5. The economic impact

A Free Trade Agreement with the US will increase the competitiveness of the Australian economy and expand GDP. Removal of low barriers will produce marked benefits. Because both the Australian and US economies are open, adjustment to the removal of constraints on trade and investment will be minimal. In this chapter, the broad economic impact of an FTA on the Australian economy will be considered and the impacts on trade, investment and industry policy will be reviewed. Some observations will be offered about the long-term prospects of the United States economy and their bearing on formation of a Free Trade Area with it.

The long-term success of a free trade agreement depends upon the economic context in which it operates. Questions to be answered cover obvious matters such as the relative economic size of the partners and the relative size of potential changes within the total economy in either case. Less obviously, how have the two economies performed in recent times? How robust and flexible are they likely to be in dealing with changes brought about by freer trade? How open are they and thus how likely are they to benefit from changes to trade patterns? And what sort of broader benefits can be envisaged?

These questions are hard to answer precisely, partly because we do not know what form the final agreement might take, and partly because the economic future is inherently uncertain. However, with a review of the main developments and features of the two economies, we can draw broad conclusions about the likely economic response to an agreement.

An FTA will also have marked effects on other aspects of Australia's economy, particularly on its participation in the emerging global information economy and on Australian business culture. These aspects are considered in more detail in Chapter 6.

Relative Scale

In 1999 the US economy produced nearly a quarter of world Gross Domestic Product and in the two years to 1999 it provided almost one third of the total increase in global spending. It is an US$9 trillion plus economy. Adjusting for relative purchasing power, the US economy is twice the size of the next largest economy (China) and three times the size of the third (Japan). It bears comparison alone with the enlarged European

Union. As part of a North American Free Trade Area with Canada and Mexico, it is a formidable force for global economic leadership.

Australia is a US$400 billion economy, less than one twentieth of the US, and ranks just outside the top twenty economies in the world, according to World Bank figures. The Australian economy is smaller than that of Mexico or Canada, the two countries that are partnered with the US in the North American Free Trade Area.

In terms of GDP per capita, the US ranks first among the major countries at more than US$21 000, with Australia at sixth at about 80 per cent of the US figure. The Australian ranking has changed little over the last ten years.

A free trade area between Australia and the United States would comprise a market of over 292 million people, with a combined gross domestic product (GDP) of around US$9.7 billion. The United States would contribute overwhelmingly the dominant share of the combined economies.

Australia's national output is around 4 per cent of the United States'. A way of viewing the economic association from the US perspective is to see it as the addition of another medium sized state roughly equivalent in GDP to that of Pennsylvania.

Relative economic scale has greater relevance to Australia in considering the potential benefits of an FTA with the United States. The net income gains from liberalisation arising from changing prices and production patterns in the affected industries (to reflect comparative advantage) are limited only by the size and diversity of the US economy, which is not a substantial limit. For the US, the net gain relative to the whole economy would be real but smaller and therefore likely to be less visible nationally. For the US, an FTA is thus a much less significant national economic decision than for Australia.

It should also be borne in mind that access to the US market may also provide access to the markets of its partners in NAFTA, thereby enlarging the potential for Australia to make gains from liberalised trade.

Nevertheless, it is unlikely that the differences in scale will lead to the Australian economy being swamped in some way. The direct impacts will arise in specific industries as a result of the elimination of specific barriers and the indirect effects will be limited by the magnitude of the first round effects. The US is a major trading partner but still has a trade weight in our balance of payments of only 22 per cent compared with 36 per cent for the European Union taken as a whole and 20 per cent for Japan.

Full access to such a large market as the United States offers the potential to markedly change the Australian economy and over the longer term to raise living standards to levels comparable with the US average. For the United States, however, the benefits from AUSFTA will be more modest because the influence of Australia on its economy is relatively small. That would be true of most of the US' trade partners.

The overall result will almost certainly be a net gain to both countries. However, any adverse effects may be more narrowly distributed than the benefits. The negative impact could be regionally significant in either country. In this case the relative economic scale may be less important politically if there are powerful constituencies resisting change in both countries.

