



An Australia–USA
**Free Trade
Agreement**

ISSUES and IMPLICATIONS

A Report for the
Department of Foreign
Affairs and Trade





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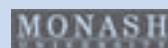


**FOREIGN
AFFAIRS AND
TRADE**

by The Australian APEC Study
Centre, Monash University
August 2001



The Australian
APEC
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Foreword

The Australian APEC Study Centre, based at Monash University, was commissioned by the Department of Foreign Affairs and Trade to prepare an analysis of the impact on Australia of negotiation of a free trade agreement between Australia and the United States.

Mindful that free trade agreements perform a larger role in today's globalised world than simple removal of trade barriers – they are instruments to promote closer relations between economies – this study was conceived from the outset to assess the impact of an agreement between Australia and the US for its wider implications.

Consider the case of investment. In the past, free trade agreements did not cover investment. However so much production today is global that in many industries the capacity to invest has become as important as a capacity to trade for companies in international business.

This is highly relevant to the economic importance of the United States to Australia. It is Australia's second largest trading partner (just shaded in 2000 by Japan) but it is by far Australia's largest source of foreign investment. It is without question Australia's most important economic partner.

Trade agreements necessarily are instruments which shape relations among countries in the long term. Commitments to make changes are usually secured through a series of incremental steps staged over time to give business and the community time to adjust to change. So a long-term view of interests is necessary. It is never easy to predict the future but it is even more difficult to do so today.

The global economy is in a process of dramatic change. We talk regularly about globalisation and focus on the negatives as well as the positives. However the greatest agent for change in the global economy and global society is information technology. We have entered the Information Age but the pace of change is so great that all we know with certainty is that the full impact of information technology will be greater and different to what we expect.

A final point to make about wider implications stems from an old truism about trade: businesses trade, not governments. Evidently one of the key impacts of closer economic relations with the US will be on the Australian business community. It has become

apparent in recent years that Australian business and management culture is increasingly influenced by US mores.

With the foregoing in mind, the Australian APEC Study Centre assembled a team with multidisciplinary expertise to prepare this report. As well as reviewing the traditional impacts on trade between the two countries and of the strategic importance to Australia's wider foreign and trade relations, the report aims to address the impact on Australia's investment interests, the impact on Australia's capacity to succeed in the Information Age and the impact on business and management culture in Australia.

The research group was Alan Oxley, Chairman of the APEC Study Centre and Director of International Trade Strategies, Dr Alan Moran of the Institute of Public Affairs, Patrick Xavier of the Swinburne University and Consultant to the OECD on Information and Communications Technology, David Uren, Director of *themanager.com.au* and Editor of *Asia Inc* magazine and Kristen Osborne, a consultant with International Trade Strategies.

The group received considerable assistance from the Department of Foreign Affairs and Trade, in particular Dr Ashton Calvert, David Spencer, Bruce Gosper, Tim Yeend, Jon Richardson and Rajan Venkataraman. Susan Begley also advised on trade statistics and provided updates on previous DFAT analysis.

The APEC Centre also held a conference in Canberra on 21 June which was well attended by the business community. It received financial support from a number of businesses as well as the Department of Foreign Affairs and Trade, which met the costs of attendance by some American experts. A number of valuable papers were prepared and a number of issues considered in depth. The Centre also consulted on 22 June in Canberra with business groups on attitudes to an FTA. These activities have assisted greatly with the preparation of the analysis.

The common view of participants at the conclusion of the June conference was that a Free Trade Agreement is more important to Australia than had previously been considered. The research group reached the same conclusion as it worked on this report.

Alan Oxley

Australian APEC Study Centre

August 2001



Executive Summary

Introduction

Australia has signalled its interest in negotiating a Free Trade Agreement (FTA) with the United States. Australia is in good company. The success of the US economy over the last decade has excited the interest of many countries around the world in closely linking their economies with the US. In so doing, they hope not only to improve access to the world's largest consumer market, but also to secure the attention and gain the confidence of the world's largest source of investment capital.

While the US had until recently signed only one FTA (ie, the North American Free Trade Agreement, NAFTA), so far this decade it has signed an agreement with Jordan and has begun negotiations with Singapore and Chile. It is also at the forefront of negotiations for a Free Trade Area of the Americas (FTAA) covering the entire Western Hemisphere (except Cuba).

In seeking to negotiate an FTA with the US, Australia would be joining a trend not restricted to the US alone. Global interest in using free trade agreements to expand trade, investment and other economic linkages between countries has increased dramatically in the last decade and a half. Even so, it would be a significant step for Australia. To date Australia has a free trade agreement with only one other country – New Zealand. An agreement with the US would add a new dimension to Australia's trade policy. It would also mean a significant new element in the bilateral relationship with the United States as a whole.

There has already been some debate about the advantages and disadvantages of an FTA with the United States. Arguments so far aired in favour are that an agreement would:

- Increase investment and trade between the two countries;
- Produce dynamic benefits from closer economic links with the world's biggest and most competitive economy and the heartland of the Information Economy;
- Strengthen the overall bilateral relationship; and
- Give momentum to liberalisation in the WTO and in APEC.

Some reservations have also been expressed, the most common being that it would represent a departure from Australia's broad strategy of strengthening economic relations in East Asia and that it would qualify Australia's strategy of pursuing trade liberalisation on a multilateral basis through the World Trade Organization. There is also concern in some quarters that an FTA would result in more competition from US companies or that it might impinge on some sensitive areas of domestic policy.

This report was commissioned to assess the implications for Australia of an Australia-US Free Trade Agreement (AUSFTA). Towards that end, it considers the pros and cons of FTAs in general and the relevance of free trade agreements today, trends in Australia's trade and investment with the United States, what an AUSFTA might cover, and the impact on Australia's economy. It also discusses the implications for Australia's bilateral relationship with the US and implications for Australia's global interests and regional relationships.

The relevance of free trade agreements

The extent to which countries of the world have removed barriers to trade in the last half century is unprecedented. The level of trade among countries has never been greater and the corresponding benefit is that standards of living around the world have never been higher. The underpinning of this system was laid down with the multilateral trading system that was established by the General Agreement on Tariffs and Trade after World War Two and continued under the WTO.

This new system has emerged in parallel with the traditional system of managing relations among states to promote political goals and advance national security. Trade liberalisation is a new tool in international relations. It promotes economic interdependence between countries and, accordingly, where economic interdependence between countries is deep, it can directly enhance national security.

The global interest in FTAs is an integral part of this process of promoting economic integration of states. FTAs are legally binding agreements involving two or several states to remove all barriers to trade between them. In recent years FTAs have become increasingly popular. FTAs are seen as easier and quicker to negotiate than multilateral agreements, as there are unlikely to be as many contentious issues. Furthermore, countries can set more ambitious goals for full liberalisation in the context of an FTA where such goals may not win support in larger forums.

FTAs have become increasingly popular for another reason. Commitment to facilitate freedom of trade and investment between two countries has become an important way of building and cementing a closer relationship between them in a broader context. The proposal for a Free Trade Agreement between the United States and Australia needs to be seen in this context.

Pros and cons of FTAs

A long-standing debate about FTAs focuses on their potential to divert rather than create trade. The theoretical basis for this argument is well understood, by providing special conditions for the partner country, an FTA can divert trade away from the most efficient supplier of a particular good to a supplier in the partner country, with the result being less than optimal allocation of resources. However, such risk tends to be lower where the countries negotiating an FTA do not impose high trade barriers against other countries. This is the case with Australia and the US. Studies on the impacts of FTAs, including by the OECD, have shown that FTAs have produced relatively little diversion and have played a role in encouraging wider trade liberalisation.

FTAs can also lead to practical difficulties. They create a host of new rules which can sometimes be a complication for businesses. For example, FTAs create rules of origin to distinguish between products from within the free trade area and products from outside it and can create new rules on customs procedures, technical standards and labelling. Negotiators need to aim to minimise the cost to business of such rules when negotiating the details of FTAs.

What would an FTA cover?

Based on respective experience from FTAs with Canada and Mexico (US) and with New Zealand (Australia), AUSFTA is likely to cover a similar wide range of issues. An agreement to lower most tariffs to zero should be expected, as well as measures to expand investment and trade in services. Agreements to harmonise standards and facilitate trade would be likely.

Agriculture is likely to be the thorniest issue, with US barriers very high on particular products, such as sugar and dairy products. It is argued by some that the United States would not be prepared to make concessions on some agricultural products and that the value of an FTA would therefore be substantially, if not wholly, removed. On the other hand, the United States has granted concessions to other countries in FTAs, notably Mexico in NAFTA, where Mexico secured long-term commitments to almost full access to US agricultural markets. Furthermore, both Australia and the US have been strong supporters of the WTO principle that FTAs should eliminate tariffs and quotas on substantially all the trade between the parties, covering all major sectors.

An agreement gives Australia an opportunity to bid for improved access to the US agricultural market. Australia may also face challenges from the US, such as to remove the single desk marketing arrangements for exports of grain. Notwithstanding these differences, agriculture should not block negotiation of an FTA. The very broad range of interests that each country could pursue in an FTA should help create scope for negotiating solutions from which both will benefit without compromising vital interests.

Moreover, the agricultural issue needs to be seen in a broader and longer-term context. FTAs provide scope to phase in reductions over longer periods to enable adjustment in the sectors concerned. Furthermore, the current situation regarding agricultural protection in the US is by no means immutable, given changing global production patterns. It should also be recognised that US-Australian linkages in food and agriculture go far beyond difficulties in sensitive sectors: in particular there is very substantial investment by each country in the other's agrifood sector.

An FTA would also create an institutional arrangement where both countries could reach agreement on regulatory issues such as technical standards, business visas and recognition of professional qualifications which, while seemingly mundane, often impede the conduct of business.

Economic impact

Australia's trade and investment with the US has been more dynamic and has grown faster over the last five years than with any other major trading partner.

Trade and investment will expand under an FTA. The Centre for International Economics, Canberra, has modelled the effect of the removal of all barriers to trade between the two economies. Its broadest conclusion is that the Australian economy could expand by as much as \$4 billion. The United States would experience gains of a similar magnitude. Gains to Australia would accrue in all sectors.

However, in addition to the direct impacts of removing bilateral trade barriers, an FTA would have dynamic benefits for the Australian economy. An FTA would link Australia's economy to the world's biggest, most competitive and most innovative economy. Possibilities of economic downturn in the US in the short term notwithstanding, the prospects are that over the next two decades the US economy will remain very strong and will lead the world economy. As well as the greater investment and trade such a closer alliance would deliver, an FTA would enhance Australia's direct access to the world's best practice in development of the Information Economy, business practice and public policy in economic management.

Investment

The United States supplies one third of Australia's foreign investment, more than any other economy. Foreign investment from the US has been growing at an annual rate of 25 per cent, compared to 17 per cent for investment from all sources. Australia ranks eleventh among destinations for US direct investment abroad.

The United States is now host to over 50 per cent of Australia's direct investment overseas, having superseded the UK in 1998 as the leading destination for Australian FDI.

Australia is also the eighth largest foreign owner of US assets. The 134 companies that are ultimately owned by Australian interests had a total value of over \$US59 billion in 1998, employing around 84 000 people.

Foreign investment will continue to be vital to maintaining growth in Australia. An FTA will directly and indirectly boost US investment in Australia.

While the United States is now the largest source of foreign investment in Australia, only one per cent of the offshore stock of investment by US enterprises is in Australia. Australia is competing not just with the rest of the world for investment by US enterprises, but is in effect competing with every one of the 50 States in the USA. This is a very busy and large market in which it is difficult to be seen or heard. The physical distance between Australia and the US and the location in nearly opposite time zones are additional disincentives for Americans to seek to engage with Australia.

Negotiation of an FTA is an event of public policy significance in the US. Conclusion of an FTA is seen by the US business community as an endorsement by the Administration of the partner country's long-term prospects as a place to do business. While the negotiation is under way, the FTA commands as much attention as a very highly priced investment promotion campaign. This process alone will boost Australia's investment stocks in the US.

More directly, an FTA could improve conditions for investors from both countries through putting in place legal guarantees and implementing other measures aimed at providing a further sense of certainty for investors. Such measures would not only encourage US investors to invest in Australia but may also further encourage them to use Australia as a base for operations in the Asia-Pacific region.

Expanded trade

The US market accounts for around 11 per cent of total Australian exports and is the source of one fifth of Australia's imports. Trade between Australia and the US has accelerated over the past five years and would increase in both directions under an FTA.

In recent years, merchandise exports to the US have grown more than exports to any of Australia's other major trading partners. Particularly noteworthy have been elaborately transformed manufactures and wine exports. The changing composition of exports reflects the changing nature of the Australian economy. Whereas resources and agricultural commodities once dominated Australian exports, over the last fifteen years the highest average growth in exports has been in manufactured and processed products and services. The US now takes one quarter of Australia's manufactured exports and one third of its services exports.

The US will continue to be a large market for agriculture and minerals, but it will also be a growth market for manufactures and services. This is likely to be a long-term

trend. Australian industries in these sectors are globally competitive and the US market is largely open.

Nevertheless, there are relatively high barriers in certain sectors, which affect Australian exports. For example, high barriers apply to dairy, sugar, meat and cotton. There are also a few barriers in certain manufacturing sectors, such as shipbuilding, and high tariffs apply to some commercial vehicles, and restrictions, many of which are state-based, act as impediments to delivery of some services particularly the professions.

The agreement among 34 North and South American countries to negotiate a Free Trade Area of the Americas (FTAA) by 2005, creates a very practical interest for Australia as well. Several of Australia's most active competitors in global trade in agriculture will be pressing for preferential access to US agricultural markets in the FTAA negotiations. The FTAA will also constitute a powerful inducement for US investors to invest in Latin American markets. Australia has a keen interest in ensuring that Latin American countries do not secure an advantage over Australia in access to the US market. Especially given the likelihood of the US negotiating more FTAs in the future with more of Australia's competitors, an Australian US FTA constitutes a potentially vital piece of trade negotiating insurance.

Best practice benchmarks for the Information Age

For Australia, one of the most important long-term economic benefits of an FTA with the United States may be the linkages forged between the information economies in each country. A clear lesson from the 1990s was the importance of the information economy for growth.

Australia has not had the dot.com investment boom to the same extent as the US, but adaptation of IT systems in business and society in Australia is almost at the same level as that in the United States. The Economist Intelligence Unit, in its latest assessment of the propensity of economies to fully utilise IT technology, rated the US as first in the world and Australia second.

The United States is the home of the Information Economy and driver of the Information Age. It is likely to remain at the forefront of research and development in this area and at the leading edge of efforts to realise the full potential of e-commerce. Standards developed in the US are likely to become the global standards in the field. An FTA can anchor Australia's economy to these global reference points for success in the New Economy. In addition to dispelling Australia's 'old economy' tag, the closer investment and business linkages that will follow from an FTA will stimulate Australia's adoption of the leading benchmarks of the New Economy that it will need in order to flourish in the Information Age.

Other best practice benefits

Best practice benefits from an FTA can extend to business culture in Australia as well as public policy. Companies learn from each other as much as they draw from the lessons of their own experience. They observe their competitors, suppliers and customers and modify their own strategies to keep abreast of the latest developments. Modern business practices in Australia already draw heavily on US standards and practice, especially in the use of technology as a business tool and in the application of management techniques. It is a process smoothed by Australia's cultural affinity with the US. The growth of trade and investment will amplify the opportunities for businesses to raise their productivity and hence profitability.

Learning from best practice also takes place at the level of government. It has been noted in both Europe and other regions that a process of economic integration between nations can generate a 'policy reform effect' that can enhance the benefits of the process both for internal participants and for businesses from third countries. For example, regional integration might strengthen a country's competition policy or improve public policy in areas like government procurement and intellectual property protection. Such reforms can benefit business, both within the free trade area and from outside it.

Strengthening the bilateral relationship

An FTA would significantly strengthen the bilateral relationship with the United States. This is timely.

Australia and the United States enjoy a genuinely close relationship based on a shared history of cooperation in peace and war, wide-ranging commercial ties and extensive people to people links. The relationship is marked by a shared commitment to democracy, international security, and an open trading system, as well as an interest in maintaining a strong US presence globally and within the Asia Pacific region in particular.

An FTA would help maintain the momentum of the bilateral relationship, with great benefits for both Australia and the US. An FTA would put the Australia-US trade and investment relationship on a similar level to our well established political and strategic relationship. It would reinforce public awareness in both countries, and particularly amongst younger generations, of the enduring relevance of the Australia-US relationship.

Both countries have underlined their commitment to modernising and revitalising the bilateral relationship. As the former certainties of the Cold War recede, along with the passing of generations with directly shared war-time experience, the task of anchoring the rationale of the relationship in the public mind becomes more challenging. In this

respect, an FTA could add a vital dimension to sustaining the relationship as it moves forward into the 21st Century.

An FTA would also create a new mechanism for maintaining a close relationship with the United States at a time when there are new pulls on the United States to pay greater attention to other regions and issues. There is no guarantee that the historic importance of the modernisation of China and the rise of Japan and East Asia will give the idea of the “Pacific Century” a permanent call for priority in Washington. As a global power, there have always been other demands for Washington’s attention. A new and significant contender is the Western Hemisphere.

Democratisation and economic liberalisation in Latin America, with the attendant expansion of trade and investment as well as the growing Latin influence on the United States through migration is returning the Western Hemisphere to the forefront of American thinking about the future. It is in Australia’s long-term interests to be active in maintaining the attention of Washington policy-makers and to encourage US interest in engagement in East Asia. The interests are economic, strategic and geo-political. By increasing US interests in the Western Pacific, an Australia-US FTA is a tangible way of serving these purposes.

Implications for Australia’s trade policy interests

Policy towards the WTO

A leading imperative for Australia’s global trade policy is to maintain the effectiveness and authority of the WTO multilateral trading system. Australia is a global trader, meaning that its exports go to and its imports are sourced from all regions of the globe. This pattern has been crucial to the success of Australian trade over the last few decades and was instrumental in minimising the fall-out from the Asian economic crisis of the later 1990s. Thus, it is in Australia’s interests to seek liberalisation of trade on a world-wide basis and the development of universally accepted rules governing trade.

Furthermore, elimination of global protection of agriculture, a core goal of Australian trade policy, can only be achieved with global solutions through the WTO. The WTO provides the only system through which powerful economies like the European Union, Japan and the United States can be induced to remove unfair trade barriers to exports of agricultural products.

Consequently, no public policy case can be sustained to argue that for Australia negotiation of an FTA with the United States is a credible alternative to negotiations in the WTO. The case for an FTA stands on its own merits, as does the case to prosecute global trade liberalisation through the WTO. The two are not mutually exclusive.

It has been argued that Australia diminishes those global interests by pursuing Free Trade Agreements. However, Australia has shown itself capable of simultaneously pursuing both its overriding global goals and bilateral or regional initiatives. In addition, the global record now suggests that regional and bilateral liberalisation supports, rather than diminishes, global liberalisation.

Countries willing to pursue a more ambitious agenda for liberalisation create momentum for such measures to be considered in the multilateral context. Negotiation of an FTA between Australia and the United States creates an opportunity to reach agreement on measures to promote economic integration that can then be used as benchmarks in the global negotiations. The agreement between Australia and New Zealand in ANZCERTA to open services markets served as a benchmark for the negotiations in the Uruguay Round to create a new system for global liberalisation of trade in services. There are opportunities, for example, in agriculture, investment, harmonisation of standards and enhancement of public confidence in the safety of traded food, for an Australia–US FTA to develop similar cutting edge outcomes.

The degree of commonality between Australia and the United States today on economic policy is striking. The United States will not have negotiated an FTA with a more open economy. Australia and the United States would have a golden opportunity to make their FTA an exemplar on how to use FTAs to advance both their mutual economic interests and encourage wider liberalisation in other bilateral agreements, regional fora and the WTO itself.

Policy towards APEC

For over a decade, a leading international policy interest of successive Australian Governments has been to secure closer engagement with Asia, including by economic integration. A principal vehicle has been APEC, the formation of which was an Australian initiative. Australia has also supported sub-regional trade linkages such as the proposal to join the ASEAN Free Trade Area (AFTA) and the Australia–New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).

Some analysts in the APEC region have expressed concern that the proliferation of proposals for FTAs and sub-regional arrangements undermines APEC. There is a counterview, shared by many governments in the region, that sub-regional agreements actively contribute to the achievement of the long-term goals in the APEC Bogor Declaration to eliminate barriers to trade and investment by 2010 in industrialised economies and 2020 in developing economies. In the same vein, an Australia–US FTA can support the general strategy of promoting economic integration among APEC economies.

The economic crisis in Asia has blunted capacity and interest in trade liberalisation and domestic market reform. It has similarly slowed progress by members of ASEAN in implementing the commitments to reduce tariffs under the ASEAN Free Trade Area. A

number of members of APEC have embarked on proposals for new sub-regional arrangements, although their prospects remain unclear

However, where open economies, like Australia and the US, are willing to execute bilateral FTAs, there is a distinct benefit in the demonstration effect for the rest of APEC. It shows that some members are taking action that is consonant with the long-term commitments in the Bogor Declaration to eliminate barriers to trade and investment.

As described in the previous section, an FTA with the United States is also a tangible way of maintaining a US focus on economic integration in the Asia Pacific region at a time when developments in the Western Hemisphere are demanding more attention from US policy-makers. Continuing US leadership in the region is vital to the success of APEC and as such is in Australia's own interests.

Implications for Australia's regional relationships

One question consistently raised about an FTA is the impact on Australia's relations with third parties. The question has political and economic dimensions, but the most commonly aired question is political – can Australia strengthen its relationship with the US without raising questions in East Asia about its commitment to East Asian regionalism?

There has been no suggestion from any government in East Asia that Australia has diminished the priority it attaches to economic integration among Asia Pacific economies. Australia remains a leading proponent of APEC and it embraced the proposals from ASEAN to link the ASEAN Free Trade Area with the Australia-New Zealand Closer Economic Relations Trade Agreement. It was failure of ASEAN countries to agree among themselves to proceed with this concept that put the idea on hold. Australia is nevertheless an enthusiastic participant in the less ambitious goal of building a Closer Economic Partnership between ASEAN and Australia and New Zealand.

Australia is also negotiating a free trade agreement with Singapore and has agreed to a joint scoping study with Thailand on a possible free trade agreement. Australia initiated an exploration with Japan about measures to strengthen the economic relationship, which concluded with a major study that identified strategies such as negotiation of a Trade and Investment Facilitation Agreement.

Perhaps the most tangible commitment by Australia in recent years to economic development and stability in the East Asian region was its pledges totalling four billion dollars to provide support for the balances of payments of Indonesia, Thailand and South Korea following the impact of the Asian currency crisis. Only Japan was more generous.

So long as Australia is negotiating agreements with East Asian Governments and stands ready to pursue any proposal to achieve economic integration with other countries in East Asia, pursuing an agreement with the US should not detract from Australian engagement with East Asia. While maintaining its support for economic integration in and with Asia, there is no good reason why that goal should lead it to set aside proposals to enhance economic interdependence with countries or regions outside East Asia where significant benefits can be won.

The second impact to consider on other countries in the region is whether or not an Australia-US FTA would create trade diversion and damage the interest of other trading partners. As noted above, the risk of trade diversion from an Australia US FTA is small so long as barriers to other countries are low and continue to be lowered. Preliminary analysis of the impact of removal of barriers in an FTA suggest no significant impact on the trade of Australia's other trading partners. In fact, the Centre for International Economics' analysis indicated very little trade diversionary effect. In fact, New Zealand would experience a small positive economic gain.

In light of increased interest in recent years in regional and sub-regional agreements, there has been advocacy of principles to be followed when negotiating agreements to minimise the risk of trade diversion. Two such principles are that agreements should be comprehensive and structured so that other parties can join them.

Australia should certainly seek to ensure that commitments in an FTA are comprehensive. That is in its self-interest. It is possible to set up a bilateral FTA in a way that other countries could join. Whether this proved workable in practice might be problematic, given the particular market access interests, and sensitivities, each country would be expected to have with prospective members.

Conclusion

The benefits for Australia in negotiating an FTA with the United States are significant and wide-ranging. There will be an immediate benefit of attracting greater investment from the United States and increased trade as a result of the removal of trade barriers. A Free Trade Agreement between Australia and the United States would inject a new dynamism into the liberalisation process.

The long-term benefits are twofold. The first is a strengthening of the overall relationship with the United States. It is appropriate that the defence core of the relationship be broadened by adding an economic core given that in today's world, nations mark closeness of relationships between states by economic linkages as much as military linkages.

The second is the importance of a close economic relationship with the United States as the globalisation of the world's economies proceed and, more importantly, the impact of the Information Age continues to evolve. The US will be the world's leading

economy at least into the first half of the twenty-first century. As the home of the Information Economy, it will continue to set the global standards for economic success. A key economic benefit of an FTA will be to tie economic reference points in Australia more closely to those of the world's leading economy.

The US economy will continue to expand. If Australian business is attuned to US standards and business practices, expansion into the US market will be facilitated.

Australia has always been a global trader and is likely to remain so. Asian markets will remain very important to Australia. To succeed in those markets Australian business has to adopt the highest standards, the world's best practice. Closer alignment with US best practice would increase the chances of success in those markets.

Most of the debate over whether or not Australia should seek an FTA with the United States is based on two questions. Can we do that and maintain our interests in global trade structures like the WTO or important regional structures like APEC? Can we maintain engagement with Asia and strengthen the relationship with the US at the same time? It is a debate conducted largely among the foreign and trade policy cognoscenti in Australia.

When the questions are posed outside that rather narrow group of specialists, the inevitable response is "why not?" This response not only has the virtue of common sense, it reflects a basic reality. From the time Australia began its long process of engagement with Asia in the late sixties, it has never been perceived as being at the expense of long-standing and traditional relations, such as with New Zealand, the United States and Europe. Australia's historical trade and investment patterns show it to be a global trader and this is not likely to change.



1. Introduction

Australia is interested in negotiating a Free Trade Agreement (FTA) with the United States. Australia is in good company. Global interest in using free trade agreements to expand trade, investment and other economic linkages between countries has increased dramatically in the last decade and a half. Even so, it is a significant step for Australia. To date Australia has a free trade agreement with only one other country – New Zealand. An agreement with the US would add an entirely new dimension to the bilateral relationship.

The proposal for a free trade agreement has stimulated some conferences and some debate in the media. The idea of an FTA is still relatively new so reactions to date have been generally positive. Arguments aired in favour so far suggest that an agreement would:

- Produce dynamic benefits from closer economic links with the world's biggest and most competitive economy and the heartland of the Information Economy
- Increase investment and trade between the two countries
- Give momentum to liberalisation in the WTO and APEC, and
- Strengthen the overall bilateral relationship.

The most commonly expressed reservations about an FTA are that it might:

- Undermine the credibility of Australia's efforts to strengthen relations with Asia
- Weaken the authority and effectiveness of the multilateral trading system based on the WTO
- Require Australia to take domestically sensitive measures action in sectors such as cultural industries to open them to increased US competition
- Fail to deliver significant improvements in access to US markets in key agricultural sectors with high barriers.

With anti-globalisation sentiment prominent, an FTA would also be likely to attract criticism as an instrument of trade liberalisation that intensifies the adverse effects of globalisation. The role of the US as an engine of the global economy, and the extent of its economic and cultural influence, will presumably add to the piquancy of such criticism.

As the debate so far has shown, there are significant potential benefits for Australia. An econometric analysis of the direct economic impact by the Centre for International Economics concluded that an FTA would expand trade and boost economic growth in both countries. This report has been commissioned to assess the broader implications that are less amenable to quantitative analysis. How will an agreement affect relations between the US and Australia, particularly trade and investment? How would an agreement affect Australia's global interests? Preparations are under way in the World Trade Organization to relaunch the next round of multilateral trade negotiations. How do the two activities relate? How would Australia's trading partners be affected? Australia is committed to engagement with Asia and development of APEC. What effect would an agreement have on those objectives? What would be the implications if Australia did not have a free trade agreement with the United States?

This introduction to the report will review the nature of free trade agreements, assess the global setting for trade liberalisation, consider the role of free trade agreements in international relations, and set out the approach taken in the report to assessing the implications of an FTA.

What Free Trade Agreements do

Free trade agreements are legally binding agreements between two or several states to remove all, or nearly all, barriers to trade between countries. They are instruments for trade liberalisation and economic integration.¹ FTAs have also become touchstones for closer relationships among their members. The extent to which countries of the world have removed barriers to trade in the last half century is unprecedented.² The level of trade among countries has never been greater and the corresponding benefit is that standards of living around the world have never been higher.

Free trade agreements are usually differentiated from multilateral trade agreements which are managed by the World Trade Organization. The core agreement of the WTO is the General Agreement on Tariffs and Trade (GATT). The aim of the GATT is to standardise how countries regulate trade so that all countries can benefit, and to open up world markets by removing restrictions on trade. Using GATT rules, countries have progressively opened up world trade since 1948. This process of multilateral trade liberalisation is slow and difficult. All countries participate (today more than 140

1 Free trade agreements need to be differentiated from general trade agreements. Countries often sign agreements to promote trade with each other. The commitments in these agreements are to facilitate and promote trade such as making customs procedures less bureaucratic or mounting joint trade promotions. They are generally not legally binding. Free trade agreements contain legally binding commitments to reduce controls on imports such as tariffs or quotas.

2 Many point out that the freedom to trade and invest between 1870 and 1913 was comparable. Comparisons can be taken only so far. The modern system of the nation state had not fully evolved and a significant amount of global commerce was conducted under Imperial rules.

countries are members of the WTO) and all areas of trade are covered so reaching agreement is difficult. In free trade agreements, liberalisation is easier. Fewer countries are involved. It is typical for parties in free trade agreements to agree to remove all barriers within finite periods. By contrast, in multilateral processes it is common to settle on more modest targets of agreeing to reduce, rather than eliminate, trade barriers.

Countries mainly join free trade agreements for the following reasons – to support domestic economic reform by engaging in trade liberalisation, to secure access to the markets of other countries, and to strengthen general economic relationships with other countries. To date, Australia has negotiated a free trade agreement with only one other country, New Zealand.

Multiple paths to liberalisation

There are four main ways in which countries can reduce trade barriers –unilaterally, through bilateral agreements, through regional or plurilateral agreements, or through the multilateral processes of the WTO. Most countries are members of the WTO. Its multilateral processes are activated about once a decade when a global negotiation is held to reduce trade barriers. The last set of negotiations was the Uruguay Round which ran between 1986 and 1994.

It is becoming increasingly common for WTO members to liberalise unilaterally or to undertake bilateral or plurilateral liberalisation to complement participation in multilateral liberalisation. This is also Australia's experience. It unilaterally liberalized controls on imports to gain the benefits of making the economy more efficient and improve growth. And it negotiated a bilateral agreement with New Zealand. It did both while simultaneously negotiating multilateral reductions in the Uruguay Round.

Whereas the European Community has negotiated free trade agreements with a wide range of countries,³ the United States did not negotiate free trade agreements until the late eighties. It relied on multilateral processes to achieve trade liberalisation. That changed with the negotiation of a free trade agreement with Canada in 1988, then the US and Canada negotiated agreements with Mexico to create the North American Free Trade Area (NAFTA). The US did not cease working the multilateral processes as it developed bilateral and regional trade agreements. It worked on both at the same time. US interest in regional and bilateral trade agreements has intensified. The US Administration has committed to negotiate a comprehensive free trade agreement covering all the nations of North and South America except Cuba and it has begun negotiations on free trade agreements with Singapore and Chile.

3 The Agreements tended to provide preferential access for the other party to a limited range of products in the markets of the EC, rather than removal of all barriers, and they almost never provided access for agricultural products.

Interest in negotiating bilateral and regional trade agreements is now worldwide. Regional trade agreements have been negotiated in South-east Asia⁴, Latin America⁵ and Southern Africa.⁶ In East Asia, Japan, Korea, Singapore and New Zealand have all initiated discussions about a variety of bilateral agreements. For its part Australia has initiated negotiations with Singapore on a bilateral agreement and announced a joint scoping study with the Government of Thailand on a possible FTA.

There is also renewed interest in multilateral trade liberalisation. The global trade community is about to turn its attention once again to the multilateral trade process. Following the failure of WTO Ministers at the meeting in Seattle in November 1999 to agree to start a new round of global trade negotiations, a new Ministerial WTO meeting will be held in Qatar in November 2001 to try again. Preparations for that meeting have stimulated renewed debate about the impact of trade liberalisation and globalisation.

The Global Setting for an FTA

It is sometimes said that the era of trade liberalisation and the process of globalisation which accompanied it is on the wane, evidence being the worldwide pattern of public protest against global economic conferences since the WTO meeting in Seattle in November 1999.

Anti-globalisation critics maintain that trade liberalisation widens the gap between rich and poor, favours large corporations and works against the interests of small and weak developing economies. The positions of the governments of developing countries suggest otherwise. In recent years the number of countries wanting to join the World Trade Organization has increased, not decreased. Thirty countries, are in the queue to join the WTO. The benefit that most seek is that membership will buttress their efforts to get the market economy functioning better inside their own economy. This was the avowed reason China applied to join the WTO and why Russia has applied.

The economic case to maintain momentum for trade liberalisation is very strong. It is the emphasis that trade liberalisation gives to using the market to direct allocation of resources in an economy that sets most anti-globalisation critics against it. Yet it is precisely the failure to encourage this that is causing growth to lag in Asia and why efforts to promote development throughout the developing world are languishing. It is no accident that the lack of support for trade liberalisation among a number of East Asian economies has occurred at a time when growth is lagging.

Despite the claims by anti-globalisation critics that globalisation has widened the gap between rich and poor, the record is that global standards of living have never been higher and the relative number of poor people in developing countries has never been

4 The ASEAN Free Trade Area.

5 Mercosur, a common market between Argentina, Brazil, Paraguay and Uruguay.

6 SADC, the Southern African Development Community

lower. Countries, developed or developing, that have embraced open market policies and liberalised trade have on average raised the standard of living of their people much more than those that did not.⁷ To damn now the only economic model that has been proven to address the problems of weak growth in developing countries is to discount the only effective strategy available to generate growth in poor and small economies.

Globalisation has brought great benefits to most countries. It has also altered the way in which international relations have been conducted and has given a new importance to trade agreements because of the economic integration they foster. An analysis of the importance of globalisation and impact of globalisation is set out in Annex 1.

Globalisation is a more important and more profound process than most criticisms of it suggest. It has altered the way in which nation states cooperate and created new opportunities for states to enhance prosperity and, in certain circumstances, improve national security.

One of the great innovations in international relations in the twentieth century was the common accord among nations to bind in international law the principles governing international trade. These rights have been established by the General Agreement on Tariffs and Trade as global rights in a multilateral trading system. They have also been created in regional agreements among groups of states and in bilateral agreements between states to remove barriers to commerce between those states. The extent to which states collaborate together for mutual advantage has been elevated to an entirely new plane.

The emergence of a global community makes the twentieth century a watershed in human history. Global markets have been created. Producers are now able to sell their products almost anywhere. The application of information technology to the global market place has resulted in the creation of the Information Age, which will be a new driver of growth for decades to come.

This new system of economic relationships bound by international legal rights has emerged in parallel with the traditional system of managing relations among states to promote political goals and advance national security. The building of economic linkages and the attendant interdependence that it creates is a new tool in international relations. Where economic interdependence between states is deep, it can directly enhance national security.

How globalisation benefits Australia

Globalisation has delivered significant benefits to Australia. Globalisation is fundamentally about open societies and freer movement of goods, services, capital and

⁷ A comprehensive resource on the statistics on the impact of globalisation and the arguments in favour and against is available on the APEC Study Centre website www.apec.org.au.

people. These are threatening to some societies. But in Australia's case they are a deep part of the tradition of economic development in Australia since European settlement.

Australia has already reaped the benefit of opening up its own economy. Record levels of growth in recent years are testimony to that benefit. Australia has a great deal to gain from seeing others open their markets for trade and increased flows of investment. Markets for many farm products in the European Union, Japan and the United States remain closed to Australian exports. There are significant barriers to Australian exports of automobiles and processed food in the East Asian region. Trade liberalisation will bring down those barriers, the result being more business for Australian companies and more, well-paid jobs for Australian workers.

The new role of Free Trade Agreements

As noted above, Free Trade Agreements in international affairs are now seen as instruments for achieving closer economic relations as much as mechanisms to remove trade barriers.

There is still apprehension on economic grounds about use of FTAs for trade liberalisation because they have traditionally been considered second best instruments for trade liberalisation. It has long been understood by economists that if all countries participate in a global market in which each is able to trade what each is best at producing, the economic return to each economy is optimised. In contrast, agreements among small numbers of countries to remove barriers between themselves and not other trading partners can distort trade and damage economic interests.⁸ Broadly speaking this is why the multilateral trading system, established by the General Agreement on Tariffs and Trade (GATT), is regarded as the best system for trade liberalisation. Most countries participate in it.

Such concerns about trade diversion are reduced greatly if barriers to trade in the countries entering the agreement are low, as in the case of Australia and the United States.⁹ It is very unlikely the interests of other countries would be damaged by trade diversion from an Australian US FTA. The analysis by the Centre for International Economics on the impact of removal of all trade barriers between Australia and the

8 The concern about agreements between pairs or small groups of countries is that if they remove trade barriers between them but not with other trading partners, the result could be diversion of trade towards the parties inside the agreement at the expense of parties outside. The arrangement could even be to the long-term disadvantage of the parties inside the agreement. Such an arrangement over time might result in less growth and accumulation of wealth than if they liberalised instead through the multilateral system. The touchstone of whether a free trade agreement contributes optimally to total net wealth is whether or not the effect of the arrangement is to create more trade than is diverted.

9 They also disappear if the members of an FTA lower trade barriers with third parties at the same time as they are lowering trade barriers between themselves. The Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) was not considered as having diverted trade because both countries unilaterally reduced their trade barriers with other trading partners in parallel with the ANZCERTA program to eliminate all trade barriers between the two countries.

