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JOINT STANDING COMMITTEE

ON FOREIGN AFFAIRS, DEFENCE AND TRADE

Trade Subcommittee

Wednesday, 12 November 2008

Members: Senator Forshaw *(Chair)*, Mr Hawker *(Deputy Chair)*, Senators Arbib, Mark Bishop, Ferguson, Fifield, Moore, O'Brien, Payne, and Trood and Mr Baldwin, Mr Bevis, Mr Danby, Ms Annette Ellis, Mr Gibbons, Ms Grierson, Mr Hale, Mr Ian Macfarlane, Mrs Mirabella, Ms Parke, Ms Rea, Mr Ripoll, Mr Robb, Mr Robert, Mr Ruddock, Ms Saffin, Mr Bruce Scott, Mr Kelvin Thomson and Ms Vamvakinou

Trade Subcommittee members: Ms Saffin *(Chair)*, Mr Bruce Scott *(Deputy Chair)*, Senators Ferguson and Forshaw *(ex officio)* and Mr Gibbons, Mr Hale, Mr Hawker *(ex officio)*, Mr Ian Macfarlane, Mrs Markus, Mr Ripoll and Ms Vamvakinou

Members in attendance: Senators Ferguson and Forshaw, Mr Hawker, Mr Ian Macfarlane, Mr Ruddock, Ms Saffin and Mr Scott

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WITNESSES

Subcommittee met at 11.07 am

GARNAUT, Professor Ross, Professor of Economics, Australian National University

CHAIR (Ms Saffin)—Welcome. Thank you for agreeing to come to this private briefing of our committee. You have read the terms of reference for our inquiry. We would like to benefit from your knowledge, understanding and wisdom of APEC, trade and enhancing trade in the region or anything else you would like to tell us about. The floor is yours. We will not ask about ETS and CPRS, as much as we want to.

Prof. Garnaut—I thought I would open with some general remarks and then you can take me into some more detailed territory in discussion as you wish. I thought it would be useful to say a few things about where the international trading system is headed in the world and the region and Australia's participation in it before talking about APEC and the sorts of trade policies that fit alongside development of APEC. Then I will raise a couple of trade policy issues from the contemporary environment.

I think this is a bad and dangerous time for the global trading system. I think there has been serious fracture in the open multilateral trading system, which has served Australia well for a long time. There is lip-service to open trade and multilateralism. The intellectual and political mood has turned against open trade. It has been an insidious process over a period of time. You do not get the wise support for free trade as a matter of course in the domestic political discussion in many countries—maybe any countries—that we had at various times in the past. I fear that the current environment—the environment of deep recession in developed countries and problematic growth in many developing countries—will be an unhappy environment for support for open trade in the period immediately ahead. I myself think that global free trade is tremendously important for global development and for Australian development, so I see these things as very unfortunate developments.

Support for free trade is not an instinctive characteristic of human beings, rather the opposite. The idea that each country will do better if it opens up to free trade whatever anyone else does is correct, demonstrated by economic analysis and by the experience of every country that tried it, but it is not the instinct of humanity and so it is always hard to make the case. Even in this country, where we have done so much better economically since we opened up to international trade in the 1980s and 1990s, the polling shows continued quite strong support for protectionist measures of various kinds. This is a common feature of political attitudes to free trade everywhere. So the case for free trade is never made. You have to keep making it, and at the moment no-one is really making it.

A symptom of that is the stalemate in the Doha Round. While what had survived on the negotiating table up until that last failure a couple of months ago was not ideal, it would have been a very substantial step forward. And for governments not to be able to take that step I think is evidence of a big problem. Everyone blames someone else or something else. The Indians and the Americans blame each other. I think the problem is wider than any country's position at that time. There is just not the support for opening trade.

What was on the table would have meant significant things for agriculture and our agriculture. For those who lived through the mid-1980s, removing agricultural subsidies forever as a legal feature of the export trading regime would have been a big step forward. Even if right at the moment they are not the biggest problem in agricultural trade, they could come back as big problems. There were huge problems under the Export Enhancement Scheme in the United States and the European subsidies in the early and mid 1980s. So it is a big pity that that Doha Round, even with its limited objectives, even at the end did not take that last step.

Another symptom of the weakness is the proliferation of bilateral and regional free trade agreements. While they are dressed up as free trade, they are not. As they become more important in the overall system the problems with them become greater. It bureaucratises trade. If you are a country with free trade agreements with a number of countries, all under different rules of origin, then you have invited bureaucracy into every business decision. There is a decision to be made then about whether this component comes from Thailand, America, China or Japan and it is treated differently depending on that. Every company has to have people who are experts in the stuff that has actually got nothing to do with the fundamental economics of producing goods and services at a lower cost. This is getting worse and worse. The environment is now one where it is accepted that that is the main way forward. That is symptomatic of a deep problem in the multilateral trading system. We happen to be pretty big losers from that. The proliferation of bilateral arrangements through Asia has meant that the terms of access for our agricultural products in a lot of markets are relatively poorer than they were.

We have benefited so much from getting government out of the boardroom in the last quarter of a century. To have a mechanism that is systematically putting it back in is a costly business. The costs accumulate, bit by bit, over time as the cost of protection did in Australia. There is not a single point in time at which you can say there has been a whole lot added, but it gradually gets worse.

Some of these developments are also symptomatic of APEC having lost its way on trade policy. The only organising idea for trade liberalisation within APEC that ever made sense was open regionalism, which was the idea that the APEC countries would work together to support an environment in which each country would become a more open economy and, individually but through a process of discussion and consultation—in which what was happening in each country was influential in others—encouraged liberalisation within each country and where APEC was a force for progress in the multilateral trading scheme.

Even in relatively recent times, since the new order of proliferation of free trade agreements became important, there have been two instances when APEC was of considerable importance on a global scale in pushing forward a genuine free trade agreement through the multilateral system. One of these occasions was in the immediate aftermath of 9-11 when APEC was meeting in Shanghai and APEC’s decision in November 2001 to give a strong push for Chinese membership of the WTO was influential. At that same meeting there was a strong APEC push for finally launching the Doha Round. That was important at the time. So I am not saying that APEC is not playing that role in open trade at all. They were important developments but it was a fair time ago and there is no current momentum for APEC to play a role in support of genuine free trade.

The idea of open regionalism guided APEC through its first decade or so. ‘Open regionalism’ is defined as opening each country of the region to trade without in any way discriminating against outsiders—essentially they do it through the mechanism of unilateral liberalisation in each country. That had huge momentum in the western Pacific region really until the Asian financial crisis in 1997 and 1998. It has no momentum now. Now you do not hear about the old idea of open regionalism in an APEC context. It used to be the organising idea. I think it is the only idea that actually works within APEC as an instrument of trade liberalisation.

Finally I have a few remarks on contemporary risks. I see the current financial crisis as a financial crisis of a dimension without precedent in my professional lifetime. Whether it becomes a global recession that is the biggest in my lifetime, we will have to wait and see. It may. The particular form that the crisis has taken—extreme weakness in the financial system—has led to a proliferation of government roles not only in the financial sector but beyond it in a crisis atmosphere without the framework having been carefully thought through. I think there are risks that that can put into the system—government interventions that have consequences that are in the end costly and hard to unwind.

Another risk in the system at the moment is associated with the issue that it was my presumptuous task to do a major report on recently—climate change. The risk here is that, when some countries put in place strong constraints on restricting emissions of carbon and other greenhouse gases and other countries do not put in place comparable constraints, the pressures for those that are doing it to put in place barriers to trade so that their firms are not at a competitive disadvantage are irresistible. Those pressures take a different form in Australia than in Europe and North America. In the US and Europe the issue is mainly competition from imports from countries that do not have comparable regimes. In Australia the bigger issue is a level playing field for exports. In both Europe and the United States, alongside the discussion of strong regimes for reducing greenhouse gases there is discussion of measures to put penalties on goods coming from countries that do not have comparable emissions constraints.

CHAIR—Excuse me, Professor Garnaut. Senator Ferguson has to leave and would like to ask a question.

Senator FERGUSON—Earlier when you were talking about it being a bad and dangerous time for the global trading system you first said that free trade agreements were not really free trade agreements.

Prof. Garnaut—Yes, they were not really free trade.

Senator FERGUSON—No, they were not really free trade. I guess if we said they were ‘freer trade’ than currently existed that would be a fact though.

Prof. Garnaut—No, not in general. It is sometimes the case, but not in general.

Senator FERGUSON—You said there is a stalemate in Doha and that bilateral agreements were making life difficult for multilateral agreements to take place and were making other distortions. What are the options? If we are getting nowhere at Doha, and we have not been for quite some time, and you say that a free trade agreement is not really a free trade agreement, what are the options for governments of any persuasion to try and free up the trading processes that currently exist? If multilaterals are not going to work, if free trade agreements are not free trade agreements, what are the other options?

