

Chapter 1

1.1 In mid-2001, the Prime Minister signalled Australia's interest in negotiating a free trade agreement with the United States. At the time, the United States administration was seeking renewal of its Trade Promotion Authority. This Authority allows it to negotiate trade agreements, which can then be accepted or rejected by the Congress but not amended.

1.2 In November 2002, the United States formally announced its intention to enter into negotiations with Australia. United States legislative requirements required a ninety day period after announcement to allow consultation with Congress, before formal negotiations could begin.

1.3 Each country produced a statement of objectives for the negotiations and these can be found at Appendices 3 and 4 of the Senate Foreign Affairs, Defence and Trade References Committee's report *Voting on Trade* of November 2003.

1.4 The first formal round of negotiations was held in Canberra in March 2003 and the second and third rounds in Hawaii in May and July 2003. These discussions focussed on developing the broad framework and the legal text and also reaching agreement on the Chapter structure.

1.5 Negotiations on market access did not begin until the third round. United States legislation required the completion of an economic assessment of the Free Trade Agreement by the United States International Trade Commission before commencement of that part of the negotiations.

1.6 A meeting between the Prime Minister and President Bush, in Texas in May 2003, sealed the urgency of the process. The leaders announced that their intention was to complete negotiations by December 2003.

1.7 A further negotiating round took place in October 2003, followed by the final sessions in December 2003 and January 2004. On 8 February 2004, the Minister for Trade and the US Trade Representative announced the completion of negotiations. The formal process of signing the Agreement took place in Washington on 18 May 2004. The draft AUSFTA was tabled in both Houses of Parliament on 4 March 2004.

1.8 The negotiation of the AUSFTA is the latest and possibly most significant event in the history of trade between the two countries. A chronology of key events of Australia's trading relationships with the United States has been appended¹.

1 A. Rann, 'Chronology of events leading to the Australia United States free trade agreement, *Unpublished memo*, Foreign Affairs Defence and Trade Section, Parliamentary Library, Department of Parliamentary Services, Canberra, 2004.

The Senate Select Committee

1.9 On 11 February 2004, the Senate established a Select Committee on the Free Trade Agreement between Australia and the United States of America, to report to the Senate within three months of the text of the agreement becoming publicly available, or on such later date as determined by the Committee². The Select Committee was asked to:

- determine whether the Agreement as a whole is in Australia's national interest; and
- examine its impact on Australia's economic, trade, investment, social and environment policies.

1.10 The government made the draft text of the AUSFTA publicly available on 4 March 2004, under the provision that it still needed to be 'legally scrubbed'. The Senate Select Committee held its first meeting on the 11 March 2004. At this meeting, Senator Peter Cook was elected chair, and the Senator George Brandis deputy chair. The other Committee members are Senators Conroy, Ferris, O'Brien, Boswell, Ridgeway and Harris.

1.11 The Committee wrote to over 200 key stakeholders, organisations and industries bodies inviting submissions, and advertised in the press. At the time of writing this report there have been 530 submissions made to the Committee. A copy of each submission can be viewed at www.aph.gov.au/senate_freetrade

1.12 The first public hearing was held in Sydney on 4 May 2004 - a list of hearing dates³ and locations can also be viewed at the above mentioned website. The Committee has heard from a cross section of witnesses and will be holding several more public hearing after this interim report is presented to the Senate.

1.13 The Committee has also held several round table discussions on key aspects of the Agreement. These roundtables brought together leading economists and trade specialists⁴, experts in intellectual property and copyright issues⁵, and organisations and specialists with a keen interest in the Agreement's possible ramifications for the Pharmaceutical Benefits Scheme⁶.

1.14 As well, the Committee engaged a private consultant (Dr Philippa Dee) to assist in its assessment of the AUSFTA. The Committee has released Dr Dee's report, which will inform the Committee's judgement on the overall impact of the AUSFTA.

2 Journal of the Senate, No.126 dated 11 February 2004

3 Although the Committee Chair proposed numerous hearing dates in the month of April while the Senate was not sitting, agreement could not be reached to hold hearings on those days as a number of senators were not available.

