

The importance of the Australia US Free Trade Agreement to Australia**Submission by Alan Oxley on behalf of****the AUSTA Business Group****to the****Senate Select Committee on the Free Trade Agreement between Australia and the
United States of America****30 April 2004****Executive Summary**

AUSTA believes the Australian United States Free Trade Agreement (AUSFTA) to be the most important trade agreement negotiated by Australia since the completion of the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) and the adoption of the Agreements of the Uruguay Round (1986–94). The result of AUSFTA is “deep economic integration” as characterized by the World Bank. Agreements that achieve such integration have been dubbed “WTO plus” agreements. The Agreement liberalises the Australian economy, facilitating its integration with the global economy. This is the role of a trade liberalisation agreement.

Fears not borne out

A range of arguments were made against the idea of a free trade agreement with the US when it was first proposed. AUSTA believes that subsequent events have laid these fears to rest.

The argument that negotiating an FTA would limit Australia’s ability to negotiate multilaterally is not supported by historical experience. The Uruguay Round was negotiated by Australia while it negotiated ANZCERTA. In fact, the majority of Cairns Group members were negotiating bilateral or regional agreements at the time the Uruguay Round was concluded.

The argument that Australia would lose the economic interest and good will of its Asian neighbours is not supported by the facts: Australia has since concluded similar agreements with Thailand and Singapore, is accelerating talks with China on economic integration and has just been invited unanimously by its South East Asian neighbours to take a larger role in ASEAN economic integration. The claimed “choice” between Asia, Europe and North America is false: evidently Australia must engage all these regions.

The argument that Australia would fail to win any concessions from such a large partner misses the point of trade liberalisation and was not substantiated. Cutting barriers to trade and investment is not a zero sum game. Australia will benefit both from lowering its own

barriers, and importantly from the lowering of barriers to American markets accomplished under the Agreement.

The arguments that AUSFTA will impair Australia's social welfare net has not been borne out by the text of the agreement. Its provisions do not weaken the pharmaceutical benefits scheme (PBS), but instead make it more transparent. There are claims that prices for pharmaceuticals will increase under the agreement, however the mechanism by which this will occur is yet to be demonstrated. Cultural interests have been safeguarded – including in new media – as recognised by representatives of the cultural industries.¹

Assessing the economic impact of the agreement

The debate over econometric modelling of the effect of the agreement is misplaced. Econometric modelling is unsuitable for assessing the impact of trade liberalization commitments in this agreement because the techniques are not capable of adequately measuring the impacts. They are very rough instruments which are principally useful for determining the direction of large shifts in economy wide growth. The extent of shift created by this agreement, which tend to impact narrowly on specific industries, will be measurable on specific industries in the short term (which is not what econometric modelling does – it measures economy wide impacts).

Econometric models are also static and can only provide backward looks. They can not anticipate all the effects of liberalisation on the behaviour of market actors and are very weak – if not ineffective – on reductions of measures other than quantifiable trade barriers to trade in goods. Services are notoriously difficult to measure and models are weak in measuring the impact of liberalisation of investment rules. There is no robust way the impact of trade facilitation can be measured with quantitative methods.

Econometric models when used for trade liberalisation are also heavily dependent on wide knowledge and experience by the modellers on the impact of trade measures on trade and growth. It is our observation that all the econometric modelling done on the impact of the Australia US FTA has been significantly deficient in that respect as well. The most effective form of economic assessment of the impact of the Agreement would be an economic policy analysis rather than econometric modelling. There are very good economists who could provide such an analysis, but none have been asked to do so.