Prof. Garnaut—One trouble with free trade agreements is that they sound like free trade but you are talking about something completely different. This was carefully worked out in the economic discussion at the time of the formation of the European community through the work of Viner and others. When two countries remove trade barriers against themselves but keep barriers to the rest of the world two things happen. It does free up trade between those two countries but it actually increases distortions in trade with other countries. It can lead to the replacement of low-cost production from a third country with higher cost production from your partner country. That is the opposite of free trade; that is protectionism. For example, in the motor car industry, if we have a free trade agreement with the United States and Thailand but do not have it with Japan and Korea—and we still have some tariffs mercifully; they are going down to five per cent but even five per cent matters—then there will be some cases where either final products or components that used to come from Japan and Korea, because they are the competitive suppliers, will come instead from Thailand or the United States. That is a protectionist development. So a free trade agreement is a mixture of increased protection—in this case, protection of your trading partner—and the freeing up of trade bilaterally. The way the political economy and the political environment in which free trade agreements are negotiated works is that usually countries take steps to block the true free trade elements. The biggest gains from trade between us and the United States, for both of us, would have come from opening up United States agriculture, but they excluded sugar completely and put very long time frames on other agricultural products, so—

Senator FERGUSON—Mainly beef, and we never filled our quota anyway, so it did not really affect us.

Prof. Garnaut—In recent circumstances of very strong growth in demand in Asia we have not filled the quota, but we are doing these things for a long period of time. The general point is that there were no restrictions in the negotiations on the protectionist elements. All the protectionist elements went ahead and were agreed to by both sides very quickly. The real free trade elements were contentious.

Similarly, in discussions between Australia and China, at an early stage China said that it needed to put some constraints on agriculture. We said we needed to put some constraints on textiles and some other things. Who knows? In the current circumstances we might want to put some constraints on services related to investment. Again, there is no issue about the protectionist elements of the free trade agreement. Everyone agreed to those in a moment. But the real free trade elements that could increase welfare in both countries were contentious and restrictions were put around those. That is in the nature of the political economy of negotiating a free trade agreement. It is just part of the way things work. And it is the way the rules of origin are negotiated, which end up being highly interventionist, especially if you have very detailed rules of origin. That is the way in which you really do bring governments right into the boardroom. Experts on dealing with governments become central to business, and I think that is very dangerous to productivity growth.

What do we do if we are facing roadblocks in a multilateral agreement? Let us keep in mind that, first, the biggest benefits from free trade come to the country that does it itself. The biggest benefits we could get from opening markets would be to get rid of the last of our protection. We have got rid of most of it but, let us be clear, we would be richer if we got rid of the rest.

Secondly, the biggest benefits we have got from other countries opening their markets is the unilateral liberalisation that they have done. Much more than half of our export trade is now with Asia. A very high proportion of that trade would not be happening if it were not for unilateral trade liberalisation in those countries, which they have done because it was in their own interests.

When I started working on China, China did not import significant amounts of minerals. The reasons for that were the standard protectionist reasons. There was an argument that you would displace a large domestic mining industry and there were arguments that it would be strategically risky for China to rely on foreign countries for supply of basic raw materials. They had that debate and they got rid of all of that and we are the beneficiaries.

So the main way you get gains from other countries' liberalisation is through their own processes. The most important thing we can do is to encourage those processes. The worst thing you can do is engage them in bilateral discussions and have them thinking that their own liberalisation is a concession to us.

There is a valid concern for businesses and governments in countries that have strong carbon emissions constraints that their emissions intensive enterprises not be subject to competitive advantage simply because other countries do not have it. Firstly, we need to accept that, while there is a variable approach to these issues across the world, countries will be taking steps to look after emissions intensive industries. Secondly, we need to recognise that in certain circumstances there is a valid case for that. So we have to be thinking about rules for that.

If there is an emissions trading scheme or other carbon constraints in the United States, as is very likely in the period ahead, tagged onto those bills—as was tagged onto the Warner-Lieberman bill that went before the Senate a few months ago—will be conditions requiring the government to place restrictions on trade from countries that do not have comparable things. There is a very big risk that that will open the door to old-fashioned protectionism. You are doing things for one reason and then you add all sorts of other things. So we need rules about how that is handled.

I put a fair bit of effort into my report on developing some principles. They have not been discussed much. It is a fairly technical bit of the report. I will not go through the details now, but I would like to commend that to the committee. In chapter 14 on the emissions trading scheme is a discussion, including a number of diagrams, related to support for trade exposed emissions intensive industries. I think the principles there are valid. If all countries adopted them, we would have some protection against protection, protection against everyone doing their own thing and adding a whole lot of protectionist things to them.

I think we also need a WTO agreement on how to handle these things. I think that is going to become so important. It is almost inevitable that in Europe and the United States there are going to be measures of this kind, so we need international rules on how you go about doing these things. Otherwise it will just be a reason for the proliferation of standard protectionist devices. This could be a possible role for APEC. A good role for APEC is developing ideas about regimes that are duplicable internationally. It could be applied first on a regional basis—get the right principles in place in each country—and then take them to the WTO if they are soundly based, and they would not be soundly based unless they were of a kind that could be generalised into the WTO. That is a possible valid role for APEC.

Mr HAWKER—You talked about the need to get the ETS rules into the WTO.

Prof. Garnaut—Not the ETS rules; the rules about how you assist trade exposed emissions intensive industries.

Mr HAWKER—I am just thinking of the recent history of Doha. This sounds as though there could be another decade of discussions. In the current global financial crisis you get the feeling that we might be taking one step forward and two steps back all the time. Is that a realistic assessment of where we have got to in terms of this whole trade issue—and you have linked emissions trading in as well? It does look as though we are running into a very rocky patch or something worse.

Prof. Garnaut—I agree, David. It is an awful time for the system, and that was in my opening remarks. As I mentioned at the end, you could do this in stages. We could apply the right principles now ourselves. I would like to see the principles that I outlined in chapter 14 for the treatment of trade exposed industries more widely discussed in Australia. I have had a lot of support from mainstream economists for that approach, but it is a bit technical and there has been no wider discussion. I think a lot of the problems that are being discussed in relation to the government’s green paper and in other ways would be sorted out if the discussion focused on the principles that I outlined, which are different.

This is an area in which you could usefully get an understanding within APEC because it does not in any way put a barrier to generalisation of this into the open trading system. The WTO could be a later step. The most important thing is to get the ideas out. I have had recent discussions in Washington and London and people have focused a bit on the points that I made. The process may be a number of countries individually putting in place principles with a mind to what can be generalised to a global system later. It is really important that you have that extra step in mind when you take the first step.

The two most important cases for the period ahead are what happens in Europe and what happens in the United States. We need to be aware of and engaged in their discussion of these issues. But in the end we will not be safe from this being an avenue to protectionist interventions until it is embedded in the WTO. You are quite right to take the view that that will not happen quickly.

Mr HAWKER—You raised another worrying issue when you said that the response to the current financial crisis had led governments to make different decisions in different countries and obviously some of them have been fairly rushed. I am just wondering what processes are available for people to say, ‘Hang on. We are exacerbating the problem if we do not get some harmony in what is being done in response.’

Prof. Garnaut—Of course, it is always hard in a crisis. In the nature of a crisis, everyone is responding to it. I was thinking particularly about the risks to the trading system. The global trading system rules have some constraints on trade in services that are in principle affected by some of the things that are going on now in the financial system. All I can suggest at this stage is that as a community we try to keep in mind the wider implications of short-term measures. Some countries systematically support their banks, for example, in ways that are inconsistent with what other countries are doing.

There is no way in which you can get coordination in what everyone is doing in a crisis—I do not want to be unrealistic about that—but we need at least to be mindful of the distortions that can be left in the trading system. We do not want the banks that prosper in the world to be the banks that have the greatest government support at home rather than the banks that are the best at banking. I am raising that as a risk, an issue we should be thinking about, because there is a danger that when this episode is over we will have distortions in our trading system, especially in relation to trade in services, that are costly and very difficult to unwind.

Mr RUDDOCK—I am not normally a member of this committee, so are you happy for me to ask questions?

CHAIR—Please. I am happy for you to ask, Philip.

Mr RUDDOCK—I was interested in these objective studies, as distinct from assertions, that point to some of the advantages that are derived from, for instance, unilateral opening up of trading opportunities. What I thought was particularly interesting was your comments in relation to West Asian economies, I think you said—

Prof. Garnaut—Western Pacific, which is East Asia.

Mr RUDDOCK—East Asia, okay. I need to get that clear. East Asian economies had opened up in the APEC region and that opening up was essentially underdone through the Asian financial crisis. That was a simple explanation that I took from what you were saying, and I wondered what the arguments were that persuaded them to perhaps move back rather than accept that unilateral continued opening up would provide benefits for their economies.

