Australian Government

Department of Foreign Affairs and Trade

22 June 2004

Brenton Holmes
Secretary
Senate Select Committee on AUSFTA
Parliament House
CANBERRA ACT 2601

Dear Secretary,

The Department of Foreign Affairs and Trade is concerned that the Philippa Dee report provided to the Senate Select Committee contains a number of misleading or unfounded criticisms of the Australia US Free Trade Agreement. We would like to respond to a number of claims in her report. We have prepared a supplementary submission for the Committee's consideration.

Yours sincerely

Stephen Deady
Chief Negotiator
Australia US Free Trade Agreement

Supplementary Submission to the Senate Select Committee on the Free Trade Agreement between Australia and the United States of America

Department of Foreign Affairs and Trade

June 2004

Key Points on Dr Dee's report to the Committee

- The Dee report underestimates the significance of the liberalising commitments in AUSFTA.
- On the day the Agreement takes effect over 97% of US tariffs on Australian' non-agricultural goods will be eliminated. At the same time, 66% of US agricultural tariffs will be eliminated, and a further 9% reduced to zero within four years. On key products such as beef and dairy we get significant and immediate market access gains. Rejecting the Agreement would mean that we would forgo these substantial improvements in market access.
- On services and investment, the commitments we have achieved go well beyond those obtained in the WTO and offer the advantage that they are negatively listed (so that new services will be captured). A Most Favoured Nation (MFN) commitment means that we will get any better treatment on services that the US makes in the future with other trading partners.
- For goods, services and investment, there are substantial advantages in having the commitments bound bilaterally.
- Dr Dee's claim that AUSFTA has not achieved faster progress than multilateral trade negotiations does not bear scrutiny.
- Dr Dee's estimate of the costs of extending the term of copyright ($700 million in net present value terms, or $88 million annually) overstates massively the possible costs, and is based on the incorrect assumption that the commercial value of copyright works does not diminish over time.
- Dr Dee is wrong in suggesting that some of the patent provisions "have the potential to delay the introduction of generic drugs into the Australian market". The Government has made it clear on a number of occasions that the price of medicines under the Pharmaceutical Benefits Scheme will not be affected by the Agreement. There is no basis for the claim that the Agreement will lead to higher prices for generic or other drugs.
- Dr Dee's view that the AUSFTA rules of origin will be highly restrictive and involve significant compliance costs is wrong. These will be, in general, more liberal and simpler to administer.
- While acknowledging the commercial opportunities, Dr Dee's estimates of the benefits from more open access on government procurement are well below those of the Centre for International Economics (CIE). The Department regards the CIE estimates as conservative.
- The CIE modelling – which suggests annual gains to Australia of around $6 billion a decade after entry into force – remains the best guide to the magnitude of benefits Australia will gain.
- Dr Dee arrives at her own estimate of $53 million through three steps, each of which the Department sees as invalid. She:
    - rejects the G-Cubed model on which the CIE relied (although G-Cubed is better able to estimate the impact of a preferential agreement on capital accumulation and output over time);

- wrongly rejects the CIE's assessment of gains from investment liberalisation and dynamic gains; and
- makes a number of invalid downward adjustments to the results the CIE obtained with GTAP, partly reflecting the incorrect conclusions she has reached on such issues as the impact of rules of origin, government procurement, and the costs of extending copyright.

Introduction

The Department of Foreign Affairs and Trade welcomes the opportunity to make a further submission to the Senate Select Committee on a Free Trade Agreement between Australia and the United States of America. This follows the testimony provided by its officers. The Department is making this Submission against the background of the public release by the Committee of a report by Dr Philippa Dee which is highly critical of the Australia-US Free Trade Agreement (AUSFTA).[1]

The Department believes the analysis in Dee's report is deeply flawed. It considers that many of the judgements which it makes on trade policy issues are wrong. Contrary to Dr Dee's conclusion, the AUSFTA has achieved very substantial access gains which go well beyond those likely to be achieved in a multilateral round. The report's findings on copyright are based on quite unrealistic assumptions and overstate substantially the costs to Australia of extending the term of copyright. The findings of the report on economic modelling are also wrong, and underestimate massively the gains which will flow to Australia under the Agreement. Dr Dee suggests that some of the patent provisions in the Agreement "have the potential to delay the introduction in generic drugs into the Australian market, which would increase drug prices in Australia". This assertion is wrong and is not supported by any analysis in the report.