Cutting-edge integration

The AUSFTA delivers cutting-edge integration. The Agreement covers not only trade in goods but in investment and services. These two areas are of increasing importance. In the early 1990s investment and trade within firms began to rivals arms length trade in

¹ Kim Dalton, Chief Executive, Australian Film Commission, "Cultural Impacts", Paper presented at the Australian APEC Study Centre/AUSTA Business Group "US Free Trade Agreement – The New Opportunities and Impacts" Conference, 1 and 2 March 2004, Rydges Hotel Canberra.

value.² Trade in goods – with the exception of key sectors such as agriculture and textile clothing and footwear – is now overwhelmingly free.³

The World Bank finds “services and investment to be the two most important areas beyond merchandise trade where there are gains for widening the scope of integration.”⁴ Trade and investment trends between Australia and the US show that investment is now as important as trade in value.⁵ Investment also carries technology transfer that doesn’t come equally with goods.⁶ The services sector is the fastest growing sector in advanced economies. Eighty percent of the US economy is in services.⁷ International trade in services is now a major global activity. The World Bank finds that bilateral agreements can be a more effective route to services liberalisation.⁸ In the case of investment no multilateral route is currently available.

In both services and investment, AUSFTA provides vital coverage, cutting the cost of doing business, reducing economic distortion and promoting economic prosperity.

Liberalising Australia

AUSFTA will make Australia more competitive. It initiates the process of reducing Australia’s tariffs to zero. It greatly frees controls on investment. The Howard Government has until recently been reluctant to embrace the rhetoric and philosophy of trade liberalisation. It has never indicated how it would reach the APEC Bogor goal of zero tariff and investment barriers by 2010, nor set out its ambitions for global reduction of industrial trade barriers in the Doha Round in the WTO.

AUSFTA will provide impetus for the Government to remove residual barriers to trade and investment. It will encourage the adoption of concrete targets for full liberalisation by Australia in APEC and WTO, and then further them in those forums.

The Government will shortly need to extend the investment treatment offered to the US to its other major investment partners, Europe and Japan. It will be just a matter of time before these standards are extended. The AUSTA business group has argued consistently that these benefits should be extended on a Most Favoured Nation (MFN) basis.

The AUSTA group believes it is possible to negotiate bilateral and regional agreements which produce sound results which create net improvements in economic welfare. Australia and New Zealand negotiated such an agreement (ANZCERTA) and the AUSFTA also falls into that class. It would not be in Australia’s interests to eschew such

² UNCTAD (United Nations Conference on Trade and Development) (2003) World Investment Report, UNCTAD, New York; UN World Investment Report, 1996, Annex Tables 3, 4 (pp. 239-248).

³ World Trade Organization, International Trade Statistics, www.wto.org.

⁴ World Bank (2000) *Trade Blocs*, World Bank, Washington, p.89.

⁵ Australian Bureau of Statistics.

⁶ UNCTAD (2003) “Transfer of Technology for Successful Integration into the Global Economy”, New York: United Nations, UNCTAD/ITE/IPC/2003/6.

⁷ World Fact Book, Central Intelligence Agency, www.cia.gov.

⁸ World Bank, op. cit.

opportunities for the sake of (misplaced) fidelity to the idea that the only form of trade liberalization worth securing is multilateral. AUSTA members are strong supporters of the WTO. From the standpoint of improving national economies, the best form of liberalization is unilateral. AUSTA has supported the argument that Australia should unilaterally remove all remaining barriers to trade and investment. But it also considers that Australia should negotiate regional and bilateral free trade agreements that improve the competitiveness of the Australian economy.

An agreement for the future not the past

Information technology has generated large productivity gains in production and distribution of goods and services and in organisation.⁹ The OECD finds the economies to have benefited most from these gains to be the United States, Canada and Australia.¹⁰ Such productivity gains are the source of growth in developed economies. Improvements in IT will continue to come from the US, the leader in these industries for the foreseeable future. Technology improvements will also come more via services and investment than through trade in goods.¹¹

The debate on the political setback of not receiving full agricultural access has diverted attention from the broad importance of the Agreement. The Agreement is about much more than agricultural access and industrial tariff cuts.

While Australia may remain a minor innovator in IT in global terms, it must continue to be a major adaptor. In this sense the Agreement looks to the future and the sectors most likely to deliver future growth. It links Australia with the world's leading economy in IT lowering barriers, protecting investment and service links, and enhancing prospects for technology transfer. It is very important for Australia as a middle sized economy to maintain the most competitive standards in the world economy.