Prof. Garnaut—If I could just restate what I was trying to say, what was lost in the East Asian financial crisis was not the benefits of the liberalisation that took place—actually, there was not much retreat—but the idea that that was the way to keep going. So there has been very little unilateral liberalisation in the past decade. The exception is China, and of course it is very big, important exception. China has continued to liberalise. But take South-East Asia. If you went back 15 years or 20 years, leaving aside the former communist countries of South-East Asia, you would say that the Philippines and Indonesia were the most protectionist economies. Under Ramos as President, 1992 to 1997, and under Suharto from the mid-eighties to the financial crisis, the Philippines and Indonesia underwent major liberalisation, and those economies benefited greatly from that. There have been no episodes of significant liberalisation since then.

What arguments were important? I think that the crisis itself broke the momentum of liberalisation. The focus was on domestic expansion and restoration of economic activity and for a while the focus went off reform affecting long-term productivity, and that shift of focus allowed the very productive ideas that had been prevalent from the mid-eighties to 1997 to lose traction.

There was a view in a number of East Asian countries, especially those that had suffered most from the crisis—very importantly, Korea, for example—that the crisis had been the result of too much exposure to the international economy and to the international financial institutions. There was a bitter resentment in Korea and, to a lesser extent, South-East Asia and Indonesia of the roles of the Washington based financial institutions. There was an increase in profile of an anti-globalisation ideology that was not based at all in economic analysis of what happened in the financial crisis but was important in the domestic political discussion.

I think the East Asian financial crisis created an environment in which bilateral and regional free trade agreements became more important because they did not involve big foreigners from outside the region. So I think that East Asia played its part in what has been a global step back into fragmented arrangements, so-called free trade agreements, whereas until the financial crisis the western Pacific region—East Asia, Australia, New Zealand—were notable for not being enthusiastic about bilateral free trade agreements. So I think those were three very important components in the change of ideas. The sad thing to me is that there was so little reflection on how much benefit the countries that have been engaging in liberalisation actually got when they were doing it.

Mr RUDDOCK—I am looking for where you find objective modelling, perhaps, that actually proves the propositions in relation to unilateral opening up. I was interested in the analysis that you made of the present crisis and the potential for increased bureaucratisation within the corporate area through some of the measures that have been taken to deal with the current economic circumstances. It seems to me that you have to weigh it up. I can understand the costs of bureaucratisation, but there are also costs through lack of transparency in relation to the way in which a lot of the financial institutions have undertaken their work. A lot of the regulation that is going to evolve will be regulation that requires greater transparency—and it will require some additional costs in providing access. The question is: how do you weigh up those costs as against the costs of not doing anything?

Prof. Garnaut—I am not saying not to do anything in current circumstances. When you have a crisis of this dimension the best solution is not for government to do nothing. These are circumstances in which you need strong government responses. I am not making that very general point; I am pointing to some risks in the process. On the evidence for the advantages of unilateral liberalisation, the best simple source is a book that my friend Professor Jagdish Bhagwati at Columbia University in New York published a few years ago called *Going Alone: The Case for Relaxed Reciprocity in Freeing Trade*, which gives a number of case studies of unilateral liberalisation, some from this region but also globally. Jagdish writes very clearly—it is a collection of other people’s writing with a couple of overall chapters by him. That is one source.

For the Australian experience, which is a very important one, there is lots of material, but some of the wide-ranging Productivity Commission reports on what happened to productivity in Australia through the process of opening up and reform are probably the most thorough source for that. Australia is a nice case study for the rest of the world.

The point you made at the end is the correct point: what we need in the current circumstances of financial crisis is not non-intervention but the right sort of intervention. No markets work effectively without good regulation. It is true that you do not have a market economy without good law. Good law, in relation to financial institutions, will contain elements of prudential supervision, but the rules should be of a general kind and focused on what is genuinely necessary to protect the system and to protect people who are not in a position to protect themselves—and they need to be about transparency.

I think that, on the whole, Australia has done a pretty good job of that. I think our financial system is in genuinely good shape. I would say it is certainly in much better shape than that of any other developed country. That is, to a considerable extent, the result of good regulation with a strong focus on the essential elements of prudential supervision and transparency. I think a very important part of avoiding a recurrence of the current extraordinary circumstances will be the strengthening of effective regulation in the United States. That is part of the American discussion at the moment; there is a realisation of that. But that will not be maximum possible regulation—in fact it can easily lead to excessive and ham-fisted regulation. The response to the Enron crisis a few years ago provides a good example of that.

Mr RUDDOCK—I suspect there will be over-reaction.

Professor Garnaut—Yes, of the same kind as Sarbanes-Oxley and that will be costly, so let us keep that in mind. I was pointing to a risk so let us keep that in mind as we respond to this crisis and bear in mind that, while we have to get out of the crisis as quickly as we can, what will matter when it is over are the old things: productivity growth and efficient performance. The nature of the regulation is going to be the key to that.

Mr RUDDOCK—Thank you very much.

Mr BRUCE SCOTT—I am sorry I was not here for your presentation, Professor, I had other duties. I was in the UK last week talking to their House on climate change and their bill, and they have upped the ante in relation to targets. As all of those at the committee said, none of them will be there in 2050 anyway. Another interesting point is that there is so much more that we could be doing now rather than having this hypothetical target 40 or 50 years out. Their advice to me was that 80 per cent of global emissions come out of our major capital cities around the world—either in the production of what they consume or the power or whatever.

Professor Garnaut—Or the transport.

Mr BRUCE SCOTT—All those things. There is so much more that could be done in the here and now. Obviously an emissions trading scheme is going to be somewhere in the future, but retrofitting homes, insulation, solar and all those other things could be done, and yet we are not moving at all at any pace in this area. Coal-fired power stations are still being built. I do not know where the next one is going to be in Australia. There was one in my own electorate completed just a year or so ago. All the wrong signals are out there. I guess the electorate is pretty confused about all this.

Professor Garnaut—I have just written 627 pages about it. I presume that is not an invitation for me to go into that at length. I think you need to have a very clear view of where you are headed as well as a view of what you are going to do right now—and you need a path to get there. One of the things I tried to do in my report was to show that there is a path in our country and in others that, for the world as a whole, adds up to a solution. If you just look at what you are doing here and now without looking at the longer-term path, you do not know if you are going to get there and you will not get there. I think we need the longer perspective but we need do need to be doing things now.

The question is: what now? I think the centrepiece of our efforts should be some market based arrangement, and the emissions trading scheme seems to be best for Australia although it does depend, as I say in the report, on us being able to implement a clean system with wide coverage and very few exceptions. The more you introduce exceptions and free permits handed out politically and so on—

Mr BRUCE SCOTT—It is like trade protection. It is similar to that.

Prof. Garnaut—Yes, the weaker is the case. If you take those things too far you are better off introducing a simple carbon tax, and I say that in the report. But the best thing is to get it right and to have a good trading scheme. I think that has got to be the centrepiece but it can never be the whole effort. I think it is the only thing we need for the emissions reduction objective. But then you have to ask what else you need to be able to get to that objective at lowest cost. There you have to recognise a number of market failures that will affect the efficiency of businesses' response to that. The biggest one, in my view, relates to research development and commercialisation. In the nature of things you will not get an optimal level of investment by private businesses in research development and commercialisation without government assistance, simply because there will be externalities. There is lots of exciting work going on in Australia, particularly in Australian businesses, on new technologies for reducing emissions. Let us just take one of hundreds: the work on deep rock geothermal—

Mr BRUCE SCOTT—At the back of my electorate in the Cooper Basin.

Prof. Garnaut—in South Australia, Tasmania and Victoria but especially in the Cooper Basin area of South Australia. The people doing that work take a lot of risk, they will run into a lot of dead ends and they will learn a lot. One of them will succeed. The first one that succeeds will be copied by others, so there is a case for giving some support to the pioneers, from which the others learn. But you do not want that to become old-fashioned protectionism, so you need simple rules. I have suggested a simple arrangement for matching funding for investment in innovation in low-emissions technologies—say dollar for dollar. If you qualify as to low emissions, generating new knowledge with externalities, then you qualify for that.

Just briefly, there are the two other important areas of market failure that will need correction alongside the emissions trading scheme. One relates to network infrastructure. You cannot rely on the market automatically in all circumstances to provide that. That is going to be important in relation to transmission grids and some other things. The other one is market failures in relation to information required to use effectively old technologies. This is very important at a household level or at a small firm level. It would be a big research job for a small firm to look at all the ways in which you could cost-effectively reduce emissions in a new building that was being put in place. Until some people have started to do it you will not have the support mechanism. You will not have the architects and plumbers and so on who can help you with that. So I have a chapter in my report on the information market failures. They are the ones that are really important as to buildings, which is the point that you brought up.

CHAIR—Do we have any last questions on trade? If not, please continue.

