



business tax reform a process that is never complete

there are few areas of economic reform that can provide more benefits to the community than proper adjustments to the tax system. At the heart of the economic system is a process by which governments direct the value added of the community away from those who have created it and towards their own purposes instead. This is legitimate and supported by the business community. There are, however, caveats. Obviously where taxation levels are too high this can cause economic damage. It is also highly damaging where the structure of the tax system inhibits productive activity or where it distorts the economic system so that individuals pursue activities that may make sense for themselves but result in an actual reduction in community wellbeing overall.

New technologies and innovations are continually being developed that make some tax proposals possible which not long ago could not have been realistically undertaken. Equally, they can make previous decisions on tax appear anachronistic. Tax reform can therefore never be removed from the reform agenda. There are always changes that need to be made and should be made if we are to promote equity and growth.

As just part of what is a larger more comprehensive business agenda, there is the need to lower the general level of taxation, restructure the top marginal rates of income tax, improve the welfare-to-work transition, ease the compliance burden on business, lower the rate of payroll tax and maintain fiscal discipline.

ACCI and its members have embarked on a review of taxation issues that are key to business in Australia. During the course of the next twelve months ACCI will be releasing policy announcements on proposed changes to the tax system. In this article we prepare the groundwork for reform, setting out a number of the background issues in the case for further tax reform.

The Burden of Business Taxation

Overwhelmingly, the most important problem confronting business is the level and complexity of business taxation. In ACCI's Pre-Election survey

I N S I D E

The Australia-United States Free Trade Agreement. The proposed Australia-United States Free Trade Agreement (A-US FTA) is likely to be one of the most important bilateral economic and commercial agreements ever negotiated by any Australian Government. Realising a bold, comprehensive and worthwhile A-US FTA will, however, not be without its challenges.

First and foremost, any A-US FTA must not detract from the primacy of the World Trade Organisation (WTO) system in international trade law and trade liberalisation.

Second, any A-US FTA must be 'WTO-plus', delivering outcomes beyond those achievable within the WTO system.

Third, both countries will come to the negotiating table with difficult issues on which they will be seeking concessions from the other country, while having their own sensitive sectors where making concessions may prove particularly challenging.

Fourth, while the United States is an important bilateral economic relationship for Australia, careful consideration must be given to the implications of any A-US FTA for our bilateral and regional relationships elsewhere in the world.

conducted in October 2001, out of almost eighty issues presented to more than 2500 business respondents across Australia, the two most important issues were these:

1. The frequency and complexity of changes to tax laws and rules
2. The level of taxation.

Moreover, these were recorded in the same position and in the same order for all sizes of firm. Small, medium and large sized businesses all found that the complexity of the tax system and the frequency of changes made was the greatest problem facing their businesses while the level of taxation came a close second.

A further measure of how important the tax system is in affecting economic growth can be seen in the results from ACCI's *Survey of Investor Confidence* (Table 1) which measures in each quarter the degree to which various possible factors are an inhibitor to investment growth. The table below records the average intensity of all 20 of the issues included in this measure.

What is unmistakable is the importance of the level of business taxes and charges in containing investment growth. Not only is this issue at the top of the scale, as it has been since the start, but the index level is substantially above the second most important issue, which lies almost eight index points behind.

If governments are serious about creating the underlying conditions for faster growth and rising incomes, making the tax system less complex and lowering the level of taxation are critical. The processes of tax reform must begin here.

Table 1
Constraints on Investment
Average Index Level
January 1998 to August 2003

Constraint	Average
Business Taxes and Charges	53.0
Non-Wage Labour Costs	45.1
Insufficient Demand	45.0
State Government Regulations	44.1
Wage Costs	43.7
Local Competition	43.6
Federal Government Regulations	42.8
Availability of Suitably Qualified Employees	42.3
Current Levels of Debt	35.6
Local Government Regulations	33.8
Charges by lending institutions	33.4
Insufficient Retained Earnings	33.1
Interest Rates	30.7
Resistance to Workplace Change from Unions	29.5
Resistance to Workplace Change from Employees	29.1
Raising Equity	26.4
Raising Loans from Financial Institutions	25.8
Availability of Training Facilities	24.6
Import Competition	22.0
Exchange Rate too High	21.6

Source: ACCI Survey of Investor Confidence

We acknowledge that our survey also shows business concern about the frequency of tax changes. This is a serious issue when we are here arguing for more changes. Obviously a balance has to be struck between needed reform and the ongoing administrative burden that change can cause. The judgement has therefore been made by our members to press ahead with the necessary reforms.

