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SENATE

SELECT COMMITTEE ON THE FREE TRADE AGREEMENT BETWEEN AUSTRALIA AND THE UNITED STATES OF AMERICA

Reference: Free Trade Agreement between Australia and the USA

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SENATE

SELECT COMMITTEE ON THE FREE TRADE AGREEMENT BETWEEN AUSTRALIA AND THE UNITED STATES OF AMERICA

Tuesday, 6 July 2004

Members: Senator Cook *(Chair)*; Senator Brandis *(Deputy Chair)*; Senators Boswell, Conroy, Ferris, Harris, O'Brien and Ridgeway

Senators in attendance: Senators Boswell, Brandis, Conroy and Cook

Terms of reference for the inquiry:

To inquire into and report on:

1. The Free Trade Agreement between Australia and the United States of America to ensure it is in Australia's national interest; and
2. The impacts of the agreement on Australia's economic, trade, investment and social and environment policies, including, but not limited to, agriculture, health, education and the media.

WITNESSES

BROWN, Mr Nicholas, Assistant Secretary, Trade and Economic Analysis, AUSFTA, Department of Foreign Affairs and Trade 1

BROWNING, Ms Michaela, Executive Officer, Trade Policy Issues in Free Trade Agreements, Department of Foreign Affairs and Trade 1

CHURCHE, Dr Milton, Director, Services and Investment Negotiations, Free Trade Agreements, Department of Foreign Affairs and Trade 1

CORDINA, Mr Simon, Acting General Manager, Intellectual Property Branch, Department of Communications, Information Technology and the Arts 1

CRESWELL, Mr Christopher Colin, Copyright Law Consultant, Attorney-General's Department 1

DEADY, Mr Stephen, Lead Negotiator, AUSFTA, Department of Foreign Affairs and Trade 1

GREVILLE, Ms Virginia Jane, Special International Agricultural Adviser, Department of Agriculture, Fisheries and Forestry 1

HARMER, Ms Toni, Executive Officer, International Intellectual Property, AUSFTA, Department of Foreign Affairs and Trade 1

LEGG, Mr Christopher, General Manager, Foreign Investment Policy Division, Department of Treasury 1

LOPERT, Dr Ruth, Medical Adviser, Medical and Pharmaceuticals Services, AUSFTA, Department of Health and Ageing 1

MYLER, Mr Paul, Legal Counsel, US FTA Task Force, Office of Trade Negotiations, Department of Foreign Affairs and Trade 1

QUINN, Mr Martin Joseph, Director, International Intellectual Property Section, Office of Trade Negotiations, Department of Foreign Affairs and Trade 1

SMITH, Dr Heather, General Manager, International Economy Division, Department of Treasury 1

WYERS, Ms Jessica, Assistant Director, Legislation and Policy Development Section, IP Australia 1

Committee met at 9.38 a.m.

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CHAIR—I declare open this meeting of the Senate Select Committee on the Free Trade Agreement between Australia and the United States of America. The terms of reference of this inquiry are available from the secretariat staff. Today's hearing is open to the public. This could change if the committee decides to take any evidence in private. Witnesses are reminded that the evidence given to the committee is protected by parliamentary privilege. It is important for

witnesses to be aware that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate.

We have a broad order of business to follow. We will be considering the extent to which the implementing legislation that is now before the parliament addresses the sorts of issues that witnesses have raised and that were reported in the committee's interim report. This morning we will address matters of quarantine, the environment, investment and services, and questions relating to manufacturing and associated questions of economic modelling. In the afternoon we will turn to intellectual property issues and pharmaceutical and other health issues.

I welcome officials from DFAT and elsewhere. Thank you for making yourselves available. Mr Deady, do you have any opening remarks?

Mr Deady—No.

Senator CONROY—I want to start on quarantine first. At our committee hearing on 18 May we were trying to establish the relationship between the new SPS committee established under the FTA and the import risk assessment process. In answering some of the committee's questions, Ms Greville, you gave a range of descriptions about how this interaction and relationship would take place, which included: 'it will be taken account of', 'a useful adjunct', 'a helpful step forward', 'due weight would be given', 'a positive step forward', 'some weight would be given' and 'quite a lot of weight would be given'. So there were a variety of descriptions that we were kicking around. I just want to go back over that a bit and try in my mind to establish exactly how this process is going to interact. Do you want to try and clarify it for me again? It is probably more me than you, I am sure, but I just want to get an absolute understanding of how this scientific decision or analysis that takes place over in the SPS committee will interact with the import risk assessment committee.

Ms Greville—I do recall our conversation last time. Perhaps in order to clarify it, I need to go back a step and differentiate between the sorts of issues that will be discussed in the standing technical working group or the SPS committee, whether or not they relate to a specific IRA, and the decisions which confront an IRA panel or the Director of Plant and Animal Quarantine, who actually makes the quarantine decision. I think that, in order to understand this, it is very important to understand that the issue before the working group will never be whether commodity X should be traded into Australia or commodity Y should be traded into the United States. Those are quarantine decisions that are the sovereign right of either government or any government concerned.

The issues that the standing technical working group will be considering are technical or scientific—for example, is the available science conclusive that fumigant A kills pest B at a particular temperature and, if not, what further experimentation is necessary or would the addition of measure Q to the current practices of an exporting party lower the risk to an importing party of an incursion of a pest or disease? So the process within the standing technical working group will be that the scientists on either side will attempt to achieve a meeting of their scientific minds and resolve, to use the words of the text, to their mutual satisfaction any of these kinds of issues which are germane in an import risk analysis or which MAY not be related to a specific import analysis but may be alive in international debate somehow. We consider that to be a very useful process.

Such resolution is often possible, but not always. For example, we have an ongoing issue with the United States on shuttle stallions—that is, the movement of stallions for breeding purposes between countries. Our scientists have just come to the point where they agree that they cannot agree. We want some additional scientific research and the Americans do not, so the result is that we maintain our regime and insist on the test that they believe is unnecessary. Then the issue becomes: what happens to that resolution in the context of the consideration by an IRA panel of the much wider issues in a specific import risk analysis? The answer is that it is essentially up to the panel.

The panel will be considering all manner of scientific opinion on a range of issues. Part of its job is to determine what weight to give to what opinion, hence my wide range of descriptions about the sort of weight that would be given. Essentially the weight that will be given will depend on what weight the panel chooses to give to it. It is hard to imagine it would not be useful to the panel to know that the competent authorities from the two jurisdictions agree, to continue the analogy, that a virus X is killed by heating to temperature whatever for however many minutes. But it is not binding on the panel to include that in its recommendations or its findings if it makes another finding, or on the balance of global scientific opinion it believes otherwise.

Senator CONROY—Last time you said there would be some common individuals. Biosecurity Australia is obviously represented in quarantine import risk assessment but it is also likely to be represented on this new working party as well.

Ms Greville—Just to explain, the standing technical working group under the FTA arrangements will comprise Biosecurity Australia on the Australian side and its counterpart competent authority on the US side, the Animal and Plant Health Inspection Service, APHIS. There may be other people, but they will be the chairs and comprise the bulk of the scientific expertise on that body. Under our current import risk analysis process, as you may be aware, Biosecurity Australia has responsibility for the import risk analysis process and it convenes the IRA panel that undertakes the import risk analysis. Biosecurity Australia generally chairs that IRA panel and, depending on whether it has the expertise in-house, it may make up the panel. If it needs to call on expertise from outside its own organisation, which is frequently the case, the panel will include scientific experts from elsewhere—perhaps state governments or academic institutions or wherever they need to call on them from. So Biosecurity Australia in every circumstance I can think of would be represented both in the standard technical working group, which it co-chairs, and on any given import risk analysis panel.

Senator CONROY—The issue that concerned me the most after our last discussion was this idea that a scientific consensus could be reached on the SPS committee and the impression I have, perhaps wrongly, that once this scientific consensus was reached, because Biosecurity Australia was involved in reaching the scientific consensus, that would automatically be the view of the scientists. If they were in-house I certainly got the impression that it would be, 'Well, this is the official Biosecurity Australia scientific consensus,' and therefore those scientists from within Biosecurity that are dealing with an individual matter would be bound by that. More importantly, regularly they bring in outside experts, and the issue is whether or not they would be bound by the scientific consensus or they would be entitled to conduct their own scientific analysis. It may be that they come to the same position as under the new working panel the Biosecurity scientific consensus. But the issue is whether or not they are actually entitled to

make a scientific judgment or they are bound by the consensus that has been reached over there. That is the nub of my concern.

Ms Greville—The short answer is that the IRA panel is not bound by any decision that the standing technical working group may arrive at. Having said that, though, as I said earlier, given that the import risk analysis panel is grappling with the big picture of considerations about what recommendations it is going to make on whether the trade should occur and under what circumstances, in the course of that they have to confront a number of scientific issues and in the course of doing that they do not always, as I understand it, return to the fundamentals. If there is a body of scientific opinion that is considered to be conclusive then they will often rely on that scientific opinion to make the next step judgment in their import risk analysis. So, as I said to you, it is hard to imagine that they would not find it useful that the two competent authorities had agreed that, when you are putting a net over a pallet of fruit, the holes in the net need to be a certain size to stop a certain pest popping out. If in the course of the import risk analysis they have a range of different views then they will certainly take those into consideration and may come to a different view.

Senator CONROY—I am trying to become convinced that the IRA process is still independent and the panel do not just have to have this scientific consensus agreed over here—they are entitled to sit down, weigh the evidence and make their own independent judgment. That will be a little harder, obviously, if they are purely Biosecurity people, because it is a brave person that says, 'No, the other five people who work with me are idiots and they've got it wrong.' I am trying to become comfortable in my mind on this issue of the independence of the scientific process.

Ms Greville—I certainly understand the import of your question and your concern, and I can assure you that the import risk analysis process is entirely independent of the standing technical working group. The IRA panel can draw on the standing technical working group to provide useful input if it wishes to, but it is not required to do so and it is not required to give any particular weight to the conclusions reached by the group.

Senator CONROY—Moving on to some of the more bureaucratic issues, have you decided yet who will sit on the SPS committee and the technical working group?

Ms Greville—You asked me that last time. As I said to you then—and it is still the case—there has been no discussion between Australia and the US since the negotiations were completed about the detail of how those bodies will work. They do not, as I am sure you would understand, exist until the agreement enters into force. We have an arrangement at the moment where Biosecurity Australia and APHIS talk from time to time about technical and scientific matters, and that is continuing. We have not given any time to discussing how the new arrangements will work other than to acknowledge to each other during the negotiations that we see them as being very much a formalisation of our existing arrangements.

Senator CONROY—Is the government consulting with industry on the establishment and design of these bodies?

Ms Greville—We have certainly talked to anybody who has asked us about them but, given that they are essentially a formalisation of bilateral government-to-government negotiations, we

have not sought industry's input into how they should be constituted. We have told industry exactly the same as what we are telling you, and to a large extent industry knows this already—we have talked regularly competent authority to competent authority in this precursor to the FTA arrangements, in the margins of the SPS committee and in the plant and animal quadrilaterals, which are meetings of the four SPS good guys. They know that and they understand that that process is ongoing.

Industry have not expressed any particular interest or concern to us about how these bodies will be constituted other than the concern that has been expressed by some perhaps less well-informed commentators about the import of these arrangements and how they gel with the import risk analysis process. We have had the same sorts of conversations with them as we are having with you to assure them that there is no suggestion or possibility that the import risk analysis process will be compromised or undermined in any way.

Senator CONROY—There is a number of controversial issues at the moment around a number of sectors that are potentially going to be impacted by this FTA. Pork is an obvious one. Will Australian industry personnel—such as members of the pork industry, the Cattle Council or the stone fruit industry—be represented on any of the groups? We have the new agreement to let avocadoes into the country, but we have not had any agreement yet from the US on the quarantine process for stone fruit.

Ms Greville—I need to go back to the beginning of what you said. First of all, while some concerns have been expressed publicly about the relationship between individual IRAs and the free trade agreement, as we have said before and are happy to say again, there was and is no relationship between a specific import risk analysis and the arrangements that were negotiated in the FTA. There is a final import risk analysis report out on pork. Pork will only be affected by the free trade agreement to the extent that Australia will reduce or eliminate its tariff on cooked pig meat for United States exporters from the date of entry into force of the agreement. In that sense, that is the only relationship that I can think of between pig meat and the free trade agreement.

When these arrangements are in place, and in fact while the current interim arrangements are in place, any import risk analysis that is being conducted by Biosecurity Australia, we will—as we do—consult with the trading partner through the various forums. We also have a consultative, inclusive and transparent process with stakeholders domestically. There is no import risk analysis, to jump ahead, on stone fruit yet. Stone fruit—just to clarify a point in quarantine terms—is peaches and nectarines, not avocados. The United States is very keen for us to start a technical market access consideration for US stone fruit and it is on our list of priorities that we will eventually get to. When the import risk analysis process for stone fruit commences, it will be run according to the import risk analysis handbook, so there will be various stages when domestic and international stakeholders can be consulted. If the standing technical working group is established by then and if the United States seeks for it to be a subject that the standing technical working group looks at, we will also be engaged through that process in consultation with the Americans. I am not sure if that answers your question completely.

Senator CONROY—Reasonably. I would like to come back to peaches, nectarines and avocados. At the moment we are not able to get avocados in.

Ms Greville—Sure. What we achieved through the free trade agreement was elimination, at least to some extent, of the market access barriers.

Senator CONROY—We got a seasonality clause.

Ms Greville—We have some quota access but, until the free trade agreement enters into force, we have no capacity to export avocados to the US, for two reasons: firstly, because we have no quota and the US market is bound by a quota; and, secondly because they have not yet completed our technical market access request for avocados—a quarantine request. Under the free trade agreement we have established a quota which does have some seasonality provisions but does have year-round access, which is something that was misunderstood earlier on by some commentators. We have 1,500 tonnes for half of the year and 2,500 for the other half the year, so overall we have 4,000 tonnes of access that we have not had before, at a zero tariff.

The Americans still have not finished our technical market access request, so we do not have quarantine permission yet, but we will. It is in their priorities and they are working around to it, but these things on their side take a lot of time, and frankly they take a lot of time on our side too, so is always a matter of each side encouraging the other to apply appropriate resources and appropriate priority to technical market access requests. We will continue to do that and, if the standing technical working group is established by then, that will be one of the forums through which we pursue that.

Senator CONROY—Just so that I can clarify it and to make sure that I have it absolutely right, can you outline the specific role of the two committees, the SPS and the technical working group?

Ms Greville—The SPS committee established under the agreement has a mandate outlined in the text. Its purpose is very much to involve representatives of all of the federal bodies with a responsibility for sanitary and phytosanitary matters within each jurisdiction in cooperative dialogue on the matters detailed in the text. It will meet shortly after the entry into force of the agreement and annually thereafter unless Australia and the US agree otherwise. It has been agreed between the parties that representation—that is, which agencies will attend—will depend on the agenda for each meeting.

Senator CONROY—Who would be the core members? There must be some core members.

Ms Greville—There are agencies within each jurisdiction at the federal level that have responsibility for SPS matters as well as Biosecurity Australia on our side and APHIS, the Animal and Plant Health Inspection Service, on their side. There are also bodies like Food Standards Australia and New Zealand on our side and Food Safety and Inspection Service on their side. On the US side there is also the Environment Protection Authority; on our side it may be the Department of the Environment and Heritage. It will certainly include the Department of Agriculture, Fisheries and Forestry, the Department of Foreign Affairs and Trade and possibly the gene technology regulator. So there is a range of bodies on either side who have responsibilities which can be described within the charter of the sanitary and phytosanitary agreement.

The purpose is to involve all of those bodies where necessary, partly because there is a feeling between Australia and the US that we do not necessarily understand each other's division of responsibility—the way that we understand and apply the SPS agreement—and also, to be frank, because within jurisdictions it is not necessarily the case that everybody understands how everybody else works. The idea of the overarching SPS committee is very much about cooperation, increasing understanding and providing each with an opportunity to explain to each other how it works so that misunderstandings do not occur and accusations do not fly backwards and forwards about bad citizenship under the WTO and SPS agreements.

As I said, in discussion during the negotiations we did acknowledge on each side that it involves a lot of people. If we are going to meet every year, that is an awful lot of people who have to go somewhere who will all not necessarily have the same level of interest in what is on the agenda at the time. Hence, there is an understanding that if there is nothing on the agenda that has anything to do with food or human health and it is all about animals and plants, then it will just be those interested people, or vice versa.

Senator CONROY—Who would chair the SPS?

Ms Greville—It will be co-chaired. There will be an Australian chair and an American chair.

Senator CONROY—Which agency?

Ms Greville—The Americans made it clear informally in the discussions that they anticipated that the United States trade representative's office would chair. I do not recall, to be honest, whether that is in the text. I do not think it is, but they certainly made it clear that that was their intention. We have not actually had the conversation on our side about who will chair. I am sure the Department of Foreign Affairs and Trade believe that it would be appropriate for them to chair, but I am not sure that that conversation has been played out.

Senator CONROY—What about the technical working group?

Ms Greville—The technical working group is constituted as a working group of that overarching SPS committee. Hierarchically, it will provide a report of its activities to each of the meetings of the overarching committee. The overarching committee then reports in turn to the joint committee that is established under the free trade agreement to oversight the whole relationship. The technical working group will be chaired by the heads of the organisations in each jurisdiction identified as the competent authority. In our case that is Biosecurity Australia; in the US case, as I have said before, it is the Animal and Plant Health Inspection Service. Its purpose, as I have outlined, is to discuss technical and scientific matters of interest to the parties and to achieve consensus, where possible, on specific technical and scientific matters.

Senator CONROY—You mentioned a recent example involving stallions.

Ms Greville—Yes.

Senator CONROY—Yes, where we actually have not done it, even under the existing system. You mentioned—I am not trying to verbal you—that this will formalise the current

existing informal process. Could you take me through what the informal process at the moment is?