4 Committee Hansard, 5 May 2004, p18 - 67 www.aph.gov.au/senate_freetrade

5 Committee Hansard, 17 May 2004, 1-42 www.aph.gov.au/senate_freetrade

6 the proposed date for the PBS round table discussion is 21 June 2004 – a program will be available on www.aph.gov.au/senate_freetrade

1.15 It should be noted that while the Senate has been holding its inquiry so has the Joint Standing Committee on Treaties. This Committee's report on the AUSFTA is expected to be tabled during the parliamentary sitting week 21-24 June 2004.

What is a free trade agreement?

1.16 A free trade agreement is typically a bilateral, preferential⁷ agreement between two countries aimed at securing maximum access to each other's domestic markets in order to facilitate trade in goods and services. It commits the parties to policies of non-intervention by the state in trade between their nations. Such an agreement usually entails:

- removing or lowering explicit trade barriers, including import taxes (tariffs) and import quotas.
- softening or eliminating non-tariff or 'hidden' trade barriers – for example, quarantine laws, production and export subsidies, local content requirements, foreign ownership limits, and domestic monopolies.

1.17 Free Trade Agreements necessarily involve an exception to the Most Favoured Nation (MFN) principle, the fundamental rule guiding trade in goods among members of the World Trade Organisation. Under the MFN rule, members of the WTO must give fellow WTO members no less favourable treatment in terms of tariff rates and other trade measures than they afford to any other country. However, WTO rules allow individual countries to afford preferential treatment to partners in an FTA, provided that the FTA conforms to certain strict conditions.

1.18 The rationale for allowing this exception is set out in Article XXIV of the General Agreement on Tariffs and Trade (GATT) of 1947, which recognises the desirability of increasing freedom of trade by the development of closer integration between member countries through agreements establishing free-trade areas. At the same time, strict conditions apply to FTAs to ensure that they serve a liberalising purpose in international trade and do not encourage the establishment of new barriers. Nor should FTAs provide an occasion to introduce new measures discriminating between trading partners.

1.19 The crucial test of an FTA is that it must eliminate all tariffs and other restrictions on substantially all trade in goods between its member countries. Although WTO members have differed over how precisely to define 'substantially all trade', few would disagree that this means, at the very least, that a high proportion of trade between the parties - whether measured by trade volumes or tariff lines - should be covered by the elimination of tariffs and other restrictive trade regulations. Australia

7 Some economists contend that a 'preferential' agreement is, by its very nature, also 'discriminatory' – that is, discriminatory against all those countries that are not included in the FTA.

considers that this must be a very high percentage, and that no major sector should be excluded from tariff elimination.⁸

1.20 The WTO also provides for bilateral or regional agreements liberalising trade in services. While an FTA as defined under the WTO does not have to include trade in services, most contemporary agreements that are labelled 'Free Trade Agreements' cover both goods and services, reflecting the growing importance of the services in the global economy.

1.21 In addition to trade in goods and services, FTA frequently cover such issues as investment protection and promotion, government procurement and competition policy, which are either not yet encompassed by WTO rules or only partially covered.

1.22 FTAs often also contain practical provisions in areas such as harmonisation or mutual recognition of technical standards, customs cooperation, application of subsidies or anti-dumping policies, electronic commerce, and protection of intellectual property rights.

Multilateral v bilateral trade agreements

1.23 A prominent concern among critics of free trade deals is that Australia's negotiation of a free trade agreement with the United States of America would be detrimental to current multilateral trade and service negotiations by undermining the principles of the multilateral trading system through the WTO. For example, the negotiation of a bilateral trade agreement with the United States might undermine Australia's policy support for, and credibility in, multilateral negotiations.

1.24 The suggestion that negotiation of an FTA with the United States will undermine the multilateral trading system or signal a lessening of Australia's commitment to the WTO and multilateral liberalisation has always been strongly contested by DFAT.

- FTAs are sanctioned by the WTO ... if they are comprehensive and trade creating...;
- FTAs can help the WTO system to generate momentum by liberalising difficult sectors among a few countries...⁹

1.25 The Committee notes the arguments made by DFAT above, but notes also that some of these points have been contested, and some clarification may be required. For example, FTAs are sanctioned by the WTO only if they are compliant with the WTO constitution. A better example of FTAs generating momentum for the multilateral round may be the North American Free Trade Agreement and the Uruguay Round.

