On 19 May Australian trade minister, Mark Vaile and his US counterpart, Robert Zoellick, signed the Australia – United States Free Trade Agreement, preparatory to its ratification by the US congress and passage through the Australian parliament. The merits of the FTA in terms of net benefit to Australia continue to be the subject of debate. This brief looks, firstly, at the findings of several studies, which have attempted to quantify any net economic benefit to Australia, and, secondly, examines industry reaction, identifying some of the main winners and losers under the FTA.

Part I

The macroeconomic benefit

There continues to be much debate about the merits of the Australia–United States Free Trade Agreement (AUSFTA). Apart from noting the direct benefits to Australian industry, those favouring the ratification of the FTA also cite the more general advantage of increasing links with the world’s largest economy. Those who do not want to see the FTA come into effect express disappointment that it does not live up to expectations in terms of coverage, and concern that, in some areas of the Agreement, the door is left open for interpretation, which could be to Australia’s disadvantage. These conflicting views probably will not be swayed by economic analysis alone; nevertheless, this should be the starting point for an evaluation of the merits of the AUSFTA.

As one attempt to assess the measurable economic benefits to Australia from the AUSFTA, the Department of Foreign Affairs and Trade commissioned the Centre for International Economics (CIE) to update its previous study on the agreement, which was prepared in 2001, before the detail of trade and other liberalisation was known. The study used two econometric models to assess both its domestic and cross-border impacts. The study used GNP, rather than GDP, as the preferred measure to quantify the macroeconomic benefit to Australia’s welfare from the FTA, since it includes not just the impact of domestic output changes (captured in GDP), but also investment income flows into and out of Australia. The study calculates that, 10 years from the inception of the AUSFTA, GNP, most probably, would be $6.1 bn, 0.6%, above the ‘baseline’ (or the level to which GNP would have grown without the FTA). The CIE uses the ‘discounted present value’ method to quantify the current value of the FTA-driven increase in economic growth over a twenty-year period. The following chart illustrates the contributing factors to the net gain in GDP and GNP.

The CIE finds the bulk of the gains in welfare come from what it terms a reduction in risk premium, achieved through investment liberalisation. It asserts that by lowering the barriers to foreign direct investment, the equity risk premium associated with investing in Australia is likely to fall, lowering Australia’s cost of capital and boosting investment. (The benefit to Australia under the preferred welfare measure (GNP) is lower because it includes the need to service the resulting increased foreign investment.) Merchandise and services trade liberalisation under the FTA would add close to $1 bn a year to GNP and GDP after a decade. The benefit from this source is low, due both to the relative openness of bilateral merchandise and services trade already, and to the diversion of trade that occurs when barriers to trade are removed for only one trading partner rather all trading partners.

Dynamic productivity gains also are small relative to what they would be without the FTA since trade barriers are relatively low, and because only a partial bilateral liberalisation is undertaken. (The CIE notes that, while there is ample evidence for the existence of dynamic gains, there is robust professional debate’ about their size.)

Some other findings in the CIE report

The study also draws some other conclusions about the macroeconomic and microeconomic effects of the FTA:
• The effect on Australia’s real exchange rate is marginal;

• The FTA will bring extra employment and wages growth;

• All States gain from the liberalisation of trade and government procurement – the largest gains being in New South Wales and Victoria;

• Commitments relating to the Pharmaceutical Benefits Scheme (PBS) under AUSFTA were not likely to have a material impact on the cost of the Scheme and/or the price of medicines under the Scheme.

• Available evidence suggested the incremental cost of extending the copyright on literary and artistic works from 50 to 70 years under AUSFTA’s intellectual property commitments would be marginal.

• The only significant limitation of the benefits of the AUSFTA stemming from the Agreement’s ‘rules of origin’ requirements is that it may prevent 90% of textile and clothing products from gaining preferential entry into the USA. (It would not hinder existing textiles trade.)

• The AUSFTA’s safeguard provisions (as they apply to beef and horticulture, for example) are not expected to have a material effect on the outcome of the Agreement.

The CIE also identified a number of major industries where economic modelling could not take account of ‘real world’ vagaries or intricacies. The industries included: beef; dairy; passenger motor vehicles; light metals and financial services and are covered in individual case studies. There is also a case study on government procurement.

**But other studies conflict**

There have been at least two other in-depth econometric assessments of the AUSFTA following the release of the detail of the agreement earlier this year. (There also were several assessments undertaken between 2001 and 2003, while the agreement still was being negotiated.)