United States¹⁰ shows that overall an agreement would not result in trade diversion. Moreover, there is now a widespread view among economists that generally liberalisation between pairs or small groups of countries gives momentum to global liberalisation rather than undermining it.

In this era of unprecedented, deeper economic interdependence, free trade agreements typically span a wider range of issues than removal of barriers to trade in goods. They now can encompass services, intellectual property, investment, harmonisation of technical standards, harmonisation of business law and trade facilitation.

Free trade agreements have become new instruments for demonstrating close relations with other countries, as well as for securing the economic benefits of greater economic interdependence. The implications of a free trade agreement between Australia and the United States need to be assessed in this broader context as well as in the more traditional one of directly enhancing trade and investment flows.

Approach to the Study

Chapter 2 of the study will provide an overview of the trade and investment relationship between Australia and the United States.

The study will then review the impact on the Australian economy. It will begin (Chapter 3) with a discussion of the advantages and disadvantages of FTAs. Chapter 4 will cover what an FTA between Australia and the US might look like and Chapter 5 will assess the impact on Australia's trade and investment. It will conclude with a review of the other dynamic impacts, particularly on the Information Economy and Business culture (Chapter 6).

The study will consider the broader implications for Australia's international policy, first on bilateral relations (Chapter 7), then on Australia's global interests (Chapter 8) the implications for Australia's regional interests (Chapter 9).

¹⁰ Centre for International Economics, *Economic Impacts of an Australia - United States Free Trade Agreement*, Canberra, 2001. See http://www.intecon.com.au/reports_list.htm



2. Australia/United States trade and investment

Introduction

The United States plays a major role in the Australian economy. The trade and investment relationship with the US is more dynamic than with any other major trading partner. Trade and investment have grown faster with the US in the last five years than with any other country.

The US market accounts for around 11 per cent of total Australian exports and is the source of one fifth of Australia's imports. The US supplies one third of all foreign investment. It is the largest single country source. Australia is host to about 4 per cent of US foreign investment, similar to the share of US investment in Mexico and Japan.

Trade and investment between Australia and the US has accelerated in recent years. Australian exports have experienced strong growth to the US, particularly in elaborately transformed manufactures and wine exports. Over the past five years, merchandise exports to the US grew by more than exports to any other major trading partner. The US also remains the single most important partner for trade in services, making up almost two thirds of Australia's services trade. As with goods, services trade with the US has grown more rapidly than with other major trading partners in recent years.

Foreign investment from the US has been growing at an annual rate of 25 per cent, compared to 17 per cent for investment from all sources over the last five years. The United States is now host to over 50 per cent of Australia's overseas investment abroad, having surpassed the UK to become the largest destination for Australian foreign direct investment in 1998.

Australia ranks eighth among foreign owners of US assets and eleventh among destinations for US foreign investment.

Australia, being only 4 per cent the size of the US economy is less important to the US as a trading partner. United States exports to Australia account for just 1.6 per cent of total United States exports and Australia is the source of only 0.7 per cent of United States imports.

The importance of the United States in Australian trade

Japan and the United States vie to be Australia's largest country trading partner. In 1999–2000, total trade of each with Australia was around \$32 billion. Japan is Australia's largest single export market, accounting for 19.3 per cent in 1999–2000 (the US is the second largest market, with 9.8 per cent). The US is the largest single source of imports, accounting in the same year for 20 per cent, Japan accounting for 12.8 per cent).

There are significant differences in the growth and composition of trade. Since the Asian currency crisis, Australian exports to the US have grown faster than with any other major trading partner. In contrast, export growth to Japan has lagged average export growth, reflecting the poor growth in the Japanese economy.

Within the composition of trade for 1999–2000, exports to Japan were dominated by primary products. Seventy per cent of exports were primary products and 4.3 per cent were elaborately transformed manufactures (ETMs). In the case of the US, 57 per cent were primary products and 24 per cent were ETMs. Over the last decade and a half, ETMs have on average been Australia's fastest growing export sector. The US is the largest single market (19 per cent) for Australia's ETM exports.

The US is also the single most important trading partner for trade in services, making up almost two thirds of Australia's services trade.

A more complete analysis of Australia's international trade and the relative place of the United States in it is set out in Annex 2.

Merchandise Trade between Australia and the United States

Table 2.1 Total trade between Australia and the United States

Financial year, million A\$

	1984–85	1989–90	1994–95	1999–00
Exports	3458	5426	4643	9577
Imports	6426	12373	16044	23003
Trade balance	-2968	-6947	-11401	-13426

Source: Australian Bureau of Statistics

Australia has a trade deficit with the US. Exports to the US in 1999–2000 were \$9.6 billion and accounted for a little under 10 per cent of Australia’s total exports. Imports from the US were 21 per cent of the total at \$23 billion. The US economy has similarities with that of Australia, both countries are efficient agricultural producers and major mineral producers and exporters. Total trade is shown above at Table 2.1 and growth below at Table 2.2.

Table 2.2 Growth in trade between Australia and the United States

Financial year, percentage growth

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
Export growth	6.49%	-9.66%	-5.36%	2.73%	-8.51%	-0.52%	19.64%	41.04%	2.44%	19.95%
Import growth	-7.26%	2.34%	10.74%	7.79%	14.46%	9.36%	0.55%	12.42%	5.34%	10.10%

Source: Australian Bureau of Statistics

Between 1984 and 1990, the US share of Australian exports ranged between 10.5 per cent and 11.4 per cent. In 1984, exports to the US were \$3 billion. Primary products accounted for 84 per cent of exports and manufacturing 16 per cent. By 1990, exports had almost doubled to over \$5.8 billion. Primary products were just over \$4 billion (72 per cent) and manufacturing comprised approximately \$1.6 billion (28 per cent). Exports of ETMs more than tripled their 1984 levels.

Within the five years between 1990 and 1995, exports to the US fell considerably, with primary products experiencing negative trend growth. This was primarily due to a fall in the exports of three primary products – meat, crude oil and alumina – due to restricted access to the US market and the development of other markets outside the US.¹ Over the five year period, exports of ETMs increased by 22 per cent. The US share of Australian exports fell to 6.9 per cent.

In recent years, Australian exports to the US have been rising steadily. In calendar 2000, exports to the US were over \$10 billion and comprised nearly 10 per cent of all Australian exports. Primary products recovered from their 1995 levels. The value of crude oil exports increased substantially due to favourable oil prices and wine exports increased considerably. Although imports remain in excess of exports, export growth has tended to be faster than import growth. ETMs grew over 134 per cent above 1995 levels. Primary products accounted for 55 per cent of exports and ETMs accounted for 35.5 per cent.

¹ Department of Foreign Affairs and Trade, *Australia – United States Trade and Investment Review*, 1996, p55.

The overall trend in the US import share has been relatively stable at 20–23 per cent of the total. In the case of imports, the variety of US outputs means no one sector of manufactured goods dominates. Aircraft and parts, telecommunications equipment, computers and measuring and controlling instruments and car engines are the most important items. But together these account for only 30 per cent of the total.

The aggregate export and import trends disguise some major trade shifts. They are discussed in greater detail at Annex 2.

Australia's Services Trade with the US

Trade with the US for both goods and services grew much faster than the average. One reason for this is undoubtedly the fact that US trade in total grew rapidly in the period and we took our share of the growth in world demand generated by this. The US remains a major net exporter of services to Australia. In 1999–2000, compared to services exports of \$4.6 billion, Australia's imports were \$6.4 billion. Table 2.3 below gives a breakdown of our trade in services with the US since 1996–1997.

Table 2.3 Australia's Trade in Services with the US

\$million

		1996/97	1997/98	1998/99	1999/00	% change*
All Services	Exports	3220	4097	4394	4588	42
	Imports	4949	5521	5662	6248	26
Transport	Exports	617	671	654	722	17
	Imports	1069	1273	1065	1244	16
Travel	Exports	809	981	1136	1287	59
	Imports	1307	1355	1317	1578	21
Communications	Exports	257	376	223	288	12
	Imports	117	153	160	348	197
Insurance/Financial	Exports	511	577	584	555	9
	Imports	333	503	467	479	44
Computer/Information	Exports	100	336	449	442	342
	Imports	133	142	169	167	26
Royalties/Licences	Exports	177	290	263	330	86
	Imports	769	856	983	1036	35
Other business	Exports	576	704	855	815	41
	Imports	656	708	779	731	11
Other	Exports	173	162	230	149	-14
	Imports	565	531	722	665	18

*1999/00 over 1996/97

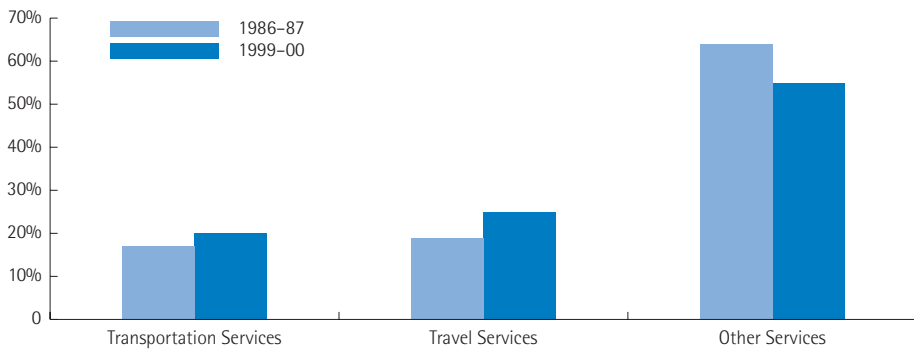
Source: Department of Foreign Affairs and Trade

During this period both exports and imports of services with the US have grown strongly, focused on transport and travel. Trade in services with the US has been characterised by a commensurately greater proportion of services trade in finance, computer/information services and other business services compared with services trade as a whole.

Over a longer time frame of a dozen or so years, the nature of service trade has changed. Travel and transportation have smaller shares (due to relatively lower prices) and there has been a growth in the “Other services” category. This is discussed in detail at Annex 2.

By contrast to the trends in services exports, travel and transportation have tended to show an increasing share of Australian services spending in the US. Figure 2.1 illustrates this.

Figure 2.1 Share of Selected Services in Australian Imports of US Services



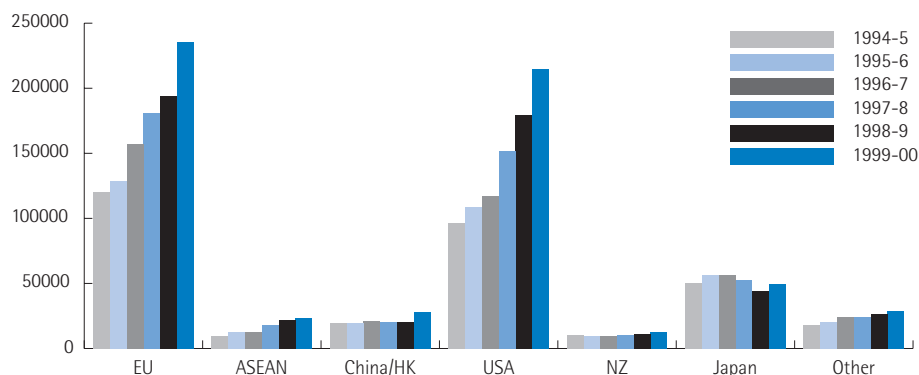
Source: Australian Bureau of Statistics, Cat 5363, various issues

US Investment in Australia

According to ABS data, investors in the USA presently account for over one third of Australia’s investment inflow. It is the largest single country source of investment in Australia. The total value of US investment in Australia amounted to \$215 billion in 1999-2000. As Figure 2.2 below illustrates, foreign investment from the USA is slightly below that from the EU aggregated with these two sources dwarfing all others.

Over the past five years, the value of total foreign investment has increased at an average annual rate of 17 per cent. Investment from the US has increased at an average rate of 25 per cent. Australia is a significant venue for US investment. It accounted for about 4 per cent of the total stock of US Foreign Direct Investment abroad in 1999, a share similar to that of NAFTA partner, Mexico, and comparable to that of much bigger economies like Japan and France.

Figure 2.2 Foreign Investment Levels in Australia



Source: Australian Bureau of Statistics, Cat 5363

US Investment in Australian Privatised Businesses

The privatisation of government owned assets in Australia was a major policy feature during the second half of the 1990s. US businesses tend to have been the most important foreign investors, buying 28 per cent of the assets by value. It is in the energy sector that the US buyers have dominated. US buyers took major shares in the Victorian distribution and transmission privatisations. Four of the five Victorian electricity and two of the three gas distribution businesses were bought by US energy companies; several of the electricity businesses have since had ownership changes. US firms have also been active in buying gas pipelines in other states and have bought and constructed power stations in Victoria, Western Australia and Queensland.

These developments have led to a new wave of US businesses actively involved in Australia. In addition to the traditional heavyweights like Ford, General Motors, General Electric, IBM, Kellogg's, Exxon etc., we now have firms like Duke Energy, EPIC, Mission, Texas Utilities, AES, Utilicorp, and AEP as major US investors.

In addition to these major energy investors, the privatisations have brought US firms like RailAmerica, and Genesee & Wyoming into Australia.

Investment in Agrifood businesses

Agriculture and food processing is a notable and expanding sector for US investment in Australia, reflecting in part Australia's growing importance as a food exporter to Asia. Those corporations range from long established major US agrifood corporations such as Cargill, Kraft Foods and Coca-Cola, right through to much smaller family-owned US agrifood companies such as JM Smucker Company and the OSI Group. Some, like Kraft Foods, Kellogg Co and HJ Heinz, have been active in Australia for well

over half a century; while others have arrived only recently, such as ConAgra, Archer Daniels Midland and Chiquita.

Australian Investment in the United States

According to the US data, Australia ranks eighth among foreign owners of US assets.² About 1.7 per cent of foreign owned assets in the US are ultimately owned by Australian companies, which together employed around 84,000 workers in 1998.

When analysed as a cumulative stock of foreign direct investment³, Australian direct investment in the US totalled \$US13 billion in 1999, the eleventh largest source of foreign investment to the United States. This comprised a little over 1.5 per cent of the total stock of foreign direct investment. Australian Bureau of Statistics data, which use a more accurate assessment of the market value of assets, put the June 2000 level of Australian direct investment in the US at \$89 billion (\$US46 billion), a fivefold increase since 1995.⁴ This made the US easily the most important destination for direct Australian investment abroad, accounting for 51 per cent of the total. When portfolio investment to the US of \$43 billion is included, we find the US accounting for 2 per cent of Australia's total foreign investment.

In 1998, there were 134 companies in the US ultimately owned by Australian interests, most having multiple operations. Their total value was around \$US59 billion (\$96 billion). This compares with the 2000–2001 Australian 'all ords' market capitalisation of \$653 billion.

Australian owned companies are prominent in broadcasting, building materials manufacture, mining, steel manufacturing and real estate. Australian owned firms have shown an increased presence more recently in information technology and wine.

Prominent investments include many of Australia's largest companies in all sectors – resources, agriculture, manufacturing and services. A list of leading Australian investors in the US is included in Box 2.1 below.

2 US Department of Commerce: Bureau of Economic Analysis, *Foreign Direct Investment in the US: operations of US affiliates of foreign companies*, (1998). This survey of all US companies with more than 10 per cent foreign ownership represents the most accurate picture of Australia's investment interests in the US. Its key advantage over Balance of Payments data is that it identifies the ultimate owner of the investment rather than the first non-US owner. The first seven countries on the list of foreign owned assets in the US are the UK, Japan, the Netherlands, Germany, Canada and Switzerland, which together account for around 80 per cent of the total.

3 Bargas, S.E., *Direct Investment Positions for 1999*, Survey of Current Business, July 2000, Bureau of Economic Affairs.

4 Australian Bureau of Statistics, *Balance of Payments and International Investment*, Cat. 5363.0 1990–2000. The equivalent US Bureau of Economic Affairs data use historical cost valuations of the original investment flows. This can be misleading when trying to assess the level of activity: the investment flows are valued at market prices and large capital flows may not necessarily be reflected in increases in the measured investment position.

Box 2.1 Leading Australian investors in the United States

- **News Corporation**, although nowadays having a predominantly non-Australian share register, is one of the world's largest media companies. News Corporation's diversified global operations cut across all facets of publishing and broadcasting.
- **Lend Lease**, through Lend Lease Real Estate Investments, manages around \$US41 billion worth of real estate in the U.S. primarily in shopping centres and office space.
- **Westfield** is a major player in the U.S. shopping centre market, with interests in 40 major retail centres branded nationwide as 'Westfield Shoppingtowns' across 9 states.
- **BHP Billiton** has major U.S. interests in petroleum exploration and production and thermal coal mining. BHP Petroleum is a highly successful leader in exploration for offshore petroleum in the Gulf of Mexico,
- **CSR** is one of the largest construction materials companies in North America through its U.S. subsidiary, which operates at more than 250 sites across 30 states and employing more than 9000 people.
- **Orica North American Explosives** offers a comprehensive distribution network of explosives systems, services and products through 32 sites across the U.S.
- **Ansell**, which remains 80 per cent owned by Pacific Dunlop, makes more than 50 per cent of global sales in the U.S. market.
- **PBR Automotive**, a division of **Pacifica**, is a major supplier of brake components to the U.S. market through its plants in Columbia, South Carolina, and Knoxville, Tennessee.
- **Pasminco** operates two underground zinc mines at Gordonville and Clinch Valley in Tennessee and an electrolytic zinc plant in Clarksville, Tennessee
- **Tower Software's** US operation, based in the Washington D.C. area, is focused on support for its widely used TRIM Captura electronic document and records management software solution.

Box 2.1 continued

- **Southcorp** is a major player in the U.S. wine market, not only through its exports from Australia, but also through its Californian wine operation, Seven Peaks.
- **LookSmart**, founded by an Australian couple, is a major search engine for the Internet, employing more than 500 people in the U.S..
- **Simsmetal America** operates public Recycling Centres and scrap processing facilities and mill services in 13 locations in California, Virginia and Illinois.
- **James Hardie** is the largest manufacturer of fibre cement products for use in residential construction and is a leading company in the U.S. siding market. It also has a large gypsum wallboard operation.
- **Wattyl** generates around one quarter of total sales revenue from its U.S. operations, which includes a production plant in Baltimore.
- **Western Mining Corporation** owns 40 per cent of Alcoa World Alumina and Chemicals (AWAC), the world's largest alumina producer.
- **Fosters**, through Beringer Blass, manages six Californian wineries, an investment worth around \$2 billion.
- **Pratt Industries** has major operations throughout the Eastern USA, covering all aspects of corrugated packaging production, with headquarters in Georgia.
- **QBE** provides general insurance and reinsurance services in most states, employing 70 people, with headquarters for the Americas in New York.
- **Village Roadshow's** production division, based in Los Angeles has as production partnership with Warner Bros. Its most successful movie to date has been *The Matrix*, one of the 25 highest grossing films of all time.
- **Austral**, the fast-ferry maker from Perth, has a joint venture with a US shipbuilding company in Mobile Alabama expected to be employing 1000 people within 5 years.

Conclusion

The trade and investment relationship between Australia and the United States reflects the similarities between the economies and the general openness of each economy. The US has been a market for Australian agricultural and minerals products for many years, although some agricultural industries face trade restrictions. The economic relationship, already strong, is growing. This reflects the new global competitiveness of the Australian economy, particularly in the manufacturing and services sectors.

Australian investment in the United States has risen significantly, reflecting competitiveness in particular in Australian services industries. The Australian services sector is by and large globally competitive and many large companies have established in the US market because market growth is no longer available in the smaller Australian market. Services sectors are generally undeveloped in Asia. There is also expansion into services markets in Europe, but the expansion appears to be greater in the United States.

3. FTAs – advantages and disadvantages

The principal point of Free Trade Agreements is to secure trade liberalisation. While the traditional debate about FTAs is the danger that they can divert rather than create trade, the record to date suggests there has been little diversion and that FTAs and regional agreements have been effective in encouraging wider trade liberalisation. A practical advantage of FTAs is that they are quicker and easier to negotiate than multilateral agreements because fewer parties are at the table. Parties can secure advantages that are harder to win in bigger forums.

The disadvantages are twofold. If FTAs are not set up within the right framework of policies, they can diminish rather than enhance economic welfare. The second disadvantage is that they are not good vehicles for liberalising trade in sectors on which parties outside the agreement have a major influence.

FTAs as drivers for liberalisation

While multilateral agreements under the GATT and WTO have been the leading arrangements bringing greater trade liberalisation in the world economy, narrower agreements like the European Union and the Canada-US bilateral FTA have also been significant. For Australia, the Closer Economic Relations agreements with New Zealand have made important contributions in allowing Australia and New Zealand to become, in substance, a single economy.

While trade liberalisation is usually a negotiated process under which each party makes “concessions” in opening up their markets, greater access to the market for the second country is only the first gain for the first country. The second gain is the benefit to the domestic economy of reducing protection. It is similar to gains from unilateral liberalisation.

How liberalisation occurs

Bilateral trade liberalisation can be thought of as bringing changes to the participants in two ways: through diverting goods and services from countries that become disadvantaged in relative terms from the liberalisation, and by displacing higher cost goods and services. Liberalisation that displaces goods with cheaper goods is clearly

preferable and it is the likelihood of some trade diversion that has brought objections to bilateral and regional free trade agreements as opposed to multilateral agreements.

Traditionally, trade benefits have been most apparent in FTAs where countries have vastly different economic structures. Comparative advantage in different areas of production allows both partner countries to gain as a result of specialisation. A refinement of this analysis (the so-called Heckscher-Ohlin model) shows how trade raises the prices of the cheaper good in each of the trading partners while lowering the prices of the scarcer (imported) good to more than offset this. This view of trade gains has been at the heart of the process over a long period – text books often described it as Australia sending primary products to England and receiving manufactures in return.

More recently, the gains stemming from the European Union and from the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) have highlighted different forms of gains, or, perhaps more accurately, a different view of the same gains. There the gains were realised by countries with structurally much more in common than the traditional trade-gain theories highlighted. The gains came from intra-industry trade – the trading partners appeared to be buying and selling goods that they already made in their home countries. Two factors account for the gains from this intra-industry trade following liberalisations between countries with similar economic profiles:

- increased competitive pressures on suppliers that were previously less heavily challenged in their home markets;
- a variation of the traditional comparative advantage gains that takes advantage of the increased specialisation of modern production and the increased number of stages through which materials are transformed prior to reaching the final consumer.

Freeing up trade between countries with similar economic profiles often produces benefits without some of the disruption that sometimes accompanies agreements between countries with radically different economies. Where firms face increased competition from rivals producing similar goods and services, they usually lift their performance to the benefit of consumers in all participating countries. This is most vividly seen in the European motor industry.

In other cases, the increased intra-industry trade brings improvements through *de facto* increased scale economies. For example, in the European case, it has led firms to specialise in parts of a production process that they previously undertook in its entirety, or to concentrate on particular market segments.

The problem of trade diversion

A trade bloc created by a free trade agreement leads to expanding trade through trade *creation* and trade *diversion*. The latter stems from sales won at the expense of third country suppliers, which become less competitive purely because they face a tariff barrier that does not apply to suppliers within the new free trade area. Such increased trade actually reduces the economy's overall efficiency. It is trade creation, whereby less productive activities in the partner contract and the more productive expand, that defines many of the benefits of the agreements. This in turn depends on:

- the relative importance of each country as a trading partner in a liberalised trade environment;
- the size and extent of existing trade barriers;
- the degree to which the effect of removal of barriers to trade between members results in more or less access overall by trading partners into the free trade area, and
- the degree to which a reduction in trade barriers between the two countries causes industries to expand that are relatively high cost on a global scale.

The final calculation of whether an FTA diverts or creates trade is the net balance of the diversion and creation.

Little evidence of diversion

Most recent studies of the impact of trade blocs have found that trade diversion has been less apparent than was previously assumed to be the case. A 1995 study by the OECD¹ concluded that there was no evidence that these agreements had created trade diversion. While conceding that it was in some cases difficult to assess diversion, the anecdotal evidence suggested that these agreements had probably served to stimulate trade liberalisation elsewhere, including through multilateral liberalisation.

The Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) would have been a model candidate for creating trade diversion because trade barriers in Australia and New Zealand were high by OECD standards at the time of signing. However, ANZCERTA was not considered to have diverted trade because both countries unilaterally reduced their trade barriers with other trading partners in parallel with the ANZCERTA program to eliminate all trade barriers between the two countries. This obviated the risk of trade diversion.

A study by the Department of Foreign Affairs and Trade of the impact of NAFTA² concluded that there was no evidence that the agreement had had diversionary effects.

1 OECD, "Regional Integration and the Multilateral Trading System: Synergy and Divergence", Trade Directorate, February 1995.

According to Professor Anne Krueger,³ the bulk of Mexican products that increased output/exports to the US rapidly under NAFTA were also the ones whose exports to other destinations grew most rapidly. She also recognised that about two-thirds of Mexico's trade was with the United States even prior to NAFTA. She goes on to say, "The maquiladora industries that were established in Mexico took advantage of the duty-free treatment on the materials component of imports re-exported to the United States prior to NAFTA." The NAFTA experience lends weight to the conclusion that Free Trade Agreements between countries with low trade barriers are overwhelmingly more likely to lead to trade creation rather than trade diversion.

Promoting liberalisation

There is an emerging body of thought that bilateral and regional trade agreements support multilateral processes of trade liberalisation, rather than undermine them. This is less an economic argument than a political one. The 1994 OECD Study referred to above reflected a general view among governments that the regional agreements had supported the broader multilateral process that was running concurrently.

It is possible to point to a number of areas where agreements to liberalise in regional fora set precedents that were followed in the multilateral negotiations. ANZCERTA demonstrated how it was possible to set disciplines to open markets for services. Officials in the then nascent negotiations in the Uruguay Round point to the demonstration effect ANZCERTA had on efforts to develop multilateral rules.

Nor is there evidence that negotiation of bilateral or regional agreements distracts governments from the task of managing multilateral negotiation. The record shows the opposite. The consolidation of the European Community under the Single Market program, and the negotiation of the US-Canada FTA and subsequently NAFTA, occurred while the Uruguay Round was being negotiated. Neither regional activity hindered achievement of very significant agreements in the Uruguay Round.

It is important to recall the circumstances surrounding this outcome. At the time there was apprehension that the world might fragment into regional trading blocs. Governments outside Europe were deeply concerned the EC Single Market program would create a 'Fortress Europe' trade bloc, and that NAFTA might lead in a similar direction. The commitment of the leading economies in Europe and North America to a successful conclusion to the Uruguay Round, and the reconfirmation of support for multilateral trade liberalisation constituted by the Uruguay Round agreements, put paid to such apprehension. This demonstrated that the interest of the world's leading economies in regional liberalisation was not at the expense of multilateral liberalisation.

2 DFAT, *NAFTA after Five*, www.dfat.gov.au/geo/americas/nafta/chpt5.html, March 2000.

3 Anne O. Krueger, "Trade Creation And Trade Diversion Under NAFTA", Baldwin conference, National Bureau of Economic Resources, August 15, 1999.

Some leading free trade economists, such as Professor Jagdish Bhagwati at Columbia University remain very uneasy at this development, in particular the preparedness by successive US Administrations to pursue bilateral and regional agreements.⁴ Their apprehension serves as a form of vigilance about the risk of trade diversion. It does not amount to a case against negotiating any kind of free trade agreement, and points to the need to ensure they are negotiated within the right context.

Practical Advantages

An obvious attraction of an FTA is that members obtain preferred access to the markets of other members. As noted above, this may not produce optimal outcomes in the long term. It depends on the overall impact of the arrangements and other concurrent trade policies. Trade agreements set rules for regulating trade and trade-related activity as well as incorporating commitments to remove trade barriers. The record has shown that members of trade agreements can also secure agreements in FTAs for rules that confer advantages upon their trading partners and reduce trade irritants and restrictions that could not otherwise be secured from multilateral trade agreements.

Box 3.1 below sets out some benefits secured by the North American Free Trade Agreement (NAFTA) – USA, Canada and Mexico – and ANZCERTA – Australia and New Zealand – that were not available under the multilateral rules of the WTO or its predecessor, the GATT. These details are drawn from the comparative analysis of WTO, NAFTA and ANZCERTA set out in Annex 7.

Practical disadvantages of FTAs

FTAs only confer economic advantages when they are negotiated with countries which are significant trading partners. The relatively modest level of trade with some prospective partners has in the past been one factor deterring the Australian Government from pursuing individual FTA proposals.

FTAs also increase the complexity of the international trading system and can raise transaction costs for business. For example, complicated rules of origin are required to prevent third country product entering via the other party. With different rules negotiated under different agreements, enforcement of these rules and compliance with them by business can be a complicated task. Business also has to take into account the different dispute settlement mechanisms as well as different standards regimes and other harmonisation arrangements.

The negotiation of RTAs is resource intensive and there can be an ‘opportunity cost’ in devoting resources to bilateral or regional, as opposed to multilateral. The NAFTA agreement, for example, was over one thousand pages long and required the establishment of more than two dozen committees and working groups.

4 Bhagwati, Jagdish, “Regionalism and Multilateralism: an Overview” in De Melo and Panagariya (eds), *New Dimensions in Regional Integration*, Cambridge University Press, 1993.

Box 3.1 Benefits secured from FTAs not available under WTO agreements

Measure	Beneficiary	Agreement
Phase out over 15 years of most barriers in the US to agricultural exports	Mexico	NAFTA
Removal of all tariff and non-tariff restraints on all traded goods	Australia New Zealand	ANZCERTA
Removal of export subsidies on all bilateral agricultural exports	Canada USA	NAFTA
Agreement not to distort bilateral trade with subsidies.	New Zealand Australia	ANZCERTA
Right for investors to receive national treatment	Canada USA Mexico	NAFTA
Freedom from anti-dumping penalties	Australia New Zealand	ANZCERTA
Rights to have anti-dumping penalties reviewed	USA Canada Mexico	NAFTA
Harmonisation of standards and conformance procedures	Australia New Zealand	ANZCERTA
Removal of restrictions on most traded services	Australia New Zealand	ANZCERTA

Source: Annex 7

4. What would an FTA between Australia and the US cover?

What subjects would a free trade agreement between Australia and the US cover? What type of measures would be included? What about the contentious issues? Can anything be achieved on agriculture? To consider these questions, other free trade agreements will be reviewed to see what precedents exist and some of the more contentious issues will be discussed.

What makes an FTA?

The essential feature of a free trade agreement is that it discriminates in favour of the interests of the members of the agreement. Under a free trade agreement, barriers to trade, generally tariffs and quotas, are removed on trade between members, usually after a period of phase out. The result is that businesses in the member countries secure preferred access to the markets of other members over companies from non-members.

The nature of free trade agreements has evolved over the last few decades. Once free trade agreements were relatively straightforward. They set out commitments to remove tariff and non-tariff barriers to trade in goods among the parties to the agreement. Often they did not achieve ‘free trade’ but were agreements to reduce barriers to agreed levels. Today they cover much more than trade in goods. They cover services and investment and increasingly other areas to promote closer economic relations between countries. Some are even, and more appropriately, called agreements on “Closer Economic Relations” rather than “Free Trade Agreements”.

The widening ambit of international trade agreements

In the mid-1980s, the traditional ambit of all international trade agreements widened. The European Community led the way by substantially deepening the ambit of its Single Market to cover such areas as investment, competition policy, opening services markets, advancing and protecting intellectual property rights, standards and trade facilitation. These were enshrined in the Single Market Act and extended to other European nations through the European Economic Area. The European Union and the establishment of the common currency have also led to the adoption of measures constraining economic policy.

In the NAFTA Agreements, the three North American governments similarly expanded the ambit of regional agreements. NAFTA encompassed rules to open services markets, created legal rights for foreign investors, adopted competition policies for government monopolies, and set rules for technical standards and recognition of qualifications. To demonstrate how comprehensive the process of closer economic relations could be, in parallel to NAFTA agreements were negotiated on standards the three countries would apply on labour and environment issues.

Before NAFTA was completed, the process of forming a free trade area between Australia and New Zealand accelerated, resulting in the Australia–New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). As well as eliminating all barriers to trade in goods, it committed both countries to remove all barriers to trade in services, except in certain exempted sectors, and provided for harmonisation of standards. It committed to eliminate anti-dumping actions and harmonise competition policy and to prevent subsidisation of traded products. ANZCERTA also established the ANZ Food Authority, a joint institution that develops food standards for Australia and New Zealand.

By the time the Uruguay Round was completed in 1994, the ambit of multilateral rules of the GATT had also been extended in the new WTO to cover services and intellectual property.

Thus, in trade agreements involving fewer countries, such as regional or bilateral free trade agreements, it is possible to reach agreement on issues to strengthen the economic relationship that is not otherwise possible in wider fora. Accordingly, the ambit of ANZCERTA, EU and NAFTA agreements is wider than that of WTO agreements.

What an Australia–US FTA might cover

In order to assess the likely impact of an AUSFTA, it is necessary to have some sort of idea about what an FTA might include. There will be some issues that will be difficult to resolve given the traditional differences between Australia and the USA. Issues most commonly mentioned in this context are agriculture, investment and cultural policy.

It is not necessary to try to anticipate the outcome of negotiations in order to form a picture of what an FTA might look like. There are three approaches that will be employed. The first is to examine other trade agreements to see what they contain and what precedents they may set. The second is to identify the issues where either barriers are in place or where there has been a dispute. Since the point of a trade agreement is to remove barriers, it is logical that if they exist on one side the other side will seek their removal. The third is to identify interests common to the economies which provisions in an FTA can advance to their mutual benefit.

Precedents from other agreements

It is instructive to review the provisions of NAFTA and ANZCERTA and to compare them with the WTO Agreements. Since the US, Canadian, Australian and New Zealand economies are all at similar states of development, it would be reasonable to assume that many of the provisions in these agreements would also figure in a US–Australian FTA and that the structure would be similar. In the same vein, since the WTO agreements set the rules for the multilateral trading system, most provisions in its agreements are found in regional and bilateral agreements. Table 4.1 summarizes the key provisions of NAFTA and ANZCERTA and the WTO agreements. It draws on a more detailed comparative analysis of the basic provisions of the WTO Agreements, NAFTA and ANZCERTA, which is contained in Annex 7.

Table 4.1 Provisions in relevant trade agreements

Issue	WTO	NAFTA	ANZCERTA
Structure	WTO administers several agreements.	System comprises bilateral agreements among US, Canada and Mexico. Some side agreements and understandings.	One central agreement. Some related understandings and side agreements.
General Principles	Non-discrimination National Treatment	Non-discrimination National Treatment.	National Treatment.
Exceptions	General exceptions for security, health and safety, quarantine and moral issues.	Follows WTO.	Follows WTO.
Rules of Origin	Loose guidelines.	Complicated rules, particularly for clothing and textiles and automotive products.	Simple rules.
Tariff reductions	As determined in negotiating rounds.	General goal of phase out – immediate, or in 5, 10 or 15 year programs. Mostly 10 years. Some exceptions.	All tariffs eliminated over 5 and 7 year periods.

Table 4.1 continued

Issue	WTO	NAFTA	ANZCERTA
Non-tariff measures	Quotas prohibited except in some specified circumstances.	Quotas prohibited, except in some specified circumstances.	All quotas and export restrictions phased out over 7 years.
Duty drawbacks, remissions on duty	No specific rules.	Gradual elimination of duty drawback.	No specific provisions.
Agriculture	Export subsidies permitted within limits, high domestic subsidies permitted, quotas apply for limited access in some products.	New reductions to be negotiated. secured free access to the US market, some products (corn, sugar, orange juice, vegetables) have longer transition periods (of up to 15 years). Canada will apply WTO rules in trade with Mexico and the US.	No special rules for agriculture. Special transition arrangements applied to phase out controls on dairy products (now expired).
Automotive	No special rules	Progressive removal of restrictions on trade and investment controls between Canada and US with Mexico for periods up to 25 years.	No specific provisions
Clothing and textiles	Quotas to be eliminated by 2008. Special safeguards rules apply.	Commitment to remove barriers over a 10 year period. Exceptions permitted. Special safeguards rules apply	No specific provisions.
Energy and petrochemicals	No specific provisions.	Specific rules to secure trade rights and to govern actions of regulatory bodies.	No specific provisions.

Table 4.1 continued

Issue	WTO	NAFTA	ANZCERTA
Subsidies	On industrial products, export subsidies are banned, certain domestic subsidies are actionable, all subsidies are subject to countervailing action. Looser rules apply to agriculture subsidies	Export subsidies are banned in agricultural trade between Canada and the USA and circumscribed in agricultural trade with Mexico.	Subsidies were banned on all products traded between the countries. Subsidies which distort trade in services are prohibited.
Anti-dumping and countervailing	Duties can be imposed if damage by subsidised or dumped imports can be demonstrated.	Rights to challenge and review countervailing and anti-dumping actions are provided.	Anti-dumping action is prohibited. Each country recognises the other's competition policy law instead.
Safeguards	Rules stipulate when members may restrict imports causing damage.	Rights are provided to take safeguard action. NAFTA members have rights to be exempted from safeguard actions applied against countries outside NAFTA.	No specific provisions.
Government Procurement	Government procurement excluded from GATT rules, but a plurilateral agreement limits this exclusion.	Rules restrict favouritism for national suppliers and require national treatment.	No specific provisions. A separate Agreement provides national treatment.
Sanitary and Phytosanitary Measures	The right in the GATT to restrict imports on quarantine and health grounds is restricted to justifications based on sound science and risk assessments.	Provision reflect WTO rules.	Provisions reflect WTO rules and commit to harmonisation of quarantine standards and processes.