Important traditional gains

AUSFTA provides important gains in key traditional areas as well. The trade agreement provides duty-free access from day one for over 97 per cent of Australia's manufacturing exports to the US, worth \$5.84 billion last year.¹² Access for Australia's agricultural sector is also improved, most notably in beef and dairy. More than 66 per cent of agricultural tariffs go to zero from day one of the Agreement. Stephen Martyn, Chief Executive of the Australian Meat Industry Council has pointed out that these gains are

⁹ United Nations Conference on Trade and Development UNCTAD (2003) E-Commerce and Development Report 2003, Internet edition prepared by the UNCTAD Secretariat, pages 41 and 45, available at www.unctad.org/en/docs/ecdr2003ch2_en.pdf.

¹⁰ Organization for Economic Co-operation and Development (OECD) (2003), "ICT and Economic Growth: Evidence from OECD Countries, Industries and Firms", DSTI/IND/ICCP (2003) 2/FINAL, Paris, OECD, 22 April.

¹¹ UNCTAD (2003) "Transfer of Technology for Successful Integration into the Global Economy", New York: United Nations, UNCTAD/ITE/IPC/2003/6.

¹² Australian Bureau of Statistics.

better than what could have been expected in the same time frame from WTO negotiations.¹³ Agriculture is still largely excluded from commitments in the WTO, and progress on liberalization has all but stalled.

Pharmaceutical benefits

The FTA delivers on a fairer, more transparent process for the pricing of medicines, and the potential to attract up to \$1 billion in research investment. In a submission to the Inter-Departmental enquiry into the future of the PBS, the Medical Oncology Group, essentially a group of Australia's leading cancer specialists, said that "there are a number of issues relating to the drug evaluation and subsidy system in Australia and its capacity to meet the challenges associated with continuing to provide affordable access to new high-cost medicines." The Group recognized the following areas of concern:

- "Lack of openness and transparency in the deliberations of the PBAC;
- Scope of cost-effectiveness evaluations employed;
- Limited opportunities for stakeholders other than the PBAC and sponsoring companies to have some input into the decision making process; and
- Lack of an appeals mechanism."¹⁴

AUSFTA substantially addresses all these problems. The AUSFTA makes no changes to the methods used to set prices. Changes, which are process related, will enhance the environment for investment in medicines in Australia.

Facilitating economic integration in APEC

Since the adoption of the APEC Bogor declaration in 1994, there has been a lot of talk but little action about trade liberalization among the APEC economies. There has been little domestic policy action to bring this about. And whether or not commitments to liberalize should be binding has been an issue in APEC since the failure at the Osaka APEC Summit to formalize them.

USTR Robert Zoellick has argued that high quality bilateral agreements can strengthen the foundations of growth in emerging markets. He argues that one benefit of this is "competitive liberalization," where negotiation of an FTA with one country will encourage others to do more. Negotiation by the US of agreements with Singapore, Chile and Australia, and by Australia with Singapore, Thailand and the US has certainly had that effect. Most leading economies in East Asia which, up until now, have been

¹³ Steve Martyn (2003) "The US Free Trade Agreement A Good Deal for The Red Meat Sector?", paper presented at the Australian APEC Study Centre/AUSTA Business Group "US Free Trade Agreement – The New Opportunities and Impacts" Conference, 1 and 2 March 2004, Rydges Hotel Canberra, paper available at www.apec.org.au/docs/fta04Martyn.pdf.

¹⁴ Quoted by Steve Haynes in "The Triumph is in the Text", paper presented at the Australian APEC Study Centre/AUSTA Business Group "US Free Trade Agreement – The New Opportunities and Impacts" Conference, 1 and 2 March 2004, Rydges Hotel Canberra, paper available at <http://www.apec.org.au/docs/fta04Haynes.pdf>.

reluctant to commit to legally binding commitments to trade liberalization are now willing to do so.

The agreements between the United States, Australia, Chile, Singapore and Thailand have achieved liberalization and set new standards for legal protection of economic freedom. This is a major contribution to efforts to promote global prosperity.