Market Access Issues

Dr Dee underestimates the significance of the liberalising commitments in the Agreement. The AUSFTA will deliver very substantial market access gains to Australia. Rejecting the Agreement would lead Australia to forgo the opportunities these access gains will provide for our industry. Without the deal, we will get no improvements in market access to the biggest economy in the world; we would deny all parts of Australian agriculture (apart from sugar) significant market access gains and free trade over time. For nearly all industrial products the tariffs are removed immediately.

In the case of goods, we would, for example, forgo:

- improved access conditions for beef, which will see the tariff on our quota eliminated immediately and the quota itself, currently 378,000 tonnes, substantially increased over time, - growing by 18.5 per cent over 18 years, and then effectively becoming free trade;
- free trade for wide range of agricultural products from day one, including for most of our lamb,sheep meat and wool exports, and many horticultural products;
- substantial increases in our quota-constrained dairy exports to the US, possibly of around $55 million in the first year alone and with compound growth of 5 to 6 per cent per year thereafter;

[1] P. Dee, *The Australia-US Free Trade Agreement: an Assessment.* Paper prepared for the Senate Select Committee on the Free Trade Agreement between Australia and the United States of America, June 2004.

- improved access for our processed food exports, which will see them obtain zero tariffs within four years for a range of fruit juices and for baby foods;
- immediate removal of the 35 per cent tariff on canned tuna, to provide duty free access to the $650 million US market;
- removal of the 25 per cent tariff on light commercial vehicles, that has previously kept Australian utes out of the market.

Similarly, the report underestimates the gains in services and investment access. The report contains significant errors in its examination of the key obligations on services and investment in the AUSFTA, particularly in its comparison of these to existing WTO obligations. A notable example of this is the way it appears to present the most-favoured-nation (MFN) provision in the services and investment chapters as simply a repetition of the MFN provision found in the WTO's General Agreement on Trade in Services (GATS). Such a presentation completely misunderstands the value of the MFN provision in the AUSFTA, which ensures that if the US, in any future FTA, gives better treatment to another country on services and investment, then that liberalization will be extended to Australia. This is an important guarantee of Australia's future ability to compete in the US market. The MFN provision in the GATS does not achieve the same result, as it does not apply to benefits granted in FTAs.[2]

Similarly, there is very limited recognition in the report of the many other areas in which the provisions on services and investment go beyond existing GATS provisions. There is only passing mention of the strong provisions on investment protection, and no mention of the extent to which the performance requirement article provides significant WTO-plus protection against a range of trade and investment distorting measures. There is also no mention of the very liberal 'rules of origin' in the services and investment chapters. These rules mean that all enterprises organized under Australian law, and branches operating real businesses in this country, will be entitled to the benefits of the services and investment chapters, irrespective of who owns or controls them. This is a very significant aspect of AUSFTA, as it means that the Agreement should enhance Australia's attraction as an investment and business location for investors from third countries, and not just investors from the US.

The report also significantly underestimates the extent to which the services and investment commitments go beyond what the two countries have given in the WTO through its treatment of the fact that many parts of the agreement on services bind (or, what the report refers to as "codify") the status quo and the fact that there is some sectoral overlap of commitments between AUSFTA and the WTO. In relation to the binding of the status quo, such binding – for goods as well as services - is highly valuable and is a major reason for carrying out trade negotiations. The US and Australia cannot go back on these commitments without risking relevant bilateral dispute settlement. This provides greater certainty that the conditions that we have committed to in each other's market will not become less advantageous.

The report also fails to recognize that even where there is some overlap in the sectoral coverage of WTO and AUSFTA commitments, AUSFTA can be more liberal. The

[2] Dr Dee appears to have some awareness of the fact that AUSFTA involves this important benefit, but incorrectly ascribes it to the workings of the 'ratchet mechanism' – see *ibid.*, p.36, footnote 5.