Mr IAN MACFARLANE—Professor, in regard to your statement that the best form of mechanism is an effective carbon trading scheme, as distinct from a carbon tax, would you explain that to me? By coincidence I just happen to have in front of me a statement from Treasury official David Gruen, who said that carbon capture and storage, or CCS, would 'come on stream some time between 2026 and 2033'. So that is 20 to 25 years away. In the meantime a carbon trading scheme as to, let us say, electricity generation is effectively a tax.

Prof. Garnaut—I know David's work very well.

Mr IAN MACFARLANE—He is at Treasury, which is modelling this whole thing.

Prof. Garnaut—Yes, and I worked with him on the modelling for my report. As to what he is saying and what he means there, I am sure it is that under the assumptions in the modelling that is when CCS comes on—

Mr IAN MACFARLANE—I am not arguing with that. In fact that gels with my thinking that you are not going to have CCS for 20 to 25 years, so effectively under either proposal, either a carbon tax or a carbon trading scheme, you have actually got a carbon tax in the absence of technology to lower carbon.

Prof. Garnaut—The difference between a carbon tax and an emissions trading scheme is not the effect on price. It is there under either system. The difference is trading in permits. That is the essential difference between the carbon tax and the emissions trading scheme. But even if the solution in the energy sector is going to be carbon capture and storage—and that will be worked out in the marketplace; that might be the best solution or there might be better ones—so even if it is—

Mr IAN MACFARLANE—Nuclear is the best one but we are not allowed to consider that apparently.

Prof. Garnaut—I have modelled the effects of that for my report. It is in chapter 20, Ian.

Mr IAN MACFARLANE—I read it.

Prof. Garnaut—So, yes, you could have a look at that. But even nuclear will not work without the incentive structure, without the carbon price—

Mr IAN MACFARLANE—I am not arguing that.

Prof. Garnaut—Even if carbon capture and storage is the answer and even if it is not available for 2026, and they are both questionable propositions—but even if those things are true—you need a carbon price which will be rising steadily over time in the interim period because there are lots of other things that will be happening. At a certain carbon price it becomes profitable, for example, to put in investments to dry coal in Victoria, which reduces emissions very considerably by, say, 30 per cent. There are lots of other things that will be happening along the way.

Mr IAN MACFARLANE—Sorry, perhaps I did not make the question clear. For the black coal industry generating electricity from now until 2026, they have effectively got a tax over which they have no control. That is, they have got no choice but to go and buy the credits because they do not have the technology to lower the emissions. In that situation wouldn't a tax be better? The tax would at least be set, whereas the carbon price could rise dramatically particularly in the absence of some of this technology coming on stream.

Prof. Garnaut—The carbon tax would not be doing its job unless it was also rising.

Mr IAN MACFARLANE—I agree.

Prof. Garnaut—The job is not just for one sector, the black coal sector; it is for the whole economy. The rising price, amongst other things, will be increasing incentives to conserve on energy use, to introduce lower emissions alternatives and to make the smaller changes and the smaller investments as to black coal generation that reduce emissions. All of these things will be encouraged by the rising carbon price before the big breakthrough, whatever it is, on CCS or whatever it is.

CHAIR—Professor Garnaut, unfortunately we have to wind this up now. I would like to take the opportunity to say thank you on behalf of the subcommittee. We really appreciate the time you have given us. We also acknowledge your vast experience and intelligent thinking in the area of trade. I said at the outset we would not ask about ETS and CPRS—but we did.

Mr IAN MACFARLANE—I was not here for that, Madam Chair.

CHAIR—I know and neither was my deputy.

Mr BRUCE SCOTT—But it all does impact on trade and our competitiveness.

CHAIR—Yes, I know. It was too compelling for the people here and we could not resist, Professor. You raised quite a few issues and we will be mindful of them as we continue our inquiry. I note the observation about unilateralism, because the political rhetoric, wherever it is, is always about how you cannot go it alone whatever it is. I think that is a really important guiding principle. It is also about being mindful, in the global financial crisis, of having trade on the agenda. There are quite a few good guiding principles, so I would like to say thank you, Professor, very much for those.

Prof. Garnaut—Thank you, Madam Chair. It has been very nice to be here. As I said before, none of my views are secret.

CHAIR—We are aware of that. Again, thank you very much, Professor.

[12.06 pm]

BARTY, Mr Grame, Regional Director, Americas, Austrade

MOIGNARD, Mr Michael Stanley, General Manager, Government and Communications, Austrade

MOREHOUSE, Mr Hugh Roderick, Regional Senior Trade Commissioner, ASEAN, Austrade

SMITH, Mr Laurie, Regional Director, North-East Asia, Austrade

CHAIR—I would like to welcome the delegation from Austrade. I think it would be best if we go straight into your presentation to us and then we will have a discussion, in the same way we did with Professor Garnaut. We are being recorded by Hansard. Are you happy for that to happen, to have it on the public record?

Mr Moignard—Yes.

CHAIR—If there is something that you want to say in camera, please advise us.

Mr Moignard—It is a pleasure for us to appear in front of the committee today. We thank you for the opportunity. I am the general manager of government relations and communications. I have just returned, in fact, from 4½ years in India as senior trade commissioner, where I met Mr Macfarlane a couple of years ago in another role.

Mr IAN MACFARLANE—Another life.

CHAIR—The wheel goes around.

Mr Moignard—I have just been back here a short time to take up the government relations position with Austrade in Canberra. With us today we have three of our regional directors. I will give you, if I may, a bit of background to Austrade and the way we are organised.

CHAIR—Please do.

Mr Moignard—We also prepared a submission to the committee, which has been lodged. I hope the committee has had a chance to see that submission—

CHAIR—We have.

Mr Moignard—but we would also like to summarise some of the key issues from each of the regions. In summary, Austrade is the export and investment agency for the federal government. It is constituted under the Australian Trade Commission Act. It is part of the Foreign Affairs and Trade portfolio and we report to the Minister for Trade. Our role is to be a focus for the government's trade and investment facilitation programs. We now have inward investment programs since the office of Invest Australia was integrated into Austrade as of 1 July 2008. So we are a fully integrated both trade and investment agency. We have a coordination role with other government agencies and also with state governments. Another major role of Austrade is to administer the EMDG Scheme.

Operationally, we are set up in a number of divisions. We have four offshore divisions, representatives from three of which are here today. We also have an exporter services division, which is located in Australia, with 18 offices around the capitals and other parts of regional Australia. Our global network is very broad. We have coverage in 60 countries across the world in 110 locations. So we have a very broad network globally, but, similarly, our national network is quite broad. We also work closely with the TradeStart operation, which has 50 locations across Australia. They are with providers of services to Austrade, where we work with them very closely.

The uniqueness of Austrade is that we bring a commercial and a public sector view to assisting Australian business. We do have an integrated holistic view of trade and investment—both inwards and outwards. We have a very strong network in those major markets where Australian companies are seeking opportunities and, because of the connections we have back in Australia, both with our exporter services program but also with our coordination role with other domestic portfolio departments, we have a knowledge of Australian capability that can be matched to the market opportunities that our overseas network is providing. Therefore I think that we do bring a unique set of principles to issues of trade and investment, particularly where the opportunities are arising offshore and how we can capitalise them for Australian business.

We deal with probably around 5,000 companies which we assisted to make export sales last year. But, in terms of direct, one-to-one relationships with companies, it is many more that. Not only do we have a very strong database of Australian companies that we are dealing with but I think one of the unique opportunities that we bring is our network of buyers and customers, as we refer to them, offshore. So we are in daily contact with companies that are interested in either investment into Australia or purchasing Australian goods and services. It is that network—that relationship that we can build as a government agency to bring both the overseas buyers and the Australian firms together—that I think gives us the ability to provide what we consider to be an important service to the Australian business community.

That is a brief overview of where Austrade sits. With your forbearance, I would now like to ask each of our regional directors to make a short presentation to the committee summarising the submission that we have provided.

Mr Barty—Thank you, Mike, and thank you to the committee for inviting us. I represent the Americas region and am based in Los Angeles. We are active in Canada, the US and, of course, Latin America. Without going into great detail, I just wanted to highlight to you the areas of differentiation we see at the moment. We live in interesting times in the US at the moment and I do not think you need for me to expand much more on that, but I do point out that we still believe there are very exciting opportunities in the US. We believe that there is a lot of investment about to be undertaken in clean technology. President-elect Obama has made a commitment to the commercialisation of clean technology—$150 billion over 10 years.

I recently presented to the Dow Jones venture capital fund. The investors are clearly waiting for government direction before they make investment, but unquestionably energy security is of great interest to the American community and business community. We believe that there will be a major investments made, so we are looking to ensure that Australian technology and capability is incorporated into that commercialisation process, which we believe will be a significant.

We are also closely monitoring advanced manufacturing and financial services capability. We believe that there will be opportunities going forward, but obviously there are changes in that environment right now, so it is best to be monitoring that activity.