Tax Receipts and Government Spending

The strength of the Australian economy is dependent not upon government spending, but upon the strength of private industry whose activities in fact fund public sector outlays. Financing the level of public outlays is a burden on all taxpayers.

No consideration of the current structure of the Australian taxation system would be complete without regard being had to the issue of the proper role and extent of government spending. The international comparison in Table 2 gives some indication of the detrimental effect of structural rigidities within the economy arising from pervasive government intervention.

Raising revenue to fund government outlays is in itself costly. Not only are there direct costs involved in the collection and administration of tax obligations, but there are broader unseen economic costs that result from the distortion of economic decision making. Both may be difficult to measure precisely, but these costs are real, of a substantial magnitude and represent a loss to the economy.

Table 2
Government Spending and Unemployment

Government spending as a percentage of GDP and levels of unemployment as a percentage of the Labour Force, 1999

	GDP	Unemployment
Australia	31.5	6.7
Britain	39.1	6.1
Germany	45.9	8.8
France	52.1	11.3
Italy	48.3	11.3
Euro Area	46.8	10.0
USA	30.0	4.2
Japan	38.1	4.7

Source: *OECD Economic Outlook*, December 2000: Annex Table 28

Ultimately, tax revenues are used to fund government expenditure on goods and services and the various income supplements it provides to individuals and business. While some level of public sector involvement in private affairs is inevitable and desirable, the question of degree is constantly the subject of debate.

Consideration of the appropriate level of government spending requires a proper weighting of the supposed benefits from current expenditures against the costs, properly construed, of raising the revenue required to meet that expense. It is only where these benefits exceed the costs that government has a clear economic mandate to intervene in the economy.

The counterpoint is well illustrated by the continuing malaise being experienced by the Japanese economy. Failed attempts to stimulate economic growth through the construction of large public infrastructure projects with little social value – so called ‘bridges to nowhere’ – have succeeded only in producing a mountain of public debt which represents an increased tax burden for the next generation of Japanese taxpayers, but which has not succeeded in creating a return to

the robust economic conditions that had prevailed for much of the post-war period.

Tax revenue diverted toward unproductive or marginally productive uses are doubly costly, in the first instance when raised, and subsequently when they are misspent. It is of fundamental importance that clear economic rationales are provided for proposed future government spending, and that current wasteful expenditures are eliminated.

Compliance Burden on Business

The increasing complexity and sheer volume of Australia’s tax law represents an ongoing burden for Australian business. Resources devoted to compliance with an unnecessarily complex tax system are entirely wasted in terms of added productivity. Consequently, overall social wellbeing could be improved if these costs were reduced.

There will always be some level of cost incurred by business, or individuals, in complying with the tax system. It is the extent to which these costs are unnecessary, or arise as a result of complexity or ambiguity that is capable of remedy, that there exists scope for

improvement. Identifying these areas is the province of good government.

The first stage in addressing the issue is to gauge the magnitude of compliance costs through an in-depth study on the topic. Given the large public benefits that would flow from such an undertaking, the task is best funded by government and conducted in consultation with business groups, academics and tax professionals.

Measurement of these costs would underpin suggestions for general and specific reforms that could be implemented to reduce the compliance burden. This may include some form of concessional treatment for small business.

It is widely accepted that complexity and its resulting compliance burden fall disproportionately on small business. Economies of scale exist in tax compliance, which, due to their size, small businesses are unable to realise. A differential level of compliance costs argues strongly for differential tax treatment for small business where that would enable reduced compliance costs.

The issue of the compliance burden on business is a perennial one and largely reflects the increasingly complex economic relationships that characterise modern economies. Nevertheless, it would be detrimental to our national interest to dismiss consideration of the issue as being too difficult. Comprehensive research into the area of compliance costs should be undertaken as one part of a continuing effort to alleviate this deadweight loss to the economy.