Ms Greville—Let me go back one step from that. We have always talked to our trading partners about SPS matters and, if either one of us has a problem or a concern with the other one, we write to each other or we contact each other in various ways. That is effective as far as it goes. However, in August 2001 there was a meeting between the agriculture departments of each jurisdiction with trade representatives. It was called the high-level dialogue on agriculture. I will confirm the date for you. I think it may have been 2002. The Secretary of the Department of Agriculture, Fisheries and Forestry and the Deputy Secretary of the Department of Foreign Affairs and Trade met with the chief US agriculture negotiator, the undersecretary from USDA for farm and foreign agriculture services, the undersecretary for regulatory matters, APHIS and Biosecurity Australia in Washington. We discussed a whole range of issues to do with our agricultural relationship, including the reasonably high level of concern on either side about the way that our SPS matters were progressing.

The US had a list of things that they were not happy with and we had a list of things we were not happy with, and out of that high-level dialogue it was agreed that there would be a face-to-face meeting of the competent authorities to work through a list of concerns on either side with a formal agenda that would then report back to the high-level dialogue. That took place in August 2002 and the high-level dialogue was July 2002. So, since August 2002, we have met either face to face, via teleconference or video conference between about every six weeks and three or four months to work through a table that we compiled at that first meeting. That had a progress report on each of the technical market access requests of interest either way.

Senator CONROY—Is it possible to get a list so we can see what that informal working group has been working on—nothing confidential, but an indicative list of the sorts of issues that are being informally considered.

Ms Greville—Yes, I can certainly provide you a list of the technical market access requests on either side that have been the subject of discussion in that working group. I should also say that, during that period of time, a number of issues on either side have reached the quarantine decision-making stage. In each case, the working group discussed where it was up to and established whether there was anything that the competent authority on either side could do to assist the potential importing country to go through its process. In some instances we discovered that there had been misunderstandings—that one side has sought information from the other that the other was not aware that not providing it was holding up the process. So it has been very useful to help us understand each other's process and where the delays are likely to happen. It also gives a focus within each competent authority for the need to provide technical information as quickly as possible.

Senator CONROY—Do we have any of these informal working groups with other countries or is this a particular US initiative?

Ms Greville—The way that it is constituted and the way that group works is probably particular to the United States, but we do have regular dialogue with other important trading partners where we explain on either side what the delays or problems are and seek additional information if necessary. This is the only one that I am involved in, so I cannot talk with any

authority about the way it works with other trading partners. But we certainly do have discussions, as we are obliged to do under the SPS agreement, about technical market access requests with other trading partners.

Senator CONROY—Will there be any trade representatives on the TWG?

Ms Greville—Quite possibly. It was certainly discussed during the negotiations that the chairs of the overarching SPS committee could attend the standing technical working group. There is no issue on either side about trade representatives being involved. Equally, it is understood on both sides that trade representatives have an important role to play in SPS discussions but not in terms of the scientific consensus-reaching.

Senator CONROY—You are not an expert on stone fruit, are you, Mr Deady?

Mr Deady—No.

Senator CONROY—Ms Greville?

Ms Greville—No, although I know a bit more about some of them than I ever really wanted to.

Senator CONROY—So neither of you have drawn the short straw yet?

Ms Greville—There has been no discussion about who the actual people will be, other than that the chairs on each side will be Mary Harwood, from Biosecurity Australia, and Ron de Haven, who is the newly appointed head of APHIS.

Senator CONROY—How will we keep track of these two new bodies of individual import risk assessments that are taking place other than an academic interest: that is, we know that something is going on with pork or we know something is going on with apples over there? What will be the liaison process, given that Bio Australia is involved in both?

Ms Greville—I am not sure if I have your question right, but let me say this first and then you can tell me if I have missed the point. At any given moment, Biosecurity Australia is likely to be addressing a very large range of technical market access requests from all over the world. Within that there is a subset of technical market access requests on which the United States is either sole requester or one of the requesters.

It was acknowledged explicitly in the negotiations around the technical working group, and it is also in the text, that that set of import risk analyses, or technical market access request processes, is likely to be bigger. I am sorry, I have expressed that badly. We have acknowledged that there is a big list. If the United States or Australia wish to pursue at a greater depth technical and scientific consultations in respect of a particular one or some particular ones, they will need to prioritise those and the standing technical working group will have to agree that it has the time and resources to deal with them.

Senator CONROY—But they are not meant to be looking at individual cases. Or are you saying that only the SPS does not look at individual cases but the technical working group can be tasked to look at individual cases?

Ms Greville—The technical working group will continue the work of the current arrangement insofar as both sides envisage that every time it meets one of its tasks will be to update the progress on every one of the import risk analyses that it is doing that is of interest to the other side—so the whole set of what Australia is doing in respect of US requests and the whole set of what the US is doing in respect of Australia. The standing technical working group then has the capacity to drill down a bit deeper to a subset of that. It says in the text that either party can request the standing technical working group to—I forget what the wording is—develop a work plan or a work program in respect of a particular issue. The United States may say to Australia, 'You're doing an import risk analysis, or you are just about to start one, on frogs' legs, and that is of great interest to us. We would like the working group to follow the progress of that import risk analysis and for us to be engaged on particular technical issues that fall out of that.' They cannot do that, and neither can we, on every single one of the technical market access requests that we are likely to be undertaking at any given time. So they will choose the one that is of most interest to them—as we will do for them—and seek, if it seems useful, to have technical consultations throughout the process of that IRA.

Senator CONROY—I understand the concept of following the progress; that is fairly straightforward. Bio Australia would say, 'We're currently looking at frogs' legs as part of an IRA.' Then they may say, 'We'd like the technical working group to look at some of the science around frogs' legs.' I am trying to make sure that I fully understand the processes. You use the word 'engaged'. I got the impression that the IRA could outsource its scientific assessment by engaging the standing technical working group. Is that what you meant to imply?

Ms Greville—No. I meant to imply that Biosecurity Australia will inform APHIS, if it is a US technical market access request on frogs' legs, that we are about to commence an import risk analysis on frogs' legs. There are various stages in the import risk analysis process where, as a general rule, under current arrangements, we would engage with stakeholders if stakeholders wished to be engaged. The way that the working group will fit in with that is that it will develop for itself a specific work plan to conduct technical and scientific exchanges in a way that those technical and scientific exchanges are in parallel with the import risk analysis process.

So if it is at the beginning of the import risk analysis process—when the import risk analysis panel, chaired by Biosecurity Australia, releases a paper, which is what it generally does, on the scope and approach proposed for risk assessment and the expertise required for that assessment, which is part of the transparency that is undertaken already in our import risk analysis process—then the standing technical working group can, at the meeting that coincides most closely with that process, have a discussion about the scope and approach proposed for the risk assessment and the expertise required. If APHIS feels that the scope and approach has missed something out or included too much in then that is the opportunity for APHIS to say that. I make the point, though, that APHIS always had the capacity to make those points to Biosecurity Australia and did so through different avenues. This means that the two competent authorities will sit down and have that conversation face to face or however the meeting is established.

The next step in the IRA process is usually to produce a technical issues paper. The import risk analysis process will still produce a technical issues paper if it is the sort of IRA that needs that. At that point, the working group can discuss the technical issues paper and Biosecurity Australia can hear from APHIS their views on whether they agree that the technical issues identified are in fact the technical issues that they believe are the case—that is, whether the pests and diseases identified are the right pests and diseases. I should editorialise that often the competent authorities in two jurisdictions have different opinions about whether they have a particular pest or disease. The importing country generally starts out with a kind of census of pests and diseases and the exporting country whittles it down, producing scientific evidence to support the statement, 'We don't have that one,' or, 'We used to have that one, but we don't have it anymore.' So that dialogue is quite important.

Senator CONROY—Would the dialogue that is taking place within the technical working group also be taking place within the IRA? Are the American organisation that you have mentioned only going to be saying this through the technical working group or will they engage directly?

Ms Greville—They can do any of the above. The stakeholders from the exporting country's side are not just APHIS. If it was the 'Frogs' Legs Association of the United States, it may well have strong views. But the industry organisation or the peak body or the frogs' legs farmers of wherever—

Senator CONROY—Florida!

Ms Greville—may also have strong views about which pests and diseases they have. They may have made those views known to APHIS and APHIS may be passing them on through the standing technical working group, or they may make those views known directly through the stakeholder consultation process that is part of the import risk analysis. The standing technical working group facilitates the exchange between the two competent authorities but, as I said before, not only do we already have a formal arrangement to do that but even absent the formal arrangement they still have the capacity to participate in the process. The fact is that they have not always participated in the process.

Senator CONROY—There is a difference between participating in the process and having the ability to shape the process, and that is where I am trying to make sure there has not been a change.

Ms Greville—I may not be explaining it very well, but the process has always allowed for the exporting country's authorities to state their views about all the aspects of the import risk analysis process. This continues to allow them to express their views; it just provides a slightly different forum for them to do so.

Senator CONROY—The point I am trying to get clear in my own head is that, if APHIS decide that they simply wanted to engage the technical working group process without going to the IRA process, the IRA process could become secondary to the working group process, and that would be an issue that would concern me.

Ms Greville—I do not believe that to be the case, but I do understand the point you are making. I guess it comes back to the fact that Biosecurity Australia is the competent authority engaged in the technical working group and also the convener and overseer of the import risk analysis process.

Senator CONROY—Yes.

Ms Greville—Biosecurity Australia's reason for being, in an importing sense, is to run the import risk analysis process and that is their greatest priority. The standing technical working group—and I am about to use one of the words I used last time—is very much an adjunct to that. It is one of the ways, but not the only way, that the import risk analysis panel can receive input from APHIS. There is nothing to stop APHIS communicating with the import risk analysis panel separately. I suspect that they would not because they would pass on their views to Biosecurity Australia in the standing technical working group and Biosecurity Australia would make sure that those views, to the extent that some consensus was reached, were passed on to the import risk analysis panel. The import risk analysis is the big and important process and I do not think there is any danger of it becoming secondary. APHIS, however important the US is as a trading partner, is only one stakeholder in an import risk analysis process that has invariably a very big range of stakeholders.

Senator CONROY—Annex 7-A(4b) suggests that working groups shall provide a forum for engaging at the earliest appropriate point in the risk assessment and regulatory process of each party. What stage would you envisage that being? We talked about the different steps—IRA consult the stakeholders then issue a technical issues paper. That suggests that they would be involved earlier than that.

Ms Greville—In order to understand that clause it is important that I make the point that, even though our import risk analysis process is now well established and very transparent and has a number of stages—

Senator CONROY—Brave statements in the light of a number of decisions recently. That is part of the concern. But that is not a problem you have caused, Ms Greville.

Ms Greville—I am not sure I agree with you, Senator, but never mind. Notwithstanding the fact that there are many places during an import risk analysis process where stakeholders can be involved, it is fair to say that stakeholders do not always choose to involve themselves in that process. For example, industry bodies or even the competent authority in the US or other trading partners have not always availed themselves of the opportunity to comment on the technical issues paper or the draft IRA and have waited until the final IRA and have shrieked and protested and said, 'Our views were not taken into account' or 'The science is faulty' or whatever it is that they say. That is one point.

The second point is that the way this arrangement is constructed and the way the text is articulated it says that either party can request that the working group establish a work plan to address a specific measure, project or issue. If the US or Australia identify at the beginning of an IRA process that they want that issue or project to be addressed by the working group then they can be engaged right at the beginning of the IRA process. It is possible, though, that an import risk analysis process has been going on for a number of years and once this arrangement is in

force either of us, Australia or the US, might identify that we want the working group to work on the issue of transmissibility of a particular disease that we realise is going to be of issue in a particular IRA that is much closer to its end. It is then not possible to go back to the beginning of the IRA and engage, so we have to shunt in at the side at whatever stage the process is at.

Senator CONROY—I am thinking more of the ones that will commence after rather than ones that have already been happening for a few years.

Ms Greville—Regarding the ones that will commence after, if it is one that the working group is going to establish a work plan to deal with issues that fall out of it then the engagement will be at the very beginning. The subparagraphs in section B—a, b, c, d, e, f—identify the sorts of stages in an import risk analysis process where it would be useful to have technical and scientific consultation between the competent authorities. If it is just beginning then the engagement will be on the scope and approach proposed.

If we are already past that and we are up to the technical issues paper then it will be on the technical issues paper. If we are past the technical issues paper but there are still issues between us on biology and transmission of pests and diseases then that will be what we talk about. In some instances there could be consultation on all of those stages. In others we may have reached the point of consensus on whatever the scientific issue is early on and we do not need to engage on it again.

Senator CONROY—Is there any requirement following all of this adjunct consultation that either party is bound to accept a report of the IRA? Is there any diminishing of the capacity for someone to stand up and scream and kick and say, 'I wasn't consulted'?

Ms Greville—None whatsoever. Well, let me say that after this process is over it would be difficult, I would have thought, for either party to say they were not consulted. But that is not to say that they agree.

Senator CONROY—Or accept.

Ms Greville—The quarantine decision is, as you know, the sovereign right of the importing country. If Australia makes a quarantine decision after this process that applies a certain measure or in a worst-case scenario says that trade cannot proceed in a certain commodity and the US is not happy with that, I am sure they will say so, and they have every avenue available to them to do that that they currently have. The same goes for us. If some of the import risk analyses that they are currently undertaking for Australian commodities come out with findings that we believe are inappropriate, we will take whatever action we deem appropriate at the time.

Senator CONROY—In terms of the process, when the IRA produces its report will the US be able to access or comment on it prior to the release of the report? I know we are saying we want them engaged at the various consultation levels, but is there a consultation level now where they get to have a look at the final report to make any last-ditch attempts to influence it, to change it, to disagree violently behind closed doors before they disagree violently with the doors open?

Ms Greville—The text is actually quite explicit. It says that the parties can discuss the risk assessment, including the provision of the full risk analysis report, at the appropriate point in the process of each party's responsible agencies.

Senator CONROY—What is the appropriate point?

Ms Greville—The appropriate point is the point at which we generally make our import risk analysis available, which is the draft IRA process for us. The American process is slightly different. They do a pest risk analysis quite early on in their process and they tend to make it public then, but not always. Then they go into their very complex rule-making process, which is one of the complaints that we have about the way that their SPS decisions are made. So each party has a point at which it generally makes public its draft recommendations. What this says is that we are happy to sit down and consult with them at that point. It does not tell them that we will give them that in advance of other stakeholders.

Senator CONROY—So the IRA will do its draft. It does not then give it across to the working group, it does not give it to the SPS; it just issues it.

Ms Greville—The import risk analysis draft report is issued electronically and all of the stakeholders have access to it at the same time.

Senator CONROY—And the final report?

Ms Greville—After the draft there is a comment period. After the comment period the panel reconvenes to consider whether the draft report should be amended or corrected or whatever. When that process is over, the final is released, again electronically. There is a stakeholder notification that goes out to everybody on the Biosecurity Australian stakeholder list, so they all have access to it at the same time. It is on the public file. It is instantaneous to the extent that the technology allows. That will be when the standing technical working group has access to it as well.

ACTING CHAIR (Senator Brandis)—We will take a short break.

Proceedings suspended from 10.30 a.m. to 10.39 a.m.

CHAIR—We now turn to the next section, investment and services. I have a couple of questions for Treasury officers about the economic modelling. We have the CIE modelling work. The Senate has now released to the public the analysis done by its consultant, Dr Philippa Dee. We have the work provided to us by the NIEIR on behalf of the metal workers union. Prior to those three contemporary pieces of analysis of the outcome of the agreement there is all the background modelling work that has been done, including the ACIL report *A Bridge Too Far*, the earlier modelling by the CIE, the in-house document about trade diversion impacts of FTAs done by the Productivity Commission and so forth. What you are looking at as a layperson in the face of all of this is a series of competing arguments about what is right and what is wrong. In trying to balance all of that and get a clear idea, a less than coherent picture emerges. Can Treasury tell us what it thinks the economic outcome of this agreement would be? Can you break the deadlock?

Dr Smith—I think you have hit on the dilemma of where we are at in terms of the comprehensiveness of negotiations on trade agreements these days and where the economic literature and the modellers are at on their ability to catch up to what is embodied in a number of agreements. Our view—I will also defer to our DFAT colleagues, who have been more intimately involved in the modelling—is that we would not focus specifically on bottom-line numbers of the agreement but look generally at the overall assessment of the benefits. Within the Treasury portfolio there is a large services component where we think intuitively that there are gains to be had just by virtue of investment liberalisation being a good thing. Intuitively and empirically on tariff liberalisation we know that that over time, in terms of the impacts it has on freeing up resources for other areas of the economy, it is a good thing.

To come back to the nub of your question, there are competing views out there. They are very much driven by the underlying models, which specifically seem to be G-cubed and GTAP. They are the only models that are really available. On the other hand, I think we are at a bit of a junction where the profession itself is trying to play catch-up on modelling other issues, whether it be government procurement, rules of origin or foreign investment in a more specific context. There is no agreement as to what is the right bottom-line number, but nonetheless we think there are gains over time for the Australian economy just by virtue of benchmarking to a very competitive economy. When one thinks about why one would undertake FTA negotiations in the first place, if you can benchmark to the most competitive economy in the world then we think over time that has real benefits for the Australian economy.

CHAIR—I do not want to misrepresent your views; I am very keen to try to get what clarity can be extracted from this debate, and it may well be that little clarity can be extracted. If that is the case, we have to accept that and then make our best judgments. But are you saying that (a) no independent analysis has been done by Treasury, and (b) intuitively, though you think that there are some positives here, you are not in a situation to quantify what they might be?

Dr Smith—That is correct. We have not done any individual modelling ourselves. We do have the G-cubed model in the division I look after, but we would not necessarily use it for trade policy analysis. We would use it more for looking at macroeconomic shocks to economies. We do not have the expertise or the resource base. When one starts to look at impacts on industries, it is very sector based. I think there are other people with greater expertise on that.

CHAIR—Can you shed any greater light on the disparate findings of the CIE outcome and the criticisms and arguments of our consultant, Dr Dee?

Dr Smith—Perhaps I could refer that to the Department of Foreign Affairs and Trade because I have been overseas the two weeks and have not actually had a good look at the report. My understanding is that Dr Dee looks at a number of assumptions within the CIE study but does not actually present a specific model. Within those assumptions there are foreign investment, government procurement and other issues. With your permission I will refer that to DFAT, which has responded specifically to Dr Dee's analysis, and to my colleague, Chris Legg, on the investment side.

