that the level of subsidy required is not escalated. If the required subsidy for medication is increased, the overall cost of the PBS will continue to escalate. We need to ensure the PBS remains viable. The reference pricing system, whereby the Australian government negotiates the prices of drugs listed on the PBS, must be strengthened and maintained.

It is possible that inclusion of the PBS within the FTA would enhance the vital role of the PBS within the Australian health system, subject to a number of conditions. The implementation of the FTA will be crucial to how the agreement works in practice and how it will benefit the Australian community. Reducing access to and affordability of medicines would not be acceptable to the AMA.

The AMA believes that transparency is fundamental to the quality use of medicines in Australia and thus supports greater transparency across the whole paradigm of PBS processes. The AMA is concerned that commercial-in-confidence secrecy surrounding research data, including the identity of the comparator drugs used in evaluations of the cost effectiveness et cetera, is a major restraint on the quality use of medicines. In order that the use of medicines is consistent with QUM principles, it is imperative that all the information considered by the Pharmaceutical Benefits Advisory Committee be available to clinicians. All the information that is given to the PBAC should be available to clinicians to ensure best practice management. Such transparency across the whole PBS approval process is fundamental to AMA support for the FTA. It would also allow a clear understanding of the PBS listings and the reasons that restrictions apply.

The AMA believes that the independent review process of the PBAC recommendations required by the FTA must be truly independent and not dominated by any sectional interest, be that industry, professions, consumers or government. Any such review should focus on the issues of concern and not reopen the whole application. It needs to be undertaken by a specialised subcommittee comprising experts relevant to the subject under review. It should consider only information originally provided to the PBAC and relevant to the requested review, and reporting back must be to the PBAC and not directly to the government. The review should also be pragmatic and facilitate, not delay, the PBAC approval processes for PBS listed pharmaceuticals. This will be critical if the FTA is to genuinely enhance the Australian PBS, as claimed.

With respect to patents, the AMA acknowledges the importance of effective intellectual property laws to support and encourage research and development of innovative medicines. The existing Australian patent laws provide effective support for a viable innovative medicines industry in Australia. We must also ensure that any changes to Australian patent laws do not delay the availability of new medicines, increase the cost of medicines in Australia or hinder innovative Australian research.

The AMA would be very concerned if the medicines working group envisaged as part of the FTA were to assume any role in setting rules or making decisions related to the PBS as this

would undermine Australian sovereignty. We note and endorse assurances that this group of federal health officials from the US and Australia will be strictly a consultative forum.

Regarding work force issues, the free trade agreement chapter on cross-border trade and services includes provisions to encourage Australian and US professional bodies to develop mutual recognition arrangements. We understand this will involve agreement between individual states and the US and Australia. Accordingly, it is not likely to be a swift process. The AMA endorses the need for meaningful consultation before any moves in this direction are made and looks forward to involvement in direct consultations. In conclusion, as the peak body representing the medical profession in Australia, the AMA will be vigilant on the progress of the free trade agreement processes to ensure that Australian patients' rights are protected.

CHAIR—Thank you very much for your submission and your opening statement. First of all, on the Pharmaceutical Benefits Scheme and the exchange of letters on pharmaceuticals, are there any things in there—that is, the review mechanisms and so on—which, of themselves, will necessarily lead to increased pharmaceutical prices?

Dr Haikerwal—The significant concerns of industry are why we do not get our drugs listed, why these restrictions are put on and why we as clinicians have to go through so many hoops to get these medications for our patients. Unfortunately, the current system, where the commercial-in-confidence arrangements do not allow for information to be given out, means that we do not get access to that information. Therefore, we are in darkness as to why these processes have happened. There is an opportunity through this process to allow transparency to occur so that, when a decision is made, everybody knows why it is made and why the restrictions are currently applied. If the conditions were to change or be varied, hopefully the access to drugs would improve. In terms of costing specifically, I am not sure if there is any direct involvement in this process. But, obviously, the concerns are around patents and the manner in which the drug prices are negotiated.

Mr Shaw—Also, depending on how the review process is developed—and there is no detail on that as yet—it could delay the process.

CHAIR—In the section of your submission relating to the review of the PBAC recommendations, you have five dot points. Are all of those consistent with the Australia-US free trade agreement, in your opinion?

Dr Haikerwal—I believe so, yes.

CHAIR—So all of these—things like an independent review process and so on—are achievable within the context of the Australia-US free trade agreement and that would be important from the point of view of the AMA?

Dr Haikerwal—It is important that the points are adhered to because they bring back into play the relationship with the government's own advisory committee, on whom the government relies for information, and they make sure that that committee is not demeaned by an alternative process which may not have access to the same degree of information.

Mr WILKIE—I suppose in relation to the appeal process or review mechanism, we do not have the details here, but you are saying that you are happy with the assurance being given by government. If that review process does not meet your standards, what should we do with the free trade agreement?

Dr Haikerwal—The AMA's position recently was that pharmaceutical benefits should really be completely off limits. Obviously it is now part of the agreement and that is the reality—we have to work within the reality. Our belief is that, if these processes undermine the manner in which the PBAC reaches its decision and then undermine the way in which that decision is carried out in an unfair manner or in a way that will negate the effectiveness and clinical competence of the doctors around that PBAC, it would be very unfortunate and certainly something that we could not support in any way.

Mr WILKIE—So I suppose what you are saying is that, if the free trade agreement had the potential to severely damage the Pharmaceutical Benefits Scheme, the AMA would not support the free trade agreement.

Dr Haikerwal—It is of absolutely paramount importance to us that the PBS needs to be maintained to support Australians in terms of the medicines they can receive in a cost-effective manner.

Mr WILKIE—It has been put to the committee that the review process—whilst not having an ability itself to overturn a decision to reject a particular drug—could be used publicly, if it ruled favourably in the case of a particular company or drug, to really force a review by the PBAC to get that drug listed. Do you think that could be an issue?

Dr Haikerwal—I certainly have great confidence in the PBAC and in their processes. I believe they are a most competent group of people around that table, who take into account all the information that is provided. Currently their hands are tied, in that they cannot reveal to clinicians, for instance, what that information is, so that clinicians can then understand why they have put on certain restrictions. If something came up for review by the proposed review body, it should have the same information that the PBAC have, and it should only be talking about the reasons why that submission was rejected, rather than starting the whole process, holus-bolus, with new information. If there is new information, it should be submitted to the PBAC, because they are the ones who still have to be the arbiters of this set of standards that we expect as a community for the pricing of our medications and the restrictions that should or should not apply.

Mr WILKIE—But do you think that potentially a drug company could use a review which was in its favour to try and force through some change to the PBAC's views?

Dr Haikerwal—Obviously, if the whole idea of having the review panel is to say, 'We have a problem with the way in which you have reached your decision,' and that decision is contrary to that of the PBAC, the expectation is that the PBAC would then review their findings.

Mr WILKIE—Okay.

CHAIR—Is there anything wrong with a review process per se?

Dr Haikerwal—I do not think so. I think there is some good reason for a review process to be there. However, implementing any change that may be suggested has to go back to the PBAC, because that is where all the information is centralised and analysed by these people. And, if you have 12 people around a table who have such expertise, and it is constantly undermined, you will not actually get another 12 people.

Mr WILKIE—I suppose that is the problem. If you were continually getting reviews that were against what the PBAC had already dealt with, the drug company would then use that decision and continually come back trying to force their hand. I think that would be the main concern that could occur.

Dr Haikerwal—If you put the transparency there and you actually had all the information in the public arena, then individual clinicians—as well as the PBAC—could also see what the data is. I think you would come to a very similar conclusion. Maybe you could change some of the restrictions, some of the authority requirements that are there—the hoops that people have to pass through—but the fundamentals would remain intact, because they are considered on a very carefully thought out basis.

Mr WILKIE—Right now, there is no hint that the actual review process will be transparent, is there? That is just something that you hope will happen.

Dr Haikerwal—We are very concerned about any review process (a) not being transparent and (b) actually being able to circumvent the decisions of the PBAC and the PBAC process, which is fundamental to the way in which our medications are available to us. It is a fundamentally sound system that provides good medicines at a reasonable cost. It is enviable across the globe, and other people want to take it up—wherein lies a problem.

Mr WILKIE—Thank you.

CHAIR—There were five points, which you said should include a review—and you have already said that, as you understand it, they are consistent with the Australia-US free trade agreement. If those five points were part of the review mechanism, what would be the position of the AMA?

Dr Haikerwal—Obviously, if those five parameters were met, in a transparent manner, we would be comfortable with that.

CHAIR—Thank you.

Mr ADAMS—Regarding transparency, if a pharmaceutical company has a 20-year patent, why would it want to keep the commercial-in-confidence? People are going to break it down over the next 20 years and have something on the market after that. I understand that is how the system works. If a drug company argues that commercial-in-confidence is significant, must it be broken down because of that?

Dr Haikerwal—I think the commercial-in-confidence is really hampering the whole process of clinical care. We often do not get the whole story, and the problem that we as clinicians face is that something is approved or not approved or has an authority or does not, yet there is almost

direct to customer marketing via media or whatever saying, 'This drug can do this.' The public is not getting the full picture. If the full picture were given, you could then understand why it was not listed or why there is a restriction put on it. So, if you are only getting one area magnified and for the rest you have a blindfold on and your glasses are rose tinted, you are not getting a very good picture. We think it is vital that you actually get a clear picture of the whole story so you can then make a good clinical decision.

Mr ADAMS—We want to recognise that innovation and we want to recognise the amount of history and time that has gone into this research, and they are entitled to be rewarded for that. Are you suggesting that that is probably used also to try to get a better price than otherwise?

Dr Haikerwal—Certain drugs do get better prices here than in other parts of the world. It is not as though the Australian government is particularly stingy about the way in which it pays for its pharmaceuticals. The AMA believes that the prices paid by the Australian government are fair, and we certainly understand that the cost of bringing a drug to market is huge and therefore has to be recovered. The concerns we have are with the actual data to justify a listing. A list that is probably of larger scope than is necessary, that is shown up by the data as being effective, is being used to promote a particular barrow which would be better if it is targeted than if it is widespread.

Mr ADAMS—So, in this review process, we could say we want that information put up-front: 'Let's have the criteria that says recognition will be given for the research and the costs and everything else but we want to know what that actual cost is—don't muck about with that; let's put it out in front. If we're going to have reviews, let's have them honestly and up-front.' That is the AMA's position?

Dr Haikerwal—The AMA would contend that any drug that goes to the PBAC for listing on the PBS with a government subsidy should have a complete openness about the whole data around that medication.

Mr ADAMS—Totally transparent information so that the Pharmaceutical Benefits Advisory Committee has all the information before it?

Dr Haikerwal—The PBAC does have all the information but it cannot reveal it, so as end users—either as patients or as doctors—we cannot access it.

Mr ADAMS—That is right. You get these major campaigns being run, sometimes on terrible diseases that become a public issue, and it is all about pressure. As a country we should really say, 'We're not going to cop that rubbish; we've got a system and we should protect that system.'

Dr Haikerwal—I agree absolutely.

Mr ADAMS—On 9 March the US Senate Finance Committee was told that the PBS prices for patented drugs would increase as a result of the free trade agreement with Australia. You have some concern with that sort of statement being made in the US?

Dr Haikerwal—Obviously it is a concern: if any particular increase comes to bear on the Australian system, it is a concern. A similar set of letters was circulated in Australia by certain senior congress members from the US. It is imperative that we do have access to medications for our people in the manner that we are accustomed to. If it is simply because of an agreement that prices will rise, then that is not acceptable. If they are to rise because there is new innovation or a drug is more expensive, that is reasonable.

Mr ADAMS—They should be rewarded for that innovation.

Dr Haikerwal—Exactly. But, at the end of the day, the system that we have is so good, so effective and so efficient that it does send fear to industry.

Mr ADAMS—Regarding your concern about patent laws, you do not think that use patents, which have been used in the United States and which give patents another life for a whole variety of reasons, are a valid proposition?

Mr Shaw—We do have use patents in Australia, but not to the same extent that they do in the US.

Mr ADAMS—What are the reasons behind use patents? Is it to give a patent a longer period?

Mr Shaw—They are most commonly used when a patent has not been taken out on the common compound but, rather, on the use to which that compound is put. If someone develops a new use for a compound which has been commonly available, possibly for centuries, they can patent that use of it.

Senator KIRK—I have some questions following on from those of Mr Adams. They are in relation to the comments made by the Senate Committee on Finance in the United States. I do not think you mentioned in your answer to Mr Adams the reasons or basis underlying the suggestions made at the finance committee in relation to the increase in the cost of PBS drugs.

Dr Haikerwal—The concern was that they felt that they were probably getting an unfair price from the Australian government, which was driving a harsh bargain. They felt that this might reduce the impact of the pricing authority in determining the price of products. That would be the main reason why that would be there.

Mr Shaw—That is correct, yes.

Dr Haikerwal—If you have negotiated a price, you are not going to be doing it roughly. If it is too low you would not be selling your products. We have seen that with other drugs that were not brought onto the Australian market or were withdrawn from the Australian market. We see that across the Tasman in New Zealand, where medications just are not available. I think that is the line that we have to steer along to make sure that our population does get the access to medication that we need it to have and—because fair's fair—that we allow a decent price for it.

Mr Shaw—Have you seen the transcript of that US Senate committee hearing?

Senator KIRK—No, I have not. I was going to ask if you might be able to table it.

Mr Shaw—We have a hard copy which we are happy to table.

Senator KIRK—Thank you.

CHAIR—If you would like to table it, we will authorise this transcript as an exhibit to the inquiry. That is moved by Senator Kirk and seconded by Mr Adams. As all are in favour, that is now an exhibit to our inquiry.

Senator KIRK—Are you reassured that this possibility that has been suggested in the US Senate finance committee will not in fact become manifest in Australia under the free trade agreement?

Dr Haikerwal—No, we are certainly not reassured. That is why we want to be very direct about our concerns about this system, the excellence of the system that we have, the need for the system to be maintained and for PBAC's autonomy not to be undermined.

Senator KIRK—Have you sought any reassurance from any of the major players such as the Minister for Trade, for example?

Dr Haikerwal—My president has written to the Minister for Health and Ageing on this issue and certainly has made representations in a face-to-face manner.

Senator KIRK—Have you received a response from the minister?

Mr Shaw—Not yet, no. We are happy with the briefings and consultations that we have had from both DFAT and the department of health and their assurances that that consultation process will continue as the implementation of the FTA is rolled out and developed. But we do need to be fairly vigilant.

Dr Haikerwal—We certainly reserve the right to make the public very aware of any implications for health care should this thing roll out in a manner that is not acceptable.

Senator KIRK—Have you sought any external advice—from consultants, for example—as to the likely operation of the agreement in this regard?

Mr Shaw—Yes. We have been meeting with other stakeholders on both sides of the fence, such as Medicines Australia and others.

Senator KIRK—Do they share your concerns?

Mr Shaw—It depends on the group. I do not think that Medicines Australia would share our concerns but we are consulting with them on trying to ensure that what is developed is for the common good and in the public interest.

Senator MASON—My colleagues have ably asked questions regarding the PBS, so I will not. Part of the aim of the US free trade agreement is to enhance the recognition of professional qualifications. Will this agreement assist in the recognition of Australian qualifications in medicine? Will it assist, for example, the chairman to practise medicine in the United States?

CHAIR—I passed my exam for recognition in the United States 15 years ago.

Senator MASON—There you go. I should not have asked. Will it make it easier for Australian doctors to practise in the United States?

Dr Haikerwal—The hope is that it would, but the answer is that it probably would not. That is the long and the short of it. These are individual agreements between states. Although Australia is going through a process of some sort of harmonisation of that across our states, it is not likely to be occurring over there right now. The exam that the chairman would have taken in the past is back with a vengeance; it has not gone away. There is certainly an expectation for people to pass that exam unless there are special circumstances where a person of specific qualities is there on a research or academic posting. But in terms of working unrestricted in the US, the same hoops would need to be jumped through.

Senator MASON—The United States medical system also has to play to the federal nature of the United States, so registration is state by state. Is that right?

Mr O'Dea—Yes. Registration in both countries is done at a state level. What the agreement does is what other agreements have done. It is a pretty standard procedure. It establishes a framework for a dialogue between the federal and state agencies in the US and Australia. Whether it improves things depends on the outcome of that dialogue. I suspect that there will be movement between particular states in Australia and particular states in the US, and those discussions will probably be focused on a few of the bigger states with the better health facilities or whatever.

Senator MASON—I must ask these questions when we talk to the lawyers, Chair, because for a long time in Australia if you were admitted in one jurisdiction it was difficult to practise in another. You may know that. It is much easier now. It would be nice to think that we could practise in the United States, Mr Adams, but I suspect that once again it would be more difficult than perhaps you might have thought.

Mr ADAMS—We still have the Senate and that is a state house, Senator.

Mr O'Dea—In Australia the difficulty in registration between states is a financial one, really. You have to pay.

Senator MASON—That is right. I know that in the United States there are slightly different legal systems in some of the states. But still there is a tendency to protection among all professions. It is not that easy to practise in the United States as a doctor or indeed as a lawyer. But it would be interesting to know what is happening and how it will be made easier.

Dr Haikerwal—That transfer of information and personnel and the desire to try out other systems are actually very invigorating for both systems. I think it will be useful. It would be good to make sure that that does happen and does ease the process.

Senator MASON—I think it would be terrific in the legal area. It is becoming easier with agreements with places like Singapore and so forth, but I am not so sure about the United States as yet.