WTO services commitments generally reflect the level of access of a decade ago. The standstill commitments in AUSFTA will bind current access – which can often be more liberal than the WTO commitments. In addition, in relation to overlapping sectoral commitments in AUSFTA and the WTO, these commitments can be more valuable in AUSFTA when combined with stronger disciplines in the latter on issues like investment protection.

The negative listing approach used in AUSFTA for services and investment is, by its nature, more liberalising than a positive listing approach used in the GATS. In a positive listing approach, the parties specify the products or services that they are prepared to bind under the relevant commitments. The benefits of the commitments are confined to those items specified. In a negative list approach the parties specify the products or services they want to exclude from the commitments. Unless specifically provided for in the text, new products and services that are not defined and not listed are included under the liberalising commitments contained in the Agreement. For this reason, a negative listing approach tends to be more liberalising. It also tends to embrace innovation and change and encourage the development of liberal markets for new technologies and services.

Dee's claim that "Australia appears to have made more such promises [of "market opening" in the services and investment area] than the United States"[3] is seriously flawed and based on a series of inaccuracies and simplistic analysis. For example, the report's presentation of the two countries' respective commitments[4] misrepresents the market access commitments by neglecting to point out that Australia has taken out a reservation similar to that of the US in relation to all market access measures by our State and Territory Governments. In addition, the report fails to do a proper assessment of the respective value of the commitments made by the two countries. It states that the US made no concessions "similar to Australia's relaxation of FIRB screening", implying that we made larger commitments in this area. However, it fails to make the basic point that the US has made very liberal bindings on Australian investment into the US, including the fact that it has not retained the right to have an investment screening process such as Australia has as part of our foreign investment policy.

The report also incorrectly claims that the United States made more concessions, in certain services and investment areas, to Singapore and Chile in their FTAs than it did in AUSFTA. These claims are apparently based on several inaccuracies in Table 7 of the report, such as inaccurate presentation of the outcome of the Singapore-US FTA in the financial services area.[5]

There is no acknowledgement in the report of the widely recognized fact that in the services area, domestic regulation often provides the primary barrier to increased trade, or of the extent to which AUSFTA contains significant initiatives aimed at addressing such barriers that go beyond both the work of the WTO and what has been

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[3] *Ibid.*, p.7.

[4] See *ibid.*, pp.7-9.

[5] One example is Table 7, where the Report claims that two reservations (relating to sole trustees and primary dealers) that the US took in AUSFTA are not found in the US-Singapore FTA. In fact, the US reservations in the latter FTA contain exactly the same two reservations as are in AUSFTA. See *ibid.*, p.138.

done in other FTAs. In particular, there is virtually no discussion of the financial services outcomes, including the agreement to a work program to promote the integration of our financial services sectors through examining a range of issues related to cross-border trade in securities.

While there is a mention of the Professional Services Working Group, the report fails to acknowledge the importance of promoting greater recognition of professional qualifications and experience to a whole range of services trade. It also tends to dismiss potential benefits in this area by suggesting that promoting recognition on a "preferential" basis could give rise to trade diversion. However, in practice, bilateral cooperation is the only effective way to promote recognition of professional services qualifications, and this is reflected in the fact that there is no serious multilateral initiative to promote such recognition in the WTO. AUSFTA is the first agreement in which the US has committed to a major work program on professional services recognition, and if this opportunity is lost there is no alternative mechanism available to pursue this important issue in a comprehensive manner.

Broader Trade Policy Issues

Dr Dee's claim that AUSFTA has not achieved faster progress than multilateral trade negotiations does not bear scrutiny.[6] With the exception of beef and cheese, Australia received only limited improvements in agricultural market access from the United States in the Uruguay Round.[7] Nor would it be likely to obtain anything remotely corresponding to the market access gains achieved in the US under AUSFTA through the Doha Development Agenda. It is, of course, true that there are issues (like agricultural support programs and export subsidies) where real progress can only be achieved multilaterally. But agreement under AUSFTA does not prevent Australia from continuing to accord the highest priority to a successful outcome from the Round.