State Taxes

State governments continue to rely upon a range of narrowly based, highly distorting taxes for their revenue collection. In themselves these taxes represent large impositions on the business community, as well as through high compliance costs and reduced overall economic efficiency.

A large number of these taxes were to be abolished as part of *The New Tax System*. Instead, following the Senate compromise, their removal has been postponed until 2005 and subject to the financial circumstances of state governments. These taxes fall disproportionately upon business, and include debits tax and stamp duties on business conveyances, credit arrangements, instalment purchase arrangements and hire agreements.

It is a business priority to see that those taxes which are scheduled for review in 2005 by the Ministerial Council under the *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations* are reviewed in a proper manner and that they are indeed removed by the States.

A more central concern for business is payroll tax. Australia is one of the few countries in the world to levy substantial payroll taxes for general revenue raising. Payroll tax is a tax on employment and represents a major cost of doing business. The principal state tax priority for business is a reduction in the rate of payroll tax in order to enable the creation of more jobs and lower the rate of unemployment.

No Increase in the GST Rate will be Tolerated

The possibility of raising the GST rate from its present ten per cent has been proposed. It is therefore essential to state unequivocally that business is opposed to any increase in the GST rate. The ten percent rate must be seen as set in stone. No increase in its rate would be acceptable to the business community.

The original intention was to place the GST on all goods and services. Had it been done in this way, the tax would have been simpler to apply and would have raised sufficient revenue to eliminate a number of the more burdensome state taxes, including payroll tax. It is one of the most important missed opportunities of the tax reform process that the GST ultimately did not encompass a wider range of goods and services sold in Australia and is unable, therefore, to finance the removal of a range of currently existing state taxes.

But this is now water under the bridge. The important issue now is to ensure that increases in the GST rate are not seen as a source of government revenue. It had always been the concern of the business community that once a broad-based consumption tax was introduced, that it would become the floor upon which further increases would take place. Such taxes are nearly invisible and can provide rapid increases in public revenue that divert expenditure from private purposes to those of the government.

It was only because the government implemented a series of safeguards that hopefully have made increases in the rate almost

impossible to introduce that business was willing to see the GST legislation passed. This remains as true today as it was then. Business does not want to see the proportion of national income utilised by Australian governments at all levels increased, but rather would like to ensure that outlays as a proportion of GDP are continuously reduced.

If governments would like to see growth in the real level of public spending, then such increases should occur only as part of a growing national economy. In that way, real outlays can increase even while the proportion of national income utilised by governments is reduced. This is the ideal approach sought by business.

Within this framework, it is imperative that the GST rate not be raised. Business would strongly oppose any move to increase the GST from its present rate of ten percent.

Tax and Investment

While a great deal of tax reform has taken place during the past four years improvements still remain necessary. This is particularly true of Capital Gains Tax (CGT) and as such businesses need to set the agenda and drive future reforms. The Review of Business Taxation (RBT) recommended numerous changes to Australia's taxation system following which many were implemented.

However, since the introduction of the changes to Australia's CGT legislation international events have changed the circumstances in which businesses compete. The United Kingdom, for example, implemented a budget that significantly cut their capital gains tax.

Recent tax cuts in United States reduced taxation of dividends and capital gains to 15 per cent (currently as high as 38.6 per cent). This measure is being applied to all companies including those which are foreign owned.

While changes to Australia's CGT regime over the past four years have been substantial the rest of the world has continued to move forward. Given these outcomes it is necessary to revisit some of alternative methods canvassed by the RBT but not accepted by the Government on revenue neutrality and budgetary grounds.

Similarly, the role of superannuation remains a major issue. The adequacy or otherwise of Australia's retirement income system will have an important bearing on future rates of growth. The possibility of rapid increases in government welfare outlays on the Age Pension and other forms of spending associated with an ageing population are going to need very careful consideration. The present arrangements are in a host of ways entirely inadequate to the task.

Personal Income Taxes

Australia's high rates of personal income taxation continue to impede the international competitiveness of the Australian economy and stand as a major barrier to higher labour force participation. Personal income tax reform, with the aim of removing the disincentives to productive activity, should be high on the tax reform agenda.