In the case of Latin America, we have undertaken an analysis of Latin America based on the four securities, as we refer to them: energy security, water security, food security and financial security. Out of that, we believe there are six Latin American countries that represent outstanding opportunities for Australian growth. They all have common characteristics in regard to the liberalisation of trade and their approach to the Asia-Pacific, in particular, and are stable and have the motivation to become part of the world community. Those six countries include Mexico, Colombia, Peru, Chile, Brazil and Argentina. We think there are outstanding opportunities going forward in Brazil and we would like to continue to focus on our efforts in building those opportunities in Brazil. We also think there are astounding opportunities to establish strong relationships and trading with Colombia and we are moving towards doing that. A parliamentary committee visited Colombia and Argentina in August and met with President Uribe and, I think, were also very impressed with what they saw and heard.

The point I would like to make to the committee is that this is a once in a generation opportunity to engage with the Latin American countries. They are clearly interested in working with Australia. We have established very good student exchange relationships. Recently in Santiago 15,000 students registered interest in attending the expo on higher education. We are drawing big crowds of students from Colombia and Brazil as well. As you know, that augurs well for the future.

I would like to report to the committee that, in my mind, there are excellent opportunities in the US, as that market changes, and there are excellent opportunities in South America that we aim to build on, particularly in those six countries.

CHAIR—Thank you. We will proceed with the presentations.

Mr IAN MACFARLANE—I will just ask: what was the fourth thing is said? You said energy, water, food and something else.

Mr Barty—Financial.

Mr Smith—I am based in Shanghai. My predecessor, who wrapped up his work with Austrade about four or five years ago, was based in Tokyo. When I started, the decision was made that I should be based in China, which obviously is a major growth market for Australia. The markets that I am responsible for can be counted on the fingers of one hand, which is very different to the other very extensive regions that we are organised into. Japan, China, Korea, Taiwan and Hong Kong are the markets in which we have representation, and we have about 170 staff across 23 locations in those markets. Obviously Japan, China and Korea are Australia's first-, second- and third-largest markets.

I thought I would give the committee a sense of the footprint of the work that we do and a little bit of texture of the work that we do and the way that we see the environment in Japan and China—the two biggest markets in that region. In terms of our footprint, if you take a market like China, there are around 4,200 companies per year exporting to China. China is a very promising market—I think China has done a terrific job marketing itself as being open for business—but it is also a challenging market in which to get things done. We have dealings with around 2,000 companies a year in that market. When you think about our footprint across the exporter community, we are touching around half the Aussie companies that are active in that market. That is mainland China.

If we look at Hong Kong, there are even more companies exporting to Hong Kong. There are around 5,000 or so. We tend to touch only about one in six of those companies.

CHAIR—More Australian companies?

Mr Smith—More Australian companies exporting to Hong Kong. That is interesting in itself, isn't it?

CHAIR—It is.

Mr Smith—One thing to keep in mind is that Hong Kong is an important gateway to mainland China, so part of that is indirectly destined for China. The other lesson that we can draw from that is that it indicates where Austrade tries to position its services. Hong Kong is a more modern market and a more open market. The rule of law operates in clearer and more predictable ways in Hong Kong. The rules of the game in a business sense are a little clearer and easier to understand for Australian companies, and English is more widely spoken. So there is really less of a gap for Austrade to fill in terms of helping companies take some of the key steps they need to be successful. So our footprint in a market like Hong Kong is substantially smaller. In Japan, Korea and Taiwan you will get figures between those two extremes of 15 per cent or so and 50 per cent. There are large numbers of companies that we are working with in each of these markets. I guess that is one of the key messages.

In terms of the sectoral spread of the companies that we work with, we do some work with big agricultural and resource and energy commodity exporters. If you look at the total population of companies that we work with, obviously that is a minority of the work we do. A lot of those companies are big enough and resourced enough to be able to look after themselves. If they have a problem it will often be a policy issue. The areas we tend to get most involved in are where new markets are being opened up, where a new product or commodity is coming on-stream into a market and where there are issues and problems that we can provide some support for resolution. For example, quite a few years ago now we had staff on secondment to both Australian LNG and the Gorgon consortium. They were looking to secure LNG contracts in China. There was some practical, logistical support that we could provide to some very big players there. A few years ago the cotton industry began looking very seriously at Japan and China. That commodity was not well established in those markets, so we were very active working with them.

Manufacturing and services companies though are the bulk of the companies we work with in China and elsewhere around the world. Services as a proportion of Australian exports to the markets in the region I look after as well as more generally are typically 10 to 20 per cent of total exports. I would say that amongst the portfolio of companies that we work with, those that are our clients, closer to 30 or 40 per cent are in the services sector.

Obviously much of what we do is driven by client demand—what Australian companies would look for support from the Australian government for. We also look at the environment to try to read some of the bigger trends to see how we should be shaping our responses and look proactively for opportunities as well. The baseline size of China now is obviously very big after 25 years of rapid growth, but looking forward we can see another 20 years of growth and the size of China's economy likely to quadruple in that time. There is urbanisation continuing. Another 300 million people are going to be going into cities across China, so we see a lot of opportunities being created by that continued urbanisation. There are changing growth drivers in China. Just two days ago you saw the announcement of the big stimulus package that the Chinese government released. It is quite a watershed really that export growth is no longer the main driver of Chinese economic development; it is domestic demand. Principally at the moment that is led by government pump priming but also growth in consumer spending as well.

Also in China a big factor that we are taking into account as we do our planning and try to identify lead indicators for Australian companies is the industrial restructuring that is already well underway in China. China is not the stereotypical place that other people might think—that it is all low-end, low-value-added manufacturing. There is already very rapid industrial restructuring underway in China and low-end, low-value-added manufacturing is closing down. It is sometimes moving to China's interior and in many cases it is moving to Vietnam, Pakistan, Bangladesh and so on.

That is what we look at in a market like China to help shape our proactive agenda going forward. We see opportunities, therefore, in building, construction and infrastructure going forward. There are not just the people who get lead contracts in those sectors but also the second and third tier suppliers in those industries. Obviously, China is a massive manufacturing country. Australia has a smaller manufacturing base but companies with unique niche technologies and manufacturing capabilities should be looking at China. A series of other priorities fall out of our analysis of those bigger changes that are afoot in China as well as just sheer proactive client demand.

Japan is the other market that sometimes gets a little neglected given the scale of the economic engagement that Australia has with Japan. It still remains out largest market by quite a large margin. There is a sense that growth has stopped in Japan and that all the growth is in China now. It is true that there is a smaller number of net new opportunities in Japan being created by growth, because growth is substantially slower, but there is a lot of restructuring going on in Japan and there are other changes there, which means there are new changing opportunities for Australian companies. The demographics in Japan is, I think, a well-known story over the last 10 or 20 years—the greying of Japan—but that is continuing to drive changes in opportunities for Australia companies. Japan also, over the last five or 10 years, has become substantially more open to inwards investment. It used to be quite closed throughout the 1970s and 1980s, but there are now opportunities for Australian companies. The internationally oriented sector of the Japanese economy is now poised for a new wave of outwards investment. Its companies have restructured and its banks have restructured. Corporate profitability has been at record high levels over the last five years or so, and Japanese companies are very actively looking for new opportunities. I think that will be an opportunity for Australia as well.

I might leave my comments there. That will give you a sense of the texture of the work and the way look at some of these big markets in north-east Asia.

ACTING CHAIR (Mr Bruce Scott)—Is Roderick next?

Mr Morehouse—I am an Acting Regional Director. David Twine sends his apologies; he is indisposed. For the next month I have got his job, plus my own, plus a couple of other things. I will talk a little bit about ASEAN in the Pacific and then leave Michael Moignard to talk about South Asia because I cannot match his knowledge. I think this way I will stay out of jail with you guys.

Mr IAN MACFARLANE—Who is talking about India?

Mr Morehouse—India is South Asia—if you take out all the trappings. I am based in Jakarta. I cover ASEAN. We have a new strategy going there. ASEAN, if you take it as a group—and from 2015 we are going to have to take it as a group—is the single largest two-way market Australia has. It is currently the third export destination for Australia, but we are missing out in investment.

ACTING CHAIR—Can you describe that group?

Mr Morehouse—The ASEAN group is 10 countries. The obvious ones are Indonesia, Thailand, Malaysia, the Philippines, Singapore, Laos, Vietnam and Burma. That’s eight countries.

ACTING CHAIR—Did you say India?

Mr Morehouse—We have two other countries attached to our group: East Timor and Brunei.

ACTING CHAIR—You did not mention India.