The condition of the Australian economy

Overall, the 1990s are likely to be viewed in retrospect as a decade of outstanding economic progress and stability, particularly the latter half. Both the Australian and US economies have performed strongly. They have seen the longest period of uninterrupted growth in the post-war period. The reasons for this are complex but generally sound economic policies in the two countries in the 1980s and 1990s and an absence of serious external shocks provide much of the explanation. It is worth comparing the data for the two economies with the aggregate for the seven major countries of the OECD (which includes the US). They are set out in Table 5.1. In almost every case the performance of Australia and the US has been significantly superior compared to the major OECD economies.

Table 5.1 **Economic Indicators 1990s–Australia, USA and major OECD economies**

	GDP % growth			Employment % growth			Unemployment %			CPI %			Current A/c % of GDP	
	Aust.	US	OECD	Aust.	US	OECD	Aust.	US	OECD	Aust.	US	OECD	Aust.	US
1990/91	-0.2	0	1.3	-3	-2.7	0.7	8.4	6.3	5.9	5.3	5.5	5.1	-4.5	-0.4
1991/92	0.5	1.2	1.4	-1.9	-0.2	0	10.3	7.2	6.6	1.9	3.2	3.6	-3.3	-0.4
1992/93	3.6	3.2	1.6	0	1.2	-0.2	11	7.3	7.1	1	3.1	2.9	-3.6	-1
1993/94	4.1	3.1	2	1.9	2.0	0.6	10.5	6.5	7.3	1.8	2.6	2.5	-3.6	-1.5
1994/95	4.6	3.7	3	4.0	2.2	1	8.9	5.7	6.8	3.2	2.9	2.3	-6	-1.8
1995/96	4.3	2.7	2.3	2.5	1.0	0.6	8.4	5.6	6.8	4.2	2.7	2.2	-4.3	-1.4
1996/97	3.7	4.1	3.1	1.0	2.2	1.3	8.6	5.2	6.7	1.3	2.9	2.2	-3.3	-1.6
1997/98	4.8	4.5	3.1	1.4	1.9	1.2	8.3	4.7	6.5	0	1.8	1.8	-4.1	-2
1998/99	5.3	4.0	2.5	2.1	1.4	0.9	7.6	4.4	6.3	1.3	1.7	1.3	-5.6	-2.9
1999/00	4.4	5.2	5.1	2.8	1.5	1.2	6.9	4.1	6	2.4	2.9	2	-5.3	-4.1
10 yr average	3.5	3.2	2.5	1.1	1.1	0.7	8.9	5.7	6.6	2.2	2.9	2.6	-4.4	-1.7
5 yr average	4.5	4.1	3.2	2	1.6	1	8	4.8	6.5	1.8	2.4	1.9	-4.5	-2.4

[1] OECD covers only the major 7 countries
Source: ABS, Cat 1350, February 2001

1 OECD — average performance of the seven largest OECD economies

Australia has recorded a real annual growth rate of about 4.5 per cent in the last five years and 3.5 per cent for the decade, a little better than the US figure but effectively level pegging. This is a remarkably strong sustained rate in historical terms and was associated with increases in GDP per capita and hence improved living standards. Employment growth has also been strong in both countries, especially in the last five years. In both countries there was progress in reducing unemployment although the US did considerably better, with its unemployment rate falling to 4.5 per cent compared with 6.9 per cent for Australia.

Both countries also recorded strong productivity gains. Australian multi-factor productivity growth (the growth after excluding increases in working hours and additional capital) has been the second highest in the OECD during the decade of the 1990s. This multi-factor productivity growth is a strong indicator of increased efficiency of labour and capital.

In both countries, price (and wage) inflation was held at levels well below what would be a cause for alarm. The underlying rate of price inflation now is just over 3 per cent for Australia and just over 2 per cent for the US. The stability provided by the good inflation performance stimulates growth.