At its current level, the top marginal rate of income tax is not only high, 48.5 percent including the Medicare levy, but it is also applied at a relatively low level of income. A taxpayer earning just over 25 percent more than Average Weekly Earnings is confronted with the top marginal rate of personal income tax.

Personal income tax relief gains its greatest economic and social impetus when it is looked at in its international context. Australian rates of personal income taxation stand in marked contrast to those in most other advanced economies, particularly in respect of the low threshold for the top marginal rate. The fact is well illustrated in Table 3, put together by KPMG. It should be noted that for most of these

economies the current and proposed top marginal tax rates are the same, but for some it is intended that the rate be lowered. The proposed lower rate is noted in the middle column.

While equity considerations are said to underlie Australia's highly progressive personal income tax scales, this objective is met at a cost measured in terms of efficiency, labour force participation and the international competitiveness of the Australian economy. Unless changes are made, these are costs which will grow over time.

To the extent that high marginal income tax rates reduce investment, work effort and innovation in the economy they actively work against social equity. Slower rates of economic growth and job creation lead to higher rates of unemployment and lower real wages for those able to find work. Both factors adversely affect equity.

At the most basic level high marginal income tax rates act to discourage personal initiative and effort. Within the paid workforce, the incentives to work harder, seek promotion or augment their human capital through vocational training are diminished.

This can also have an effect on business owners and the self-employed. It is not just employees who are discouraged from additional income producing efforts but so too are other income earners. If high tax rates make it less worthwhile to undertake productive activity, the scale of enterprise in Australia is diminished as a result.

The effect on the broader economy is detrimental. Reduced economic activity results in lower GDP per capita, while a less skilled workforce means decreased productivity. This

TABLE 3
Top Marginal Tax Rate Trends for Selected Economies

Economy	Current Top Marginal Tax Rate	Proposed Top Marginal Tax Rate	Current / proposed Income Threshold (A\$)
Australia	48.5	48.5	60,000
Canada	45.7	45.7	114,800
France	52.7	-	82,600
Germany	48.5	42.0	98,000
Hong Kong	15.0	15.0	330,900
Ireland	42.0	42.0	106,900
Korea	36.0	36.0	118,300
New Zealand	39.0	39.0	53,400
Singapore	26.0	20.0	323,400
United Kingdom	40.0	40.0	83,900
United States	47.4	44.3	549,100

Source: KPMG, *Australian Taxation in an International Context*, December 2002.

adds up to a lower standard of living for all Australians.

As outlined in the Government's *Intergenerational Report* released in May 2002, declining workforce participation may also be a problem for the long-term sustainability of the Federal budget position. If measures are not adopted to maintain the proportion of the population in the workforce a long-run deterioration in government finances may be the result. Personal income tax relief should be a core component of measures designed to encourage participation.

In addition, with professional workers becoming increasingly mobile internationally Australia is faced with a choice between personal income tax reform or failing to attract and retain highly skilled workers. Australian-born professionals are more likely to seek employment overseas, while international expertise will tend toward those countries with less onerous income tax burdens and which deliver higher after tax incomes.

A clear economic case exists for reducing the income tax burden on the Australian taxpayer. An anticipated long-run decline in the labour force participation rate will need to be countered by increasing incentives to remain in the workforce, while internationally Australia must maintain its competitiveness. The top marginal rates of taxation needs to be restructured as a matter of priority, having particular regard not only

to reducing the top rate but also towards raising the threshold at which it is applied.

Poverty Traps

It is widely recognised that the interaction of welfare payments and the personal income tax system can give rise to high effective marginal rates of taxation for low-income earners.

As a worker moves from welfare to work, government allowances are reduced while eligibility for certain forms of support cease. At the same time, income tax begins to be paid on earned income. Faced with the prospect of receiving little extra disposable income for entering paid employment, there is a reduced incentive to seek paid work in place of welfare dependency.

In addition to being damaging to the wellbeing of individuals, and often by extension to their family, unemployment represents a loss of productive capacity in the economy and a further burden to be borne by taxpayers. Rather than trap people in welfare dependency, the tax system and welfare payments should be structured in such a way as to promote movement into paid employment.

Restructuring of the income support system is a necessary adjunct to addressing equity considerations. The Government has already taken the initiative on the welfare to work transition with the imminent ~~introduction of the~~ *Working Credits* scheme to commence on 20 September 2003.