CHAIR—I have seen the DFAT response to Dr Dee's analysis, and that has been made public. I have no objection to hearing it again, so I am not trying to close the door on that avenue. But we have not heard Dr Dee's response to what DFAT has said, and I understand that she has quite

a lot to say about that. So, if DFAT want to say something now, they can, but I want to come back and talk to Treasury about their views on this because, at the end of the day, in terms of economic issues, it is Treasury we heed more than DFAT—with the greatest respect to a stellar department.

Senator BRANDIS—Can I just interrogatively ask: why do you say that?

CHAIR—That is a question you can take up with me in committee.

Senator BRANDIS—I will put on the record that that is not a common view: that Treasury's view should be regarded as inferior to DFAT's views.

CHAIR—No, you have got the emphasis around the wrong way.

Senator BRANDIS—Or that DFAT's view is inferior to Treasury's views, for that matter.

CHAIR—In terms of the economy, I heed Treasury; in terms of foreign affairs and trade, I heed DFAT—and I am talking about an economic issue here. Anyway, enough of the committee byplay; let us go to the issue.

Mr Deady—We will give a brief response; we will not take long because we have given a response to Dr Dee's report. I think it is worth Mr Brown making a couple of points to hopefully clarify this issue because there are a couple of things that I think we need to reinforce for the record. We are, in fact, talking about two different models when we talk about the $6 billion gains with the G-cubed model. The outcome for Australia with the GTAP model that CIE also ran was estimated at about $350-odd million. When Dr Dee used that model, she came up with the $53 million with these various adjustments that she went through. But I will ask Mr Brown to clarify that, because I think you can rationalise the $53 million and the $350 million.

Mr Brown—The report prepared by Dr Philippa Dee took a particular view of the modelling that was done which encapsulated her rejecting the general G-cubed analysis. She questioned the dynamic gains that were ascribed to G-cubed and she also questioned the gains that came from the investment liberalisation, which have been discussed many times before in the context of the committee's deliberations. I need not dwell on those at this stage except to say that, as far as the department is concerned, the modelling that was done by the Centre for International Economics remains in our view the best guide to the magnitude of benefits likely to flow from the AUSFTA. By way of general observation, the modelling that was done with G.-cubed we think articulated in a modelling context quite well, given the limitations imposed by quantitative analysis, the deeper links that the proposed agreement establishes between Australia and the United States, particularly in the area of investment and improvements in productivity that are delivered by trade liberalisation.

The analysis by Dr Dee focused specifically on the analysis that was undertaken using the G.TAP model—the general equilibrium model—of the economy, which focused on particular sectoral effects. The idea of that analysis was not so much to identify the total amount of gains but more to look at what was going on in the sectors and to identify areas which may gain and those which may not gain as much as others, and so on. The CIE came up with a national

welfare benefit of about $359 billion. Dr Dee took that figure and then she specifically rejected some of the assumptions that were used to reach that number.

There were three main assumptions. The first one she rejected was the analysis by CIE insofar as the rules of origin were concerned. She cut by one-third the trade gains because of the rules of origin that are being adapted in the agreement. She also questioned the analysis of the benefits flowing from government procurement. We have discussed government procurement quite extensively elsewhere and we have pointed out, for example, that now 28 states in the United States have signed up to the arrangements for government procurement and we think the approach the CIE adopted was conservative. Also, the analysis was limited to feed data from the Canadian Commercial Corporation and we know that government procurement business will flow across the border between Canada and the United States more widely.

CHAIR—I do not want to interrupt you, Mr Brown, but it would be useful to me if we could take these points one at a time. You have the next point to come to, which is, I think, the investment criticism she makes. Is that the next point you are going to make?

Mr Brown—No, my next point concerns copyright.

CHAIR—Okay. Go on and finish your presentation and I will come back and ask you some questions. I read the Dee criticism and to me it makes a great deal of sense, and I want to ask you some questions about it.

Mr Brown—I will just make the point on copyright and then perhaps we can move on to your points. Dr Dee took some of the assumptions that were cited in the CIE report—assumptions that were identified as unrealistic in the CIE report—and she came up with a figure of something like $88 million per annum as additional costs of extending the copyright from 50 to 70 years. However, this assumption overlooked what everybody involved in copyright knows, and that is that copyright material typically depreciates over time and has an economic life which typically is quite short. If we make allowance for that in our analysis, that $88 million becomes relatively insignificant.

CHAIR—But she came up with a figure of $200 million net present value.

Mr Brown—She came up with a figure of $700 million—

CHAIR—Yes, $700 million.

Mr Brown—net present value over time. If you allow for limited economic life of copyrights—say, between five per cent and ten per cent per year depreciation of the value of income from copyrights or cost of copyrights—that figure diminishes very substantially so as to be relatively insignificant.

Senator BRANDIS—And that fact was not given regard to by Dr Dee?

Mr Brown—Yes, she overlooked that.

CHAIR—Reading her criticism, she makes allowances in her analysis for the fact that copyright deteriorates in value over time. She makes that very point.

Mr Brown—No, she does not.

CHAIR—I have her thing here and I will come to it. What she does say, though, is that some copyrights do not—that is the reference to Mickey Mouse. But she does make the point that other copyright does deteriorate over time. It is in that section, when she makes the differentiation between what does and what does not, that she has considered this question about deterioration.

Mr Brown—Her analysis takes into account the net present value calculation, which means that the benefits received in the future are worth less than the benefits received now—this is straight discounting. In her analysis she does not take into account the fact that copyright incomes typically depreciate over time—that in the first years of new material typically more income is received than in later years.

CHAIR—I will say at this point that we did ask Dr Dee to reply to your analysis. I have just been handed the reply but I do not have the capacity that, as soon as a document touches my hand, I instantly understand its contents, although from my days as a minister I know that there is a bureaucratic understanding that that does happen. In my case it does not; I have to actually read the document, and I have not read the document, so I might have to come back to you on this, Mr Brown. Do you have any further comments to make? Perhaps we should make available to you what Dr Dee has said.

Mr Brown—I have that.

CHAIR—You have seen it?

Mr Brown—I have seen it, and her response seems to reflect a misunderstanding of the analysis of copyright. I refer in particular to paragraph 16 of her response.

Senator BRANDIS—I observe that, given that we certainly have not had an opportunity to consider Dr Dee's response to your critique of her report, it would probably be best practice to defer this until either this evening or perhaps tomorrow morning.

CHAIR—Or after lunch, even. The document is eight pages. We are trying to wrap this hearing up and get all the loose ends tied together as best we can and so what Senator Brandis has said is a sensible thing. It just might mean that from a programming point of view it inconveniences people. My hand has touched this document but that does not mean to say I understand it. I do need to comprehend it properly to deal with this discussion. That does not mean to say there are not further questions I have for Treasury. Perhaps I will just ask a couple of questions about some of the other things that you have said. Do you want to say anything about Dr Dee's analysis of investment at this stage, Mr Brown?

Mr Brown—Not at this stage. We can follow that through with questions.

CHAIR—Later on.

Mr Deady—I would like to say one thing here. I am sure you will want to ask Treasury some questions about this, but I would just make the point that we are very comfortable with the way the CIE did the analysis in attempting to come up–as Dr Smith has said—with a way of measuring it in a modelling exercise. It is a new activity.

If you look at the practicalities and the real world outcomes of trade agreements, going back to the NAFTA agreement, foreign direct investment in Canada was four times higher in the seven years after the NAFTA agreement was signed than in the seven years before and in Mexico capital inflows were three times higher in the seven years after NAFTA was signed than in the seven years before. Whatever you might think about the numbers, I think this reflects a real dynamic that means trade and investment are linked and liberalisation and integration do lead to these sorts of outcomes. As Andy Stoeckel has said very clearly, if you think the impact is zero then you have to have a good solid economic argument as to why it is zero, particularly in the face of economic reality.

CHAIR—I do not disagree conceptually with what you say. The question, though, for me is how you quantify it. The quantification of it in this terrible process we have called democracy means that people bandy around headline figures as if they are absolutes. Our obligation here is to try and get behind them, try and work out what we think they mean and provide, if you like, a bit of sober analysis. I do not absolutely support quantification by modelling but I do think it is an important input in the overall balance of our considerations. I am trying to see if there is a way in which we can reconcile these differences. The advice you have is that there is not, basically, but intuitively there is some advantage.

At least from my position, what we are doing here is against my multilateralist religion. However, we are living in a brave new world of proliferating bilaterals and we cannot hark back to where the world was a decade ago and where we would prefer it to be now; we have to try and work this out. From the point of view of the processes the Senate should engage in as the legislative wing of the government scrutinising the executive work of the government and bringing into force these agreements—meaning that both wings have to work together—trying to get a clear fix on this is a worthwhile exercise, not just for this event but because in the wings other possibilities are emerging, some of which, if the agreement with China goes ahead, will be even more complex. It is worth while at this time to try to get the way in which we assess these things right and get it established so that we do not have to worry about it in the future and we at least have that process under way.

Senator BRANDIS—Mr Deady, I am not an economist. I like to think of these things in terms of the different sorts of evidence that are presented to the committee. I am a lawyer, so thinking in those terms helps me. It seems to me that we have basically had three sorts of evidence about what the effects of this agreement might be. We have had the modelling evidence, which has produced inconsistent conclusions because different models have been suggested by different institutions or academics and they have critiqued each other, which is fair enough; we have had the CIE evidence, which is favourable, and which I take it is adopted by DFAT as its view; we have had Dr Dee's theoretical evidence, which suggests a contrary conclusion; and we have had other evidence of that character.

The second category of evidence which we have had—and, Mr Deady, I was prompted to say this by something you just said because I do not think we have paid sufficient attention to it—is

what I would call historical and comparative evidence: that is, how comparable free trade agreements have historically worked. To me that is the most powerful evidence because it demonstrates to us not what might happen in futuro but what has, in reasonably comparable circumstances, in fact happened.

The third category of evidence that we have had is what I might loosely call the pragmatic evidence—that is, the evidence of the people who are actually going to be doing the trading under the free trade agreement; and I do not think this is controversial. Overwhelmingly, those people have said one of two things. Either they have said, 'This will help us a lot,' or some of them have said, 'The benefits to our sector will be marginal or nonexistent.' In representing a sectoral group of traders I do not think anybody has said, 'This will hurt us.' I stand to be corrected on that but my overwhelming impression from the businesspeople, if I can call them that, is that at worst it will not have any particular impact on their sector, but for many it will have a very beneficial impact. This is editorialising, I know, but I thought it might be a useful rejoinder to Senator Cook's observations. If you take the theoretical evidence—

CHAIR—I was not aware we were debating it.

Senator BRANDIS—it is inconsistent, because you know what economists are like; I am sorry. If we take the historical and comparative evidence, it is not inconsistent and it is based on real facts. If you take the pragmatic evidence, although with various varieties of emphasis, it all tends towards the same conclusion. Having made those observations, can I invite you to respond—you, in particular, Mr Deady? I am very keen on the historical and comparative data, which I think perhaps we have not paid enough attention to.

Mr Deady—I must admit I am driven to a significant degree by the historical data. This is the third trade agreement between two developed economies. The lessons of the Canada-US trade agreement in particular but more broadly NAFTA and our own agreement with New Zealand do need to be taken into account when you are assessing what we have done with the United States here. I know there had been some questioning of the CER agreement and the outcomes there but I do not think there is any serious questioning in the wider community of the benefits that have accrued to both economies from the CER with New Zealand and the deeper integration that that has led to. With Canada and the United States, again I do not think there is any doubt. If you look at the hard facts of trade flows, of investment flows between those two countries following NAFTA, they are very substantial and not really questioned.

On NAFTA itself, there is still probably some debate in the United States. If you go back to the immediate signing of the agreement there certainly was a debate about great sucking sounds, jobs flowing to Mexico and all these terrible outcomes for the United States. None of that has eventuated and there has been the prosperity and growth of the Northern Hemisphere in the last decade. This is me editorialising, but it does reflect what we are actually talking about here: liberalising and freeing up economies and the benefits that accrue from those activities. That is what you do see as a result of trade liberalisation broadly. FTAs, in this case, are an important part of contributing to that reform and liberalisation; and that is the historical record.

CHAIR—I will come back to my line of questioning. I thank my colleague. As he says, he is a lawyer and cannot resist an adversarial sort of argument.

Senator BRANDIS—It was not adversarial.

CHAIR—Yes, it was.

Senator BRANDIS—I was merely making some observations.

CHAIR—I prefer an analytical approach to an adversarial approach and to try to get at the facts here rather than one-upmanship on either side of this table, because if we do not advise according to a decent sort of analysis and we advise according to trying to win an argument I think we then mislead. Since we are on the issue of historical matters, no-one here is proposing the Ross Perot argument about the giant sucking sounds in relation to NAFTA. That is a comic analysis. It might have some public currency but usually only to lampoon it, not to regard it seriously. I do not think anyone here is proposing that as a serious question, and we are all relatively familiar with CER and the impacts of NAFTA.

But, if we are going on the historical evidence, we would have to have some regard—wouldn't we?—for the Productivity Commission's paper on trade diversion in free trade agreements. I think there is a fundamental truth about this: compared to regional and multilateral agreements, bilateral agreements, by their nature, can be negotiated relatively easily and quickly. But another feature of them seems to be that they provide relatively few benefits. The more partners in a trade arrangement, the bigger the benefits for everybody: the fewer the partners, the less likely the benefits. That is one of the reasons why I much prefer to hunt trade agreements at a multilateral level than at a bilateral level. But we are in a bilateral era. We would run a bit of a risk of confusing the public in reaching a number of agreements. It looks like progress is being made but, if the benefits from them are limited, what real economic progress are we making, compared to spending the same amount of time trying to get a regional or multilateral agreement? I think that is extremely questionable. But that is a more philosophical issue, and we have to deal with this bilateral agreement now. But, if we were to look at it historically, the work done by the Productivity Commission on the trade diversion aspects of bilateral preferential trade agreements has to be considered, too, doesn't it?

Mr Deady—I have looked at that work but not in absolute detail. I think it is a good piece of economic analysis, but it is just that. It looked at a whole raft of agreements. I am not sure about the level of detail it really got into on what the economic benefits may be. I think some of the results were a bit strange. They looked at all sorts of agreements, including unilateral agreements like our agreement with New Guinea—we have a trade arrangement with New Guinea—and that was somehow supposed to lead to a negative outcome. My economics is limited, but I could not understand that as a serious piece of analysis; that is a developing country preference that we give to Papua New Guinea.

CHAIR—I accept the argument about New Guinea. I do not have the document in front of me, but, as I recall it, they looked at about 16 bilateral trade agreements and came to the conclusion that around two-thirds of them had resulted in significant trade diversion. We can take out the New Guinea one. If some poor examples are included in the total number they looked at then that obviously weakens their conclusion. But it seems to me that their conclusion was overwhelmingly that a significant amount of trade diversion is involved as a potential cost of bilateral agreements. Dr Dee says that she is unable to model it. She thinks that you actually have to engage in the agreement and then assess what the trade diversion was.

Mr Deady—I think we are back into arguing about the modelling and how you measure these things. I will use one other example from the Productivity Commission study. It found that the negative trade diversion in our own CER was greater than the trade creation. As a practical outcome, I do not believe that. If the modelling analysis showed that—and I am sure this was only a very minor part of what, as you have said, was a very large study with numbers that generate as broad an outcome as they can—I do not think it stacks up to the historical reality.

CHAIR—If there is no other work that you can point to, can you explain why you do not believe it?

Mr Deady—It is just the practical economic reality. The dairy industry was the industry in Australia that was most concerned about CER at the time, although there were others. Competitive pressures eventually emerged as a result of CER. Deregulation accompanied that, and all sorts of other factors were involved in leading to those outcomes. But we now have a much more efficient dairy industry in Australia than we had prior to 1983 and prior to the CER—I think that is an example. I do take your point about the gains perhaps being limited. Again, I think it comes back to modelling outcomes. Australia and the United States are open economies with average tariff levels that are very low. Because the average tariffs are so low, the shocks from modelling produce small outcomes.

CHAIR—They are two open economies, basically.

Mr Deady—So it is not surprising that the gains are not great. I know that you are not suggesting this and that is not to say either that they are not beneficial. That leads to the other question of the dynamics and the other impacts there might be from the deeper integration, head-turning capital flows investment that also flow from these outcomes.

CHAIR—I am not saying that if the gains are not great that is a reason to not proceed with it. I am saying that is a reason to keep this in perspective because whether you proceed with it or not it still leaves the wider policy argument about where Australia's national interest should be in terms of what it emphasises in its trade policy. If the gains are not all that great and you decide to proceed with this and you say to yourself as you do so that this has got the particular advantages that it brings, let us not throw our hats too high in the air and celebrate too wildly. These are not the optimal possible gains for Australian policy so let us look at where the balance of effect should go to obtain better gains in the end. That is what we are here to do.

Mr Legg—I can add one thought on the productivity study that you are referring to that is relevant to my area of expertise. Whilst it did have equivocal results in terms of trade diversion and trade creation, from memory I think it did show reasonably unambiguously that the benefits on investment were pretty strong across-the-board in most of these agreements. I think that goes to the point my colleague was making earlier that as these agreements become more comprehensive and cover a wider range of things it is hard to capture all those benefits. But certainly with investment, if you think that is one of the drivers of the benefits in terms of a developed economy with a healthy services sector, even if you cannot measure those benefits at the time, we feel unambiguously in Treasury—at least in my area, investment—that the outcome in the USFTA on investment is a good thing for Australia. You can argue about the quantification of it, but we feel very comfortable that what we are doing here preserves the right of the

government of the day and future governments to protect the national interest but reduces compliance costs and risks and uncertainties for investors, and that must be a good thing.

And just getting back again to the debate about Dr Dee and CIE, Dr Dee basically argues that there is no impact on the equity risk premium. That is an honourable view and it is probably the view that we would have had 10 years ago in our earlier paradigm of defending the Foreign Investment Review Board processes. It is the way that we would have argued it. But I guess the CIE study has made us question whether we should have that view and the more I think about it the more I am open to the idea that there probably is an impact on the equity risk premium. It is hard to quantify but there is probably some impact. It gives me more comfort that what we are doing will have material benefits for the Australian economy.