Mr Morehouse—India is not part of ASEAN. In terms of what ASEAN is about, ASEAN is merging markets in most senses, with the obvious exception of Singapore. We call that a gateway market. There are currently over 2,000 Australians resident in the country. In the other markets it is good business and growth in normal times. We will talk a little bit about not-so-normal times. You could almost say ‘anything goes’. There are very few industry sectors that we do not have an interest in. The area we probably have the weakest interest in would be clean energy, but, if we get our coal technologies right, it will be a very large interest—but we need the technology. In terms of spread, we are located in all centres. I think you will find that the difference between Austrade and other agencies is that we have predominantly locally engaged staff. Where we have ones and twos of Australian staff, we will be supported by tens and 15s and, in some cases, only fours and fives of local staff. Although we have a wide spread our touch is actually fairly fine.

I will tell you a little secret about Austrade in all of Asia—and I think this is true of America as well: we handle more clients per head than a private banker in Australia. The average number of clients going through an office in Indonesia, for example, is 3,200, of which 500 get intensive care. They are the people who make the deals. There are only 15 client-facing officers in that group, to give you an idea of numbers. That is why sometimes we are a bit thin. The changes we are doing in ASEAN are simple. We have moved away from a country by country approach and are now reflecting what industry already reflects, and that is they are looking at ASEAN as a market base in total. That gives us the ability to migrate clients across the board. One of the simple things we do out of that is, in Singapore now, we are attacking those Singaporean-based Australian companies to take them to the other ASEAN markets. There is such a simple obvious logic once you stop and count the right way.

The Pacific actually has more Australian exporters than those going to the United States, China and Japan combined. More people go the Pacific Islands than go to China, Japan and the US. Of course, they are mostly small. They are predominantly going to New Zealand. We have more exporters going to New Guinea than we have going to Indonesia, and yet our volume of trade is dramatically lopsided. In our business we do not just look after large exporters; we look after the full range of exporters. So although the big figures, when you look at the balance of trade, might say, ‘Forget that one,’ there might be more of your constituents in it there than we have in our big markets. I think that is worth remembering. That is the nature of our business in Austrade too.

The Pacific is generally a broad based, big brother grocery trade. It is predominantly where there are small companies trying to cut their teeth in small markets. So it is a good match for most of our SME businesses, with notable exceptions. The notables are the large trading houses, in the main, and the mining companies in New Caledonia. So that is our spread. It is a thin, lean machine. I think we represent quite a lot of companies. We probably touch in most of our patch about 60 per cent of the exporters going through, which is actually a pretty heavy touch.

Mr Moignard—I will talk very briefly on South Asia, where I have spent the last 4½ years. I returned to Canberra last month. The South Asia experience is very similar to the ASEAN experience. We do look holistically at South Asia. It includes Pakistan, Sri Lanka, Bangladesh and Nepal. Afghanistan is part of that as well. Obviously, predominantly the trade is with India. Our trade with India over the last five years has grown almost 30 per cent a year. It has been one of our fastest growing trading partners over that period.

The main focus of our exports at the moment is the commodity sector, so it is coal, gold, wool, vegetables and copper concentrate. In the services sector, which has also been growing very rapidly, the main area is education services. There are something like 70,000 Indian students currently studying in Australia. So it is quite a diversified market.

In terms of Austrade’s footprint there, we see much more opportunity to move into areas such as infrastructure, building and construction. The infrastructure message in India is that they cannot stop their current increase in spending on infrastructure. In fact, we had some Indian officials here just this week who made the comment that India cannot afford to reduce its input into the infrastructure and construction sectors even in the current financial crisis. So there are certainly opportunities there for Australian business. A number of major Australian companies are already in that business, working very successfully in India.

Financial services, the food processing and harvesting sector, particularly for post-harvest services, are areas that we have been looking at very closely in the last 12 to 18 months. Taking up something that Grame said, India certainly has a food security issue. I think there is a lot of opportunity for Australia to provide services to their food processing sector.

In the resources sector there is very strong two-way investment. In fact, we are seeing now more investment from Indian companies into the Australian resources sector than the other way around. There are some changes afoot in terms of the mining legislation in India which we believe will be able to provide more opportunities for Australian investment, but we are awaiting those changes, which are currently going through the Indian parliament. We are seeing considerable investment. As we saw with Japan and China in the seventies, eighties and nineties, we are now starting to see Indian investment into the resources sector here, particularly in metals and in coal.

All told, it is a very positive story. We have increased our breadth of small offices in India. We are now located and have representatives in around 10 cities. One thing to note in India is that you have something like 26 or 27 cities with a population greater than one million. While we all hear of Delhi, Mumbai, Kolkata and Chennai as being the big cities, you still have a city like Pune which has 5 million people. Bangalore has six million or seven million people. Hyderabad has five million people. If you just take those cities on their own, they are considerable market opportunities. We are increasing our breadth of locally engaged staff, mainly at the business management level, to get a broader spread across those cities so, again, we can find where those opportunities are. We are trying to move away from the major cities—which is not to say that we do not have major presence in them, but it is a country where you need to spread, develop and broaden your relationships into those areas that are called second-tier cities. This has been a major strategy of Austrade's in last 12 to 18 months. With that, I might leave it and welcome any questions the committee may have.

Mr IAN MACFARLANE—I have a few questions. In terms of investment by Australian companies in South America, the discussions I have had with mining companies here in the last three weeks is that that is one place they are retreating from off the back of the financial crisis and the collapse in base metal prices. How do you think that is going to affect our investment opportunities in South America, particularly in places like Chile?

Mr Barty—If companies are making decisions about the reduction in commodity prices then they are global business decisions they are making, so the point I want to make is that I do not think that necessarily reflects on any attitudes to South America in particular. However—

Mr IAN MACFARLANE—It is not the BHPs and Rios; it is the middle and small sized ones.

Mr Barty—We just had a Chile FTA business mission where three of the large companies were represented. Recently, just in the last month, 500 small businesses attended that session with great interest. I think that when we talk about the six countries—in particular, Colombia, Chile, Peru and Brazil—they still represent significant investment opportunities.

Mr IAN MACFARLANE—Still?

Mr Barty—I would probably assert that it is still a business case model for them. If nickel has gone from $26 to $6, that is a significant drop. Therefore, that may well change their attitude. However, BHP and Xtrata are major companies in Chile, Colombia and also Peru, so they are not going to change their investment. Part of our strategy is to coat-tail those existing Australian companies with the smaller companies. Colombia in particular is really looking for mining services support, so one of the things we have been looking at is that maybe with the downturn—and I was just in Western Australia—it might actually be more attractive now for some of those mining services companies to participate in the six Latin markets rather than focus on the Western Australian market. I think you might get some swings and roundabouts. Unquestionably, each of those markets is as focused on the China and India growth as we are and I think that is part of the change in the relationship with South America going forward. We now tend to be complementary and supplementary rather than competitive.

Mr IAN MACFARLANE—I have a more generalised question in relation to China and India. There has been a suggestion that, in fact, India might be a more secure market for us going forward on the basis that it is less reliant on exports and—as I think you said, Mike—is very focused on keeping its development going. I know that China announced yesterday almost $1 trillion, but India is a more domestically focused economy than China is. I just wondered: as finance tightens and investment opportunities overseas have to be more critically examined, is India going to win out of that vis-a-vis Australian companies investing in China?

Mr Moignard—It is a difficult question. The Indian market has been very much domestically focused, although what is interesting to see is that it has been opening up in the last four or five years. In fact, you can see from our trade stats that we have been the beneficiaries of that. If you go back to the Asian financial crisis, for example, India was much less affected really because it was quite a domestic economy. It now has many more links to international networks and there will be effects on the Indian economy. But in terms of the program of infrastructure, resources and agriculture, for example, I think you will see not quite business as usual but India will continue to develop. It is still looking to grow at 7½ per cent. That is the most recent number I have seen. That is a pretty reasonable growth rate. So, while it is being affected much more than people might have anticipated, there are still growth opportunities there.

Mr IAN MACFARLANE—As a supplementary question to that, and following the comment that Laurie made about Hong Kong, there are some similarities with the legal system and also of course with English being spoken. Does that give India an advantage over China? Those same similarities occurred with Hong Kong.

Mr Moignard—The legal situation comes from a very similar background to ours, with a British rule of law and common law. That helps us significantly. Also Indian law has a long history. With China, law and law-making is an evolving process, but in India it is not. I think that certainly does give us an advantage. Companies at least understand where they stand. Secondly, the role of English in business is such that you find that nearly everyone you deal with in the Indian market has a very good understanding of English. That helps significantly. It also helps to really bind the country together. As you are aware, there are many languages in India, but the language of business is English. That does give us some advantage as well.

Mr Smith—There are some high-level conclusions we can draw about aggregate opportunities in different markets. But we probably need to drop down to another level and say, 'For a given industry, what is the situation?' If we have an Australian manufacturer who wants to produce offshore, then different decision points and different options open up. Is it producing offshore for export or for sending back to Australia to incorporate a product that is going to be exported to world markets? Or is it producing offshore because you want to develop the domestic market in China and India? Then I think you have the different industries to consider.