The intent of the scheme is to encourage welfare recipients to enter the workforce by allowing them to retain their income support entitlements for a period of time after they acquire paid employment. This occurs in circumstances where the payment would otherwise be reduced or cease altogether as a result of the recipient's new income.

An earned-income tax credit, conditional upon family size and income, is another means of ameliorating high effective marginal rates of taxation for low-income earners in low-income families. Those eligible are provided with a tax credit for taking up paid employment that can be used to offset their tax liability.

If they are to reduce the problems created by poverty traps, tax credits should be implemented in such a way that, in combination with eligibility for income support payments, there would be sharp increase in work incentive. An appropriately targeted earned-income tax credit would reduce effective marginal rates of taxation and provide higher disposable incomes to its recipients.

The *Working Credits* scheme is a step in the right direction but there is the potential to do more. There needs to be more investigation on the effectiveness of a targeted earned-income tax credit as a means of both increasing work incentives and increasing real incomes for low-income earners who choose work rather than to receive welfare.

australia-united states free trade agreement

the proposed Australia-United States Free Trade Agreement (A-US FTA) is likely to be one of the most important bilateral economic and commercial agreements ever negotiated by any Australian Government. A bold, comprehensive and worthwhile A-US FTA will not be without its challenges but will also not be without its rewards, which over the long term will be substantial.

The debate surrounding any final Agreement on the A-US FTA must not obscure the more important issue of its economic and commercial substance. Nor should it ignore the wider issues that surround any such bilateral agreement.

First and foremost, any A-US FTA must not detract from the primacy of the World Trade Organisation (WTO) system in international trade law and trade liberalisation. Australia's vital national economic interests are best served by challenging, not facilitating, any trade or related initiative that could compromise the leadership and over-riding standing of the WTO and rule of international trade law.

Second, any A-US FTA must be 'WTO-plus', delivering outcomes beyond those achievable within the WTO system. If an A-US FTA merely repackages the trade liberalisation and facilitation opportunities available in the WTO suite of agreements, then the FTA negotiations will have been for naught.

Third, both countries will come to the negotiating table with difficult issues on which they will be seeking concessions from the other country, while having their own sensitive sectors where making concessions may prove particularly challenging.

Axiomatically, deliberately ignoring or unreasonably delaying negotiations on (or deferring

implementation of) such 'difficult and sensitive' sectors will diminish the credibility and the ultimate commercial and economic value of any final Agreement. Both sides have much to gain from such an agreement so that both sides will need to adopt the necessary compromises on their own sides of the negotiating table.

Fourth, while the United States is an important bilateral economic relationship for Australia, careful consideration must be given to the implications of any A-US FTA for our bilateral and regional relationships elsewhere in the world.

We need to be sensitive to the potential for any FTA to divert trade and investment and to stimulate other bilateral and regional FTAs which may have adverse impacts on Australia (for example, the proposed ASEAN-China FTA).

Yet for all the possible risks, the potential benefits are so large that this is an opportunity that must be seized. Integrating Australia more closely with the world's strongest economy will raise domestic productivity growth in ways that otherwise could not be achieved.

A bold and comprehensive free trade agreement between Australia and the United States is very much in Australia's interests. It would mean more investment, more jobs and stronger economic growth.

A Free Trade Agreement just means getting rid of artificial trade barriers such as tariffs, quotas and other restrictions, enabling both countries to expand their trade in goods and services.

Contrary to a lot of misinformation, some of it verging on hysteria, the proposed Australia-US FTA will not be a free-for-all arrangement, where the larger country is able to impose its will on the smaller partner.

An FTA with the US is about improving access for Australian manufacturers and other exporters to the huge American market – the largest and most dynamic in the world today. Indeed, many people may not realise the United States' is already Australia's largest single trading partner, and one of our fastest growing export markets. The United States is also our second most important destination for manufactured exports (after Japan) and our most important market for investment and services.

The opportunities for Australian firms from closer economic relations with the United States are potentially massive.

With the USA's positive attitude towards Australia after the Iraq War, this is a once-in-a-lifetime opportunity to reach an economic agreement that will enhance Australia's continuing economic growth for many years to come. We must not let it pass us by.