CHAIR—Your answer covered a couple of areas, firstly, about the Productivity Commission report. I do not have it in front of me now but my recollection is that what you have said about it is right. The only reason that we have got into this discussion is that my colleague Senator Brandis places a great deal of emphasis on what has happened and what the effects of these things are. The trade diversion impact as assessed by the Productivity Commission on bilateral trade agreements is, in terms of this mix, an important consideration too. That negates the overwhelming sunny scenario I think to some extent. The other thing about the equity risk premium issue was one of those things that we might have to pursue in the context of all of the criticisms afterwards. But I think that is a major argument by Dr Dee and I can empathise with her argument.

I do not understand how you can then use an improvement in Australia's equity risk premium to calculate the level of benefit to the national economy by quantifying that extra investment. The artistry of doing that is something that I was going to ask you about, but you may have just answered that, Mr Legg, in your little analysis about equity risk premiums. You did not accept the Dee argument in full, but you did not seem to accept the CIE argument in full either.

Mr Legg—I think what the CIE study asks us to do is contemplate the possibility—and I think it is a reasonable possibility—that the existence of foreign investment screening arrangements will play into general perceptions of risk and uncertainty about the future investment climate in Australia and the possibility that, at some future point when people have invested here, they will not then be able to sell their investment to a wide range of potential buyers because they may be more limited to selling only to Australian buyers. We have not said that we adhere to a particular quantification of the benefits of this. We have said that the CIE study is a reasonable effort to quantify it. We would not say that this is the only set of assumptions you should use to quantify it. But we believe that it suggests that, even if you had even more conservative assumptions, a materially significant benefit would flow through some impact on the equity risk premium. I do not accept the argument that there is, just by matter of theory, no impact on the equity risk premium.

Another point I would make—and I would make this point now, because I am supposed to be on a plane this afternoon and I was getting a bit worried when you started suggesting that we would come back to all of this—is on Dr Dee's point about diversification; that foreign investors can diversify away the equity risk premium issues. I am not someone who claims to be the best theoretical economist, but I would say as a pragmatist that diversification means that you invest somewhere else. If the argument is that diversification is a way of dealing with the equity risk

premium, I think that means we are assuming that investors would not invest in Australia but would invest somewhere else. I think that the diversification argument does not actually suggest that there are no benefits from addressing this issue. Obviously, if you assume away those benefits then your analysis will not measure any benefits. That is what Dr Dee does.

CHAIR—I follow that. Do you have something to add, Dr Smith?

Dr Smith—I would just add to Chris Legg's point. I guess it comes back to what I was saying before about where the literature and the empirical modelling are at. It is very hard to model investment. I would take the equity risk premium as a proxy measure for that until we can find some other mechanism for measuring it. The G-cubed model is traditionally used to look at how capital flows will move when you have shocked an economy, whether it is in terms of a trade shock or some other shock, so I would say that it is a second best way of doing it. But there is no first best mechanism to model that. However, as Chris Legg said, we think there is something in it just by virtue of opening up to investment and the very fuzzy world of what goes along with investment—that is, spillovers, technology transfer, best practice and all of those mechanisms, which again are hard to model.

If I may, I will just come back to the comment about how important it is to get things right going forward. In the Treasury context, we would have a different take in the sense of how we engage in our international economic diplomacy. We would encourage, whether it is through APEC or within the region or elsewhere, the importance of comprehensiveness within agreements. The issue concerns two words that I have noticed Robert Scollay coming out with—he has done a lot of modelling of scenarios in East Asia of various free trade agreements—namely, 'benign progression' and how we get benign progression in the trade agreements that we and other countries are involved in. Certainly, through APEC and a few other mechanisms, we now encourage countries to think about some of the uncoordinated nature of the agreements that they are engaging in. We think that, in the Australian context, we understand the importance of comprehensiveness in agreements, but, as I said before, it is very hard ex ante to measure some of the impacts of this. Even looking at Australia's trade liberalisation experience during the eighties, it is very hard to disentangle it from other types of microeconomic reforms in terms of its impact on the economy and the good productivity story which we saw following that. We know that, in there, it has been very important in freeing up areas of resources in the economy.

CHAIR—I thought the Scollay work—and it has been ages since I read it—led to the Fred Bergsten proposal for APEC about APEC becoming a trade bloc and setting aside open regionalism in favour of creating an Asia-Pacific trade bloc. If that went ahead you could argue, respectably, that the gains to Australia would be much greater than pursuing a matrix of FTAs. That makes a lot of sense to me, but of course we are not living in that world any longer. We will leave the economic analysis for the moment and move to quarantine to allow Senator Boswell to ask his questions.

Senator BOSWELL—Thank you for that, Chair. We did have Dr Fairbrother at, I think, the second last hearing of this committee and he put a number of propositions on behalf of the chicken industry. The *Land*, which is a very influential country magazine, has done an article on the free trade agreement. In saying that it is an influential country magazine, it covers all of New South Wales farmers and I would say many others as well. I want to run through some of the things that Dr Fairbrother said, and I will ask you to respond. The article said:

Dr Fairbrother said section seven provided for the establishment of a high level committee and a specialist committee to report to the former—

I do not know who the former is; it is probably the World Trade Organisation—

to resolve disputes to achieve consensus on quarantine within strict timetables

We have had this raised on a number of occasions before and I think you may have answered it, Mr Deady. Can you tell me what those committees do?

Mr Deady—I will ask Ms Greville to respond. We did go through the details this morning, again, of both the committees established under the SPS.

Senator BOSWELL—Could you tell us what the two committees actually do, because there is a great deal of angst in rural Australia at the moment on this. I would like to allay those fears if possible.

Mr Deady—I will just say one thing before I pass to Ms Greville, because we do understand the concerns you raise. We have certainly heard them and we have read them also. Ms Greville can go into detail and we will quickly run through again what the committee and the working group do. I would just say, if I can, again, as we explained this morning, there is nothing in the establishment of these committees which will impact on the integrity of the IRA processes in Australia. The science based nature of the import risk assessments will not be affected by the establishment of these two committees under the FTA. There is nothing at all in this chapter on the sanitary and phytosanitary aspects of the FTA that will in any way add to or subtract from Australia's rights under the SPS agreement of the WTO. There is nothing here that now gives the Americans any additional rights over Australia beyond what is already agreed to by both countries in the SPS agreement of the WTO.

That is the framework we have established. These committees are there, they are real and their aim is to improve the communication and dialogue between ourselves and the United States on important quarantine issues—both our interest in relation to the United States—Senator Conroy talked about avocados this morning, something we now want to pursue very actively with the United States because we have got some access now—and their quarantine issues in relation to us. These committees are about doing the best we can to have that communication, have that consultation, have those processes as transparent and timely as possible, but they do not impact in any way on the science of the IRA processes.

Senator BOSWELL—Let us go through the first committee. What is it called?

Ms Greville—The first committee is called the SPS committee—the sanitary and phytosanitary committee—established under the agreement. As I explained this morning, its mandate is outlined in the text but its purpose is to involve representatives of all of the federal bodies within each jurisdiction who have responsibility for SPS.

Senator BOSWELL—Who are they?

Ms Greville—In Australia's case it will certainly be Biosecurity Australia, but it will also include FSANZ—Food Standards Australia New Zealand—possibly the Office of the Gene Technology Regulator, and quite likely the Department of Environment and Heritage, the Department of Agriculture, Fisheries and Forestry and the Department of Foreign Affairs and Trade—all of whom have responsibilities in their normal course of events which impact on the SPS agreement one way or another. I do not pretend to know the whole list on the US side, but it will certainly be the Animal and Plant Health Inspection Service, the Food Safety and Inspection Service, the Environment Protection Authority, the Office of the United States Trade Representative and the US Department of Agriculture, and there may well be others.

Senator BOSWELL—That is committee number 1. Are they there to investigate, for example, the speed of people who want to import or export?

Ms Greville—No, the mandate of that committee is articulated in the text.

Senator BOSWELL—Could you read it out for us?

Ms Greville—Certainly. It says:

The mandate of the Committee shall be to:

(a) enhance mutual understanding of each Party's sanitary and phytosanitary measures and the regulatory processes that relate to those measures;

(b) improve mutual understanding of specific issues relating to the implementation of the SPS Agreement;

(c) review progress on and, as appropriate, resolve through mutual consent, sanitary and phytosanitary matters that may arise between the Parties' agencies responsible for such matters; and

(d) consult on:

and there is a list of things that are consulted on—

(i) matters related to the development or application of sanitary and phytosanitary measures that affect, or may affect, trade …;

(ii) issues, positions, and agendas for meetings of the WTO SPS Committee, the **Codex Alimentarius Commission** and its subsidiary bodies, the **International Plant Protection Convention**—

Senator BOSWELL—Okay, that should do. There is something going through the bush now that says, 'Righto, this is a backdoor operation that can override biosecurity.' What I want on the record, if you can give it to me, is an unqualified statement that this committee will not have any overriding ability to go in and displace the biosecurity.

Ms Greville—Certainly, I am very happy to provide you with that assurance. The arrangements in the agreement are in every respect 'as well as' and not 'instead of' the current IRA process. The working group and the SPS committee are forums for consultation between Australian and US officials and scientists on technical and scientific matters. The important

point is that any quarantine decision affecting any Australian industry interests will still be the result of our existing process, which is transparent and challengeable in every way. In no way will any discussion by the SPS committee or the standing technical working group take the place of our import risk analysis process.

Senator BOSWELL—I have some more detailed questions, but first of all can you tell me what the second committee is called and what it does?

Ms Greville—The second body is known in the text as the standing technical working group on animal and plant health. It will act as a technical working group underneath the SPS committee and it will report to it. It will be chaired by the heads of the organisations in each jurisdiction identified as the competent authority—in Australia's case Biosecurity Australia; in the US the Animal and Plant Health Inspection Service. Its purpose is to discuss technical and scientific matters of interest to the parties and to achieve consensus where possible on those technical and scientific matters.

I might mention again, because I know you were not here at the time, Senator, the discussion I had this morning with Senator Conroy where I went to some lengths to distinguish the sorts of issues that fall into that category, scientific and technical, compared to a quarantine decision. I would like to make the point that at no point will that standing technical working group or the SPS committee established under the free trade agreement be considering whether commodity X should be traded into Australia or commodity Y be traded into the United States. That is a quarantine decision, which is the sovereign right of Australia or the US. What the committee will be considering are specific technical issues, such as does a particular fumigant kill a particular pest; if so, at what temperature or what concentration—

Senator BOSWELL—Say an IRA says, 'You will hit X with methyl bromide,' and someone on this committee says, 'Well, methyl bromide is a bit vicious. It has an impact on the environment. We should use chemical Y.' That chemical might be different from what Biosecurity has recommended.

Ms Greville—There is certainly the capacity within the standing technical working group for Biosecurity Australia and APHIS to have a useful conversation about what is the best mitigant: if you have got a particular pest or disease, what is the best way to reduce the risk to the level that is appropriate to Australia or the level that is appropriate to the US, depending on which way the trade is going. They can have that conversation and they can discuss whether methyl bromide is the right fumigant or whether it should be something else, whether cold treatment is better than fumigation. They can have that discussion and if possible they can have a meeting of the minds about what they think is the best mitigation for a particular pest.

The import risk analysis panel is the one that makes the recommendations that lead to a quarantine decision. They will be made aware of whatever the discussion is between the US and Australia competent authorities but they are not bound by it in any way. They will give whatever weight they determine is appropriate and they will be taking it into account along with all of the other information that other stakeholders and other scientists have made available. As you know, Senator, the IRA process involves a lot of consultation and a lot of different scientific opinions. The IRA panel's job is to weigh up all of those different opinions and those different

scientific views and come out with a recommendation that they believe is the best recommendation that is appropriate to Australia's appropriate level of protection.

Senator BOSWELL—I have got a series of questions that I would like to put on the record. One is whether the free trade agreement provisions will allow the US to reopen Australia's IRA on cooked chicken meat despite prior IRA decisions. Could you give us a comment on that?

Ms Greville—Certainly. When either party refers a matter to the working group to be the subject of technical consultation, that party has to provide technical information in support of its preferred approach to resolving the matter. That means that one party cannot require the working group to work on an issue that has already been finalised unless there is technical information germane to that issue which has not already been considered. In other words, if the US has new technical information in respect of trade into Australia of cooked chicken meat which suggests that different measures could meet Australia's risk mitigation requirements, it could bring that information forward and refer the matter to the working group. But neither party can require the working group to work on a matter just because that party did not like the decision. I also make the point that, with or without this agreement, as a WTO member we are already required to consider alternatives to measures which can achieve the required outcome. So, whether we had this committee or not, if the US had that view, that there was new science or a new mitigation method for dealing with the risks of cooked chicken meat, they could bring that to us and we would be required to consider it.

Senator BOSWELL—So the committee does not add anything.

Ms Greville—There is no capacity to require the working group to reopen a decision just because you do not like it.

Senator BOSWELL—So we really got that capacity under the World Trade Organisation to re-present—

Ms Greville—That is right. As I am sure you are aware, science moves on and the development of technical and scientific responses to certain risks and diseases also moves on, so it is not beyond the bounds of possibility that a disease or a pest that could only be dealt with via, for the sake of the argument, fumigation may at some subsequent point down the track be able to be dealt with by a different measure. So, under the WTO, an exporting country can bring to the attention of an importing country that there is a new way of dealing with the risk—

Senator BOSWELL—That has always been the case.

Ms Greville—That has always been the case under the SPS agreement and that is not changed by these arrangements; it just provides a forum for them to do that.

Senator BOSWELL—The free trade agreement has provision to allow the United States to reopen Australia's IRAs without recourse to prior challenges.

Ms Greville—I read that in the *Land* article, too. To be honest, I did not understand exactly Dr Fairbrother's point. I think it was the point that we have just talked about: there is no capacity to reopen an existing decision unless there is new technical and scientific information which is

germane. They already have the right to do that under the SPS agreement, and this does not change it.

Senator BOSWELL—Let us just come back to that point and we will give it a bit of thought: that any review under the free trade agreement will be undertaken without notification to or consultation with effective Australian industries or without any requirement for transparency or reporting to parliament.

Ms Greville—That is part of the issue that we have just been talking about. The arrangements in the FTA are not instead of our IRA process, so were Australia and the United States to have a discussion on a technical issue—whatever that technical issue may be, whether it is the cooking regime for chicken meat or whatever it is—that US-Australia forum is not a decision making forum in the sense that it cannot change our quarantine decision. The only way Australia will change a quarantine decision is as a result of an IRA process.

Senator BOSWELL—So it would have to go back to another IRA.

Ms Greville—It would have to go back to whatever the arrangements are for amending quarantine decisions.

Senator BOSWELL—They could not just rock up and say, 'We've sent it to the committee and the committee has agreed.' It would then have to go back to an IRA—

Ms Greville—I am sorry; I am not an expert on the IRA process and I do not want to have something on the record that commits Biosecurity Australia to something that is at odds with their process. The point that is important is that there is no way that the standing technical working group under the FTA can come to a conclusion about a different measure that will then just be imposed. There will be a process. Whether it is another full IRA, whether it is an amendment to an existing IRA or whether it is a review of an existing process—

Senator BOSWELL—But it would be transparent.

Ms Greville—there will be some kind of review and it will be transparent. There will be an opportunity for domestic stakeholders to comment on it and for—

Senator BOSWELL—Mr Deady, How would I get this answered by Biosecurity, who are not here?

Mr Deady—Biosecurity Australia are not here but I am happy to reinforce precisely what Ms Greville has said. That is what we negotiated, and that is what the text is very clear on. There is absolutely nothing in any of these working groups that any decision they took—again, these are subject to us agreeing; they have to be mutually agreed as part of these working groups, and even if they were mutually agreed as part of the working group they would still have to go back, as Ms Greville has said, to part of the IRA process—

Senator BOSWELL—And the IRA is a public document. Does it report to parliament? No, I do not think it does—but the minister has to sign off on it so it would have to report to parliament.

Ms Greville—I think the quarantine decision is made by the Director of Animal and Plant Quarantine, who is stipulated in the Quarantine Act and who is the Secretary of the Department of Agriculture, Fisheries and Forestry. The decision is made by him, not by the minister.

Senator BRANDIS—I would like to get something on the record to make it abundantly clear. Mr Deady, going back to your answer a moment ago, if the effect of the agreement is as you have said does it simply amount to this: those who contend otherwise in relation to quarantine simply do not understand what the words of the agreement mean?

Mr Deady—I really believe that they do not fully understand what we have negotiated and what the words of the agreement mean—that they are reading into it things that are not there, let me put it that way. The integrity of the IRA processes is in no way affected or undermined by the committees we have set up. The committees are there, as we have tried to explain, to facilitate the processes, to improve their timeliness and to improve the dialogue between us and the United States over these important quarantine issues, but the science that governs the final quarantine decisions through the IRA process is not impacted at all by this agreement for neither Australia nor the United States. There is a concern in this country that the Americans have no concern over quarantine. Believe me, they do, and their quarantine processes are very rigorous and, frankly, not as transparent as ours. Some of the things we were trying to get through this agreement were to improve the transparency for Australian industry doing business in the United States. But we are not attacking the science based nature of those processes in the United States; we are about the transparency and the timeliness of those processes. That is what we believe these committees give us.

Senator BRANDIS—Mr Deady, in your expert professional view as the chief negotiator of this agreement, any other interpretation of the meaning of the agreement than that which you have just expanded is simply unavailable?

Mr Deady—It is unavailable, it is wrong. There is no way in this area that any other interpretation could be made as to what we have agreed and what these committees and working groups will do.

Senator BRANDIS—Thank you.

CHAIR—If that is the case, Mr Deady, you will have no objection whatsoever to backing up that statement by providing all the details about how these bodies will work. That will simply confirm what you have said.

Mr Deady—We are going through the processes of putting these things in. As Ms Greville said this morning, this is formalising a process that we already have in place to a very large extent. It is giving it a legal structure that is not there at the moment but it is formalising the process. I am very comfortable. As we have said, we will provide to the committee the range of issues that does reflect very much that there is a two-way street here. We are pursuing Australia's interests in the US market and they have certain requests of us. We have been going through that process for almost two years now. This is an area where there is no doubt about this. The very first article in the sanitary agreement—7.3—reaffirms the SPS agreement, the science based nature of quarantine. That was never an issue between us and the United States in the negotiations.