I think the decisions that are right for companies will tend to vary a little bit, depending on where they are on that set of issues. For example, I think it would be reasonable to say that China has, over 15 years or so, built some terrific industrial estates that have got great infrastructure. It has ports that are very modern, highways and freight systems that are very effective. So if you are 100 per cent focused on international markets, I would suggest that China has a bit of an edge at the moment. Domestic markets in China can be more of a mixed bag. If you want to attack to attack the domestic market, you will perhaps find a few less barriers in India than you will find in China.

But, again, you do not want to generalise too much because, if you look at industry in China, you might get one where some rusty old state owned enterprises are the champions that tend to get looked after by decision makers. So it might be hard to get your Chinese produced product in the door of some of those state owned enterprises because there are some other SOEs that are producing locally that tend to get preferential treatment or where, by habit, they are the preferred suppliers. But in other cases you will have some feisty, privately owned companies that want the best that money can buy. Or you might get some big foreign players in an industry operating in China who again want really good value for money. So we tend to try to break it down a little to see what the industry is, what its goals are and who the major players are in a market like China or India. I think some of the logic reveals itself when you unpick it at that sort of level.

Mr IAN MACFARLANE—Can I follow up on that point? There are some classic examples, such as GUD, Sunbeam, some of the Victa range and a few other things, and people who used to make suits here—Paul Cohen and his crew—who are now basically totally reliant on Chinese production designed in Australia. Is that continuing? Is it escalating or has it basically plateaued out? If you look at Studio Italia, they have completely stopped local production. All their suits are designed here and some of them are flown in just on the basis that in getting the product they want they need to keep it in the store.

Mr Smith—I think the relocation of that production out of Australia has got to be substantially complete by now.

Mr IAN MACFARLANE—You think it is complete? That is interesting.

Mr Smith—I think it is in large part complete. There are obviously retailers or producers who have a proportion of their range that is highly seasonal in nature, so there are very short lead times and there is a reason to keep that production at home in Australia. You can also get the highest value-added product. That is going to remain in Australia. There will be other niches where there is a logic to retaining production in Australia, but I would think if we are looking at TCF or at fashion products, as you have suggested there—

Mr IAN MACFARLANE—General manufacturing.

Mr Smith—that most of the migration that is going to go to China seems to have gone there. I am talking in broad terms; there would be some other markets, I think, where that migration is not as far advanced. Some of the European countries probably have retained a bit more of that production at home, but the migration is certainly underway, even with the highest-end Italian labels, for example, doing exactly what you have described out of factories in China.

Mr Morehouse—I would add one other comment, if I may. I am actually sitting between the two giants, and that is not coincidental. So maybe you should go to ASEAN as well.

Mr IAN MACFARLANE—Or Vietnam. Vietnam has the potential.

Mr Morehouse—Or Vietnam. But the reality of life is that it is not actually industry that decides; it is individual companies that decide, and they do not necessarily decide one market anyway. So if you are going to hit India the odds are you are probably also keeping your left eyeball on China. The other issue is that in terms of manufacturing base what happened more and more in the last 15 or 20 years is that the physical part of manufacturing left Australia, as we all know, but the technical and design parts stayed. We have more fashion designers selling into ASEAN than any other part of the world. Those clothes are not made in Australia, but they get more percentage of the profit line back in Australia than any other part of the world. They are employing people in their drafting studios and people to do fabric sampling for them et cetera.

Mr IAN MACFARLANE—I know who is making a profit out of Studio Italia, and it is not the Chinese.

Mr Morehouse—Probably, but you are damned if you do and damned if you don’t, because you cannot compete unless you do that. So I think it is changing.

Mr Smith—I do not understand the economics of a suit, but certainly—

Mr IAN MACFARLANE—I could tell you, but I would not want Hansard to record it!

Mr Smith—It is the same logic as a Barbie doll or an iPod, which is that the margin that is captured in China is a small total of the final retail price of your Barbie doll or your iPod, or of your suit in many cases, but the high-end design and all of the distribution and retail margins are maintained here in Australia as well.

Mr BRUCE SCOTT—I want to go to the opportunities that will present themselves with the new regime in the US, particularly in clean technology. Do you see that in any particular sphere? Is it in energy? Is it in motor vehicles?

Mr Barty—There is enormous interest in the US in a range of alternative energies being promoted, particularly wind and solar, which is referred to as solar-thermal, which is kind of like mirrors reflecting and concentrating heat. We understand there will be major breakthroughs in photovoltaic, which is a standard solar mechanism, and there have been test credits for solar extended by the US government, and there is a major wind corridor. The utility grids now better understand how to employ wind into the grid. Unquestionably, there will be major investments in wind and solar in the US as part of the major grid. However, the newest area in which we see a lot of interest is generation 2 bio. Generation 2 bio is really about non–food crops. The terms they use are feedstock and algae, which really means whatever the input is and the chemical processes that are associated with synthesising that to create sucrose or whatever mechanism they can use.

Mr IAN MACFARLANE—Is it ethanol or biodiesel or is it just biodiesel with—

Mr Barty—It is basically creating a sugar output, an energy output. Interestingly, some of that can be converted to bio-oil or bio-diesel, or it can create an ethanol product. Of course, the move is away from food crops. I just visited the sugarcane capability in Sao Paulo in Brazil as well. I would have to say that is quite outstanding. It is not just in relation to transportation; they are also creating a bioplastics capability—replacing oil usage in other capabilities as well. Generation 2 bio and, if you like, generation 1 based around sugar production, from experiences in Brazil, is extremely interesting. Out of that conference we registered automatically a lot of interest from companies saying, ‘We look at a map and we see there is a lot of land in Australia.’ By the way, generation 2 crops can also be grown in sea water, so there is as much interest in coastal capability for crop production as there is regarding land. They are investing in a number of projects in Africa at the moment which are not using arable land and do not require a lot of water. Essentially the feedback that we are receiving and we are really trying to focus on is: you give me the land or the sea and its characteristics, and the climate, and we will determine the crop.

ACTING CHAIR—’You’ is who?

Mr Barty—They are the investors and the technology producers. What we think we have discovered is a very good inwards investment opportunity in Australia. This is almost like looking for cattle farms in the 1900s. It is looking for areas to grow algae or feedstock for generation 2 bioproduction. We think there are great opportunities for Australia where we can provide a unique characteristic.

The other area that we are really interested in and referring to is what we are terming a whole-of-coal solution. I was interested in the comments before from Professor Garnaut. Unquestionably, power generation and energy security remain the largest requirements of any growing nation. As populations grow—and there will be an additional 100 million people in the US in the next 30 years—power consumption grows. It is the same for every urbanised city that has extraordinary population growth. So power generation is not going away. The alternatives for new energy are still lengthy and costly, and that will have to roll out. Therefore there is still a high interest in old technology, which is natural gas and coal. Coal is less attractive if it is not clean. Austrade can position that Australia has a whole-of-coal solution. Whole-of-coal means the commodity, whether it is steaming or coking coal. We have research. We do not have an answer but we have research in carbon capture, sequestration and storage, and we have an ETS. I am not to judge the research or the ETS, but we have an approach. At the moment that is quite interesting to governments both in the US and in Latin America, because at the moment this a government-to-government decision. This is actually not for industry to influence.

Governments are required to make strategic decisions about energy security or food security, and they are looking for advice. We actually see outstanding opportunities to position Australia—at a policy level and at a research level—to create political engagement with countries that are interested in this. We can do that on a non-threatening independent basis, and of course it still improves our coal sale prospects, given that coal is our largest export at the moment to Latin America, including Mexico.

Mr IAN MACFARLANE—I think we just lost the Mexican market, didn't we?

Mr Barty—The Mexican one is coming back, and Austrade have been active in helping the energy commission to write the new parameters. I think the Mexican energy commission would admit that it was not a successful process for them so they look like issuing a new tender shortly, and we hope that we have been able to position Australian companies well as to that. It will be a long-term contract, so that will be better. From our perspective, we are taking an approach that says that energy security is the issue. There is old energy and there is new energy. We have an outstanding capability—and we have a story to tell—as to old energy. If we can actually manage that—and I note the period around carbon capture and storage that we were talking about, 20 years—and if we can do that, I believe that Australia will be sitting on a multitrillion dollar opportunity. That is if it can be achieved. We know it is the holy grail.

Mr HAWKER—This is with coal?

Mr Barty—Yes.

Mr HAWKER—You were talking about some of the other technologies and you were speaking about biofuels and so on. I wonder if you would expand on what opportunities you see there, because that sounds pretty fascinating.

Mr Barty—Yes, I think there is a lot of opportunity. It is not one that we have been focused on, because we have been concerned about food crops. They require of course seed, water and arable land, and we saw the effects of the corn ethanol subsidy in the US on the price of tortillas in Mexico, so I do not think we want to repeat that. I think the sugarcane industry in Brazil is a quite separate issue. It is quite self-sustaining, so maybe I will touch on that.