Mr Shaw—We would have two concerns. One would be the maintenance of standards and the other would be that the floodgates are not simply opened for an exodus of Australia's doctors to the US.

Senator MASON—Surely not.

Mr WILKIE—I think the other way would probably be more of a problem in that there are low-paid US doctors wanting to get in here and actually make a decent living for themselves. They tend to get ripped off over there in some places. In relation to putting that into practice, do many of our doctors go to the United States to practise?

Dr Haikerwal—Absolutely. Doctors in Australia are well recognised overseas for their qualities and expertise and the service they provide, certainly in the UK and in the USA. The qualifications of BTA do a lot to somebody's prestige.

Mr WILKIE—A lot of professionals have come before the committee suggesting that visa access has been very difficult for professionals from Australia who are trying to get into the US. On some occasions they have had to wait up to two years to get visas. Has that been your experience?

Mr O'Dea—Yes. Part of the task of this group and the free trade agreement is to sort out the visa arrangements as well. It is definitely part of the story. It is quite routine now for Australian doctors—physicians and surgeons—to seek some post-training experience in the US.

Mr WILKIE—Would US doctors coming to Australia experience the same sorts of problems with visas?

Mr O'Dea—They would, but that again is part of the framework to be sorted out. The flow in these things is usually from the smaller economy to the bigger economy, and I think our doctors go there for experience much more often than their doctors come here.

Mr WILKIE—It is fair to say, though, that the agreement does not deal with this—it just allows for ongoing dialogue—whereas in other agreements that the US negotiated they actually sorted out these issues.

Mr O'Dea—I think that is right. We certainly do not want to stifle temporary movements of our doctors to the US to get experience. It is a great thing, but we do not want them to go there permanently.

CHAIR—I just want some clarification. Is it still the case that an Australian medical graduate from one of our medical schools automatically has recognition in the United Kingdom?

Dr Haikerwal—Not anymore. You still have to register with the GMC and PLAB, the proficiency in language testing board, which could be important.

CHAIR—Presumably an Australian graduate would not have difficulty with a language proficiency test.

Dr Haikerwal—There would be no difficulty, but they would have to sit the exam.

CHAIR—For the United States, what are the steps that an Australian graduate would take?

Dr Haikerwal—The steps are similar. They would have to do the same set of exams except that they come in multiple-choice questions. Then they have to be recognised over there with the second part and then get registration with individual state boards.

CHAIR—With an individual state. It is probably true that most Australian graduates would go there as part of their training rather than emigrate to the United States.

Dr Haikerwal—Yes.

CHAIR—I think that is the case. Do United States graduates do the AMC exam here?

Dr Haikerwal—The expectation is that they would in order to have unrestricted practice but, if they go to an area of need where they have a speciality that is recognised, they can work in that speciality in approved posts in an unrestricted manner.

CHAIR—Without any proficiency exam?

Dr Haikerwal—As long as they have been recognised by the local medical board in the state and the visa requirements are agreed to.

CHAIR—Another category is American citizens who are studying at Australian medical schools. In my electorate, Flinders University medical school has a number of American citizens who are doing the course as overseas students. Will they have to go through the same requirements as an Australian graduate?

Dr Haikerwal—To enter the United States?

CHAIR—Yes.

Dr Haikerwal—I think from a professional qualification point of view they may well do, but, obviously, with regard to visa requirements they would not. Certainly, if they wish to stay and practise in Australia, they can do two years under the latest scheme that was announced by the previous health minister, Senator Patterson. So they could work for two years. The American system certainly finds Australian medical degrees a great bargain compared to studying medicine in the US.

CHAIR—I also want to ask you a bit about your submission on patents. I think you have made some very valid points about the practice in the United States which involves compounds remaining in patent for a much longer period just by changing the formulation or whatever. In your opinion, is there anything in the Australia-US free trade agreement which would allow that?

Mr Shaw—It could. A lot of the devil is in the detail. The FTA is 1,000 pages long, but there is very little detail in it—at least with regard to health areas, so the negotiators are quite open with us about the fact that the details need to be worked out, developed and negotiated. We

welcome the fact that we have been consulted on that and look forward to continuing to be consulted.

CHAIR—It is an important issue to raise. As I understand it, we are keeping in principle Australia's existing intellectual property regime.

Mr Shaw—Yes.

CHAIR—There are some changes to copyright, for example. The article on patents generally reflects Australia's current laws. It is not anticipated that major changes to the Patents Act will be needed to implement the FTA.

Mr Shaw—I think they changed their mind on that. I think there is one change needed, although it might be to the Therapeutic Goods Act in regard to the patents area. It relates to drugs coming off patent and the hoops that a company that wants to manufacture generic products needs to go through in terms of notifying the patent holder.

CHAIR—What does that involve?

Mr Shaw—I think it is mainly if they want to start their development process before the drug comes off patent. That would be usual. If they want to hit the market as soon as a drug comes off patent, they need to get access to some of the information. At the moment, because it is a registered drug, they have been able to get that information through the TGA. My understanding from the briefings we have had is that the change that will be required is they will need to notify the patent holder of their wish to have that.

CHAIR—I have it here. In relation to changes to the Therapeutic Goods Act, it says:

… that a patent owner be notified of an application for marketing approval in those cases in which the person seeking the approval considers the patent invalid and intends to market a generic version of a patented product before the patent expires.

That is separate, though, from use patents.

Mr Shaw—That is a very separate issue, yes.

CHAIR—And there is nothing in the Australia-US free trade agreement that involves the introduction of use patents in Australian intellectual property.

Mr Shaw—No, apart from—and I cannot remember the exact words—a general undertaking to think seriously about a closer alignment of the patent laws between the two parties.

Senator MASON—I have been reading through this exhibit from the United States Senate Finance Committee. You say in your submission that that committee suggests that Australian PBS prices for patented drugs would increase as a result of the free trade agreement. I think that is a bit of a gloss on what I have read here.

Mr Shaw—Certainly Ambassador Zoellick did not agree to that, but one of the senators was quite excited about it.

Senator MASON—Senator Jon Kyl does suggest that perhaps there should be a greater sharing of the burden of the cost of research and development. That is true, but Ambassador Zoellick did not say that.

Mr Shaw—No, he changed the subject basically.

Senator MASON—He said:

It is not a question really of raising prices; it is a question of kind of distribution of those prices, like one of the things we learned in Australia was because of the pricing system they had, generic prices were higher than they are relative to the research based prices.

What he is saying is that because of the way we do things the markets are always distorted. I think it is a bit of a gloss to say there was a suggestion put forward by Senator Kyl, because Ambassador Zoellick's evidence would seem to mean that it is not a question of raising prices.

Mr Shaw—Yes.

Senator MASON—Would you agree?

Mr Shaw—Our submission did not suggest he had said that but certainly the media reports at the time did.

Senator MASON—The second paragraph on the first page of your submission says:

The AMA remains concerned at suggestions, for example at a meeting on 9 March 2004 of the US Senate Finance Committee, that Australian PBS prices for patented drugs would increase ...

I think 'would increase' is slightly over the top as a description of the evidence. Do you agree?

Mr Shaw—Our reading was that Senator Kyl was essentially congratulating Ambassador Zoellick on setting up a situation in which they would increase. Ambassador Zoellick then gently hosed that expectation down.

Mr ADAMS—Possibly because he understood that there would be some concerns in Australia about that?

Mr Shaw—Yes.

Mr ADAMS—But the US senator, who is probably going to vote on this agreement, was in agreement; he thought there was going to be an increase for the drug manufacturers of the USA.

Senator MASON—He was in agreement with himself.

Mr ADAMS—I think you are making light of a very important issue.

Senator MASON—I am not making light of it. This is the evidence.

CHAIR—We have the transcript of what was said.

Mr ADAMS—I would like to make a point. Senator Mason is taking this as a very flippant point. It is a point that I believe is very important in this agreement—and that is the accountability and maintenance of the PBS. I think there are expectations in the United States that out of this agreement will come an increase in patented drugs. That has been given in evidence; it is there and on the record. We should accept that has been given. It was said in a US Senate committee hearing, and that is the reality.

CHAIR—We have it as an exhibit to the inquiry and so we can—

Senator MASON—The evidence is from one Republican senator—specifically rebuked by the ambassador. That is the evidence.

CHAIR—In that regard we can draw on the exhibit.

Senator TCHEN—I have several questions. I would have liked to have asked Mr Adams whether he always takes what is said by USA senators more seriously than what is said by Australian senators—but I cannot.

Senator MASON—Well said.

Senator TCHEN—Mr Shaw, do you jump to attention every time a senator or a politician gets excited about something?

Mr Shaw—Are you talking about Senator Jon Kyl?

Senator TCHEN—Yes. Until now, I had never heard of Senator Kyl; I did not know he was an authoritative figure in the United States.

Mr Shaw—The media reports in Australia at the time suggested that Ambassador Zoellick was the one who had suggested that the prices would go up, and it took us a little while to track down the actual transcript.

Senator TCHEN—So you are less excited than you were before?

Dr Haikerwal—I think it would be a fair comment that at the time the FTA was subject of an awful lot of media interest and interest within Australia and that we would act on any information that we could get from the USA—which has been minimal.

Senator TCHEN—I appreciate that comment because it is germane to a question I want to ask of you later. Still on the patents issue, do you gentlemen have any comments to make on Mr Zoellick's contention that the Australian pricing mechanism allows for our generic prices to be higher than they should be relative to the research based price?

Dr Haikerwal—I think the evidence shows that in the United States when a drug goes off for patent it drops to about 10 per cent of the actual cost and in Australia it drops to about 60 per cent; also the penetration or use of medications that are generic in Australia is not as widespread. I think the relative price of generics in Australia would be more expensive than the price of generic drugs in the US, as obviously the US market is much greater.

Senator TCHEN—So higher generic prices have nothing to do with patents. If harmonisation of the kind you talk about does occur, do you see there being a possibility of a reduction in the prices of generic drugs in Australia?

Dr Haikerwal—I think it depends on how many people in the country need that particular medication; it depends on the extent of the use of the medication. A greater volume will force the prices down, and the volume is greater in the States.

Senator TCHEN—So the ball will come back into the doctor's court and it will depend on how he prescribes.

Dr Haikerwal—Absolutely.

Senator TCHEN—'Transparency' is a term which features in your submission—and it is used quite frequently in this inquiry also. What exactly do you mean by it?

Dr Haikerwal—It relates to the process by which medication comes on to our PBS for us to use. Obviously the Therapeutic Goods Administration has to recognise a drug as being a therapeutic product that is worthy. A submission is then made by the manufacturer for that drug, through the PBAC, to go on to the PBS. All the information had by the manufacturer is submitted to the PBAC. The PBAC has to then make a decision as to the circumstances under which that drug will be available. With a drug that has a list as long as your arm relating to why I can and cannot use it, a problem arises in that I think the PBAC does not want me to use it. Then phone calls have to be made and I have to go through and over all these other sorts of hoops and hurdles.

What the PBAC would say is: 'We are doing this while bearing in mind all the cost-effectiveness data that we have.' However, they are not allowed to reveal back to us the clinicians the full issues—what that data is that made them restrict it only to a certain group or subgroup of the larger group that could potentially benefit. If you take the most recent diabetes medication group, the glitazones, they have a large potential audience but in reality only a small audience. They are not allowed to reveal to us the reasoning behind that. We then get the manufacturers going out and saying, 'These drugs are superb. You need to be able to use these on a regular basis because they will have much better effects.' But they are only using a certain proportion of their data. They are not giving us the full picture. It may be okay with this data but, if you look at the whole data, it is not that beneficial to the entire group. I am just using that as an example. I have not seen the data to be able to comment whether it will or will not benefit the larger group of people.

Therein lies the problem: you do not have the information to be able to make a reasoned choice about medications for a patient unless you ask for them to pay for it privately, because the PBAC is not allowed to reveal that information. Then the manufacturer coming out to the

public—either through the patient groups or the lobby groups, if you like, or otherwise—and saying that you should be able to use that makes the whole thing a very jumbled mess. It almost looks like we are not giving people medication that would benefit them, and we cannot get access to it. We cannot access it because they have decided that there is no point, and they cannot tell us why there is no point. If everybody knew what the information was—'That is why it is only good for this group and not the whole group'—then we could say, 'Fair go. You can't have it. It's not going to be much cop for you,' and the patients would say, 'Okay. If it's not going to do me any good I don't want a course of it anyway.' The transparency is not going to be a hindrance but a help.

What we will say about the PBS is that currently it is under a tremendous strain. However, some drugs are used suboptimally. In the *Australian Financial Review* today the cholesterol lowering agents are mentioned as coming down in price because of patent issues. However, there is actually going to be a greater number of people needing them as the criteria for going onto these drugs changes.

Senator TCHEN—So what you are saying is that the transparency the AMA is seeking is transparency between the PBAC and the medical professionals; you are not seeking a public access form of transparency where all this information would be in the public domain?

Dr Haikerwal—We certainly contend that if any medication is submitted to the PBAC, the Pharmaceutical Benefits Advisory Committee, to be listed onto the PBS, then all the information that is presented to the PBAC should be accessible to the public, and that would include us.

Senator TCHEN—Do you think that would actually help? Transparency and the ability to see the information is one thing; the ability to understand the information is something else altogether. For example, I am sure that you are quite happy to show me your script, but my ability to understand your script is severely limited. The interpretation I have of your script could be totally wrong.

Dr Haikerwal—Absolutely. That is why we would expect that the clinicians who are involved in that particular sub-area will then be able to make an informed decision based on the entire data that they have as to whether it is worth treating more than the subgroup that can currently access that medication. Obviously, for the majority of people who have no understanding of the medication the data will be of no use; for a clinician outside their area of expertise it may be of no use; but for the specific groups of specialists and certainly general practitioners it will be of use. For individual patients of course we have consumer information in the package—consumer product information. That is an important part of the public being aware of what is going on too.

Senator TCHEN—I understand. I appreciate that, because I was a bit confused earlier when you said, specifically, that the AMA has full confidence in the PBAC, and yet it appears that you may not be all that comfortable with the recommendation. You have made it quite clear that that is because of the inability to enable the clinicians to make an assessment on an individual basis—I understand that—but you do appreciate that my concern is about the term 'transparency'. For example, as Senator Kyl and Ambassador Zoellick have said earlier, the media got it quite wrong even though they had the information in front of them.

Dr Haikerwal—Yes.

Mr WILKIE—With respect to the transcript that has been tabled, quoting—

Mr Shaw—Before you start, do you have another copy that we could have a look at? I gave away the only copy that I had with me. I do have another one back in the office, but I only brought one with me.

Mr WILKIE—That is okay. The transcript quotes Senator Kyl, but I want to go back to what Ambassador Zoellick said before Senator Kyl made his comments, which is in the previous couple of pages. Ambassador Zoellick made the comment:

I worked with Senator Kyl on this pharmaceutical benefits system, which I know we may want to talk about a little further, but I think it's an important development, and I appreciate his help. He went to Australia on this with us.

Basically, Zoellick was saying that the expert in regards to the PBS was Senator Kyl. Someone said that he hosed him down later, and I do not think that that is necessarily true. Ambassador Zoellick was acknowledging that what Kyl had to say was quite noteworthy.

CHAIR—Short of inviting Senator Kyl or Ambassador Zoellick before the committee, I think we can only ask the AMA. The AMA can speak for themselves, and I am sure Senator Kyl and Ambassador Zoellick can speak for themselves as well.

Mr WILKIE—What I am saying is that Ambassador Zoellick did comment, and he said Senator Kyl was actually one of the authorities on the agreement.

Senator MASON—He is a diplomat. They all say that.

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

Proceedings suspended from 12.27 p.m. to 2.01 p.m.

DAVIS, Dr Brent, Director, Trade and International Affairs, Australian Chamber of Commerce and Industry

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

Dr Davis—Thank you, Mr Chairman. It is always a pleasure to appear before these parliamentary inquiries. We did a recent count, and I think this is No. 47 for me. So I will not claim novice's immunity. We very much supported the formation of the treaties committee a number of years ago. We find it a very useful means for promoting some transparency about many of our treaty instruments. For those of us with a legal background, we know the primacy that can be afforded to treaties over domestic law. Regrettably in the past—and it is nonpartisan comment—all too many treaties pass through our parliamentary or legal processes with less than sufficient attention. We see this committee as being a very useful means for shining some light into some corners.

The Australian Chamber of Commerce and Industry's view on the USFTA is reasonably straightforward in our submission. We see it on balance as a positive initiative for Australia. Of course the treaty itself is only a part of the matter. It is a legal instrument. The dividends or otherwise of the FTA will really depend on how businesspeople on both sides of the Pacific respond to it. It is a legal document which has a number of positive features. What we have to do now to assess its full effectiveness is to ensure that the business community and others understand what is in the instrument and move to realise the opportunities which are opened by it.

CHAIR—Thank you very much. You said that the ACCI sees the FTA on balance as positive. Do you want to say what you see as the pros and cons for your members?

Dr Davis—We have long been a supporter of free trade. This goes back a long way, but in more recent time we would point to instruments like ANZCERTA—between Australia and New Zealand—and the various GATT, now WTO, rounds. We have invested a lot of our intellectual and financial capital into promoting those causes within Australia and elsewhere. Our view remains that the WTO must be the main game in global trade liberalisation. It has the largest number of members, it has the broadest sweep of coverage and it has a reasonably robust dispute settlement mechanism. Our goal is to make the whole world one big free trade area. We have attended numerous ministerial and other meetings at the WTO to press that agenda.