Table 4.1 continued

Issue	WTO	NAFTA	ANZCERTA
Standard and technical barriers	Mandatory standards must be non-discriminatory and provide national treatment and be based on sound science.	Rules are similar to WTO, but more permissive in some respects when consumer and environment issues are in play.	WTO provisions apply. Additional agreements commit to harmonisation of standards and conformance and mutual recognition. Food standards are to be common.
Customs Administration	Rules govern customs valuation.	Rules govern administration of rules of origin.	Rules govern administration of rules of origin. Customs procedures are to be harmonised.
Competition Policy	No specific provisions. Voluntary guidelines are available for telecommunications services.	Provisions govern anti-competitive behaviour of state enterprises and monopolies.	No provision in CER. An understanding commits to harmonisation of business law.
Temporary Entry	No specific provisions. Scope for liberalisation of temporary entry in the GATS.	Provisions lay down rules for temporary entry for business purposes.	No provision in CER. The Trans-Tasman Travel Agreement gives rights of residence to citizens of both countries.
Services	GATS requires non-discrimination when services markets are opened and negotiations for progressive, global liberalisation. Special rules apply to financial services, telecommunications, labour and air and sea transport. Australia and Canada exempted cultural industries. US exempted maritime transport.	Non-discrimination is to be progressively introduced and national treatment is required. No residency restrictions are permitted on licensed services providers. Canada excluded cultural services, the US excluded maritime transport and government services, including health and social services.	National treatment is required. All barriers to services removed, except where stated. Australian exemptions are air services, coastal shipping, broadcasting and television, third party insurance, postal services. NZ exempted aviation and coastal shipping.

Table 4.1 continued

Issue	WTO	NAFTA	ANZCERTA
Telecommunications	An Annex to GATS requires rights of access to publicly owned networks. The Information Technology Agreement requires elimination of tariffs on most IT products.	Tariffs on Telecoms equipment removed over 10 years. Access must be provided to public networks, with exemptions on public interest grounds.	No special provisions.
Financial Services	An Annex to GATS details rules elaborated for nominated services, following GATS principles. Controls for prudential purposes are permitted.	Rights are provided for suppliers and consumers to supply and purchase services in all members. National treatment is qualified by a right for reciprocal treatment.	No special provisions.
Investment	Generally not covered by WTO. Some trade related investments are limited. GATS allows non-discrimination to apply to a right to establish.	Foreign investors get national treatment and a right of non-discrimination in relation to establishment, conduct, acquisition, expansion and management of investments. Conditions on investment are generally not permitted. Exemptions apply. Investors have a right to establish. A tribunal can settle disputes between investors and Governments.	No rules on foreign investment.

Table 4.1 continued

Issue	WTO	NAFTA	ANZCERTA
Intellectual property	TRIPs Agreements sets new standards for copyright, industrial property, trademarks and integrated circuits and rules on geographical indicators and applies WTO disputes procedures.	NAFTA rules are similar to WTO rules.	No provisions.
Sub-national government	WTO obligations fall on national governments which are responsible for compliance by sub-national governments.	Central governments are obliged to ensure sub-national entities: <ul style="list-style-type: none"> ■ apply national treatment on services and investment issues; ■ apply NAFTA rules on regulation of financial services ■ treat foreign investors without discrimination. 	
Dispute settlement	WTO disputes procedures amount to compulsory arbitration.	Legally binding dispute mechanism established.	No binding disputes procedures
Labour and Environment	The exemptions provisions of GATT permit most environmental restrictions. The GATS Protocol on Movement of Natural Persons provides a framework for rights of movement of labour.	No explicit environment or labour provisions. NAFTA obliges members to give priority to environment agreements where provisions clash with other agreements. Separate side agreements on labour and environment deal with non-trade issues among NAFTA members.	No specific provisions

From the foregoing it can be reasonably deduced that many of the issues covered by NAFTA and ANZCERTA will be included in an Australian US Free Trade Agreement. Some, such as energy and petrochemicals, which related solely to US-Mexican bilateral economic interests, are unlikely to be included.

Trade barriers and investment issues

A second guide to what an FTA could cover would be areas of trade where barriers exist in each country and/or issues over which there have been trade disputes or contention. It is not necessarily the case that because there has been dispute over an issue it will be addressed or solved in an FTA. It may be decided that the issue is better dealt with elsewhere or that it does not have a place in an FTA.

Following in Table 4.2 is an overview of issues where either barriers to trade exist or where there has been contention. Contention may take the form of a dispute, such as the current one over US controls of imports of lamb; through indication of concern, such as by the United States in its annual “National Trade Estimates” report on foreign trade barriers¹ or Australia’s TradeWatch publication;² or where each country has an established position on access. A more complete list of trade barriers applied by both countries is set out in Annex 3.

Table 4.2 Australian and US interests in the bilateral trade relationship

Issue	US interest in Australian positions	Australian interest in US positions
Tariffs	Lower remaining Australian tariffs.	Lower high US tariffs, particularly in agriculture.
Agriculture	Remove AWB’s single desk export monopoly. Expedite review of quarantine bans on imports of chicken, pork, Florida citrus, stone fruits, corn, apples, Californian table grapes.	Remove non-tariff restrictions, usually tariff quotas, on imports of sugar, dairy, cotton and beef. Secure US compliance with WTO directive to remove safeguards controls on lamb. Secure removal of domestic and export subsidies on grains, sugar, dairy products.
Subsidies	Ensure consistency of subsidies for automobile and clothing and textiles with WTO requirements.	See above.

¹ See www.ustr.gov

² <http://tradewatch.dfat.gov.au>

Table 4.2 continued

Issue	US interest in Australian positions	Australian interest in US positions
Anti-dumping		Address potential punitive effects of anti-dumping procedures.
Countervailing		Address punitive effects of imposition of countervailing duties on subsidized imports.
Investment	Remove discretion to deny foreign investment on grounds of "national interest".	
Government procurement	Secure Australian membership of the WTO Government Procurement Agreement limiting preferment to national supplies.	
Maritime Transport		Secure removal of ban on use of foreign built and owned ships for seaborne commerce between points in the US.
Air services	Secure "open skies" for air services.	
Telecommunications	Remove restrictions on broadcasting on broadband.	Ensure Australian carriers are charged fair accounting rates and Internet access rates.
Business services	Secure recognition of US professional qualifications.	Remove restrictions, such as skill and residency testing procedures, on Australian professionals, such as engineers, accountants and architects.
Intellectual Property	Restrict parallel importing of recorded music and branded goods. Concern about laws permitting de-compilation of software. Concern about adequacy of protection for test data for pharmaceuticals. Concern that civil rather than criminal remedies are favoured for abuse of copyright or music	
Cultural industries	Secure removal of measures to protect domestic cultural industries such as local content rules for broadcasting.	

From the foregoing, a general idea of what is likely to inform the approach of each side to negotiation of an FTA can be drawn. It is stressed that this is a picture painted from existing positions, not a prediction of how each side will prepare its negotiating brief. There are a number of important issues that are not covered in the above table. For example, how can an FTA be used to advance common interests between the economies, such as in the area of e-commerce? Could an FTA be used to enhance public confidence in the health and safety of food products traded between the countries?

Issues in the FTA

In early comments about a possible FTA, both governments have indicated that an agreement would have to be comprehensive. A comprehensive agreement, rather than a more narrowly focused one, is the best way of promoting a closer relationship between the two economies. Such an approach also offers scope for mutually beneficial trade-offs and provides an opportunity for trade irritants to be addressed in a constructive way before they evolve into disputes.

A comprehensive approach does not mean, however, that all barriers will be removed in the context of the agreement itself. It simply means that all broad themes will be addressed and no particular issue will, *a priori*, be excluded. If individual barriers are to be retained, it will be through a negotiated outcome, which may in turn allow the party to retain one of its own barriers.

It is not the aim of this report to canvass in detail every issue to be covered in an FTA. Some issues have already attracted attention, in particular, investment, agriculture and cultural policies. These and other issues likely to be a focus of interest are reviewed. This report argues that these are the areas in which the most significant impacts of an FTA are likely to be felt. An overview of other matters likely to be covered in an FTA is then provided, including discussion of some of the areas that are likely to be sensitive for Australia.

Investment

In the NAFTA agreement, each country guarantees national treatment to foreign investors from the other two parties. The aim is to encourage foreign investment because it guarantees foreign investors they will not be singled out for special treatment. NAFTA went further and created rights under Chapter 11 of NAFTA for foreign investors to challenge governments if their rights to national treatment were not respected. Special legal tribunals were established for that purpose.

It is likely that the United States and Australia will pursue a similar objective of granting investors from the other country national treatment. As discussed in greater length in Chapter 5, one of the most important benefits for Australia from an FTA would be to encourage greater foreign investment from the United States by drawing the attention of US investors to the Australian market. Provisions in the FTA that provide certainty to US investors in Australia would encourage US investors to take a stake in the Australian economy and thereby generate a very important continuing benefit from the agreement.

The same provisions would work in the interest of Australian investors in the United States. They would benefit from the same guarantee that they would not be discriminated against in the US, which has become the leading destination for Australian investment abroad. It needs to be recalled in this context that the US is a federal system and the rules and regulations of state and local authorities usually have a bigger impact on foreign investors than federal laws. This explains why in NAFTA sub-national authorities are specifically bound by the national treatment rule. All three members of NAFTA have federal systems.

On the other hand, the right to challenge legally the compliance of governments with the provisions of Article 11 of NAFTA, has been a major point of criticism of NAFTA since it was negotiated. In particular, there is criticism that the application of Chapter 11 has gone well beyond the original intention of providing safeguards against expropriation: arbitration panels and the courts have extended the meaning of expropriation by allowing private companies to successfully challenge domestic laws on matters such as the environment. However, there is no reason why a flawed mechanism should be adopted in an Australian US FTA. It is up to our negotiators to get it right. NAFTA member Governments have themselves been discussing ways to address the problems that have arisen in application of Chapter 11.

An FTA might cover other issues relevant to the interests of investors in both countries. Previous agreements negotiated by both countries have included, for example, special visa provisions for foreign investors and provided for equal treatment in government procurement decisions. However, it is not clear how an FTA might deal with one of the more important issues affecting the bilateral investment regime, namely taxation of foreign investments. Profits from investments in the US repatriated to Australia face a withholding tax of 15 per cent while the corresponding figure for US investments in Australia is 10 per cent. A separate double taxation treaty, currently the subject of review and renegotiation, covers these arrangements, but there may be scope for them to be brought under the framework of a comprehensive FTA.

Finally, the US has consistently raised concerns over the application of Australia's foreign investment screening process and, specifically, the "national interest" criteria. Australian governments have argued just as consistently for the retention of screening but the history of ANZCERTA might provide an indication of how the issue could be

constructively addressed. Australia and New Zealand have agreed to take the agreement into consideration when applying the national interest criteria and to avoid to the fullest the imposition of restrictions on investors. Furthermore, the two governments agreed in 1999 to raise the threshold level for investment screening to \$NZ50 million and \$A50 million respectively.

New Economy issues

This report argues in Chapter 6 that one of the most important long-term impacts of an Australia-US FTA will be felt in the area of the new economy. As this is a new area in both economies there are few impediments to business, although some exist. There are restrictions in Australia on the use of the Internet for broadcasting. Australian telecommunications providers face high costs for access to US telecommunications and ISP systems. Both countries have developed laws to facilitate e-commerce transactions. There may be scope to harmonise these laws.

Important impacts on this sector are likely to be primarily derived from agreements covering other areas. For example, any agreement that delivers an improved bilateral investment environment is likely to promote US investment in this area. Similarly, guarantees of continued effective protection of intellectual property rights would encourage US firms to undertake research in Australia by drawing on the skilled workforce available here. Mutual recognition of skills could also play a role.

Agriculture

Extensive protection of certain agricultural sectors in the United States, particularly sugar and dairy, has long been regarded as the principal stumbling block to a bilateral agreement. It has been argued that it would be too difficult for a US Administration to give preferential access to its market to importers as competitive as Australian farmers.³ Some still argue in Australia today that unless access to US agricultural markets could be secured in an FTA, there is little point pursuing an agreement and, since the same commentators tend to rate prospects for that as low, there is no point proceeding.⁴

3 A study by Professor Richard Snape commissioned in 1986 about the prospects of a free trade agreement between Australia and the US concluded that the principal barriers to Australian exports were agricultural and since there was little prospect of the US agreeing to remove those barriers in a bilateral negotiation, there was no real point in negotiating an agreement. In a broader study completed in 1994 on regional Free Trade Agreements, Snape arrived at the traditional neo-classical economic position that free trade agreements are second best instruments for trade liberalisation and again concluded that prospects for access to US agricultural markets were weak. An agreement with the US should only be considered if the multilateral processes failed. See Snape, Morgan and Adams, "Regional Trade Agreements, Implications and Options for Australia", 1993.

4 Professor Peter Drysdale makes a closely related point that efforts to secure access to US agricultural markets through an FTA will damage Australia's global farm trade interests – See Opinion, *Australian Financial Review*, 1 August 2001.

There is no question that securing liberalisation of agricultural markets is one of the toughest tasks in world trade. Not only has it been the bane of the multilateral trading system for decades, it has been a stumbling block in bilateral agreements negotiated by the US. It was effectively exempted from its agreement with Israel, and in the bilateral agreement with Canada the issue was basically set aside. The parties agreed to leave agricultural trade to the WTO.

With regard to this general view about the significance of the prospects for negotiating agriculture in an Australia–US FTA there are three points to make:

1. It is not the case that seeking concessions over agriculture from the US is a fruitless endeavour.
2. There are significant long term pressures on the US agricultural sector which suggest that it should not be presumed that high levels of protection of agriculture are an immutable feature of US public policy over the long term.
3. It is no longer the case that agriculture is the only issue of economic significance in Australia-US economic relations.

The third point has already been demonstrated in Chapter 2. Trade with the US in non-agricultural issues has become significant, as has investment. We will now consider points one and two.

The North American Free Trade Area was an innovation in many respects. Important in this context is that Mexico secured rights to almost full access to US agricultural markets, although a phase out period of up to 10 to 15 years was allowed for the most sensitive products. In a free trade agreement negotiated by the Clinton Administration with Jordan, but not yet approved by Congress, Jordan also secured access to the US agricultural markets, again with longer implementation periods in some cases.

It is important not to overstate the value of what Mexico secured. Implementation periods of up to 15 years were agreed for some of Mexico's key exports. Gallagher has explained how subsequent to the negotiation of NAFTA, the United States clawed back the value of the concessions made over access to the sugar market.⁵ Nevertheless, while concessions granted over a fifteen year period may at first sight not appear to be of great relevance, it is important to bear in mind Australia's long-term interests in the US market and the long-term perspective of Australian exporters. Particularly in the event of a stalling of multilateral negotiations on agriculture and with major agriculture exporting nations likely to secure improved access to the US market under the Free Trade Area of the Americas, the value of access achieved under an FTA could become very significant.

5 See Gallagher P., Inquit Pty Ltd, "Agriculture - the Strategic Issues", 27 June 2001, on www.apec.org.au

US participation in negotiations for a Free Trade Area of the Americas is also relevant to Australian interests in this sector. Key Latin American countries have made clear their strong interest in securing good outcomes in this sector. Just as in the case with Mexico, the US will likely be forced to make concessions in this sector if it is to secure its own market access interests in those countries. Thus, the US is gradually having to address the issue of its high levels of protection for certain agricultural products. An FTA with Australia would be seen in the US as part of this process. US negotiations with other regional partners are thus creating a dynamic which could lead to outcomes for Australia that might not have otherwise been possible.

The early positions of both the US and Australian governments was that the starting point of any negotiation would be that everything was covered⁶. While there is no denying that agriculture will be the focus of intense negotiations, it is very unlikely that the sector would be altogether excluded from an agreement. It is essential to bear in mind that on the global stage, the US and Australia (the latter through its membership of the Cairns Group of agriculture exporters) are both ardent proponents of liberalisation of world markets for agriculture. For strategic reasons, neither country would wish to give the impression that they considered agriculture to be too hard. Both would likely seek an agreement that dealt with agriculture in a comprehensive manner as a way of setting ambitious benchmarks for later multilateral action.

It is not just the initiation of negotiations, multilateral and regional, which creates a dynamic element in this environment. The impact of globalisation will create long-term pressures on the US farm sector over time to become more competitive. Hooke points out the impact that globalisation is having on the food processing sector, a major consumer of farm product.⁷ Food processors are globalising production and seeking competitive sources of supply. In the United States this will start to put pressure on producers to supply product at globally competitive prices. Government protection of producers will no longer be enough to tie processors to suppliers at whatever price the protection mandates. In globalised production systems, it is an increasingly viable option for producers to relocate to sites where better-priced supplies are available. This was a conclusion reached by Australian and US agriculture experts at the conference on an US–Australia Free Trade Agreement mounted by the Australian APEC Study Centre in Canberra in June 2001.

The US has its own interests in agriculture as shown in Table 4.2. It has become particularly critical of Australia's quarantine management. This issue is discussed below in the section on quarantine and biosafety issues.

6 Media reports in May 2001 claimed this principle had been accepted in exchanges between the US Administration and Canberra.

7 Hooke, M, Australian Food and Grocery Council, "Agricultural Negotiations and a New Comprehensive Round of Trade Negotiations in the WTO", June, 2001, www.afgc.org.au

Tariffs

Most free trade agreements carry commitments to reduce tariffs to zero. With Australian tariffs averaging 3.7 and US tariffs averaging 2.8 per cent, this would not be difficult in an FTA, except in the areas where both Governments have tariffs with high peaks, such as in agriculture in the case of the US, clothing and textiles in the case of both countries, and light trucks in the case of the US and automobiles in the case of Australia. This can be seen in the summary of the average tariffs of both countries, which was prepared by the Centre for International Economics, in Table 4.3.

Also relevant to the consideration of tariffs is the commitment both countries have made as members of APEC to eliminate all trade barriers by 2010, although neither to date has indicated how it intends to meet that goal.

Subsidies

The incidence of subsidisation of industry in both countries is low on average, again with the exception of agricultural industries in the US. Reduction of agriculture subsidies, particularly those provided by the EU and the US, is a key Australian trade priority, which is actively pursued through the WTO and through Australia's membership of the Cairns Group of agriculture exporting countries. For its part, the US in its National Trade Estimates has pointed to Australia's Export Market Development Grants and the import duty credits scheme as it applies to automobile producers.

While both countries would be likely to use the opportunity of FTA negotiations to push their interests on subsidies, it is not clear how this might be achieved in practice. Subsidies are not by their nature bilateral measures, and therefore may be difficult to remove on a bilateral basis.

However, bilateral negotiations have in the past succeeded in imposing some restraint on subsidy activity. For example, under the Andriessen assurance, the EU undertook not to export beef that has benefited from export subsidies to Asian markets of value to Australia. Under ANZCERTA, Australia and New Zealand agreed to eliminate subsidies affecting goods traded between them. Similarly, NAFTA commits its members not to subsidise exports to the other parties and also to take into account the interests of the other parties when subsidising exports to non-members. Also of interest is that the draft text of the Free Trade Agreement of the Americas (FTAA) deals quite comprehensively with subsidies. While this text is at a very early stage, it suggests there may be scope for constructive discussion of the issue.

Table 4.3 Post Uruguay Round Levels of Protection

Sector	US %	Australia %	Sector	US %	Australia %
Paddy rice	0.30	1.00	Processed rice	0.30	0.00
Wheat	1.80	0.00	Sugar	80.00	0.00
Cereal grains n.e.c.	0.00	0.00	Food products n.e.c.	1.60	2.40
Vegetables, fruit, nuts	1.00	0.80	Beverages and tobacco products	1.40	4.80
Oil seeds	3.80	0.00	Textiles and clothing	5.80	9.90
Peanuts	45.00		Wearing apparel	11.60	15.70
Sugar cane, sugar beet	80.00	0.00	Leather products	7.30	8.40
Plant-based fibres	0.10	0.00	Wood products	0.40	5.20
Crops n.e.c.	0.90	0.00	Paper products, publishing	0.30	4.60
Bovine cattle, sheep and goats, horses	0.00	0.00	Petroleum, coal products	0.70	0.10
Animal products n.e.c.	0.30	0.00	Chemical, rubber, plastic products	2.00	2.70
Raw milk	0.00	0.00	Mineral products n.e.c.	3.50	4.40
Wool, silk worm cocoons	0.00	0.00	Ferrous metals	2.50	4.40
Forestry	3.00	0.00	Metals n.e.c.	0.50	2.70
Fishing	0.20	0.00	Metal products	1.50	5.50
Coal	0.00	0.00	Motor vehicles and parts	1.40	9.30
Oil	0.20	0.00	Passenger motor vehicles		15.00
Gas	0.00	0.00	Light commercial vehicles	25.00	
Minerals n.e.c.	0.10	0.40	Transport equipment n.e.c.	1.4	1.30
Bovine cattle, sheep and goat, horse meat products	2.20	0.00	Electronic and equipment n.e.c.	1.10	0.20
Meat products n.e.c.	1.80	0.30	Machinery and equipment n.e.c.	0.80	2.90
Vegetable oils and fats	0.00	0.00	Manufactures n.e.c.	2.00	3.90
Dairy products	23.90	3.20			
Butter	84.60				
Cheddar Cheese	15.50				
Mozzarella Cheese	23.60				

Services and cultural issues

Both countries have among the most open services sectors in the world. Domestic laws in the US at both the federal and state levels somewhat constrain domestic and overseas service providers alike, including in the financial services and telecommunications sectors. Skills recognition and residency requirements also affect Australian architects, engineers and accountants. Australia will no doubt look for these restrictions to be removed in the context of an FTA but past US experience does not give a good indication of how it might be dealt with. The US has tended to negotiate separate mutual recognition agreements.

The US has been a strong advocate of deregulation of international air services through bilateral agreements. Australia regulates who fly on international routes to and from Australia. Under the umbrella of ANZCERTA, Australia and New Zealand negotiated a Single Aviation Market. However, given the different characteristics of the US air services sector, this model may not be directly relevant.

Coastal shipping is one of the more contentious issues in the bilateral trade relationship. Under the US Jones Act, commercial shipping between points in the US is restricted to US built and owned vessels. This has restricted the capacity of Australian manufacturers to supply this potentially lucrative market and in some cases has forced them to enter joint ventures with US-based partners and set up their manufacturing facilities there.

The US has also consistently pressed for removal of restrictions on broadcasting of film and television in international agreements on services. In Australia's case, the US points to local content rules for broadcasting as restricting US product. This has led to concerns expressed by Australian cultural industries – film and television production in particular – that an FTA will lead to removal of the preferences granted to Australian cultural industries. These concerns have been intensified by the successful campaign by New Zealand to have its audiovisual products given national treatment for the purposes of filling local content quotas in Australia. However, in the wake of this case, the Government made a commitment to protect the Australian audiovisual industry in future trade agreements.

Experience of other FTAs is enlightening in this respect. Under NAFTA, Canada exempted its cultural industries from the scope of the provisions on services. This has also been the experience under the GATS negotiations where most countries, including Australia, exempted audiovisual services from the application of the agreement.

Competition policy

There are philosophical aspects of national competition policy in common in Australia and the US. Their previous agreements address competition policy to some degree. ANZCERTA sought harmonisation of business competition policy although action to

implement has stopped short of that. NAFTA requires Government owned monopolies to respect competition policy principles. The similarities between the Australian and US economies suggest there is very fruitful ground for cooperation over competition policy. However harmonisation is an ambitious and difficult goal and, as Cassidy observes, may not be necessary to promote closer economic relations in this case.⁸

Both countries have active anti-dumping procedures. Australia and other countries have challenged US practice in this regard, specifically the practice of passing anti-dumping duties to the affected industry. Under ANZCERTA, Australia and New Zealand surrendered the right to levy anti-dumping duties against each other in return for cross recognition by each party of the other's competition policy laws. In NAFTA the US accepted provisions which created special panels to provide for review of anti-dumping and countervailing actions.

Technical Standards

Harmonisation of technical standards could be an important outcome of an FTA. These standards, although seemingly innocuous, can act as barriers having a major impact on the viability of products in another market. For this reason, most FTAs devote considerable effort to harmonising standards. Under the umbrella of ANZCERTA, Australia and New Zealand have negotiated a number of agreements on such issues as quality assurance testing and mutual recognition of certification and accreditation systems. Similarly, there were provisions in NAFTA to ensure technical standards were based on science and did not create unwarranted trade restrictions. Both countries have similar traditions on the philosophy of regulation and standards setting.

Quarantine and Biosafety issues

The tradition of strict quarantine controls to provide high standards of protection of human, animal and plant health and of basing such controls on sound science and risk assessment, is strong and similar in both countries. Both countries strongly support the WTO provisions governing sanitary and phytosanitary controls on trade. Philosophies towards administration of biosafety regulations are also similar. As major food producers and exporters, there is strong common interest in effective international rules providing for safety and public confidence in food standards. However, the US contends in its trade barriers report that Australia's conduct of its import risk assessments has not complied with its obligations under the WTO Agreement on Sanitary and Phytosanitary Measures and that in some cases imports have been prohibited without the due completion of an import risk assessment.

Australia, for its part, has staunchly defended its strict quarantine controls. It argues that they are strictly based on scientific considerations, comply with international

⁸ See Cassidy, Brian "Can Australian and US competition policy be harmonized", June 2001, paper delivered at the APEC Study Center conference on US/Australia FTA (www.apec.org.au) for an illuminating discussion.

agreements on sanitary and phytosanitary controls and are justified given that Australia's historic geographic isolation has left it free of many of the plant and animal diseases found in other countries. It is hard to see Australia retreating from these positions in the context of an FTA. Again, however, previous agreements negotiated by both countries offer an indication of how the issue might be treated in a constructive way. Both NAFTA and ANZCERTA create institutions that seek to harmonise quarantine practices including inspection standards, and to examine technical differences to ensure they do not lead to disputes.

Intellectual Property

The US and Australia have very similar approaches to intellectual property law as it relates to trade issues. The US has very actively pursued strict enforcement of IP laws in the context of the FTAs it has negotiated with other countries. Both countries strongly enforce IP law. However, in its report on trade barriers, the US criticises Australia's decision to remove restrictions on parallel importing of sound recordings as well as legislation permitting limited software decompilation. Australia's approach to protection of test data submitted to regulatory authorities has also attracted criticism.

There is concern on the US side that application of intellectual property law in some areas is not as rigorous as the US would prefer. A summary of US interests can be found in the 2001 National Trade Estimates report. Whereas Australia has negotiated agreements with the EU on use of geographical indicators on wine, in the process eschewing use of European geographical indicators, the US has not.

Labour and environment issues

Previous US administrations have accepted labour and environment issues as relevant to trade agreements. Side-agreements on labour and environment were negotiated alongside NAFTA. The US-Jordan FTA contains provisions on these issues within the text of the Agreement itself and these are subject to the same dispute resolution mechanism as other provisions. However, the Bush Administration is opposed to these measures. It is not clear what will happen to this agreement.

Australia's position has been that trade agreements should focus on issues directly related to trade and that other issues should be addressed in multilateral agreements specifically addressed to those issues. Despite this difference of approach, Australian and US labour and environmental standards are similar and therefore this issue is unlikely to be an issue of contention in an FTA.

Trade facilitation

In APEC and in the WTO both Australia and the US have supported measures to facilitate trade, such as harmonisation and streamlining of customs administration and issuance of business visas.

Other issues

When governments negotiate free trade agreements, the process is regarded as an opportunity to settle other, related matters. A review of NAFTA shows economic issues that were the subject of dispute between the US and Mexico at the time, in particular energy and petrochemicals, were included in the agreement. It is common for there to be side-agreements on issues. There are several side-agreements in ANZCERTA. One was an agreement to work to harmonise business law and competition policy. There was a side letter setting out an understanding between the two governments that the pace of removal of barriers in dairy trade between the two countries would be slower than that set out in the agreement.

Business groups in both countries will regard the negotiation as an opportunity to push long-standing issues and will try to enlist government officials in their cause. US business groups are particularly effective in lobbying their government and given the US' recent experience in FTA negotiation, they will be well prepared to do so. Until the decision this year to negotiate an FTA with Singapore, Australian business groups had had no such experience since the conclusion of ANZCERTA. Therefore, if negotiations with the US should eventuate, it will be particularly important that businesses and other relevant stakeholders work very closely with the Government to ensure that Australian interests are pursued effectively.



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 recognise 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 ensure that Latin American agricultural export competitors do not secure an advantage over Australia in access to the US market through the FTAA negotiations. It 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 Trade⁵, 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.



6. Best practice in the global economy

Dynamic and indirect effects of an FTA

The direct gains of trade liberalisation and the benefits of economy of scale were considered in the previous chapter. These advantages are enhanced by other dynamic and indirect benefits. Measuring the dynamic benefits of trade liberalisation is a challenge. Although attempts may be made using dynamic modelling that takes account of the interdependence of nations, impacts such as the influence of best practice remain in the realm of the anecdotal.

However they are calculated, the benefits are distinct. They derive from more robust competition and absorption of best practice in both policy and business management. They can be deduced from those aspects of a business and economic relationship in which there is already a notable strength. In this chapter, the benefits of greater competition, and the benefits for adaptation to the Information Economy, for business culture and pursuit of sound policy are considered.

The enhancement of competition

Improved competition should be one of the longer-term benefits of a closer relationship with the US. The removal of trade barriers brings an immediate improvement in competition in the markets affected. The effects of increased competition are lower prices to consumers and improved productivity.

In addition to the direct stimulus to competition resulting from the greater price competitiveness of trade resulting from liberalisation, the presence of an agreement should encourage greater market entry by companies from many industries into each others' domains with resulting heightened competition. Although that competition can bring discomfort to incumbents that may have hitherto enjoyed some margin of protection, the benefits are felt throughout the economy.

The hallmark of US markets is their competitiveness. Infrastructure is highly advanced, so there are few internal markets protected by the kind of geographic boundaries that have rendered Australian capital city markets prone to oligopoly. The level of competition in the United States has encouraged firms to focus tightly on their points of maximum strength, an attribute that has assisted their global expansion.

Many of the Australian firms that went to the United States in the wake of the dismantling of exchange controls in the mid-eighties believed that with strength of management they could turn around assets bought cheaply in America, only to find that the problems were more intractable. Industry over-capacity, cut-throat competition and an unequal relationship with customers made a turn-around impossible, even with the highest calibre management. The margins that Australian businesses expected had never prevailed in the US. The Australian companies that have performed in the US have done so with careful appraisal of markets and by matching US practice.

The competitiveness of US markets gives US firms some advantage when they enter international markets. A.T. Kearney finds that Australia is the fourth most desirable destination for foreign investment by US multinationals, and the most favourably viewed destination in the Asia Pacific Region.¹ However, these preferences do not flow through to actual investment because of the restraints posed by market size and remoteness. To the extent that an FTA encourages US firms to see Australia as a natural extension of the US market, it will bring more US entrants to Australian markets.

The effects of this will vary greatly from one market to the next. There is no greater guarantee that US firms entering Australia will find success than there is for Australian business moving to the US. The Australian funeral parlour industry is an example where US entrants believed they could bring greater efficiency benefits but found the synergies in their global model were not effective. On the other hand, one US entrant has made a significant difference in the level of competition in the event management business.

The United States, like Australia, has a highly developed competition policy regime. There are sufficient examples in the recent history of both administrations to provide reassurance that easier access to markets will not be used in an uncompetitive manner. The Australian Competition and Consumer Commission, for example, was instrumental in curtailing the scope of a proposed merger of Coca Cola and Cadbury Schweppes world-wide.

The power of best practice

Companies learn from each other as much as they draw from the lessons of their own experience. They observe their competitors, suppliers and customers and modify their own strategies to keep abreast of the latest developments. The growth of trade and investment therefore amplifies the opportunities for businesses to raise their productivity and hence profitability. The impact of this process may already be seen in Australia's relationship with the US through the prisms of its adoption of information

1 AT Kearney, *Foreign Direct Investment Survey*, 2001

technology as a business tool and of management techniques more generally. In both areas, it is a process smoothed by Australia's cultural affinity with the US.

Learning from best practice also takes place at the level of government. It has been noted in both Europe and other regions that a process of economic integration between nations can generate a 'policy reform effect' that can enhance the benefits of the process both for internal participants and for businesses from third countries. For example, if a country's competition policy were strengthened by regional integration, it would in turn enable companies outside the area to gain profits within the area so long as a principle of non-discrimination were maintained.

Best practice: the use of technology

The structural changes taking place in technology-intensive industries including those occurring in telecommunications and biotechnology, the Internet, information and communications technology (ICT), and the development of knowledge-intensive industries, are having a profound effect on both the US and Australian economies. The US is leading global change in these areas. Australia is one of the handful of countries where change is occurring at a similar rate.

It is apparent that Australia is tracking closely trends in the US and is among a select group of countries that are similarly following suit. These countries have identified themselves as contenders for economic leadership in the New Economy.²

On the other hand, it is clear that in a number of areas that are key to the New Economy, Australia's position is mid-pack rather than at the forefront. Increasingly the New Economy indicators, such as cost of leased lines and ease of access to the Internet, will be the basemarks for competitiveness in the New Economy.

If Australia is to seize New Economy opportunities in an era of rapid globalisation, it will not be sufficient for Australia to be a middle-ranking competitor in the world economy. Customers are increasingly sourcing products and services globally, making it increasingly necessary to be a world leader with innovative, best-practice technologies, production processes, products and services.

Despite the recent sharp slowdown in growth in the US economy (from an annual rate of nearly 5 per cent in 1999–2000 to a current rate of just over 1 per cent), it is at the

2 The term 'New Economy' is used in this paper in a broad sense to refer to the combined impact on national economies resulting from:

- ┆ globalisation
- ┆ developments in Information, Communications Technologies (ICT) including technological and commercial 'Convergence' of telecommunications, broadcasting and information technology
- ┆ application of ICT to 'old economy' sectors/industries including information intensive industries (such as financial services)
- ┆ developments in so-called 'knowledge-based' industries, including biotechnology
- ┆ growth of services as a percentage of GDP and trade.

forefront of developments in the New Economy. The US is still the world leader in many of the technologies that are impacting dramatically on the world economy, including health, biotechnology, financial services and IT. Moreover, the US possesses the sort of characteristics crucial for success in the New Economy, notably entrepreneurship and innovativeness. The US is likely to remain the global leader of the New Economy.

It is generally accepted that these increases in US productivity, growth potential and growth itself are linked and are explained principally by the surge in investment in ICT.

The US Council of Economic Advisers has estimated that, of the 1.6 per cent annual acceleration in US productivity, 11 per cent came in the ICT industries themselves, 63 per cent came in the rest of the economy (partly stemming from use of better information technology) and the rest came from the capital deepening of investment in ICT by non-ICT sectors. There was strong growth in the capital stock and the capital/labour ratio grew by more than 70 per cent. A parallel estimate is that two-thirds of the economic growth surge in the US in the second half of the 1990s resulted from the production and use of computers.

A recent report by the OECD³ highlights Australia, along with the US, Netherlands, Norway, Finland, Denmark and Ireland as economies that led the way in the 1990s in terms of growth and multi-factor productivity.

Australia has certainly been quick to apply ICT technology. In 1999, expenditure on ICT products and services in Australia exceeded \$US36 billion. This placed Australia in the top 10 countries in the world. IT spending as a share of GDP and per capita ownership of computers was the second highest in the world. As a percentage of GDP, the 'spend' in Australia was the fifth highest in the world. Moreover, the market is expected to maintain average growth rates of 8.5 per cent per year in the next few years.

Australia exhibits the preconditions to quickly adopt technologies and processes developed in the US. By keeping abreast of such developments, Australia will be better positioned to develop products and services that are competitive in various markets.

Despite the rapid uptake of ICT in Australia, Australia is not generally perceived as a New Economy country. An FTA with the US can be symbolically important to help dispel Australia's "Old Economy" image. The closer investment and business linkages which will follow from an FTA will inevitably lead to adoption in Australia of the New Economy benchmarks that apply in the United States. An FTA could anchor Australia's economy to the global reference points for success in the New Economy.

3 OECD, *The New Economy - Beyond the Hype*, Paris 2001.

A Free Trade Agreement between Australia and the US can help boost Australia's prospects for seizing these opportunities. Foreign direct investment will help sustain the flow of state-of-the-art technology and management practices. This will improve competitiveness in Australia and enhance prospects of technology, skills and entrepreneurial innovativeness in New Economy industries being transmitted quickly from the US.

Best practice: management methods

The rise of the United States as the supreme economic power has also seen the rise of American management thinking. A characteristic of American management is its preparedness to put ideas into practice in an effort to improve performance.

This started with the work of Frederick Taylor at the turn of the twentieth century who believed there was a single best method of organising work. His 'scientific theory of management' consisted of breaking a task down to its simplest parts, selecting the most suitable person for each job and devising the right set of incentives. This was translated into practice by Henry Ford with the assembly line and further advanced at General Motors by Alfred Sloan who developed the multi-divisional firm.

Australia is an early adopter of many American management techniques, particularly those that relate to finance or operations management. The balanced scorecard has a strong following among Australian corporations. The total quality movement did well here in the eighties, while technology solutions such as enterprise resource planning are being widely adopted. Both BHP and Coles Myer were working on shareholder value models as early as 1993. The American consulting company that pioneered the concept, Marakon, was formed in Connecticut and put its second office in London and its third in Melbourne.

German companies did not start using shareholder value concepts until 1995, while French companies only started applying them last year. The Japanese are only beginning to talk about shareholder value now, while the Italians have yet to begin.

Australia has been quicker to adopt flatter management structures than has Europe and is seen to share an entrepreneurial approach with the United States, although not to the same degree.

Weaknesses in Australian management practice relate to its market size and its history. Management consultants point to the problems of oligopolistic markets that leave Australian companies very focused upon their direct competition, but less interested in experimenting with niches, or upsetting established supplier or distribution channels.

The fact that Australian companies could not invest abroad until exchange controls were removed in 1984 means that many companies diversified, rather than developing the deep areas of expertise required to compete in global markets. Australian companies are still not as focused on their core competencies as Americans.

The differences are greatest in human resource management. Although there are highly unionised pockets of American industry, it never had anything resembling Australia's centralised industrial relations system, which led business in this country to abrogate large areas of human resource management responsibility to the Industrial Relations Commission and its predecessor.

Recent studies show that US firms in Australia invest much more in human resource management than Australian-owned companies and provide more formal training to all front line managers in employee relations. There are therefore elements of US practice from which Australian companies still have something to learn. To the extent that their implementation is effective, Australian business productivity stands to gain.

