

Drought Paper # 2

Following up from the drought policy paper titled *Drought – Time for a New Approach?* released on 17th February, the second paper has been completed and released on the web.

This paper, titled *Politics and Drought Assistance* looks at some of the facts and figures of drought assistance. The analysis in the paper blows a hole in the widely held belief that farmers are existing on the public purse, only 4.8% of farmers are receiving federal EC assistance. But there are major problems in the preparations for drought and the delivery of assistance.

The paper calls for enhancements to the very successful and beneficial Farm Management Deposit scheme and the formation of a single federal body responsible for drought relief and rural adjustment, with this body as the decision making and funding agent and the states delivering the services. <http://www.agrifood.info/>

It's a Trade War – of Words.

A war of words has broken out with the recent release of the ACIL report into the proposed free trade agreement (FTA) between Australia and the United States.

The Association's 2002 Congress featured a lively debate on the merits or otherwise of the mooted FTA, where the contrasting views promised great benefits on one hand and possible major trade problems on the other. The debate was lively and the parties views were strongly entrenched.

The recent ACIL report found that there would be little or no benefit from the proposed FTA, mainly because what is likely to be left out of any agreement is what would be of most benefit to Australia.

ACIL rightly point out that any FTA will be subject to domestic US political pressure. There are some industry sectors that will be exempt from 'free trade' because of the political sensitivity of opening these industry sectors up to international competition.

Unlike Australian farmers, their counterparts in the US are more than willing to punish and reward political representatives who don't act in their interests. In fact, the US 'farm vote' is the most volatile sector of the US electorate, one of the reason why they are able to extract such a good deal from their federal and state governments.

The executive summary from the ACIL report is below and is followed by a riposte from Alan Oxley, a well known proponent of the proposed FTA.

A Bridge Too Far? - An Australian Agricultural Perspective on the Australia / United States Free Trade Area Idea

A report for the Rural Industries Research and Development Corporation by ACIL Consulting - February 2003

Executive Summary

This report by ACIL Consulting Pty Ltd (ACIL) has been prepared for Australia's Rural Industries Research and Development Corporation, a government-funded organisation which allocates a portion of its funds to the exploration of topical farm policy issues. Its purpose is to review, from the Australian farm sector's perspective, the proposal for a free trade agreement (FTA) between Australia and the United States of America (US).

Our assessment is that the economic benefits of the FTA to Australia as a whole are, at best, very finely balanced. The impact on Australian farmers is likely to be negative, especially if domestic political considerations in the US prevent genuinely free trade in the most sensitive industries — sugar, dairy and meat. Given this, the case for the FTA must rest on broader strategic arguments, the articulation of which has not been clear to date.

Trade diversion effects, the diversion of government resources away from other trade initiatives, and the disaffection of countries that on the whole are more important trading partners, all threaten the worth to Australia of a special trade agreement with the US. Note "special": it is unlikely to be genuinely "free".

The official view seems to be that these problems are illusory (or at least can be readily overcome) and that they are small relative to the gains to be had. This is not ACIL's view, nor that of several other commentators. ACIL doubts the robustness of the quantitative support advanced to date by commentators for the US FTA idea. For example, the Centre of International Economics' (CIE's) work for the Department of Foreign Affairs and Trade (DFAT) in 2001, which argued that, on balance, such an agreement would be trade creating, found that if it started in 2001 it would be raising real GDP by 0.33% annually and real consumption by about 0.4% by 2010 relative to otherwise.

Modelling commissioned as part of ACIL's research indicates there is room for doubt that a free trade agreement with the US (even one covering all protection and all products) would be of benefit to Australia.

The reasons are complex. They relate to the fact that much of the increased bilateral trade with the US would be trade diverted from Asia. There is also the fact that, given the current low levels of protection we now have and the relative price insensitivity of Australian commodity sales, any parallel opening up of export opportunities has to be substantial if Australia is to obtain a positive national income result. ACIL's modelling has projected that a bilateral deal with the US involving a phase-in of **complete free trade** over 5 years from 2005 would be slightly detrimental to the Australian economy.