Our concern always, of course, is to advance trade liberalisation. We share the concerns of other parties who say the more regional and bilateral free trade agreements we have the more vulnerable we are to creating a two-tiered multilateral system—that is, a WTO system—and a whole raft of regional and bilateral agreements. In principle, I think that holds with the United States free trade agreement just as much as it does with the FTAs with Singapore and Thailand,

and others that we are looking to negotiate. However, we do share the Australian government's view, which is that these instruments can have a positive dividend where they bring forth outcomes that would not normally be available in the WTO. For example, the US FTA has chapters on investment; the WTO at the moment does not. The US FTA has a chapter on government procurement; the WTO at the moment does not. So we can see some useful broadening of agendas and some trialling.

The other issue is that we do—and we have heard this allegation—compromise some of our negotiating positions in the WTO. We are aware of the argument that, for example, we have made concessions on agriculture in the US FTA that we would not have made elsewhere. The third view we take is that if we can continue to progress trade liberalisation in regional and bilateral agreements like the US FTA then we can provide some discipline, if you like, for those within the WTO who refuse to do so—that is, small cliques or fora within the WTO cannot hold the overall initiative to hostage because they have a multiplicity of agenda. It reminds some people that, yes, the WTO is the main game, but seeking to hold it hostage to a few narrow vested interests just does not work, and there are alternatives out there. On balance, our constituencies say the WTO is the main game, but if the WTO is in recess and is not making progress—as seems to be the case at the moment—then we should not sit on our hands blindly but we should look at trade liberalisation options where we can find them, as long as they are, firstly, WTO consistent and WTO-plus.

CHAIR—I wanted to ask you about that. You see the Australian-US free trade agreement as WTO consistent?

Dr Davis—We could not imagine the Australian government, whether it was an Australian Labor Party or a Liberal-National Party coalition government, going into that sort of agreement. We are aware from our work with the Department of Foreign Affairs and Trade that they are very sensitive to the WTO obligations. Indeed, our foreign policy, and our foreign trade policy especially, has us as a very active intervenor in the WTO dispute settlement processes, and I do not think it would be in Australia's diplomatic advantage or trade policy advantage to be a defendant at a dispute settlement panel.

CHAIR—The free trade agreement is WTO-plus?

Dr Davis—At the moment it would appear so. I think we have made some progress in areas like government procurement, where the WTO is silent, and investment, where it is also silent. In terms of some other areas, it is hard to say whether it is WTO-plus in areas like intellectual property. We are still working through those sorts of issues. I cannot speak to agriculture; that is outside our area of responsibilities.

CHAIR—Does the ACCI believe it is a reasonable approach, given that what was the millennial trade round, renamed the Doha Round, appears to have stalled? Is it the opinion of the ACCI that it is a reasonable approach to look for further liberalisation through bilateral free trade agreements, as long as they are consistent with the WTO?

Dr Davis—There is a two-part answer to that. The first part is: where the WTO is inactive, as it appears to be at the moment—that is, with agreements like the US FTA. That is only an example. As members of the committee may well be aware, our foreign service is looking to

negotiate a free trade agreement with the People's Republic of China and the Association of South East Asian Nations. Again, the question of the US is just an example. In our view, when the WTO is passive or, if you like, drifting in neutral then it is a good strategy. The second part of the answer is that, if it came down to the last unit of resources and the Australian government of whichever political persuasion had to make a decision between a bilateral negotiation and the WTO, we would always say that, if it were an either/or decision and you could use that one lot of resources only once, we would say, 'Tip it into the WTO ahead of a bilateral negotiation.'

CHAIR—In the third last paragraph you say that if some of the implementing legislation were amended 'there is an arguable case such actions could render the FTA voidable'. Would you care to expand on that?

Dr Davis—As members of the committee have probably been briefed, the United States process running parallel to your own process is based on what is called 'fast-track'—that is, it is an all-or-nothing vote in the United States Senate: they vote the entire thing up or they vote the entire thing down. They cannot go through what they see as the wont of the United States Congress saying they like this or dislike the other and ask for things to be written. That would put their negotiators in an untenable and probably weakened position relative to the other party.

I do not need to elaborate on the Australian process here. However, one of the key issues in any treaty, apart from what is in it, is always: what are some of the consequential amendments to legislation? It is well known that nine items of federal legislation will need to be amended consequent to this instrument; I cannot speak on the number that will need to be amended at a state level. My understanding of the law of international treaties is that the Australian parliament will obviously have to consider the consequential amendments to legislation. If they do not pass those amendments, or if they substantially amend that legislation in a manner that is inconsistent with the draft instrument, the other party may treat that as a breach, or, potentially, depending on how they wish to play it, a denial of benefit or nullification, in which case they could walk away.

So in one respect the United States system has an all-or-nothing approach and in another respect the Australian parliament is also all-or-nothing. Hypothetically, if, for whatever good reason it may come to, the parliament refuses to change one of the nine pieces of legislation, the Americans may say: 'That is a significant part of our negotiations. We deem that you have not acted in good faith and have not delivered on your obligations. We see a denial of benefit or a nullification. We refuse to ratify.'

Mr WILKIE—You said that under the WTO we have to call this a free trade agreement. Why is that?

Dr Davis—We do not have to call it a free trade agreement. The main obligation under the WTO rules is GATT article 24 which covers substantially all trade. That is the legal obligation we have to show.

Mr WILKIE—Do you think this agreement actually achieves that, given that we have so many restrictions that will not be lifted until 18 years down the track? A lot of people have said to us that we have achieved a trade agreement but certainly not a free trade agreement. That view has been clear in a lot of the submissions we have received. What is the ACCI's view?

Dr Davis—It is certainly a freer trade agreement. What is a free trade agreement? The purest free trade agreement in the world is probably the ANZCERTA agreement between us and New Zealand. I guess it is a bit like beauty. Is it free? It is freer than it was. Is it pure—lilywhite? No, it is not. But it is certainly a trade liberalisation agreement. We have also heard the argument that these are not trade liberalisation agreements but market liberalisation agreements, because there are chapters in this instrument, as there are in others, that do not deal with trade issues—for example, competition. An argument could be made that it is in fact a freer market agreement as distinct from a free trade agreement. There are many different semantic perspectives one can bring to this.

Mr WILKIE—I was reading your newsletter, the *ACCI Review*, of April 2004, which I think forms the main part of your submission. You made comments in it regarding services. You have said that Australian negotiators have achieved greater mutual recognition of qualifications for professionals. We have heard from professional organisations that acknowledge that is not the case whatsoever. A working group will be established to look at qualifications, but the agreement did not achieve any actual recognition of qualifications.

Dr Davis—Again, it is a step forward. One necessarily has to be brief in these notes, but the objective of that working group is to move towards stronger mutual recognition of qualifications. We look over our shoulder and see the Singapore free trade agreement where there was better recognition in some of the professional areas—for example, law, engineering and dentistry—and it is our expectation that the US-Australia FTA will go in the same direction. Of course, it is a much more complex system. They have a larger number of universities.

Mr WILKIE—I suppose the submission says it has 'achieved greater mutual recognition' when, in fact, it has not achieved any. It has only achieved a continued discussion about qualifications. What did the ACCI then think about the fact that we did not get any greater access for our professionals into the US in terms of visa provisions?

Dr Davis—Visas are a complex issue and one can look at some parallel initiatives there in the immigration area. They are looking towards an electronic travel authority arrangement that will help one get into the US market. I think we do have to be careful and Mr Wilkie's questions are touching on probably one of the real problems we look at with these agreements, which is that at the outset we expect the agreement to be everything in one go. I think that is a misconception out there in the broader community. I am convinced Mr Wilkie can obviously see the difference. The New Zealand FTA, for example—ANZCERTA, the Australia-New Zealand Closer Economic Relations (CER) Trade Agreement—actually took three iterations. There was a foundation iteration negotiated in 1980 under Mr Fraser's administration. There was a second iteration in 1984 brought into place by Mr Hawke, and then a second and one-half iteration in 1990. So, again, I think we have to look at this as a first step along a path of processes. In agreements like this it is not unusual to see the setting up of structures, for example, committees on mutual recognition and services—and there is a raft of others in there—that act as stepping stones to go forward. If you like, we have only just taken the first substantive step on a longer program and I would suggest that this committee or its successors may be here in five or seven years time looking at variants 2, 3 and 4.

Mr WILKIE—I am just wondering, has the ACCI had a chance to have a look at the new Centre for International Economics budgeting and model?

Dr Davis—As best one can in four hours.

Mr WILKIE—I was going to ask you if you supported the findings but I suppose you really need more time to analyse it.

Dr Davis—My PhD is in econometrics so I come at these things a bit more—how can I say?—analytically robust than some others. Yes, I have looked at the modelling. As I say, my PhD is in econometrics so I have an advantage. I know these guys well. Modelling is indicative. What it does is provide you with an insight where there would be nothing otherwise. I think everyone knows it is not an exact science, but it is better than the alternative, which is wandering in the dark. The modelling is robust in a practical sense in that they do use two very credible models: GTAP and G-cubed. I think they have chosen two very good models in there. Their numbers are indicative. There are some innovations in there that I have not seen used before and I am having a look at some of those at the moment. I am aware of the debate over the investment component, for example. I notice the standard errors that are in there are quite wide, which is unusual, and, with regard to some of their work on the dynamic benefits of productivity, I think it is long overdue that that sort of thing is taken into account.

Do we have a view on the reliability of those figures? We regard them as ballpark indicative. They are only starting points. They are an attempt at moving from statics to dynamics. But, of course, what we all know—and as I said in my opening remarks to the chair—is that all this depends on how people react to it. The agreement of itself is useful, but the true dividends of the whole FTA come in how business people in Australia and the United States respond to it. So, do we see these sorts of results coming in? I think in the long run, probably yes. It is hard to model things like government procurement, which is a big opportunities sector. It is hard to model services. It is almost impossible to model intellectual property. We can get a better feel on manufacturers, but the barriers tend to be very low there. So if you are leading to the question: do we regard the figures as credible? Yes, we do. We can cover the margin but we think, as a broad estimate, they are probably a reasonable assumption. Of course, the other side is that you cannot pick up some activities that are not able to be modelled. An example would be of one of our ordinary members who has had problems with the interpretation and administration of regulations. This chap will win new markets, he tells us, worth about $80,000. It is not a big number in terms of modelling, but for his enterprise it is quite a substantial fillip. There are a lot of benefits that simply are not picked up by macro modelling.

Mr WILKIE—Given that 60 per cent of the benefits outlined in the analysis talked about foreign investment increasing, do you think that is a fair comment?

Dr Davis—That most of the benefits rely on one sector?

Mr WILKIE—Do you agree with the analysis that there is going to be that sort of increase in foreign investment?

Dr Davis—We are mindful of the view of the Australian Treasury, which is that they have not been convinced that Australian foreign investment rules constitute a real barrier.

Mr WILKIE—I suppose that is where I am coming from: given that the model is relying so heavily on foreign investment to bring the figures up, is that realistic?

Dr Davis—Yes. As I say, I can only take the view of the Treasury that their policies have not been a barrier to foreign investment. It is a discussion we have had many times. Again, I would say it is a swings and roundabouts exercise. There is probably a large number of benefits that just are not captured by this stuff. If we took our investment as being, say, an overestimate, one could probably make a good argument that the inability to include some of the dividends from government procurement in the agreement may well take its place. So it is a swings and roundabouts exercise.

Mr WILKIE—I am very interested in the foreign investment area, particularly given that it does make up so much of the report's findings. I think they would have used the model for government services if they had thought there would be any great benefit in there.

Dr Davis—It is always a case of developing these exercises.

Mr WILKIE—You would have thought so.

Dr Davis—They generally have what we call high standard errors, which is the measure of their reliability. Our view, as I say, is that they shine a light into an area which would otherwise just be dark, and we get some information rather than nothing.

Mr WILKIE—How credible do you think the modelling is given that when we looked at getting a totally free trade agreement in the earlier modelling they had suggested that we would be $4 billion better off, and now we did not get a free trade agreement; we got the agreement that we have with all the restrictions that are in place, yet the modelling is suggesting over $6 billion in benefits?

Dr Davis—I think one of the key differences in the structure of the two models is how they deal with the dynamic productivity feedback effects, and that is that they have put some weight on those.

Mr WILKIE—Do you think those dynamic gains are justified?

Dr Davis—Conceptually, absolutely.

Mr WILKIE—In reality?

Dr Davis—In reality, absolutely. Are their numbers correct to two decimal places? One could have a very interesting academic argument about that, but I think that they are a reasonable ballpark figure for the extent of academic knowledge that was available to econometric modellers at the time. I think those dynamic benefits are quite credible and I think there is little point in probing them for their veracity.

Mr WILKIE—I am trying to work out, I suppose, what has changed between the modelling they used in the first instance and the modelling they have now used here. I do not take this as gospel, but I think the modeller suggested at one stage that you could not use dynamic gains and now he has turned around and said, 'Yes, we can,' and you have two different results.

Dr Davis—I think you need to take those dynamic benefits into account. Again, it is probably not one of the more exact components of it. I have not studied it closely enough to look at things like what they call 'elasticities', which is the responsiveness to various initiatives, at the exchange rate profiles they have used or at some of their confidence intervals. I think it is a very legitimate line of argument for this committee. It may be worth a break-out session amongst some technical econometricians, where we could have some more robust debates with the committee in attendance, if you wish. I know you have engaged Dr Dee, who was with the Productivity Commission. I am sure she will give you some good advice. But again, these are just best estimates based on knowledge. I would certainly support their work on the manufacturing component; I would certainly support their work on the dynamic feedbacks—I think that work is overdue—and, again, one can have a good discussion about the investment component, mindful of the Treasury view, which is: 'We don't see there are any barriers.' I think there is a division of view within the government on these matters already.

Mr WILKIE—Fair enough. Given that a free trade agreement, if we had achieved it, would have been so important for ACCI members that they would have wanted there to be a really rigorous examination of the findings and the modellings, is the ACCI concerned that the Productivity Commission was not the body that looked at the modelling, given their experience?

Dr Davis—The broader principle for both parties is: what is the role of the Productivity Commission? Its traditional role has been to look at micro reform structural change type issues. While there are some talented people in there, it is not a specialised econometric agency per se. This is probably a broader issue: could the Productivity Commission have done it as well or better? Possibly, possibly not. Could they have turned it round in the same time frame if it was necessary? Possibly, possibly not. If Mr Wilkie is looking for a specialised answer I would say that you may get a marginal gain in accuracy from the Productivity Commission, at the cost of a marginal loss in timeliness. As the committee would well know, the United States Congress has quite a definitive timeline on these matters.

Mr ADAMS—Are you saying that we have consistently used the Productivity Commission on these issues and we have now gone away from the actual model and the body that we have traditionally given the work to?

Dr Davis—Up to a point, that is so. The PC has generally modelled microeconomic structural changes issues. I do not know that it puts its hand up as having great expertise in an international econometric style of modelling. If the PC were to do this sort of work, I am not convinced that it would drift that far away from using GTAP and G-cubed—I think it would probably use those models. You might get more detailed reporting, but I think you might make a trade-off in timeliness in that. The Centre for International Economics and the gentlemen behind these exercises are economists of international standing, and so it would be hard to challenge their intellectual rigour. If something is lost between their reports and that published by the Australian government then that is another issue entirely.

Mr ADAMS—You said that the organisation supported the free trade agreement through trade liberalisation, but isn't it true that trade agreements are really about change to domestic arrangements too, in opening them up? You might have mentioned that a bit earlier. It is really about changing some domestic circumstances as well. How do you see this agreement doing that within Australia?

Dr Davis—There are probably two components: there is a legal component and a cultural component. The message that comes from Australia engaging in trade liberalisation—and we should be mindful that this is a process that has been going on for 20 years under both major political parties—

Mr ADAMS—Sure.

Dr Davis—is one inducing a cultural change. We have seen that over the last 20 years, and that cultural change means that we are no longer a large protectionist island at the bottom of the world. We have to engage with the world, whether it is Asia or the whole world et cetera. We have seen a cultural change come from the WTO system in these free trade agreements.

The second influence is legislative—barriers and hurdles that were there are legislated away. For example, government officials in the United States may have said in standards and conformance testing, known as technical barriers to trade, 'These are the rules I have to implement because this is what congress has legislated'—there is probably an Australian counterpart—'and I have little discretion.' If these free trade agreements move forward to change domestic legislation then the government officials will implement them accordingly. We expect some of the greatest dividends to come from rationalisation and reduction in some of these technical barriers to trade—for example, standards and conformance type arrangements.

To jump back to Mr Wilkie's earlier question, they are almost impossible to model. What happens if they ask me to break down three per cent of my cargo instead of one per cent of my cargo? They may be only small values but if it is destructive testing, say, of asparagus then that might be a small amount in a macromodelling sense but to the enterprise it can be of real value—that is, having one container every year checked intensively instead of five or all of them interfered with on a random basis.

Mr ADAMS—Sure, but then there is the cost if something from our country enters the United States or something from their country enters ours and wipes out an industry or increases the cost of, say, 20 per cent or 30 per cent of production.

Dr Davis—When you say 'wiping out' are you talking about disease or dumping?

Mr ADAMS—Disease. I know that is not your area of expertise, but I thought you were dealing with this measurement of looking at the technical things. They have set up a technical committee under Quarantine, which has got some people pretty concerned that it is really about forcing the risk out. As you said, instead of checking every box, you only check one in five or one in 100. People are getting pretty concerned that that may break down and force an extra risk to the wellbeing of a lot of industry in Australia.