Dee's report fails to take into account the reality of the international trading environment. Without the Agreement, Australia's existing position in the US market will continue to be eroded over time as other countries, many of them direct competitors for Australia in the US market, negotiate FTAs with the US that enhance their own access while ours remains static. Standing still means going backwards.

Dee refers to a number of incidents of precedent setting, both in a positive and negative sense, in the Agreement. The bilateral agreement reflects elements peculiar to the bilateral trading relationship and domestic processes and stakeholder interests for both parties. By the same token, the Government did negotiate the Agreement with a view to achieving the most liberalising and standard setting model that it could for future FTAs. In designing and negotiating strategies for the FTA the Government looked to other models and commitments and domestic experiences and expectations to prepare Australia's objectives. But every negotiation is subject to its own special

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[6] *Ibid.*, p.39.

[7] Australia achieved a tariff quota of 378,214 tonnes of beef to the US in the Uruguay Round, compared with average access of around 330,000 tonnes per year in the previous five years. Australia's cheese quota to the US was increased from 4,000 tonnes to 7,000 tonnes per year in the Uruguay Round. Our cheese quota alone in the FTA (we gain access in other dairy products as well) increases by 9,750 tonnes to 16,750 tonnes with guaranteed continuing growth thereafter)

circumstances, and it does not follow that the AUSFTA sets the scope for future Agreements in stone.

Dee also refers to a number of consultative forums established under the FTA to oversee the market opening commitments, to facilitate enforcement of customs or regulations, or to aid transparency. For the last, the report concludes that "because they are in areas where US ambitions appear to have been thwarted, there is concern that they will become forums for ongoing pressure on existing Australian policies".[8] This assumes a one-sided nature to the consultations and bypasses the long history of the Australia US relationship to consult and cooperate on a range of fronts on a range of issues at any time. Consultative mechanisms designed to aid transparency will assist understanding and provide a more formal mechanism to the existing informal channels of communication that have always and will continue to exist between two such close trading partners.

Issues Concerning Copyright and Pharmaceuticals

Dr Dee's estimate of the costs to Australia of extending the term of copyright ($700 million in net present value terms or $88 million per annum) overstates massively the possible costs and is based on highly unrealistic assumptions.

Adding another 20 years to the period of copyright protection will normally have a major impact in the short and medium term only if there are works or other material of considerable age still being sold commercially, or copied. For example, a book whose author died in 1955 would enter the public domain in 2005 under existing copyright law, but would remain subject to copyright for a further 20 years under the proposed change. But copyright for a book by an author who died in 2000 would not be affected until 2050. The evidence we have, which is confirmed by the analysis the CIE has carried out, is that the economic life of most copyright material is short. This suggests, as the CIE notes, that "the costs imposed by extending the copyright of existing works are not likely to be great".

Dr Dee makes a number of highly simplified assumptions to arrive at her estimate. She assumes a constant flow of royalties to each author, and a constant flow of authors, with each author producing one work 30 years before death. There is therefore, in her view, an additional 1/80 in royalties in the first year of AUSFTA in the first year of the Agreement, an additional 2/80 in the second year, and an additional 20/80 (or ¼) in the 20th and following years. Dr Dee estimates net overseas payments on copyright material as $350 million, so that the additional annual payment is up to ¼ of $350 million, or around $88 million. The present value of this stream of costs (assuming a 7 per cent discount rate) is $700 million.

The flaw in this analysis lies in the initial assumption of a constant flow of royalties and authors over time (including extending backwards over time).[9] This allows Dee to make the assumption that the additional royalties will rise as she has suggested.

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[8] *Ibid.*, p.12.

[9] Dr Dee purports here to rely on similar assumptions to the CIE when it looked at possible benefits, but fails to acknowledge that the CIE report explicitly states that most works lose economic value over time. See CIE, *Economic Analysis of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States*, Canberra and Sydney, April 2004, pp.37.