8 Department of Foreign Affairs and Trade at http://www.dfat.gov.au/trade/negotiations/us_bkg.html

9 *Submission 54 to Voting on Trade Inquiry*, pp. 39-40 (DFAT)

1.26 The Australian Government is pursuing a combined multilateral, regional and bilateral approach to trade policy suggesting that Australia may be ‘left behind’ if it does not negotiate free trade agreements in tandem with multilateral negotiations:

Many other countries are in the process of negotiating or seeking free trade agreements with our trading partners. This could pose risks to our interests if our competitors were to gain preferential access to our export markets. It is possible, too, that investment might be diverted from Australia to other countries that have negotiated preferential access with each other. Inaction as others negotiate free trade agreements could risk an erosion of our competitive position in those markets.¹⁰

1.27 DFAT considers free trade agreements that are comprehensive in scope and coverage can complement and provide momentum to Australia’s wider multilateral trade objectives. DFAT stated that one of the best ways of ensuring this occurs is for agreements to meet the criteria in the WTO agreements.¹¹

1.28 However, free trade agreements are contrary to the fundamental ‘most favoured nation’ principle that underpins the WTO.

The most favoured nation principle became the first article of the GATT. A shared understanding that trade relations should be on a most favoured nation basis is really the first vehicle for carrying forward this idea. Institutionally, the idea is embodied in Article I of the World Trade Organisation, the most favoured nation clause, which is based on the old GATT. Of course the GATT included Article XXIV, which was to provide an exception to the most favoured nation clause. That exception was introduced to keep open the possibility of developments in Europe that were desirable for political reasons—the developments that became the European Union. But the founding fathers—I think they were all fathers, not mothers—of the GATT and the WTO never envisaged that Article XXIV would become the main game.¹²

1.29 The Committee also notes arguments that suggest that, with the more recent focus on regional and bilateral trade agreements, there is a risk that Australia and the world may see the emergence of the same global tensions that applied prior to the Bretton Woods Agreement. Such a situation may see deepening political divisions and Australia being excluded from certain trade blocs with enormous economic consequences.

[If] trade discrimination becomes the norm and if one decides who to favour and who to exclude, partly on political grounds—countries that seem to be political friends at a point in time—there is a danger that political

10 Department of Foreign Affairs and Trade, *Advancing the National Interest*, p. 59

11 See DFAT website: www.dfat.gov.au/trade/negotiations/australias_approach.html. See also, Department of Foreign Affairs and Trade, *Advancing the National Interest*, pp. 58–63

12 *Committee Hansard (Voting on Trade Inquiry)* 22 July 2003, p. 198 (Garnaut). See also, *Submission 70 (Capling)* to the *Voting on Trade Inquiry*

divisions will be entrenched and deepened. There is a danger that at this time, when more than ever we need trust and cooperation across the civilisations of the world to defeat the scourges of terrorism, we will entrench some important divisions in the international community. In our region there is a danger that we will end up over time—not tomorrow but over time—with a division down the Pacific, with us being part of a block with the United States and most of East Asia having discriminatory arrangements amongst themselves that leave us out. That would obviously have horrific economic consequences for us. The economic consequences would be much smaller for the United States and Europe, but they would be huge for us, because they are our main export markets. In addition, there is a danger that that would make cooperation more difficult on the many things that we have to co-operate on at this difficult time in the world.¹³

1.30 The Committee acknowledges that it is inherent in bilateral and regional free trade agreements that the MFN principle is not followed. However, the Committee notes that APEC, a regional economic forum that Australia helped establish, is based on the principle of ‘open regionalism’. In other words, what progress APEC makes in opening up markets in member economies is then automatically shared with the world on an MFN basis. This approach strengthens the multilateral system and prevents the Asia Pacific region from becoming an exclusive economic club.

Australia’s economic relationship with the United States

1.31 The United States is Australia’s most significant economic partner when measured in terms of combined trade and investment activity. However, of all its trading partners, Australia carries the largest trade deficit with the United States, which distorts the economic relationship.