Dr Davis—We have long recognised that risk profiling is essential in clearing customs and, as we say in the trade, boxes across borders—and, in our case, it is usually a waterfront. We have long recognised that it is impossible for Australian Quarantine or Customs to check every container coming into an Australian seaport and we have recognised they need to move to a risk-profiling approach. We have worked with them long and hard on that. We think we have largely got it right. We have some difference in view about how they price it, but we believe at least the structural approach is broadly correct.

We think the US FTA would be reasonably straightforward. The question concerns issues of transhipment and when ships have stopped in other ports, but we imagine the risk profiling of quarantine should be less problematic than with some of our Asian trading partners where certain diseases are more prevalent. For example, India-Australia trade would be particularly problematic. That is not to say that the FTA should be a wedge to unnecessarily lower our standards. We believe in serious bipartisan support in the science based approach to quarantine and testing.

Mr ADAMS—Yes, but that is what you do when you change the profiles, isn't it? If you take it from five boxes to 120, you have set up a bigger risk component for that product.

Dr Davis—Not really. It depends how you select the five boxes. If you want to just follow a simple random sampling technique from statistics and that simple random sample is gathered properly, you have the same chance of capturing a disease or a problem. You also have a capacity for subjective intervention. If you have a reason to believe that there is a virus or a problem either inside the box or more often outside the box—that is, quite literally, something growing on the side of the container—then you have a chance to intervene. For example, I know that, in Tasmania and the Northern Territory, they fumigate just about everything that comes in because of their climatic issues. I cannot see direct Australia-US trade by sea necessarily bringing in any more diseases and air transport trade will probably not either.

Mr ADAMS—Your philosophy that this is a continuous process of breaking down barriers, which fits into that of Quarantine, is really about changing those profiles over a period of time so you get back to a pretty even sort of process.

Dr Davis—We have no problem with 100 per cent tear it apart policy for a country of high disease. We would be very concerned if the Indian Ocean trade was let in on a random sample basis, because of the giant African snail problem. They are huge creatures about the size of a cat. It is a case by case approach. We have a free trade agreement with New Zealand but, when they got fire blight in the apples, up went the barriers. Hypothetically, even if we had a free trade agreement with the east coast of Africa, we would still expect exceptionally high quarantine standards. We could have trade barriers with New Zealand but still run at a low quarantine risk, bar one or two exceptions.

Mr ADAMS—They are trying to change the fire blight procedures as we speak.

Dr Davis—As the Tasmanians would know, they have a wonderful opportunity to export apples to Japan and overcome barriers. Yet, perversely, we do not have free trade in agriculture with Japan.

Mr ADAMS—That is right, because we have no fire blight and other things. Do you think this agreement has any effect on our trade with Asia?

Dr Davis—Not per se. I think any number of Asian countries would be quite pleased to have a free trade agreement with the United States if the United States came forward. Equally, we are now at various stages of negotiation with ASEAN, the Association of South-East Asian Nations, about a free trade agreement. As we read in the press, Mr Howard may well go to Vientiane in November, subject to the outcome of the election, and launch an FTA process. Possibly Mr

Latham will be in that position, depending on the will of the Australian voter. We also have discussions in place with China. So I think the idea of FTAs is well known.

Has the US FTA been a catalyst in motivating some other countries towards FTAs? We understand that it has had a positive effect with Japan. The Japanese administration have come to the view that 'We either jump on the wagon or we get left behind.' Their problem is still agriculture, although they are starting to break down at least the principle of trade barriers to agriculture if not the substance—for example, with Tasmanian apples and certain products from Thailand and Mexico.

Mr ADAMS—They will have to change their domestic voting system before they get through their trade issues.

Dr Davis—I defer to others on politics.

Mr ADAMS—I want to ask you about the people movement issue that the United States put up barriers to. They did not set up anything to help break down their sugar issue. You would have thought that they might have tried to do something about their own closed loop there, but they chose not to. They cut off the people movement and said that it was a migration issue. We have received evidence that if we went down this line with the freer flow of investment and changed our regime we would find that joint ventures are pretty important. That seems to be emerging as an issue. For example, if you have the expertise you can go to another country and set up a joint venture, but it needs people flow. Are you concerned that there is a barrier there that we have not broken through from a business and technical perspective?

Dr Davis—One can come to the issue you have raised, Mr Adams, in one of two ways. You can treat it as an issue of the services movement of natural persons or you can treat it as an investment issue. You have dealt with both components at the same time. One component is investment in what they call the essential personnel provisions—that is, 'My investment critically depends on these executives, professionals, tradesmen and intermediate management people and it will not succeed unless I can bring these people with me.' That is quite a common feature of most international investment instruments—the movement of essential personnel as an investment. The second part you deal with is the broader issue of the liberal movement of natural persons. The ability to move freely across borders is usually only a third-generation issue in trade agreements.

Mr ADAMS—That is right. I am not worried about that as such, Mr Davis.

Dr Davis—A CER is a classic example.

Mr ADAMS—I am not overly worried about that. I understand how that fits into trade and everything, but that first one is the one that I am concerned about.

Dr Davis—The tying of investment and people is a common feature of the first one. It is not unique to the US FTA. It has been around in any number of BITs, as we call them—bilateral investment treaties. The Australian government, both major parties, have accepted that nexus between capital and labour. It is not a unique provision.

Mr ADAMS—They have ruled us out, though. They have not accepted that that is in the agreement. The Americans would not move on that.

Dr Davis—On the nexus between essential personnel and investment?

Mr ADAMS—Yes.

Dr Davis—I find that rather unusual.

Mr ADAMS—I think that is the evidence I received. I might be wrong.

Dr Davis—The BITs we have had with the US—the bilateral investment treaties—have always looked at that. I know from our work in other places, such as the International Chamber of Commerce, that the United States has always been one of the strongest advocates of that link with what is called essential personnel issues.

Mr ADAMS—Yes, they may be on their side but they were not too keen on our side. That is what I understand.

Dr Davis—Trade in services is always hard. It probably would be a second- or third-generation issue, when we have moved along the four modes of supply in the GATS—modes 1, 2, 3 and 4. The Americans have to be mindful of most favoured nation treatment. Others have instruments with them and would be looking to leverage up anything we have agreed with them.

Mr ADAMS—Sure, but if we are going to have a freeing up of investment then we might need it. We have a report that is based on the gains that we make, which are about freeing up the investment. I think it is an important point.

Senator MASON—To go to the crux of it, in the second last paragraph of the ACCI review appended to your submission relating to the free trade agreement you say:

While there may be a temptation to score political points at various stages of the relevant parliamentary debates, it would be unfortunate if the longer-term dividends of the FTA were held hostage to such games.

Do you agree with that?

Dr Davis—I wrote the article. I think it is impeccably said.

Senator MASON—Then you conclude—and this really summarises so much of what we have seen over the last month or so:

Rather, while these debates may usefully look at the implications of the FTA for different winners and losers, the better perspective is that this is an Agreement for the whole Australian economy, not just one or two industries.

Is that right?

Dr Davis—Yes.

Senator MASON—So in your view, taken as a whole, this is a good thing for the Australian economy?

Dr Davis—Yes.

Senator MASON—Taken as a whole, is it in the public interest?

Dr Davis—I would like the parliament one day to write the legislation and define the public interest in one place. I believe the good senator is a lawyer and has looked at competition law and found that there are something like 28 different concepts that underpin the public interest in competition law, and we can go on and look at other places. By our definition of the public interest—that is, will it give us better trade outcomes, better economic growth and better employment opportunities?—taken as a whole, yes, it will. Is it perfect? No. Could we have done better? Possibly. Are there competing mechanisms that would give us better outcomes in other places? Yes—the WTO. But it has had dividends. It has probably brought others to the table—the ASEAN countries especially, possibly less so China and maybe Japan—to press ahead with trade liberalisation which they may not have otherwise done so. Do we see losers? There are always going to be those who feel worse off or go through a denial of benefit. The sugar industry is an example of that. That is: we thought we were going to get a gain, we did not get a gain and we expect compensation for something we thought we were going to get but did not get. That is a whole new perspective on public policy.

Senator MASON—I am not an economist, but where you have trade liberalisation it always strikes me that the losers—or those who were deprived of what they thought would be a benefit, which I think is a better phrase—are easy to see and can make a lot of noise. But the broad beneficiaries in the community and in industry often do not have much of a mouthpiece. There may be enormous benefits to trade liberalisation, but they are spread fairly evenly across many people. The people who did not benefit or who lost, squealed. That is legitimate, but so often politicians are hostage to people who did not receive what they thought they would receive.

Dr Davis—If you are not an economist, Senator, you have a marvellous understanding of game theory.

Senator MASON—That is all I want to say. Do you agree?

Dr Davis—It is a comment feature of bipartisan Australian politics. Winners tend to be content and go away, the losers scream. The interesting dynamic that has come out of this is that someone who thought that they were going to get a benefit but did not get it got something anyway. That is a very interesting development in public policy. Will I be required to be compensated because I thought I was going to get something and I did not get it after all?

Senator MASON—That is another issue.

Dr Davis—Wiser political minds than mine will deal with that one.

CHAIR—In your evidence you mentioned a couple of times the CERTA with New Zealand. What do you think the experience has been, over 21 years now, of this bilateral agreement with New Zealand?

Dr Davis—ANZCERTA is probably regarded as one of the purist free trade agreements in the world. There are probably several lessons from ANZCERTA that would apply to the US free trade agreement and the others that are in the pipeline. One lesson is that you never go from point zero to point 100—the whole distance—in one hop. You go through several hops. From my observations, the US one is looking much the same—that is, you go about 60 per cent of the way in the first hop, 30 per cent of the way in the second hop and the last 10 per cent in the last hop. I am only talking economic and commercial issues at the moment. I will leave the more vexed issue of political union, such as that of Australia and New Zealand, which has come up in ANZCERTA, to the side.

I think the US FTA is much the same. I know, because we were a party to some of the Australia-New Zealand ministerial trade talks under ANZCERTA, that, to be frank, they have run out of issues, and you are looking at very particular, finite—if you like, to five decimal places—type issues as an agenda, but largely it is trade. From time to time we have through our constituency some trade irritant, but it is more often than not something that can be resolved through our diplomatic officials talking to the New Zealand diplomatic officials. More often than not it is just a curious interpretation of an obscure regulation, and it is usually handled fairly well.

We would say that at the moment with ANZCERTA there is probably not much further to go in some of the core trade issues. The next step is quite a bold step, which is closer economic union—for example, a single stock exchange; single futures markets. I know there is talk that goes around from time to time of a single currency. I think that is as bold an issue for the New Zealanders as for us. We do hear talk from time to time about political union. Those who have done Australian constitutional law know that the New Zealanders only have to say that they want to come in under, I think, 115 or 121 of our Constitution, and New Zealand becomes the seventh state mandatorily. But I think that is an issue quite down the way for any of us.

CHAIR—But there is certainly much more liberalisation involved in 2004 compared with 1983, when it all began.

Dr Davis—Quite so. But to come back to Mr Adams' point, the movement of natural persons is in fact not part of ANZCERTA; it is actually a stand alone agreement—the trans-Tasman migration agreement.

Mr ADAMS—It has helped the agreement too, hasn't it?

Dr Davis—It has. It has been a great opportunity, and it simplifies it. The US has more complex issues on liberal movement of natural persons than two countries at the bottom of the South Pacific. I think it is a much more vexed question for the US. It has more roll-on issues with Europe, especially Latin America.

Mr ADAMS—And we are at an historical time in 2004.

Dr Davis—We have done a sketched outline that would say that the Australian and US governments, regardless of their party politics and colour, will probably reengage about 2010 for the second generation of issues. We have AUSMIN. We have had a ministerial forum which was set up during, I think, the Hawke years. Its agenda has been a bit more heavy towards the

geopolitical rather than the economic—something of a modest disappointment to us. We would have liked a more balanced agenda. We would reasonably foresee the second generation starting in about 2010. A number of the members have observed that there are working parties under all of this. Almost by definition and diplomacy, that will be the feedstock to set the agenda for that second generation—that is the outcome of those working parties. Plus there are issues that the constituency that I represent identified—for example, 'I've read the agreement. I thought this was going to do it, and then officials from both sides said, "Hang on, that's not what we expect" and so on.' Dispute settlement is of course a matter of consensus and negotiation, which we think is the best thing for this type of instrument.

CHAIR—On page 2 of your submission you said:

The Australian Government has also made a commitment under the FTA to substantially harmonise our intellectual property laws with those of the United States ..

And yet on page 99 of the guide to the agreement, prepared by DFAT, there is a little box saying:

The Article on Patents generally reflects Australia's current laws and it is not anticipated that major changes to the Patents Act 1990 will be needed to implement the FTA. Australia's ability to access certain exceptions ... have been preserved.

Dr Davis—Can you advise me on whether that reports on the nine items of legislation that require amendment? Did they disclose that in that piece?

CHAIR—That is basically the guide to the agreement. With respect to the nine items, we have been advised that, on the intellectual property side, annex 8 of the national interest analysis says:

- Amendments to the *Copyright Act 1968* to address a number of obligations, including, but not limited to, copyright term extension, ISP liability and criminal penalties.

And then it goes on to list a number of those obligations. Annex 8 goes on to say:

- Amendments to the *Patents Act 1990* to ensure that the ground for revocation of a patent will continue to be available.

There seems to be some difference of opinion as to whether we have harmonisation or whether we are keeping the Australian Patents Law pretty much as is, with those copyright term extensions and so on.

Dr Davis—You have identified one of the two major areas—the other one is government procurement—that really does require a lot more consideration by the Chamber of Commerce and Industry as to what it means. We are initiating a program in the second half of this calendar year to go through what the IP chapter really means, because the convergence tends to suggest that the US position is fixed and that we are to converge towards them. Our understanding of the nine items of legislation—the general above-average weight—is that most of them have an IP dimension to them. We want to get a clear understanding of what that means. For example, the US Congress have just passed what they call a 'mickey mouse' clause. It is not meant to be a pejorative term but to say that a trade mark like the Mickey Mouse caricature can go on in perpetuity as distinct from the death plus 50 or the death plus 70 rule. Of course, you have patents, you have trade marks and you have them when they are used and left unused, and there is the linkage between a patent trade mark or a common usage name and an Internet domain

name, for example. The US law says that if you own a known entity or a name, you have first entitlement to it as an Internet name. I do not know whether that same law applies in Australia. The classic example is the dispute for the McDonald's restaurants. I think that that will be an area that will require a lot of study. I know it is beyond the domain of this committee, but it may be worth another committee of this parliament studying that one carefully.

CHAIR—One thing that has been raised is the treaty of Nara that Australia has with Japan and whether investment liberalisation can be offered without offering it also to Japan. Do you wish to say anything about that?

Dr Davis—As we understand the Nara treaty there is a provision on national treatment. International trade law is very clear on national treatment. If one just applies the law, the Japanese have an instrument that they believe is binding; as we understand the debate, it is a provision that should be offered to the Japanese. We wrote national treatment into the treaty of Nara, and if we have made a commitment then the Australian government should honour its commitments.

CHAIR—We will obviously take departmental advice on this as well. Is there an investment section in the Australia-New Zealand CERTA? How did the investment section work?

Dr Davis—It is a sequencing issue. For members of the committee who are not aware, there is national treatment or most favoured nation. National treatment simply says that you will treat a foreign entity no less favourably than you would treat a known national. Most favoured nation means that you will treat me no less advantageously than you would treat any of your friends. You would have to look at the detail of the Nara treaty, but the Nara instrument came after ANZCERTA, as I understand the sequencing, so it predates the US FTA. Every time we have an instrument that touches on investment where the Japanese believe it to be a better arrangement than exists under Nara, they can put up their hand and say, 'Me too.' This is the complicating issue that Mr Adams started to touch upon in many of his points—that is, that if the United States have agreements which have most favoured nation and national treatment written into them, then, sure as little eggs, the ambassadors up in Pennsylvania Avenue will be racing down the corridors so fast to say 'me too' that you will not be able to move in the Capitol Building. That is a part of the complicating issue for all of these in the future—that is, most favoured nation and national treatment. As we sit down with China, I think about the second document that the Chinese will have in front of them will be the Australia-US FTA. They will be saying, 'That's the minimum we are going to negotiate, guys'—they may say it more elegantly but that will be the core message—'and we want something better.' If we have a web of these creatures with New Zealand, ASEAN, China and the United States, it might be a nice little bit of ping-pong keeping them all in balance, as we ratchet our way up advertently or inadvertently.

Senator MASON—Each one is a leverage, in effect.

Dr Davis—Correct—on each other—unlike the WTO system, where it is all in and equally in, with a few exceptions for developing countries.

Mr WILKIE—You mentioned sugar earlier. I am not necessarily fishing for a comment here but I heard it said recently that sugar ended up probably being better off by not being party to the agreement because of the subsidies they are going to get out of the government.

Mr ADAMS—That is domestic.

Mr WILKIE—Domestic; that is right—tongue in cheek.

Dr Davis—No; actually a legal principle to deny all benefit underpins that, but again it is more a political issue than a legal issue at this juncture.

Mr WILKIE—You have mentioned ASEAN. I suppose this is a little bit away from the current agreement, but do you think we would be getting a better deal with ASEAN if we were members?