But as already noted, the commercial life of most works is quite limited. The cost to Australia of extending copyright is highly sensitive to the rate as which the commercial value of copyright is assumed to depreciate from the time the work is produced. Even modest rates of depreciation reduce the cost enormously. For instance, a modest rate of depreciation of 5 per cent per annum would decrease the present value of the stream of costs by over 95 per cent.

Extending the term of copyright has both benefits and costs. Contrary to the suggestions in Dr Dee's report, the closer alignment of our intellectual property laws with those of the United States by extending the copyright term for an additional twenty years will not involve substantial costs. The copyright industry has assessed the extension as cost neutral. The CIE found the costs as likely to be minimal.

Dr Dee suggests that some of the patent provisions in the Agreement "have the potential to delay the introduction in generic drugs into the Australian market, which would increase drug prices in Australia".[10] This assertion is wrong and is not supported by any analysis in the report.[11] With respect to pharmaceuticals, the Government has made clear on a number of occasions that the changes introduced under AUSFTA will not prejudice the operations of the Pharmaceutical Benefits Scheme. The Agreement reinforces Australia's existing framework for intellectual property protection of pharmaceuticals. There is no basis for the claim that it will lead to higher prices for generic or other drugs.

Rules of Origin

Dr Dee believes that the rules of origin (ROOs) negotiated under AUSFTA are likely to be far more restrictive than assumed by the CIE and that they will involve significant compliance costs for business. She implies that it is to Australia's long run disadvantage to have negotiated an agreement which differs from the "relatively simple regional value content rule" of the kind found in ANZCERTA. Both of these arguments are incorrect.

The ANZCERTA rule may be simple to express but in practice it has proved difficult to administer because it involves cost calculations including the apportioning of overheads. Aside from the time and costs to industry associated with compliance under this system, it can lead to long disputes with Customs during audits. On the other hand, the change-of-tariff-classification approach under AUSFTA does not involve cost calculations for 88 per cent of items (on a six-digit basis). The view of industry and Australian Customs is that the change of tariff classification model is more efficient, and the compliance costs lower, than under the ANZCERTA model. Rather than the ROOs under AUSFTA being the result of "protectionist lobbying" which Australia "may now be seen to be condoning",[12] they are the result of the search for a more efficient way of determining origin. The AUSFTA will be, in general, more liberal and simpler to administer.

The view that the AUSFTA ROOs will be highly restrictive or involve significant compliance costs has not been supported by the Department's consultations with

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[10] P. Dee, *The Australia-US Free Trade Agreement: an Assessment*, p.10.
[11] Dr Dee herself places a question mark over this comment in Table 1 of the report. See *ibid.*, p.51.
[12] *Ibid.*, p.13.

industry. The exception is the textiles and apparel sector, where we have not hidden our disappointment that the US would not move from their "yarn forward" model for that sector. But this sector is a very small part of the two-way trade.

Dr Dee supports her suggestion that ROOs will be restrictive by referring to the low percentage of trade carried out at preferential rates within ANZCERTA and other preferential agreements. However, as the Department has made clear in its previous answers to the Committee, the 30 per cent figure she cites creates the wrong impression about the impact of the rules of origin in ANZCERTA.[13] For many items in Australia-New Zealand trade, the MFN tariff is zero or the duty involves excise taxes not waived under a free trade agreement. If these elements are removed from the analysis, the proportion of the relevant trade that enjoys preference under ANZCERTA is very high; indeed, 99 per cent of the relevant imports from New Zealand into Australia are accorded duty free entry under preference.

Trade Remedies

Dee contends that the US FTA transitional safeguards provisions do not require a causal link between the surge in imports and injury. This is not correct.

Article 9.1 of AUSFTA provides: "During the transition period, if as a result of the reduction or elimination of a customs duty under this Agreement, an originating good of the other Party is being imported into the territory of a Party in such increased quantities, in absolute terms or relative to domestic production, and under such conditions that the imports of such originating good from the other Party constitute a substantial cause of serious injury, or threat thereof, to a domestic industry producing a like or directly competitive good, that Party may . . . "

While not identical, this language is consistent with that of Article 2.1 and other elements of the WTO Agreement on Safeguards and clearly requires a causal link between the three elements of the equation: the tariff reduction, a surge in imports, and those imports constituting **a substantial cause** of serious injury of threat thereof to a domestic industry.