CHAIR—This is not a trite point; this is quite a major point in my view and it applies to the PBS as well. No-one is questioning your authority as a negotiator; no-one is trying to subvert your opinion as an expert in this field. What we have is an agreement with items of delegated legislation in it and the Senate has traditionally opposed that and likes to see the black letter of what this is. That is where the debate is at.

Senator BOSWELL—There is an article in the *Land*, which is where a lot of farmers get their information—the *Land*, *Country Life* and the rural press. The article in the *Land* says:

... the Australian Chicken Meat Federation has grave fears concessions Australia has apparently made over quarantine in its free trade agreement (FTA) with the US will allow a "back door" entry to the Australian market the US could not achieve through World Trade Organisation (WTO) procedures.

Do you know of any back door?

Mr Deady—There is no back door for the United States to gain access for chicken meat into Australia. The process is a quarantine issue. The IRA processes are the ones that determine the quarantine regime and the measures that would apply to imports of chicken meat into Australia and nothing in this agreement alters that.

Ms Greville—Could I add that, following the publication of that article in the *Land*, the following Tuesday—which I think was last Tuesday—there was a follow-up article to that article written by the same journalist which addresses some of those points and provides the answer to some of those points.

Senator BOSWELL—So he has gone through them. Let me just get it on the record. The comment was that under the FTA concessions have been made by Australia on quarantine and that the US clearly believe concessions have been made by Australia. Who in the US is saying that Australia has made concessions? I have seen it a few times.

Senator BRANDIS—It is probably all those congressmen trying to get the agreement through the Congress!

Senator CONROY—The eminent Senator Boswell does not need your help.

Senator BOSWELL—People have made statements that the US believe we have given concessions. Have you heard anyone from America say that?

Ms Greville—Some statements have been made. To be frank, we had some of this conversation at a previous hearing—and I know you were not there.

Senator BOSWELL—I am sorry about that.

Ms Greville—The point I made then—I think it was Senator Ferris who asked me the question—is that there is no doubt that some interests in the US, primarily agricultural interests, believe that our SPS regime, our quarantine regime, is too strict and that some of the quarantine decisions we make are unwarranted and unjustified. They believe, therefore, that they are not based on science. To be frank, what they do not understand is that we have a different level of

acceptable risk from the one that they are used to. So when we impose different measures or more stringent measures on their exports than they are used to in other markets, they immediately assume that our measures are not based on science and are not warranted.

To that extent, they look at this agreement and see that we will be having technical and scientific consultations. It is understandable that they think that those technical and scientific consultations may cause us to change our mind, because they believe that our measures are not based on science. We know that our measures are based on science. We are not at all afraid of having a technical or scientific consultation with our opposite number in the United States. In fact, we see it as an opportunity for them to understand how science based, transparent and robust our system is, with the hope that they will stop criticising it to quite the same extent as they do now. I think that is part of the reason why there has been some publicity in the United States suggesting that this will mean that our system will change.

Senator BOSWELL—You are saying very clearly that, under this free trade agreement, the US do not get any concessions on biosecurity.

Ms Greville—Absolutely not. All they get is an opportunity to have technical and scientific discussions—which, in fairness, they already had but did not always avail themselves of—so that when we produce our quarantine decisions they will at least understand the basis of them, even if they do not agree with them.

Senator BOSWELL—What will the role of Biosecurity Australia under Australia's free trade agreement be?

Ms Greville—Biosecurity Australia are the competent authority in Australia for discussions on animal and plant health and quarantine. They will play a part in both of the bodies—the SPS committee and the animal and plant health working group. Biosecurity Australia will co-chair, with its opposite number in the United States, the standing technical working group on animal and plant health.

Senator BOSWELL—Will Biosecurity Australia's present guidelines be required to be changed because of the FTA?

Ms Greville—Absolutely not.

Senator BOSWELL—I think that is all I wanted to get on the record.

CHAIR—I will stick with the CIE analysis for the moment without going to the discussion about Dr Dee's and DFAT's analyses. I have the section here but I will not look it up; I will go from memory. What the CIE analysis says about the potential impact on our trade deficit is that the deficit continues at a widened level for a number of years, starts to close at around 2016 and then closes at about 2025, whereafter it becomes a mild surplus. The table in their document concludes at 2026, so you cannot see the longer range. Given that we have a deficit of $1.8 billion, according to May figures, and our bilateral trade deficit with the US is 73 per cent of that, the question is whether this agreement exacerbates the deficit or not. In the CIE figures, the deficit widens. I am not inviting a long discussion about deficits, because my view is that you take the aggregate, not the bilaterals. What can be said about our trade deficit with the United

States is that, while it is huge—and it is the biggest single bilateral trade deficit of all—what we purchase from the United States are cost-efficient inputs into our production that enable us to generate a trade surplus with East Asia, albeit not sufficient to eclipse the overall deficit. However, the impact of a widening deficit on the Australian domestic economy for the next 20 years will be to put pressure on interest rates and inflation at a time when household debt in Australia is at record levels and when we are coming through a property cycle in which people may have overborrowed to finance housing. Does Treasury have anything to say about those types of issues?

Mr Legg—My area of responsibility is foreign investment policies. Dr Smith may have something to say on that. But I will make a few observations which I think reflect things that Dr Parkinson has said previously to this committee. We would not necessarily see the current account deficit as being the measure of wellbeing in terms of whether or not the agreement is a plus or a minus. The current account deficit is a reflection of the balance between savings and investment. Of course, if the CIE study says that we are going to get a large boost of investment against the baseline—whatever that baseline is—then the current account deficit must widen because that is how the equation works.

CHAIR—Yes, and the study shows that it does.

Mr Legg—Yes. And that investment is probably a large plus, whether or not the current account deficit is ultimately widening. Whether that is a bad thing or a good thing depends on how you use the investment that is flowing into the economy. If you feel comfortable that the broad policy settings and reforms of the last 10 or 20 years have allowed us to ensure that we use foreign savings efficiently—that we are a more dynamic and flexible economy than we were, say, in the 1970s—then we are more sanguine about whether or not we worry about current account deficits.

Dr Smith—I do not have much to add except that we would not be building in that sort of story if we were looking at forecasts. I do not represent the domestic area of Treasury, obviously, but again on potential policy changes like that it is very hard to build that into how we see exports and imports faring. Nor do we think it is an 'exports good, imports bad' story. It has positive benefits for consumers over time as well. But, just to reiterate what Mr Legg has said, it comes back to general macroeconomic settings and also the competitiveness of Australian industry and the services sector more broadly. So we would not focus specifically on the terms of trade change—just as it is very difficult to build in, for instance, Uruguay Round effects or to build that into how one will view the economy over time.

Mr Legg—If I could add one more thought, in terms of the impact on, for instance, interest rates, whether or not interest rates go up depends on whether there needs to be a policy response to the current account deficit, and that depends on a judgment as to whether the higher current account deficit is sustainable. So, there are a number of links there. I do not think it follows necessarily that interest rates have to be higher. Obviously, if what is driving the higher current account deficit is in fact a greater propensity of investors to invest in Australia, that says we are getting more foreign savings, all other things being equal, than we would without this agreement, and that implies that interest rates would be lower because we would not have to have high interest rates to attract the foreign savings.

CHAIR—It does not just imply investment; it implies sucking in goods and services as well, which puts upward pressure on prices, doesn't it, if our current account deficit widens?

Mr Legg—I do not follow how sucking in foreign supplies puts upward pressure on prices; you will have to explain that. Presumably, we would have a larger supply of competitive and efficient foreign goods; that would keep some competitive pressure on prices over time. I am not an expert on the domestic macro side of this but, having sat and listened to others talk about this for some time and having been in Treasury on and off for 20-odd years, one of the stories is that one of the reasons why inflation over the last few years has been a non-issue in some ways has been the efficiency of the domestic producers because they are under competitive pressure from foreign suppliers. So, to the extent that they are under more pressure from foreign suppliers, one would assume that those forces are strengthened in terms of the disciplines on domestic price levels.

CHAIR—Dr Smith, do you have anything to say?

Dr Smith—I think Mr Legg is exactly right. We have seen this across a number of economies, whether it is manufacturing margins falling or narrowing, but price pressures have certainly abated in that sense. I do not really have anything to add to that.

CHAIR—The other issue, while you are here, Mr Legg, is trade diversion. Does Treasury have a view on what the trade diversion potential of this agreement is from an Australian point of view?

Mr Legg—I will have to defer to Dr Smith because that is an area which is outside my expertise.

Dr Smith—We have not done any work in looking at that again because that is an ex post story—but we would not normally look at that anyway. It is more of a micro issue. Our domestic area of Treasury may look at that over time, but I am not aware of any work planned in that sense.

CHAIR—Okay. Professor Peter Drysdale says that the trade diversion impact of this agreement outweighs the net gains; Dr Stoeckel says that it does not; and Dr Dee says you cannot measure it until after you apply the agreement and then you measure it to the extent that it has occurred over time. What are we to make of that? There is a conflicting body of argument coming at us: how do we assess that? How does Treasury assess that?

Dr Smith—As I said, we would not normally focus on those types of policy issues in an area of Treasury that looks at macroeconomic impacts. We do not focus on the impact of FTAs on the domestic economy. Trade diversion is difficult to measure anyway, if you are assuming that you are not necessarily trading with the least-cost supplier, as implied by trade diversion—that is very difficult to separate out from third-country impacts.

CHAIR—What it means is that our consumers are subsidising the least efficient producers—in this case, in the United States—rather than buying from the most efficient producers elsewhere in the world.

Dr Smith—That is right, yes. It is a very micro relationship, separating out price and volume effects, which is not something that we would focus on.

Mr Legg—My own humble understanding of this is that, to the extent that you are doing a trade deal with one of the most competitive economies in the world, the trade diversion effects ought to be less than if you were doing it with an economy which was far less competitive and efficient than that of the US. So, whilst the modellers can argue about how it flows through in their particular set of stylised facts about this particular deal, intuitively you would expect that the trade diversion effects of a deal with the US would be far less of a risk than with some other economies that one might speculate about doing a deal with.

CHAIR—I think that is why, when I read the US analysis of this agreement, I come to the conclusion that the trade diversion effects for the United States are greater than they probably are for Australia. But we do not judge this on the welfare of the United States economy; we have to judge this in our national interest. To the extent that the trade diversion effects occur here, to what extent do they undercut the gains of the agreement? Having had this discussion with you, I am now not sure what the answer is at all. As to how we do this prospectively, I just do not know the answer.

Senator BRANDIS—We do it comparatively. We see what has happened with comparable free trade agreements where we have the data.

CHAIR—If you do that, then you go back to the Productivity Commission study which argues that the trade diversion effects are mostly quite negative.

Senator BRANDIS—That is one piece of evidence.

CHAIR—What other pieces of evidence are there?

Senator BRANDIS—That is one of the questions I am about to ask when eventually I get the call.

CHAIR—You cannot complain, Senator Brandis, because—

Senator BRANDIS—I am complaining.

CHAIR—Then I do not recognise the validity of the complaint, because you interfere with everyone else's questioning and then complain that you do not get the call.

Senator BRANDIS—No, I occasionally interject a question which is on the very topic.

CHAIR—However, I have arrived at my final point, for which I do not know what the answer is and you cannot shed any light on it, so I will not go any further. Senator Brandis, you may now, as it was always intended that you would have, have an opportunity to ask what questions you wish.

Senator BRANDIS—Thank you, Mr Chairman. I want to pursue the very point that Senator Cook has left—the trade diversion argument. I have to apologise in advance that I am not an economist.

Senator CONROY—We know.

Senator BRANDIS—The only economist on this committee is Senator Conroy, whose views about the free trade agreement we regard with great respect, so pardon me if I use some technically artless expressions.

Senator CONROY—I have never claimed that title.

Senator BRANDIS—I am claiming it for you, Senator Conroy, to augment your standing in this debate. Mr Legg, let me get your last answer to Senator Cook straight. You say that, if there is a trade diversion effect arising from a bilateral free trade agreement, the more efficient the other party to the agreement is, the less likely that effect will be felt by Australia. Others can contribute to this if they wish.

Mr Legg—It has been a while since I have looked back at Trade Theory 101, but let us take a look at trade diversion as I understand it. You buy goods—in this case, from the US—which are being produced less efficiently than those you would buy from a third party. The fact that the US is a very efficient economy—one of the world's most efficient economies and clearly one of the world's most dynamic economies—implies that the potential for that to happen is less than if you were doing this deal with a country which was actually quite insular and not as dynamic and more likely to be providing goods which could be more efficiently obtained somewhere else. That was the only point that I was making.

Senator BRANDIS—Let us say you compare the United States economy with any other economy which is less efficient and with which Australia might otherwise engage in multilateral trade agreements. Assuming as a constant that the United States economy is the most efficient economy of the potential trading partners, is there ever a point at which that trade effect reduces to zero?

Mr Legg—To answer that question probably requires a level of technical expertise which I do not have. It then becomes very much a sector-by-sector issue in terms of the pattern of trade and the relative efficiency of the US in particular sectors on particular goods. I am thinking as I say this that anybody watching this back in Treasury will be very amused to find me sitting here talking about these very theoretical issues as I do not have that sort of reputation. I think it is very much an empirical sort of issue, beyond the general statement I made earlier.

The other point on trade diversion I would make, getting back to some of the general points that Senator Cook was raising, is that Treasury's view is that many of the benefits of this agreement will be things that do not fit within that model of trade diversion and trade creation, the traditional views of goods trade, if you like, but will come from the things which are hard to model and hard to quantify. I know it sounds like a bit of a cop-out to say that these are necessarily intangibles, but we have a lot of faith in the dynamic benefits of those intangibles flowing through over time. In some ways it is for that reason that we are less energised by the

modelling debate about limited parts of this agreement in terms of trade diversion versus trade creation.

Having said all of that, I also want to say that, a bit like the chairman, my religion is the same—and I think Treasury's is the same—that is, if you had a world in which you could do these things multilaterally then that would be better. But that is not the world we are in, and it does not mean that, therefore, this deal should not be a deal that we do if we think we can get some positive, albeit second-best, outcomes.

CHAIR—I am pleased to hear we are disciples in the same faith.

Senator BRANDIS—Dr Smith, do you have some observations to make on the same point?

Dr Smith—If you think about trade creation and diversion, we are talking about an array of policy instruments which we as a country in the past have also been engaged in—whether it is tariffs or subsidies. So that in itself does distort trade from what you would think is trade driven by a comparative advantage or complementarities between two countries. I think Mr Legg is right: when you have two very open and very competitive countries—and we do have similar economic structures in the industrial structure and the services sector—it is really a question of third country impacts. Would we in reality be importing, say, a labour-intensive good from the US? You could think, in a trade diversion sense, that we may prejudice Thailand or China—countries which are predominantly focused on labour-intensive items. If we benchmark to the US, we see that we have similar industrial structures. Work done by the IMF, which also used a GTAP model, has also thrown up some data saying there may be some trade diversion in a few products.

Senator CONROY—What about, say, textiles? Would we import a boot from the US instead of from China because of this agreement? If we end up doing that, it would be a trade diversion.

Dr Smith—Absolutely. We would not normally do that, not on a comparative advantage basis anyway.

Senator BRANDIS—And obviously we would not import the boot from the US.

Senator CONROY—You might because you have reduced the tariff which reduces the cost compared to China. That is the point. That is what trade diversion is.

Mr Deady—It seems to me—and I think this is similar to the points that Dr Smith and Mr Legg are making—from the Australian perspective that, because we have gone through the tariff reductions we have gone through, we are now talking about a very low level of Australian tariff on average. If we ever got to zero, there would be no trade diversion in any FTA obviously—for example, Singapore has no trade diversion in any agreements it does. The fact that we have a very low external tariff—a very low MFN tariff—means that diversion, by its very nature, has to be limited. I think the example to talk about is something like textiles, where the tariff is still 15 per cent and where there is a margin. That one, as we know, for other reasons is coming down more gradually anyway—which again diminishes the amount of diversion from day one. I do not think the Americans suddenly will be outcompeting the Chinese in the textiles market into Australia as a result of this FTA.

I think it gets back to this point: what is the trade creation and what is the trade diversion? These are small numbers that we are talking about. In the modelling that Dr Stoeckel did the actual numbers are small. According to my economics, if creation is greater than diversion then that is still a good thing—and that is what Stoeckel's numbers show. I watched the debate between Professor Drysdale and Dr Stoeckel on this issue, and I really believe that Professor Drysdale misread the table at that meeting.

CHAIR—He has since provided a note to us in which he maintains his argument.

Senator BRANDIS—So, by and large, you are with Dr Stoeckel on this?

Senator CONROY—Either that or you want your money back!

Mr Deady—I must admit that, on trade diversion, I am very much with Dr Stoeckel. I look at these things and the reality of the trading relationship. I talk to industry around Australia about what the impact of these things would be. One example was the automotive industry. I talked to parts producers. They said that going to a zero tariff in the United States would not really affect their decisions in relation to China, because China is so competitive. If that is the case in auto parts, it is certainly the case in labour-intensive manufactures. As Mr Legg has said, in other areas the US is already a very efficient producer, or the tariff is already zero—60 per cent of the trade is already at zero. There cannot be any diversion, because every country benefits from the openness of the Australian economy.

Senator BRANDIS—Dr Smith, are you familiar with the various modelling studies that have been given in evidence to this committee—Dr Dee's study, the CIE study and the evidence that has been provided by other economists and modellers?

Dr Smith—I am not that familiar with Dr Dee's study. I have been travelling for two weeks, so I have not had a chance to look at it. As I said, in Treasury we do not focus in great detail on the studies themselves. I would say DFAT would spend a bit more time looking at those studies than we do.

Senator BRANDIS—Mr Brown, are you familiar with each of them?

Brown—I have looked at Philippa Dee's study.

Senator BRANDIS—As I understood it, your evidence before was basically that DFAT adopts the CIE as the best of the studies.

Mr Brown—Yes, we do.

Senator BRANDIS—Can you comment on the limitations of this kind of modelling in relation to an agreement whose benefits, I think everyone has told us, will largely be felt in what have been called 'dynamic effects'? I do not want us to be more impressed than we should be by the science because we are not economists. I would be interested in you, and indeed others at the table, offering some general observations on the limitations inherent in the exercise which each of the modellers has assayed, irrespective of the conclusions they have reached.