Dr Davis—If we were to join ASEAN, we would join on their terms and conditions. The ASEAN instrument was largely formed to shift away from the South-East Asian history of the 1960s, during the Vietnam era, when the political dynamic was a lot different. Our perspective on ASEAN is that a free trade agreement between Australia and New Zealand—the CER partners—and ASEAN is worth considering. We have never agreed that it should tie into what they call the AFTA agreement—the ASEAN free trade area—because the AFTA agreement is, in fact, a manufactures-only agreement. There are two standout instruments apart from that that they have already: a services instrument and an investment instrument.

Our view is that ASEAN and CER should talk but write a completely new agreement because there is an inequality of robustness. CER is a higher quality instrument than ASEAN. I think the first step for Australia and New Zealand to take would be to look at the quality of the ASEAN suite of instruments, consolidate them all into one and then use that as the negotiating point. I do not know that it would be a matter of one or other signing on to the other party's agreements; I think we would just have to have a new bridging instrument.

Mr WILKIE—Going back to the CIE modelling, if based on their assumptions you were to take out foreign investment—which, according to them, makes up 60 per cent of the gains—would you say that really the benefits of the agreement to Australia overall are then marginal?

Dr Davis—It is swings and roundabouts if you took out investment and were better able to quantify some areas like government procurement and some of the technical barriers to trade; what you would sacrifice by taking out investment you would gain by putting other things in.

Mr WILKIE—You talk about government procurement. How realistic do you think our getting access to many of those markets is? Given that we are not a preferred partner and will only be able to tender for some government procurement, how real do you think gains there will be for Australian companies? Some have said, 'Look, it's enormous,' and we have had other evidence saying, 'Look, in theory, there is a possible gain there but, in reality, it would be highly unlikely that we would achieve success in many tenders.'

Dr Davis—If we can get national treatment under US government procurement, that would be a positive. The second generation issue we would like to see is that the government procurement chapter is broadened to include US foreign aid; at the moment that is not included. Again—and Mr Wilkie has touched on an issue which concerns the question of economies of scale—the US is a big market and we are a small market. I know of any number of our members who say: 'Yes, I could do business in the United States, but they will take my whole year's production in four

weeks. So I can win market position, I can get on the shelves at Wal-Mart, I can do it in the backblocks of Tennessee, but I cannot deliver the quantities they want.' That is the just an economic-size relativity.

Can we win and hold in the US government procurement market? Yes, I think Australia producers have a niche capacity: if we go into that market thinking we can win and hold niche markets, we will do remarkably well. If we think we are going to go in there with a big bang, I think we will be disappointed by and large. The modelling is indicative. If we come to this being hung up about tens of millions of dollars, no, we will not see big dividends. But the big bang will come from the individual exporters who win $20,000 here and $60,000 there—and there will be a lot of them. To give an example, a chap we know who is part of our network wants to export Australian game meat. He says that if he can get down technical barriers to trade like testing and quarantine he can double his supply. He thinks he can get $200,000 of that market a year. That does not show up in the modelling. But that doubles his business, and he thinks he can double his business about every three years just by that. Again it does not show up in this but it certainly shows up in jobs in his enterprise, and that is how it will aggregate.

Mr WILKIE—Is your organisation a bit disappointed that a lot of the states have not signed up to government procurement provisions? Out of 50 states I think 30 say they might be available and 26 or 27 have signed up at this stage. That must be disappointing.

Dr Davis—We think they will progressively come on board. Again, it is front-end loading versus progressive implementation. Another perspective is to ask, 'Would we be disappointed after five years, if most of them were still out?' Yes, we would. What would be our expectation after five years? We would expect that most of them will probably be in there after five years.

Mr WILKIE—Which way do you think California will go? Do you think they will come on board?

Dr Davis—California is an interesting case study within the United States and compared with others. I cannot speak clearly enough because any reading of United States politics is sort of the US, the south and the Midwest, and California is a case study on its own. I simply cannot give you a particular answer in relation to that state. I would have to defer to our foreign service; they would have a better read of it.

CHAIR—As there are no more questions, Dr Davis, thank you for your attendance before the committee today. The secretariat will forward to you a proof copy of the transcript of evidence as soon as it becomes available. We have received submission Nos 177 to 180. I require a resolution that they be accepted as submissions and be published—moved by Mr Wilkie and seconded by Mr Adams.

[3.05 p.m.]

LEE, Miss Miranda, Executive Officer, Australian Digital Alliance; Copyright Adviser, Australian Libraries Copyright Committee

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?

Miss Lee—Yes, I do. I would like to start by providing the committee with some background on the Australian Digital Alliance and the Australian Libraries Copyright Committee before I go on to summarise our position on the copyright provisions of the free trade agreement. The Australian Digital Alliance is a nonprofit coalition with diverse members ranging from universities, research organisations, libraries, archives, IT industry groups and individuals. It was formed to advocate balanced copyright law, which gives effective protection of the interests of copyright holders as well as the wider public. The Australian Libraries Copyright Committee is a cross-sectoral body acting on behalf of libraries and archives on copyright and related matters. It seeks to have the interests of some 11 million users of libraries and archives recognised and reflected in copyright legislation.

We have made a submission to this committee because we have serious concerns about the impact of the FTA on our learning and cultural environments. We believe that the copyright provisions of the FTA will ultimately result in long-term damage to the creative, intellectual and innovative potential of the Australian community through diminishing access to knowledge. We believe that the implementation of the FTA will effectively tip finely balanced copyright law in favour of copyright owners without adequate consideration of its impacts on public access and the cyclic nature of producing new works.

I would like to comment on two particular areas of concern. The first is copyright term extension, which we strongly oppose for its detrimental impacts on Australian creators and users, and the significant economic burden that will be imposed on users, cultural and educational institutions. In conflict with the recommendation of the Intellectual Property and Competition Review Committee, the adoption of the FTA provisions will extend copyright term without thorough investigation of its impacts and without basis on reliable and independent data that support its claimed benefits. Copyright term extension will impose significant economic burdens through an extended period for payment of royalties, and the inflation and extension of transactional costs of seeking permissions from copyright owners. Seeking permission for out-of-print or commercially unavailable works is an onerous process and, in a large number of cases, fruitless because of lack of or outdated information. These costs are incurred by those that seek to use information and those that facilitate access to it.

The range and number of scenarios where permissions might need to be sought is as wide as the tens of thousands of extra works which will be caught by the extension provision. However,

both Australian and US economic analyses of the issue demonstrate that there are questionable gains that will be made by creators—as opposed to copyright holders—from an extension, but definite though unquantifiable burdens created for users and facilitators. The extension of copyright will delay the entry of works into the public domain and deprive a generation of creators of the ability to draw from a rich collection of works. This is particularly true for creators of materials such as reference books, online materials, CD-ROMs multimedia materials, and documentary and educational films, all of which draw heavily upon public domain material. This result undermines the basic objective of copyright, which is to encourage the creation of new works and an intellectually vibrant society.

The most baffling omission yet to be addressed, however, is the fact that Australia is by a substantial margin a net importer of copyright material, most of it from the US. By agreeing to extend copyright term, we are volunteering to impose upon ourselves a tremendous transfer of funds clearly and directly affecting our balance of trade.

The second issue of major concern is the anticircumvention and technical protection measures. We have grave concerns about adopting the FTA obligations, which we believe will commit Australia to a restriction of access to digital materials and effectively discourage the development of software systems and products. This undermines current law and policy, which provides for a technologically neutral and balanced approach to copyright. The adoption of the FTA provisions will effectively preclude non-infringing uses of digital material.

The provisions of the FTA are lifted directly from the US DMC Act. Its adoption is inappropriate given the different balancing mechanisms of our respective legislation—in particular, the much more limited user rights in the Australian regime. The issue is aggravated by the fact that, increasingly, material is being provided in electronic formats and sometimes only in electronic formats. The ban on the act of circumvention as required by the FTA is a fundamental departure from the approach taken by parliament when enacting our digital agenda act. The view taken by parliament is that adequate legal protection should focus on commercial dealings with circumvention devices rather than seek remedies against individual users of those devices.

Adoption of the FTA will also remove existing rights of circumventing TPMs to communicate works by libraries and archives for users in other libraries, the reproduction of works for preservation purposes and communicating works by educational institutions. A raft of cases in the US highlights the raised potential for abuse of copyright legislation, particularly in relation to interoperability and scientific research. There is no reason to believe that Australia would be exempt from such a development. The adoption of the FTA will essentially discourage innovation through its built-in conflation of access with copyright. We believe that the FTA will entrench a US model of dealing with TPMs, which is essentially to enable copyright owners to protect rights outside of those granted by copyright and impose limitations on use far beyond those available in print materials. In Australia the issue is still undergoing judicial consideration in the case of Sony v. Stevens. The adoption of the FTA will, of course, usurp this domestic process.

In conclusion, the ADA and the ALCC believe that the adoption of the FTA will graft the most flawed and damaging aspects of the US model of copyright regulation onto our current finely balanced regime. The outcome would be a fragmented regulatory system which sets a level of copyright protection far higher than that in the US. This would be made at the expense of

reasonable access to works, which undermines the basic underlying public interest rationale for copyright, which is to promote creation, education and innovation.

CHAIR—Thank you for your submission and opening statement. On copyright term extension, I know there is a vigorous debate in academic circles over what the impact of a copyright term extension would be, but what sort of impact would it have? How much of the material that Australian libraries are using would actually come under this band—that is, life of author plus 50 years, which is now being extended to 70 years and, for other media, 50 years moving to 70 years?

Miss Lee—It is difficult to quantify the amount of material, but I think the crux of the debate is its effect on the ability of users to access works that would otherwise come into the public domain in order to create new works. By extending copyright term we basically delay the entry of those works into the public domain, thus putting a bar to the amount of materials that can then be recycled, for want of a better word, into new works by Australian creators and users.

CHAIR—As I understand it, both Europe and the United States have life plus 70 years in their copyright laws.

Miss Lee—Yes, that is right.

CHAIR—If we extend it from 50 to 70 years, is there anything that can be done to counterbalance that? You have talked about the need to strike a balance and said that things need to be available for public use and so on. Do you see any way that you can extend copyright term from 50 to 70 years but still have those sorts of things available for public benefit?

Miss Lee—The provisions in the FTA relating to copyright term extension are fairly non-negotiable. If it comes in, we would have to look at different balancing mechanisms. One which has been raised by a number of the stakeholder groups is the introduction of fair use, which is a balancing mechanism to give broader rights for users. If we were to extend the copyright term, that would certainly be one thing that would be worth exploring in trying to maintain a balance.

Mr WILKIE—Was your organisation consulted about the extension from 50 to 70 years?

Miss Lee—It has certainly been raised with us as a possible inclusion in the agreement, but, as a stakeholder, the negotiations are essentially closed to us, so it has been by way of rumours. From the supporting statements made by representatives of the Minister for Trade, we were firstly under the impression that it was not going to go through. When the draft text came out, it was in fact included, so there was an element of surprise for us in seeing that.

Mr WILKIE—So in answer to the question, you were not formally consulted about the impact or asked for an opinion. The department did not write to your organisation and say: 'This is what has been proposed. What are your thoughts?'

Miss Lee—We were consulted and we gave our opinion to those representatives.

Mr WILKIE—And you were opposed to it at that point?

Miss Lee—Yes, we have always been opposed to it.

Mr WILKIE—But you were under the misapprehension that they were going to listen to you and not include it?

Miss Lee—That is right.

Mr WILKIE—Has the government talked about compensating universities or libraries for extending the copyright provisions?

Miss Lee—We have not heard that from any of the departments, but that is certainly something that we have raised as a sector.

Mr WILKIE—So, are you pursuing that?

Miss Lee—Yes.

Mr WILKIE—It would make you like the sugar industry, I would think. Will it be very difficult for the industry to comply with the changes being proposed? I think you have touched on that already.

Miss Lee—Its effects are more dispersed. As facilitators, we will try as best we can to serve the needs of our users. The effects of the copyright term extensions are basically to reduce by a large degree the likelihood that materials caught by the extension would be reused again and incorporated into new works. That is because of the rather arduous, and sometimes impossible, process of locating the copyright owner. Most of the time when the copyright owners have been contacted, granting permission is not an issue—actually getting to them is.

CHAIR—We had some evidence two weeks ago in Sydney from the Australian copyright agency. They said they had done an analysis of the work that was going on in libraries and found that something like only 0.2 per cent of materials that were being copied in libraries would actually come within this copyright term extension.

Miss Lee—I am not familiar with the study. It may or may not be accurate; I am not really sure.

CHAIR—Perhaps you could not be aware of that study. But they said that they supported these changes because they felt that the impact of copyright term extension on libraries copying material—that sort of thing—would be relatively small. They said, for example, that most people are not going to journals that are 50 years old, let alone 70 years old. I go back to my original question: apart from the philosophical debate about where copyright should go, do you have any idea what the impact would be of the copyright term extension? Do we know how much material that is being copied now that is in that 50-year time frame and would be extended to a 70-year time frame?

Miss Lee—I could not give you figures on the amount of material for a variety of reasons. Many of the searches are abandoned. Not many, but a significant number of the requests by users or searches on copyright owners are fruitless because of the difficulties caused by publishing

companies going out of business or melding and copyright owners disappearing. In the case of, say, a publishing house, they have deeper pockets, so they would be in a position to traverse the various obstacles that come with contacting and gaining permissions from copyright owners. Researchers and scholars will be the groups that will feel the most negative or heaviest impacts from copyright extension.

Senator MASON—On copyright term extension—it seems to be the topic of the moment—the chair used the term 'philosophical discussion'. Perhaps it is not so philosophical, though. Do you accept that this issue is a question of balance? On the one hand, you have researchers and students and so forth who want access to information earlier but the developers—the originators—of intellectual property would not mind at all if their copyrights were extended. I suppose my question to you is: while you speak for libraries and so forth, can you really argue that this is a one-sided argument and that some people are going to be disadvantaged? Unless you adequately protect the producers of intellectual property, less intellectual property will be produced. My question is: what is wrong with the change in balance?

Miss Lee—The balance is central—

Senator MASON—Do you think it is right here and wrong in the United States? It is a fair question.

Miss Lee—No. There are a couple of points that need to be teased out. Firstly, users do not include just students and one-off individuals. Users include companies and the publishers themselves.

Senator MASON—All users—I do not mind who the users are.

Miss Lee—Given that, and given that copyright creators are separated from copyright holders—they are not necessarily the same people—that casts another layer on considering the balance that needs to be achieved. Overriding it is the fact that all materials rely on previously created works, so there has to be some level of access in order to create an environment in which we can produce new works. We should not be diminishing that if we are serious about trying to create a society which is able to fulfil the maximum potential for creating new material.

Senator MASON—Sure. It just strikes me that you think—and this is fine—that in the balance we should tend towards the users of copyrighted material. Other people might say, 'No, we should tend towards the protection of the people who develop the material.' I do not see this as a black-and-white issue at all.

Miss Lee—No, I agree.

Senator MASON—This is an issue where there are good arguments, surely, for saying there should be greater protection for people who develop intellectual property.

Miss Lee—I would not agree with extending—

Senator MASON—That is fine.

Miss Lee—the level of protection for copyright holders or, rather, creators. I certainly think that—

Senator MASON—Users would not think that, would they? Users would think that there should not be. But if you were a developer of intellectual property, you might think that this is a good idea.

Miss Lee—We certainly do not disagree with creators having copyright protection. Of course they should, because this is the way our society works. They get rewards and can continue to produce new works. That is what we want, too, as users. If they stopped creating new works, we would not have any books to read anymore.

Senator MASON—Precisely.

Miss Lee—We are not trying to take away their rights; we are just trying to sustain some level of reasonable access.

Senator MASON—You think that the balance is right as it is currently cast but that the copyright term extension, in a sense, takes the balance in a direction you do not want it to go?

Miss Lee—That is right. It is one of the ways in which the balance is being tilted, I think, as we move more towards a society which relies particularly on technology. It is being used in combination with the protection measures that I mentioned in my opening remarks. That is the danger. It is the cumulative effect of all these things which is tipping the balance.

Senator MASON—You believe it is tipping the balance in favour of copyright holders, copyright developers?

Miss Lee—Yes, if certain provisions were put through.

Senator MASON—I raised the point because I did not want the record to read that this was an issue where copyright extension was somehow against public policy. It is not. It depends on how you read public policy.

Miss Lee—I think it contributes to one of the things that undermines public policy.

Mr ADAMS—I think we left that a little bit open. I take it the issue is that you are not against people getting recognition for their creativity and their property, but it is then the recognition of those who store and look after copyright getting paid on that basis. In this country we have developed a process where, all of a sudden, people are saying, 'We're going to impose another regime on you.' That is where your concern is, isn't it?

Miss Lee—Yes. We are also concerned that, through adopting the FTA, we might limit ourselves in the power we have to change and develop our own mechanisms for creating a copyright regime which serves our national interests.

Mr ADAMS—Which has grown up in Australia through our culturally Australian way of doing things. There is the other process that says, 'Have this,' and it is very different.

Miss Lee—That is right. The size of our economy and our publishing and entertainment industries are significantly different from the US, so there is a disjunction, I suppose, in taking something which works for them and then grafting it onto our regulatory schemes.

Mr ADAMS—To improve trade.

Miss Lee—Yes, apparently.

Mr ADAMS—Thank you.

Senator MASON—Do we know that an extension of copyright terms would not work here? Do we know that? We don't, do we?

Miss Lee—What do you mean by 'would not work'?

Senator MASON—You say that this is a home-grown idea of Australian public policy makers. In this country we tend to change our public policy and our legislation all the time. What is to suggest that copyright term extension would not be in the public interest?