Best practice: economic policy contribution to growth

Australia is a powerful advertisement for the power of unilateralism in economic policy. During the last two decades Australian governments have been engaged in an unprecedented process of economic reform. The core infrastructure industries of finance, energy, transport and communications have been opened to local and international competition. The labour market has been partially reformed to improve its flexibility. A number of previously protected manufacturing and primary industries have been exposed to overseas competition.

It is believed that these reforms rather than the application of ICT made the greatest contribution to improved productivity in Australia in the 1990s. No doubt, they would have become mutually reinforcing and ICT would have become more of a factor as the decade progressed and productivity growth accelerated. Nevertheless, those industries that were the focus of reform have had the highest productivity gains. The IMF has estimated that labour productivity in Australia was 15 per cent higher in 1998 than it would have been under the previous growth path, mainly as a result of the structural reforms in trade and competition policy.

A further factor is the successful inflation-targeting monetary policy of the Reserve Bank, which helped to destroy the pre-existing inflation mentality and generate a less volatile growth trend. At the same time a major shift to equity financing in foreign investment eased the concern over the continued current account deficit in the balance of payments.

The result was that the increase in productivity in Australia was evident throughout the decade and was more broadly based than in the US. This growth was sustained through the Asian economic crisis.

Australia has generally been an enthusiastic supporter of the open multilateral trading system. Like many other countries it has had its periods of trade protectionism but has for many years now accepted that such policies lead to lower growth in incomes and poorer choice of products for Australians.

Box 6.1 Australian Reform Measures

Australia has undertaken very substantial economic reform in the past 20 years. The aim has been to improve the working of the economy through more efficient and competitive enterprises producing higher levels of product and incomes.

Major reforms were:

- Industry protection – tariff and quota protection gradually reduced throughout the 1980s and 1990s with significant changes brought about by the 4 year program commenced in 1988.
- Industrial relations – the introduction of enterprise bargaining and other decentralisation of industrial relations to the firm level, greater scope to customise apprentice and trainee schemes.
- Government business enterprises – corporatisation and privatisation of Government business enterprises at Commonwealth and State levels, including reform of pricing, management, Community Service Obligations and introduction of competition; water supply reform; national gas strategy; rail reform in some States.
- Competition – Competition Principles Agreement 1995 with ongoing review of legislation; introduction of competition into previously monopolised areas such as telecommunications and electricity; dismantling of rural marketing schemes, price supports and buffer stocks; construction of privately operated tollways
- Taxation – GST; removal of transaction taxes such as BAD and FID; reduction of corporate tax rate; reform of Capital Gains Tax.
- Contracting – widespread adoption of contracting out of commercial service by government.

In more recent times, governments have accepted that internal economic structures and markets can also benefit from greater competition. A dramatic series of reforms in labour markets, transport, finance, communications, energy and other sectors reinforced trade liberalisation and helped give Australia an unprecedented surge of new growth. Box 6.1 above summarises the reforms over the past dozen or so years.

The United States has also experienced an active two decades of policy reform. The United States never had the level of government ownership of business assets of Australia or Britain, nor did it have anything resembling Australia's system of centralised wage fixing, nor a body with such sway over international trade as was exercised by the Australian Tariff Board through much of Australia's modern history. The United States has nevertheless embarked upon bold policy reform in numerous areas of public administration, ranging from taxation to regulatory reform, electronic commerce, environment and social welfare.

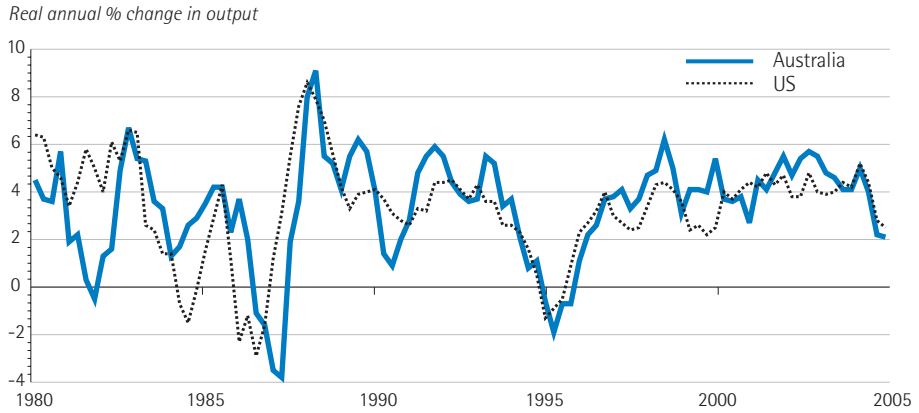
Leading Australian regulators would never embark upon important reform without first appraising what is taking place in the relevant authorities in the United States. Although national conditions and culture render many US solutions inappropriate to shared problems, the US authorities have the advantages that scale brings to policy research and development. The level of collaboration between Australian and US policy authorities means that there is some reverse flow of ideas. For example, Australia's targeting of welfare has influenced US policy debates.

Australia can struggle to register in the thinking of the world's largest economic power on policy issues. An FTA with the US will do nothing to alter the preponderant influence of domestic considerations in American policy decisions that have international consequences, however it may be expected to bring at least a marginal improvement in Australia's profile in American policy making.

It is remarkable the extent to which the Australian economy already parallels the United States. The growth of no other country so closely tracks the United States as Australia, not even Canada or Mexico. Modelling by the Reserve Bank of Australia shows that, compared with a weighted average of the GDPs of Australia's main export markets, US GDP growth is a better predictor. The reasons for this are not straightforward: the Asia Pacific economies (apart from Japan), for example, take four times as many of our exports as the United States. It is suggested, however, that the reasons may include policy coordination with the United States and a cultural affinity that leads the businesses and investors of both countries react to common issues in similar ways.

The economies of Australia and the United States are already pursuing a common path. The dynamic and indirect impacts of an FTA may be expected to bring benefits that cannot be factored in a quantitative method in advance. However the likelihood is that they will bring closer the economic performance of businesses in the two nations.

Figure 6.1 Australia and the US grow together



Source: Thomsen Financial Data Stream

7. The bilateral relationship and an FTA

An FTA would significantly strengthen Australia's bilateral relationship with the United States. Australia's economic relationship with the United States has become more diverse than with any other major trading partner. This is an historic trend deriving from economic reform in Australia. An FTA would consolidate that trend and expand the core of the bilateral relationship beyond security and defence cooperation. It would create new infrastructure to maintain a close relationship with the United States at a time when there are new, historic pulls on the United States to pay greater attention to other regions and issues.

Stronger economic links

In the previous chapters, the assessment was made that an FTA is likely to strengthen the trade and investment relationship with the United States. There is an historic dimension to this.

Until the early 1960s, Australian policy hindered rather than facilitated trade and investment with the United States. Membership of the Commonwealth System of Imperial Preferences and the sterling block skewed Australia's flow of trade and investment towards Britain. In 1950, Britain was Australia's leading source of imports and investment and the largest export market. These linkages also skewed Australia's trade away from Japan.

The scrapping of Imperial preferences, the move to convertibility of the Australian currency, the development of Australia's mineral resources, as well as Britain's entry to the EEC, led to a steady growth of trade and investment with the United States and Japan. Until the 1980s a new pattern became fixed. Japan became Australia's largest market (accounting for about 20 per cent of Australia's total exports) and the United States became the biggest supplier of imports. Its share of foreign investment also steadily rose.

Patterns of trade and investment between Australia and its major trading partners were dominated by Australia's agricultural and resources base. Japan invested heavily in resources and became a leading export market. The pattern was similar with the United States, except that Australia became a major supplier of beef as well as a recipient of US investment as US businesses expanded globally in the post-war period. Australia

heavily protected its manufacturing. As such, patterns of exports were shaped by trade barriers and subsidies.

Unilateral liberalisation of trade barriers on manufactures and the deregulation of the services sector of the economy that began in the 1980s in Australia initiated a new phase in trade and investment patterns. Australia's manufacturing sector became globally competitive and started exporting. The United States became the biggest foreign investor in Australia, Australia's largest market for elaborately transformed manufactures and Australia's largest single market for services exports. It also became the largest destination for Australian foreign investment.

Japanese trade and investment expanded into agriculture following the opening of some of its agricultural markets in the late 1980s. However, Australia's trade with Japan has not witnessed anything like the growth in manufactured exports to and investment in the United States and, to a lesser extent, Europe that has occurred since then. The basic reason is that Japan's markets for manufactures and inward investment in services have not been as easy to access as those in the United States and Europe.

There are signs that this may change. The issues are closely related to the need for economic reform that is widely accepted as necessary in Japan if economic growth is to be restored. However, if Japan does not open its economy up in this way, then the patterns of trade and investment between Australia and Japan are not likely to change. The degree of integration between the two economies could remain restricted to an economic relationship where Australia is a predominantly supplier of resources and agricultural commodities.

The opening of the Australian economy has resulted in increased flows of trade and investment between Australia and the United States. By removing remaining barriers, an FTA will consolidate that trend and enable Australia to secure the full benefits of a fully liberalised economy.

If the long-term projections made in the previous chapter about growth in North America are correct, an FTA will generate very important opportunities for Australian business to participate in that growth. It may be, however, that the ultimate bonus from an FTA for Australia will be integration with the economy at the heart of Information Age and the attendant improvement of business culture that will follow from being able to draw on the world's best.

Collaboration over international economic policy

An FTA will build upon the institutional dimensions of the relationship and create a more formal basis for joint consideration of trade and economic linkages. Australia will acquire trade rights under an FTA and enjoy a closer relationship on trade issues. In the past trade has been a matter of as much contention as cooperation in the bilateral relationship. Disputes over bilateral agricultural trade issues have been a regular source

of disagreement. At the same time, there has also been close cooperation between the US and Australia to pursue global liberalisation of agricultural trade since the Uruguay Round began. Collaboration in this vein continues in the WTO over efforts to open world markets for agricultural trade.

The open nature of the economy in each country predisposes both governments to approach questions of market economics and regulation with similar perspectives. Collaboration between Canada and the United States over international economic issues intensified following creation of the North American Free Trade Area. A logical consequence of an Australian US FTA would also be closer collaboration in international fora on such issues.

An FTA will enhance an affinity between Australia and the US (and Canada) for collaboration over international resource issues. All three economies are global suppliers of mineral resources. It is common for the three to find themselves at odds with members of the European Union in fora where international economic and resource issues are considered. The Europeans tend to see global resources issues from the standpoint of consumer and processor, whereas Australia, United States and Canada are producers and exporters as well.

Geo-strategic significance

Finally the geo-strategic significance for Australia of strengthening its relationship with the United States through an FTA is great. This has two dimensions: one strictly bilateral, the other regional.

Modernising the relationship

Australia and the United States enjoy a genuinely close relationship based on a shared history of cooperation in peace and war, wide-ranging commercial ties and extensive people to people links. It is marked by a shared commitment to democracy, international security, and an open trading system, as well as an interest in maintaining a strong US presence globally and within the Asia Pacific region in particular. Both countries derive significant benefits from cooperation on a range of security, economic and multilateral issues. Box 7.1 sets out the main features of the relationship in greater detail

Both Governments have sought to modernise and revitalise the relationship in recent years. The 1996 Australia-United States Ministerial Consultations (AUSMIN) in Sydney set the stage for this process. The two countries released a Joint Security Declaration reaffirming their intention to work together, and with others in the region, to promote common security interests and a regional security environment that promotes democracy, stability and prosperity.

An FTA would help maintain the momentum of the bilateral relationship, with great benefits for both Australia and the US. An FTA would put the Australia–US trade and investment relationship on a similar level to our well established political and strategic links. It would reinforce public awareness in both countries, and particularly amongst younger generations, of the enduring relevance of the Australia-US relationship.

It is worth recalling that the relationship has been bolstered by a rather novel feature - the contacts among citizens of both countries that formed during the Second World War. Members of that generation who served in the Pacific have provided a reserve of goodwill towards Australia within American society that exists for few other nations. Australians who have experienced this first-hand understand the importance of it, those who have not do not. The number of members of Congress and senior figures in Administrations, including the Presidency, who have brought that interest to bear in attitudes towards Australia has been surprising over the years.

That Pacific generation has all but passed on. If the linkages which it provided are not replaced, Australia's capacity to draw the attention of the most powerful country in the world will be diminished. An FTA is an effective means of creating new institutional linkages with the United States. This will continue to ensure there is more to the relationship with the United States than just defence and security, as important as that is.

Moreover, later generations - particularly in Australia - associate the relationship with the bipolar alignments of the Cold War period. As the apparent certainties of the Cold War recede, along with the passing of generations with directly shared war-time experience, the task of anchoring the rationale of the relationship in the public mind becomes more challenging. In this respect, an FTA could add a vital dimension to sustaining the relationship as it moves forward into the 21st Century.

An FTA is also effective for this purpose because it happens to reflect an innovation in the way in which states manage relations with each other in the international system. Chapter 1 and Annex 1 describe the emergence of economic relationships between states as a powerful new means to build relationships between each other and to enhance global security through creation of economic interdependence. Economic interdependence has provided powerful glue for the achievement of stability and security in Western Europe.

FTAs are another means of promoting that economic interdependence. In situations where FTAs result in economic integration of economic activity, they have themselves become touchstones of special and close relationships with other countries.

Box 7.1 The Australia – United States bilateral relationship

Australia and the US have a long history of close defence and security cooperation. Australian and American forces have served alongside one another in every major war of the past century: in both World Wars, in Korea, in Vietnam, in the Gulf War, as well as in peacekeeping operations such as Somalia.

The ANZUS Treaty symbolises and formalises a close alignment of strategic interests with the US. It also provides a framework for practical cooperation in areas such as intelligence, defence technologies, and logistics and support arrangements. The cessation of the traditional trilateral ANZUS relationship involving New Zealand has not diminished the very close defence and security ties between Australia and the US. The 50th anniversary of the signature of ANZUS is being celebrated over the course of 2001.

In addition to these established security ties, Australia has actively encouraged a continuing constructive US role in the development of multilateral consultations and exchanges on security issues within the region, including the ASEAN Regional Forum.

The Asia Pacific's economic, political and strategic landscape has undergone profound change. Australia's strong regional credentials, coupled with traditional US influence and policy of regional engagement, provide a sound platform for a mutually beneficial maintenance of stability in the Asia Pacific.

The Asia-Pacific region accounts for around two-thirds of the global trade of both countries. Reflecting these shared economic interests, Australia and the US have played important roles in the formation and development of the Asia-Pacific Economic Cooperation (APEC) process. Both countries have worked closely together to ensure successful outcomes which have helped chart the future development of APEC as a forum for enhanced regional cooperation. More recently, Australia and the US deepened their cooperation in responding to the Asian economic crisis.

Australian and American sporting associations, artistic institutions, and academics interact continuously, reinforcing the shared cultural understanding and complementary perspectives which physical distance might otherwise diminish. The network of Australian/American Studies centres and associations in Australia and North America, and bodies such as the Fulbright Australian American Educational Foundation in Australia, help facilitate and expand educational ties.

Globalisation has enhanced people-to-people links between the two countries, and the strong Australian and American economies have underpinned substantial tourism growth. The US is Australia's fourth-largest source of tourists - over 400,000 Americans visited Australia in 1999–2000.

The Pacific Century and the rise of the Western Hemisphere

There is a wider, regional significance in Australia's forming an FTA with the United States. It was presumed over the last two decades that the twenty-first century would be the Pacific Century, the result of the confluence of the power and influence of the United States and the economies of East Asia, in particular Japan and China. This is a region of vital interest to Australia. Its interest is strong in seeing the US continuously engaged in East Asia, not only in the security equation, but also as a source of influence to encourage emerging economies to adopt open economic models. As mentioned above, there is a security dividend of greater stability from economic interdependence and the prosperity it can deliver. From this standpoint, an FTA with the United States has the twin advantages of keeping the United States engaged in the region and fostering a special relationship with the US.

That confluence of factors to generate the "Pacific century" will be major feature in coming decades. However, in the last two decades the idea of a confluence of interests between North and South America in the Western Hemisphere has also emerged as a powerful phenomenon. The clearest international expression is the idea of a Free Trade Area of the Americas, promoted first by George Bush senior, then Bill Clinton and now George W Bush. With the formation of NAFTA in North America and Mercosur in South America, as well as greater preparedness by South American governments to open their economies, the logic for an open economy in the Western hemisphere is strong, even if the ambitions to create it seem far ahead of the preparedness today of governments to liberalise.

A combined North and South American market would number more than 800 million people. Removal of all barriers to trade and investment in the Western hemisphere is an impressive ambition. We have already postulated in Chapter 5 that the North American Free Trade Area has better prospects of securing economies of scale by removing barriers to trade and investment in North America than the European Union has in achieving the same in Western and Central Europe. Add the dynamism of the North American economy to a commitment in South America to remove barriers, and the idea of a Western hemisphere trade area becomes a commanding one.

It too has a certain historical momentum. This is not the first time the United States has sought to secure influence in the Western hemisphere. It has a long tradition under the Monroe doctrine of active intervention to secure interests. It is one reason relations between the United States and many Latin American countries were difficult in the late nineteenth century and for most of the twentieth century. The democratisation of Latin America and opening of national economies that began in the 1980s, including particularly the negotiation of a common market in Mercosur which make Argentina and Brazil trading partners instead of military rivals, has dramatically changed the equation. The US interest endures, but influence the US would secure through a pan-

hemispheric free trade area is quite different from previous engagements. Trade and investment would replace the threat of military intervention.

The idea of the FTAA and the negotiation of NAFTA – the first-ever free trade area negotiated between developed and developing economies – also resonates with the increasing latinisation in US society. The cultural and economic pull of Latin America is now strong. It is the largest source of immigration to the United States. Spanish is emerging as a competitor to English in some parts of the United States. Miami has emerged as one of the great US metropolises to join New York, Chicago and Los Angeles. In US international policy the trans-Atlantic interest was significant in US policy since the First World War. In the post World War Two period, a distinct Asian Pacific interest emerged in US public policy. Since the negotiation of NAFTA, there is a strong Western hemispheric interest. All these interests have deep roots in US international public policy.

Nations in the Asia Pacific region like Australia have always been concerned to ensure US Administrations give appropriate priority to developments in the Asian Pacific area. They were always aware there was a competition for attention in Washington with trans-Atlantic interests. The Western hemisphere is a new contender for attention in Washington. History suggests there is inevitability about economic integration in North and South America. This will not be a quick process. But already there is competition for US interest, for example between APEC and the FTAA concept. In 2001, the conclusion must be that there is more interest in pursuing trade liberalisation and economic integration in Latin America than there is in East Asia. Little concrete action is being taken to implement the Bogor Declaration to remove barriers to trade and investment in the APEC area whereas the Heads of Government of the Western Hemisphere are strongly endorsing the idea of an FTAA.

It is in Australia's long-term interests to keep US interest in engagement in East Asia. The interests are economic, strategic and geo-political. Negotiation of an FTA with the United States is an additional means of reinforcing interests in US international public policy that maintain a long-term focus on developments in the East Asian region. Moreover, as noted in Chapter 5, an FTAA would pose serious competitive challenges in trade for Australia. An AUSFTA would also help position Australia to address those challenges.

8. Implications for Australia's global trade interests

A leading imperative for Australia's global trade policy is to maintain the effectiveness and authority of the WTO multilateral trading system because of its contribution to global economic welfare. Australia's overriding global goal in trade policy is to eliminate global protection of agriculture. This can only be achieved with global solutions through the WTO. Some contend Australia diminishes those global interests by pursuing free trade agreements. There is no reason why Australia cannot support its overriding global goals and simultaneously pursue bilateral liberalisation. The global record now suggests that regional and bilateral liberalisation supports, not diminishes, global liberalisation. An Australia–US FTA can serve as a leading edge example of such support.

Australia's trade interests are global

Much is made of the fact that over half of Australia's exports, now go to East Asia.¹ However this must not disguise the fact that Australia is fundamentally a global trader. Australia's capacity to trade with all regions of the world and across all sectors of the economy creates a resilience which helps manage downturns in demand in markets in major regions. It is a key reason Australia weathered the fall in demand in East Asia since 1997 following the Asian currency crisis. Trade expanded in areas outside East Asia.

In 1999–2000, 53 per cent of Australia's exports went to East Asia. Export growth to East Asia outstripped growth to all other areas until 1995. For example, between 1990 and 1995, exports to East Asia grew at twice the rate of exports to the rest of the world. Growth of trade to East Asia is not new but consolidates a standing trend. In 1979–1980, 44 per cent of Australia's exports already went to East Asia. The pattern of export to East Asia vis a vis the rest of the world reversed after 1995. Between that year and 2000, export growth to the rest of the world grew at twice the rate of export growth to East Asia.

Many economists predict that export growth to Asia will recover. This must depend upon on recovery of economic growth in Asia and there are reasons to be cautious about that in the short to medium term. The leading economy, Japan, is teetering on

1 Defined here as ASEAN, South Korea, Japan, China, Hong Kong, and Chinese Taipei.

the brink of recession. Recovery of growth in Japan will depend upon fundamental reforms which are not likely to be undertaken quickly. The economies hit by the Asian currency crisis have still not completed the necessary reforms their financial systems and corporate governance require to restore stable bases to their economies. They are susceptible to even small external shocks. Recession in the United States would have an adverse effect on the prospects for these economies.

Whether or not there is recovery sooner or later in Asia, the fact that Australia is a global trader must be the fundamental point for defining Australia's interest in international trade. Other than large economies, the normal export pattern for most countries is for a handful of products to dominate exports and for exports to be concentrated in a few markets, usually adjoining economies. Eighty per cent of Canada's trade is with the United States. Germany is the largest trading partner by far for Sweden and Switzerland. Australia was closer to that model in 1950 when 36 per cent of all exports went to Britain and one product – wool – accounted for 52 per cent of exports.

The situation today is a notable exception to that pattern. The largest single export market for Australia is Japan, which takes around 20 per cent of Australia's exports. The largest single export product is coal, accounting for around 12 per cent of all exports. The United States, Europe and New Zealand have traditionally accounted for around 10 per cent of Australia's exports. The rest is spread among other countries. Australia's remoteness from major markets and its wide resource endowment means that its exports today are almost evenly split between agriculture, minerals, manufacturing and services.

The wide spread of Australia's export markets and the diversity of the export mix is unusual for an economy of Australia's size. It also means that Australian producers and manufacturers have a capacity to move into new markets as they emerge. Australia's recent, dramatic increase in exports to the Middle East is a case in point. Over the last five years, exports to the Middle East have increased more than fivefold to \$1.5 billion in 2000. The bulk of these exports were automobiles.

Australia's import pattern is starting to show a similar spread. In 1995, 62 per cent of Australia's imports came from the world's three biggest economies – Japan, the US and the EU. The largest single source, at around 25 per cent, is the United States. This is normal. Most countries import most products from these three economies. They are the major producers of capital and consumer goods, which is what most countries import. The share of imports of the three had dropped by 2000 to 55 per cent, an effect of currency devaluation in the East Asian region.

Australia's fundamental trade interest is to see a global economy where Australian producers of goods and services have the maximum opportunity to undertake commerce where they can and to ensure that global arrangements facilitate such a result and promote competitiveness in the Australian economy.

Australia's global trade interests – the centrality of the WTO

Australia has three overriding trade policy interests. The first is to see a global system operating that fosters through commercial exchange the optimal utilization of resources in Australia to improve the standard of living of the Australian people. The second is to ensure that that system offers the same opportunities to other countries for the humanitarian benefit it can deliver and for the promotion of stability in international relations that it can bring. The third interest is to secure removal of trade barriers to Australian exports.

The welfare benefits of the WTO

All three goals can be delivered through the multilateral trading system based on the rules of the World Trade Organization. Only the global benefits of the first two goals can be delivered through a bilateral system. Countries can secure agreement to reduce barriers in bilateral or even regional agreements. The premise underpinning the system is that if the exchange of goods and services between all economies is based on the comparative advantage of each economy, all economies will receive the optimum economic benefit. A global trading system based on this premise would result in increases in the standards of living of all economies which chose to actively participate in it. This will contribute to global prosperity and promote international security.

By and large the WTO trading system has gone a long way to create such a system and to secure such results. The record growth and increase in standard of living of people in the world since the GATT was negotiated to a large extent is a result of the creation of the global multilateral trading system. The average tariff on global trade is now down to around 6 per cent. The preservation of this system is in the interest of economies, but it is especially important for smaller nations and those which are not members of significant trade blocs. While it would not be in the interest of any member of the European Union to see the multilateral trading system fail, they at least have some sense of security because of access to the markets of other members of the European Union guaranteed by EU agreements. Most nations do not have the luxury of such a fallback. For Australia, and most other countries, preservation of the authority and effectiveness of the multilateral trading system is absolutely vital.

While the WTO system has been effective in enhancing global economic welfare, there are areas where trade barriers remain high and exchange of products is restricted. Most notable is the agricultural sector and global trade in clothing and textiles. Trade barriers are also significant in many services industries. Trade barriers also tend to be higher in developing countries than developed countries.

The WTO therefore must still be regarded as 'work in progress' if it is to fully serve its purpose of providing all nations the opportunity to secure the optimum economic

benefit for their people. Garments, textiles and agricultural products are areas of specialization in trade for many developing countries. It is a measure of the lack of generosity of the industrialized world that it has given such a low priority to the task of opening world markets in the areas of greatest interest to so many developing countries.

There is a need for another round of multilateral trade negotiations in the WTO. There are outstanding commitments from the Uruguay Round to embark on another set of negotiations to reduce trade barriers in agriculture and in services. These negotiations have technically started. However, they will not gain full momentum until they become part of a global negotiation on a wider package of issues. Efforts to secure such an agreement have not been successful. The WTO Ministers failed at the conference in Seattle to reach agreement on such a package. There will be a fresh effort to secure an agreement at Doha, Qatar in November 2001.

The problem of world trade in agriculture

Removal of protection of global trade in agriculture has been Australia's leading trade priority ever since the GATT was established. Markets for agricultural products in Europe, Japan and to a lesser extent, the United States, the world's biggest markets for food, are also heavily restricted. The European Union is the single largest market for food but Australia exports very little to it. The OECD estimates that world subsidies of agriculture amount to \$US400 billion annually. These subsidies push down world prices, which means that Australia (a very competitive producer and exporter of grain, red meat, dairy products, sugar and many horticultural products) earns much less from exporting agricultural products than it should.

An important start to open world agriculture markets was made in the Uruguay Round of trade negotiations which ran between 1986 and 1994. An initial program to reduce support for agriculture was started, but it was a six-year program and it expired in 2000. While non-tariff measures have been significantly reduced under that program, tariffs remain high and payment of subsidies to farmers remain very high. The issue of reducing these barriers is so politically sensitive that it is difficult to conceive of the EU, Japan or the US agreeing to agree to deep cuts in subsidies and protection of agriculture other than through a global negotiation in the WTO.

The only realistic way of reducing intervention by the governments of the world's largest economies in the production and trade of agriculture is to secure agreement in the WTO to progressively reduce subsidies paid to agriculture and barriers to trade in agriculture. Australia's leading global trade interest therefore must remain further global liberalisation in the WTO, with particular emphasis on agricultural trade.

Pursuing this goal outside the multilateral trade system is not an option for Australia or anyone else. Australia may secure increased access to US agricultural markets

through an FTA, but this is not a solution to the global problem of protection of world agricultural markets.

Trading rights created by the WTO

It is also of vital importance to Australia that the rules of the WTO remain effective. The WTO is a valuable instrument for Australia to seek removal of other trade barriers to Australian exports. A number of areas of high export interest to Australia are restricted by high trade barriers. A number of countries, many in Asia, have very high barriers against automotive imports, which are now one of Australia's major manufacturing exports. Services markets are also heavily restricted in Asia. Restrictions on imports of clothing and textiles in Europe and North America from developing countries restrain the global market for wool, another major Australian export. Every time there is a multilateral negotiation to reduce trade barriers, there is an opportunity for Australia to press trading partners to reduce barriers.

The WTO rules also restrain members from trying to create unfair advantages for their enterprises in world trade. It constrains abuse of subsidies and dumping, and misuse of technical barriers as disguised restrictions on trade. It obliges parties to limit the extent to which they might discriminate against others when they form customs unions or free trade areas.

Finally, the WTO has a very effective system of compulsory arbitration which enables any member to challenge the compliance of any other member country's policies with its WTO obligations. The WTO system provides Australia (and every other member) with extremely valuable rights in international law. Anything which undermines those rights undermines vital national interests.

Removing trade barriers

The third basic interest in Australian trade policy is to seek removal of barriers erected by others to Australian exports. The way in which the WTO supports that has been discussed. Countries can also seek removal of barriers through bilateral or regional trade agreements. This is one key reason for forming a Free Trade Area with the United States – to seek removal of US barriers to Australian imports.

Squaring off multilateralism and bilateralism

Does a proposal by Australia to reach a free trade agreement with the US diminish the importance of its evident interest in securing further global liberalisation in the WTO? There are two arguments. One is that negotiating bilateral agreements represents an alteration of priorities that does not reflect national interests insofar as an agreement with the US cannot bring about a global reduction of barriers. A second is that

negotiation of an FTA now would divert valuable resources (time and resolve) from the critical business of launching a new WTO round.

The question of priorities is one for government to decide. Progress in the WTO remains a fundamental priority but this does not prevent governments from pursuing other priorities. Successive Australian Governments have stated that they will pursue multilateral, regional and bilateral trade issues simultaneously and they have. In the late 1980s, while the Australian Government was intensively involved in the first part of the Uruguay Round, it launched the APEC initiative and accelerated the creation of a free trade area between Australia and New Zealand.

Australia was not alone in working to secure results through the Uruguay Round multilateral trading system while at the same time pursuing regional or bilateral liberalisation. While the EU (then EC) was negotiating in the Uruguay Round it was completing the Single Market Program which resulted in the Maastricht Treaty. The United States at the same time negotiated first a bilateral agreement with Canada and then completed NAFTA with Canada and Mexico. As the Uruguay Round drew to a close, the ASEAN countries negotiated the ASEAN Free Trade Area. Many trading nations have demonstrated that it is possible to maintain multilateral trade liberalisation as a high priority while undertaking liberalisation on a regional or bilateral basis in parallel. As noted in Chapter 3, experience suggests that negotiation of regional and bilateral agreements has been a spur to multilateral liberalisation and not a drag.

The issue then swings to the second argument. Can both multilateral and other liberalisation activity be resourced satisfactorily at the same time? The test of whether or not a priority is diminished is the extent to which resources are reduced for that priority. There is no intrinsic reason why Australia cannot follow trade initiatives to establish an FTA with the US in parallel with efforts to launch a successful WTO Round.

The pattern would seem to be not that regional or bilateral activity cannibalizes interest, resources or commitments to multilateral liberalisation, but that the taste for one stimulates the taste for the other.

Another reality bears in on this issue. Since 1988, the United States has decided that it will negotiate free trade agreements with other countries. It has not indicated that this represents a diminution of its preparedness to pursue global liberalisation through the WTO. Even if Australian authorities were to decide that the WTO should warrant higher priority in Australian trade policy interests, would it be in Australian interests to disregard US propensity to enter bilateral agreements, especially when it was doing it with countries who were less significant trading partners of the US than Australia?

How an Australia – US FTA can provide cutting edge leadership in trade liberalisation

Largely as a result of the experience with trade liberalisation over the last two decades, thinking about the relationship between bilateral and multilateral trade liberalisation has changed. As noted in Chapter 3, a 1995 study by the OECD concluded that a general effect of bilateral and regional trade liberalisation was to support and encourage multilateral liberalisation.

There are several examples where innovation in trade liberalisation has occurred in smaller fora and then been expanded upon and given global standing in the WTO. Australia played an active role in such a development. As noted earlier, Australia and New Zealand showed how liberalisation of trade in services could be achieved before negotiators in the WTO had worked out how to deal with this multilaterally.

Negotiation of an FTA between Australia and the United States creates a number of opportunities to develop approaches that could improve the effectiveness of the multilateral trading system in opening world markets.

Multilateral trade negotiations are typically drawn-out affairs. It is most likely that an FTA between Australia and the United States would be completed well before the next round of negotiations in the WTO is completed. There is a strong prospect of using an FTA to adopt approaches on problems in international trade that could then be developed further in the WTO. Both Australia and the United States could set that as a secondary policy objective of negotiating an FTA.

Reforming trade in agriculture is a clear case in point. The design of processes of liberalisation can have a critical effect on the success of the process.² The Agriculture Agreement negotiated in the Uruguay Round principally secured removal of non-tariff controls and established rules on how to reduce protection. This was a very important step. But if the negotiations in the next round are to be successful, substantial reductions must be achieved. Clear guidelines are needed on how that is to be achieved. Australia and the United States have a common goal to secure global reduction of support for agriculture. Approaches to reducing such support that could be applicable

2 Any reader who reviews the modalities for reducing support for agriculture in the WTO Agreement on Agriculture will be instantly stuck at how technical and complex the rules are. And as the reader comprehends the impact of the rules, it will become increasingly clear how technical definitions and exemptions can easily frustrate the original intent to reduce protection. In the WTO Agreement, very broad exemptions were permitted. The level at which non-tariff measures were converted to tariffs resulted in no reduction of protection when the conversion took place. Members were permitted to lump large numbers of products together for the purpose of measuring how commitments to reduce financial support paid to agriculture was to be measured. This enabled members to avoid reductions on some products.

in the WTO negotiations could be developed in the bilateral agreement.³ Such precedents could also serve as valuable guidelines for negotiations over agriculture in the FTAA.

One of the thornier issues to emerge in international trade now is how to enhance public confidence in food safety and manage trade in new products such as genetically modified organisms, while at the same time opening markets to trade. Many environmental groups argue that controls on trade are essential to maintain public confidence in food. This is not necessarily the case, but these sorts of arguments will be exploited by European farm groups to keep out imports of safe and high-quality foodstuffs that cost less than European domestic products. Australia and the US could develop standards and conventions in bilateral trade to address public concerns about food safety that would have utility in the WTO and related fora.

Other areas in which an FTA could have utility in promoting wider global liberalisation are use of technical standards, use of sound science to guide regulations on trade, definitions on rules of origin, investment rights and temporary residence rights for services professionals. These are just a few examples.

The degree to which there is commonality of thinking in Australia and the United States today on public policy management in economic policy, as observed in Chapter 6, is quite striking. The United States will not have before negotiated an FTA with a more open economy. An FTA presents an excellent opportunity for Australia and the United States both to advance their mutual economic interests and to encourage liberalisation elsewhere in other bilateral and regional fora as well as the WTO itself.

3 This may seem overly ambitious, but if both governments set themselves such a goal, agreements could be established would have wider utility. They may set out long goals for reductions of barriers, and lay down rules that could be applicable in WTO fora. Examples of issues to consider could include: how to progressively replace quotas with tariffs over time; how to relate reductions in barriers to market access with constraints on payment of subsidies to ensure subsidies do not substitute for the protective effect of the higher tariff; how to define exemptions to ensure they do not undermine the overall goal of liberalisation; and how to set up sub-negotiations so that full liberalisation in specific areas of trade in food and agriculture can be achieved without tying the pace of liberalisation to movement in the most intractable areas.

9. The regional dimension

Australia's regional trade interests

A leading international policy interest of successive Australian Governments has been to secure closer engagement with Asia, including by economic integration. A principal vehicle has been APEC, largely an Australian initiative. There has also been interest in sub-regional trade linkages. Some concern has been voiced in Australia that seeking a trade agreement with the United States will diminish Australia's commitment to engage with Asia. This chapter looks at the implications of an FTA with the US for Australia's interests, both economic and political, in Asia.

Attitudes in East Asia to trade liberalisation

Australia's trade policy has shown an enduring interest, and demonstration of interest, in advancing engagement with Asia on a regional and bilateral basis. However, while economic integration was a high priority for most East Asian Governments through most of the 1990s, it is clear that today, especially following the Asian economic crisis, trade liberalisation is a lower priority. This is despite the welter of proposals for new trade and regional agreements that continue to be put forward around the Asia Pacific region.¹

While the term "free trade" is used to describe many of these proposals, the record of the East Asian region on trade liberalisation since the mid-1990s is patchy. Efforts to implement the proposed program of Early Voluntary Sectoral Liberalisation in APEC could not secure consensus at the APEC Summit in Kuala Lumpur in 1998, principally because of opposition from Japan. The process of trade liberalisation in the ASEAN Free Trade Area has all but stalled because of difficulties in implementing the agreed tariff cuts, including Malaysia's refusal to reduce tariffs for its automotive sector. Commitments to liberalise financial services among ASEAN countries likewise remain

¹ There are proposals by Singapore for bilateral free trade agreements with the US, Japan, Australia, NZ (completed); by Korea with Mexico, Canada, NZ; by Australia and the US, Singapore, and Thailand; and for a bilateral FTA between New Zealand and Hong Kong. There are proposals for FTAs/closer economic relationships between Japan and Korea, Japan and Mexico, and between NZ and Chile. There is a proposal for an FTA between China and ASEAN, proposal for Closer Economic Partnership between ASEAN and Australia and New Zealand and there is a proposal to examine an ASEAN plus Japan, Korea and China economic relationship.

unimplemented. And the proposal to create a free trade area between AFTA and ANZCERTA had to be substituted for a more modest goal of building a Closer Economic Partnership because ASEAN leaders could not agree to proceed with the idea.

There are two reasons for the fall in support for trade liberalisation. Economic recession in the region led industries to adopt more inward looking approaches, including through calling for trade barriers to be maintained. It also focused leaders on internal issues, such as reform of financial and administrative mechanisms. Secondly, it resulted in a general lack of leadership in East Asia to pursue ambitious international agendas. This has been compounded by political difficulties in some key countries of the region.

However, the need for market-based reforms has never been more relevant. They are at the core of what has to be done to restore economic stability and growth in the East Asian region. Yet the general response has been to defer taking necessary action or, in some cases, retreat from market based reforms. Only China, pursuing its membership of the WTO and domestic economic reform, Taiwan, also ready to accede to the WTO, and Singapore, which is building a network of bilateral agreements, show significant policy momentum in these areas.