Mr Brown—My first observation is that you can only disaggregate and pull apart the world that we are trying to describe so far. Partly for that reason, when we contracted out our work on the modelling, we asked for some case studies to be done which identified particular areas which were, in some ways, beyond modelling. For example, light metals were a part of the case study, and opportunities have been picked up in that area which could not necessarily have been picked up properly in the modelling. So certain niche areas cannot be picked up easily. Also, as I think Dr Smith has explained quite well, the art of modelling is still in a state of progress. There are still developments being made in trying to articulate how we might be able to explain the dynamic effects rather better. There are still views out there that indicate it is not really appropriate to model the dynamic effects of trade agreements, because there are so many indirect effects as well.

Senator BRANDIS—That is the point I was hoping you would come to, and I want you and the others to elaborate on that as fully as you wish. To what extent can you model at all for dynamic effects?

Mr Brown—Dynamic effects result from increased competition that is induced by the agreement itself. Opening up Australian producers to more competition from overseas provides an incentive to increase productivity and to arrange businesses in such a way that they deliver better prices and deals to consumers and other producers alike. In our view, the CIE has adopted an appropriately prudent way to model this and has come up with reasonable gains flowing from the productivity increases that would result. Others say that the jury is still out on this, but I think Treasury would certainly say—and we would certainly agree—that the evidence to date from the effect of economic reforms, including opening up the Australian economy, are such that substantial dynamic effects have flown through to the economy.

Senator BRANDIS—You are now going into the area that I described before as a historical and comparative area.

Mr Brown—Exactly—yes, that is right.

Senator BRANDIS—When dealing with an agreement like this, would you regard the historical and comparative evidence as a more reliable indicator than the economic models?

Mr Brown—Economic modelling tries to make use of history in the way they put in the data and the parameters and so on. So in a way they are an abstraction of history, sometimes necessarily a fairly rough abstraction of history.

Senator BRANDIS—And an extrapolation, I suppose, too, because they only speak to the future.

Mr Brown—An extrapolation in the sense that what they do is assume certain policy initiatives and see what sorts of results come out—in technical jargon, a policy simulation.

Senator CONROY—I am never giving you any money to speculate on the stock exchange for me, George!

Senator BRANDIS—I am just rather impressed, Mr Brown, by the idea that, if we have the actual knowledge of what has happened under comparable agreements in the recent past, it is going to be a bit more reliable—and I think this is your point, Mr Deady—than speculation based on contestable assumptions as to what might happen in the future.

Mr Brown—A point made at the start of the CIE report is relevant. It was about quantitative modelling, and what quantitative modelling can do is sharpen and open up the debate on particular issues where people have different views. I think this has certainly been reflected in the various discussions that have been held before this committee.

Senator BRANDIS—Mr Deady, do you want to say anything more about the difference between history and conjecture?

CHAIR—I suppose every time a frontbencher cites the advantage of the CIE model, George, you will correct them, particularly in the election campaign!

Senator BRANDIS—Mr Chairman, you are taking such a partisan view of this! My point is really the point I made to you before, Mr Deady, but having heard what Mr Brown had to say I wonder if want to add anything. We have to look for guidance in all of the evidence we have received and one category of that evidence is modelling. Another category of that evidence is historical experience. The evidence from the modellers is inconsistent because both their assumptions and their methodologies have been inconsistent, one with another.

CHAIR—That does not mean one of them is not right.

Senator BRANDIS—So, in assessing all of the evidence, one looks to, as it were, the hard evidence rather than evidence that, by its very nature, involves assumptions and uncertainties. I am really defending myself against Senator Cook's jibe.

Senator CONROY—I am looking forward to Treasury responding to defend the entire concept of economic modelling shortly.

Senator BRANDIS—Mr Deady?

Mr Deady—I do feel that it is important to look at the historical record, and if you do look at it, as Mr Brown has said—

Senator BRANDIS—What does the historical record tell us about agreements like this, Mr Deady?

Mr Deady—If you look at the performance of the Australian economy over the last 20 years, you do see that reform and deregulation has led to a more dynamic, more competitive and more outward looking economy—all of those gains that I do not think really are contested in recent Australian economic history.

Senator CONROY—By any political party, other than maybe the Greens.

Mr Deady—I use the example of the Australian dairy industry because I do know that industry relatively well. I do not think there is any doubt about the greater efficiency and competitiveness in that industry as a result of deregulation and reform, part of which does trace back to a trade agreement—the CER agreement. Dr Stoeckel uses an example, which I had not thought about, of Japan liberalising beef in the Uruguay Round. Of course, the Japanese beef farmers thought that was the end of the world and they still are very heavily protectionist, as we see by them jacking up safeguards et cetera, but the fact of the matter is that they actually increased production after the Uruguay Round outcome and some competitive pressures improved some aspects of the industry in Japan.

I do believe unequivocally that there are dynamic gains that result from reform and liberalisation, and that is why I am very comfortable with this. This is the way that Stoeckel actually structured the model. He said, 'Let's look at the trade effect in isolation'—and on the G-cubed model that is about $1 billion worth—'and let's whack in a dynamic impact', and I believe that is not seriously contested. I know that Dr Quiggin has a different view about this. He is a far greater economist than I am, but I still think that, on this one, he is wrong. When you look at economic history, there is a dynamic gain there. So you get that bit and then the third bit, which we have talked about—the injection from the investment outcome—and that gives you the overall numbers. As Dr Stoeckel said, you can argue about the numbers, but I think those three things show quite reasonable benefits. They also reflect economic history, in my view, and reality.

Senator BRANDIS—Does it follow from that, Mr Deady, that, when we look at these models, because they are part of the evidence, we can test the methodology and criticise the assumptions but, at the end of the day, intuitively one would be more comfortable with a model whose predictions reflected what has in fact happened in somewhat comparable circumstances with other free trade agreements than a model whose predictions or projections flew in the face of what the historical experience has been of other comparable free trade agreements?

Mr Deady—I certainly believe so and I think that is Mr Brown's point. The assumptions, the various mathematical equations and the elasticities that are injected into those models reflect the best that the modellers can do in looking at economic performance and outcomes and projecting those into the future. Therefore, I think it is quite reasonable to have a particular number in there because we believe there will be a dynamic impact from liberalisation. If we look at economic history, we would say, 'The fact is that, historically, this has occurred, so let's jam it into the model and see what result it comes up with.' That is all the model then does.

Senator BRANDIS—Again, when we are testing the assumptions made by the modellers, we would feel more comfortable with a set of assumptions which more closely reflected the actual history of comparable agreements than a set which did not?

Mr Deady—Yes. You are paying for their professionalism—and, in our case, the professionalism of the CIE—to do that and we are very comfortable with the way the model works. They used widely respected and widely used modellers for both of the models that we had them do. We are very comfortable that they do reflect as close to reality as they can, but they certainly do not do that. To push the envelope out, there is a debate out there now about what some of the gains from integration are. As to the trade and investment linkage, I do not believe there is a real debate about trade and investment. There is a much greater linkage there with

globalisation than perhaps there was previously. Investment, foreign investment and capital accumulation have always been a critical part of economic development. I think it is fair to say that, because of the more open world economy, globalisation and those things, trade and investment are now even more closely integrated, so how can you give some effect to that through modelling? It is not unreasonable to try and come up with an estimate, given that we have made some commitments here to the United States on investment.

Senator BRANDIS—Do you think that, of the various models that have been presented to the committee, the CIE model more nearly reflects the actual historical experience of comparable agreements?

Mr Deady—If you are looking at economic history and the performance of the domestic economy then you can certainly make a very strong case for the need to take account of some dynamism and competitiveness impacts of deregulation. Looking at investment, which is the big number in the modelling that CIE did, what I looked at was the historical fact of the NAFTA agreement. I think that is compelling. Because of the nature of all of the commitments that Canada, the United States and Mexico entered into under those agreements—that is, the whole nature of the framework that was agreed, the greater certainty and the greater access to the US market—on the facts, that led to very large increases in investment in both Canada and Mexico in the seven years immediately following NAFTA compared with the seven years leading up to the signing of the NAFTA agreement. I think that is a fact. I think it is very useful for us and for Dr Stoeckel to say, 'That is the economic history—how can we perhaps give effect to it through our modelling?'

Senator BRANDIS—Do you agree, Mr Brown?

Mr Brown—Certainly, yes. I think the emphasis given by Dr Stoeckel—

Senator CONROY—Mr Legg, Dr Smith, do you all want to agree with each other? Mr Myler, you haven't agreed with us yet!

Mr Myler—I am disagreeable!

Senator BRANDIS—Sorry, Mr Brown, you were interrupted by Senator Conroy. Did you want to finish?

Mr Brown—Yes, I agree very much.

Senator CONROY—You give a glowing endorsement of Mr Deady. Dr Smith wants to join in.

Senator BRANDIS—Dr Smith, I want to give the Treasury an opportunity to address its mind to this question, which is of interest to me. I have made observations about the historical and comparative evidence against the modelling evidence. I am particularly interested in your view of the relationship between the two. I would have thought really as a matter of logic that modelling evidence whose assumptions most closely conform to historical experience of nearly comparable agreements is most likely to be the most reliable of what is an intrinsically uncertain kind of evidence because it projects into the future. What do you think about that, Dr Smith?

Dr Smith—As I mentioned at the beginning, I think we are in an evolutionary mode in terms of thinking about economic modelling. It is only relatively recently—over the last decade—where you would use a computable general equilibrium model to think about economy-wide effects of trade policy. Most of the models have been static models very much focused on trade in goods.

There is a dynamic story around just liberalising your traded goods sector. When it comes to thinking about historical evidence, there is a lot of that in our region. The Australian case was also very unilaterally driven as well: we liberalised because we knew it was good for our economy, regardless of what other countries were doing. So in that sense the dynamic benefits have always been in a trade-liberalising scenario, whether it is trade in goods or now in an extension of everything else embodied in trade agreements, and they are very difficult to estimate. We have seen the dynamic benefits through the Australian economy and through other countries in East Asia, whether it is undoing the rent-seeking behaviour of importers having preferential import quotas, lifting tariffs and freeing up resources, as I think Mr Legg mentioned before, bringing about competitive pressures on producers which were not there before or lowering the prices of items for consumers. All of those are dynamic benefits which are very hard to model.

I would just reiterate that it is an evolutionary process. Most recent modelling is trade-in-goods modelling. As I said, there is a dynamic story around that, but I think we are in a new world in thinking about how to model FTAs. In the past, unilateral trade liberalisation has delivered benefits to countries regardless of thinking about a more preferential approach.

CHAIR—Did you say unilateral or multilateral?

Dr Smith—Doing it for your own reasons.

CHAIR—As we did?

Dr Smith—Yes. That is the historical story.

Senator BRANDIS—Dr Smith, I understand what you are saying about the uncertainty of modelling, particularly agreements of this kind. Would it be fair to say as a matter of general principle that a model whose assumptions more closely conform with historical experience in the most nearly comparable precedents to this agreement would be more reliably based?

Dr Smith—As Mr Deady said, NAFTA is one of the key examples. A long debate went on within the academic and policy communities in the US on modelling the impacts. The net result is that it has been very positive for both employment and trade. As Mr Deady said, that tends to be the one that is put out as the benchmark. It is quite a complex and detailed agreement with a number of chapters. As I said, the profession is yet to catch up in terms of what is going on in our part of the world in modelling those impacts but, in terms of comparable experience in NAFTA, it was a positive story when, at the time, it was not considered by the economic profession to potentially be a positive story.

Mr Legg—To get a clear view, I would like to add the observation that part of the problem of why one would model this—

Senator CONROY—We were wondering why you wasted the money, given your views on modelling.

Mr Legg—We certainly were not the people who employed CIE. It is unfortunate if the debate about the modelling is all about the number at the end of it. I do not think the modellers would say that that is what they are doing.

Senator BRANDIS—No, I do not think they do.

CHAIR—Politicians do, though.

Mr Legg—The problem with history is that it is difficult to disentangle the various effects in history. You can see that liberalisation over time has had desirable impacts. It adds to our intuitive feeling that these were good policies, and there is a lot of empirical evidence on this. But what the modellers add is the ability to disentangle that, albeit necessarily in a set of stylised facts about how things operate, so that you can disentangle the various factors and how they flow through over time and how they might flow through in the future. You can have a debate about those stylised facts. That is what the modellers contribute to this process. If the models are used to say that the correct answer is $6 billion, as opposed to $4 billion, $10 billion or whatever, then I think we are missing the point of the value of the models.

Senator CONROY—Explain that to the Prime Minister the next time he says a number for you—'Mr Legg said you're missing the point.'

Mr Legg—The models do not say, 'This is the right number.' They give you an indication that things might be positive or negative. They give you a sense of how things will flow through. Looking back in 10 or 20 years time, it will be almost impossible to see how the CIE divergence against baseline flowed out because that baseline would have moved all over the place over that period.

CHAIR—Everything else does too.

Mr Legg—Yes. So the models are a necessary part of this process, just as looking at empirical evidence is. Ultimately a judgment has to be made about the balance of all this. It is not a choice about what is the best way of getting the right number.

Senator BRANDIS—Let me ask you the question I asked of the others. In assessing these models, would you agree, as a general rule, that the model whose assumptions most nearly conform to historical experience is likely to be the most reliable of the models, allowing for the fact that it is an intrinsically uncertain exercise?

Senator CONROY—We would still be operating off the first model ever invented.

Mr Legg—I certainly pay heed to the NAFTA experience in terms of what one hopes to be the outcome or would reasonably expect to be the outcome of this sort of deal. The CIE's model has tried to put some proxies into things that others in the past have not. It is reasonable and heroic to do that. It adds to our understanding of how some of these things flow through. Whether it is the best predictor or whether in future we might have better predictors, I do not know.

Senator BRANDIS—It is interesting, but perhaps not very surprising, that everybody has referred back to the NAFTA agreement as the best precedent. Dr Smith, did I understand you to be saying before—again, I assume it was a generalisation—that in America the economists by and large underestimated the effects and the benefits of the NAFTA agreement?

Dr Smith—I guess it was more an ideological debate.

Senator BRANDIS—I have heard a bit of ideology in this committee, don't you worry, Dr Smith.

Senator CONROY—You should not talk about Senator Boswell like that!

Dr Smith—As I said, it was a very complex agreement with multiple rules of origin and provisions, as I understand, between trading partners. On the other hand, it has led to countries like Japan and Korea knowing that they have to get into that market to access preferential tariff rates.

Senator BRANDIS—Is it generally true that the benefits of the agreement were underestimated by the economists who were projecting forward when they undertook their studies in the 1990s or whenever it was?

Dr Smith—I cannot go back and recall the exact modelling outcomes. As I mentioned, it was a debate which was not really settled until you had some hard macro numbers coming out over a long period of time. That comes back to, ex post, how you measure this—it takes a long period of time—and even then, how you wash out that effect from other effects. As I said, the net assessment of NAFTA after at least a 10-year debate was that it was a positive agreement.

Senator BRANDIS—Mr Deady, you were quoting some multiples of figures before.

Mr Deady—These are not modelling numbers. The three NAFTA countries put out a publication. I think it was called 'NAFTA after eight years' or some sort of name like that. It contained those sorts of numbers on investment on export growth. As I said, there was very strong investment growth and very strong trade numbers. Virtually all three countries doubled their exports to each other over the first seven years. Again, they produced very significant trade and investment effects following the NAFTA agreement.

CHAIR—I understand Senator Conroy has some questions on the environment. I have one more question—because I think we may have wasted a fair bit of time trying to drive to this conclusion—before we leave this point. Is it fair to say that the bigger the market that you open the more likelihood that the gains will be greater? I see nodding of approval. That is a 'Yes'.

Dr Smith—Yes.

CHAIR—The Canadian economy is about 70 per cent bigger than the Australian economy. I am not sure what our relationship of the Mexico economy is, and of course there is the United States economy. We are looking at a much bigger area with NAFTA than we are looking at with Australia and the United States. So it follows that the advantages from NAFTA must be greater.

Mr Deady—If we are looking at a comparison—

CHAIR—We are not doing a like-to-like comparison. We are doing a—

Mr Deady—I think that is misinterpreting the numbers if you are looking at a comparison of Canada before NAFTA with Canada as still Canada—so seven years after compared to seven years before led to that sort of increase.

CHAIR—So that we do not do violence to Dr Dee's analysis, 90 per cent of the population of Canada lives within 160 kilometres of the border and there are strong north-south correlations. The distinctive feature of the Canadian economy vis-a-vis other economies is that trade with the United States is much higher as a percentage of trade than with any other economy.

Mr Deady—Absolutely. Yes.

CHAIR—This is the trouble with taking an adversarial approach rather than an analytical approach in trying to arrive at a conclusion: you can slant the evidence to suit your conclusion. I just wanted to get that on the record. My final question—and I have hesitated to go there; but, what the hell, let's go there—is that, according to the CIE study, 60 per cent of gains from this agreement come from the changes to the investment provisions. If that is true and if you multilateralise the investment provisions, you could multiply the advantage to Australia by 3.7 times overall. That means the overall benefit from multilateralising the investment is much greater than the overall benefit from this bilateral agreement. That is true, isn't it?

Senator CONROY—We are not running away from the modelling already, are we?

CHAIR—Whatever the figures are in the model—and I think the CIE model is a bit rubbery—if you multilateralise the investment provision rather than just keep it preferential, you multilateralise the benefit to the Australian economy as well and to a level more beneficial than the total value of this FTA. I am a diehard multilateralist. I cannot resist it.

Mr Legg—I hear what you say, but I think that it depends on your saying that all those numbers are absolutely the right numbers to be using here, and I am not certain of that. It is all a bit academic.

CHAIR—It does depend on that.

Senator BRANDIS—Mr Chairman, you have been rude to the witnesses and rude to the members of the committee all morning. Let Mr Legg answer the question.

CHAIR—I am interrupting Mr Legg, as you interrupted Mr Brown on several points, because I think he is off the point. The point is that, whatever you think is the benefit that comes out of the CEI model—and I think it is overstated—it attempts to model the advantages of lifting the threshold on the FIRB. My point is that the figures show a preferential deal with the United States. If you lifted it for everybody, not just the US, then you would multiply the benefit that comes from that gain, whatever the gain is.