The National Institute for Economic and Industrial Research (NIEIR) lodged a report with the Senate Select Committee investigating the AUSFTA as part of a submission by the Australian Manufacturing Workers Union. In its assessment the NIEIR rejected the positive conclusions of the CIE study, estimating that the deal would produce a net loss to Australia of some $47 bn (about 0.4% of GDP) in present value terms. It also estimated an average annual loss of some 58,000 jobs, with significant risk of higher losses. It estimated that manufacturing employment would be almost 40,000 lower by 2025 with the AUSFTA. The NIEIR study criticised the CIE’s study for the importance attached to services trade in its calculation of the benefit from trade liberalisation (37% of the benefit from trade liberalisation), while, for its part, NIEIR omitted services trade from its calculation of direct effects. It also criticised what it regarded as the CIE’s refusal to acknowledge the possibility of negative outcomes from foreign investment.

The NIEIR focussed on what it described as a considerable loss of sovereignty under the AUSFTA, claiming it would constrain the ability of future Australian governments to control domestic activity and employment, and to stop the drain of economic assets, such as intellectual property and technology, to overseas companies. This would remove an important tool for the government, one that is essential if Australia is to make the transition to a knowledge-based economy, the NIEIR asserted.

The Senate Select Committee commissioned Dr Philippa Dee, an experienced trade economist, to conduct an assessment of the AUSFTA. The Dee report disagreed with the CIE study on a number of points. Particularly noteworthy was the Dee report’s view that it is highly doubtful that the changes to the FIRB screening would have any general effect on Australia’s risk premium (which accounted for around 60% of the net economic benefit to Australia in the CIE assessment). On Dr Dee’s calculations the annual gains to Australia from the AUSFTA would amount to about $53 mn.

The Dee report also observed *inter alia* that:

• Sections of the AUSFTA establish precedents, such as the omission of sugar, acceptance of one-sided rules of origin and widespread safeguard provisions, that may affect Australia’s options in future bilateral or multilateral agreements;

• The disproportionate acceptance of US standards on intellectual property in a way that overrides Australia’s copyright and digital law reform processes has also set another important precedent;

• The CIE’s estimate that Australia would achieve 30% of Canada’s penetration of the US government procurement market was too high – probably closer to 4%;

• Australia’s net royalty payments could be up to $88 mn higher a year under the agreement.
Joint Standing Committee on Treaties (JSCOT)

A parallel parliamentary inquiry, along with that of the Senate Select Committee inquiring into the AUSFTA, has been held by JSCOT. After a three-month inquiry from June until mid-August, by which time the detail of the AUSFTA had become available, JSCOT released its report in late August, before the final report of the Senate Select Committee. JSCOT has recommended the ratification of the AUSFTA (17 of the report’s 18 chapters received bipartisan support), but Labour MPs and senators on the Committee stopped short of recommending ratification, stating that further investigation was necessary.

The Committee concluded that, while the size of the net benefit to Australia from the AUSFTA was the subject of debate, there would be a positive economic benefit.

JSCOT came up with 23 recommendations affecting the legislation that would be needed for the AUSFTA to operate in Australia. Principal among these recommendations were those directed at reaffirming the Pharmaceutical Benefits Advisory Committee’s (PBAC) independence and ensuring the transparency of decisions made under the AUSFTA review process related to the Pharmaceutical Benefits Scheme (PBS). (The Committee received evidence that the review mechanism would not be able to recommend price increases for pharmaceuticals.) JSCOT also recommended that, in drafting the required PBS legislation, there should be no mechanism that would cause undue delay in the entry of generic drugs onto the market.

Other recommendations covered issues such as the extension of copyright terms under AUSFTA, and issues of mutual recognition and work visas for business people between Australia and the USA. JSCOT also recommended that the economic impact of the AUSFTA be reviewed by the Productivity Commission five years after it comes into force.

So is there a net benefit to Australia?

Readers would be forgiven for being confused by the often-conflicting outcomes of the various assessments and inquiries into the AUSFTA. None of these has provided a definitive answer. Inherent in economic modelling outcomes, even despite rigorous methodology, is that the assumptions applied in the model have a substantial bearing on the results. This helps to explain such diverse outcomes, as have occurred with modelling the AUSFTA. At the same time it is probably unrealistic to expect that all traces of partisan politics can be removed from Parliamentary inquiries.

On the basis of the information available it seems most probable that there would be a modest net benefit to Australia from the AUSFTA, but there are significant risks, both upside and downside, to this scenario. Even accepting that a modest net benefit is the most likely outcome from the agreement, this expectation is still overhung by a number of contentious issues in the Agreement, which pose a risk to the net benefit result but which are especially difficult to quantify or evaluate, including: the impact of the PBS review mechanism on drug availability and cost; the impact of changes to intellectual property legislation; restrictions on Australian content rules in new media; the impact of the AUSFTA dispute resolution process; restrictions affecting the ability of the government to change the regulation of investment and services in future; the impact of the agreement on Australian quarantine and food labelling laws.

Given the inability of economic analysis to provide a clear and reliable answer to the AUSFTA question thus far, acceptance of the deal, or otherwise, will probably be based on political grounds. In practical terms this means that, if the Opposition support the AUSFTA, it will come into force; if not, it will make it very difficult, but not impossible, for the government to get the necessary amending legislation through. The Opposition has indicated its intention to await the final report of the Senate Select Committee, due in mid-August, before deciding its position.