One reason ACIL's results differ from those of the CIE is that ACIL has not assumed the FTA will, of itself, induce a significant productivity increase throughout Australia's service sector as a result of greater awareness of US managerial methods. ACIL is not at all convinced that this is a plausible assumption to make, but it is central to CIE's analysis.

The qualifications to the CIE's results have tended to be lost in their subsequent promotion. As for agricultural commodities, not surprisingly our results show large increases in the volume of trade in sugar in particular and, to a lesser extent, in dairy products and meat. As with the CIE's projections, the net increases for these products are generated by increased sales to the US which are bigger than the amounts diverted from China, Japan and Korea. Whether these increased sales to the US would be allowed, given the realpolitik of US agricultural protection, is another matter. <http://www.rirdc.gov.au/reports/GLC/ACIL-ABridgeTooFar.pdf>

From The FTA Analyst – Issue 3, 5 March 2003

Criticisms of the FTA

The idea of an FTA with the US has divided free trade economists and has generated some surprising claims, which in the end have little to do with free trade and miss the basic point of the FTA – being globally competitive. The Centre of International Economics, one Canberra free trade icon, working with another, Warwick McKibbin from ANU, on government commission reported that an FTA could add US \$2 billion to the Australian economy in the long run. Ross Garnaut from ANU, also a free trade icon, and ACIL, a Canberra consultancy, also a well-known free market address, whom Garnaut says he advised, both have criticized the econometric modelling used in the report.

Garnaut says the gains showed by the modelling are insignificant. Ironically, he uses the same modelling to argue an FTA will divert trade with Asia. The diversion he detects is trivial, naturally. And those experienced with econometric modelling know small results are notoriously unreliable. And it is not in fact his basic argument. It is this: Australia is at risk of retaliation in Asia from an FTA with the US, the US will give no ground on agriculture and we would be better off working in the WTO instead of in bilateral trade agreements. We will come back to these points in a moment.

ACIL's work is also on government commission, but the sponsoring agency will not endorse it. They have a point. It asserts that Australia will gain nothing from freeing up the services sector with the US. Have the WTO, the OECD and the World Bank got it wrong in pointing out that the services sector is the driver of growth in advanced economies? The US has got the biggest and most efficient services sector in the world. Is ACIL saying Australian business won't gain by adopting its standards of competitiveness?

Australian business considers the real benefit from the FTA will probably be double what the modelling shows. It knows that if the Australian environment for business is aligned with the settings used in the US, business in Australia will be more competitive and better able to compete in the world's markets in future. That is the long term gain of the FTA. ACIL share Garnaut's non-economic critiques. Let's look at them.

Will Asia react negatively? No. Asian Governments are pursuing free trade agreements themselves. Seeking an FTA with the US didn't stop China doing the historic gas deal with Australia or starting to negotiate a framework bilateral economic agreement with Australia. No one has claimed (yet) that Japan's lift in the beef tariff, which will hurt Australia's beef producers, is retaliation. Japan's Prime Minister in fact wants an FTA with Australia. Singapore now has an FTA with Australia and Thailand wants one.

Australia can do better in the WTO? Maybe they haven't been watching. The EU has effectively put the WTO negotiations on ice. They are supposed to finish in 2005 and the EU has said it won't consider any big changes to its farm policies until 2013. It will be a long wait for results from the WTO.

And will Australia get a bankable result on agriculture? Even if you were not confident, given how important that is, you would have a go. The National Farmers Federations supports the FTA and the Australian beef and dairy industries believe significant gains can be secured. When you strip away all the claims, it appears to boil down to a re-run of the "Asia versus US" argument. Claims that Australia can't do an FTA with the US without damaging relations with Asia have never been borne out by the facts. To suggest that this is the case is to simply say Australia can't both have good relations with Asia and the US. Of course we can. We always have. Asia is important but Australia is a global trader and must be globally competitive.

Alan Oxley is Director Austa, the Australian business group for FTA <http://www.austa.net>