Mr Legg—I think that is arithmetically correct. But the point is how you get to that point. That is an issue for policy, which I do not want to comment on here. The government is in the process of doing a deal with the US. Agreements are reached. Both sides are trying to implement them. We will see if they get implemented. We have to see what happens in the US. There is talk of other agreements to be negotiated. The government at this point has not taken a decision on whether to multilateralise. It has in its mind, I guess, the environment we are in, so I do not want to comment on the direction of policy that it should take in this regard. I am in the business of implementing the agreement that has been struck.

CHAIR—We are not the government. We could make a recommendation like that.

Senator BRANDIS—Were you finished, Mr Legg?

CHAIR—Senator Brandis, we have had this argument before. You are out of order, so please be quiet.

Senator BRANDIS—You cannot talk across the witnesses.

CHAIR—You are out of order, Senator Brandis.

Senator BRANDIS—Why don't you let Mr Legg finish his answer rather than rudely interrupt him?

CHAIR—Senator Brandis, I am sick and tired of your continual interjections in this. If you misbehave yourself for much longer, I will refuse to take questions from you.

Senator BRANDIS—That would be consistent with the manner in which you have chaired this committee from the start, Senator Cook. You are an embarrassment and a disgrace.

CHAIR—You will withdraw those remarks.

Senator BRANDIS—I withdraw.

CHAIR—I think you are an embarrassment and a disgrace too, and I withdraw. Before we go back to the question, I want to make this clear to you, Senator Brandis: I am the chairman. I chair this inquiry fairly—

Senator BRANDIS—No, you do not.

CHAIR—and I give everyone the chance to ask their questions. If I ask a question of a witness and then interfere with their answer to keep them to the point of my question, I shall—as you do all the time. Let us not have this cant about how unfair I am and how you are some paragon of virtue. You are an irritant and you ought to comply with the recommendations of the chair. If you do not, you must simply be bent on a process of disrupting this hearing, for what advantage I cannot possibly imagine, because it serves you no advantage politically to disrupt this hearing. You will attend to the rulings or you will be dealt with.

Senator BRANDIS—Are you going to let Mr Legg finish his answer?

CHAIR—Excuse me. Mr Legg.

Mr Legg—I had, I think, made the substantive point, but the government or any government looking forward would have to think of a range of issues relating to national interest, beyond that arithmetic, in terms of how they decided to take investment restrictions going forward and whether or not they wanted to extend those to other countries. I leave it in the government's mind to think through those issues. The arithmetic may not be the only part of the national interest equation.

CHAIR—We talked earlier about unilateral change. Earlier Australia unilaterally dropped tariffs. It did not drop tariffs as part of a negotiation; it dropped tariffs for reasons of improving the efficiency of our economy. It seems to me to be odd to wait to make a change that might be beneficial to the economy in the hope that someone might give you a concession in a further round of negotiations elsewhere. If the proposition is going to be beneficial to the economy, then why wouldn't you move immediately?

Mr Legg—I cannot comment on what one should do in that situation.

Senator CONROY—I am noting the time. I would like to move on to the environment. It might take more than 10 minutes—it could take 20 minutes.

CHAIR—Let us see how we go. If Senator Brandis keeps out of the discussion we will get through it a lot quicker. We are now on the environment.

Senator CONROY—Dr Churche, I am not sure whether you have had the misfortune of reading all the submissions but I want to refer to the ACF's submission. At paragraph 1.3 they ask: 'Are environmental measures excluded from the operation of the Investment chapter?' I want to go to a point they raise and get your views clear in my mind about whether or not the concerns of the ACF are valid. The paragraph states:

The answer to this question is 'no'. Article 11.11 of Chapter 11 appears to give comfort to environmental concerns by stating that:

> *Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.*

However, if an environmental law expropriates or significantly interferes with the investments of a U.S. corporation, the Australian government would still be liable to compensate that corporation, notwithstanding Article 11.11.

Do you want to respond to that?

Dr Churche—With regard to the issue of the expropriation article, I think it is very important to emphasise that the obligations we accepted under the investment chapter are no different from the obligations that Australia already has both under customary international law and under treaties we have been negotiating since the late 1980s as part of our bilateral program of investment promotion and protection agreements. We have those with about 18 countries at the

moment. So the obligations we have here on expropriation are essentially identical with the obligations both in those existing treaties and under customary international law.

If it were the case that current Australian practice, such as what we do in relation to environmental measures, was in some way inconsistent with the US FTA then those measures would already be inconsistent with our obligations under existing treaties and under customary international law. It is certainly not our view that we are in violation of those existing—

Senator CONROY—So that would be existing WTO obligations?

Dr Churche—We have obligations under customary international law. We also have obligations under our 18 IPPAs, investment promotion and protection agreements, which we have been negotiating since the late 1980s. So we have a lot of experience with these types of expropriation provisions. We also have an expropriation provision in the Australia-Singapore FTA.

Senator CONROY—If a government took an action to protect the environment, could it or could it not give rise to compensation? You are saying we have existing obligations. Could you explain what would happen in that case and if there is any difference from what happens under the US FTA?

Dr Churche—In relation to the expropriation article, it is certainly the case that two types of expropriations are recognised. There is direct expropriation where, for example, you nationalise property—you directly take over the title and seize the property. There is also the concept of indirect expropriation where, through some sort of other government action, the property owner is essentially deprived of enjoying the benefits of that property.

That could, in principle, take place through some form of regulatory action or taxation measure. It could constitute in certain circumstances a form of indirect expropriation. However, there is a very long experience of dealing with these sorts of issues and of what we mean by indirect expropriation under both Australian law and the law of other jurisdictions, as well as in international law both in customary international law and in treaty law. That is why I emphasised the fact that we already have existing obligations. It is no different from what we have under these other treaties.

While it is possible that you could indeed have an environmental measure which in certain extreme circumstances was a form of indirect expropriation, you would have to look at the details of the exact measure. There is also recognition that in most cases most general, normal regulatory activities, whether they are for environmental purposes, health purposes or other general public purposes, do not constitute indirect expropriation, and compensation would not be due under those circumstances.

We have an additional safeguard in this agreement. It is something which the US initiated, I have to say, because there has been quite an active debate in response to NAFTA, particularly because of the investor state dispute settlement provisions. One of the things which the Americans have done in response to that in their recent FTAs is to propose this annex covering expropriation, trying to clarify and give some general understanding about what expropriation means and, particularly, what indirect expropriation means.

This is something which, even though we do not have it in our other treaties, in our view is an interpretation of customary international law which we agree with. We think that our existing treaty obligations also have to be read in the same way as stated in this annex, but the annex gives an additional safeguard. So we think what we have here is quite a good step, because we have heard that domestic debate here as well. We think this is quite a positive development and we have additional safeguards here, additional protections, at least in terms of having it quite clearly stated by both parties, 'This is how the expropriation provision'—and, particularly, indirect expropriation—'will work.'

It makes quite clear that, except in rare circumstances, non-discriminatory, regulatory actions designed and applied to achieve legitimate public welfare objectives do not constitute indirect expropriation. It gives some examples of those sorts of policies—policies to protect public health, safety and the environment. That is an additional safeguard that we have in this FTA which we think is quite an important initiative and which we are very happy to agree to.

Senator CONROY—So, while the ACF may be concerned about 11.7.1(c), they need to read it in conjunction with that annex, which makes it clear that environmental measures are not considered to be indirect expropriation?

Dr Churche—In the vast majority of cases that is going to be the case. There always can be the odd case. The reality is that these things can be captured by protectionist interest. There is no question about that; all things can go wrong. All types of government measures, whether they are environmental measures, health measures or whatever, can in extreme cases be abused. In some cases, an environmental measure could constitute a form of indirect expropriation.

Senator CONROY—In your mind—as someone with much more experience in this area than me—what would that be? Give me an example of what you would describe as an extreme circumstance.

Dr Churche—It clearly could be discriminatory if, when you had a situation in which a range of manufacturers were all involved in a similar sort of activity and all had the same sort of adverse effect on the environment, the government stepped in and said, 'The only one of those manufacturing plants we're actually going to impose the environmental regulation on is the American one.' There is no objective basis for that and clearly in that circumstance—and you still have to look at the facts of the case—that is the sort of scenario where it could indeed be a form of indirect expropriation which should be compensated.

In that sort of circumstance it may well be illegal, because we have some obligations in the expropriation chapter in which we both say, 'In principle, even though both countries have the sovereign right to expropriate property, we should not do so unless it is for a public purpose and is done on a non-discriminatory basis.' If you are actually doing that sort of expropriation in a discriminatory manner, through that sort of indirect expropriation, that could well be in violation of that general obligation not to do that sort of expropriation except for a public purpose and except on a non-discriminatory basis.

Senator CONROY—If the government wants to conduct an environmental impact statement, is that going to cut across anything, in your view?

Dr Churche—There is nothing here at all. That is one of the things that it is very important to emphasise in relation to the investment chapter: there is nothing there which in any way stops normal government regulatory activity or normal government behaviour. There is certainly nothing there which would stop an environmental impact assessment being done as part of normal government behaviour.

Senator CONROY—So conducting one would not be considered as slowing a process down or interfering with a property right?

Dr Churche—That is not going to be a discriminatory activity. You have a national treatment obligation, in which you say you do not discriminate against foreign investors. An environmental impact assessment is not something which is in any way going to discriminate against foreign investors.

Proceedings suspended from 1.00 p.m. to 1.39 p.m.

CHAIR—Before we go to the next section, there are a couple of questions on the departmental criticism of the Dr Dee analysis. Over lunch I read the Dr Dee rebuttal of what the department has said. I must say that I am not sure that, in the time available, I adequately digested all the points, but I note that there are 24 points that she made in her rebuttal that disagree on the facts of what the department has said of her commentary and/or disagree in terms of the argument. I am not sure that we have time to go back over all of this, but has the department now seen the rebuttal from Dr Dee?

Mr Brown—Yes, we have.

CHAIR—Do you accept it?

Mr Brown—We certainly contest the basis of most of her rebuttal.

CHAIR—That would suggest that you do agree with parts of her rebuttal.

Mr Brown—Not necessarily.

CHAIR—Not necessarily?

Mr Brown—I think the best way to do it would be to go through it. What I am alluding to are points of emphasis rather than fact.

CHAIR—As I said, there are 24 things. In fairness we would have to have Dr Dee explain some of her points. I am not sure we are in a position to do that now.

Senator BRANDIS—Let me indicate, for the sake of convenience, that I propose to ask Mr Brown to go through the document point by point. You can ask the same question now if you like but, one way or another, I think Mr Brown should be given the opportunity to do that today. If you do not, I will.

CHAIR—I indicate for the record that this inquiry has not been able to ask Dr Dee a single question about her report. We asked her to reduce to writing her argument after the department provided a criticism of it. I think it would be unfair not to extend to her an opportunity to explain her report but nonetheless to give the critics of her report a long run in answering it. One of the reasons this committee has not been able to give Dr Dee an opportunity to examine her report is that it became inquorate at the time in which we had scheduled a hearing for her to do that. I would not like gamesmanship on the committee to interfere with a proper analysis of the argument, so it may be that the appropriate course is to find a time that Dr Dee can be available and we can extend her the elementary courtesy of at least explaining her position before we go through the criticism of it. I am not sure that I can take it much further this afternoon.

Senator BRANDIS—I have questions for these witnesses when you have finished.

CHAIR—You may well proceed to ask your questions now, and I will reserve the right, if I think it necessary, to ask them some questions following your interrogation.

Senator BRANDIS—Of course.

CHAIR—However, I do make the point—I make it again—that this committee reserved the opportunity for Dr Dee to come and speak to her report. This committee was rendered inquorate so it could not proceed. She has not yet had that opportunity. I think an elementary courtesy to someone that we have engaged of her standing requires that the opportunity be extended to her.

Senator BRANDIS—I do not dispute that, incidentally. Mr Brown, dealing with your response to Dr Dee's report—and I am not unaware of issues of time, although we do have all of today and all of tomorrow set aside for this—can you make your main points, please? Be aware, of course, that Dr Dee will no doubt scrutinise the transcript and will have an opportunity to surrejoin to your rejoinder.

Mr Brown—Perhaps I could begin by keying off our discussion of modelling this morning when we talked about the fact that the development of modelling is still ongoing and there are different views about modelling. I think that Philippa Dee reflects an approach very much at the more conservative end of the spectrum, in particular she rejects the argument that we should be taking into account dynamic gains. She rejects almost out of hand the G-cubed modelling on that basis. We would assert that there is a substantial body of evidence which supports the existence of these dynamic gains, indeed the gains from investment—for example, the gains flowing from the NAFTA that we talked about this morning. We would argue that any full quantitative analysis of the effects of the AUSFTA, insofar as is reasonably possible, needs to take these into account. We would also argue that the CIE has approached this in a reasonably prudent and conservative way.

Senator CONROY—Treasury was not prepared to endorse the half a per cent figure.

Mr Brown—Treasury were prepared to support the argument that there are benefits flowing from the freeing up of investment under the AUSFTA.

Senator CONROY—I think they described it as a 'thought exercise', for the record.

CHAIR—Order! I think it is best if we concentrate on just one person asking the questions at a time.

Mr Brown—That is the first point: she rejects the dynamic and the investment gains that the government has always said are on offer as a result of the AUSFTA. She then goes on to address the sorts of results that would be thrown out by a more traditional modelling procedure, in particular using GTAP. She picks up on our assumptions on that, and she makes that point in the first paragraph of her response. She said:

The department states that I have underestimated the significance of the market access gains in the agreement.

She goes on to say:

On the contrary; I have accepted the market access gains claimed by the CIE ...

But she also points out that she has reservations about Australia's ability to meet the rules of origin. We would hold that that is a fairly significant reservation: limiting the market access gains that we say are on offer. We would contest that, and we can perhaps discuss that later on.

Senator BRANDIS—Do you accept that she has accepted the market access gains claimed by the CIE?

Mr Brown—What I have just indicated is that she goes through it in a fairly systematic way, but the bottom line is that she contests the market access gains that are indicated through the new rules of origin conditions that will apply.

Senator CONROY—Are these your personal views? Are these the endorsed departmental views that you are putting now in response to Dr Dee?

Mr Brown—These are views that are reflected in the supplementary submission that we prepared.

Senator CONROY—What I am asking is whether it came under Mr Deady's name.

Mr Brown—I am sure that Mr Deady would clarify any comment I made if he thought that I was—

Senator CONROY—I am just looking to gain an understanding, when you make a response on the choice of model, of the experience and background that is being drawn upon to make a judgment of which is the best economic model and whether GTAP or G-cubed—or G-square rooted!—was the best model. I just wonder what expertise we are drawing on.

Mr Brown—As part of the process of the management of the consultancy, we talked to the successful tenderers.

Senator CONROY—So you went back to Mr Stoeckel and asked him to respond?

Senator BRANDIS—Mr Chairman, throughout these hearings you have objected to my jumping in on other senators' time. As recently as just before lunch you admonished me about that.

Senator CONROY—It has never stopped you, though.

Senator BRANDIS—For consistency, if the rule is that there will not be this kind of dialogue from the table, it should be applied consistently.

CHAIR—I will take that as a point of order and rule on it.

Senator CONROY—I accept your admonishment, Senator Brandis.

CHAIR—Order! You will recall earlier this morning I allowed you an extended interposing in my line of questioning because I thought—

Senator BRANDIS—With your agreement.

CHAIR—With my agreement. I took it, since there was no objection from you that there was consent to Senator Conroy's interjections. However, since you have raised the issue I rule that, from now on, you will have half an hour to ask your questions, Senator Conroy will have half an hour and we will go back to you again. I ask senators not to interject upon other senators when they are pursuing a line of questioning. I say to the witnesses that, when you do hear interjections, you should respond to the questions put to you by the person who has the call.

Senator BRANDIS—Thank you very much, Mr Chairman. Mr Brown, the opportunity I would like to give you in the half an hour that we have—I am really just going to ask you one question—is for you to take as much of that half an hour as you need, and I suspect you will not need all of it, to respond to it. Having regard to the response document that is before you, you said to the chairman when we resumed words to the effect that there were many points in relation to it that you would cavil with. I want to give you, without being interrupted by me or anyone else, the opportunity to make the points you want to make about the response document—in your own way, but it is probably best just to take it sequentially.

Mr Deady—I would make one point: Mr Brown certainly has my absolute full confidence in responding to the issues of the modelling and other aspects of the questions and issues that Dr Dee has raised. There are, though, a number of issues that other officers will respond to. There is a whole section on services and a section on remedies and various things that other people will comment on.

Senator BRANDIS—Absolutely. My question is directed to the proper officer, if I can use that expression. Between now and 21 minutes past two can you make the points that you want to make? If you do not get the opportunity to make them as fully as you wish, no doubt you can produce another piece of writing for the committee.

Mr Deady—We will start with the modelling I think.

Mr Brown—As I have already indicated, the department believes that the CIE modelling gives the best overall picture of the impacts of the AUSFTA. As I have already indicated, Dr Dee has indicated that she does not support or that she rejects the use of G-cubed as being inappropriate for modelling the effects of a free trade agreement. We contest that for reasons that have been outlined fairly fully elsewhere before the committee. She also rejects the dynamic gains which we have also talked about and which I referred to a few minutes ago.

Senator BRANDIS—They are pretty fundamental differences, aren't they?

Mr Brown—They are indeed.

Senator BRANDIS—To my untutored ear in economics, most of the witnesses have said to us that where you find the benefits of this agreement is in the dynamic gains. Do you agree with that?

Mr Brown—Yes. We would argue that such a focus provides a very partial picture of what is involved with going forward with this agreement. Just referring to the analysis that she does undertake with regard to GTAP, she comes up with a bottom line of $53 million compared with the bottom line that CIE comes up with, in the context of the partial picture provided by GTAP, of $359 million. She reaches this by rejecting our contentions about the rules of origin. She also contests the findings that the CIE comes up with concerning government procurement. Finally, she contests the view that the extension of copyright by 20 years has a bottom line cost of $88 million per annum.