Miss Lee—If we are talking about trade, the fact that we are an importer, I think, is a major consideration.

Senator MASON—Sorry, an importer of what?

Miss Lee—An importer of copyright materials—that is, movies, books and music from the US in particular. That is probably the most obvious consideration in the economic sense. The copyright term extension has also had its problems in the US and it has always been a controversial thing. It is not settled in any sense of the word.

Senator MASON—You have not really been able to tell us what the impact of this will be, except in general terms, because we do not know the amount of material that this will affect. You say it is a change that is not in the public interest, but I am not sure how this is going to affect the average person in the street.

Miss Lee—For a person writing a book, an extra 20 years of material would be caught by the provision. They would find it much more difficult to gain access to and use that material because they will have to go through the process of seeking permission. Educational institutions will be affected by the extension in the period of time for which they have to pay royalties. Libraries and cultural institutions, any time they put an exhibition together, will have to deal with the material being copyright for an extra 20 years.

Senator MASON—Fair enough.

Mr ADAMS—So we could have less access in Australia?

Miss Lee—That is right.

Senator MASON—What is the converse of that? What advantage would there be for the developers of the intellectual property?

Miss Lee—For the vast majority of materials, it does not really matter to them, because it is after the first 20 years that most of the revenue is recouped. But one in 1,000 works would be seminal, of particular significance or famous. It is that one work, I think, that pushes them towards favouring a copyright term extension, through which they can continue to recoup for that one property which has made money for them.

Senator MASON—It sounds pretty marginal. I do not know much about this issue at all, but it sounds like it will be relevant to a very small amount of material.

Miss Lee—But that small amount of material could be, as in the US, Mickey Mouse, which is making millions of dollars for the Walt Disney corporation.

Senator MASON—Is there anything wrong with that?

Miss Lee—Yes, there is. Copyright is supposed to be for only a limited period of time. It is limited because of the cyclical nature of producing new works. If another extension is added on top of copyright, it is basically perpetual copyright. That does not serve the interests of the public, because it means works will be locked away and no-one will ever be able to transform, use or learn from those works.

Senator MASON—That depends on the costs of developing ideas. As you have said, the last thing we want to do is inhibit companies from developing new ideas and products. One thing the West has done, of course, is develop property rights. The sound protection of property rights is central to our liberal democracy and our capital system. There is nothing more important than that, in terms of creating wealth, is there?

Miss Lee—No. There is nothing inherently problematic about that. Again, it is about balance.

Senator MASON—I agree.

CHAIR—I have the transcript of the evidence given to the committee two weeks ago by Copyright Agency Limited. They did their own research into the copying of out-of-copyright material in the education sector. What they found—and they said these figures are quite raw—is that the proportion of copying in the education sector that is out-of-copyright material is 0.3 per cent—that is, three of every 1,000 pages copied are out-of-copyright material. Then they looked at the implications of the period of 50 to 70 years, and they found it was 0.02 per cent, which is roughly two pages out of every 10,000 pages. So they did find it was quite a limited effect. They also found that the works in this period of 50 to 70 years are the works of composers, visual artists and, largely, poets, rather than the technical material that is often copied in educational institutions. Those were their comments.

Miss Lee—Again, I cannot comment on the accuracy of that survey. We do not dispute that the proportion of works affected may be small, but nonetheless it is important because of the dispersed effects of copyright extension in chilling scholarly research and in creating this atmosphere of fear, basically—using works on an extended period of time.

Senator MASON—Fear? I did not hear that.

CHAIR—We have talked a lot about copyright term extension and we have not talked about the anticircumvention measures. In the guide to the agreement, on article 17.4.7—on which you have provided a lot of information, and thank you very much for that—it actually says:

Implementation of this Article will require legislative change. The nature and extent of those changes need to be carefully explored.

That is coming from the Department of Foreign Affairs and Trade. In your submission, I think you said that your organisation is opposed to copyright term extension and I think you are also opposed to the anticircumvention measures. But then you go on to say that, if the government does proceed to ratification, the implementation of the legislation should be done in such a way as to ensure minimal impact and to maintain the current balance as much as possible. Do you have any suggestions on that?

Miss Lee—Again, I think this would be an area where perhaps the notion of a wider, fair use type of provision could be useful. It is difficult to tell at this stage, without seeing the draft implementing legislation, how restrictive an interpretation would be made out of the FTA provisions, but certainly I do not think anyone would disagree that it would be a considerable narrowing of what rights of circumvention we have now in our current legislation.

CHAIR—Your point is one that has been made by other organisations—that is, we are extending the terms of copyright but we do not have fair use, which they have in the United States. Out of interest, do they have fair use provisions in Europe, as well, or in the United Kingdom? You do not know.

Miss Lee—Sorry. I think they have fair dealing as well.

CHAIR—Thank you. As there are no further questions, I would like to 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. Thank you very much.

Miss Lee—Thank you.

Proceedings suspended from 3.38 p.m. to 4.06 p.m.

GARNAUT, Professor Ross Gregory, (Private capacity)

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?

Prof. Garnaut—Yes. Firstly, I would like to explain the absence of my colleague Bill Carmichael. Bill was looking forward to his appearance. Unfortunately, he has some surgery scheduled for this week and he was unable to make it today for that reason. Secondly, I would like to thank you for rearranging my appearance from this morning. The introductory remarks have been prepared jointly by Bill Carmichael and me. We consulted on this last Friday.

The letter introducing our submission establishes that there are no time constraints in the agreement, as negotiated, limiting the parliament's ability to ensure it has the analytical support it needs to assess the impact of the FTA on Australia. That process therefore need not be hurried. There is time for the parliament, on the advice of the Joint Standing Committee on Treaties, to put in place an appropriate process for it and interested members of the community to consider the consequences of the FTA for Australia. Our letter also argues that, because the agreement involves a wide range of sensitive domestic policy areas not hitherto affected by trade policy decisions in Australia, its impact warrants measured consideration by the parliament. It further argues that this should begin with a public analysis and report by the Productivity Commission of the costs and benefits for Australia on the agreement as negotiated.

I want to move now to our submission itself and the associated attachments. These describe the problems that flawed domestic decision making has introduced into the international trading system in recent years. These flaws and their consequences are manifest in the processes used so far in negotiating the agreement with the United States. The approach relies entirely on external processes and reasons for reducing trade barriers. Trade policy is treated as an extension of foreign policy. The consequences of this approach are described in attachment 2.

The competing approach, the general thrust of which has been supported by the Prime Minister, recognises that trade barriers are the international manifestation of domestic decisions taken by national governments to protect particular domestic industries against international competition. The support of the Prime Minister to which I refer is to be found in his answer to a letter that Bill Carmichael and I wrote to him last year, and that correspondence is attached to our submission.

Contrary to the impression created by the present bargaining approach to trade negotiations, the gains available to participating countries depend on the decisions they take at home about their own barriers. The gains they collectively take away from the negotiating table depend on the barrier reductions they take to it. This is expanded in attachment 2 of our submission. Domestic processes that raise domestic awareness of the economy-wide benefits from lowering domestic barriers are thus the key to restoring progress in trade liberalisation, whether this is

pursued unilaterally, through FTAs or multilaterally through the WTO. The approach we and others advocate therefore includes a domestic transparency process to underpin trade negotiations by focusing advice and decision making within participating countries on the economy-wide gains available from liberalising domestic markets. The role of this process is to inform, not to manage or control, public understanding and discussion of what is at issue for national economic welfare. In view of the Prime Minister's support for this approach, we recently prepared a draft transparency proposal to provide a basis for an Australian transparency initiative in the Doha Round. That draft proposal, which is copied as an attachment to our submission, sets out the case for adding transparency arrangements to existing WTO processes.

Australia's conduct in negotiating the agreement with the US has taken a quite different path. In assessing the benefit for Australia, both before negotiations began and after the agreement was finalised, the body relied on by successive governments to inform them and us about the effects on our future economic welfare was sidelined. Instead of seeking an assessment from the Productivity Commission in accordance with the approach endorsed by the Prime Minister, a private consulting firm was engaged on both occasions to assess the gains for Australia. The firm's first assessment, made before negotiations began, was used to suggest annual gains of $4 billion. These were in fact potential gains on the basis of highly restrictive assumptions. They could eventuate only if negotiations had provided comprehensive access to US markets, most importantly in the highly protected sugar, dairy and beef markets. They also depended on such large liberalisation of services that productivity rose by an average of 0.35 per cent across all service industries in Australia. Given the influence of the American farm lobby over US trade policy and US procedures in place for providing relief from important competition, together with practical constraints that mean the Australia-US free trade agreement will provide little new liberalisation of services, our gains from the agreement were greatly overstated by the assessment on which the government relied. Yet those estimates were still being quoted to provide support for the agreement after it was finalised, as though they reflected the actual outcome for Australia.

Last Friday DFAT released the results of the consulting firm's assessment of the agreement as negotiated. While the main sources of gain in the original estimate had disappeared or shrunk dramatically, somehow the total net benefits had greatly increased. That somehow turns out to be mainly through what are described as 'back of the envelope calculations' of gains, hitherto overlooked, from easing FIRB restrictions. The use of estimates in this way hinders rather than helps community understanding and discussion of what has been achieved for Australia in the agreement that has been negotiated. It is evident from submissions to this inquiry that it has also created public uncertainty about how decision making on trade and protection policy will be conducted in the future. For these reasons, we urge this committee to ensure that an appropriate basis is put in place for the parliament to assess the implications of the agreement for Australia before it considers enabling legislation. In our view, an appropriate basis starts with a public inquiry and report by the Productivity Commission.

Our submission concludes by arguing why and how the conflict in Australia's trade policy between the approach pursued so far in negotiating the agreement with the US and the approach needed to restore progress in liberalising through trade negotiations should be resolved now, while there is still scope for an Australian transparency initiative in the Doha Round. Since preparation of this statement last Friday, I have had the chance to read the report released on Friday by DFAT in support of the US FTA. As a contribution to the Australian public policy

discussion by a government entity, it raises serious questions about the process of consideration of the FTA. Its release strongly reinforces the theme of our submission—that is, that informed public discussion of this matter requires an independent, transparent report by the Productivity Commission. I submit my notes on the CIE DFAT report, along with the statement I just made.

CHAIR—We will table them and we will accept them as supplementary submissions.

Mr ADAMS—I so move.

Mr WILKIE—I second the motion.

CHAIR—They can now be published on our web site as well. First of all, in the national interest analysis on the United States-Australia free trade agreement, there is a bit on the economic analyses and modelling, and this was published before we had the CIE study. This is what the NIA said:

> Even so, it is unlikely that a model can capture all the dynamic benefits of integrating Australia with the world's largest, most dynamic and most competitive economy, as well as the extent to which Australian firms innovate faster—

and so on. How much weight do you think we should put on a model or study showing the economic benefits of the free trade agreement?

Prof. Garnaut—I agree with the statement that a model can only capture some of the benefits and some of the costs. It is the general experience with genuine trade liberalisation that the effects on the economy turn out to be rather larger than the standard economic analysis suggests or the standard modelling approaches of the past have suggested. But the starting point of those increased benefits is a move genuinely in the direction of free trade. It has been economists' conventional wisdom for a long time that an economy's movement towards free trade will raise national income and generally increase economic welfare, subject only to some questions about distribution effects.

Studies of the actual practice of trade liberalisation have shown that it is common for realised benefits to be in excess of the benefits from genuine trade liberalisation that are revealed in the standard static economists' models. That is immediately a caution about relying only on models. An example of that is the Australian experience. If you go back to the eighties, when the febrile discussion of trade liberalisation was being influential, the basic modelling upon which economists relied showed substantial gains, but what has happened in the economy since then is the big lift in productivity in the 1990s and Australia's shift from being a laggard in per capita income growth through most of the 20th century to being one of the leaders of the world in the last decade of the century, all of that shows—most economists would agree, although there would be some dissenters—that the actual benefits exceeded the static calculations of what the benefits were going to be.

So, when we are applying that sort of idea to a bilateral free trade agreement, we have to answer this question: is this free trade agreement genuinely a move in the direction of free trade? That is never a simple question to answer. This question was asked rigorously in the early postwar period, first of all by the eminent American economist Jacob Viner, who set out to analyse the costs and benefits of movement towards what became the European economic union.

He introduced the ideas of trade creation and trade diversion within a regional or bilateral free trade agreement.

Trade creation is a movement in the direction of genuine free trade, and there is some of that in a bilateral or regional FTA. Trade creation is where high-cost production in one country is replaced by lower cost production in the partner country. For example, there would be trade creation if the United States liberalised the sugar trade and low-cost production from Australia replaced high-cost production from the United States. There would be welfare gains from that trade creation.

But a preferential area is not all about movement in the direction of free trade. The other, contrary movement in a preferential area is in the direction of trade diversion, because one thing that happens in a preferential area which does not happen in a genuine movement to free trade is that some low-cost production from a third country is replaced by high-cost production from the trading partner. For example, Australia imports some brands or types of cars from Japan because they meet Australian consumer needs more cost-effectively than equivalent products from the United States. However, if you took away the 15 per cent tariff on American production but kept it on Japanese production then it might be cheaper to bring in a car from the American subsidiary of Nissan rather than from the company in Japan, even though the cost of production in the American subsidiary was higher than in Japan. In that case, the preferential area would lead to the replacement of a low-cost source of supply—in this case, Japan—with a high-cost source of supply—in this case, the United States.

That is called trade diversion and that is a movement in the opposite direction from free trade. Trade diversion is a movement in a protectionist direction. The big question about any small group or bilateral free trade agreement is whether the movement towards free trade, the trade creation, is more important than the movement towards protection, the trade diversion, where—as in the example I gave—high-cost American product will be protected in the Australian market from the products of low-cost third countries by the Australian tariff.

This is always an empirical question. In the work through the 1950s begun by Viner and involving other eminent economists including Lipsey, there was the eventual development of a piece of economic theory called the theory of the second best, which emerged straight out of the discussion of free trade areas and customs unions. The theory of the second best establishes that if you have some distortions, like protection against everyone, it is not necessarily second best from an economic point of view to remove protection against some countries. The theory says that you cannot tell a priori whether or not it is going to be a movement in the direction of free trade. There is no getting away from the necessity to assess the particular free trade area and the particular economies concerned. So, whether trade creation exceeds trade diversion—whether the free trade elements exceed the protection elements—is always an empirical question.

I was a little bit surprised to see the interesting conclusion in table 7.1 of the CIE report that says that, after all of the exclusions of potential trade creation in areas like sugar, beef, dairy and so on, in this FTA—based on the results of their GTAP modelling—trade diversion exceeds trade creation. There is not even a sentence on that result in the body of the report, but the result is there in the table. So, according to their calculations, the welfare effects on Australia of trade diversion are greater than the welfare effects of trade creation. On the basis of that model, this does not meet the test of a movement towards free trade.

If the initial movement from any change in trade policy is in the direction of free trade, a reasonable presumption on the experience of many countries is that the dynamic effects will compound those good effects. But if the initial movement is in the direction of protection—that is, if trade diversion exceeds trade creation—any dynamic effects will compound the negative effect. The initial loss in incomes will be compounded by reduced levels of investment and taxation, and so we will have dynamic effects down the track. So one must take into account the dynamic effects. Generally, these are in the direction of magnifying the initial resource allocation effects.

In addition, there are many types of effects that are, in their nature, very difficult to model. The most important of these are commonly called political economy effects. Economists and others disagree about the political economy effects. It is a view held by some, including me, that engagement in tit-for-tat bilateral negotiations weakens domestic support for trade liberalisation and strengthens domestic pressure group demands for subsidies and interventions of various kinds. This is a lesson of experience that we have seen work its way out in Europe and North America. Through these negotiations, it is what has happened in the sugar industry and others. But not everyone agrees on that—in the end we have to make judgments about that.

Another very important set of political economy effects that, in their nature, cannot be modelled are the effects of action on small group or bilateral FTAs on the quality of the multilateral trading system. It is my view that pursuit of FTAs is damaging to the multilateral trading system. It diverts high political and executive leadership and administrative resources from the main game of multilateral liberalisation. It also allows protectionist interests in some countries to avoid pressure for liberalisation. For example, Korean and Japanese protected interests, especially in agriculture, are absolutely delighted with the way the world has drifted towards bilateral FTAs. They know that, if there is a real multilateral negotiation, they will have no choice in the end but to join the deal and do something in agricultural liberalisation. But with bilateral and small group FTAs they can choose partners that will not put that sort of pressure on them. So they have said that they are not interested at this stage in an FTA with Australia or the United States. They have done one with Singapore and one of the Latin American countries that are not so fussed about agricultural access.

So it is my view that the political economy effects on the global trading system are adverse, especially for Australian interests. They are especially important for Australian interests because agricultural traders are especially vulnerable to the protectionist pressures that are let loose by bilateral negotiations. More than any other developed country other than New Zealand, Australia has a powerful interest in breaking down protectionism on agriculture in other countries.

There are some views to the contrary. My long-time friend, sometime colleague, occasional interlocutor and debating partner on these issues is Fred Bergsten, who is head of the Institute for International Economics in Washington DC. It was Fred's view a number of years ago that the US's pursuit of bilateral FTAs would set up a process of competitive liberalisation. Fred Bergsten's article of seven or eight years ago said that if the US got cracking and did a number of these FTAs, it would put pressure on other countries to enter multilateral negotiations.