Australian policy

Policies for economic engagement in Asia

Australia has been very active in trying to encourage greater market-based economic integration in the East Asian region. APEC has been the principal instrument for this over the last decade. Australia was an active supporter of the APEC program of Early Voluntary Sectoral Liberalisation (EVSL).² Australia has also pursued sub-regional and bilateral approaches. It strongly supported the proposal to bring the ASEAN Free Trade Area (AFTA) and the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) together. Australia has recently completed a joint study with Japan about promoting closer collaboration between the two economies, and has embarked on a similar project with the Republic of Korea. Australia is negotiating a free trade agreement with Singapore and has agreed to undertake a scoping study with Thailand on an FTA.

2 Under the EVSL Program, a set of liberalisation measures which APEC members were to implement voluntarily was negotiated. The project was fraught with difficulties. Mexico and Chile elected not to participate, the latter on the grounds that partial liberalisation was undesirable. The limited scope of the measures did not bear scrutiny. In 1997, the welfare effects on the Australian, Chinese Taipei and New Zealand economies were modeled in each country and reported to the annual APEC Study Centre Network Conference. The conclusions for each were that the net effect on economic welfare was negative. When the package was put to Governments to approve at the Kuala Lumpur APEC Leaders Summit, it was vetoed by Japan, not because it was an imperfect model of liberalisation but because the Japanese Ministry of Agriculture considered that it went too far.

Australia also demonstrated its support for the economies of East Asia during the Asian currency crisis. Australia generously funded balances of payments support for Indonesia, Korea and Thailand. Only Japan was more generous.

Despite Australia's willingness to strengthen economic relations in East Asia, its exports to the region have flagged since 1995, owing largely to the economic crisis. They appear to have recovered somewhat in 2000, but a significant amount of that increase can be attributed to increases in oil prices by OPEC (petroleum is a significant Australian export to East Asia) and to rises in world prices for beef and wool.

Despite this recent downturn, Australian policy-makers and governments have continued to emphasise the importance of the region to Australia. At the same time, Australia's successful avoidance of the effects of the crisis also reinforced the value of Australia's strong trade and investment links with the rest of the world.

Nevertheless, whether or not growth recovers in the short term or the long term, and whether or not East Asian economies recover the giddy growth rates of the early nineties, the reality is that in the long term countries in the region will remain major economic partners for Australia. It would be contrary to Australia's self interest not to foster close economic relations with East Asia nor to seek to maintain close political relations.

Asian engagement ahead of all other policy?

One line of reasoning within Australia that has been given some airing in media opinion columns and at conferences is that Australia will diminish its capacity to pursue engagement in East Asia if it concludes an FTA with the United States. One argument appears to be that economic engagement in Asia should be the dominant priority of Australia's international economic public policy. Given the strategic importance of the region to Australia, the case for this can be understood.

However, this has never been the expressed policy of successive governments (all have been careful to avoid saying that one region is more important than other or that one country is more important than another). Although it is certainly true that engagement with Asia has acquired greater importance in Australian diplomacy over the last two decades. There are some implications in the assertion of Asian engagement as the policy interest to override all others that deserve consideration.

Suppose for a moment this is accepted as the dominant policy paradigm. Is this a policy to apply in all circumstances? Where Australia's willingness to engage in further economic integration did not match the policy settings of governments in the region, would the proponents of an "Asia first" policy contend that Australia should eschew opportunities to secure economic integration outside East Asia simply to pursue an apparent political objective?

To assert a political goal (integration with Asia) over an economic goal (allowing trade and investment to expand wherever businesses want to operate) has worrying and costly implications. The fundamental premise of economic integration based on open market economics is that countries should permit natural comparative advantage to work to allow trade and investment to flow wherever it will yield the best return for the nation.

Australia has imposed political objectives over economic self-interest in the past. It used the British Empire then Commonwealth System of Imperial Trade Preferences to ensure that Australia gave preference to British imports and directed its exports to Britain. This had the effect of diverting trade away from Japan and the United States and caused a loss of economic benefit to Australia. The lesson of this was well learnt by Australian farmers who refused all suggestions in the sixties that Australia should not sell wheat to Communist China because Australia did not recognize the People's Republic of China. It would be contrary to the national self-interest to pursue Asian engagement to the exclusion of all other policy and it would receive very little respect in East Asian countries, who themselves have not followed such a course.

There is no cause for Australia to cease doing what it has always done - building close relations without regard to considerations about whether or not strengthening a relationship with one country represented a diminution of interest in strengthening relations with others. This is a standard challenge for diplomacy in all countries.

If the suggestion is that Australia needs to consider any proposal for strengthening its relationship with the United States, such as negotiating an FTA, in the light of its possible impact on relations with countries in East Asia, that is an altogether different proposition. Other countries in the region do not feel so constrained (Singapore is negotiating an FTA with the US and South Korea is studying the idea.) And given that the strengthening of the relationship with the US is important to Australia's economic and political interests, to suggest that actions to strengthen ties should not be pursued for their own merit must surely be to subsume Australia's national interest to that of another country's.

In this respect, there have been suggestions that strengthening the economic relationship with the US might spill over into strategic issues, such as current US interest in building an anti-ballistic missile defence system. Stronger ties with the US at this time, goes the argument, might be seen as siding with the US on an issue which has generated concern in the region, in particular with China. There is no automatic reason why this should be the case. It is part of the art of public policy and diplomacy to separate consideration of issues that are not and should not be joined. Managing these issues is a matter for the domain of diplomacy.

Is Australia being excluded from new Asian groupings?

For some analysts, there is understandable unease about proposals for some form of economic integration arrangement between ASEAN and China, Korea and Japan (known as ASEAN plus Three). The concern is that a regional body in which Australia was not a member might be established. Before considering the question of what Australia could do about that, it is worth reflecting on the prospects for ASEAN plus Three and other proposed regional groupings.

Economic integration is not achieved by political declaration. Like trade liberalisation (which is part of the process of economic integration) it is difficult. It requires high levels of political commitment, formal legal commitments, changes to policies, structural adjustment and management of powerful domestic political interests. If the ASEAN economies cannot maintain their own timetable for liberalisation within AFTA and if Japan and Korea feel the idea of a fully fledged free trade agreement between the two countries is too ambitious, settling instead for a weaker agreement on economic cooperation on investment and services, what are the prospects in the short to medium term for some sort economic community among the ASEAN Plus Three group? This is an issue about which Australian analysts would be advised to bide their time before assuming that Australia is in danger of being excluded from meaningful regional integration.

Staying alert to opportunities

Notwithstanding the above, it is also a diplomatic duty for Australia to remain alert to such developments in the region and continue to demonstrate preparedness to strengthen economic ties with any trading partner in East Asia. It should be ready to consider any proposal to that end and to implement such proposals when they are made, as in the case of the proposed free trade agreements with Singapore and Thailand.

It should be noted that East Asian Governments have not expressed a view about the appropriateness or otherwise of Australia's interest in an FTA with the United States. If Australia were to pursue such an FTA, it should not be difficult to assure East Asian governments that this in no way diminishes Australia's policy of engagement with the region.

An Australian US FTA and APEC

What about APEC? Does an FTA diminish APEC's authority? Does it encourage the trend today in the region for a proliferation of bilateral and sub-regional agreements and does that harm the standing of APEC? There are two issues. What will this flurry of activity produce? How will it affect APEC?

It is already clear that some of these proposals for trade agreements will produce more significant results than others. As noted above, economic integration is always difficult to achieve. As a working rule of thumb, where economies are open, the likelihood of agreements with significant, legally binding commitments being struck is strong. Where economies are not open and governments are not pursuing a market reform agenda, results are likely to be modest; little more than political agreements to cooperate which make little if any contribution to economic integration.

Where agreements produce real commitments to liberalisation, there is no doubt this can be beneficial to the broad APEC Bogor goal of removing all barriers to trade and investment by 2010 and 2020. Agreements among any of the following – Australia, Chile, perhaps Hong Kong, Singapore, the United States, Canada and Mexico – could be expected, on the basis of established policies, to lead in that direction. The Bogor commitments are still 9 and 19 years out and remain realisable as broad targets. The rate of liberalisation required to achieve them is no less than the average rate of trade liberalisation among APEC countries, undertaken either unilaterally or within the disciplines of the WTO, over the last 10 to 15 years.

Bilateral and sub-regional agreements that achieve liberalisation can have a demonstration effect for the rest of APEC and can help to maintain some momentum for trade liberalisation among APEC economies. As argued in the previous chapter, an Australian–US FTA could serve to show leadership on economic integration among APEC economies, as can free trade agreements with Singapore and Thailand.

Furthermore, the trend towards extending free trade linkages across the Pacific can create a broader dynamic towards integration within APEC extending beyond the East Asian/Western Pacific region. Negotiations between Singapore and the US, and preliminary discussions between Chile and, respectively, Korea and New Zealand, and even exploratory talks by Japan with countries like Mexico and Canada, reflect an emerging trend.

Although this remains a very tentative trend, one can discern in it potential for broader consolidation of economic integration across APEC, and even beyond towards closer alignment of APEC as a region with the emerging Free Trade Area of the Americas. While such an idea might seem speculative, the 'pressures for inclusion' created by a spate of regional and inter-regional activity can build what has been described as a 'domino effect', drawing previously reluctant participants into integration and liberalisation processes.³

There is also something of a tendency, in Australian media commentary in particular, to see APEC as having passed its prime. This is a perception not held as strongly in the rest of the region. Such perceptions disregard the substantial institutionalisation of

3 See Baldwin, Richard E. "The Causes of Regionalism", *World Economy*; Vol. 20: Issue 7; 1997, for a discussion of domino theory.

APEC. With the annual Leaders' summit, regular meetings of Ministers and numerous technical working groups, no other organisation in the region apart from ASEAN is so well institutionalised. The ASEM (Asia Europe dialogue) process appears to be losing momentum and discussions about an ASEAN Plus 3 economic integration are simply at the point of study.

For so long as the United States remains a strategic player in the Asia-Pacific region, as an important market, a source of technology and investment, the largest export market for most APEC economies and the home of the information economy, there will be a logic for APEC. The dynamics of the annual APEC Summit are proof of that. There is no other occasion when the Heads of State of the United States, China and Japan can meet without the occasion of their meeting itself being an issue. APEC was not established to promote political stability. But the APEC Summit has come to play a leading role in managing trans Pacific relationships.

Impacts on trading partners

The econometric modelling work by CIE for DFAT (see Chapter 5) suggests no trade diversion of any consequence for third countries as a result of an Australia-US FTA. The two small exceptions identified were related to the possibility of improved Australian access to the US dairy and sugar markets. In that case there might be some diversion of Australia's sugar trade away from one or two countries in East Asia and there may be consequences for New Zealand's dairy trade with the US. Generally, however, an AUSFTA was seen as having a likely positive, if small, impact on New Zealand, particularly through the flow-on of increased growth in the Australian economy.

Efforts have been made to establish guidelines to minimise the trade diversionary effect of sub-regional and bilateral agreements. These include provisions to enable others to adhere to agreements at later dates.

The low likelihood of trade diversion from an Australia-US FTA has been addressed several times in this report. However, in order to foster a positive attitude towards trade liberalisation among APEC countries, it would be in Australia's interests to seek such a provision in the FTA to facilitate membership by any other country, and in particular New Zealand, given the virtually complete integration of the Australian and NZ economies. This may be difficult to achieve. Securing the agreement of the US to structure a bilateral agreement so that third parties might subsequently join may be difficult. There is a long tradition of basing trade agreements on reciprocal terms in the US Congress. That is not a reason why Australia should anyway seek to craft an agreement that would serve such a purpose.

Australia's strategic interests

As noted above, the US is a vital element of economic activity in the Asia Pacific region. It is the major market for most East Asian economies, the major supplier of capital, as well as the hub of the globalised IT manufacturing industry which has been such a vital part of economic development in East Asia. It is also a strong force for open market reform in the region. Its presence and economic engagement in the region is vital to strategies to secure economic integration among Asia Pacific economies.

While APEC may be institutionalised, its loss of momentum for trade reform and economic integration has diminished the standing of APEC in Washington. From the outlook in Washington DC, there is more momentum behind the idea of creating the Free Trade Area in the Americas than there is for realising the Bogor Declaration. At some point soon, APEC Leaders will have to confront this reality.

In the interim it is fundamental to Australia's interests in promoting open market integration among APEC economies to encourage US engagement in East Asia. An FTA between Australia and the US creates linkages that build such interests into US policy settings. It is a tangible way of encouraging continuing US interest in economic development in East Asia.

It is essential that Australia pursue its public policy interests in a way that demonstrates continuing interest in engagement with East Asia. It has done so already. Much, if not most, of the anxiety about being seen to diminish that interest by entering an FTA with the United States is over-wrought. Managing this requires the straightforward exercise of diplomacy at which Australian Governments are well practised. As with the question of whether Australia can pursue simultaneously an FTA and its interests in the WTO, the answer is the same: both can be done at the same time. Indeed, Australia's interests in advancing economic integration in East Asia are positively promoted by an FTA with the United States.

Glossary of terms and abbreviations

ABS	Australian Bureau of Statistics
AFFA	Agriculture, Fisheries and Forestry—Australia
AFTA	ASEAN Free Trade Agreement
ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
APEC	Asia-Pacific Economic Cooperation
AQIS	Australian Quarantine Inspection Service
ASEAN	Association of South East Asian Nations
Austrade	The Australian Trade Commission
CER	Closer Economic Relations
DFAT	Department of Foreign Affairs and Trade
EMDG	Export Market Development Grants
EU	European Union
FTAA	Free Trade Agreement of the Americas
GATS	General Agreement of Trade and Services
GATT	General Agreement of Tariffs and Trade
GDP	Gross Domestic Product
GM	genetically modified
GMOs	genetically modified organisms
ICT	Information and communications technology
IP	intellectual property
IT	information technology
NAFTA	North American Free Trade Agreement
Mercosur	Common Market of the Southern Cone

MFN	Most Favoured Nation
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
R&D	Research and development
SME	Small and medium enterprises
TCF	Textile, clothing and footwear
WTO	World Trade Organization

Annex 1. The nature and future of globalisation

The proposal for a Free Trade Agreement between Australia and the United States needs to be seen in the context of a steady process of trade liberalisation and economic integration which has been one of the distinguishing features of international relations in the twentieth century.

Globalisation is a more important and more profound process than most of its critics suggest. It has altered the way in which nation-states cooperate and created new opportunities for states to enhance prosperity and, in certain circumstances, improve national security. Its impact on countries is not even. But in Australia's case it is distinctly positive. The nature of the benefits globalisation bring Australia will be similar to those achieved under an FTA with the United States.

The twentieth century was the most innovative yet in human history. All aspects of human relations were altered, including how nations deal with each other. The twentieth century produced the worst wars in human history and the most destructive weapons ever devised. At the same time, it also created the most effective system yet devised to promote order among nations and to resolve differences peaceably.

Protecting the security of its people is the first obligation of any government and, accordingly, this has always been given highest priority in foreign affairs. For a long time the most important relationship one state might have with another has been a military alliance. Australia's treaty alliance with the United States underpins Australia's national security and the relationship with the United States is therefore, arguably, Australia's most important.

One great innovation of the twentieth century was establishment of an international framework for managing conflict among nations. This is the system of collective security and conflict resolution established under the United Nations. It was the United Nations community that collaborated to drive Iraq's forces out of Kuwait during the Gulf War. This system is not so effective as to render redundant the need for states to seek alliances to maintain national security, nor does it prevent powerful states from taking independent military action if they choose to do so. But it has been sufficiently effective to bring a level of order to the management of global security that is greater than any in previous experience.

A second great innovation in international relations in the twentieth century was the development of a common accord among nations, bound in international law, to give freedom to citizens from all countries in the accord to conduct commerce with each other. These rights were established by the General Agreement on Tariffs and Trade (GATT) as global rights in a multilateral trading system. They have also been created in regional agreements among groups of states and in bilateral agreements. The extent to which states collaborate together for mutual advantage has been elevated to an entirely new plane.

The initial goal of these arrangements was to remove barriers to trade so that each country could export what it produced best and import what other countries could produce best. Under such a system, all would achieve optimum growth. This system worked. It has evolved and has promoted a process of deeper economic integration. In Europe it has resulted in the formation of the European Union, the foundation of which has created such a level of interdependence among members that it is unthinkable today that Germany and France would make war on each other again. Contrast this with the period between 1870 and 1939 when both countries went to war three times, twice generating world wars.

This new system has generated extraordinary benefits. Never has the standard of living of so many people been lifted in such a short period. Never have so many people been lifted out of absolute poverty. The point is often made that the gap between the rich and the poor has never been wider. That is a statistical fact. But it must be considered for its relative significance, in particular the circumstances of the nations with the greatest number of poor. It is also a fact that the nations who have reduced poverty and lifted the standards of living of their people the most are those who have opened their economies and participated more actively in the global system of open economic exchange.

The result is the emergence of a global community, which makes the twentieth century a watershed in human history. Global markets have been created. Producers in one country can sell almost anywhere. The application of information technology in the global markets created by this process has fused to create the Information Age. This new system has emerged in parallel with the traditional system of managing relations among states to promote political goals and advance national security. It is a new tool in international relations. Where economic interdependence between states is deep, it can directly enhance national security.

It is going too far to say that economic interdependence is replacing collective security as the principal tool in international relations to maintain peace among states. On the other hand it is plain to see that members of the European Union no longer need armed forces to protect their people from military threat from other members. It is difficult to predict how the international system for managing relations between states will evolve.

But it is clear that building strong economic linkages has become a new feature of the global system of relations among states.

The importance of globalisation to Australia

In the decade between the mid-1980s and the mid-1990s, there was a significant institutionalisation of international arrangements to promote economic integration. The European Union was consolidated and expanded. The North American Free Trade Agreement was negotiated and the Uruguay Round of trade negotiations refurbished and expanded the multilateral trading system, in the process creating the World Trade Organization.

These arrangements were designed to increase the benefits that trade liberalisation and economic integration based on open markets had already delivered in the period since the Second World War. However they also spawned an anti-globalisation backlash which has had expression in riots in North America and Europe against meetings of international economic organisations as well as a vociferous body of literature against globalisation.

The anti-globalisation critique does not represent a single coherent idea; other than that agreements to liberalise trade should pay more regard to social issues, in particular measures to protect the environment and promote labour rights. This is in part because the groups that lead the anti-globalisation movement have disparate interests. The violence in Europe and North America is led by a minority of self-described anti-capitalist protesters and anarchists. Broader support for the critique comes mainly from two quarters: from organised labour in North America, and in Europe from environmental groups.

Increasingly, the anti-globalisation rhetoric has incorporated more traditional arguments against free trade. These are that globalisation forces workers in all economies to compete against each other, that permitting imports from the cheapest producers forces jobs offshore and that, as the AFL-CIO in the United States puts it, globalisation is forcing a race among countries to push labour standards to the bottom. There is also an anti-free market strain in the critiques. It is commonly said that globalisation gives new power to massive multinational corporations and it is also claimed that the interests of poorer countries are overridden in this system.

It is somewhat ironic that these arguments were being mounted in the United States during the 1990s, a time when the United States had its highest sustained growth, highest job growth and lowest unemployment for decades. The most potent complaint in the US is that real wages of low wage earners have not increased at the same rate as those of high-income earners during this period of high prosperity. This is partly true. Robert Reich¹ argues that this is true of unskilled (mostly male white) workers in the old economy industries, particularly manufacturing. Not surprisingly, there have

1 Reich Robert B, "The Future of Success" Knopf, New York, 2001

been significant rises in wages for skilled and semi-professionals (mostly women) in services industries. As noted in the next chapter, the greatest job growth in the United States has been in services industries, which now generate 80 per cent of the growth in the United States.

The anti-globalisation critics in Australia employ most of the arguments of the critics in Europe and North America, as well as the element of anti-foreign populism that is common in anti-free trade debate. However, except for some parts of the union movement and in some rural areas, there has been little direct anti-free trade sentiment in Australia. One reason is that Australians had to confront the consequences of long-term protection of manufacturing at an earlier stage when Australia found that the sector had become so uncompetitive that it was diminishing the national wealth and putting standards of living at risk. Removal of protection of manufacturing has led to a turnaround in competitiveness. Australian manufacturing is now Australia's strongest export growth sector. The nature of the manufacturing sector has changed. It will no longer be the mass employer it once was. But it now provides well-paying work, especially in the industries that export.²

The issue that generated the greatest anti-globalisation passion in Australia was the campaign against the proposed Multilateral Agreement on Investment.³ It won support from both the left and the right of Australian politics, although it had little impact on the two mainstream parties. The reason was clear. More than most countries, Australia has developed and thrived on foreign investment and until national savings levels increase, Australia will continue to rely on foreign investment to fund growth.

The same could be said for open trade and migration, both of which are also opposed by leading anti-globalisation forces.⁴ Globalisation is fundamentally about open societies and freer movement of goods, services, capital and people. These are threatening to some societies. But in Australia's case they are more part of a tradition that stretches back to European settlement.

Australia depends greatly on foreign trade and investment and will benefit from more global liberalisation. Markets for farm products in the European Union, Japan and the United States remain largely closed to Australian exports. There are significant barriers to Australian exports of automobiles and processed food in the East Asian region. Australia has already reaped the benefit of opening up its own economy. As the next

2 The study by Austrade and ABS. *A Portrait of Australian Exporters* (2000) demonstrates this clearly

3 This was a draft convention prepared in the OECD to set global rules to remove restrictions on foreign investment. The proposal was shelved after a global campaign of protest and trenchant opposition by the French Government. The latter feared France would be required to expose cultural industries to competition, particularly from the US.

4 While most of the anti-globalisation critics are opposed to free trade, the picture is more mixed on the question of immigration. Environmental groups generally want migration wound back to reduce the size of the population. In this they make common cause with groups like One Nation, but not many other NGOs who are cool on free trade but not opposed to migration.

chapter shows, growth in Australia has been at near record levels. Australia has a great deal to gain from seeing others open their markets. This will mean more business for Australian companies and more, well-paying jobs for Australian workers. To the extent that the anti-globalisation campaign supports those who do not want to open their markets to Australian exports, the anti-globalisation campaign works against fundamental Australian interests.

The advent of the New Economy

It is sometimes said that globalisation has peaked, that the public policy mood in leading Western economies is now turning away from it. Time will tell what effect the public mood will have on the process of policy formulation. However, the reality of globalisation is continuing regardless in most countries and it is being pushed along by the advent of the Information Age, or the era of the New Economy. Comparisons are drawn with the Industrial Revolution in terms of the depth of the change being wrought. Furthermore, the rate of change and innovation appears to be accelerating.

It is worth reflecting on the impact of information technology. A more detailed analysis of the importance of Information and Communications Technology (ICT) for the economies of both Australia and the US is set out in Chapter 6 and Annex 4. The largest single impact of information technology has been on communication. The capacity to digitize information and then transmit it instantly has profoundly altered the capacity of people everywhere to communicate with each other. Instant communication is immensely popular, if the extent of Internet use around the world for non-commercial transaction is any guide. All commercial transactions depend on communication. When that is made instant, commercial exchanges proceed across geographical and political boundaries much more quickly and already governments are finding it difficult, if not impossible, to control them.

We have also observed that there is an enormous momentum behind IT. The amount of computer power available is steadily increasing and the cost is steadily falling. As noted above, we should assume that the fundamental capacity of people to communicate will continue to expand and that therefore, an inevitable consequence will be greater freedom to communicate. There is every reason to assume that the process of globalisation will continue. In fact, this process may be seen as a natural consequence of the Information Age.

The lesson is not to try to control the development and spread of communications technology, but to understand its implications, to anticipate its consequences and to manage those effects. This would be a much more productive approach for those who are concerned about the effects of globalisation.

Trade agreements are instruments for the long-term. Both the United States and Australia have embraced information technology with enthusiasm. While commerce and economic exchange between the two countries have traditionally been seen in terms of trade - exports from Australia of raw materials, and lately manufactures, and imports from the US of capital and consumer goods - and in terms of investment, it is imperative to think about the nature of the economic relationship between the two countries from the standpoint of New Economy issues.

Those who aspire to see the end of the age of globalisation should reflect on the fact that everything upon which the Information Age is based is derived from the same drivers that created globalisation. The Information Age will encourage those same drivers to shape the future.

The countries that continue to liberalise, that seek to integrate their economies with others, that foster adoption of the technologies and processes of the Information Age are those that will have the best opportunity of raising the standards of living of their people in the Information Age. A Free Trade Agreement with the United States is a valuable piece of policy infrastructure for that purpose.

Annex 2. Australia's trade with the US

The following Annex comprises two parts. The first describes Australia's international trade in merchandise goods and services, placing the United States' role as a trading partner in that wider context. The second describes in more detail the trade relationship between Australia and the United States.

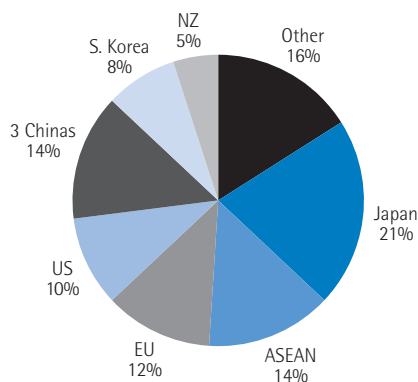
1. Australia's International Trade

Composition and direction of Australia's merchandise exports

In 1999-2000 Australia's exports were valued at \$97 billion and imports were \$110 billion. Although the European Union taken as a whole was Australia's largest trading partner (\$36 billion), trade with both the US and Japan was about \$32 billion. Trade with Hong Kong, the People's Republic of China and Taiwan ("The three Chinas") valued at \$25 billion was the next largest, though considered as a whole ASEAN (\$29 billion) was somewhat larger. Other major trading partners were Korea and New Zealand (\$12 and \$11 billion respectively).

Japan remains Australia's main export market. Even though its low economic growth over the past decade has tended to reduce its share, it remains at 21 per cent. Japan is far and away the major market for primary products, which now comprise about 68 per cent of total Australian exports (having once comprised over 90 per cent). The three Chinas, the European Union and the ASEAN group comprise our next largest export markets. Each takes 12-14 per cent of the total, while South Korea takes 8 per cent. The US takes 10 per cent of the total and New Zealand 5 per cent. Total export shares by grouping are illustrated in the figure below.

Figure 2a.1 Total Australian Exports by Market 1999–2000



Source: Australian Bureau of Statistics, 2000

Trends in the direction of Australia's merchandise exports

Economic turbulence in the Asian economies and the sluggish Japanese economy have added to the traditional volatility of Australian exports caused by commodity price changes. Exports to Japan, Korea, ASEAN and “the three Chinas” rose only slightly from the mid 1990s whilst exports to the US market more than doubled. Australian exports to the US grew by more than 17 per cent between 1994–1995 and 1999–2000, the largest increase of our main trading partners. Australian export trends by market are illustrated in Table 2a.1 below.

Table 2a.1 Australia's export trends by market

Financial year, A\$ million

	Growth %		
	94/95	99/00	94/95–99/00
Japan	16282	18800	2.58
Korea	5250	7615	7.51
ASEAN	10439	12851	3.85
3Chinas	8698	12854	7.96
EU	7498	12039	10.09
NZ	4791	6731	6.75
USA	4643	9577	17.71
Other	9451	16788	12.94
Total	67052	97255	7.51

Source: Australian Bureau of Statistics

The share of the US, Japan and ASEAN of Australian exports over the short and long term is illustrated in Tables 2a.2 and 2a.3 below. They reveal that over the long term, the share of exports to ASEAN countries has increased and that to the EU and US has fallen only slightly. Short term, Japan's share of exports has fallen. Exports to Hong Kong, China and Taiwan collectively and to the US, have increased.

Table 2a.2 Australia's export share by market: short term

Financial year, percentage share

	Growth %		
	1994/95	1999/00	94/95-99/00
Japan	24.28	19.33	-3.40
Korea	7.83	7.83	0.00
ASEAN	15.57	13.21	-2.52
3Chinas	12.97	13.22	0.31
EU	11.18	12.38	1.78
NZ	7.15	6.92	-0.52
USA	6.92	9.85	7.04
Other	14.10	17.26	3.74
Total	100.00	100.00	0.00

Source: Australian Bureau of Statistics

Table 2a.3 Australia's export share by market: long term

Financial year, percentage share

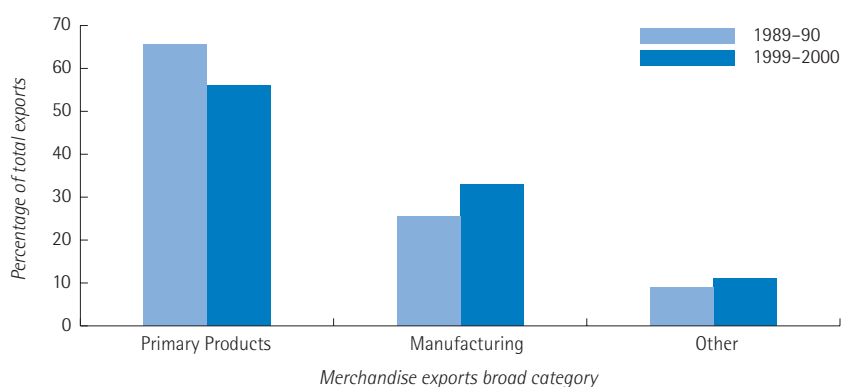
	Value			Growth %	
	1979/80	1989/90	1999/00	79/8-89/90	89/90-99/00
Japan	26.94	26.04	19.33	-0.30	-2.34
Korea	2.11	5.50	7.83	14.56	3.85
ASEAN	7.51	10.41	13.21	3.51	2.45
3Chinas	7.67	8.83	13.22	1.38	4.52
EU	15.08	14.43	12.38	-0.39	-1.29
NZ	4.58	5.33	6.92	1.50	2.71
USA	10.83	11.06	9.85	0.19	-0.99
Other	25.29	18.40	17.26	-2.48	-0.56
Total	100.00	100.00	100.00	0.00	0.00

Source: Australian Bureau of Statistics

Trends in the composition of Australia's merchandise exports

For the financial year 1999–2000, Australia's global merchandise exports comprised 56 per cent primary products, including processed foods, and 33 per cent manufactures, with the remainder accounting for confidential and miscellaneous items. This compares with financial year 1989–1990 where primary products accounted for over 65 per cent and manufactures accounting for 25.5 per cent. See Figure 2a.2 below.

Figure 2a.2 Percentage composition of Australia's global merchandise exports by broad category 1989–90, 1999–2000



Source: DFAT, APEC Region Trade and Investment, 2000

In recent years there has been a marked trend that has seen an increase in Australian exports of elaborately transformed manufactures (ETMs). In 1989–1990 ETMs comprised 60 per cent of manufactures exports and 67 per cent in 1999–2000. These goods tend to be the areas of demand and trade that are growing most rapidly in response to increased affluence and globalisation trends. Although it is facile to regard ETMs as more sophisticated than other goods (even “unprocessed” coal and iron ore undergo considerable processing and applications of intellectual capital prior to export) they tend to require more marketing input and product development.

The pattern of Australia's exports of elaborately transformed manufactures is somewhat different to that of its aggregate trade. The US is presently the largest market for ETM exports, with New Zealand, the European Union and the ASEAN group also comprising important markets.

The shares of Australian exports of ETMs to the following countries in 2000 were: US 19 per cent, EU and New Zealand 16 per cent, ASEAN 15 per cent, Hong Kong, China and Taiwan collectively 11 per cent, Korea and Japan both 5 per cent, and other countries 13 per cent.

Australia's merchandise imports 1999-2000

Australia's imports comprise a wide range of capital goods, producer inputs and consumer goods. The US and the EU are the most important import sources (\$23 and \$24 billion respectively) with ASEAN as a group (\$16 billion and growing strongly), the three Chinas (\$12 billion) and Japan (\$14 billion) also being major suppliers. The following Table 2a.4 below illustrates the share and magnitude and trends in import growth by source.

Table 2a.4 Australia's import trends by market

Financial year, A\$ million

	Value		Growth %
	1994/95	1999/00	94/95-99/00
Japan	12777	14138	1.78
Korea	2028	4311	18.76
ASEAN	6418	15661	24.00
3Chinas	7142	12044	11.44
EU	18218	24366	5.62
NZ	3554	4373	3.84
USA	16044	23003	7.23
Other	8438	12187	7.40
Total	74619	110083	7.92

Source: Australian Bureau of Statistics

Australia's International Trade in Services

World trade in services was about \$US7 trillion in 1999 with US exports accounting for about a fifth of the total. Australia ranked 18th with 1.3 per cent. Over recent decades, services employment has been growing to comprise a larger share of the employment of most OECD economies. Information technology has been a major part of this.

Both the US and Australia are relatively open economies to service competition and have strengths in human capital formation and a high degree of IT expertise.

In 1999-2000 Australia's total trade in services was worth \$58 billion and was close to balance. Both exports and imports were dominated by payments for travel (40 per cent), transport (29 per cent) and, to a lesser degree, other business services (10 per cent). The pattern differed in that travel showed a solid but diminishing surplus and transport showed a significant and growing deficit.

Table 2a.5 shows the services trade for several countries and groupings in the context of the goods and income elements of the balance of payments.

Table 2a.5 Australia's Balance of Payments 1999/2000

\$ billion

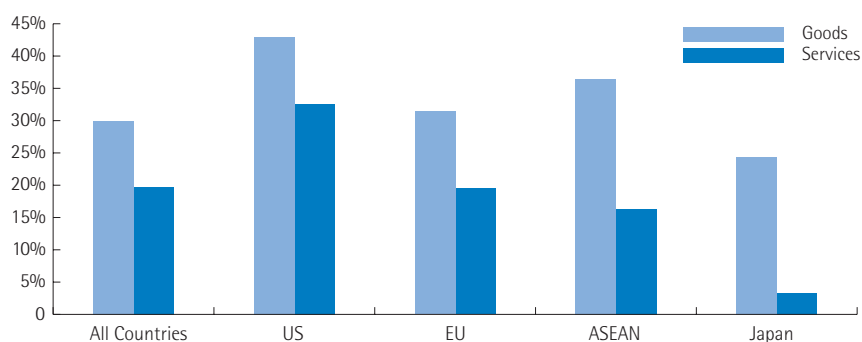
	Current Account	Services		Goods		Income	
		Exports	Imports	Exports	Imports	Receipts	Payments
All Countries	-33.7	28.2	29.7	97.7	110.6	12.8	32.1
US	-19.6	4.6	6.2	9.7	23.3	4.6	9.5
EU	-18.9	5.7	7	12.2	24.6	3.5	9.1
ASEAN	-2.1	4.1	4.2	13	15.1	0.9	0.7
Japan	4.3	3.4	2	19	14.3	0.3	2.1

Source: Australian Bureau of Statistics, 2000

Services trade is now the equivalent of 28 per cent of our trade in goods and is substantially greater than income receipts and payments. The EU remains the most important trading partner in services followed by the US and Japan. Together with ASEAN, these make up almost two-thirds of our services trade. The US remains by far the single most important partner and accounts for 16 per cent of Australia's services exports. As with goods, service trade with the US has grown more rapidly than with other major trading partners in recent years.

Figure 2a.3 below shows the growth in goods and services trade in the last three years.

Figure 2a.3 Growth in Australia's Goods and Services Trade by market 1996-1997 – 1999-2000



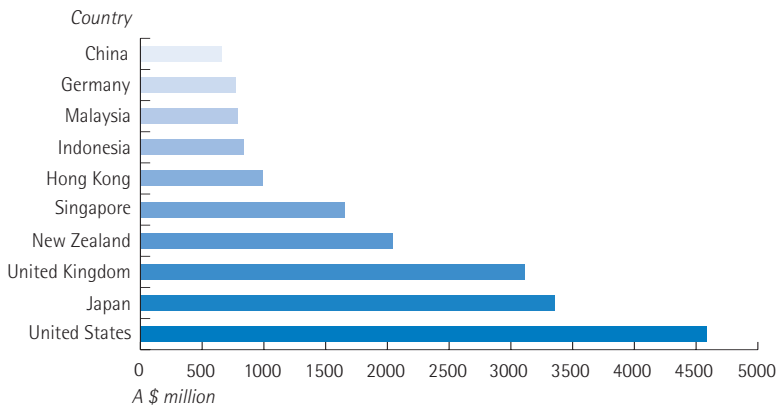
Source: Australian Bureau of Statistics

What is immediately apparent from the above chart is that trade in goods grew 10 per cent faster than trade in services, although the latter did grow by one fifth in the period.

In the case of goods and even more of services, the relative decline in the Japanese share is remarkable and has already been mentioned. This previously dominant engine of our trading sector has given way to others, notably the US. The stagnation of the Japanese economy in the 1990s and the strong growth in the US economy played a large part in this.

Despite the Asian economic crisis, growth in services trade with ASEAN was not much slower than the average (in goods it was substantially the average.) Figure 2a.4 illustrates the major individual country destinations of Australian service exports.

Figure 2a.4 Top Ten Destinations for Australian Services Exports 1999–2000



Source: Australian Bureau of Statistics, Cat 5363, various issues

2. Australia's Trade Relationship with the US

Composition of Australian Merchandise exports to the US

The composition of Australian exports to the US has changed considerably. Not only have exports to the US grown rapidly but also within total exports, over the period since 1984, there have been marked changes. Table 2a.6 illustrates this.

Table 2a.6 Composition of Australia's exports to the US

Calendar year, A\$million¹

	1984	1990	1995	2000
Primary Products				
Crude Oil	450	575	214	1,166
Meat	514	1,150	591	1,454
Alcoholic Beverages	11	49	76	422
Other Primary	1,540	2,405	1,680	3,027
Total Primary	2,504	4,143	2,534	5,755
Simply Transformed Manufactures (STMs)				
Zinc	29	67	17	254
Chemicals	34	56	138	271
Iron and Steel, Unworked	2	38	55	187
Other STMs	33	101	192	303
Total STMs	98	262	401	1,015
Elaborately Transformed Manufactures (ETMs)				
Steel	58	130	36	64
Motor Vehicles and Parts	33	330	118	698
Aircraft and Parts	53	184	199	297
Other ETMs	243	716	1,311	2,840
Total ETMS	387	1,360	1,664	3,899
Total Manufactures (ETMs + STMs)	485	1,622	2,065	4,914
Total Exports	3,000	5,801	4,626	10,983

Source: Department of Foreign Affairs and Trade, STARS Database

¹ All values in Tables 2a.6 to 2a.10 are at current prices.