Bilateral Trade and Investment

As noted the United States is Australia's largest single trading partner, the second most important destination for our manufactured exports (after Japan), and the most important market for investment and services.

The United States is also one of Australia's fastest growing export markets, experiencing a five-year trend growth of some 16 per cent. By comparison, Australia is the United States' 24th largest trading partner (measured as a proportion of total United States trade), and its 15th largest export market.

Bilateral trade between Australia and the United States totalled more than \$A44 billion in 2001/02, accounting for almost 15 per cent of Australia's total international trade.

The United States takes 10 per cent of our manufactured exports, and is the largest single market for Australia's exports of elaborately transformed manufactures. It is also the single largest destination for Australian services exports, accounting for 15 per cent of services export income.

It is also the largest single source for Australia of manufactured and services imports, accounting for 18 per cent of merchandise and 20 per cent of services imports by value. Major items in the area of manufactures imports include aircraft and parts, computers and parts, and telecommunications equipment.

Australia also has a strong, and growing, investment relationship with the United States. According to official statistics, the United

States was the largest single destination for Australian investment abroad (\$A177 billion) and our largest single source of foreign investment (\$A235 billion) at 30 June 2001.

These investment linkages are expected to deepen and expand with the entry into force in 2003 of amendments to the Australian-United States Double Taxation Agreement.

Existing Agreements

Australia and the United States already have a loose, formal economic and trade relationship, in the form of a bilateral Trade and Investment Framework Agreement (TIFA), which is intended to act as a platform for trade and investment policy dialogue between the two countries.

While Australian and US trade ministers have met only sporadically over the past decade under the TIFA framework, successive Australian Governments have used it to press issues such as market access for small firms, promoting US investment in Australia, and encouraging active US involvement in global and regional trade liberalisation.

Australia and the United States also have other economic and commercial agreements covering for example, legal co-operation on competition law and policy matters, and on double taxation.

At the Heads of Government level (the Australian Prime Minister and the United States President), there appears to be strong political support for a more formalised and closer commercial and economic relations.

The Australian and United States' Governments have set a high standard threshold for the proposed bilateral FTA. According to the Australian Government:

'Both governments have agreed that an agreement should be comprehensive in scope, should aim to complement our respective efforts in the WTO negotiations, and set a high standard for FTA agreements between other countries.'

Regional Trade Agreements

The WTO is generally regarded as the foundation stone of international trade law, operating primarily through a suite of multilateral trade agreements covering sectors such as manufactures, services, intellectual property, and agriculture.

A fundamental principle of the WTO system is what is known as the Most Favoured Nation (MFN) rule. In essence, MFN requires WTO Members to afford other Members no less favourable treatment than they give to any other Member country; in short, treating each other equally best.

Regional trade agreements (RTAs), such as FTAs, are allowable exceptions to this principle.

Under WTO rules, individual countries can afford preferential treatment to their partners in an RTA providing the rules of the RTA conform to certain strict conditions which are designed to ensure these arrangements do not create new barriers or introduce new forms of discrimination between trading partners.

The critical test for an FTA to be in compliance with WTO rules is that it must eliminate all tariffs and other

Summary of Trade Barriers of Concern

Sector/Theme	Australia	United States
Agriculture	Ö	Ö
Audiovisual and Entertainment		Ö
Automotive	Ö	Ö
Electronic Commerce		Ö
Export Subsidies		Ö
Financial Services	Ö	
Government Procurement	Ö	Ö
Industrial Products (Non-Automotive)	Ö	
Intellectual Property Protection		Ö
Investment	Ö	Ö
Processed Food and Beverages	Ö	Ö
Professional Services	Ö	
Quarantine		Ö
Shipbuilding	Ö	
Tariffs (General)		Ö
Telecommunications	Ö	Ö
Textiles, Clothing, Footwear and Leather	Ö	

Source: Compiled by the Australian Chamber of Commerce and Industry

restrictions on substantially all trade in goods between the participating countries.

While the precise definition of ‘substantially all trade’ has not been finally settled within international trade law, it can generally be seen as inferring a high proportion of trade between the parties, either measured in volume terms or tariff lines. The Australian Government has set down its interpretation in the following terms:

‘Australia considers that this must be a very high percentage, and that no major sector should be excluded from tariff elimination.’