Both national governments have adopted conservative fiscal policies so that government deficits and debt are not a burden.

The Australian current account of the balance of payments has been consistently large throughout the decade. Concern in this regard has tended to subside given the apparent ability of the economy to service overseas capital, which is the counterpart of the deficit. In part, this is because the composition of the inflow has changed to favour equity rather than debt so that any deterioration in the economy is more quickly reflected in the return on overseas assets and thus in the current account itself.

The recent history is of two strongly growing, flexible and robust economies, which would be well able to take advantage of a liberalised trade regime between them.

The impact on the Australian economy

A Free Trade Agreement between Australia and the United States (AUSFTA) would inject a new dynamism into the liberalisation process in each country. This would be especially true for Australia. Australia would be the junior partner in the trading bloc, the partner with lower levels of income and smaller economies of scale in terms of cost structures. Australia would, therefore, see considerable benefit in terms of market openings and more competitive supplies.

The Centre for International Economics (CIE), Canberra, has modelled the effect of the removal all barriers to trade between the two economies.[2] Its broadest conclusion is

2 Centre for International Economics, *Economic Impacts of an Australia - United States Free Trade Area*, Canberra, 2001. See http://www.intecon.com.au/ reports_list.htm

that over 20 years, the net increase in economic welfare in Australia could be nearly $US10 billion dollars and for the United States, over $US10 billion. Proportionately smaller reductions in trade barriers would produce proportionately smaller increases in GDP and economic welfare. The conclusions of the analysis are set out below in Table 5.2.

The CIE study only examined the direct impact of removing trade barriers that could be modelled mathematically. As this report argues, in many respects the indirect and dynamic benefits of an AUSFTA, in areas like investment and the 'New Economy', could well be as important as the direct impact, particularly for Australia.

It should be noted that the growth of Australian exports of elaborately transformed manufactures to the US and the simultaneous imports of these products is characteristic of economies able to take advantage of greater specialisation and more intensive competition. This pattern indicates that Australian industry is capable of maintaining a competitive position against US outputs, a conclusion that the CIE modelling supports.

Impact on Trade

Australian exports to the United States account for around 2 per cent of Australia's GDP and for around 11 per cent of total Australian exports. These exports represent just 0.7 per cent of United States imports. United States exports to Australia account for under 0.2 per cent of US national output and 1.6 per cent of total US exports.

Both the United States and Australia are among the most open economies in the world. Average tariffs are 3.8 per cent for Australia and 2.8 per cent for the United States. Under the WTO Agreement that followed the Uruguay Round of trade negotiations, virtually all US tariffs and 94 per cent of Australia's are "'bound'" (cannot be raised without offering compensation to affected exporting countries). The somewhat lower aggregate rate for the US may be illusory since, while Australia has hardly any specific tariffs in addition to the normal ad valorem rates, the US has a number of these.

Even though average tariffs are low, a free trade agreement that removed low tariffs would offer considerable increased trading opportunities.

This is because it is profit levels that act as the main drivers for business activity. Typically, profits might comprise less than 10 per cent of the price of goods. Hence when confronting even a relatively low tariff rate of 5 per cent (about 15 per cent of Australian and 30 per cent of US tariff lines are at rates greater than 5 per cent) a firm might:

- absorb the costs, in which case, a profit margin at 10 per cent would be halved and the market would be relatively unattractive;
- charge a higher price and see a diminished demand;
- decline to contest the market.