Primary products

Reflecting farm conditions, commodity prices and the general state of the US and other economies, Australia's primary commodity exports to the US have shown considerable year-on-year variation.

Over the years since 1984, there was strong but irregular growth in meat, worth \$1.5 billion in calendar 2000 and a spectacular growth in wine (worth less than \$2 million in 1984 and over \$400 million in 2000). Wine's very rapid growth took it to comprise almost 4 per cent of exports in 2000.

Other food products showed only slow growth. Among the reasons were other favoured producers displacing Australian sugar, but dairy (worth \$58 million in 2000) and fruit and nuts (worth \$78 million in 2000) showed strong growth. Overall, food exports to the US are worth over \$2.3 billion and having dipped during the first half of the 1990s grew by 30 per cent in the second half of the decade. See Table 2a.7 below.

Table 2a.7 Australian Food Exports to the US

Calendar year, \$A million

	1984	1990	1995	2000
Bovine meat f.c.f.	512	1101	518	1212
Non bovine meat	8	49	74	246
Alcoholic beverages	11	49	76	422
Processed food (b)	624	1302	735	2044
Unprocessed Food	153	138	88	278
Total Food	777	1440	823	2323

Source: Department of Foreign Affairs and Trade, STARS Database

Crude oil exports from Australia, worth \$1166 million in 2000, represent a sourcing preference by US refineries. Though a major exporter of natural gas (largely to Japan and Korea), Australia is a net importer of crude oil.

Other primary product exports include ores (particularly tantalum) worth \$144 million in 2000, wool worth \$46 million and fertilizers (\$23 million).

Overall, primary products saw a fall in their export share from 84 per cent to 55 per cent over the period 1984 to 2000.

Manufactures

Elaborately Transformed Manufactures

ETMs showed strong growth especially motor vehicles and parts, aircraft parts and a wide variety of machinery. Although individual industries can be seen to have shown marked volatility, the overall pattern of this class of exports is one of strong growth:

- 35 per cent in the second half of the 1980s,
- a modest 4 per cent in the first half of the 1990s, and
- 22 per cent in the second half of the 1995–2000.

As previously mentioned, the US has recently become Australia's largest market for elaborately transformed manufactures. Refer to table 2a.8 below.

Table 2a.8 Australian ETM Exports to the US by major Sub category

Calendar year, A\$million

	1984	1990	1995	2000
Iron and Steel	58	130	36	64
Chemicals	16	31	57	276
Machinery for Special Industries	41	113	227	558
Office and Tel. equipment	50	187	339	426
Motor Vehicles & Parts	33	330	118	698
Other machinery and trans. Equip	136	368	576	1,140
Clothing and Footwear	5	34	60	63
Misc. Manufactured articles	32	81	103	253
Other ETM Exports	-2,354	-3,265	-3,510	-5,479
Total ETM Exports	387	1,360	1,664	3,899

Source: Department of Foreign Affairs and Trade, STARS Database

	% Trend Growth		
	1984–90	1990–95	1995–00
Iron and Steel	125.61%	-72.44%	80.00%
Chemicals	93.52%	82.54%	385.09%
Machinery for Special Industries	174.58%	100.39%	145.78%
Office and Tel. Equipment	277.44%	80.96%	25.60%
Motor Vehicles & Parts	898.90%	-64.22%	490.99%
Other machinery and transp. Equip	171.39%	56.44%	98.05%
Clothing and Footwear	627.19%	73.28%	6.23%
Misc. Manufactured Articles	150.20%	26.60%	146.47%
Other ETM Exports	-38.70%	-7.48%	-56.10%
Total ETM Exports	251.32%	22.39%	134.26%

Source: Department of Foreign Affairs and Trade, STARS Database

Simply transformed manufactures

This category in 2000 was dominated by zinc, chemicals and unworked iron and steel. Over the past year, the zinc price has fallen markedly and export values would have been similarly affected.

Other significant exports in the year 2000 included pearls (\$62 million) and leather (\$85 million).

See Table 2a.9 below.

Table 2a.9 Australian STM exports to the United States

Calendar year, A\$million

	1984	1990	1995	2000
Basic Non-ferrous Metals	45	92	24	325
Iron and Steel, unworked nes	2	38	55	187
Chemicals	34	56	138	271
Other STMs	17	76	185	232
Total STMs	98	262	401	1,015

Source: Department of Foreign Affairs and Trade, STARS Database

Australian Imports from the US

In the case of imports, the variety of US outputs means no one sector of manufactured goods dominates. Aircraft and parts, telecommunications equipment, computers and measuring and controlling instruments and car engines are the most important items. But together these account for only 30 per cent of the total. Table 2a.10 below indicates the composition of imports.

Table 2a.10 Composition of Australia's largest imports from the US

Financial year, A\$ million

	1989/90	1995/96	1999/00
Aircraft & Parts	2067	1477	3279
Telecommunications Equipment	173	543	1278
Computers	914	1036	973
Measuring and Controlling Instruments	359	577	772
Internal Combustion Piston Engines	302	433	728
Other Imports	8557	13479	16128
Total Imports	12373	17545	23158

Source: Department of Foreign Affairs and Trade

Australia's Trade in Services with the US

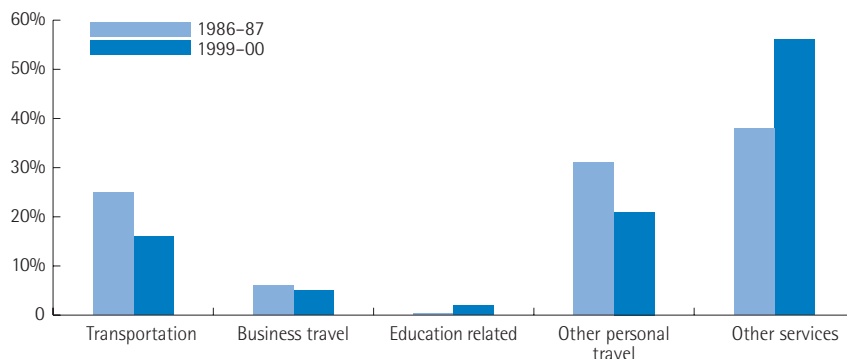
Over the past dozen or so years, the nature of service trade has changed with travel and transportation maintaining smaller shares. There has been a growth in the 'other services' category. Figures 2.1 and 2.2 and Table 2.9 illustrate this. Unfortunately both exports and imports of services with the US grew strongly with the deficit narrowing both absolutely and relatively. Transport (18 per cent) and travel (26 per cent) remained the dominant services traded but there was a greater diversity in the pattern with the US than for other major countries (transport 29 per cent and travel 40 per cent). Travel services exports grew by 50 per cent over the three years to 1999-2000 reflecting the popularity of Australia as a tourist location (the Olympics would have brought a further one-off boost in this during 2000-2001).

Compared with services trade as a whole, with the US, there is a commensurately greater proportion of services trade in finance, computer/information services and other business services. Moreover, in all these sectors Australian exports are greater than imports, partly offsetting the large deficits in transport, travel and royalties/licence fees.

Over the past dozen or so years, the nature of service trade has changed with travel and transportation maintaining smaller shares. There has been a growth in the "Other services" category. Figures 2.1 and 2.2 and Table 2.9 illustrate this. Unfortunately there is less detail available over these longer periods.

The "Other business" category contains some of the service activities that might be expected to grow rapidly with economic union. These include business consultancy, market research, research and development, legal services, and architectural services. Figure 2a.5 and Table 2a.11 indicate the magnitudes involved. Most of the transactions are between affiliated companies and are not recorded by category.

Figure 2a.5 Share of Selected Australian Services Credits in US Trade in Services



Source: Australian Bureau of Statistics, Cat 5363, various issues

Table 2a.11 Australia's Exports and Imports of other business services with the United States

\$US millions	Imports		Exports	
	1999-98	1999-00	1999-98	1999-00
Other business services	779	731	855	815
Merchanting and other trade-related	37	13	81	38
Merchanting	0	0	n.p.	20
Other	37	13	n.p.	18
Operational leasing services (a)	30	56	0	1
Misc business professional and technical	712	662	774	776
Legal accounting mgt consulting and public relations services	93	79	109	86
Legal services	57	26	80	61
Accounting, auditing, bookkeeping and tax consulting	3	9	16	15
Business and mgt consultancy and public relations	33	44	13	10
Advertising, market research and public opinion polling	33	30	24	21
Research and development	46	36	61	89
Architectural engineering and other technical	n.p.	87	38	61
Agricultural, mining and onsite processing	n.p.	123	2	1
Other	31	36	22	28
Manufacturing	2	4	2	2
Other	29	32	20	26
Other Professional services	29	32	20	26
Other services (b)	n.p.	n.p.	n.p.	n.p.
Services between affiliated enterprises nie	282	271	518	490

(a) Operational leasing for Sea and Air Transport is included in Transportation Services.

(b) Other business services not elsewhere included reclassified to Communications Services for confidentiality. n.p. not published.

Source: Australian Bureau of Statistics, unpublished data 2001

Annex 3. Trade and Investment barriers

Main United States barriers to Australian exports

Industrial Tariffs

The average US tariff is 2.8 per cent. Higher tariffs apply to clothing (11.8 per cent), Leather (7.8 per cent) and light trucks (25 per cent).

Dairy products

The United States maintains Tariff Rate Quotas (TRQ) on the importation of a range of dairy products, with out-of-quota tariffs set at prohibitive levels. Under the Uruguay Round Agreement global cheese access was set at 140 000 tonnes, of which Australia was allocated 7 000. In-quota tariffs range between 10 and 16 per cent and out-of-quota tariffs range between 60 and 65 per cent, depending upon the international spot price (the tariff rates are specific). CIE estimates that the tariff equivalent of these TRQ is around 20 per cent across cheese varieties.

US global access also increased over the last six years for the following dairy products: butter from 320 to 7000 tonnes, skim milk powder from 820 to 5 500 tonnes and butteroil from 544 to 6 100 tonnes. Using current international spot prices to calculate ad valorem equivalent tariff rates, Gallagher (Inquit Pty Ltd) assesses in-quota tariff rates at around 7 per cent to 8 per cent, less than 1.5 per cent for Skim Milk Powder, and 10 per cent for butteroil and out of quota rates at 100 per cent for butter, 35 per cent to 40 per cent for SMP and 12 per cent for butteroil.

Meat

The United States maintains a TRQ on beef. Safeguards measures have been imposed on lamb imports, but the WTO has ruled they should be removed.

Sugar

TRQs also exist on sugar, with minimum global access set at 1 139 million tonnes. Australia's quota for financial year 2000-2001 was set at 87 408 tonnes, which is only a fraction of Australia's 5 million tonnes of total exports. The in-quota tariff rate is

US1.4606 c/kg and the out-of-quota tariff rate is US33.87 c/kg in 2000. The operation of the quota heavily restricts Australia's access to the United States market. These restrictions increase the long run price for sugar in the US to US18c/lb when the long run world price stands at US10c/lb.

Cotton

Imports of cotton into the United States are subject to a TRQ of 5 per cent of United States domestic consumption. Out-of-quota imports of cotton were set at US31.4 c/kg in 2000. However, the tariff rate quota has little effect. The main United States government policy for cotton affecting Australia's cotton interests is the domestic subsidies.

Wine

A small tariff applies on wine imports. Labeling requirements are detailed and strictly enforced. A certificate of label approval from the Bureau of Alcohol, Tobacco and Firearms is required to release wine from Customs.

Ships/boats, shipping services and the Jones Act

The *US Merchant Marine Act (the Jones Act)*, the *Passenger Services Act*, and related laws severely restrict foreign access to the United States' ship and shipping services market. These laws require that merchandise and passengers being transported by water between points in the United States travel on United States built, United States flagged, United States manned and United States citizen owned vessels. Australian fast ferry firms have entered into joint ventures with US partners under which 50 per cent of the vessels may be built in Australia. The barrier remains, however, and requires that all major component parts of the hull and superstructure be built in the US and that the vessel be assembled in the US.

Government Procurement

The United States is a member of the WTO Government Procurement Agreement, which limits the extent to which preference can be given to national suppliers of goods and services to Government. However it permits considerable exemptions in particular through the "Buy America Act" which exempts all small business, defined as companies with less than 500 employees. Coverage of State Government agencies is also limited.

Subsidies

US subsidy programs in agriculture dwarf in economic impact the restrictions on imports created by tariffs and tariff quotas. They apply in almost every agricultural sector.

Australian barriers to US exports

Tariffs

The average Australian tariff is 3.8 per cent. Higher tariffs apply to automobiles (15 per cent) textiles (10 per cent) and clothing (15 per cent).

Export controls

Australia has single desk (export monopoly) arrangements for wheat and sugar.

Subsidies

Australia pays subsidies to the automotive, clothing and textile industry and shipbuilding industries. The programs are designed to be consistent with WTO provisions.

Quarantine

Australia has quarantine restrictions on imports of poultry, pork fruit and vegetables (apples, California table grapes, Florida citrus, stone fruits and corn) that have been questioned by the US.

Government Procurement

Australia is not a member of the WTO Government Procurement Agreement. Procurement arrangements exist at federal and state level, but the practical effect is that there is no systematic discrimination against foreign suppliers.

Main US controls on investment

Approvals

The United States authorities do not retain residual rights to approve investments. However, the United States reserves some areas for control on foreign investment. They include the media and fishing.

Main Australian controls on investment

Approvals

The Commonwealth Government reserves the right to approve every major foreign investments. Every significant foreign investment in Australia has to be reviewed by the Foreign Investment Review Board in the Commonwealth Treasury. The policy is administered liberally and the overwhelming majority of proposals are approved. Specific restrictions are mandated on foreign ownership in the media and uranium industries.

Sources

1. Gallagher, Peter, (Inquit Pty Ltd): "Agriculture: the strategic issues; June 2001" (www.apec.org.au)
2. CIE: *Economic Impacts of an Australian US Free Trade Area*; June 2001 (www.intecon.com.au/reports_list).
3. USTR: National Trade Estimate Report 2001 (www.ustr.gov)
4. International Trade Strategies: *Impact of Australian accession to the WTO Government Procurement Agreement – report for the Australian Productivity Board*, 1998
5. DFAT: *Australia United States Trade and Investment Review – A Partnership in Transition*, 1996

Annex 4. Information and communications technologies

The significance of the New Economy

Despite recent setbacks, the forces driving developments in the New Economy¹ are far from exhausted and the transformation to a 'digital economy' is only just beginning. The New Economy will survive both the collapse of new economy stocks and the cyclical downturn. Technology investments will continue to grow as a host of new technologies are rolled out, including voice recognition, expert systems, wireless systems devices, smart cards; e-books, cheap storage devices; new display devices and video software; intelligent transportation systems and third generation (3G) broadband wireless communication devices, to name a few.

The primary force driving the New Economy is developments in Information and Communications Technologies (ICT). The hardware and software industries covered by the term ICT are set out in Box 4a.1. The impact of ICT is pervasive. Investments in ICT are benefiting 'old' economy firms as well as the high technology, knowledge-intensive industries. They reduce costs, and make possible new forms of work and organisation. Farmers can buy genetically-modified seeds and sow them from a tractor guided by a global satellite positioning system. Textile firms use the Internet to take orders from customers around the world.

As economic activity shifts to employ new technologies and information-based services, the nature of corporate assets is changing. Patents, copyrights, organisational and human capital, customer and employee satisfaction, and other non-material items are becoming increasingly important sources of value in corporations and in the economy. There will be a host of opportunities spawned by these developments. And there are indications that Australia is well positioned to grasp some of these opportunities.

1 For a definition of the term 'New Economy' as used in this report see Chapter 6, footnote 2.

Box 4a.1 Information Communication Technology (ICT) Producing Industries

Hardware Industries

Computers and equipment
 Wholesale trade of computers and equipment
 Retail trade of computers and equipment
 Calculating and office machines
 Magnetic and optical recording media
 Electron tubes
 Printed circuit boards
 Semiconductors
 Passive electronic components
 Industrial instruments for measurement
 Instruments for measuring electricity
 Laboratory analytical instruments

Communications Equipment Industries

Household audio and video equipment
 Telephone and telegraph equipment
 Radio and TV communications equipment

Software/Services Industries

Computer programming services
 Pre-packaged software
 Wholesale trade of software
 Retail trade of software
 Computer-integrated system design
 Computer processing, data preparation
 Information retrieval services
 Computer services management
 Computer rental and leasing
 Computer maintenance and repair
 Computer related services

Communications Services Industries

Telephone and telegraph communications
 Radio and TV broadcasting
 Cable and other pay TV services

Source: *Digital Economy 2000*, US Department of Commerce, June 2000, p.23

If Australia is to seize New Economy opportunities in an era of rapid globalisation, it will not be sufficient for Australia to be a middle-ranking competitor in the world economy. Customers are increasingly sourcing products and services globally, making it increasingly necessary to be a world leader with innovative, best-practice technologies, production processes, products and services. The benefit of being more closely linked with the US is that, despite the recent sharp slowdown in growth in the US economy, (from an annual rate of nearly 5 per cent in 1999–2000 to a current rate of just over 1 per cent), it remains at the forefront of developments in the ‘New Economy’. The US is still the world leader in many of the technologies that are impacting dramatically on the world economy, including health, biotechnology, financial services and IT. Moreover, the US possesses the sort of characteristics crucial for success in the New Economy, notably entrepreneurship and a culture of innovation. The US is likely to remain the global leader of the New Economy.

Innovation and entrepreneurship are “dynamic efficiency” imperatives in the New Economy and include the ability of a nation’s institutions and firms to continuously innovate, learn, and change productively. Indeed, as markets change, technology accelerates, and competition comes not infrequently from unexpected places: such learning, creativity and adaptation have become principal sources of competitive advantage. Enabling and fostering constant innovation becomes crucial².

Australia has already demonstrated that it has the aptitude to adapt these new technologies and methods.

The New Economy in Australia and the United States

OECD studies³ indicate that knowledge-based New Economy industries⁴ comprise more than 55 per cent of the business in Germany and the US; between 50 per cent and 55 per cent in Japan, the United Kingdom and Canada; and notably almost half in Australia. Both the US and Australia had growth rates that improved in the 1990s compared with the 1980s. Several factors contributed to the increase in growth rates:

- capital investment, in particular, investment in ICT
- increased use of labour (with improved labour productivity)
- rising quality of labour (as the educational and skill levels rose)
- greater efficiency in how capital and labour are combined, (leading to improvements in multi-factor productivity).

In recent years, important structural changes have been occurring in the US as a result of:

- the growth of high technology industries, including the production of ICT products and services⁵, as well as industries such as biotechnology, medical services and education;
- growth of the services sector including trade in services; and

2 Progressive Policy Institute: *Economic Development Strategies for the New Economy*, (www.ppionline.org)

3 OECD: *A New Economy? The Changing Role of Innovation and Information Technology in Growth*; Paris 2000, OECD: *A New Economy – Beyond the Hype*; Paris 2001.

4 The OECD defines knowledge-based economies as those that are directly based on the production, distribution and use of knowledge and information. The knowledge-driven economy encompasses the exploitation and use of knowledge in all production and service activities; not just those sometimes classified as ‘high-tech’ or ‘knowledge-intensive’.

5 The OECD classifies a firm as ICT if it produces: office, accounting and computing machinery; insulated wire and cable; electronic valves and tubes; television and radio transmitters and apparatus for line telephony; television and radio receivers, recording equipment; instruments and appliances for measuring, checking, testing or navigating; industrial process control equipment; wholesaling of machinery. Equipment and supplies; renting of office machinery and equipment; telecommunications; and computer and related activities. See OECD, *Measuring the ICT Sector*, Paris 2000.

- I the impact of ICT and the Internet on the productivity and operations of traditional industries, with the substantial opportunities and scope this provides for redesigning the structure of firms, markets, institutions, and the economy itself.

In the US, these developments began to yield significant benefits by the mid-1990s by way of a higher growth rate, sharply lower prices and increased efficiency. Work conducted by the US Bureau of Economic Analysis indicates that the direct contributions of high-tech products (such as computers, software, and telecommunications) to real GDP growth in 1995-2000 averaged 29 per cent (or 1.20 percentage points) of the 4.1 per cent growth in real GDP.

Work conducted by the OECD confirms that ICT was a major contributor to economic growth in the US and elsewhere. However, while ICT investment accelerated in most OECD countries, the pace and its impact on growth differed widely. ICT investment accounted for between 0.2 and 0.5 percentage points of growth in GDP per capita over the 1980-1995 period. Over the 1995-1999 period, this contribution increased to between 0.3 and 0.9 percentage points a year, with the US, Australia and Finland receiving the largest boost. The contribution of ICT investment to GDP per capita in Japan, Germany, France and Italy has increased only slightly, and accounted for only about 0.3 percentage points of total growth in the 1995-1999 period. Table 4a.1 compares the contribution of ICT capital to GDP growth for eight countries, differentiating between the role of ICT hardware and software. It shows that ICT contributed 0.9 percentage points to US GDP growth, three times more than in Japan, Germany and Italy. Australia and Finland also received large contributions of ICT investment in GDP growth. A recent report by the OECD⁶ highlights Australia, along with the US, Netherlands, Norway, Finland, Denmark and Ireland, as economies that led the way in the 1990s in terms of growth and multi-factor productivity.

Table 4a.1 ICT percentage points contribution to annual average GDP growth, business sector

		US	Japan	Germany	France	Italy	Canada	Australia	Finland
IT and communications equipment	1990-95	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.2
	1995-99	0.6	0.3	0.2	0.2	0.2	0.4	0.4	0.4
Software	1990-95	0.1	0.1	0.1	0.0	0.0	n.a.	0.1	0.1
	1995-99	0.3	0.0	0.1	0.1	0.1	n.a.	0.2	0.2
Total ICT	1990-95	0.4	0.3	0.3	0.2	0.2	n.a.	0.5	0.2
	1995-99	0.9	0.3	0.3	0.4	0.3	n.a.	0.6	0.6

Note: The estimates are based on a harmonised deflator for ICT investment, adjusting for cross-country differences in methods. The estimates are not adjusted for the business cycle.

Source: OECD.

6 OECD; *The New Economy - Beyond the Hype*; Paris 2001.

As Table 4a.2 indicates, Australia has not proven to be quite as adept at *producing* ICT. The OECD considers⁷ that while the use of ICT is important for growth, having an ICT producing sector is not a prerequisite. While some OECD countries owe part of their expansion to ICT hardware production, others (like Japan) with a strong ICT sector, recorded sluggish overall growth. Indeed, the OECD pointed to several countries with high productivity growth that do not have large ICT sectors. Moreover, only a few countries will have the necessary comparative advantages to succeed in ICT output. The OECD considered that the key to benefiting from ICT is to focus on policies to foster its use, rather than its production.

Some express concern that Australia's ICT 'import bill', could cause problems in the future. Certainly imports of automatic data processing machines have increased steadily as a proportion of total imports from 3.7 per cent in 1991 to 4.7 per cent in 2000. Items included in this category are personal computers, storage units (disk drives) and visual display units (monitors). On the other hand, Australia is a traditional importer of capital and consumer goods and has no trouble meeting its import bills.

The US remains Australia's main source of automatic data processing machines. The value of imported computer parts and accessories has increased by 91 per cent from \$1 317 million in 1991 to \$2 518 million in 2000. However, their importance as a proportion of total imports has decreased from 2.7 per cent in 1991 to 2.2 per cent in 2000. The US has maintained its position as market leader, even though there has been an increase in competition from Asian countries.

7 OECD: *The New Economy: Beyond the Hype; Final Report on the OECD Growth Project*, Meeting of the OECD Council at Ministerial Level, 2001.

Table 4a.2 Australia's ranking as a producer of ICT goods – world production of ICT goods in 1997. (In millions of US Dollars)

	Electronic data processing	Office equipment	Radio comm. Incl mobiles and radar	Telecommunications	Consumer audio & video	Components	Total ICT
Greece	106	44	66	92	55	37	400
South Africa	174	6	137	434	229	52	1 032
Norway	243	0	322	354	7	146	1 072
Denmark	103	8	291	231	186	758	1 577
Portugal	399	19	137	211	617	608	1 991
Austria	430	47	64	578	658	1 239	3 016
Australia	1 045	30	746	784	230	376	3 211
India	771	70	554	506	1 689	999	4 489
Israel	830	8	930	1 650	77	1 163	4 658
Belgium	1 927	85	534	969	796	925	5 236
Switzerland	697	83	310	490	2 739	1 202	5 521
Finland	925	5	2 259	1 748	161	624	4 722
Indonesia	1 100	77	437	400	2 139	1 680	5 833
Philippines	800	22	350	320	484	4 608	6 584
Spain	1 536	73	288	2 606	1 247	1 010	6 760
Netherlands	3 436	959	731	718	221	1 921	7 986
Hong Kong (China)	1 895	337	297	568	2 655	2 695	8 447
Canada	3 623	118	1 884	2 826	243	591	9 285
Sweden	218	16	5 124	2 612	7	1 472	9 449
Ireland	7 879	33	318	686	47	1 679	10 642
Thailand	5 732	264	414	541	1 786	3 323	12 060
Italy	5 637	290	1 950	3 623	645	3 940	16 085
Brazil	8 150	268	1 300	1 800	4 734	3 132	19 384
Malaysia	7 544	136	996	1 637	6 355	12 667	29 335
France	7 226	521	9 846	4 743	1 898	6 915	31 149
Chinese Taipei	17 885	51	764	1 473	863	10 331	31 367
Germany	8 423	913	4 968	6 624	2 343	11 217	34 488
UK	15 246	762	7 595	2 826	2 987	7 766	37 182
Singapore	25 000	335	1 284	419	2 357	13 361	42 756
Korea	7 915	339	3 903	2 297	5 669	28 187	48 310
Japan	67 686	6 215	19 248	21 752	18 711	84 380	217 992
United States	82 391	5 058	57 551	36 151	6 435	79 212	266 798

Source: Reed electronics Research as reported by OECD, *Information Technology Outlook 2000*, Paris 2000.

Table 4a.3 Australia's Ranking in ICT traded goods in terms of export/import ratios for OECD countries, 1997

Country	Population (millions)	Electronic Industry	Rank	Office Machinery and Computer Industry	Rank
Iceland	0.3	00.1	27/28	0.27	20/28
Ireland	3.7	2.00		1.66	
New Zealand	3.8	0.16	26/28	0.07	26/28
Norway	4.4	0.46		0.26	22/28
Finland	5.1	1.97		0.75	
Denmark	5.3	0.87		0.43	
Switzerland	7.1	0.51		0.33	
Austria	8.1	0.79		0.35	
Sweden	8.8	1.94		0.30	
Portugal	9.9	0.61		0.13	24/28
Belgium	10.2	0.93		0.71	
Hungary	10.2	0.77		1.35	
Czech Republic	10.3	0.32		0.24	23/28
Greece	10.5	0.18	25/28	0.08	25/28
Netherlands	15.6	1.14		0.91	
Australia	18.5	0.20	24/28	0.27	20/28
Canada	30.3	0.55		0.55	
Poland	38.7	0.39		0.04	27/28
Spain	39.3	0.55		0.39	
Korea	46.0	1.58		1.74	
Italy	57.5	0.61		0.56	
France	58.66	1.05		0.75	
United Kingdom	59.0	0.93		0.96	
Turkey	63.7	0.23		0.03	28/28
Germany	82.1	1.09		0.59	
Mexico	93.6	1.03		2.19	
Japan	126.2	2.45		1.69	
United States	266.8	0.80	12/28	0.60	10/28
Average		0.86		0.65	

Source: *Main Science and Technology indicators 1999*, p.56, OECD 2000.

There has been a very large increase in imports of telecommunications equipment and parts and accessories, particularly since 1998. By 2000, telecommunications equipment accounted for 5.5 per cent of Australia's total imports, compared with only 2.2 per cent in 1991. This can be attributed to the increased use of mobile phones, modems and apparatus for digital line systems and networks.

The Prime Minister's Science, Engineering and Innovation Council⁸ (PMSEIC) argues that if Australia is only a purchaser of these technologies then it may not get first access to the latest technology. As a non-producer, Australia will miss out on the benefits of the trade growth in the sector. PMSEIC contends this despite the undoubted improvements being achieved through using ICT in diverse sectors such as banking, stock broking, mining and manufacturing.

Australia *does* produce computing hardware, about \$3.3 billion worth in 1999, but it is not a significant producer by international standards. In fact, it has the lowest ICT manufacturing intensity of all OECD countries. It does however have significant strengths in applications software and services. As indicated in Table 4a.4, there are about 18 000 ICT firms in Australia, mostly small and medium sized businesses, and they earned a combined \$62.6 billion in 1999.

Table 4a.4 also indicates that the number of firms manufacturing ICT fell from 473 in 1996 to 294 in 1999. However, telecommunications companies increased from 410 to 869 and firms engaged in providing computer services increased in number from 9 673 to 14 731.

Table 4a.4 Australia's ICT Sector, 1996 and 1999

	No. of businesses		No. employed		Income (\$m)	
	1996	1999	1996	1999	1996	1999
Manufacturing	473	294	19,295	10,542	4,765	3,306
Wholesale trade	2,979	2,177	36,629	39,936	17,326	22,752
Telecommunications	410	869	91,701	74,467	18,733	26,083
Computer services	9,673	14,731	55,028	74,395	8,087	10,474
Total	13,535	18,072	203,653	199,341	48,913	62,616

Source: Australian Bureau of Statistics 2000, 8126.0

⁸ Report of the Prime Minister's Science, Engineering and Innovation Council: *Australia's Information and Communications Technology (ICT) Research Base – Driving the 'New Economy'*, 30 November 2000.

Australia's ICT firms are said to have particular strengths in software and services related to mass media (including advanced audio, and animation and cartooning technology), photonics, quantum computing, Internet software, health and education software, and telecommunications applications.

One problem Australia faces in generating home grown ICT firms is scale. Some smaller countries have shown that this is evidently not an insurmountable barrier since Israel, Singapore, Taiwan, Finland, Sweden, Ireland and Scotland have been successful in creating competitive advantages in high technology industries. Several factors are involved. They include government subsidization of IT industries, proximity to large markets, low labour cost advantages and educated and skilled workforces.

Australia's overall performance in the New Economy

Australia is in many respects well equipped to benefit from developments in the new knowledge-based economy. And Box 4a.2 ranks Australia number two in 'e-readiness' behind only the US on the basis of criteria explained in Box 4a.3.

Box 4a.2 E-Readiness Rankings

E-readiness ranking (of 60)	Country	E-readiness score (of 10)	E-readiness ranking (of 60)	Country	E-readiness score (of 10)
<i>E-Business leaders</i>			<i>E-Business contenders</i>		
1	US	8.73	14	Ireland	7.28
2	Australia	8.29	15	France	7.26
3	UK	8.10	16(tie)	Austria	7.22
4	Canada	8.09	16(tie)	Taiwan	7.22
5	Norway	8.07	18	Japan	7.18
6	Sweden	7.98	19	Belgium	7.10
7	Singapore	7.87	20	New Zealand	7.00
8	Finland	7.83	21	South Korea	6.97
9	Denmark	7.70	22	Italy	6.74
10	Netherlands	7.69	23	Israel	6.71
11	Switzerland	7.67	24	Spain	6.43
12	Germany	7.51	25	Portugal	6.21
13	Hong Kong	7.45			

Source: The Economist Intelligence Unit/Pyramid Research. "e-readiness Rankings", E-business forum, 2001

Box 4a.3 Economist Intelligence Unit E-readiness ranking criteria

The six categories that feed into the EIU rankings (and their weighting in the EIU model) are:

- *Connectivity (30 per cent)*: E-business cannot function without adequate telecommunications and Internet Infrastructure. “Connectivity” measures the access that individuals and businesses have to basic fixed and mobile telephony services, including voice and both narrowband and broadband data. Affordability and availability of service (both a function of the level of competition in the telecommunications market) also figure as determinants of connectivity.
- *Business environment (20 per cent)*: In evaluating the general business climate, the EIU screens 70 indicators covering criteria such as the strength of the economy, political stability, the regulatory environment, taxation, and openness to trade and investment. The resulting business environment rankings measure the expected attractiveness of the general business environment over the next five years.
- *E-commerce consumer and business adoption (20 per cent)*: Payment and logistics systems form the backbone of this set of criteria. The extent of credit-card ownership is evaluated as well as the existence of secure, reliable and efficient electronic payment mechanisms, the ability of vendors to ensure timely and reliable delivery of goods, and the extent of website developments by local firms.
- *Legal and regulatory environment (15 per cent)*: The legal framework governing e-business is a vital factor that can enhance or inhibit the development of electronic trading. The extent of legal support for virtual transactions and digital signatures is considered. Ease of licensing and the ability of firms to operate with a minimal but effective degree of regulation are other criteria.
- *Supporting e-services (10 per cent)*: No business or industry can function efficiently without intermediaries and ancillary services to support it. For e-business markets, these include portals and other online intermediaries, web-hosting firms, service providers (ISPs), as well as web site development and e-business consultants. The rankings assess the extent to which local companies and organisations have access to these services.

Box 4a.3 continued

- *Social and cultural infrastructure (5 per cent)*: Education and literacy are necessary preconditions to a population's ability to navigate the web and drive future domestic Internet development. Because entrepreneurship and risk-taking play such an important role in building new e-commerce models, we also assess the national proclivity to business innovation and receptiveness to web content.
- *E-business leaders*: These countries already have most of the elements of e-readiness in place, though there are still some concerns about regulatory safeguards.
- *E-business contenders*: These countries have both a satisfactory infrastructure and a good business environment. But parts of the e-business equation are still lacking.
- *E-business followers*: These countries – the largest group featured in the rankings – have begun to create an environment conducive to e-business, but have a great deal of work to do.
- *E-business laggards*: These countries risk being left behind, and face major obstacles to e-business growth, primarily in the area of connectivity.

The OECD has made a more comprehensive analysis of Australia's performance in factors relevant to the Knowledge-based economy. It is set out in Box 4a.4.

Box 4a.4 OECD Overview of Australia's Performance in the Context of the Knowledge Based New Economy

Metric	Australia's status
General macro-economy	
GDP – average annual growth rate 1989-98	>3% exceeded OECD, EU averages and also Canada, UK, Germany, US and Japan; ranked 9/29
Employment growth – 1989-98	Similar to US and exceeds OECD, EU, Germany, UK, Japan; ranked 13/29
Knowledge based industries and services	
Real value added growth rates 1985-96	Growth rate for knowledge-based industries ~ 4% Exceeded OECD, EU, UK, US, Germany, and Japan, ranked 3/20
Information and communication technology	
(ITC) expenditures as %GDP 1997 (eg., hardware/software & telecommunications)	~8% of GDP, exceeding OECD, EU, US, UK, Japan, Canada, Korea. Ranked 3/27
Computers, Internet and Communications	
Cost of Internet access – July 2000	Ranked 4th lowest of 29; behind Finland, Korea and Italy
No Internet hosts per 1000 people – Sept 1999	Ranked 9/29
Cellular phones per 1000 people – June 1999	Ranked 12/29
Secure Web servers per 100,000 people – March 2000	Ranked 3/29
Human resources	
Flow of graduates Science & Engineering 1996 as a % of total employment	>0.2% of total employment, ranked 2 of 29
R&D effort	
Gross domestic expenditure on R&D as % GDP	Mid-ranked of 29 countries
% business expenditure on R&D to total R&D	Mid-ranked of 29 countries
All researchers per 10,000 labour force 1997	Ranked 7/29 countries, behind 6th placed US
Researchers in government and higher education per 1,000 labour force 1997	Ranked 1/29, above all other nations
Total basic research expenditure as % GDP 1997	Ranked 4/18, one above US
R&D expenditure by government plus higher education as % GDP	>0.8% of GDP, better than EU, OECD, Japan, US, Canada, UK, Korea, ranked 7/29
Tax treatment of R&D	
Tax subsidy per one US\$ of R&D 1998	>0.1\$ subsidy had Australia ranking 4/29

Box 4a.4 continued

Metric	Australia's status
Other types of metric reported:	
Investment in venture capital as % GDP and growth rate of venture capital; high technology industries (eg., chemicals, food, drugs, computers) in international trade; share of intermediate (eg., value added components) in trade with EU countries; foreign direct investment, mergers and acquisitions, shares of foreign affiliates in high technology manufacturing and industrial R&D; international high technology alliances between firms; cross border ownership of inventions; international cooperation in science and technology, etc	Australia scored higher than average or mid-range with most competitor nations in respect of these metrics. The metrics indicate performance on globalisation in high technology or knowledge-based industries. Of interest is the presence of research-performing foreign affiliates eg., manufacturing R&D enabling the host country to benefit from technology transfer. Best performing was Ireland with some 68% of its total manufacturing R&D done by foreign affiliates. Australia was ranked 4/17.

Source: OECD, Science Technology and Industry Scoreboard 1999: Benchmarking Knowledge Based Economics, (1999).