It is unlikely the United States Government would have a significantly different view.

Traditionally, RTAs have focused on the trade in goods. By contrast, parallel efforts on the liberalisation of the regional trade in services

have been called either ‘economic integration agreements’ (EIAs) or more simply ‘services FTAs’.

WTO rules also permit EIAs as exceptions to the MFN rule, in much the same manner as is the case for goods.

That is, they must have substantial sectoral coverage and provide for the absence of, or elimination of substantially all discrimination between the parties through either the removal of existing, and/or the prohibition of the creation of any new, discriminatory measures.

In reality, most international trade agreements using the nomenclature FTA cover both goods and services (that is, they are a combination of what the WTO rules would call an FTA plus an EIA).

The advantage of this more comprehensive approach is additional trade and related issues can be included within such framework agreements, such as

investment, government procurement, trade facilitation, competition policy (which are generally not (yet) WTO issues).

Such agreements can also include chapters on existing WTO matters, such as mutual recognition, subsidies and countervailing duties, dumping, and intellectual property.

Trade Barriers

The Australian Government, using information provided by Australian commerce and industry, has identified a wide range of trade and regulatory barriers to Australian goods, services and investment gaining access to the United States market.

Similarly, the United States Government, relying on information from the American business communities at home and abroad, have compiled comparable listings.

The table above provides a summary of the main areas of initial

concern of the Australian and United States Governments, reflecting what each of them, and their respective business communities, consider the most important barriers to trade, commerce and investment between the two countries.

While the preceding table could be interpreted as suggesting Australia and the United States have noticeably different concerns at each other's trade barriers, in reality there is a fairly high degree of commonality, in that each nation is generally willing to discuss with the other the items on their counterpart's agenda (even if they do not automatically accept the veracity of the underlying concern).

In trade negotiations terms, the Australian Government can be expected to readily engage in meaningful negotiations over US concerns in areas such as electronic commerce and intellectual property protection, although talks on issues such as export subsidies and quarantine may be more challenging. Conversely, the United States may find challenging Australian concerns over financial and professional services, and shipbuilding.

In short, none of the sectors or themes should be regarded as a priori 'out-of-bounds'. Rather, all are genuine matters for negotiations in good faith, although the 'degrees of difficulty' will vary between (and in some cases, within) sector or theme.

Econometric Modelling

The Australian Government, as part of its early consideration of the merits of entering into an FTA with the United States, commissioned econometric research into some of the broader commercial and economic dividends of such an agreement.

The DFAT-commissioned econometric modelling evaluates the benefits of the FTA on two criteria: welfare, as measured by real household consumption; and, production, as measured by Gross Domestic Product.

The modelling indicates, assuming early and full implementation of an FTA, Australian welfare would be around 0.4 per cent higher than otherwise by 2010, and 0.5 per cent higher by 2020. For the United States, the welfare benefit from an A-US FTA would peak at 0.2 per cent higher than otherwise in 2006.

The GDP gains for Australia from an A-US FTA would be around 0.3 per cent higher than otherwise in 2006 and 0.4 per cent higher than otherwise in 2010. However, for the United States the GDP-effect will be tiny (estimated at 0.02 per cent of GDP) in 2006; virtually zero.

Any A-US FTA is also likely to have a net positive trade impact, with exports increasing more than imports, thus producing an improvement in the current account deficits of both countries: by around 0.9 per cent of GDP for Australia, but negligible for the United States.

It would also be expected to have trade-creating effects greater than trade-diverting effects (that is, re-orienting trade from other countries), although the Productivity Commission has pointed out New Zealand and China could suffer falls in their exports to Australia.

Commentary about sensitivities within Asia to the A-US FTA tend to be overplayed, implying that if Australia has a closer economic

relationship with the US, we must be distancing ourselves from Asia. This (wrongly) suggested trade relations in ultimately a zero-sum game.

As any well-informed observer would be aware, a growing list of Asian countries already have, or are looking to negotiate, economic and trade agreements with the US.