Government Procurement

Dr Dee is critical of the CIE's assessment of what Australia is likely to gain from the US Government procurement market. The CIE's starting point on government procurement was the Canadian share of the market ($650 million, or 0.3 per cent of the market). The CIE then looked at various adjustments to reflect the differences between the size of the Australian and Canadian economies, and the value of US-Canada and US-Australia trade. This suggested that Australian share of the Government procurement market was likely to lie between $50 million and $360 million. The CIE assumed $200 million as the size of the Australian share for its central case.[14] Dr Dee believes Australia's share is likely to be much lower.

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[13] The figure Dr Dee cites is the proportion of Australia's exports to New Zealand which take place at preferential rates. See *ibid.*, p.24.

[14] In sensitivity analysis, the CIE allowed Australian firms' exports to the US Government procurement market to vary between zero and $400 million.

It will be some years before it is clear which estimate of Australia's share of the market is correct. However, the CIE estimate may well be conservative for two reasons. First, the CIE estimates were based on contracts won by the Canadian Commercial Corporation and did not take account of contracts won by Canadian companies independent of the Corporation. Secondly, the CIE considered only US federal procurement and did not take into account sales to US States which were added to the Agreement after the CIE study.

The key point, however, as Dr Dee acknowledges, is that "the chapter on government procurement creates commercial opportunities [and] …benefits will depend on whether Australian business are able to take advantage of the opportunities".[15] The new export opportunities created by AUSFTA in this area will be lost if the Agreement is rejected. Without the AUSFTA, Australian industry will continue to be discriminated against, while their US counterparts face no barriers to selling to governments here.

Administering the Agreement

Contrary to the suggestions in Dr Dee's report, implementation of the AUSFTA provisions will not impose significant administrative costs. Many of the relevant provisions reflect existing Australian practice, while others provide for consultation arrangements that should provide an effective mechanism for addressing any particular problems that may affect trade or business activities. Many of the consultative opportunities will be undertaken jointly and only when there are problems to discuss. They could provide important vehicles to protect Australian interests and ensure that the benefits expected from the Agreement are achieved. The provisions dealing with work programs, such as that on the establishment of a Financial Services Committee, will create opportunities that could deliver significant benefits over time through promoting greater cooperation and economic integration between the two countries. Many of these provisions were included in the Agreement at Australia's request.

The provisions on transparency and domestic regulation in AUSFTA reflect regulatory best practice, and build on similar provisions to be found in various WTO agreements. They are fully consistent with Australian practice, including the National Competition Policy and the Council of Australian Government's Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies.

Economic Modelling Issues

The Government's view is that the economic modelling which it commissioned from the Centre of International Economics remains the best guide to the magnitude of benefits Australia will gain. That work – by far the most comprehensive and thorough piece of analysis which has been done - suggested annual gains to the economy of around $6 billion a decade after AUSFTA's entry into force. It also showed that AUSFTA will boost employment by around 0.3 per cent by 2012.

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[15] *Ibid.* p.21.

In contrast to the gains suggested by the CIE, Dr Dee finds welfare gains of a mere $53 million. Dr Dee has reached this figure though three key steps as follows

- rejecting the C-Cubed model used by the CIE to explore the macroeconomic effects of AUSFTA as "simply too aggregated to be an effective tool for quantifying the trade effects of preferential trade agreements";
- rejecting/excluding the CIE's assessments of investment liberalisation and dynamic gains; and
- making a number of downward adjustments to the welfare gains the CIE obtained from GTAP ($359 million) and adding the additional costs from her estimates concerning copyright extension.

G-Cubed versus GTAP: In its report, the CIE expressed a clear preference for G-Cubed in assessing the overall macroeconomic effects of the Agreement. It took the view that, as a dynamic model, G-Cubed was better able to look at the way in which investment and capital accumulation lead to higher output over time. The macroeconomic detail and explicit treatment of expectations also makes G-Cubed the most suitable framework for modelling responses to investment liberalisation and examining the impact of future policy changes. GTAP is a comparative static model and does not fully capture the dynamic effects of capital accumulation, even with the modifications introduced by the CIE. The CIE used GTAP mainly to explore sectoral implications (it has 57 sectors as opposed to 12 for G-Cubed).