1.32 The United States is Australia’s second most important destination for merchandise exports after Japan, and our most important market for services and investment. Two way trade in goods and services in 2002 was valued at over A\$45 billion, accounting for nearly 15% of Australia’s total trade. The United States was the single most important destination for Australian services exports in 2002, accounting for nearly 15% of total services exports and has grown by A\$363 million over the last five years to A\$4.6 billion. Overall, however, Australia only ranks 28 on America’s list of import sources. In 2002, for example, United States drew only 0.6 per cent of its global imports from Australia.¹⁴

1.33 Australia is currently the United States’ 24th largest trading partner (total trade) and 15th largest export market. The United States is among Australia’s highest growth export markets, with 5-year trend growth at 16 per cent. Australia’s merchandise exports to the United States represent nearly 10 per cent of total

13 *Committee Hansard (Voting on Trade Inquiry)* 22 July 2003, p. 202 (Garnaut)

14 *DFAT Fact Sheet: United States of America* available at <http://www.dfat.gov.au/geo/fs/usa.pdf>

Australian exports. However given the firming of the Australian dollar against the US currency, this trend can be expected to plateau.

1.34 Principal exports to the United States in 2002 included beef - where Australia filled its United States tariff rate quota for the first time in late 2001 and again in 2002 - crude petroleum, alcoholic beverages, aircraft and parts, and motor vehicles. Exports of elaborately transformed manufactures (ETMs) are one of the strongest performers increasing by 63 per cent over the last five years – albeit from a relatively small base. The United States is now Australia's largest market for exports of ETMs.

1.35 The United States remains the largest source of Australian merchandise and services imports. Merchandise imports accounted for 18 per cent of total imports - major items being aircraft and parts, computers and parts, telecommunications equipment and measuring instruments. In 2002, services imports from the United States accounted for 20 per cent of total Australian services imports.

1.36 As is clear from the above, Australia continues to carry a substantial merchandise trade deficit with the United States - the largest of any trading partner. Whilst the deficit doubled over 1990-95, the bilateral balance on merchandise trade then stabilised, remaining within an A\$11-A\$13 billion range in favour of the United States. The trade deficit with the United States was A\$12.8 billion in 2002. The merchandise trade deficit is in large part the result of Australia's manufactured and high tech import requirements being sourced from competitive United States suppliers. This should all be seen in the context of Australia's overall trade deficit, which in September 2003 was running at \$2.3 billion – the fourth highest deficit on record, and the 22nd consecutive month in which imports outstripped exports.

1.37 As at 30 June 2001, the United States was the largest recipient of Australian investment (A\$177 billion) and Australia's largest source of investment (A\$235 billion, or around 30% share of total level of foreign investment in Australia). Flows of Australian investment in the United States over the last five years have been increasing from around \$18 billion in 1995 to around \$97 billion in 2001, although dropping off in 2002 to \$75 billion. In 2001-2002, the United States share of foreign investment in Australia was 28.7 per cent.

1.38 Australia's economy is small in comparison to the United States, being about 4 per cent the size of the United States economy – roughly equivalent to the size of the economy of Pennsylvania. Both the Australian and United States economies are already relatively open, Australia being one of the most open economies in the world. The United States maintains a protectionist regime in agriculture – an area in which Australia's highly efficient rural producers have a comparative advantage.

1.39 In the Committee's view, Australia's pursuit of a free trade agreement with America has as much, if not more, to do with Australia's broader foreign policy objectives as it does with pure trade and investment goals. Certainly for the United States administration, free trade agreements can only be situated within a particular foreign policy and security setting. This was made clear in a widely-reported speech (May 2003) to the Institute for International Economics by USTR Zoellick:

U.S. Trade Representative Robert Zoellick late last week said countries that seek free-trade agreements with the United States must pass muster on more than trade and economic criteria in order to be eligible. At a minimum, these countries must cooperate with the United States on its foreign policy and national security goals... The U.S. seeks “cooperation - or better- on foreign policy and security issues,” Zoellick said... Given that the U.S. has international interests beyond trade, “why not try to urge people to support our overall policies?” he asked.