Table 5.2 **Modelling Benefits of an Australia–US FTA**

Both Australia and the United States gain from the formation of a bilateral free trade agreement. Econometric analysis provides the following results:

- Expressing the stream of net benefits over 20 years in net present value terms, the gain in welfare to Australia could be $US9.9 billion and for the United States $US10.3 billion.
- For GDP, the net present value of benefits is $US15.5 billion for Australia and $US16.9 billion for the United States.
- Australian GDP could be 0.33 per cent higher by 2006. This gap would then continue to widen, leveling off by 2010 at 0.4 per cent of GDP — an annual increase in that year of nearly $US2 billion.
- US GDP, even though rising only by 0.02 per cent above what it might otherwise be, still amounts to an annual increase of $US2.1 billion in 2006.
- Welfare (as measured by real household consumption) and production (as measured by GDP) rise for both countries over time, with the removal of barriers to trade assumed to be over a five year period.
- Using the APG-Cubed model, by 2006, when full implementation of the FTA is assumed, Australian welfare could be nearly 0.3 per cent above what it might otherwise be. This continues to rise to 0.4 per cent by 2010 and 0.5 per cent by 2020. For the United States, welfare peaks in 2006 at 0.016 per cent above what it otherwise might have been.
- In terms of the share of GDP, the gains to Australia are bigger. This reflects the greater relative importance of the bilateral trade to Australia than the United States, the fact that a couple of key sectors, such as sugar and dairy stand to expand with the removal of the United States' tariffs, and a slightly higher average barrier removed in Australia.
- For both economies the rise in exports is greater than imports and Australia's current account (expressed as a percentage of GDP) improves by 0.9 per cent, while there is a negligible change for the United States.
- Overall, world exports rise showing that trade creation is greater than trade diversion as a result of forming the free trade area. New Zealand would be a net beneficiary, although the change would be small in magnitude.

Source: CIE, *The Economic Impact of an Australian US Free Trade Area*, 2001 (http://www.intecon.com.au/reports_list.htm)

Hence even a low tariff level may have a considerable effect on supply. In many cases removal of a low tariff barrier makes it worthwhile for firms to make more determined and sharper competitive inroads into markets that become similarly profitable to domestic sales. This increased competitive intensity has a major impact in lifting market orientation and other elements of productivity of domestic industries.

Removal of prohibitively high barriers through a free trade agreement justifiably attracts the most attention. Australia's exporters are likely to benefit most from this removal since the remaining Australian tariffs of over 10 per cent are on goods where US firms do not compete strongly on world markets. These comprise motor cars, clothing, footwear and leather goods.

As noted in Chapter 4 and Annex 3, the the main barriers facing Australian exporters to the United States are in sugar, dairy, light commercial vehicles and shipping (both ships and domestic transport services). The barrier to Australian sugar exports amounts to a tariff equivalent of 80 per cent and for dairy amounts to a tariff equivalent of 23.9 per cent. There are some other more minor barriers to trade covering lamb, cotton, metals and financial services among others. The prospects for opening agricultural markets are discussed in Chapter 4. Some benefits can be won in the short term, but the greater prospects lie in the long term.

The competitive challenge of an FTAA

It is important to recognises that, as the US negotiates a network of FTAs with various countries, Australian exporters face disadvantages compared to those US FTA partners in the US market. Already, Mexican and Canadian firms enjoy such an advantage. Moreover, in the absence of an AUSFTA, or a multilateral trade round delivering equivalent market access gains, virtually all other Western Hemisphere countries would gain a similar advantage over Australian competitors under the proposed Free Trade Area of the Americas (FTAA).

As is noted many times in this report, a major preoccupation for Australia in international trade is to see world markets for agriculture opened, including in the United States. Little attention has been paid in Australia to what the proposal for a Free Trade Area in the Americas (FTAA) might amount to. The negotiations for an FTAA are supposed to be completed by 2005. They aim to remove all barriers to trade and investment in North and South America. Gallagher, referred to earlier, has drawn attention to the commitment to negotiate on agriculture in that forum.

Australians should note that several of its key competitors in world agricultural markets are participating in that negotiation. Argentina, Brazil, Uruguay and some of the Central American states are leading beef exporters. Australia was not a significant exporter of beef to the United States until Argentine and Brazilian beef was ruled unacceptable after outbreaks of foot and mouth disease in the 1960s. Brazil and, to a lesser extent, Argentina are sugar exporters. Argentina and Uruguay are dairy exporters. Chile and Argentina are wine exporters.