The relatively small magnitude of the 'direct' economic gains from an FTA reflects the fact both Australia and the United States are already amongst the most open economies in the world. That is, there are comparatively few tariff barriers to trade between them, those that remain are generally set at fairly low levels and thus the economic distortions from tariff-trade barriers (and the gains from eliminating them) are lesser than otherwise.

For example, the average tariff on manufactured imports entering the United States is 2.8 per cent, with a third of all tariff lines being duty-free. For Australia, the average tariff rate is 3.8 per cent, with tariffs on manufactured imports generally between 0 and 5 per cent for 85 per cent of manufactures (on a tariff line basis).

Nevertheless, each nation has several sectors that are given high levels of tariff protection: for the United States, they include dairy, sugar, automotive vehicles, and shipping; for Australia, they are motor vehicles, and textiles, clothing and footwear.

Moreover, econometric modelling is unlikely to provide much more than the general direction of the changes resulting from a free trade agreement and is certain to understate the gains to Australia, especially over the longer run.

Summary of Key Negotiating Priorities

Sector/Theme	Australia	United States
Competition Policy	Ö	Ö
Customs Co-operation	Ö	Ö
Environmental Issues	Ö	Ö
Government Procurement	Ö	Ö
Intellectual Property Rights	Ö	Ö
Investment	Ö	Ö
Labour Standards		Ö
Quarantine/Sanitary and Phytosanitary	Ö	Ö
Rules of Origin	Ö	Ö
State-to-State Dispute Settlement	Ö	Ö
Technical Barriers to Trade		Ö
Telecoms and Electronic Commerce	Ö	Ö
Trade in Industrial Goods and Agriculture	Ö	Ö
Trade in Services	Ö	Ö
Trade Remedies	Ö	Ö
Transparency and Regulatory Reform		Ö

Source: Compiled by the Australian Chamber of Commerce and Industry

Key Objectives

The Australian Government has made two main statements on its objectives in pursuing an FTA with the United States. According to Australian Trade Minister, Mark Vaile:

‘An FTA with the US presents a unique opportunity to advance the interests of Australia’s exporters, and offers significant benefits to the nation in terms of economic growth and employment.

‘The Government will give a high priority to reducing the most significant market access barriers facing Australian exports, particularly in the agricultural sector.

‘We will pursue a range of Australian interests in the US market covering all areas of the Australian economy – manufacturing, services, investment, government procurement,

telecommunications and electronic commerce, intellectual property rights, and movement of people.’

The United States Government has also made a number of statements on its stances on the proposed FTA between the two countries. In their principal statement, United States Trade Representative, Robert Zoellick said:

‘We believe the United States has much to gain in pursuing a negotiation with Australia...

‘An FTA also would encourage additional foreign investment between the United States and Australia, adding to the many jobs that the significant investment flows between the two countries currently support.

‘In addition, an FTA would result in greater business integration, especially in the information technology sector, increasing efficiency and the

competitiveness of U.S. industry.’

Both the Australian and United States Government have set down, and made public, their specific negotiating objectives, defining priority outcomes across industries and sectors, a summary of which is reported in the table above.

As can be seen, both the Australian and United States Governments share a fairly much common agenda of key sectors and themes for the FTA negotiations, although it should be said there are differences of issues and emphases within a number of these ‘chapter’ headings.

Where the United States Government has proposed additional themes beyond those on the Australian Government’s list, most notably technical barriers to trade, and transparency and regulatory reform, they are not likely to prove problematic, and likely to be readily added to the negotiating agenda.

The same cannot, however, be said for labour standards, where the current Australian Government has a long-standing opposition to the inclusion of such matters within trade agreements.

Reaching Agreement

The Australian and United States Governments have committed themselves to the negotiation of a bold and comprehensive FTA between the two countries.

The agenda, issues and challenges confronting negotiators are substantial, compounded by the ambitious time frame proposed by political leaders. Protectionist and vested interests have already started calling for special treatment, usually in the form of exemption from any liberalisation initiatives.

The Australian business community wants to see the successful completion of an A-US FTA.

To the extent that the A-US FTA can deliver outcomes in trade liberalisation and market access for Australian exporters to the US market which are 'WTO-plus', and which do not compromise the integrity of the WTO system, then such negotiations are likely to be of substantial long-term benefit to the Australian economy.

The article as it now appears replaces an early draft.

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