G-Cubed is a highly respected economic model and the issue Dr Dee raises is whether its aggregation means that it would understate the degree of trade diversion in a preferential agreement. In approaching its modelling work, the CIE considered the question of whether removing an average tariff on an aggregate commodity would cause more trade diversion than removing a set of high and low tariffs across a more disaggregate set of commodities. Its view is that the answer is unclear under the import share weighting scheme used for tariffs going from GTAP to G-Cubed. In other words, it is not clear that G-Cubed understates the degree of trade diversion.

Gains from Investment Liberalisation and "Dynamic Gains": The CIE found substantial gains to Australia from the liberalisation of FIRB restrictions under AUSFTA. These findings are rejected by Dr Dee on the ground that FIRB liberalisation will not reduce the risk premium on investment in Australia. But there is evidence that complying with its provisions is seen by investors as onerous. In addition, other provisions of AUSFTA will improve the investment climate and create added certainty for investors. The CIE's modelling assumes a very small reduction in the risk premium of only 5 basis points, and in sensitivity analysis, this is reduced to 2 basis points.

Dr Dee rejects the idea of including "dynamic gains" which flow from the greater competition under trade liberalisation because "their existence has been hotly debated, and conservative evaluations omit them".[16] But there is a wealth of econometric evidence which supports the existence of these effects. The CIE has been

[16] *Ibid.*, p.35. See also pp.31-32.

conservative in its assumptions and has adjusted the magnitude of the gains to reflect the fact that it is a bilateral agreement which has been negotiated.

Adjustments to the CIE's GTAP Results: The CIE's modelling with GTAP found welfare gains of $359 million. Dr Dee makes a number of adjustments to these figures which DFAT considers unwarranted. In relation to some of the main adjustments:

- Dr Dee cuts by one third the gains from merchandise trade liberalisation on the ground that rules of origin "are likely to have much more pervasive effects than assumed".[17] This is not supported by the analysis of ROOs provided above. The CIE has already made allowance for the restrictive impact of ROOs for textiles and clothing, where they are in fact highly restrictive.
- Dr Dee has removed all of the technical efficiency (productivity) gains from the results on services, on the ground that barriers to services in the area the CIE examined (professional services) are mainly rent-creating rather than cost escalating. To capture the most important effect of removing the rent creating barrier, the CIE had assumed it was one which escalated costs, but with half of the effect estimated in the Productivity Commission work on which the estimate was based. This was done because it was difficult to model the rent-creating barrier with GTAP. The CIE's assumptions in this area are quite conservative.
- Dr Dee has reduced the effects of government procurement by a factor of 4/30. As noted, the Department's view is that the CIE estimates may well have been conservative.
- Dr Dee has added $88 million to reflect the cost of extending copyright (this is the ongoing annual value associated with her estimate of $700 million). As indicated, the Department considers this estimate to be based on quite unrealistic assumptions.

Conclusion

Dr Dee's analysis develops, in many respects, earlier criticisms of AUSFTA which have been discussed at length before the Senate Select Committee and the Joint Standing Committee on Treaties. The Department's view is that these criticisms are misleading and unfounded.

As the previous analysis has made clear, AUSFTA will deliver important market access gains to Australia. From day one, tariffs on 97 per cent of the items of our non-agricultural exports will be reduced to zero. There will be significant access gains for many agricultural products. The Agreement will make our access more certain and secure through binding commitments. Its innovative provisions on services will provide a basis for developing our trade in this sector over time. AUSFTA will help to protect Australia's market position as other countries negotiate free trade agreements with the United States.

More important still, the Agreement will develop further Australia's links with the most powerful economy in the world. The links it will establish will contribute to the

[17] Ibid, p.34.

further development of Australia as a more productive and advanced knowledge economy.

The Government's has made clear its view that AUSFTA presents an historic opportunity. It would be unfortunate indeed if this opportunity were to be lost to Australia.