Zoellick said that he uses a set of 13 criteria to evaluate potential negotiating partners, but he insisted that there are no formal rules for the selection or any guarantees. “It's not automatic,” Zoellick said. Negotiating an FTA with the U.S. “is not something one has a right to. It's a privilege.”¹⁵

1.40 During the Senate's earlier inquiry into the FTA, entitled *Voting on Trade*, some witnesses regarded these sorts of remarks as signalling America's desire to ‘cement a network of countries into a pact which will bind them to comply with United States foreign policy ambitions.’¹⁶ Others expressed concern that Australia's national interests may be compromised by being seen as inextricably bound to the United States.

Australia has built up positive trade and cultural relationships with many countries in our region. This is in part because we are not seen as an economic or cultural appendage of the United States, but as an independent country with its own trade and foreign policy, which has in the past differed with the United States on some key issues. Australia's role within the Cairns Group could be compromised if a United States-Australia FTA goes ahead.¹⁷

1.41 The Australian Government has been unequivocal in this respect. In particular, its views are declared strongly in Australia's latest foreign policy White Paper *Advancing the National Interest*.

Australia's links with the United States are fundamental for our security and prosperity... Australia has a vital interest in supporting long-term United States strategic engagement in East Asia, because of its fundamental contribution to regional stability and prosperity. The government's pursuit of a free trade agreement with the United States is a powerful opportunity to put our economic relationship on a parallel footing with our political relationship, which is manifested so clearly in the United States alliance.¹⁸

¹⁵ Quoted in *Inside US Trade*, 16 May 2003.

¹⁶ *Submission 53*, p. 20 (Edwards) to *Voting on Trade Inquiry*

¹⁷ *Submission 42*, p. 34 (AFTINET) to *Voting on Trade Inquiry*

¹⁸ Australian Foreign and Trade Policy White Paper *Advancing the National Interest* Canberra (2003) p.(xvi)

1.42 The Committee agrees that Australia's relationship with the United States is its most vital strategic and political alliance. However, that the linking of trade and investment agreements so closely to issues of security and strategic political interest is not without its tensions.

As a trade economist, I get very nervous about links between trade and security or trade and defence or other things which are not closely related to trade, because they can distort the kind of agreement that comes out of it.¹⁹

1.43 The linking of trade and security relationships is clearly regarded as desirable and appropriate by both the United States and Australian governments, but the Committee notes that the role of the United States Congress in trade matters introduces a distinctive dynamic into that linkage.

The United States trade policy is not made by the administration; it is made in the Congress. There is a long tradition—and not a very elegant tradition—of United States trade policy being bought and sold in the United States Congress, and administration views on security priorities do not always hold sway in the United States Congress. So people who give high priority to a good political relationship and to the ANZUS alliance have always taken pains to **separate** the alliance relationship from the trade relationship²⁰.

1.44 As Australia becomes more deeply engaged in trade with its regional neighbours, and especially with emerging economic powers like China, any tensions between, say, the United States and China, could place Australia in an invidious position if the Australia-United States relationship is predicated on closely entwined security and trade interests that verge on the symbiotic.

1.45 A strong political relationship between Australia and the United States is important but this does not mean that Australia can not objectively consider the costs and benefits of a trade agreement with the United States. The eminent economist Professor Ross Garnaut, in evidence to the Select Committee stated:

There will always be tensions and disappointments in the trade policy area, rather more than in Australia's relations with a lot of other countries, because Australia and the United States in many rural commodity markets are fierce competitors. That is just a fact of life. So if you want to preserve the alliance [ANZUS], not just through this government but into the long-term future, if you want to preserve a good political relationship, you will take care to separate the strategic and political relationship from the trade relationship. If ever you get them mixed up over this issue, they will be mixed up in future. In the end, that is going to be corrosive of the political relationship²¹.

19 Committee Hansard (Voting on Trade Inquiry), 9 May 2003, p:161 (Lloyd)

20 Committee Hansard (Voting on Trade Inquiry), 22 July 2003, p:203 (Garnaut)

21 *Transcript of Evidence* 15 June 2004, p22 (Garnaut)