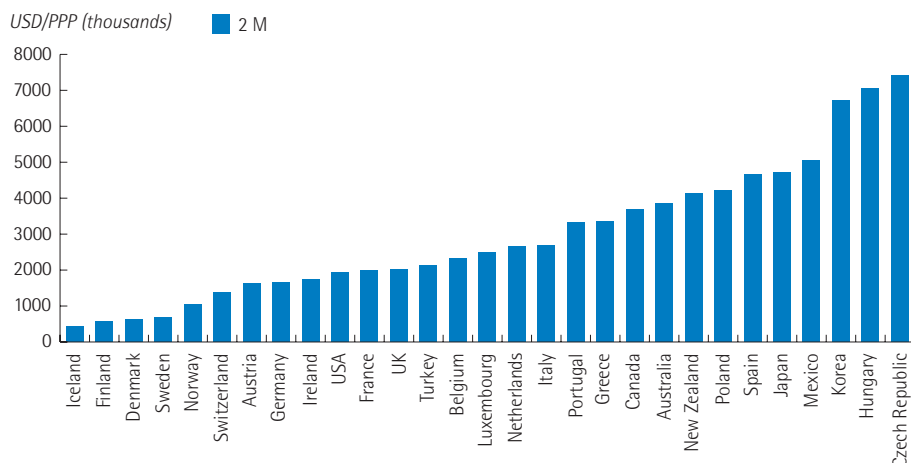
Communications infrastructure

The investment and diffusion of ICT depends not just on the cost of the investment goods themselves, but also on the associated costs of communication and use once the hardware is linked to a network. The US and Australia have developed extensive domestic and international communications networks that facilitate fast, reliable and cost effective access. The relatively earlier liberalisation of the telecommunications sector in the US and Australia resulted in a boost to infrastructure investment and lower prices and consequently a wider usage and diffusion of ICT technologies than those countries that followed later.

Leased lines

The rapid availability of leased lines at market-oriented prices is important, not least for the provision of cheaper Internet services and the development of e-commerce services. As Figure 4a.1 indicates, an OECD comparison of leased line tariff baskets for November 2000 (adjusted for purchasing power) ranked prices in the US 10th and prices in Australia 21st among 29 OECD countries.

Figure 4a.1 Comparison of OECD Leased Line Tariff Baskets, November 2000 (in USD/PPP)



Note: VAT is excluded.

Source: OECD, *Communications Outlook 2001*, Paris 2001.

Growth in Internet use

Table 4a.5 below indicates that the US is well ahead in terms of growth in Internet use and predicted to remain so. The table compares Internet use among Asia Pacific economies. New Zealand ranks second and a cluster of countries ranks third, including Australia, Canada and Singapore.

Looking ahead, 3G mobile broadband service will be important and will further stimulate changes in the New Economy by providing mobile Internet access. Australia has avoided very high auction prices and should seize the opportunity for first mover advantages by accelerating service provision. In Japan there are 24 million subscribers to NTT DoCoMo's i-mode service. This is evidence that there is consumer interest in the sort of service 3G mobile will provide.

Table 4a.5 Growth in Internet Use in the Asia Pacific 2000–2003

Projected Internet Penetration for Individuals 2000–2003 (per cent)

	2000	2003		2000	2003
Australia	34.3	62.1	Malaysia	5.6	17.5
Brunei	1.5	2.5	New Zealand	29.8	65.3
Canada	40.9	62.1	Papua New Guinea	0.1	0.2
Chile	3.1	5.8	Peru	1.5	4.0
China	0.7	1.6	Philippines	4.0	1.8
Taiwan	21.7	47.1	Russian Federation	1.8	6.9
Hong Kong	23.7	47.5	Singapore	39.7	62.3
Indonesia	0.2	0.6	Thailand	1.3	3.2
Japan	15.4	27.1	United States	44.5	71.0
Korea	20.2	58.6	Vietnam	0.1	0.5
Mexico	1.3	2.7	Total Number of Users (millions)	197	388

Source: Australian Department of Foreign Affairs & Trade (DFAT) based on projections made by DFAT, ITU and Goldman Sachs.

A recent OECD study⁹ shows that the US had the highest number of secure servers per million inhabitants with Australia in third ranking (behind Iceland). The study indicates that barriers to entrepreneurship are lower in Australia and in the US than in many other OECD countries.

The OECD also reports that in purchasing power parity terms, Internet access prices were 3rd lowest in the US, and 8th lowest of all OECD countries in Australia. The report demonstrates a correlation between the price of Internet access and Internet host penetration. The US has low Internet charges and the highest penetration, while Australia also has low prices and ranks about middle in terms of penetration.

Conclusion

The structural changes taking place in technology intensive industries including those occurring in telecommunications and biotechnology, the Internet, ICT, and the development of knowledge-intensive industries are having a profound effect on both the US and Australian economies. The US is leading global change in these areas. Australia is one of the handful of countries where change is occurring at a similar rate.

9 OECD: *The New economy - Beyond the Hype*; Paris 2001.

It is apparent that Australia is tracking closely trends in the US and is among a select group of countries which are similarly following suit. These countries have identified themselves as contenders for economic leadership in the New Economy.

On the other hand, it is clear that in a number of areas which are key to the New Economy, Australia's position is mid-pack rather than at the forefront. Increasingly the New Economy indicators such as cost of leased lines and ease of access to the Internet will be the basemarks for competitiveness in the New Economy.

Australian business has already demonstrated that it can learn from the US and upgrade to world's best practice. An FTA will accelerate that process.

Australia exhibits the preconditions to quickly adopt technologies and processes developed in the US. By keeping abreast of such developments, Australia will be better positioned to develop products and services that are competitive in various markets. During the past two decades, the composition and direction of Australia's trade has changed as a result of domestic economic reform and global trends.



Annex 5. Business cultures

American influence upon Australian management

The influence of the US upon Australian business practice has received little detailed examination despite its great impact on the local business environment. The well-regarded business academic database, ABI-Inform, for example contains only one brief article on the subject. Significantly greater attention has been given to the impact of Japanese management practice in Australia, although its mainstream influence could only be described as slight.

The US influence in Australia has extended from the powerful demonstration effect of the success of its companies both here and elsewhere, to the influence of the management consulting firms and the appointment of Americans to lead the turn-around of some of our largest companies. Australian business leaders have also learnt from their travels and experiences investing in US markets.

Both Americans and Australians understand that there is a cultural affinity between the two nations, with the bonds of language, heritage and history. The body of academic work on cultural diversity in business, which is almost the only academic literature to touch upon the business relationship between Australia and the US, points to similarities between business cultures along some fundamental axes. These include a relative egalitarianism, individualism, readiness to take risks, aggression and short-term time horizon.

Australia is regarded as an early adopter of management ideas and its companies have used US management thinking to good effect in their organisational structure and operational management. They are also sophisticated in their financial management and controls.

The weaknesses in Australian business practice relate to Australia's historic isolation from international competition and its historic reliance upon government arbitration of human resource management issues. The former has left it with oligopolistic markets and an industrial structure that lacks focus on core competencies. The latter has led to a relative weakness in human resource management skills. In each of these areas, Australian business has much to learn from US best practice.

US strengths

There are many contributing factors to US success. Geography, culture, demographics and the forces of history all play their part.

The success of the United States is first of all a function of numbers. While other populous countries that have not done so well, the depth and wealth of the US market makes it the world's standout economy. The US' 275 million people and 140 million workers produce about \$US10 trillion in GDP. This is three times the economy of next ranked Japan and five times the size of Germany's economy. American business is characterised both by the strength of its multinational corporations and by the vibrancy of its small business sector, which accounts for more than half its employment.

The rise of America as the supreme economic power has also been accompanied by the rise of American management thinking, which is characterised by a preparedness to put ideas into practice in an effort to improve performance. The articulation of this approach started with the work of Frederick Taylor and his "scientific theory of management" which was translated into practice by Henry Ford with the assembly line and further advanced at General Motors by Alfred Sloan who developed the multi-divisional firm.

US management thinking was fostered by the development of business schools. Harvard Business School was established in 1908, and had an MBA course based upon the use of case studies by 1912. Other universities also set up business studies departments, commonly under their Engineering faculties. The development of discrete management schools became much more widespread in the post-war period.

A new literature of management thinking emerged around broad topics such as leadership, strategy and managing change, or concrete topics such as marketing, information management and finance. Today, business books are the most prolific component of the publishing industry, while business titles are also the most profitable segment of magazine publishing in the United States.

A new industry emerged to propagate management thinking. Although the work of Taylor at Bethlehem Steel is seen to have given birth to management consulting, it was in the 1920s and 1930s that advisory firms started to develop, initially assisting firms with statistical surveys and then with their management method. Today, the global management consulting industry turns over a total of more than \$US110 billion, led by US groups such as Accenture, McKinsey & Co, Booz Allen Hamilton, Boston Consulting Group and Bain.

The Dutch management thinker, Geert Hofstede, notes that although the words, "manage", "management" and "manager" have been in the English language since the 16th century, it was only with Taylor that currency was given to the concept of

‘management’ as a class of people who (1) do not own a business, but sell their skills on behalf of the owners and (2) do not produce anything personally, but are indispensable for providing the motivation for others to produce.¹

Hofstede, whose reputation is built upon his theory of the cultural differences of management, points out that the relationship between supervisors and employees is quite different in Germany, France, or Japan. He suggests that there is no right and no wrong way to do it, and that the sensitive manager must be attuned to the culture of a host country. While this is undoubtedly so, the past 15 years bear testimony to the adaptability of US management methods.

The Economist magazine notes, “Companies around the world are falling over themselves to ape the American way. Daimler, epitome of stakeholder capitalism, now extols shareholder value and has become DaimlerChrysler. Michelin, once the epitome of the French, state-supported way, has caused outrage by proposing to cut its workforce even when profits are healthy. From Tokyo to Turin, businessmen talk the ugly language of ‘core competences’; and ‘re-engineering.’”²

A hallmark of US business is its use of management tools to improve performance. Although, as the Economist says, such tools are increasingly a part of the armory of any global business no matter where it calls home, US firms are much more ready to impose ideas upon their organisations whereas the Europeans prefer a more organic approach to their development.

The consulting firm McKinsey & Co summarises what it regards as the essential features of a high performing US company saying it must have:

- A clear mission that is inspirational and consistent over time;
- Aggressive long and short term goals that are measurable and adjusted over time;
- A decentralised organisation with many profit and loss units, with few layers of management, and with clear accountability and autonomy;
- Transparent performance measurement, using both internal and external benchmarking; and
- Visible and quick consequence management.³

The leadership can work with motivational levers, providing good incentives, opportunities for career advancement and a strong set of values. It can also work with coordination and control levers. These include a strong focus by the chief executive on people evaluation and career development processes, financial control and planning

1 Hofstede, Geert.. Cultural constraints in management theories. (comparison of worldwide management concepts) *The Academy of Management Executive*, vol7 no 1, 1993.

2 The Economist. “The Revolutionary Spirit”. 16 September. 1999.

3 McKinsey & Company, *Building a Distinctively Strong Performance Ethic*, White Paper by McKinsey & Company New York, 2000

processes that are part of the day to day management, and stringent and intrusive control processes for all business units that track and challenge operational performance.

Australia's proximity to US standards and practice

Although American executives are struck by the many differences between Australia and the environment they have come from, academic studies in the realm of comparative business culture overwhelmingly stress the similarities.

The first and still most influential theorist in the field, Geert Hofstede, set up a group of five different axes for measuring cultural attributes in organisations and found striking differences from one nation to the next. The dimensions he examined were:

- Power-distance: the degree of inequality among people which the population of a country considers as normal;
- Individualism: the extent to which people in a country prefer to act as individuals rather than members of groups;
- Masculinity/femininity: the degree to which a society displays tough values like assertiveness, performance, success and competition;
- Uncertainty avoidance: the degree to which people prefer to operate within structured situations;
- Long/short-term orientation: On the long-term side one finds values oriented towards the future, like thrift (saving) and persistence. On the short-term side one finds values oriented towards the past and present, like respect for tradition and fulfilling social obligations⁴.

When applied to nations around the world, Australia emerges in close proximity to the United States on each axis. On the measure of the acceptance of power and social distance between people, Australia and the US are less egalitarian than Scandinavian countries, but more so than the Southern Europe, Asian and dramatically more than the poorer developing countries.

Australians are less ready to take risks than the US and significantly less than the British, but are ranked a long way ahead of conservative nations such as France, Belgium, Japan and Greece. Australia is second only to the United States as the most individualistic of the 50 nations he studied, while it sits alongside the US among the more masculine cultures.

Hofstede's analysis has become the benchmark for countless subsequent academic studies. His data points to an Anglo culture of management based on high individualism, low to medium power distance between bosses and their subordinates, low to medium uncertainty avoidance and high masculinity. Where Asian cultures

⁴ Hofstede, *op cit*.

were much more focussed on the longer term (hence their high savings rates), the Anglo cultures were biased to the short term.

Hofstede notes that these characteristics are supportive of market philosophy. “The ideal principle of control in organisations in the market philosophy is competition between individuals. This philosophy fits a society that combines a not-too-large power distance with a not-too-strong uncertainty avoidance and individualism; besides the USA, it will fit all other Anglo countries.”

Of course, these are not the only axes along which it is possible to divine meaningful difference between cultures. Another leading theorist in the realm of comparative business culture, Fons Trompenaars, sets up four types of corporate culture:

- family style cultures with personal but hierarchical relations;
- bureaucratic and hierarchical cultures;
- egalitarian but impersonal cultures; and
- incubator cultures.

A striking feature of his studies is the alignment of Australia with the United States on questions to do with the autonomy of management. Of the 52 countries in his study, Australians were the most likely to say that leaving staff alone to get the job done was the attribute that made for a good manager. Canada ranked next, while the United States was not far behind.

At a more personal level, 82 per cent of both Australians and Americans believed that what happened to them in life was their own doing while about 70 per cent of both nations felt that the most important thing in life was to act and think in ways that best suit the way you really are, even if this does not get things done.⁵

Although the work on culture by Hofstede, Trompenaars and others depict a strong affinity between the Anglo-Celtic cultures, there is a commonality among business people the world over. A study comparing the management values in Australia, the United States and Hong Kong started with the hypothesis that Australia and the United States would be similar, but that Australia’s location, development, demography, Asian aspirations and internal dynamics would display some differences. Hong Kong, mixing the traditions of Chinese Confucianism with western business culture, was expected to produce very different results.⁶

The study explored the importance of organisational goals, of organisational stakeholders and of personal management traits in each country. Although of course there were differences, the overwhelming conclusion was the homogeneity of their

5 Trompenaars, Fons and Hampden-Turner, Charles, *Riding the waves of culture: understanding cultural diversity in business*, London, 1997

6 Westwood, Robert I, and Posner, Barry, 1997. “Managerial values across cultures: Australia, Hong Kong and the United States”. *Asia-Pacific Journal of Management*. Vol 14, April 1997.

responses. The study concluded that although traditional Chinese values were held to persist in Hong Kong, exposure to international management and business practices meant they had little impact on personal values associated with management work.

Australia's management strengths

Australian management has a number of strengths. It is flexible and practical. Studies in management culture have pointed to Australia's readiness to accept something that works, whereas US leadership needs to be reassured that everything is done to specifications. Australians work well in teams and are prepared to get on with the job.⁷

Management consultants with US-owned firms point to a number of similarities in business culture. Relative to Europeans, Australians are seen to be much less hierarchical and its senior executives more open and accessible. This informality makes it much easier for both Australian and US born consultants to move between each other's offices than it is for Europeans.

Australians, like Americans, are prepared to 'cut to the chase', whereas European business culture prefers any proposition to be supported by abundant justificatory analysis.

In relationships with suppliers, Europeans are more likely to develop a long-term relationship based upon ideas of partnership, whereas both Americans and Australians are more hard headed, and perceive contracts with suppliers as 'deals'.

Australian business has been quicker to adopt flatter management structures than has Europe. It is seen to share an entrepreneurialism with the United States, although not to the same degree.

Australia is regarded by many executives with American firms as an innovative market. They point to Australia's early adoption of the Internet and of other technologies such as mobile telephony. American companies sometimes use their Australian affiliates to trial new ideas or, on occasion, undertake research work.

Australian companies were quick to incorporate the internet into their technology platforms and to explore its strategic dimensions. It has been one of the best markets in the world for consultants in selling business-to-business solutions.

Australia's early adopter nature can extend to management tools. It is pointed out that both BHP and Coles Myer were working on shareholder value models as early as 1992. The American consulting company that pioneered the concept, Marakon, was formed in Connecticut, and put its second office in London and its third in Melbourne.

7 Irwin, Bruce, *Leaders in Australia: The Australian Cultural Imprint for Leadership*, Melbourne, 1996.

Germany did not start using shareholder value concepts until 1995, while French companies only started applying them last year. The Japanese are only beginning to talk about shareholder value now, while the Italians have yet to begin.

Australia is seen as quick to pick up tools that relate to finance or operations management. The balanced score card has a strong following among Australian corporations. The total quality movement did well here, in the eighties, while technology solutions such as enterprise resource planning are being widely adopted.

Work by McKinsey & Co suggests that Australian companies are comparatively strong on 'hard' infrastructure issues such as targets and organisation structure and, to a lesser extent, financial and operational controls. Most of its companies are also working hard to establish a strong mission, underpinned by strong values.⁸

Weaknesses in Australian management

Areas of relative weakness relate to Australia's market size and its history. Many consultants point to the problems of oligopolistic markets that leave Australian companies very focussed upon their direct competition, but less interested in experimenting with niches or upsetting established supplier or distribution channels.

The inability of Australian companies to invest abroad until the removal of exchange controls in 1984 meant that once they had run out of ability to grow in their core market, they had to diversify into other markets. This created an industry structure that was 'broad but shallow', rather than one which is 'narrow but deep', which is what success in global markets requires.

A management tool widely used in the United States but little seen in Australia is the analysis of core competencies, which involves breaking down the things a company is good at into its constituent parts to find the common elements in which a company is better than its competition. Australian companies rarely go through benchmarking at that level of detail and because of their diverse history, have little sense of the core attributes from which they derive strength. The failure of the early forays into global markets by companies such as Fosters and Amcor may be attributed to this weakness.

Australian companies are also less rigorous in their measurement of customer satisfaction and loyalty, a reflection of concentrated markets, historically protected by tariffs, in which the existence of customers is taken for granted.

By comparison, Australian companies are less comfortable with the behavioural elements of management, such as transparent positive or negative feedback, performance pay and consequences for under-performers. People management practices were seen as weak.

8 McKinsey and Company, "Building a Distinctively Strong Performance Ethic—Australasian Scorecard", 2001.

It is probably in the area of human resource management that the difference between Australia and the United States business is greatest. Although there are strongly unionised areas of the US work force, such as the motor industry and the airlines, the US has never had anything like Australia's centralised wage fixing system. At its peak, this led Australian companies to abrogate large areas of human resource management responsibility over the setting of wages, working conditions, promotion, discipline and, in some instances even recruitment, to the Industrial Relations Commission, and its predecessor, the Arbitration Commission.

A recent study has found that foreign-owned companies in Australia invested much more in human resource management than Australian-owned companies. They were more likely to have a specialist personal/human resource manager and to provide formal training to all first line managers in employee relations. They were more inclined to be part of employers' associations and more likely to draw upon the employee relations advice of law firms.⁹

US firms were more likely to have explicit plans of corporate goals and were less likely to recognise unions than either Australian or British-owned companies. They were more likely to use bonus and appraisal schemes, joint consultative committees and innovative work practices.

US firms also have a much longer and stronger tradition of using performance pay. Human resource consultants say that whereas American managers regard having half their salary tied to performance as normal, Australians will more commonly have 15 per cent to 20 per cent tied to bonuses. Whereas US studies show a much greater level of support for pay for organisational performance, Australians are used to the bonus for individual performance. There is less acceptance in Australia than in the US that when profits are flat, bonuses will not be paid at the same level.

Listed US companies report their earnings quarterly and go to considerable efforts to ensure that they hit their forecast numbers with great predictability. Having everybody in management with their salary equally tied to meeting the numbers guarantees a high level of focus upon performance.

The study mused on whether the practices of international firms had an effect upon their Australian equivalents. It noted that the studies of Australian human resource practice in 1990 and 1995 had shown an increase in the use of structured management techniques, including disciplinary procedures, however the central conclusion was that Australia still had a distance to travel.

US executives posted in Australia underline the gap between human relations and leadership practices in Australia and the United States. There is a view among American chief executives of operations in Australia that Australians are poor at

9 Walsh, Janet, "Human resource management in foreign owned workplaces: evidence from Australia." *International Journal of Human Resource Management* 12:3 May 2001.

teamwork and lack a sense of accountability to leadership. Former Telstra chief executive, Frank Blount, comments, “Among the 26 direct reports, there was too little teamwork and too much empire building”.¹⁰

The head of a \$1 billion turnover US subsidiary comments, “I did a lot of team moulding work and management retreats, but it didn’t work. We’re shifting all our senior staff to Singapore....I’ve never worked so hard and got so little work done. There is not the same level of accountability to a senior manager that there would be in the States.”

Former Westpac chief executive, Bob Joss, says he found a culture of passing on orders, moving things as quickly as possible from the in-tray to the out-tray.”

“Everything was everybody else’s problem. There was no ingrained sense of responsibility, ownership or accountability. I could see how this would lead to a level and depth of experience that was much weaker than I ever thought possible.”

“People warned I’d be frustrated by the ‘she’ll be right attitude’. I didn’t really understand what they meant until I arrived and began to see a lot of sloppiness in delivery or a quite ordinary level of service that people were happy with.”

An advertising executive comments that Australians are motivated by process rather than results. “It doesn’t matter how much gets done or what goals are achieved. What matters is involving everyone, giving everyone their say and ‘a fair go’, an equal opportunity.”¹¹

She comments that whereas Americans are motivated by success, Australians are motivated by duty. “In America, quality means certified. In Australia, quality means relationship. Americans use resumes, degrees and awards or instant credibility, a kind of success shorthand. Australians find such iterations meaningless, pompous and offensive. Accomplishments aren’t as highly valued as personal characteristics and carefully developed friendships. Earning trust can take years. As a result, goal driven Americans see Australians as lacking ambition; duty-driven Australians think we have priorities backwards.”

Frank Blount says his sense is that “Australians broadly view leadership as something rather uncomfortable, the job for the masochist, the insanely ambitious, the workaholic, or the outsider.”

“The culture of the US rewards leadership with enhanced status and aspiring to a leadership role is regarded as normal and desirable. We even respect our political leaders.”

¹⁰ Blount, Frank and Joss, Bob, *Managing in Australia*, Sydney 1999.

¹¹ Doran Bernadette, “Understanding Down Under”, *Brandweek*, 28 September 1998.

American executives in Australia have also commented on the ‘macho’ nature of its business culture. The advertising executive comments “Australians are outrageously sexist by any American standard, and things happened to me every day that would not only be politically incorrect, but also illegal (in the US).” Both Bob Joss at Westpac and George Trumbull at AMP did a lot to change the work culture to make it more welcoming of women in management.

Some of these observations reflect the frustrations of particularly tough assignments, such as turning around corporations that were either in financial difficulty or required a large cultural change, including Telstra, Westpac, BHP, AMP and Coles Myer.

It is notable that leading US management consultants do not reflect the pessimism of these US executives, several commenting favourably about the accountability and teamwork evident in Australian corporations. The consultants note that the companies that most readily adopt international best practice and that are the most interested in new ideas are also the most successful Australian businesses.

Mechanisms for US influence

Ideas can travel quickly, although the cultures on which they may depend for their success may develop more slowly. The most powerful external influences on Australian management practice are:

- Management education;
- Experience in international markets;
- The demonstration effect of foreign companies operating in Australia;
- The services of the management consulting firms;
- The appointment of US executives to Australian companies;
- Capital markets; and
- Informal contacts.

Management Education

The origins of management education in Australia go back to the thirties with courses targeted at executive managers started by institutions such as the Mt Eliza Business School. The major impetus for the development of modern business schools following US curricula came in the sixties, with what started as informal business studies groups at both Melbourne University and the University of NSW. A number of influential Australian business leaders, such as Rod Carnegie and Jim Wolfensohn, had impressed the Australian business community with the strength of learning provided by US

business schools from which they obtained their MBAs. There are now about 40 post-graduate business schools around Australia.

A survey of members of the Business Council of Australia reveals that 24 per cent have MBA qualifications, of which 70 per cent were obtained from US universities. A further 10 per cent have PhD degrees, while 42 per cent have post-graduate qualifications of some sort.¹²

One powerful method for the propagation of US ideas in Australia is through its business books and magazines. Business publishing is the largest single segment of the book publishing industry, while US magazines such as *Fortune* and *Harvard Business Review* enjoy a wide circulation amongst the upper echelons of Australian business.

Experience in international markets

Australia was slow to develop international business because of the barrier posed by capital controls, however it has developed apace since then.

Few Australian companies have operations in the US that register with the consciousness of business there. Besides the exceptional example of News Ltd, Lend Lease, Brambles and Westfield also have some profile, while companies such as CSR and Boral have some local importance in the states where they operate. However, a large number of Australian companies have some level of operation in the United States that exposes them to US management practice. Australian companies going to the United States have not found it easy, however those that have survived their early reverses tend to make good profits.

An avenue of international influence in which Australia significantly lags other markets is the presence of international directors on its company boards. Many of Australia's largest companies do, however, sponsor trips by directors to visit international markets.

The demonstration effect of foreign companies operating in Australia

Foreign companies influence Australian management practice partly through supplier and customer contracts. The motor vehicle industry, for example, helped to create a number of world class Australian motor vehicle parts suppliers by assisting them to meet the international quality and performance standards they required. Food companies such as Kellogg and McDonalds have similarly influenced their Australian suppliers.

Many individual Australian managers have gained direct experience of US experience by working for US companies. Ziggy Switkowski, for example, gained his first

¹² Uren, David "MBAs and the business community". *The Weekend Australian*, 2 December 2000.

leadership role at Kodak. A number of the US' biggest corporations are now headed by Australian executives. One of them, Ford, has more than 70 Australians in senior executive positions around the world.

The services of the management consulting firms

The first Australian management-consulting firm, W.D. Scott was established in 1938, but it was in the post-war era that the industry developed. The dominant firm until the end of the 1970s was the British owned PA. By the early 1980s, however, the large accounting firms, such as Arthur Andersen and Ernst & Winney and Price Waterhouse, had established executive recruitment services and begun to provide a broader range of management consulting services.

The larger pure US consulting firms then started building their Australian operations to service both the blue chip Australian companies and the local affiliates of their US clients. Although PA still operates, the consulting turf is dominated by companies like McKinsey, Boston Consulting Group, Booz Allen Hamilton, AT Kearney and Accenture. The technology consulting area is dominated by Accenture, EDS and IBM's consulting operation. In human resource consulting, the leading firms are Korn Ferry, Heiderick and Struggles, Spencer Stuart, Russell Reynolds, TMP and Egon Zender. Only the last of these is not from the US.

The appointment of US executives to Australian companies

The influence of American managers has had a powerful impact in Australia's financial services and telecommunications industry. Frank Blount decisively changed the culture of Telstra from that of the public service to a private corporation. The pattern of suppliers to Telstra also changed from European to American, and this has helped to preserve the influence of US management culture in the organisation after Blount's departure. Although George Trumbull's tenure at AMP did not end successfully, he is seen to have significantly changed its operating culture and both it and Westpac have acted as powerful models for the rest of the financial services industry. Senior management consultants suggest that these industries are now much more advanced than Australian manufacturing industry as a result. Department of Immigration statistics show there are 4 324 American executives in Australia as temporary residents under business visas. This is second to Britain, which has 9 631 executives in the country on the same basis.¹³

Capital markets

The influence of portfolio investors upon management practice is exercised both through the comments of analysts working on their behalf and the discipline of the

¹³ Department of Immigration and Multicultural Affairs. *Temporary Entrants 1998-99. Statistical Report No 29*, Canberra 2000.

market itself. Institutional investors are increasingly looking for the consistency of earnings that are expected in the United States. They are also tightly focussed upon cost ratios, and relate Australian data to that which prevails in other markets.

Leading broking houses sponsor tours by executives of Australia's largest companies to London and New York to meet institutional investors, and this can be a powerful source of information and inspiration for Australian chief executives.

Informal contacts

American executives comment that Australian executives, particularly those in their mid-forties and above, are very reluctant to move to overseas locations, however Australians are prolific travellers. There is a constant flow of Australian executives to the US, Asia and Europe. There is also a constant flow of visiting American executives and management thinkers who come into the orbit of Australian business leadership.

Potential gains for Australia from closer US relationship

There is a growing self-consciousness in the United States that its lead is due in part to its preparedness to implement ideas. This is reflected in studies such as Bain's survey of leadership tools and the continuing surge of investment in both business education and management consulting.

A benefit for Australia from building a closer relationship with the US is that its cultural affinity with the US and its strength as an early adopter of ideas will give it early access to new US thinking. Australian companies have already demonstrated the gains from putting US management thinking to good effect in their organisational structure and operational management, as well as in their financial management and controls.

A closer relationship with the US will play to Australia's management strengths. The autonomy and entrepreneurialism of its managers, and their preparedness to try ideas to see if they work are creative forces in Australia's business environment. A readiness to deal means Australian firms can move quickly.

Not everything that works in the US will work here, and Australia has its own distinct strengths that need to be understood in order to be developed. For example, work in the field of leadership has pointed out that Australians do not regard failure as a learning experience, as do Americans. Nor are Australians inspired by big visions that they regard as unrealistic. Leadership in Australia works by building bridges with followers so that they can envisage the future and feel secure about taking the necessary steps to get there. Attempts to simply transplant a US style of leadership to an Australian environment will fail.

However, Australians do have much to learn from the US about managing the motivation of staff, and about building accountability into their organisational practice. Australian firms need to analyse why US firms spend more than they do on human resources management, and appraise the benefits they gain from it.

The US will also continue to be a leader in innovation and technology. The understanding that this is an area in which strategy can make a profitable difference will become increasingly evident to Australian firms as they reduce their reliance upon oligopolistic domestic markets and establish deeper niches in global markets.

The diffusion of ideas may be extraordinarily rapid, with global media, capital markets, educational curriculum and management consulting firms ensuring that the latest ideas are put before business around the world. The example of shareholder value, however demonstrates that not all ideas find equally receptive audiences in all markets. Australia's cultural affinity with the United States gives it some advantages in picking up best practice, however there are important aspects of management in which our firms lag behind the world's leaders.

Although there are many channels through which ideas may find their way into Australian practice, they are all influenced by the strength and intensity of the relationship. The more cross pollination of investment, travel, trade, education and executive experience there is, the more we will learn.

Annex 6. Attitudes of Australian business to an FTA

Initial positions of industry

The positions of industry toward a Free Trade Agreement with the United States, as reflected below, are based on initial consultations conducted as part of this study as well as representative views expressed during a conference held on the implications of such an agreement in June 2001: *“An Australian United States Free Trade Agreement – Opportunities and Challenges”* run by the Australian APEC Study Centre. As a result of attendance at the consultations and the Conference, it is estimated that representatives of approximately forty organisations have been consulted and expressed their initial views in relation to the FTA.

It is worth noting that these consultations marked only an initial assessment of preliminary views of industry and would by no means be the only opportunity for industry consultation, but rather the starting point. The full range of issues is yet to be fully canvassed and researched. Once this has commenced, a formal and comprehensive process of consultations with industry would be developed by the Government. Most companies expressed that they have yet to do their own analysis at such an early stage of discussion and eagerly await further study of the issues in greater detail.

Our work indicates that industry is generally supportive of an agreement. One major peak organisation said an FTA with the US offered “enormous opportunities”, particularly through the dynamic benefits of closer links with the US economy. Many organisations underlined their support for pursuing the multilateral agenda of the WTO as a priority, but considered a Free Trade Agreement with the United States a means of delivering initial gains and further benefits over the longer term when pursued complementary to the WTO. Sectors identified early as having a strong interest in securing access to the US market include IT companies and wine producers.

The following is a summary of the results of consultations discussed according to relevant issues identified by participants and broad sectors of industry (agriculture, manufacturing, IT, mining etc):

Tariffs

Manufacturing could see benefit in securing an agreement with the US for the removal of US tariffs on some intermediate inputs, although some industries held concerns about opening up a small Australian market to greater competition from the US industry with its advantage in economies of scale. Overall, there was support for arrangements that would benefit Australia economically. The mining industry was in favour of an agreement that could deliver the removal of both Australian and US tariffs. Some agricultural industries saw an agreement as an important means for opening up protected US markets or building on existing exports and investment.

Non tariff barriers

The IT Sector raised US intellectual property enforcement as a barrier to entry as a potential issue to be included in an FTA as a means of improving market access. Manufacturing expressed interest in alleviating restrictions for market access for some products, such as electrical, through a free trade agreement, as well as dealing with regulatory issues concerning manufacturing and pricing, and in intellectual property issues.

Some cultural organisations expressed concern about the need to maintain Australian content rules in broadcasting under a free trade agreement.

Subsidies

Agriculture raised several areas in relation to subsidies that could be considered under an FTA, including the use of export credits by the US.

Quarantine

There was strong interest in maintaining a scientifically based quarantine system.

Agriculture expressed concern over the continuation of stringent quarantine controls on certain US diseases under an FTA where if relaxed, could compromise Australia's disease free status in other major export markets.

Standards and conformance

There was strong interest from manufacturing in pursuing harmonisation and mutual recognition of differing Australian and US standards for certain products and components under a free trade agreement. Some companies were interested in mutual recognition of US standards for the purpose of improving market access for their products or incorporating standards from global agreements as part of an FTA.

Services

The IT industry raised several issues in relation to US company practices in the area of telecommunications and online gambling that could be considered as part of an FTA. Some services industry noted potential benefits of attracting greater attention of US investment funds.

Competition Policy and Investment

Most industries were in favour of an agreement that could deliver increased levels of investment to Australia. The mining industry was in favour of removal of distortions in inward investment from the US as part of an agreement, though noted avoidance in all inward investment was preferable.

The IT industry noted there were additional issues regarding US non-recognition of networks and costs of access to them.

Government procurement

In the event of inclusion of government procurement in an FTA, industry held concerns over existing US non-tariff barriers in areas of defence and the use of offsets and how they could be dealt with.

Dispute Settlement

General enquiries were raised regarding the mode of dispute settlement that would exist under a free trade agreement with the US.

Environment and labour

The mining industry was of the view that there was no need for labour or environment issues to be considered as part of an FTA with the United States.

Other

Agriculture expressed a need to maintain close relationships with Asian members of the Cairns Group whilst pursuing closer relations with the US.

Annex 7. Comparison of WTO, NAFTA and ANZCERTA (CER)

	WTO	NAFTA	ANZCERTA
<i>Membership</i>	<p>There are 142 members in the World Trade Organization (WTO) as of August 2001. The WTO is a multilateral agreement. It administers 15 agreements and several related instruments. The central agreement is the General Agreement on Tariffs and Trade (GATT). WTO agreements are multilateral. All provisions apply equally to all measures.</p>	<p>There are 3 members of the North American Free Trade Agreement (NAFTA): the United States, Canada and Mexico.</p> <p>NAFTA is a preferential agreement. The benefits of the agreement apply only to the members. NAFTA consists of three separate bilateral agreements: one each between US and Canada, US and Mexico and Canada and Mexico.</p>	<p>There are two members of the Australia and New Zealand Closer Economic Relations Trade Agreement: Australia and New Zealand. CER is a preferential agreement. The benefits apply only to the members.</p>
<i>Main principles</i>	<p>There are two principles of non-discrimination in the WTO: Most Favoured Nation Treatment (MFN) and National Treatment. Every member must follow both principles in dealing with other members.</p> <p>MFN is an obligation to treat trade of one member at least as favourably as the trade of another. It means that any benefits granted by one party to another are automatically granted to all other parties to the WTO. National Treatment means that members cannot discriminate between domestic products and foreign products. Products imported into the territory of a member must be accorded treatment <i>no less favourable</i> than that accorded to products of national origin.</p>	<p>National treatment is the main principle in NAFTA. A NAFTA member cannot treat its own goods or services differently to goods or services imported from another member.</p> <p>There are obligations in limited circumstances that apply MFN among the three parties.</p>	<p>National Treatment is the main principle in CER.</p>

WTO

Exceptions to general principles

There are several main exceptions to basic principles and obligations. Article XX of the GATT allows members to take measures for certain reasons, provided they do not result in arbitrary discrimination or "a disguised restriction on trade". The grounds are listed. They include when it is necessary to protect human, animal and plant life or health, to protect public morals and to preserve natural resources. Article XX allows exceptions on national security grounds and to safeguard the balance of payments. Other exceptions allow for regional trading blocs, subject to some conditions.

NAFTA

NAFTA incorporates GATT Article XX. It also includes an amended GATT Article XXI, which allows for members to discriminate according to their essential security requirements. This exception applies in more limited circumstances for trade in energy goods and for government procurement. There are also general limitations for taxation measures and bilateral tax treaties. Measures to address serious balance of payments difficulties are also allowed.

ANZCERTA

CER allows standard exceptions that follow Article XX of the GATT.

*Rules of origin (*For NAFTA see also Textiles and automotive section)*

Rules of origin determine which country goods "originate in" or have been exported from. The WTO Agreement on Rules of Origin does not prescribe the exact rules members must have but aims at harmonising rules¹ by requiring they be transparent, administered in a uniform and reasonable manner and be based on a positive standard. This is aimed at making rules of origin objective and predictable. Rules of origin must not create unnecessary obstacles to international trade nor have restricting, distorting or disruptive effects.

Only goods that "originate" from NAFTA countries receive preferential treatment under the Agreement. The rules are complex and detailed. They provide a test for goods to qualify. Products must be made within NAFTA countries or from NAFTA materials, rather than foreign ones. If they are made of foreign materials then the final product must be significantly processed in a NAFTA country such that it meets certain requirements, such as a regional value content or a certain percentage (50 per cent or 60 per cent depending on the method used).

NAFTA also sets out special rules of origin that apply to automotive products, textiles and clothing and some agricultural products. All three countries had established rules to determine in which country the good is primarily produced by the time NAFTA entered into force.

There are special more stringent rules of origin for automotive goods and textiles and apparel. After a transition period, automotive and light vehicles will need to be 62.5 per cent of NAFTA origin, and other vehicles and automotive parts, 60 per cent. Rules for textiles and apparel dictate that they must be produced from fibre made in a NAFTA country. The test is a "de minimus" rule, which allows the amount of non-originating textiles used to make the final good to be up to 7 per cent. There are several exceptions to the rule such as products with small quantities of non-NAFTA yarn or fabric, or items in "short supply".