Australia has a sharp interest in trying to ensue that Latin American agricultural export competitors do not secure an advantage over Australia in access to the US market through the FTAA negotiations. If is difficult to envisage how agriculture can be dealt with in an FTAA. If agreement is so hard to secure in the WTO, why would it be easier in an FTAA? It would seem likely that questions of access would be more effectively addressed in the WTO since these are problems which are global in dimension.

On the other hand, whatever the practicalities, the US has agreed that agriculture will be included in the FTAA negotiations. A commitment by the United States that agriculture would be included in negotiations over an Australian FTA constitutes a potentially vital piece of trade negotiating insurance in light of the momentum that the FTAA proposal appears to have. Australia cannot afford to see so many of its agricultural export competitors be given a chance to argue for access to US agriculture markets without its having a corresponding opportunity. If Australia had not sought an FTA with the United States, the preparedness of the Bush Administration to pursue an FTAA creates a powerful reason to seek one simply to acquire that opportunity.

Impact on Investment

The significance of US foreign investment was detailed in Chapter 2. Given the low level of assistance in both Australia and the USA, it is unlikely that misallocation of investment in a US-Australia FTA would be significant. There is no substantial evidence that tariff reductions under the North American Free Trade Area (NAFTA) resulted in sub-optimal investment in Mexico and the likelihood of it occurring in Australia in response to tariff reductions is even more remote. More significant will be the 'head-turning' impact of generating increased interest in investing in Australia.

Where investment flows increase when economies are open, as is the case with Australia and the United States, the effects are beneficial.

The benefits of this 'head-turning' effect would be felt before the negotiations of the FTA were completed. Bilateral trade negotiations in the United States are not simple affairs. The complexity of the processes of government and legislating in the United States require deliberate commitments by the Administration of the day to any trade agreement. Support for agreements has to be generated in Congress. The result is that during the period that interest is being drummed up for the idea within the Administration and within Congress and during the negotiation of the agreement (which can take two or more years), considerable attention is drawn to the country concerned in public policy processes in the United States.

The importance of foreign investment

Foreign investment plays a major role within the Australian economy for two reasons.

First, Australians have tended to save less for domestic investment than is spent on capital goods. This can be measured in terms of the current account deficit that over recent years has averaged about 4 per cent of GDP, a figure that accounts for about one third of total private non-dwelling investment. Foreign investment in Australia constitutes a high proportion of domestic investment. Without this we would either have to reduce levels of consumption or see reduced investment and reduced income growth.

Second, overseas investment brings with it management and technical skills that are often not readily available domestically.

Increases of both inward investment and outward investment would be likely to improve Australian living standards. However, the basis upon which the investment occurs is important. Investment that is introduced as a result of changed regulatory arrangements or to get behind high trade barriers is not always beneficial.

These sorts of sub-optimal investments were once evident (indeed were sought after) in Australia and many other countries. Their justification was that investment would provide the ground floor to the creation of infant industries that would one day become viable without the government assistance originally extended to them. Such policies, which are now recognized as fundamentally flawed, were long ago abandoned by the USA and Australia.

Furthermore, commitment by the US Administration to negotiate an FTA with another country is seen a tacit endorsement, first by the Administration and then by the Congress, of the country concerned and of the state of its economy. For a country like Australia, this may be seen by the US business community as recognition of the political stability of the other country and of the responsibility of its economic management. It would be viewed as a positive assessment of that country's longer term prospects and of the potential for US trade and investment there. Overall, this process would draw attention to Australia, and the Australian economy, in a way which otherwise would not have happened.

This will have considerable benefit for Australia's investment promotion interests in the United States. The question of what attracts foreign investment is a very well researched field. Many factors decide why a foreign investor will invest in one country and not another. Most commonly adduced factors are:

- Rate of return on the investment
- Local tax policies
- Political stability
- Economic performance
- Independent legal systems
- Size of market
- Skilled workforce
- Low local costs
- Proximity to market
- Financial incentives

Studies show that, in most cases, economic return and political stability are the leading reasons for investment. Other factors vary according to the industry. In some sectors, such as ICT, companies with investments in large manufacturing, such as chip plants, are now in a position effectively to auction the location of plants, delivering them to the country that provides the biggest subsidy.