The Brazilians are very interested in engaging other sugar ethanol producing countries to help them in markets—North-East Asia, in particular—and also to lend them some political weight. So I think we can play some part as to sugar ethanol, but it does not have to be the whole of our story. The second aspect of our story—and this is where we can play an extremely active role, I believe—is with generation 2, which is non-foodcrop-capability feedstock. That involves utilising our research and/or the investment of researchers in the US, for example, to provide inwards investment. We have land and we have a massive coastline which can be used.

For example, take some of the plankton product, algae. It absorbs CO2 and, in a mechanism I do not understand and in a chemical process I do not understand, converts that absorbed CO2 into an output which can be converted into bio-diesel or bio-oil or some other energy-producing capability. It seems to me that is a pretty interesting opportunity. The issue for all of the other countries is land, so you could not do this in Japan, you could not do this in Thailand and you could not do this in India. I thought it was fascinating that those investors thought of Australia and how we might do that. I understand the department of innovation is investing a small amount in generation 2 biofuel and that Minister Crean is attending a biogen conference in Brazil next week.

ACTING CHAIR—I was interested in your comments, Mr Barty, in relation to biofuels and energy sources because I have a $150 million grain based ethanol plant just about completed in Dalby. They will be able to put any sort of mass through that. As to the concerns I have had, the American experience was about a subsidy and I do not think you are going to stop a grain producer in Australia putting their grain into an ethanol plant if they can get a higher return.

Mr Barty—Absolutely.

ACTING CHAIR—I hope that we here and those around the world do not look at these sorts of things and say, 'We've got to stop grain as a food source going into ethanol production', because once the grain comes out it still goes into feedlots in the intensive livestock industry. So it is not lost in the food production chain. There is a bit of a myth out there about that. I think it is a common myth in urban Australia that 'my bread's more expensive because they have converted all the grain into ethanol'. In fact, if they understood what happened they would see it is actually going into the production of chicken, eggs, beef, pork and all sorts of things.

Mr Barty—The interesting thing as to mass ethanol production in Brazil is that they use all the bagasse to actually generate electricity to run the plant, so you actually have a completely self-sustaining, energy-generating capability. I think that is extremely attractive. It will be up to researchers and other people to dictate the best way to do it, but my understanding is that the feedstock that can be used is extremely flexible, from wheat, to scrub and to pretty well anything. It is a chemical process that they are using, which is converting all of this. So we are very interested in that as that emerges and also as that commercialisation process emerges in the US. We have a team focused on looking at those opportunities.

ACTING CHAIR—We have another world first in the electorate to do with the conversion of average coal. They started last week. It is done in a plant in Chinchilla. They are converting deep coal into aviation fuel and diesel. I am going to see that next week.

Mr Barty—The US Air Force is looking to have up to 50 per cent of its jet fuel made from coal liquefaction.

ACTING CHAIR—Yes, I will be looking at that next week, and aviation fuel will be one of the products, which they will be putting out within 12 months. There are some exciting opportunities technologically as well as the products.

Mr Barty—The point that I would make to the committee is that, in our view, the American public's attitude as well as the government's attitude have changed dramatically since May, when oil went to $4 a gallon. You would have noticed during the election that energy security became a major issue for both parties. This will be driven by defence and it will be driven by energy requirements. Both the west coast and the east coast have now got consortiums of states working together to create their own cap and trade system. The states are moving ahead of the federal government anyway, so I think the US is now moving forward. We should make sure we capitalise on the commercialisation opportunities that are associated with that. The next five to 10 years will present a one in a generation opportunity, and we do not want to miss it.

Mr IAN MACFARLANE—I was in India a couple of years ago, and the Indians were looking at some huge—'megapower', I think they were called—power stations on the coast and there was an opportunity for Australian coal. Has that concept gone ahead?

Mr Moignard—Yes. The megapower station process is being pursued. In fact, I think they have had four programs that have been tendered for. It is interesting that there are two things coming out of this. As to coal, there are a number of captive mines being developed using in fact Australian services and technology to service those coal-fired power stations. Secondly, there are opportunities for thermal-coal exports into those areas. We are talking of it being probably 2011 or 2012 before they will be coming on stream, but that has been pursued. It has been very exciting in the sense that with the captive mine process we have been able to see some development in the mining sector, although it has been in coal, where Australian expertise has been able to get into some greenfield operations. That has been very beneficial for us—but it is proceeding.

Mr IAN MACFARLANE—But aren't there also some power stations being built that are specifically for imported coal?

Mr Moignard—Some of them will be using imported coal.

ACTING CHAIR—Witnesses, is there anything else that you would like to say? Time is getting on and I know we are getting closer to question time and other things.

Mr Barty—I would like to make one final mention. We are starting to see a lot of Australian agriculturalists investing in land, for production purposes, in Latin America. It is obviously part of a trend we see towards globalisation of the agricultural supply chain. It involves arable land and water—so there is land and there is water—and we are seeing that occur. We are seeing investment groups like Macquarie and some of the banks participate in markets to facilitate those investments. That is a trend we are definitely seeing, so I would report that.

ACTING CHAIR—Why are they investing over there? I know there is a big olive producer over there, which had been based in Victoria.

Mr Barty—Yes, that is right. I visited a 340,000 tree olive farm Ica, Peru. Land is cheap and labour is cheap. The cost of production is, therefore, cheap. Soil performance is good and water is readily available.

ACTING CHAIR—What countries are they mainly going to?

Mr Barty—Argentina and Brazil. Some of the plains of Peru are of interest. Colombia will be the next one to emerge.

ACTING CHAIR—That is interesting.

Mr Barty—Brazil, in our view, will be an energy centre and a global food production centre by 2050 for sure.

Mr IAN MACFARLANE—Brazil has gas and oil as well, hasn't it?

Mr Barty—It does. The only thing it does not have is coal. The interesting thing for us is that it is also climate change affected and it is concerned about the ability to continually produce hydroelectric power, which is currently 80 per cent of its power source. There are other opportunities for us there as well. That is the only issue it really has to confront in a general context. There are great opportunities.

Mr Smith—What we have seen in recent months and years in China and Japan's perception of issues like food security probably present some new opportunities for Australia in the supply sense. Japan is our biggest market for food and our biggest market all round. I think if it looks at quality, traceability and food integrity there will an opportunity for Australia to have a new surge of success in that market. Also Japanese investors are thinking again about the things they need to do to secure food supply. I think we are seeing already at the inquiry level a lot of interest in investment in Australia in agriculture. Japan really has become substantially reliant on China for quite a chunk of its processed food products over the last five or 10 years. We are seeing a sense that it will make sense to spread risk and have multiple sources of supply. We would expect to be pretty busy on that front with both opportunities in the market and strong investor interest in agricultural production in Australia and some early stage processing at least. That will keep us busy also.

Mr Moignard—There certainly is export potential for Australian thermal coal into India. I think it is coming from a broad range of opportunities. We could certainly find out for you, Mr Macfarlane, whether they are coming specifically from the four megastations. Certainly we are expecting an increase in thermal coal exports, particularly to the south of India.

Mr IAN MACFARLANE—While you are looking could you check if that coal is expected to come from the open market or from this very significant Indian investment in coal mines, particularly in New South Wales.

Mr Moignard—I could get back to you on where we see the differentiation on that, yes.

ACTING CHAIR—And Indonesia.

Mr IAN MACFARLANE—I know the Indonesians and the South Africans are going to be competitors. That 100 million figure for US population was over how many years?

Mr Barty—By 2030, so another 25 years.

ACTING CHAIR—150 billion?

Mr IAN MACFARLANE—No, 100 million extra people.

Mr Barty—So from 300 million to 400 million people by 2030. That is not all internal; that is immigration. The other important point is that—and you saw this in the last election—49 per cent of the US population by 2050 will be Hispanic. You will see that Latin six and our relationship with Mexico become much more important because the demographic for the US is changing quite dramatically.

ACTING CHAIR—In terms of food exports, we are looking at the change from the traditional European to those of other cultures. That comes back to the base food source.

Mr Barty—That is exactly right.

ACTING CHAIR—It will no longer be steak and eggs for breakfast in Australia—and it won’t be hamburgers over there either.

Mr Barty—That is exactly right.

ACTING CHAIR—Exciting challenges ahead. Thank you very much for your time. As you can see in this place, people come and go, but I can assure you that all of your comments are in the *Hansard* and will be of interest to us as we continue with our inquiry into this area. In listening to the comments in relation to Latin America and Mexico, I can now understand a little bit better why the minister wanted us to include that in this APEC region.

Mr Barty—There is a window.

ACTING CHAIR—That helps us understand. We are probably trying to break it into two areas. We took off a huge chunk. We will speak with the chair, but we will probably break it into two elements for the report.

Mr Barty—Fantastic. Thank you very much.

Subcommittee adjourned at 1.10 pm