I was in Washington DC earlier this year. I spent some time with Fred and others. I also read Bergsten's article in the *Journal of Foreign Affairs*. Amongst supporters of the FTA strategy in the United States there are second thoughts. There is realisation that the competitive

liberalisation that they had hoped for has not yielded improved impetus in the multilateral negotiations. In fact, the evidence is, if anything, to the contrary. I think that is now recognised even by economists in the US who had supported the FTA strategy. These are very important issues. These political economy issues may turn out to be more important than the things that you can model. In their nature you cannot model them, and I have to acknowledge that there is a very wide range of opinion amongst experts regarding the direction of their effects.

CHAIR—In the submission, you talk about the domestic transparency arrangements in the WTO—a proposal perhaps for a different way of conducting multilateral negotiations. Would that sort of approach be applicable to a bilateral trade agreement as well?

Prof. Garnaut—We think so. We think the missing ingredient in negotiations is a base in the domestic constituencies of each of the negotiating governments in support of genuine trade liberalisation. There is an awful paradox surrounding international trade negotiations. People who spend their lifetime studying these things know that Australia benefited itself more than anyone else by getting rid of most of its manufacturing protection. Economists and businesses in Japan know that getting rid of agricultural and service sector protection would benefit Japan more than anyone else. Economists in the US know that getting rid of that egregious protection in sugar, beef and dairy would benefit the United States more than anyone else. But everywhere producer interests are more powerful than the national interest in the community discussion of these things. Bill and I have shared the view for a long time that the key to getting genuine reform in any country is a wider public understanding of the issues.

I do not know if you know the background of Bill Carmichael, but he was for many years chief executive of the Tariff Board when Rattigan was chairman. He started the process of questioning Australian protection, and he was later chairman of the Industry Commission, as it was called at that time. Bill has no doubt and I, as someone who has never been employed by the Productivity Commission, have no doubt that institutionalising independent transparent analysis of the effects of protection in Australia played a very important role in making liberalisation easier for governments. It was not that the Tariff Board, the Industry Commission and then the Productivity Commission were making policy decisions. They were not. Their crucial role was in objectively analysing the consequences of policy decisions and publishing the results. That gradually created a better educated community. Parts of the media took an interest in the results. An increasing number of politicians on both sides of the House gradually became interested in these issues—in the actual effects of protection—and, over time, things that would have been impossible in the 1960s or 1970s became possible, and we got rid of most of our protection.

Something very similar could happen in other countries. We are not suggesting replacing existing bilateral or multilateral processes with a transparency commission; we are suggesting adding to the mix of what is happening something like the Productivity Commission. That is a relatively undemanding ask. All you are asking any other country to do is allow a process of independent and transparent analysis of the effects of its decisions. Thoughtful governments will recognise that, in the end, that is going to be helpful in freeing them to take decisions in the national interest; so they can appeal to a broader constituency than the vested interests that are always seeking protection or subsidies of various kinds. We are suggesting that Australia takes this suggestion into all of its negotiations.

In the context of bilateral discussions with the United States, China or anyone else, we propose that they establish transparency institutions that play a role in analysis of the effects of protection and trade policy and publicise that. Our proposal is built around the Doha Round, because you can obviously get much further if you can get an agreement in the WTO for many countries to do it. That is what that particular proposal is directed towards. But, if Australia and the US, Australia and China or Australia and Thailand could agree on that, we would be very far along the track.

Mr WILKIE—Thanks very much. I agree with a lot of what you have to say. I have argued that the Productivity Commission should have been looking at this agreement. If someone were to say that the Productivity Commission would not be the best body to conduct a review because of the current processes they employ for conducting inquiries and that the time frame allowable would mean that they could not report in enough time, what would be your response?

Prof. Garnaut—Let us deal with the second question first. Chapter 23 of the agreement provides for the agreement to come into force 60 days after both governments have completed their parliamentary processes. There is no time restriction at all on that. I checked this out with US government officials before we prepared the submission, and their view is a very simple and clear one: 60 days after the two parliaments have considered the matter, this can come into force whether that 60 days ends in October or December this year or February or May next year. The last time I heard, the US administration had still not decided on whether it would ask the congress to deal with this matter and take a final decision in time for the agreement to be complete before the US presidential elections.

This is one of the easier agreements for the US Congress to approve. The Central America-US free trade agreement, which is being negotiated at about the same time as the Australian one, is much more controversial because that does liberalise US sugar, so you have sugar interests opposing that. You do not have as many interests opposing our FTA because it does not threaten so many US interests. I would guess that there is a reasonable chance that the US President will ask the congress to vote on it this year. But if the President decides, for political reasons, not to put it to the US Congress this year and to hold it over to next year and congress then passes the agreement in February or May of next year, the agreement will come into effect exactly as it is now. There is no time limit built in to the processes of the agreement itself.

On the first part of the question, whether the Productivity Commission has appropriate processes, the Productivity Commission has very considerable analytical resources. It is also able to, and does, call on appropriately qualified people from the general community when it wants to augment its expertise on a particular issue. I do not know what processes people are referring to when they say that there is something inappropriate about their processes. There is a tradition of public inquiry by the Productivity Commission where they draw on a broad range of views. There is a tradition of the Productivity Commission putting out a draft report on which it receives comment from the community before it finalises its views. I do not see anything inappropriate about any of those things. The range of expertise within the Productivity Commission on these matters is very large compared with any other group—certainly, very, very large compared with any private consulting group in Australia—and it has a tradition, where it wants to augment its resources, of drawing expertise from outside. So I, myself, do not see any basis for a claim that the Productivity Commission is somehow inappropriate, but you might help me if you could be more specific about the points that have been made.

Mr WILKIE—I am trying to be a little bit careful here because we have had evidence given in a private hearing that we cannot reveal publicly at this stage. I suppose if we are looking at the time frame as being the important one, if the Productivity Commission were to say, for example, 'We can't respond to the government's request for a report in a time frame that would suit them in getting this agreement passed through our parliament,' would that be a problem?

Prof. Garnaut—To do a really good job of analysis on this very complicated agreement, which goes into far more areas than any other set of trade policy decisions in Australia, requires some time. Frankly, some of the problems of the CIE-DFAT report, to which I referred, I would guess are the result of them not having enough time. I cannot believe that some of this work would have stood if they had had time to reflect on it. You need time to do a good job on these very complex issues. But I do not see the time constraint. Chapter 23 says that this agreement comes into force 60 days after the legislative processes of the two countries have been completed. It does not have to be done by 1 October or 1 December or 1 January. So, if the Productivity Commission takes three or four months, then they come back and then this committee has hearings to discuss it—no-one expects the Productivity Commission to take decisions; it is for governments to take decisions; it is just an aid for analysis, public discussion and transparency so there is some process after the report comes out—and all of that takes until later this year, that is not inconsistent with this agreement. If it passes all of the tests the parliament puts on it and that the community wants to be put on it, it is not inconsistent with the agreement coming into effect in due course. The Productivity Commission can be asked to report in limited time frames and, on occasions, has done so in the past. However, one has to be reasonable. If one wants a thorough job of analysis, one must allow them adequate time. This is a very complex agreement, with many dimensions, so, realistically, if we want proper analysis and not top of the head work, we have to allow reasonable time—and that is months, not weeks.

Mr WILKIE—This committee would normally report and sit 20 sitting days. Sometimes we would ask for an extension if we have got a major agreement that is very complex. In this case we have not asked for an extension, although I believe we should have so that we can report back to the parliament on 23 June. Do you think we could be in a position where we are rushing our inquiry—making recommendations which are not based on hearing all the evidence and not having a look at proper modelling, such as the modelling you are talking about through the Productivity Commission—and we could end up making a report which could be fatally flawed because we have not considered all the options and congress may decide to delay passage anyway? Therefore we could have had, if we had waited, a far better inquiry. I think that is basically what you are saying.

Prof. Garnaut—Certainly it is a possibility that congress will not be asked by the President to consider the agreement this year. I think everyone understands that that is one of the possibilities.

Mr WILKIE—When do you think he will make that decision?

Prof. Garnaut—My friends in Washington have simply said that Karl Rove has not made up his mind yet. He is the President's political adviser. He will make up his mind when he is certain that there are no political risks in it. I do not think we can prejudge that. It is very natural for a head of government in these circumstances to make decisions on that sort of basis. I do not think there is a definite timetable. If they are going to go ahead and ask congress to decide on that this

year, they cannot leave it too late. If congress has not dealt with something like this by July of an election year, the chance of US approval of an agreement is likely to be wiped altogether. The constraints in congress are mechanical ones, and I am not your best source of expertise on that.

On your other question about whether this time frame is too demanding, that is for the committee to judge. As a professional economist who has lived with these types of issues for my whole life, I myself doubt whether it will be possible, between the time the agreement was reached and 20 sitting days after you were asked to consider it, to have a thorough analysis of all of these complex issues in a way that meets the tests of transparency, independence and analytical rigour, and then allow time for you to consider it and for the government to consider the report. I think that is just too hard. These issues are too complicated to deal with thoroughly in that time frame.

Mr WILKIE—Thank you. Given that the only modelling we really have is that done by CIE, do you support the findings that they have presented in their modelling?

Prof. Garnaut—I have some notes that I have attached to my submission. I downloaded that report over the weekend at the farm. I have lambing ewes, and those of you from the southern states will know that it was a particularly exciting weekend for football, but I still managed to read the report fairly thoroughly.

CHAIR—You did very well.

Mr ADAMS—Even when there was a point in it at the finish of the game!

Prof. Garnaut—Yes. Frankly, I think that some of the results do not pass the laugh test. In econometrics, where you are relying on complex models to draw conclusions, what comes out the other end depends on the quality of what goes in. Before economists are really satisfied with any piece of econometric modelling, they put it through the laugh test. The laugh test is: can someone who knows the real world that is meant to be described by the modelling exercise look at the results and not laugh? I do not think that this exercise passes the laugh test. Most of the gains, the $5.6 billion annual gains in GNP after 10 years, come from the partial liberalisation of the Foreign Investment Review Board.

I have been part of the Australian economic reform discussion for decades. Early in the reform process, the Business Council of Australia, the Treasury and different groups of economists used to work up lists of microeconomic reforms and the gains you would get from each of them. I do not even remember the complete abolition of the FIRB appearing on those lists. Not that anyone thought the FIRB was much good, but its abolition was just not a very big deal. I am one of the relatively few economists in Australia who has worked on economic reform and even talked about the FIRB. I wrote an article in the *Australian Journal of Agricultural and Resource Economics* a couple of years ago called ‘Australia as a branch office economy’, in which I looked at the effects of the Woodside decision by the Treasury. I came to the view that basically Australia does have some problems with being a branch office economy but that the FIRB does not do any good in solving it. So I am one of the few Australian economists who has even bothered to look at it.

I would quite like to get rid of the FIRB; I think its abolition 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 $50 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 industries.

Mr ADAMS—French money, British money.

Prof. Garnaut—I do not think you can talk about $4 billion, four times that and eight times that and not laugh.

Mr WILKIE—It sounds like the report has been written by Benny Hill. Following on from what you were saying, how can the gains in the second model be so large when we have not had a free trade agreement as opposed to in the first model when the modelling was done on the basis that we were going to get a free trade agreement?

Prof. Garnaut—Let me say at once: two good models are used. The problem is not with the models; it is the assumptions that are fed into the models. G-cubed is an excellent model for looking at long-run, dynamic adjustments to macroeconomic change. It is a top model. GTAP is the standard model used globally by economists, the most common model, for looking at detailed resource allocation effects. Andy Stoeckel's centre has modified the GTAP model in ways that we know from the debate between CIE and ACIL last year are contentious. But I would say that the modified GTAP model as used by the CIE is a good model. That is not my issue. My issue is with the assumptions that are fed into it. The majority of the $5.6 billion of GNE gains after 10 years come from this relatively minor reform to the FIRB.

If it really were the case that you could get $30 billion of gains for Australia by getting rid of FIRB consideration of proposals for investment in non-sensitive industries, I would suggest that the members of this committee wind up this work right now, rush into the two chambers and rush through legislation getting rid of the FIRB, because that is a huge amount of money. Budget decisions for years would be very easy ones if we added that to Australian incomes—but we do not actually think that that is the case. And the largest amount of that $5.6 billion is from this relatively small change in FIRB arrangements.

Of the rest, there is $1 billion of gains from trade liberalisation. They are drawn from the G-cubed model, which is an excellent macroeconomic model, but it does not have the commodity and country detail that allows you properly to calculate trade diversion. That is recognised in the CIE-DFAT report. They actually say there that the GTAP model is the one that gives you better treatment of trade diversion and trade creation and therefore trade liberalisation. Undiscussed in

the report, but reported in table 7.1, you have the results of the GTAP modelling, which show that trade diversion exceeds trade creation. That is unlike the results reported in the GTAP modelling from the first CIE-DFAT report that gave you $4 billion of benefits.

It is not surprising that we got a switch-over from net gains in the original report to small net losses this time, because much of the trade diversion that was modelled before is still there. No-one blocked trade diversion in the negotiations, but a lot of the trade creation was blocked. The gains to Australia in the original modelling from increased market access to the United States came heavily from a few agricultural commodities: sugar, beef and dairy. That trade creation was mostly blocked in negotiations. So it is a very natural thing that the trade creation in the GTAP results is much less now than before. I am a little bit surprised that it is so much less that trade diversion in that model exceeds trade creation, which suggests net losses to Australia. But those results do not become part of the $5.6 billion.

The executive summary of the report from which the $5.6 billion, the press releases and the government announcements come relies on the GTAP model's modelling of trade liberalisation, which gives a billion dollars of gains from trade liberalisation. But, on the evidence of the CIE-DFAT report, it is the GTAP model, not the G-cubed model, that gives you the best idea of the quantum of trade diversion, which is a necessary input into the calculations of the welfare gains of trade liberalisation.

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.

CHAIR—Thank you.

Mr ADAMS—On a different area, what do you think will be the effect on Australia's Asian trade? We have been trying very hard, and I see we have just been accepted into the Asian group. What do you think of our access issues there because of this agreement?

Prof. Garnaut—These are really complicated issues. The most complicated part of this question is trying to assess what damage has already been done and what damage could be avoided by pulling out of the agreement at this stage. If you go back to the very beginning of the debate about the FTA, I am on the public record as early as December 2000 warning that Australia going down the bilateral route—and this is the most important of the steps that we have gone very far with up until now—including having a free trade area with the United States, would run the risk of encouraging movements towards preferential trading arrangements in Asia. At the time, that idea was dismissed a bit and there were some, including some in the

Department of Foreign Affairs and Trade administration, who said that Asia is not going to go that way. Asia has gone that way.

I commonly spend and have recently spent a fair bit of time in the US, Japan and China. In each of those countries, but especially in China and Japan, there has been a very strong shift towards commitment to bilateral and regional trade and a weakening of commitment to multilateralism. That is very recent—particularly in China, where it has taken place over the last year or so. We have been influential in that. Japan's shift to bilateral and regional approaches to trade was a reaction to a feeling that that is the way other Asia-Pacific countries are going, and Australia and the US were important in that. Obviously, the US is more influential than Australia, but we gave credibility to the US FTA push. Fred Bergsten said in his article in the *Journal of Foreign Affairs* that the US FTA strategy has failed because the US have only completed FTAs with unimportant countries, and he listed Morocco, Singapore, Jordan, Central America and Australia. Of that list, Australia is not actually an unimportant country. To the extent that the FTA strategy in the US has any credibility, it is because of us. It does not get any credibility from Honduras, Morocco, Jordon or Singapore. It gets a bit from us. Fred thinks that it is not much but, to the extent that the new FTA strategy of the US under the Zoellick administration has legs, we have given legs to it.

Japan was influenced by that and other things. I know from close association with people intimately involved in trade policy making in China that the shift in China over the last couple of years and especially over the last year was motivated first of all by a feeling that the rest of the world, and especially the rest of the Asia-Pacific, was going bilateral and going regional and China would be left out if it did not get into it. In the case of China, we did an extra thing. We pushed them very hard in our own bilateral negotiations, and that has helped to reinforce the bilateral orientation.

A lot of that has already happened. As I say in my written notes, there is a question as to how much of that would be reversed if we did not go through with the FTA with the US. There is no doubt in my mind that Australia's favouring of preferential trade and what we have done with the United States have helped the movement into preferential trade in Asia. The bigger is question is: if we pull back now, will they pull back? That is an important question, and not a simple one.

Let us look at the effects of what has happened in Asia so far. Already, as part of the early harvest in its free trade agreement with China, ASEAN has been given preferential access for its agricultural products. That came into effect on 1 January. So, in a number of important industries in Australia, Australian producers are being discriminated against in their competition with ASEAN suppliers in the Chinese market. ASEAN is an important competitor for us in a wide range of products. For example, it is a big competitor for some grains, oilseeds—which is now a big export from Australia—fruit and vegetables and sugar. In fact, in the north-east Asian markets, it is the main competitor for sugar. So already there are these effects.

In Japan, our largest export market, the shift towards preferential trade has allowed Japan to close up serious engagement with the WTO on agricultural liberalisation in the context of a multilateral negotiation. It has become much harder to look forward to real gains in a multilateral negotiation from Japan in agriculture. Japanese officials, ministers and economists are quite open and explicit about this. They say that they now prefer the bilateral trade negotiations because they will not have to significantly liberalise agriculture if they take the bilateral route.

And they now have the example of the Australia-US agreement. Japan has been holding out for what we have agreed to with the United States.