Governments can do something about some of these factors, but not all them. Nearly all governments accept that a basic consideration about attracting investment is to be noticed. Most governments have investment promotion programs designed firstly to secure publicity about their country as a place to invest. The Australian Government runs the Invest Australia campaign with an annual budget of $13.4 million.[3] Most State Governments also have investment promotion campaigns to attract foreign investment to their States.

According to professionals in the field,[4] Australia's major challenge in investment promotion in the United States is simply to be noticed. Whilst it is common to perceive that Australia is competing against other countries to attract US foreign investment, the perception of Australian investment promotion officials in the United States is that in reality the competition is much greater. Australia is competing with most other States in the United States.

3 For 2000–2001.

4 From discussions with Australian investment officials in the United States.

A decision to negotiate a free trade agreement with the United States therefore has an immediate spin-off in that it attracts attention to Australia. According to the analysis of the impact of the negotiation of NAFTA by the Department of Foreign Affairs and Trade[5], US investment in Mexico increased by 50 per cent following completion of the negotiations. Evidently, a sizeable proportion of that was the direct result of the removal of barriers to trade and investment. There is no dissent among businesses engaged internationally in the United States, however, that potentially very positive spin-offs could be gained from the publicity generated by an FTA.

Once concluded, an FTA could also provide direct benefits to investors from both countries. Although there are currently few barriers to investment flows, national treatment and legal rights in the other countries' courts would provide greater certainty. Furthermore, an FTA might be accompanied by additional benefits such as special business visa provisions or treatment in government procurement decisions. Finally, as noted in Chapter 4, negotiation of an FTA might provide an additional opportunity to improve the taxation regime facing investors in the two markets.

Impact on Industry Policy

Protection of Australian industry is lower than it has been for decades. The average tariff is 3.7 per cent, although the effective rate of assistance is presently 5 per cent.[6] In 1984–1985 the average nominal rate of assistance on manufacturing was 13 per cent while the effective rate was 22 per cent. (Even at that level, assistance was probably understated because some programs were inadequately estimated.) Protection is still slowly declining. The effective rate of assistance is expected to fall to 4 per cent by 2005–2006.

Most assistance today is in the form of tax breaks to industry. While much lower than in the past, the Productivity Commission still reports that assistance to Australian industry is still considerable. It identified total budgetary assistance at around $3.7 billion in 1999–2000. This comprised $2 billion in program outlays and $1.7 billion in tax expenditures. Most support is not selective, but some programs provide specific support for particular industries.

It is unlikely that an FTA would have a significant effect on existing Australian industry assistance programs. The selective assistance to industries might need to be examined in the light of its impact on industry location. However, much of it might be

5 DFAT, *NAFTA After Five – The Impact of the North American Free Trade Agreement on Australia's Trade and Investment*, March 2000.

6 Nominal assistance rates refer to the tariff equivalent on an industry's outputs. The Effective Rate of Assistance was calculated to provide a common measure of assistance which included the tariff as well as other measures, in particular including subsidies. As assistance on inputs is normally lower than assistance on outputs, the effective rate normally exceeds the nominal rate.

little different from that commonly provided to "footloose" industries by individual American states.

All Australian Commonwealth Government programs have been designed to be consistent with WTO provisions. If the US chose to object to a particular program, it would be open to Australia to argue its retention on the grounds that it was consistent with the provisions of the WTO, unless benefit were perceived in altering or removing the program.

Long term effects

Because Australia has become one of the most open economies in the world, it is strongly placed to move forward on trade liberalisation without adverse transitional impacts on vulnerable industries.

