

Australian Senate

Select Committee on the Free Trade Agreement between Australia and the United
States of America

An Inquiry into the Free Trade Agreement between Australia and the United States of
America

Submission by

Peter John Lloyd
Professor Emeritus
The University of Melbourne

Address for Correspondence:
Department of Economics,
Faculty of Economics and commerce,
The University of Melbourne,
Parkville, Victoria 3010,
Australia

Phone: 61 3 83445291
61 3 83445035
Fax: 61 3 83446899
Email: pjlloyd@unimelb.edu.au

An assessment of the recently concluded Free Trade Agreement is a monumental task. There are 23 chapters, additional annexes and a long list of sideletters. Every provision needs to be examined in detail. Rather than attempt this task, I wish to focus on the procedures by which the Senate, the Australian Parliament and the Australian people should reach a decision to approve or not approve the Agreement.

In my comments below I wish to make two central points:

1. Economic models are a valuable adjunct to the analysis of the provisions but all economic models have severe limitations and the final decision cannot be made on the basis of the predictions of models alone.
2. In making the decision, it is necessary to distinguish between those features of the provisions which restrict the trade that will take place between Australia and the United States of America if the Agreement is approved on the one hand and those features which will result in a changed pattern of international trade. The former may be a cause of regret that the Agreement is not more liberalising but only the latter should be taken into account in the final assessment.

The Role of Economic Models

In the lead up to the negotiations, the Department of Foreign Affairs and Trade commissioned a study to model the effects of free trade between Australia and the US. This was done by the Centre for International Economics in Canberra and was published in June 2001. Independently, the Rural Industries Research and Development Corporation commissioned a study by ACIL Consulting of a prospective free trade agreement that was published in February 2003. The former found the net benefits to be positive but the latter found the economic benefits of the FTA to be finely balanced between positive and negative. The impact on Australian farmers, in their view, is likely to be negative. It would be strongly negative if the US does not grant completely free trade for sugar, dairy and meat. The difference between the results of the two models sparked off a heated debate.

After the conclusion of the Agreement DFAT called for tenders to do an analysis of the actual increase in market access for both countries in the negotiated agreement.

The contract was awarded in March to the CIE but this report is not available at the time of writing.

The main point I wish to stress is that there are severe limitations to *all* models. A model is, by necessity, a gross simplification of the economy. This is because of resource constraints and the current technology of modelling. The technology of the builders in Australia of the type of model used for analysis of trade policy options is the best in the world. This is due to a long tradition of modelling in Australian universities and the generous support for this type of modelling over the years from the Productivity Commission and other government departments.

In building these models, however, many simplifying assumptions must be made. All of the models used in Australia so far have only one representative consumer. Thus, they cannot distinguish between the income effects on different households. This is a major handicap. All of the goods produced and exported or imported are lumped into a small number of industries. It is necessary to lump into one product group some commodities which have higher tariffs than others or some which are subject to quantitative restrictions and some which are not. The resulting simulations lose much of the detail of the markets.

A more severe limitation of the earlier simulations of an Australia-US free trade area is that they left out many of the features of trade policy. They did not model safeguard actions of the type which is incorporated in the negotiated agreement for imports of beef when there is a surge of imports, or quarantine regulations. They did not model rules of origin. These are a very important feature of the agreement that determine which goods coming from Australia qualify for preferential entry under the agreements. The rules of origin in the text are trade-restricting. They did not model most of the restrictions on trade in services and domestic regulations. They did not model intellectual property rights such as those associated with the change in royalty arrangements, and the Pharmaceutical Benefits Scheme. They did not model FDI and the changes to FIRB procedures and technology transfers, nor the mutual recognition of labour market qualifications.

What is needed now is a detailed microeconomic modelling of the markets for the goods and services that are affected by these features, and then this modelling of individual markets needs to be embodied into a general equilibrium model. It is to be hoped that the CIE does some of this. Many of these features of trade policy have, however, not been modelled before in any country; for example, this applies to safeguard actions, rules of origin, most changes to service market access and domestic regulation, FDI restrictions, intellectual property rights and mutual recognition.

In the end, the model used to evaluate the actual agreement will leave out many of the important features of the agreement. This is inevitable, given the current technology of model building. Qualitative judgements of these effects will be required. The final decision made by those looking at the agreement, and especially that made by Parliament, cannot be made on the basis of the predictions of the models alone.

The Final Assessment

A number of commentators in the press and a number of submissions have commented on some features of the Agreement which will restrict the trade that takes place if the Agreement is approved. There are indeed several features which restrict the trade compared to what would occur if we had an agreement that genuinely allowed free trade between the two economies. These include the following

- the limited liberalisation of trade in agricultural products (due to the exclusion of trade in sugar, retention of quotas on beef and dairy products, residual tariffs on dairy and some other agricultural products, restrictive safeguard provisions relating to beef and some horticultural products, and long transition periods)
- exclusion of trade liberalisation measures for fast ferries and other vessels
- contingent protection for textile products
- highly restrictive rules of origin for goods trade
- the negatives list for service trade (air services and some telecommunication and financial services) and the nonconforming measures listed in the Annexes
- the failure to conclude an agreement on business visas

All of these omissions are regrettable. The net benefits to Australia would have been much greater if these features had not been agreed to. However, all of this is water under the bridge. The features have been decided and there is no possibility that they can be amended by pressure from Australia at this stage. We must take the agreement as it is and ask whether this (flawed) agreement is beneficial to the country or not. It would be unproductive for the Select Committee, in my view, to spend much time debating these features.

In assessing the Agreement as it is and reaching a decision, there is a straightforward procedure which the Committee might adopt. This is to ask what features of the concluded agreement are likely to be harmful to Australia and, having made that assessment, do these harms collectively outweigh the benefits from the trade liberalisation due to the other features of the Agreement?

In making this “harm list”, a careful distinction should be made between features which impose harm on some persons/households and those which, on the balance of the assessment of harms and benefits to different persons/households in Australia are of a net benefit to the country as a whole. In the latter group the harm to some households is sufficiently large to outweigh benefits to other households. Most changes in market access will cause some households to be better off and some to be worse off. Changes in market access will change not merely the prices of the products or services traded but also the wage rates of labour of different skills and specialisations, the rates of return on capital and rents. This kind of conflict is almost universal.

For example, the liberalisation of trade in dairy products will clearly benefit dairy farmers, owners of dairying land and dairy processing companies but it will cause an increase in the domestic price of processed dairy products to the detriment of households consuming these products. In this case, economists would note that a product or group of products for which Australia is a net exporter means that our aggregate production of these products exceed our aggregate consumption of the products. Unless one has a strong reason to weight more heavily the effects on consumers, there must be a net benefit to the country.

There are, it seems to me, relatively few features of the Agreement that are likely to be harmful to the country as a whole. The only clearly unambiguous case is the extension of the term of copyright protection by 20 years after the death of the copyright holder

Some features will be difficult to decide. This applies to the outcome of the negotiations on the local content requirements in the audiovisual sector and the provisions relating to sanitary and phytosanitary measures. The former is a complex package and the latter involves risks that are difficult to assess.

On the other hand, there are many features of the liberalisation of trade in goods (industrial products as well as agricultural, seafood and mineral products), services Foreign Direct Investment, labour and public sector procurement which will be beneficial to the country as a whole.

The overall conclusion which I wish to put to the Committee is that the way in which the Committee constructs its lists of benefits and costs will be crucial to its decision.

Peter John Lloyd
Economics Department,
University of Melbourne