We would not enter a negotiation with Japan on an FTA because they wanted to completely exclude rice and not go very far on other agriculture. I have heard Japanese people say, 'Change "sugar" to "rice", and we can already meet the liberalising requirements of the US-Australia FTA.' Under the Uruguay Round, Japan committed to more extensive liberalisation for beef and dairy—highly protected industries in Japan, as they are in the United States—than the US have under the bilateral agreement. Even if we did get into a discussion now with Japan on a bilateral FTA, how can we demand that rice not be excluded and that there be serious liberalisation in dairy and beef? What we have done with the United States—and, more generally, the drift into bilateral and preferential trade—has seriously diminished the prospects for Japanese agricultural liberalisation.

In China the situation is more complex. It is still in the early days of their preferential strategy, and so far we are losers. Some discussions are going on about whether we will enter an FTA with China, but the only thing that has happened so far with the FTA strategy for China is the preferential access for ASEAN agricultural products in competition with Australia. Some might say that, if we get an FTA with China—if we meet the rather tough conditions that the Chinese will insist on; some of those conditions, like market economy status, I wish we had done 10 years ago without an FTA—it will even up the playing field with ASEAN. But in the type of FTA that is emerging—and the Australia-US agreement will be a prominent model in Asia in this respect—it is a model in which countries can pick and choose on agricultural liberalisation. So we cannot take for granted that the Chinese agricultural liberalisation and FTA with Australia will be as comprehensive as we could reasonably have expected Chinese agricultural liberalisation within a WTO round to have been.

Mr ADAMS—I think you said—and I think it is generally understood—that trade agreements are also about change in the country of domestic law and domestic competition. You talked about culture earlier—you said that, 20 or 30 years ago, we would not have achieved what we did in the eighties and nineties. If that was so then, unless you wanted some change to the PBS in Australia, why would you have that as part of a trade agreement with the United States?

Prof. Garnaut—I am actually worried about the PBS provision. I am worried more than anything else because I am a strong supporter of a strong Australian relationship with the United States. I happened to be in Washington when the Senate Committee on Finance, which handles trade in the US, had its hearings with Zoellick on the Australian FTA.

Mr ADAMS—Yes, we have the transcript here.

Prof. Garnaut—I watched live on television the discussion of the Australia-US FTA in the finance committee. I have no doubt, partly from words and partly from body language—no doubt you can get the video—that US congressmen believed that these new arrangements would lead to more profitable trade for US pharmaceuticals companies. On reading the words of the agreement it can be seen that we do not actually promise it—we set in place a process. But I have no doubt that US congressmen believe they were promised it by the US minister. No doubt the US congressmen have made promises to the pharmaceuticals industry. The worry is that, if

we do not deliver on what they think are promises through the processes that have been set in place, they will cry foul.

A strong Australian minister in future—which I suppose will be the health minister in relation to the PBS—will, under this agreement, be able to resist it. We set in place these consultative arrangements and there is no doubt that a future Australian minister could say, 'Okay, I have heard all of the consultation, I have heard all of your views, we have looked at all of these processes and you are not going to get anything.' But we would be naive to think that it would end there. What these arrangements do is institutionalise pressure on the PBS by the US pharmaceuticals industry through the US government. A future Australian government will have to make a choice about how much it disappoints the United States on an issue that, from time to time, will be politically important in the United States and how much it disappoints the Australian community. The Australia-US relationship is such an important one that these matters are never easy.

Senator TCHEN—You mentioned a couple of times that, in terms of Australia's trade with China and any sort of future free trade agreement, ASEAN agricultural trade with China would be to the detriment of Australian trade with China. Why is that? It seemed to me that the bulk of what we can produce efficiently—for example, wheat and red meat—are things which South-East Asian countries are not able to produce efficiently. The things they can produce, which are quite often labour-intensive products, are intrinsically not very efficient in Australia anyway.

Prof. Garnaut—Australian agriculture is no longer only about grain and beef. Australia is now quite a big producer of oilseeds. If you drive from here to Wagga and then down to Melbourne in the spring there is as much yellow as green—canola. That is a very big export now. China is the world's growth market for oilseeds. In oilseeds, we are a direct competitor with Malaysian and Indonesian palm oil. Now only 16 per cent of Australians live in Queensland, so maybe you might think it does not matter very much. But I actually think those 16 per cent matter. They produce sugar and tropical fruits and vegetables. Our main competitor in the North-East Asian markets for sugar and tropical fruits and vegetables is ASEAN. For sugar, our main competitors in that region are the Philippines and Thailand. The whole range of tropical fruits comes from all the South-East Asian countries. They are just two examples. As I said, it might only affect 16 per cent of Australians in Queensland and six or seven per cent who live in New South Wales and Victoria inside the Great Divide in the broadacre farming areas but it is not a trivial group of Australians.

Senator TCHEN—Yes, I appreciate that. I am just saying that basically Australia, in terms of what we produce in agriculture, does not compete with South-East Asia because they do not produce the same thing. If they do produce the same thing it is not exactly comparable in market acceptance: for example, rapeseed and other oilseeds are not exactly comparable with palm oil. Also, our other horticultural products essentially have niche markets. They do not have broadscale markets. On the matter of competition and the ability to develop markets, there is no reason to believe—with the precedence of the Australia-US free trade agreement—that the free trade agreement we will in future have with China will not provide the same type of incentive for horticultural products.

Prof. Garnaut—That is a separate question. I can only repeat that I think the Australian agricultural producers who do compete with South-East Asia are a significant part of the Australian rural community.

Senator TCHEN—Yes, and I was saying they compete very well.

Prof. Garnaut—But we do not want them to compete at a disadvantage.

Senator TCHEN—Of course; I understand.

Prof. Garnaut—As from 1 January, they have been competing on unfavourable terms. We pay a tariff on a lot of goods on which some ASEAN suppliers are not paying a tariff.

Senator TCHEN—I understand that.

Prof. Garnaut—The extra question you raised was whether we could level up the playing field with our own FTA. Maybe we can. But it is very early days. The Chinese have agreed to enter discussions and do a feasibility study on whether they will enter negotiations.

Senator TCHEN—We were invited by the Chinese President while he was here to enter negotiations with him.

Prof. Garnaut—We have not yet entered what are called negotiations.

Senator TCHEN—I know. But I thought the invitation came from China.

Prof. Garnaut—There was agreement between the two governments. There is a lot of water to go under the bridge before we know the shape of that final agreement. If we were negotiating in the WTO, I would have a lot of confidence that liberalisation in China would be across the board, including across all of our agricultural interests. That is the way China went in the WTO entry negotiations and that was very valuable for us—quite hard for China but very valuable for us. In multilateral negotiations I would expect that to continue. The model that has been established for FTAs in the Asia-Pacific region is one in which countries pick and choose what they will liberalise, so we cannot take it for granted that there will be nice, clean access to the Chinese market under an FTA. I hope there is—if we have an FTA. I do not know whether we will or not. But if we have one I hope it is clean and that there are no areas of discrimination in favour of South-East Asia. We must wait and see.

Senator TCHEN—That was only a minor question that I wished to put to you. The issue that I would like to discuss with you is the issue which to me seems to be fundamental to your submission. For some reason my colleagues skirt around it, but I am going to rush in on this. This is about your promotion of the alternative approach of establishing a transparency institution and transparent procedures in all other countries as the fundamental way of progressing trade liberalisation. I wonder whether you could enlighten us a bit further on how Australia could approach that issue.

Prof. Garnaut—We have credibility in this because we have the very good model of the Productivity Commission, which is well known overseas. Its role in influencing the Australian

debate is very well known overseas and very much respected. Bill Carmichael, through his role as chairman of the Productivity Commission—the Industry Commission in those days—had opportunities to talk at length with successive special trade representatives, trade ministers, in the United States. They were very much attracted to that sort of model, partly because they were sick and tired of being hijacked by vested interests, and they welcomed the idea of building a better educated constituency of people in support of trade liberalisation.

I would think that the first thing we have to do is make sure that we continue to give the Productivity Commission the role that it has had for the last 30 years in Australia and not undermine it, because if we want it to be a credible model for other countries we have to respect it. Secondly, a particular proposal that we suggest is that we seek the establishment of a process in the Doha Round—first of all, an agreement that in the WTO context there will be a transparency commission, with the WTO playing a role in supervising the establishment of similar sorts of institutions in each country. For practical reasons, they are not going to be the same in every country and you really need to allow local input in shaping these institutions. If you want them to be influential, they have to have local respect and they have to reflect local concerns.

The WTO would supervise general characteristics, like independence, transparency of process through publication of results, and analytic rigour. It would be a rather general oversight of the institutions. In some cases it would be built on existing institutions in various countries, but it would all begin with an agreement in the WTO that each country would establish an institution for independent and transparent analysis of the effects of protection and trade policy decisions. The goal is to do that in the WTO and the process should be through the WTO negotiations in the Doha Round, but it would help if in regional fora, like APEC, we got similar agreements and in bilateral negotiations we got similar agreements.

If the GTAP modelling that the CIE-DFAT report says is correct and the trade liberalisation gains are approximately zero from the US-Australia FTA, we would not lose everything if a part of the agreement were for the US to establish a Productivity Commission type institution. They would not have to promise to give away or change anything, but they would set in place a process that would lead to more informed public discussion and the possibility of changes in public opinion and political decisions down the line. So it would be great if we could get agreement with some of our major bilateral partners and it would be great if we could do it regionally in APEC, but the goal would be to get a WTO agreement on the establishment of these institutions.

Senator TCHEN—You said that the Australian Productivity Commission model is well respected. What is the prospect of the same model being accepted in other countries? Being respected is one thing, but whether other people follow your example is something else.

Prof. Garnaut—Any institution that plays a role in policy making has its own history. The Productivity Commission, from the days of the Tariff Board, has its own history here. It would be naive to think you could simply transplant that into every country and that it would have the same standing everywhere. But institutions have to start somewhere. If you start with a principled commitment to independent, transparent and rigorous analysis of the effects of trade policy decisions and public dissemination of those results it is rather hard to resist that first step. Vested interests might know that sooner or later that will weaken their influence on the policy-

making process. The sugar industry in the US might calculate that if too many people know who actually pays for that US protection and the subsidies in sugar the political base for their protection might be undermined. But it is not a very big political step for a government to commit to an institution that will establish a transparent, independent process, because it is not actually taking away part of their protection. For that reason, it is not impossible to make the early steps.

As each of these bodies in each of the countries develops a life of its own, they will be challenged by vested interests, just as the Tariff Board, then the Industry Assistance Commission and the Industry Commission here were challenged by vested interests in Australia—viciously, if you remember the debates in the late sixties and through the seventies. But enough people were following what they were doing for there to be substantial community support. The vested interests were never able to sideline them, so they were gradually able to expand their influence. Bill and I would not argue with certainty that there is going to be a smooth development of these institutions in every country, but if we agree on some basic principles in the WTO and each member government is required to make a start, we will have started the process. If there are continued reviews from the WTO there is a reasonable chance that the institutions will take root. But you are quite right to raise a question about whether one can be certain that they will take root. Maybe they will not everywhere, but if they do in some major countries that will be a big step forward.

Senator TCHEN—But in the meantime, instead of putting trade liberalisation on hold, bilateral trade agreements which are consistent with the WTO framework, such as the Australia-US free trade agreement, will be step a forward, won't they?

Prof. Garnaut—To be honest, I do not think you can say the Australia-US agreement is consistent with the spirit of the WTO.

Senator TCHEN—This committee has been told by a number of witnesses that it is.

Mr ADAMS—This is a witness who says no.

Senator TCHEN—Yes, I know, but other witnesses have told us that it is consistent.

Prof. Garnaut—There never has been a bilateral free trade agreement that has been judged formally to be inconsistent with the WTO. This is one of the great weaknesses of the WTO. It has no teeth on testing compliance with article 24. Article 24 of the GATT, incorporated into the WTO a few years ago, provides that a bilateral or regional FTA has to completely remove barriers on substantially all trade within a reasonable time frame. That reasonable time frame is generally defined as a decade. Frankly, the US-Australia FTA does not meet that test, but nor do many others. So when someone says to you, 'This is consistent with the WTO,' it is consistent in the sense that that no-one is going to take us before the disputes mechanism of the WTO. That is because, firstly, no-one takes the United States there on anything unless their own interests are very directly connected to the case; and, secondly, there are a lot of other dirty hands. The fact that everyone is entering into agreements that are inconsistent with the actual words of article 24 means that article 24 has really ceased to have value. In truth, anything goes. What has happened with FTAs, including our own, has removed any discipline that the founders of the GATT might have hoped would be associated with article 24.

Senator TCHEN—You made a very strong point on the question of whether there is a time constraint on the free trade agreement. You said that your letter suggested that there is no time constraint. You have a distinguished career in academia and as a government consultant. Are you familiar with the concept that there is a political window of opportunity in all things? Would you say that in this case the Australia-US agreement is not restricted by a window of opportunity?

Prof. Garnaut—Do you mean in the US?

Senator TCHEN—Yes.

Prof. Garnaut—I do not think it is constricted by the sort of window of opportunity that would force us to make a decision this year, because the US President and congress will do one of two things by July. One possibility is that the President, or Karl Rove, will decide to put the issue to the congress, and the congress will vote yes or no. Almost certainly if the President puts it there he will know that he has the numbers, because in an election year US presidents do not particularly like issues on which they are voted down in the congress. If the President puts it to congress, it will probably be passed. It is only if the President and his advisers have miscalculated that it will be voted down. We will know by July. If it is passed, then the agreement comes into law, whatever the next President says, 60 days after the Australian parliament votes upon it. The other possibility is that the US President does not put this issue to the congress this year but leaves it to next year's congress, in which case it is hard to see why we are bound to a decision this year when they are not. Whether or not the US President and congress take a positive decision this year, the opportunity is still open for the Australian parliament to pass this agreement and for it to come into effect in the new year. The window of opportunity will still be open early next year.

Senator TCHEN—Are you suggesting that the Australian parliament's recommendation on ratifying this treaty will have no bearing on whether the United States President will make a decision on putting the same treaty to the congress?

Prof. Garnaut—The US President will probably make his decision before this Senate has made its decision. Just the logistics of sitting days probably require that. If the reason for Australia not having taken a decision before the US President takes a decision is that we require more time for due process and proper consideration, I do not think that would be seen badly in the US. Indeed, I tested out this question. One of the possibilities in Australia is that we will have an election in August or September—you people know the odds much better than I. If that is the case, this will not be passed this year, or it will be very difficult for it to be passed this year, because parliament ceases to sit some time before the election. If that happens—and I have checked this with the US government—that is no impediment to the agreement coming into effect next year.

Senator TCHEN—I understand that part. I am just wondering about the fact that the Australian parliament has not ratified this treaty. Let us have no misunderstanding about this: the United States media and political institutions will not understand this as the Australian parliament following due process but will question whether Australia has any doubts about this treaty. From your knowledge of United States politics, do you think the US President would put this same treaty before the US Congress in an election year?

Prof. Garnaut—For it to be passed this year in the United States, I think the US President will have to take that decision before Australia's senators take that decision. I do not think there is any other possibility. Regarding your first point, about whether the US media and political system will interpret the insistence on due process in Australia as political doubt, if that happens it will be a failure of diplomacy on Australia's part. If the real reason that we are taking our time is that we want to make sure this decision is taken responsibly, that all the proper analysis is undertaken and there is proper consideration by the Australian community and the Australian parliament—the Australian Senate—then it is the job of Australian diplomats in Washington to explain that and to have it understood by the US polity. If we are not able to explain the truth—which is that our processes need more time—then it is a failure in the most basic role of our diplomats.

Senator TCHEN—But our process does not need more time.

Prof. Garnaut—It depends on whether you want thorough, authoritative analysis.

Senator TCHEN—Where do we have any doubts?

Prof. Garnaut—If there are not allowed to be any doubts about any treaty that is put to you then I do not think we should be wasting time in this treaties committee. If the reality is that you cannot express any doubt then, frankly, having this committee is a waste of everyone's time. I do not think this treaties committee is a waste of time. I think it is a very important development in our parliamentary processes. I take it very seriously. I think the committee has done excellent work. But excellent work requires proper process, and insisting on proper process cannot reasonably be interpreted as having a negative view about the thing you are looking at.

Senator TCHEN—I am just putting that possibility to you.

Mr WILKIE—Professor Garnaut, thank you for your presentation and for spending so much time with us. It has been a very informative session. It has been put to us—and I think Senator Tchen touched on this—that the term 'free trade agreement' has to be included in the agreement; otherwise, we breach WTO rules. Is that your understanding, or is there a way we can say that we negotiated not a free trade agreement but a trade agreement? Is there any impediment to us suggesting that it be called what it is—what we got—and not what they would like it to be called?

Prof. Garnaut—I think the people who look at it know what it is, whatever it is called. Frankly, I do not think nomenclature is the main issue. If the Department of Foreign Affairs and Trade people who work on these things say that it helps our relationship with the WTO then it is not the term that damages us but the reality.

CHAIR—An agreement can be called an FTA, a CERTA or even a customs union, so the name, by itself, has no great meaning.

Prof. Garnaut—I would not have thought it was important. I do not know where your interlocutors are coming from on that point. Maybe there is some new WTO wisdom that I do not know about.

Mr WILKIE—I suppose you can call a sow's ear a silk purse, but it is still a sow's ear.

Prof. Garnaut—That has been said before.

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

Resolved (on motion by **Mr Adams**, seconded by **Senator Tchen**):

That this committee authorises publication, including publication on the electronic parliamentary database, of the proof transcript of the evidence given before it at public hearing this day and also on 21 and 22 April 2004.

Committee adjourned at 5.40 p.m.