An economic union with the United States would make the capital inflow or outflow similar to that between say, Illinois and the rest of the USA. In Australian terms it would be like a smaller, independent country becoming part of the Commonwealth of Australia. As with domestic investment at present, under a US-Australia Free Trade Area, investment would expand or contract in relative terms in response to changes in competitiveness, but the lack of barriers would ensure this process was faster. In other words, Australian businesses would gain more and more rapidly where they became more competitive but would lose more rapidly where they became less competitive. This process has served the 50 American states well. Although some have obviously grown faster than others, none have found themselves in serious decline.

Economists always warn about the hazards of predicting economic direction. Nevertheless, if a judgement is to be made about the importance of forming a Free Trade Area with the United States, some reflections about the long-term prospects of the United States are warranted.

In the last quarter of the twentieth century there was a great deal of speculation about competition for global economic leadership between Japan, the United States and the European Union. At the beginning of the 1990s, it was widely argued in the United States that Japan's economy was destined to be larger than the US, and some, Professor Lester Thurow at MIT in particular, argued that in the long term the consolidation of the European Community meant that it would emerge as the world's largest economic entity.[7]

A decade later, Japan was in prolonged recession having recorded the lowest growth of all major OECD economies consistently through the nineties; the European Community had become the European Union and introduced the Euro, seeing it fall steadily against the dollar from its introduction; whilst the United States had experienced its longest period of peacetime economic expansion, recording record growth through the decade, fuelled by the IT boom. As the twentieth century closed the

7 See Thurow, Lester, *Head to Head, The Coming Economic Battle among Japan, Europe and America, Allen and Unwin, 1993.*

US was the preeminent economic power. With the collapse of the Soviet Union in 1991 leaving the United States as the unchallenged military superpower, US global preeminence had never been greater.

As this report is being prepared, there is speculation about the nature of economic slowdown in the United States. The chances are strong that the slowdown will have serious global impacts, especially in East Asia, where the United States is the largest export market for most economies and a significant amount of economic activity is clearly directly dependent on growth in the IT sector in the United States. However, it is the longer term upon which the fuller importance of an FTA with the United States needs to be assessed.

Some basic factors suggest that the United States should be set for a period of prolonged economic growth in the first quarter of the twenty-first century. Because of the IT boom, productivity reached record levels. A large investment has been made in Information Age infrastructure and technology in the United States. In the 1990s, the United States had a higher immigration intake than in any decade of that century, including the first decade, which brought enormous waves of migrants from Europe. The formation of the North American Free Trade Area has created a market nearly the same size as the European Union, but with the advantage of a very large low cost labour force in Mexico and a young population with strong consumer growth.

The chances of achieving the economies of scale that the removal of barriers are supposed to create must be greater in NAFTA than in the EU, given that only three sets of national barriers need to be removed, whereas in the EU the number of sets of national barriers, now numbering 16, increases every time a new member is admitted. Removing national barriers and regulations to create a "Common Market" and a "Single Market" has proven harder in Europe than was ever anticipated. Europe also faces the cost of supporting economic reconstruction in Central and Eastern Europe. The post-communist phase in those regions has barely begun.

It is not unreasonable to conclude that the United States will continue on into the first decade or two of the twenty-first century as the biggest, most open and most competitive economy in the world. It has already been noted that one of the long-term effects of the opening and deregulation of the Australian economy in the 1980s was an intensification of the trade and investment relationship with the United States. With a strong resource base, a big services sector relative to the economy, and a globally competitive (although relatively small) manufacturing base, Australia's economy is much more like the economies of Canada and the United States than most economies in Europe. A natural consequence has been the expansion of investment by Australian companies in the United States and a steady growth in exports of elaborately transformed manufactures.

Tying Australia's economy to that of North America's through a free trade area should ensure that Australia, too, can secure benefits from the prolonged period of growth that the US economy can reasonably expect in the early decades of the twenty-first century.

It was noted at the outset of this chapter that one benefit of an FTA was likely to be greater competitiveness in the Australian economy. The way in which this would encourage best practice in key aspects of economic activity, in particular adapting to the Information Economy, business culture and formulation of economic policy, is the subject of the next chapter.