AUSFTA itself is an exemplary agreement for liberalization in APEC. Commitments are binding in law and the coverage of the agreement is comprehensive.

Dealing Australia into the bilateral trade liberalization game

With the US negotiating deals with Singapore, Thailand and the Americas, Australia's competitive position relies on being involved in this bilateral activity. Competition for high quality access to the US economy will intensify in the coming years. If Australia loses the opportunity to take up AUSFTA, its relative position will worsen. Each country that successfully negotiates a high quality bilateral agreement with the US has superior access to the world's largest economy, and has a foothold in the regional and pluri-lateral economic spheres.

An incomplete process

Economic efficiency relies on the removal of unnecessary impediments that distort the flows in the moveable factors of production: labour and capital. AUSFTA successfully helps liberalise further flows of capital. Movement of labour appears increasingly important as a source of receipts to the sale of services, technology transfer and increases in total factor productivity. Alan Winters *et al.*¹⁵ find that there is reason to expect greater gains from trade liberalization in the services sectors than in the goods sector. By restricting the flow of professionals and business people unnecessarily, we limit the benefits available through flows of skills.

For various reasons – including the global focus on security in response to terrorism – loosening rules on movement of professionals and business people between Australia and the US through AUSFTA was impractical. This does not lessen its importance. It has been on the bilateral agenda for some time, and the AUSFTA provides a platform for concrete commitments to promote the issue further.

Government must make a concerted effort to remove barriers to the movement of business people. Liberalization of any kind relies on governments making concrete commitments. Winters *et al.* point out that the movement of personnel is more difficult for governments to tackle politically because it involves a much broader range of border-related issues than those covered by the trade portfolio. Commitments must be made at a high political level and must carry a high profile.

¹⁵ L. Alan Winters, Terrie L. Walmsley, Zhen Kun Wang, and Roman Grynberg (2002) "Negotiating the Liberalization of the Temporary Movement of Natural Persons", Discussion Paper in Economics, University of Sussex, available at www.sussex.ac.uk/Units/economics/dp/Wintersetal87.pdf.

AUSFTA's momentum should be harnessed to formulate legal commitments to reduce barriers to movements of personnel. If this does not occur, the full potential benefits flowing from the AUSFTA will not be realized. Australia will not be able to export as many services as it otherwise might. Australian workers will be denied exposure to the fastest growing sectors in the US economy.

Relations with Asia

There was a concern while AUSFTA was being negotiated that the Agreement might harm Australia's relations with Asia. This has proven unfounded. In the meantime Australia has concluded trade agreements with Singapore and Thailand, as well as major resource deals with China. It has also initiated negotiations into an economic agreement with China. Since the release of the Agreement, Japan has expressed constructive interest in AUSFTA's investment provisions, which will most likely be extended to Japan before long.

There is bipartisan recognition in Australian politics of the importance of maintaining strong economic links with Asia. Judging by their actions, our Asian partners also recognize that Australia must seek to enhance relations with all its economic partners.

Impact on Australia's multilateral trade interest

It has been contended that pursuit of AUSFTA has been at the expense of Australia's interests in the negotiations in the Doha Round of the WTO. Those negotiations are effectively stalled because of lack of international consensus about how they should proceed. They will not regain momentum until administrations in Washington and Brussels decide that they are prepared for major domestic reform in agricultural policy and developing countries accept that they should reduce trade barriers. Negotiation of a bilateral free trade agreement by Australia is immaterial to those circumstances.

Public support

AUSTA commissioned Newspoll to gauge public opinion towards AUSFTA twice over the last six months. In November the Newspoll asked its standard polling group how importantly they rated the Agreement for Australia's economic future. Seventy percent of respondents rated it important or very important. A nearly identical question was posed in February after the Agreement was concluded and a nearly identical result was obtained.

Conclusion

AUSFTA provides a framework for global economic integration in the twenty-first century. Its benefits are diverse and dynamic. Some of its benefits, such as those surrounding investment, are not available elsewhere. It secures Australia's position near

the technology frontier, strengthening the Australian economy and to enable it to prosper in the global economy over the next 50 years.