Only goods that "originate" in the free trade area of Australia and New Zealand are exempt from tariffs and quantitative restrictions. There are 2 minimum requirements for goods to be considered to have originated in the free trade zone. Firstly, the last process of manufacture of the good must be in Australia or New Zealand and secondly, at least half of the factory or works cost of the goods must be made up from expenditure on originating materials, labour or inner containers.

All unmanufactured raw products of Australia or NZ are considered to have originated in the area. Products that are wholly manufactured in either country from unmanufactured raw products, or imported materials that have been determined to be of local origin², also originate in the free trade area.

	WTO	NAFTA	ANZCERTA
<i>Tariff reductions</i>	<p>The approach to tariffs in the WTO has been to allow them to continue, but to reduce them as part of a continuing process of trade liberalisation. Each member has committed to certain tariff reductions, contained for each country in a schedule of tariff concessions, listed by tariff level and product and attached to the GATT. Some of these tariffs are bound or set as the maximum tariff. Where tariffs are not bound, members may charge a tariff of their choice. Tariff concessions are applied on an MFN basis. There are several exceptions to tariff commitments. Members can seek waivers and temporary departures from tariff bindings. There are provisions for a party to withdraw a concession at any time, although compensation, or the right to grant equivalent concessions, must be afforded to parties affected.</p>	<p>There is a general obligation for NAFTA members to eliminate all tariffs on goods that meet the rules of origin test. Tariffs are to be phased out over a period of time according to one of four categories, either immediate, over 5 annual steps, over 10 annual steps or 15 annual steps.</p> <p>Tariff removal differs by good and by sector (see relevant sectors for agriculture, clothing and textiles, automotive parts and energy goods) according to agreement between each of the parties. The relevant category and staging for tariff elimination is set out in each country's tariff schedule.</p> <p>Tariffs on goods traded between the US and Canada were eliminated by January 1998. Between Canada and Mexico goods were eliminated immediately or over 10 years with the exceptions of some agricultural goods in the dairy, poultry egg and sugar sectors. Mexican tariffs on corn are to be phased out over 15 years. Tariffs between the US and Mexico will be eliminated over a five or ten year period. The US tariff on a small number of products will be eliminated over 15 years.</p>	<p>All tariffs on trade in goods that originate in the free trade area were progressively eliminated over 5 and 7 years and are now prohibited.</p> <p>Transitional arrangements required ad valorem tariffs below 5 per cent to be immediately eliminated, tariffs between 5 per cent and 30 per cent to be reduced by 5 per cent per annum and tariffs of more than 30 per cent progressively reduced so eliminated over the time period.</p>
<i>Non tariff measures</i>	<p>Article XI of the GATT prohibits members to maintain or introduce quantitative restrictions on imports or exports including quotas and import or export licences. There are some exceptions, such as temporary restrictions to relieve food shortages, for balance of payments reasons and for developing countries in certain circumstances.</p> <p>The WTO Agreement on Import Licensing Procedures imposes disciplines on users of import licensing systems.</p>	<p>NAFTA prohibits use of non-tariff measures and incorporates the full terms of GATT Article XI obligations for import and export restrictions. Members must eliminate existing quantitative restrictions unless they are specifically permitted³.</p> <p>Customs user fees are to be phased out with new fees prohibited. Canada does not maintain such fees.</p> <p>Specific provisions for the removal of blending requirements for imported and domestically distilled spirits mean that distilled products of each member have been mutually recognised as distinctive and can only be sold when they are manufactured in their country of origin.</p>	<p>All quantitative import or export restrictions and tariff quotas on trade in goods between Australia and New Zealand were progressively eliminated within 7 years. New restrictions prohibited.</p> <p>Some restrictions were subject to more progressive elimination, such as quantitative import restrictions on sugar, tyres, and margarine.</p>

1 Rules of origin relating to the granting of tariff preferences are not part of the harmonisation program.

2 Procedures for "determining" a raw material to be of local origin are set out in the 1988 Joint Understanding on the Harmonisation of Customs Policies and Procedures.

3 This permits Canada to maintain certain agricultural non-tariff measures.

	WTO	NAFTA	ANZCERTA
<i>Duty drawback, waivers and remissions</i>	<p>WTO members can seek "waivers" for certain obligations.</p>	<p>Duty drawbacks are to be gradually eliminated between the parties. Waivers or remissions on duties that are dependent on specific performance requirements, such as export to another country, are to be removed.</p>	<p>CER does not contain any such provisions.</p>
<i>Agriculture</i>	<p>For many years, restrictions on tariffs and bans on certain non-tariff measures did not apply to agricultural products. The WTO Agreement on Agriculture, which was negotiated in the Uruguay Round, provides a set of rules as well as a series of concessions and commitments that members are required to undertake on market access, domestic support and export subsidies for agricultural products. They are conceived of as part of a continuing process in securing reductions in support.</p> <p>There are separate commitments for tariffs, market access, export subsidies and domestic support. Non-tariff measures imposed at the border are to be replaced by tariffs. Tariffs resulting from this process are to be reduced by an average of 36 per cent and 24 per cent, over 6 and 10 years respectively⁴. Members can maintain current access opportunities and establish minimum access tariff quotas in certain circumstances, which are to be increased over the implementation period. Special safeguard measures are available for products that have been converted to tariffs.</p> <p>Domestic support measures that have a minimal impact on trade are excluded from reduction commitments⁵. They include general government services and direct payments to producers (such as regional assistance programs). Some other government policies are also not subject to reduction commitments.</p> <p>Members are committed to reduce the value of export subsidies over a six-year implementation period and reduce the quantity of subsidised exports. There are longer time periods for developing countries. Domestic support and certain "green box" measures cannot be challenged under the WTO Subsidies Agreement.</p>	<p>Commitments to reduce tariffs are bilateral among the parties.</p> <p>Between the US and Mexico all non-tariff measures affecting agricultural trade were eliminated in January 1994. All agricultural tariffs are to be phased out over 5, 10 and 15 years, resulting in free trade in agricultural products by 2008. Sensitive areas such as corn, dry beans, vegetables, orange juice and sugar receive longer transition periods.</p> <p>Between the US and Canada agricultural barriers remain. NAFTA incorporates GATT rights and obligations for agricultural food, beverages and related goods. A few additional exceptions remain for items covered by tariff rate quotas.</p> <p>Between Canada and Mexico market access provisions apply only to goods qualifying under rules of origin. All tariffs on agricultural food products are to be eliminated over 5, 10 and 15 years with exceptions remaining for dairy, poultry, egg and sugar products. Members are required to consult before adopting measures arising out of an international commodity agreement where this can affect agricultural trade between NAFTA parties.</p>	<p>The general rules apply to all products. A side agreement applied to dairy products, but it has expired.</p>

	WTO	NAFTA	ANZCERTA
<i>Automotive</i>	<p>There are no specific WTO provisions governing trade in automotive goods. They are subject to the general provisions of the GATT and applicable WTO agreements.</p> <p>The EU was granted a transition period to remove voluntary export restraints on automotive production in the WTO Agreement on Safeguards.</p>	<p>The majority of Canadian and US automotive and vehicle parts trade are currently duty free under the Canada US Auto Pact. Mexican tariffs on automotive vehicles and parts are to be removed or reduced by 50 per cent immediately or over 5, 10 or 25 years.</p> <p>Canada is required to phase out its embargo on vehicles entering from Mexico over a 10-year period from 2009 and the US to modify its auto standards to include Mexican content for exported automobiles.</p> <p>Mexico must open its automotive market over a 10-year transition period and undertake certain measures that modify trade restrictions in the auto sector. It will allow Canadian and US investors 100 per cent holdings in an auto parts enterprise by 1999.</p>	<p>There are no specific provisions for trade in automotive goods in CER.</p>
<i>Clothing and textiles</i>	<p>For many years, the GATT Multi-Fibre Agreement permitted imposition of discriminatory import quotas on imports of clothing and textiles from developing countries. The WTO Agreement on Clothing and Textiles negotiated in the Uruguay Round requires these import quotas to be phased out.</p> <p>Quotas are to be phased out in 4 stages. Each party expands quotas by an increasing percentage as a proportion of the total volume of imports that existed in 1990 over 5, 8 and 12 years from 1990. Remaining quotas are to be eliminated by the end of 2005.</p> <p>Imports are then subject to the general rules of the GATT. The only controls on imports are tariffs.</p> <p>There is a special safeguard mechanism for products not yet integrated into the GATT. Restraints may be imposed on trade in clothing and textiles where imports from one country enter another in such large quantities that they cause (or threaten) serious damage to the domestic industry of the receiving country.</p>	<p>Commitments for removal of tariffs between Canada and the US require elimination over a 10-year period for apparel and an 8-year period for most textiles.</p> <p>Mexico and the US, and Mexico and Canada will progressively eliminate tariffs on textiles and apparel in stages, immediately, over 5 years and within 10 years. Commitments apply only to goods listed in NAFTA within the time frame nominated by each member in its schedule.</p> <p>NAFTA specifically provides for bilateral safeguard actions to be taken in relation to listed goods during the transition period for removal of tariffs.</p> <p>Special emergency action allowing the use of quantitative restrictions is permitted for trade between Mexico and NAFTA parties against non-NAFTA goods that are causing serious damage (or threat of serious damage) to a party's imports. This does not apply to trade between Canada and the US, which is governed by the FTA which affirms GATT obligations in relation to prohibitions on restrictions on trade in bilateral goods, and which allows for the imposition of restrictions on third countries.</p>	<p>CER has no specific provisions on clothing and textiles goods.</p>

4 36% reductions for developed countries and 24% for developing countries.

5 "Green box" policies.

WTO

Energy and Petrochemicals

There are no specific WTO provisions governing trade in energy and petrochemical goods. These are subject to the general provisions of the GATT and applicable WTO agreements.

NAFTA

NAFTA has specific rules on energy, basic petrochemicals trade and related regulatory activities. Governments affirm their rights and obligations under the GATT with respect to restrictions on trade in energy and basic petrochemical goods. Existing GATT principles are clarified in relation to prohibitions on export taxes, national security exceptions and a proportional access clause.

Governments are prohibited from applying restrictions to imports or exports except in limited circumstances. Energy regulatory bodies are to apply measures consistent with national treatment and import and export restriction obligations, including licensing of imports and exports. Canada and the US are party to a "proportional access clause" that allows them to impose export restrictions for certain reasons, whilst maintaining continued access to the market for the other party. They can invoke trade restrictive measures on the grounds of national security, with qualifications. Mexico has retained reservations and investment permitting it to restrict trade in certain goods as required by its Constitution in 1994.

ANZCERTA

CER has no specific provisions on trade in energy and petrochemical goods.

Subsidies

Subsidies are governed by the provisions of the GATT and the WTO Agreement on Subsidies and Countervailing Measures. (ACSM).

The agreement establishes three categories of subsidies (prohibited, actionable and allowable⁶), and a particular set of rules for each. Prohibited subsidies include those tied to export performance and are illegal. Actionable subsidies can be challenged by other members to be removed where they cause "adverse effects" to the interests of other members. There are special more lenient rules for developing countries.

Agricultural export subsidies are covered by the Agreement on Agriculture. (See agriculture section)

There is agreement in NAFTA for all members to work towards eliminating their export subsidies.

Export subsidies for agricultural products for trade between the US and Canada are prohibited. It is considered "inappropriate" for either country to provide an export subsidy for goods exported to Mexico where there are no other subsidised imports of that good already in that party, but are permitted to provide export subsidies into the Mexican market to counter subsidised exports from other countries. They must consider each other's export interests before subsidising agricultural exports to third countries.

Each party maintains its rights to apply countervailing duties to subsidised imports on agriculture.

CER requires all export subsidies and incentives on goods traded between Australia and New Zealand to be eliminated. The parties agreed not to make payments to industry tied to production or similar measures on goods exported to the other country and to avoid using industry specific measures that have adverse effects on competition in the free trade area. Measures such as those for research and development, and those in the national interest, are excluded. Export subsidies, and incentives and other assistance measures that have a direct distorting effect on trade in services, are prohibited.

WTO

Anti-dumping and Countervailing Measures

Anti-dumping actions in the WTO are governed by the Anti-Dumping Agreement⁷. Members may impose duties on imports of another member in certain circumstances when they are “dumped”, or sold at a price below the normal value of the good and where they cause damage or “injury” to the domestic industry. The WTO provides for detailed rules in relation to dumping initiation, investigation and determinations. Settlement of anti-dumping disputes is through the general dispute settlement mechanism of the WTO.

The rules for imposing countervailing duties are governed by the WTO ASCM. Countervailing duties can be imposed on subsidised imports when they are causing injury to the domestic industry. There are similar detailed rules for initiating and conducting actions and imposing duties. Under the Agreement on Agriculture, certain subsidies on agricultural products are not countervailable.

NAFTA

Each country maintains its own regime and legislation for initiating dumping and countervailing actions, however, must consult with other members when modifying them. Amendments must be consistent with GATT or NAFTA’s object and purpose.

NAFTA provides for initiation of actions and for dispute settlement between the members over dumping or countervailing actions through bi-national panels. Any NAFTA government can seek review of a dumping or countervailing decision made by another government agency. Review panels made up of member representatives undertake judicial review, as would a domestic court. Actions found to be illegal are referred back to the decision maker for a new determination.

ANZCERTA

Countervailing measures can be taken by each party, but must be in accordance with the WTO ASCM and when there is no other mutually acceptable solution. Each member must keep the other fully informed of the countervailing investigation.

Anti-dumping actions cannot be taken between CER members. (Effective 1990) Competition law under each party extends to anti-competitive conduct instead. Third countries anti dumping actions are permitted in accordance with the WTO.

Safeguards

Under the WTO Agreement on Safeguards, members may take special “safeguard” action (impose tariffs or quotas) to protect their domestic industry from a surge or large increase in imports, where this causes “injury” to or hurts their domestic industry. Measures must conform to provisions of the WTO or the affected member may suspend concessions under the GATT.

There are detailed rules for imposing safeguard actions and procedural rules for standards of transparency, procedural fairness and public notice. There are special rules for developing countries.

NAFTA gives each member the right to take safeguard action (“emergency controls”), to impose duties on imports, if increased imports from one member “cause (or in the case of Mexico, threatens) serious injury” or hurt the domestic industry of the other. Detailed criteria must be met before any action can be taken. Actions can be taken bilaterally between NAFTA parties or against all suppliers (“global actions”).

Bilaterally, action can only be triggered as a result of a reduction in duty. When a global action is taken, one NAFTA member’s goods should not be included in another’s restrictions unless certain criteria are met. Actions are initiated by the domestic industry, investigated by a Tribunal in the member affected, and then a determination made as to whether action may be taken.

CER does not provide for safeguard actions by either party.

6. This category of subsidy expired at the end of 1999 in accordance with Article 31 of the Agreement on Subsidies and Countervailing Measures. It is now defunct. Subsidies that were allowed under the third category include those for activities such as research and development, for disadvantaged regions and environmental requirements.

7. “Agreement on Implementation of Article VI”

WTO

Government Procurement

Government procurement is expressly excluded from WTO obligations of national treatment and from several WTO covered agreements. A plurilateral agreement whereby membership is not compulsory for all WTO members limits the exclusion of the application of national treatment in the GATT. Only countries that are signatories to the GPA are bound by its terms. Australia and New Zealand are not members. The US is a member.

The agreement extends to the purchase of goods and services of central government and sub-central government authorities as well as government utilities that have been listed in the agreement by the parties. It extends only to purchases above certain threshold levels. Members must accord national treatment and MFN with respect to covered procurements.

NAFTA

NAFTA is based on the GATT Government Procurement Agreement, to which both the US and Canada are parties, but Mexico is not.

NAFTA extends to federal government entities listed by the parties in an Annex. It applies to the purchase of goods and services by government for their own use except for these that are specifically listed as exempt. It applies to goods and services above certain threshold levels. The agreement requires national treatment of covered procurements. Locally established suppliers are to be treated no less favourably than others on the basis of foreign affiliation or that the goods to be supplied are those of another party.

There are general exceptions for all parties that include national security interests, measures for the protection of life and health and intellectual property. There are detailed tendering procedures to be followed as well as a requirement for members to establish a "bid challenge system" for review of the procurement process.

ANZCERTA

CER does not include comprehensive provisions on government procurement. It ensures that one party not discriminate against suppliers from the other in selecting preferred tenderers or in applying "offsets" in relation to content.

Under the Government Procurement Agreement, the Australian federal, state and territory governments and New Zealand have eliminated discrimination between suppliers from either country by granting them equal and national treatment. Tenderers must be selected on the basis of value for money. New Zealand content is treated as equivalent to Australian for the purpose of local content preferences maintained by Australian states.

Sanitary and Phytosanitary measures

The WTO Sanitary and Phytosanitary Agreement (SPS) covers food safety and animal and plant health regulations. It provides a right for governments to take SPS measures but only to the extent necessary to protect human, animal or plant life or health. Measures must not arbitrarily or unjustifiably discriminate between members.

Members should base their SPS measures on international standards, or provide a scientific justification based on an assessment of risk. There are detailed criteria and procedures for assessing risk and for determining the appropriate levels of protection. There are also provisions that encourage members to accept SPS measures of others as equivalent to their own and for control, inspection and approval.

NAFTA is based on the rules of the WTO SPS

Agreement. It imposes disciplines on measures taken to protect human, animal or plant life or health. It allows members to impose these measures provided they are not disguised restrictions on trade and encourages them to be based on international standards. Each country may determine its own level of protection provided the measure is in accordance with scientific principles and based on a risk assessment. There are rules that allow for areas within a country to be recognised as pest or disease free. Parties have agreed to work toward accepting each other's measures as equivalent where they achieve the same level of protection.

Members can adopt SPS and quarantine measures under the general exception to CER obligations which allows measures that are necessary to protect human, animal or plant life or health as long as they are not used as a means of discrimination or a disguised restriction on trade. They must be scientifically justified. Members have committed to harmonisation of quarantine and inspection standards and procedures. Food that is not considered to be a "risk" can be imported and exported freely, subject only to the quarantine requirements of locally produced goods. Only foods considered risky, based on scientific evidence, are inspected.

	WTO	NAFTA	ANZCERTA	
<i>Standards and Technical Barriers</i>	<p>The WTO Agreement on Technical Barriers to Trade (TBT) applies to technical regulations, standards and testing and certification procedures, as they apply to goods. It distinguishes between mandatory and non-mandatory standards and procedures to ensure products conform to these.</p> <p>Mandatory standards and testing must not discriminate or cause unnecessary obstacles to trade and be based on international standards. Members may maintain mandatory standards at levels of protection that they consider appropriate for specified reasons including to protect human, animal or plant life or health and the environment, and can take measures to ensure the level of protection is met, provided they are necessary based on a scientific assessment. A Code of Practice that embodies the above principles and procedures governs non-mandatory standards. Harmonisation and mutual recognition of standards are encouraged.</p>	<p>NAFTA standards obligations extend to some services, and to sub national and non-government standardising bodies. They apply only to standards that affect trade. NAFTA allows members to maintain standards for health, safety and security provided they do not cause discrimination in trade and are based on international standards.</p> <p>NAFTA provides for greater discretion in assessing whether discriminatory standards are justified than the WTO by not mandating a scientific assessment and by allowing for potentially wider consideration on environmental and consumer grounds. NAFTA does not seek to harmonise all standards between members but encourages them to be made compatible.</p> <p>Standards for CER are governed by the WTO TBT</p>	<p>Agreement. There are additional complementary agreements of less than treaty status between Australia and New Zealand for mutual recognition and harmonisation of standards. There is commitment towards harmonisation of standards, technical specifications and mutual acceptance of certification and accreditation⁸ as well as auditing and certification of quality management systems in accordance with international standards⁹. Food standards are developed jointly under a single regulatory agency¹⁰; and there is a complete joint Food Standards Code. Goods need only comply with the standards or regulations for the sale of goods applying in the jurisdiction in which they are produced or through which they are imported¹¹.</p>	
<i>Trade Facilitation: Customs</i>	<p>The WTO Agreement on Customs Valuation governs certain procedures in relation to customs administrations of each member, particularly in relation to determining the value of goods in certain circumstances. It gives customs administrations the right to request further information of importers where there is reason to doubt the accuracy of the declared value of a good. Customs may establish the value of the goods taking into account the provisions of the agreement. Accompanying texts to the agreement clarify provisions relating to developing countries, minimum values, sole distributors and sole concessionaries.</p>	<p>NAFTA provides for rules to be followed by the customs administration of each member in administering and enforcing the rules of origin and for regulations regarding their application and other customs procedures. These include the requirement for a certificate confirming the origin of a good. There is agreement between the parties to develop uniform regulations on rules of origin and a requirement to grant rights of review, equivalent to that accorded to importers, for any person completing a certificate of origin.</p> <p>CER provides for procedures to be followed by</p>	<p>Australian and New Zealand customs agencies for determining whether goods meet the rules of origin. It provides for harmonisation of customs policies and procedures between them and for the parties to adopt common policies and practices for valuation in accordance with the WTO Customs Valuation Agreement.</p>	

8 MOU on Technical Barriers to Trade between Australia and New Zealand.

9 The Trans Tasman Joint Accreditation System (JAS-ANZ)

10 Australia New Zealand Food authority

11 Under the Trans Tasman Mutual Recognition Arrangement

WTO

Competition Policy

There are no specific WTO provisions concerning competition policy. The WTO Agreement on Trade Related Investment Measures provides for future consideration of provisions on competition policy and investment more broadly. The GATS Agreement contains provisions to ensure that monopolies and exclusive service providers do not abuse their positions. Restrictive business practices should be subject to consultations between the parties with a view to their elimination. There is an accompanying set of voluntary guidelines on competition policy in GATS. The TRIPS Agreement also contains provisions concerning anti-competitive practices in contractual licences for intellectual property rights. Remedies against these abuses must be consistent with the TRIPS agreement.

NAFTA

NAFTA requires each party to maintain measures for anticompetitive business conduct, but restricts these obligations to state enterprises and monopolies. Rules are based on the principle of non-discrimination in the purchase and sale of goods by a monopoly. The main obligation is to adopt competitive business conduct and take appropriate action to enforce adequate competition law. Parties retain the rights to designate a monopoly, but must comply with notification requirements. Monopolies must act solely in accordance with commercial considerations. Members can also designate state enterprises that are subject to the investment and financial services disciplines of NAFTA, including the right to utilise investor-state arbitration.

ANZCERTA

CER does not contain specific provisions relating to competition policy. Each country maintains and determines its own competition laws with the exceptions of some Trans-Tasman provisions regarding the abuse of dominant positions in the market place. An understanding to CER provides for the harmonisation of business law between the two members, focussing on impediments to trade that arise out of differences. It requires governments to work towards harmonisation in areas such as companies and securities law, competition policy and consumer protection and enforcement of court decisions. Harmonisation effectively eliminates anti-dumping actions between the two members.

Temporary entry

There are no specific WTO provisions on temporary entry. The GATS contains some provisions for temporary entry of persons providing financial services in accordance with negotiated commitments.

NAFTA provisions set out rules and principles regarding temporary access to each NAFTA country by citizens of each country for business purposes. There are detailed obligations concerning eligibility of business visitors and professionals.

CER does not contain any provisions related to temporary access. The Trans-Tasman Travel Arrangement operates alongside CER and facilitates the entry of Australian and New Zealand citizens into each other's country to take up employment and residence.

WTO

NAFTA

ANZCERTA

Services

The General Agreement on Trade in Services applies to measures that affect trade in services. It has three main parts: basic obligations that apply to all members, specific commitments of each member listed in national schedules, and a number of annexes addressing individual service sectors.

The general positive obligation applicable to all measures is to accord MFN treatment for services and service providers of other members. Other obligations are transparency and publication of regulations. General exceptions to these principles similar to GATT articles XX and XXI apply, an exception for members of regional trading blocks and also specific exemptions from MFN tabled by each party.

Specific commitments of each member are tabled in schedules to the GATS. Under provisions for market access, members accord treatment to services and service suppliers of another member that no less favourable than provided for under the terms, conditions and limitations specified in its schedule. Scheduled services are also subject to prohibitions on limits of the number of service providers, operators, natural persons employed in a service sector, the participation of foreign capital in shareholding or investment and the total value of service transactions. Parties can modify or withdraw their commitments, provided they consult with interested parties or provide compensation.

There are also several annexes to the agreement in relation to specific services sectors such as telecommunications, financial services, the movement of labour and air transport and maritime services.

NAFTA imposes obligations on the provision of services across NAFTA borders. Subsidies, grants and services specifically exempted by the parties are not subject to these obligations. Government procurement of services and financial services are not covered by the general service obligations.

There is an obligation to accord national treatment by requiring parties not to discriminate in favour of domestic service providers. Members agree not to increase current discrimination and to ensure future laws are non-discriminatory. They cannot require that other NAFTA service providers establish a residence or office in their country. Within 2 years, citizenship or permanent residency requirements for licensing of professional service providers of other parties must be removed.

Excluded services include the cultural industries of Canada, US maritime transportation services and government services including health and social services. Some other sectors were left unbound. Discriminatory measures listed by each member within 2 years can be maintained, but discrimination not increased unless specifically provided for. Existing quantitative restrictions may be maintained and new ones introduced but must be listed when at the federal level. Obligations for trade in services do not apply to subsidies or grants including government supported loans, guarantees and insurance.

Work programs and parties are established to develop common procedures for temporary authorisation of legal consultants and engineers.

The CER Protocol on Trade in Services provides for free trade in the provision of all services between Australia and New Zealand with some exemptions. It applies to any measure that relates to or affects the provision of a service by a person of one member country within or into the other member country. Rules on services are subject to the foreign investment policies of each country.

The basic principles are market access and national treatment. Each member must grant the other access rights to its market for service providers on terms that are not less favourable than its accords to domestic providers. Each country must also grant the persons and services of the other, treatment no less favourable than that it grants its own.

Certain services are exempt including some subject to existing government regulations, such as taxation and those listed in an Annex. Members are to review listed services with the view to liberalising trade in services. In 1999 listed services for Australia included air services, coastal shipping, broadcasting and television, third party insurance and postal services. New Zealand has included aviation and coastal shipping, which is less than originally inscribed in 1988.

In relation to services inscribed in the Annex, each member must accord to persons and services of the other, treatment no less favourable than that it accords to third countries.

WTO

Telecommunications

An Annex to the GATS Agreement on telecommunications, which is independent of specific GATS commitments, relates to measures that affect access to and the use of public telecommunications services and networks.

It requires that access to and use of public telecommunications be accorded by a member to a service supplier of another party on reasonable and non-discriminatory terms as listed by that member in its schedule to the GATS agreement. Developing countries may place some limitations on access. Rights apply to public services such as telephone, telegraph, telex and data transmission but not to the transmission of radio or television programming. This includes rights to buy or lease equipment, connect to public networks, connect private circuits, and use the public network to transmit information both within a member and to or from any other WTO member.

(The Information Technology Agreement also eliminates tariffs on most telecommunications products.)

NAFTA

NAFTA provides common rules for providers and users of telecommunications and computer services and sets out the way in which telecommunications firms can gain access to networks and services.

It requires elimination of tariffs on telecommunications equipment over 10 years and guarantees certain conditions of access, such as ensuring rates for public telecommunications services will reflect economic costs. Cross subsidisation between public services is permitted. Access to public networks and services must be on reasonable and non-discriminatory terms. Restrictions on access must be justified as necessary to protect the public responsibilities of the network operator, the integrity of the network, privacy of subscribers and confidentiality of messages. Basic or public telephone and telecommunications services, and establishment and provision of telecommunications networks and services are excluded. Operators of private networks do not acquire the right to provide public telecommunications services.

ANZCERTA

Telecommunications services are subject to the general services provisions under CER. Telecommunications are not listed by neither Australia nor New Zealand as services exempt from obligations in the Services Protocol.

Financial Services

Financial services in the WTO are governed by an Annex to the GATS Agreement, which identifies sixteen forms of financial services covered by special rules. Insurance and related services are distinguished from banking and financial services.

Obligations apply to services as listed in each member's schedule. Commitments are to be implemented on an MFN basis. National treatment obligations, where granted, refer explicitly to access to payments and clearing systems operated by public entities and to official funding and refinancing facilities. They also relate to membership and participation of self-regulatory bodies, securities and futures exchanges. There are detailed provisions on market access with respect to monopoly rights, cross border trade, the right to establish or expand a commercial presence in another member's territory and the temporary entry of personnel. Certain financial services are excluded, including those of a government authority, activities of central banks and certain activities of public entities. Measures can be taken for prudential reasons to protect investors, depositors, policyholders or persons in certain circumstances.

NAFTA governs measures of the Parties relating to financial institutions, investors and their investments and cross border trade in financial services.

Such measures are subject to the principles of national treatment, qualified by the principle of "competitive opportunity"¹². MFN also applies but preferential treatment is permitted as long as other parties are given an opportunity to demonstrate they qualify for similar treatment. An investor is permitted to establish a financial institution in the territory of another party in the juridical form chosen by the investor. Other principles include the right for consumers to purchase services in each member, for institutions to introduce any new financial services in another party's territory and the right to market access by establishing a commercial presence. Each member maintains reservations listed in an Annex. Government-owned entities such as insurance and worker's compensation fall outside the scope of the chapter. Reasonable measures for "prudential reasons to protect the integrity of the financial system or the consumers of financial services" are permitted.

There are no specific provisions in CER dealing with Financial Services.

WTO

NAFTA

ANZCERTA

Investment

Investment is not covered extensively by the WTO. The WTO Agreement on Trade Related Investment Measures applies to certain investment measures that restrict trade. Members must not impose trade related investment measures unless they are consistent with national treatment obligations and do not constitute quantitative restrictions as in the GATT. GATS provides for MFN to apply to rights of establishment to supply services.

NAFTA lays down rules on investment. It accords national treatment and MFN for investors¹³ and their investments with respect to establishment, acquisition, expansion, management, conduct or operation and sale. NAFTA parties must also not treat an investor or investment from a non-NAFTA country more favourably than that from a NAFTA country. They must also accord each other a minimum standard of treatment in accordance with international law. Investment is defined to include portfolio investment; real property, minority interests and majority owned or controlled investments from NAFTA countries. Coverage extends to investments made by any company incorporated in a NAFTA country, regardless of the country of origin.

CER has no specific provisions on investment. Investors and investments of each member are subject to the general foreign investment policies and requirements of the other country.

NAFTA prohibits parties using trade-distorting requirements on the entry of investments or throughout their ongoing operation, including performance requirements. These prohibitions do not apply to subsidised conditions on requirements to locate production, provide a service or employ workers etc. Some measures requiring domestic content are permitted provided they do not constitute a disguised restriction on trade.

Specifically listed exceptions by each country and several areas not bound are not covered by NAFTA. Members retain the right to perform functions such as law enforcement and to provide services such as social welfare and health. Unbound areas include taxes on income, capital gains or capital or corporations. Additional exceptions are permitted for listed bilateral and multinational agreements.

12 This means that an equal competitive opportunity may allow for differential treatment as long as foreign institutions or investors are not disadvantaged compared to domestic counterparts.
13 Who are investing between NAFTA countries.

Dispute settlement of investment issues

State-to-state dispute settlement is through the general provisions contained in NAFTA. Direct investor – state arbitration, including foreign investors, is through arbitration where the party has breached an investment obligation and the investor has suffered damage or loss as a result of it. If consultations fail, the matter is brought to international arbitration before a tribunal. The tribunal decides the dispute in accordance with NAFTA provisions and applicable international laws. It can appoint experts concerning factual issues and award monetary damages and costs. Awards are made without prejudice to the right of the investor to seek damages at domestic law. Tribunal decisions can be enforced only after judicial review has been completed.

Intellectual Property

The WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS) incorporates basic GATT principles and those of international intellectual property agreements and provides for intellectual property rights (IPRs) and their enforcement. The basic principles of the TRIPS agreement are national treatment and MFN. It provides protection for IPRs in relation to copyright, trademarks, geographical indicators, industrial designs, patents, integrated circuits and trademarks. Members are specifically required to comply with the Geneva, Berne and Paris Conventions, provide full copyright protection to computer programs and grant 20-year patent protection for all inventions including products and processes. Plant varieties must be protected by patents or an equivalent system. Members are required to provide procedures and remedies under domestic law to ensure adequate enforcement of IPRs, including judicial review. There are special transition periods for implementation of the agreement¹⁴.

NAFTA is patterned on the TRIPs Agreement. It commits each member to provide protection and enforcement of intellectual property rights. (IPRs) It sets out rights and rules to enforce them both domestically and as they enter or leave each country. It covers copyright, sound recordings, trademarks, patents, semi conductor integrated circuits, trade secrets, geographical indications and industrial designs. All countries agree to comply with the Geneva, Berne and Paris Conventions and the Convention for the Protection of New Varieties of Plants.

The basic principle is national treatment with certain exceptions recognised by the WIPO conventions. Main obligations include comprehensive patent obligations for products and processes in all fields of technology for 20 years and additional obligations for users of integrated circuits, trade secrets and geographical indications.

Each member must be able to enforce IPRs without causing barriers to trade through appropriate procedures. Judicial review, recourse to damages and other remedies as well as interim measures and criminal and civil penalties must be available.

Intellectual Property rights are not covered by CER.

	WTO	NAFTA	ANZCERTA
<i>Sub National Government</i>	<p>Generally, WTO obligations apply to the actions of central government bodies.</p> <p>Some agreements provide weak obligations for sub national governments. The Agreement on Technical Barriers to Trade requires central government bodies to reasonably ensure state, non-government and regional standardising bodies comply with the terms of the agreement.</p> <p>The optional Government Procurement Agreement applies to sub national government as listed by the parties in their respective schedules.</p>	<p>NAFTA requires federal governments to ensure that state and provincial governments also abide the principle of national treatment in relation to the provisions of services and investment.</p> <p>NAFTA also sets out rules on regulations by state and self-regulatory institutions regarding financial services. State, provincial and local governments must accord other NAFTA investors and investments "the best treatment provided by that government to an investor or investment".</p> <p>Competition policy requires state enterprises to act consistently with NAFTA investment and financial services obligations when they have been delegated government authority. State enterprises must accord non-discriminatory treatment in the sale of goods or services to investments in its party territory of investors of another party.</p>	<p>Generally CER applies to the federal governments of Australia and New Zealand.</p>

¹⁴ For developing countries the transition period is 5 years and for least developed countries 11 years.

Dispute Settlement

Dispute Settlement in the WTO is governed by the Uruguay Round 'Understanding on Rules and Procedures Governing the Settlement of Disputes'. It allows members to base their claims on the GATT and any of the multilateral trade agreements included as part of the WTO Agreement. The Dispute Settlement Body (DSB), comprising all the members, exercises the decision-making authority. Decisions are adopted by the DSB unless the DSB decides by consensus not to adopt them, or to appeal a decision.

The stages of dispute settlement include firstly, consultations, and secondly, where this fails, establishment of a Panel to issue a report making recommendations on the matter. An appeal may be taken on issues of law covered in the panel report by an Appellate body (AB). The AB issues a report, the recommendations of which the members concerned are bound to implement. In the event of non-implementation, there are rules governing compensation or the suspension of concessions. The DSU also contains some special provisions for developing countries and rules for disputes which do not involve a violation of an obligation under a covered agreement, but where a member believes a benefit accruing to it is being nullified by the action of another¹⁵.

There are four characteristics of dispute settlement under the NAFTA. One, Government-to-government through 3 stages of: consultation, resolution by the commission and then binding panel proceedings. Two, dispute settlement for antidumping and countervailing duties through bi-national panels with judicial powers. Three, mixed investor-state arbitration for enforcement of investment obligations and four, dispute avoidance through procedural due process. The Free Trade Commission is the central institution for dispute settlement, consisting of representatives from each member. If consultations fail and the Commission fail to resolve a dispute, arbitration panels provide a recommendation as a basis for an agreed solution, which can be binding should the parties decide. Panels have special powers to permit scientific boards to provide expert advice on matters related to the environment, technical standards and other matters. Members can choose for the dispute to be brought under NAFTA or under WTO, if applicable. Where there is no agreed outcome as to panel recommendations, compensation or suspension of equivalent benefits can be taken against the offending party. Counter retaliation is not permitted. Actions can be brought for reasons of nullification and impairment and for special rules regarding environmental measures, standards and conservation agreements. Private rights of action at domestic law on grounds of inconsistency with NAFTA are prohibited.

There are no specific binding dispute settlement procedures under CER. CER provides for members to undertake consultations with the aim of reaching a mutually acceptable solution, in the event of a grievance over the agreement.

	WTO	NAFTA	ANZCERTA
<i>Labour and Environment</i>	<p>The WTO contains no specific provisions pertaining to labour and environment.</p> <p>Under the general exceptions to the GATT in Article XX, Members may take measures "necessary to protect human or animal plant life or health" and those "relating to the products of prison labour", provided they do not cause discrimination or disguised restrictions on trade.</p> <p>The GATS Annex on the Movement of Labour permits members to negotiate specific commitments that apply to the movement of people providing services under the agreement. People covered by a commitment can perform the service according to the commitment. It excludes measures affecting employment, citizenship or residence on a permanent basis.</p>	<p>NAFTA has no specific provisions on labour and the environment. NAFTA expressly affirms the rights of the parties under the WTO Agreement and other multilateral and bilateral agreements. NAFTA will prevail where there is any inconsistency with nominated environment agreements. There are separate side agreements to NAFTA on the environment and on labour.</p> <p>The North American Agreement on Environmental Cooperation between the NAFTA parties imposes general obligations in relation to reporting, emergency environmental measures and promotion of environmental education, science and technology. Governments must adequately enforce environmental laws and regulations, although enforcement does not operate extraterritorially. The rights of other international environmental and conservation agreements are affirmed. The Agreement on Labour Cooperation recognises the rights of each country to establish their own labour laws, requires them to provide high labour standards and enforce their labour laws.</p>	<p>CER does not contain specific provisions on labour or environmental protection.</p>

15 For example, where a tariff reduction has been negotiated, if a party then subsidises the good concerned, the benefit of the tariff reduction may be nullified.