Part II

Peak industry bodies favour the agreement

For the most part, industry has reacted favourably to the prospect of the AUSFTA, indicating a belief that, on balance, it will produce beneficial outcomes. Major peak industry bodies, such as the Australian Chamber of Commerce and Industry, the Business Council of Australia and the Australian Industry Group, have welcomed the agreement. The Australian Services Roundtable was initially positive about the agreement, although it was reserving judgement pending an examination of the detail. There have been no indications of concerns since the detail of the AUSFTA became available.

The Minerals Council of Australia was strongly supportive of the AUSFTA, noting that Australia is unambiguously better off with this agreement, than if it had not been reached.

The National Farmers Federation, while deeply disappointed that the government was unable to secure greater access to the US market, for Australian agriculture, indicated it would not oppose the AUSFTA, considering there were increases in market access for some agricultural products. A source of unhappiness amongst Australian beef dairy and horticulture industries is the ‘safeguards provisions’ of the AUSFTA. These can ‘cap’ the benefits of greater access to the US market in that, if prices for some agricultural products fall enough
to trigger the safeguards, duties will be applied to Australian exports.

Industry reaction – some winners and losers

The food industry appears a particular winner from the agreement. The Australian Food and Grocery Council viewed the agreement as providing "a range of opportunities for the processed food industry in the long and short term." Benefit from removal or reduction in US protection will be gained by many key food products, including cheese, whole milk powder and processed tuna (the Tuna Boat Owners’ Association has been reported as being squarely behind the FTA). The agribusiness industry may also benefit from the phase-out of tariffs on fruit juices and baby foods.

The wine industry is another agribusiness winner. However, wine tariffs will be eliminated only after 11 years and most of the benefits to the industry will accrue after this period, reducing costs by around $30 mn a year. Benefits occurring earlier will be relatively minor.

Firms in the plastics and chemicals industry support the AUSFTA but warn of risks to investment if tariff reductions are not phased in. (The government has indicated that this would be difficult since the tariff is already a low 5%).

The Australian Electrical and Electronic Manufacturers’ Association has indicated support for the AUSFTA, while recognising it as an opportunity rather than a guarantee of success.

Invest Australia, the federal government’s national inward investment agency for attracting productive FDI into Australia asserts that the FTA would be good for financial services, as more favourable investment rules and freer movement of capital and resources would heighten investor interest.

The Cattle Council of Australia and Meat and Livestock Australia have indicated support for the agreement while expressing disappointment at the low increase in access.

Austrade has identified a number of industries which will benefit from the AUSFTA including, education (degree recognition) autos and component parts (more ‘utes’ and auto part sales) and fashion design (fewer discrepancies in duties on garments).

Concern over the potential impact of the AUSFTA on the PBS comes mainly from the Australian consumer lobby and the Australian Medical Association. Major players in Australia’s biotech-pharmaceutical industry such as AusBiotech and Medicines Australia have supported the agreement. The drug lobby says that the FTA will bring millions of dollars of investment into Australia through drug research, and provide earlier access to medicines. The AMA has expressed concern over the role and power of a new inter-governmental group made up of US and Australian health bureaucrats (the PBS review mechanism). Any support for the FTA would rest on the government’s assurance that it will not lead to an increase in the price of drugs.

Australia’s film and television industry is concerned that under the FTA US competitors will have to be consulted before any changes are made to rules protecting Australian content, and also that the FTA is vague about the government’s right to legislate for local content on new interactive media (which is imprecisely defined but includes digital TV). The extent to which these concerns are valid is unclear.

Australian Digital Alliance (universities and museums) and the Australian Libraries Copyright Committee are against the FTA’s copyright extension provision due to the increased costs it will bring to libraries, cultural and educational institutions (as the majority of copyright materials come from overseas and Australia runs a trade deficit on copyright materials with the USA).

Some trade lawyers argue that local firms will face a difficult time winning US government procurement contracts, and will face strong competition from large and experienced US tenderers.

It appears textiles, clothing and footwear industries generally will derive limited benefit from the AUSFTA due to the special ‘rules of origin’ provisions.

Conclusion

The majority of Australian industries appear to see themselves as winners to some degree from the AUSFTA. Complaints from industry regarding the adverse impact from increased competition have been sparse (although union arguments against the FTA have pointed to job losses). Criticism has been more that the gains are small and the FTA could have delivered more. Objections to the agreement largely have centred on the issues affecting public welfare, and particularly on a perceived loss of Australian sovereignty in deciding such issues as new drugs to be admitted under the PBS, Australia’s quarantine rules, media content etc. Such concerns will be seen as being important to voters. On balance it appears there is sufficient momentum behind the AUSFTA for the required legislation to be passed, nevertheless, the Opposition’s stance following the release of the final report of the Senate Select Committee is likely to be crucial.

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