As I indicated when we started out this morning, we think there is a methodological error there because she does not take into account what everybody in the copyright industry knows, and that is that new copyright material typically diminishes in value over time. You only get the occasional classic that comes out which maintains its value. Even the classics themselves have less value because over time they have to compete with more material coming on the market. So the demand for them, in economist jargon, becomes more elastic. So the returns diminish over time because they have to compete with more material—and this applies even to Mickey Mouse.

Senator BRANDIS—To focus your mind a bit more, for the purposes of my questions it would be best if you concentrated on three things: assumptions that Dr Dee makes that you regard as wrong; methodological errors; and, in relation specifically to the response document, any treatment of your response document by her which you say is unfair or puts the case wrongly.

Mr Brown—I think the best way to proceed would be if we could focus first on the rules of origin, and there are others here who are probably more qualified than I am to go through the detail.

Mr Deady—I am happy to say a few words about the rules of origin. We have made the point before that we have adopted a different set of rules of origin under this agreement with the United States. It is a change from the normal arrangements that Australia has in place in the CER with New Zealand and what we did with Singapore, but we believe that the rules of origin are in fact a very efficient way of dealing with this issue of substantial transformation. Dr Dee made a claim in looking at the CER that there is a large amount of trade that does not take advantage of

the rules of origin or the preferential trade. We challenge that, because we think that it ignores the fact that a large amount of the trade actually takes place at zero, so the amount of preferential trade is only a subset of the total trade and, of that subset, most of it in fact does take advantage of the rules of origin and the preferences.

In the case of the dealings with the United States, a vast amount of Australian product is going into the United States, including all the agricultural products and a large amount of the manufacturing products, and—and this has come not just from us but from industry—there is no real concern or doubt that Australia will meet those rules of origin. The one exception to that is the textiles and clothing area, where we acknowledged right from the start that the rules of origin were unfavourable to Australia. That was fully taken into account by Dr Stoeckel in the methodology and calculations, and we stand by the way the CIE calculated this, by rightly assuming that the vast amount of Australian product could meet the rules of origin established under the FTA quite easily.

Additionally, it was suggested, more in Dr Dee's initial study than in this rejoinder, that somehow it was going to cause Australian industry significant additional costs to pursue the particular rules of origin we have agreed with the United States. Our view, which is supported by Australian industry, is very strongly that that is not the case. A change of tariff classification is in fact a simple way, at minimal cost to Australian industry, to meet those rules of origin. Where there is a value added component, Australian industry is very familiar with such value added components. That is the approach that we use in the CER and, again, they could meet those rules of origin to meet the tests of the US-Australia FTA. So we certainly do not agree, as Mr Brown has said, that you look at the CIE results and then discount them the way that Dr Dee has done—saying that a large proportion of Australian trade would not actually meet the preferential rules of origin under the agreement.

Senator BRANDIS—Do you think that is just a false assumption?

Mr Deady—Yes. I think it is exaggerated very much to reduce the values of the agreement by saying a large amount of trade will not take advantage of the preferences. There is no evidence for that whatsoever apart from in textiles.

Senator BRANDIS—There has been a lot of evidence given to this committee by businesspeople that they intend to take advantage of it.

Mr Deady—I can say very clearly that we have had a lot of discussions with Australian industry about the rules of origin. Because it was such a change to our usual approach, we did spend a lot of time talking to them. I think we both learned through that process, and I certainly believe from everything I have heard and you have heard from Australian industry that they are very comfortable now with the rules of origin under this agreement.

A whole raft of the issues deals with the services aspects. We did have a lot of comments back on Dr Dee's initial paper on services, and I will ask Dr Churche to run through some of those issues. Perhaps I could just say that, from reading Dr Dee's rejoinder, a lot of them are not things we can really comment on. She has clarified some of her statements and claims that we, the department, have misunderstood her initial wording. We are happy to talk to her about that, but I think there are a couple of specific areas where we believe that Dr Dee has not fully understood

the specific commitments that we have entered into in the Australia-US FTA on services and investments and how they relate to our existing obligations in the WTO. Dr Churche can elaborate on that more fully than I can.

Dr Churche—I will focus on one of the early things which Dr Dee refers to in her response, and that is the issue of the MFN clause in the services and investment part of the agreement. One of the points she did make about her original study was that she did not really recognise just how important that particular provision was. In her rejoinder, one of the points she argues is that when the US enters into FTAs it always has the same set of reservations, it never changes and therefore it is unlikely that we will get any particular benefits out of this MFN clause. Just on a factual point, when you compare what we have in the services and investment reservations with those in the NAFTA, there are changes. The reality is that we have a more liberal set of reservations from the United States compared to what Canada and Mexico got in the NAFTA agreement. In terms of the point which Dr Dee is making, it is not untrue on a short-term basis. We certainly do not expect that the US will turn around tomorrow and negotiate another FTA which will suddenly have all these more liberal provisions on services and investment and therefore, through the most favoured nation clause, we will get the benefits of that. But the reality is that it does happen over time. These agreements are not just for five years, 10 years, 20 years and so on. We have already seen the evidence there that—

Senator BRANDIS—This is just the dynamic effects argument, isn't it?

Dr Churche—It is part of it. One of the reasons why we actually have more liberal commitments there from the United States is that there have been reforms in the US in the decade, and that is reflected in our agreement. Mexico and Canada get the benefits of that. Because they have an MFN clause in NAFTA, they actually get the benefits of the more liberal treatment that the United States has given to our FTA, and we would expect the same. So certainly on that historical point we think Dr Dee is simply wrong.

Senator BRANDIS—It sounds to me as though you are saying that she is wrong because she has asked herself the wrong question. By disregarding the dynamic effects—and she will have an opportunity to respond—is it your position that she has really turned her attention to the wrong issue?

Dr Churche—I think in a sense she has not looked long enough at this particular issue. I think her focus is too much on the short term. I do not disagree, I have to say, with her point on the short term—I think she makes quite a valid point—but the reality is that this is not just for five years; it is for longer. From that longer term perspective I think the evidence is that it is a rather more complex situation and that there are some real benefits in having that most favoured nation provision.

There is a bit of a comment there about how only multilateralism will protect us from future US bilateral opportunities. I am not absolutely sure what point she is making there. She seems to be suggesting that the benefits to this agreement on the services and investment side come from the fact that there are some sort of preferential benefits. The reality is that there is very little preferential when you look at services and investment. Again, one of the points we made in our original comments on her report was that she really did not recognise the importance of the very liberal rules of origin on the services and investment side. Just to take a minute as to what we

mean there, the reality is that any company which is organised under Australian law, or any branch which is located in Australia and has substantive business activities here, will get the benefits of the services and investment part of the agreement. It does not matter who owns them. It does not matter whether Indonesian, Japanese, German or French investors own those companies. If those companies are located in Australia, if they are organised under Australian law, if they have business activities here, they will benefit from the agreement.

We see that as one of the very important parts of the agreement. It means that it will not just have impacts on investment flows between Australia and the United States but it will also be very important in encouraging investment from other countries into Australia because that foreign investment will get the benefits of the agreement. I think one of the things she is missing here is that we have not tried to build preferentialism into the agreement. That is not where the benefits come from; they come from things like these very liberal rules of origin.

Just while I am on the relationship between this agreement and multilateralism, in one part of her response Dr Dee claims that some of our comments are 'misleading' or 'incorrect'. They are the words she has used, particularly in relation to the work program on professional services. In her original report Dr Dee made a number of criticisms of the FTA, essentially on the basis that this was really about preferential bilateral arrangements and that multilateral routes to promote mutual recognition of professional services were, firstly, preferable and, secondly, that there were real alternatives operating there.

We think the comments which are in her response are quite wrong, frankly. She argues that a number of activities are going on at a multilateral level which are promoting mutual recognition. She talks about, for example, a WTO paper on disciplines on domestic regulation in the accountancy sector. The reality is that those accountancy disciplines do not speak about mutual recognition at all. There is nothing in that particular paper—this is a paper which was adopted by WTO members in 1998. It actually deals with particular situations where you do not have mutual recognition; where, for example, an Australian professional has to go to the United States, they have to meet all the educational requirements and all the experience requirements to be registered in the United States, and when they do so they should be treated in a fair way; there should be transparency about the requirements they have to meet. But the paper does not deal with mutual recognition at all.

Senator BRANDIS—So it is a factual error, in effect.

Dr Churche—Yes. However, there was a different paper which the WTO adopted in 1997—and there may be confusion here—which was to do with the issue of mutual recognition. I will take the liberty of quoting a couple of sentences from that document. I think it is very useful to reflect on the fact that we are putting not just our views here but what other WTO members agree with. This document is essentially a set of guidelines for mutual recognition agreements or arrangements in the accountancy sector. It is quite a different document from the one on domestic regulation, which Dr Dee refers to, which has nothing to do with mutual recognition. This document, which was adopted in 1997 by the Council for Trade in Services, sets out a number of guidelines for mutual recognition. In the introductory part of the guidelines—I will just quote these three sentences—it says:

The most common way to achieve recognition has been through bilateral agreements. Article VII of the GATS recognises this as permissible. There are differences in education and examination standards, experience requirements, regulatory influence and various other matters, all of which make implementing recognition on a multilateral basis extremely difficult. Bilateral negotiations will enable those involved to focus on the key issues related to their two environments.

We strongly support that view. Other WTO members have supported it and have adopted this document because they actually see that when you get things like mutual recognition this cannot be done multilaterally, not in a serious way. But there is no conflict between trying to do things bilaterally and promoting multilateralism. The whole point about these guidelines is to try to make sure that those bilateral initiatives are not in any way stopped but, in fact, are very supportive of the multilateral system. We strongly believe in that and we certainly see that what we have in this agreement on professional services is fully supportive of it.

Dr Dee refers to a number of other things. For example, she refers to the APEC engineer program, which is an initiative by APEC countries in which both Australia and the United States are involved. Dr Dee is somehow suggesting that this is another multilateral or plurilateral alternative to bilateral activities. Again, I think this is a misunderstanding as to how the APEC engineers register works. It is not compulsory and the US is a participating economy, but the reality is that registration of engineers is done state by state. Even though the US participates in the engineers register, there is no requirement that all states in the US should recognise that. Even when they do, all they have to do is take account of it. They still have to make judgments as to whether or not they will recognise the qualifications of particular Australian engineers and they can impose additional requirements.

The engineering profession in Australia very strongly sees the FTA as something which will build on that. It sees that bilateral mutual recognition agreements are very much about trying to develop the benefits of the engineers register, because you actually use that as a basis and then hopefully get all the states in the United States to sign on to it and say, 'Yes, we will recognise that and accept it as sufficient and not impose additional requirements.' Again, the engineering profession themselves—I think this is reflected in the submission they have made to the committee—say they see a strong synergy between these sorts of bilateral initiatives and those sorts of plurilateral and multilateral ones. So I think a very different view is being put by Dr Dee, which I do not think professionals themselves would agree to in terms of the relationship between these bilateral initiatives and what happens in other forums.

Senator BRANDIS—Next point?

Dr Churche—Dr Dee made a number of points about what we see as weaknesses in her original analysis in a number of areas, and we had a bit of a discussion about that this morning. It is not easy to quantify the effects of her model in a whole range of areas. There is a range of very important benefits in the FTA which you really cannot give any quantitative expression to. I think it is one of the things we need to keep in mind when looking at the CIE study. Even though they did a modelling exercise, they were very careful to point out a range of things like these liberal rules of origin and the fact that a lot of bindings are of the current liberal arrangements, not of additional reforms. These are areas where the benefits are quite important but you cannot quantify them; therefore you cannot put them into their model.

Senator BRANDIS—It sounds to me as if you are in general agreement with the proposition I put to some of your colleagues before lunch—that, of all the varieties of evidence before this committee, the modelling evidence, whether it is for the agreement or against it, will be that type of evidence that is intrinsically most uncertain because it depends upon contestable assumptions, controversial or rival methodologies, and projects into the future. Would you broadly agree with that proposition?

Dr Churche—I would. I can give an example. You have to look at what the CIE did on the services side. Most of what we see as benefits from the agreement were not taken into account in the CIE modelling exercise. The liberal rules of origin were not directly taken into account. They did not really try to model the benefits of those liberal rules of origin. They also did not try to model the benefits of the bindings on current liberal arrangements. They did not get into modelling the potential benefits of what we hope to do on the financial services side through this work program we have got the Americans to agree to. They did look at the potential dynamic impacts, and they looked particularly at the mutual recognition side.

This is an area where there has not been very much study, but there was a rather innovative Productivity Commission study done in 2000 which tried to look at a number of ways to model and estimate the impacts of trade restrictions in the professional services area. The CIE tried to take that and stayed particularly focused on engineering services and looked at price-cost margins and tried to work out the price impacts of restrictions of the professional services area. The CIE used that piece of innovative research really much as a proxy to try to have an estimate as to the potential gains in relation to professional services. It is a proxy at the most, and I think it is important to emphasise that.

In some of the tables in the CIE study, they indicate the tariffs they have taken but on the services front, for example in the GTAP model, they only model price reductions in relation to professional services. There was some innovative work done by the Productivity Commission, and the modellers—I am certainly not a modeller—would all have had different views of the rigour of that original Productivity Commission study. So you use it as a bit of a proxy. It gave us a bit of an estimate. It certainly gives us a bit of an idea of some of the magnitudes, but it certainly does not try to capture all of the benefits that we get from the agreement on services front.

Senator BRANDIS—Would it be right to say—perhaps you are not the right person to ask this question of, but I will ask it of you anyway—that, in choosing from models which generate different conclusions from different assumptions and different methodologies, as a general rule the more empirically based the assumptions are the safer they are—I suppose that is almost a matter of commonsense—and, secondly, that the more closely the assumptions conform with historical experience of comparable agreements, the more reliable the model is likely to be?

Dr Churche—On the services investment front, which is the area I had responsibility for, it would certainly be true when you look at the goods areas—merchandise and trade. We have a tremendous amount of experience not only with those types of goods agreements but also in doing the modelling activities. In a sense the two are interconnected. Trade agreements were originally all about goods. There has been a lot of experience over decades trying to draw on that historical experience and feeding that data and those assumptions into the models. That is why, on the goods side, there is quite a deal of robustness in these modelling activities. On the

services investment side, I think the first thing there is that these are much newer. In terms of the sorts of things we are doing in services, it has really only been in the last 15 years—

Senator BRANDIS—I think most people agree that most of the benefits to Australia from this agreement will come on the investment and services side, not on the merchandise side.

Dr Churche—I think certainly many of the commentators would make that basic point and this is part of the problem. They are putting too much emphasis on the models because the models are most robust on the merchandise trade side. They are far less robust in terms of all the methodology and taking into account all the different aspects of the agreement.

Senator BRANDIS—And that includes the CIE model: it is less robust about investment and services than it is about merchandise trade?

Dr Churche—Yes. On both the services and investment side, there is a whole range of what we would see as benefits from the agreement. They are quite upfront about that. They do not see an easy way to quantify and model in what they have done. But they in no way attempt to suggest that, because you cannot model something, therefore it does not exist, it is not important.

Senator BRANDIS—And that is the problem with Dr Dee?

Dr Churche—I think very few modellers would certainly agree with that proposition. I certainly would not be suggesting that Dr Dee does.

Senator BRANDIS—I am not asking to put words into her mouth, but is that the gravamen of your main criticism?

Dr Churche—Certainly one of the points which we made in relation to her recent report is that she put a lot of emphasis on the modelling side of things. There is a whole range of things which we think are very important, which she just did not give recognition to. Whereas, with the CIE report, they did make that point: 'Yes, we do this economic analysis, we do recognise there is a whole range of areas where there will be important effects and we also do a modelling exercise.' Certainly, as a general comment, I would agree with that proposition that, when we looked at Dr Dee's analysis, there seemed to be more emphasis on what can we quantify, what can't we quantify? There is a whole range of things which really cannot be quantified, but she tended to be rather dismissive.

It is a bit more complex than that. On some things—for example, the status quo bindings—Dr Dee argued in the original report that a lot of them were just a replication of what is in the WTO paper. We think that is factually wrong. Yes, there is a degree of replication, but there are also areas there because the rules are stronger or because we have bindings, particularly the negative list approach, and services and investment are more extensive. We certainly think on a factual point, she underestimated just how significant this agreement is in going beyond existing WTO obligations.

Senator BRANDIS—Mr Brown, I just ask you to stop Dr Churche, because we are nearly at the end of the half an hour. Are there any other kinds of headline points you want to make quickly? At the end, I will invite you to prepare a document which sets out this more fully.

Mr Brown—I make one point just to recap what I may have said earlier about the copyright. Dr Dee has indicated that the costs for the extension of the copyright term from 50 to 70 years—using the methodology which was alluded to but not adopted, I do not think, by the CIE—would amount to $88 million per year or over $700 million in net present value terms. However, this methodology overlooks the fact that income flows from copyright diminish over time.

Senator BRANDIS—I think you have made that point.

Mr Brown—Once allowance is made for that, that $88 million per year falls right back. It is very sensitive to the sorts of depreciation rates that you wish to adopt. For example, if you take a very modest depreciation rate of, say, five per cent that figure falls to something like $3.7 million or $3.8 million per year, so it is very sensitive to the depreciation rates that are applied.

Senator BRANDIS—We are nearly at the end of the time, so rather than ask any more questions, I will put one question on notice to your department. I want you to prepare a document, and it is a document that we will of course show to Dr Dee. I want you to deal in particular with four topics. I want you to identify what you say to be assumptions which Dr Dee makes in her report, which you say are false assumptions, and explain why you dispute them. I want you to identify all methodological errors that you say she makes and explain why you say she has made an error. I want you to identify all factual errors you say she has made and give us the true facts. Finally, in relation to the response document, I want you to identify where you say—if you do—that her treatment of your response misstates, misrepresents or misunderstands your case and re-explain the point that you were trying to make that you say Dr Dee has misunderstood.

Mr Brown—Thank you.

CHAIR—I again state for the record that we have not heard from Dr Dee in explaining her initial report but we are now hearing in some detail the criticisms of her unexplained initial report as far as the public record is concerned. From a procedural point of view, it would have been appropriate to hear from Dr Dee in the first place so that we could put in context the criticisms that are now made of her and of her rejoinder. However, we are not proceeding down that path. Despite the fact that I think we are approaching this from the wrong angle, I have a couple of questions. My first question is: does anyone in the department question Dr Dee's professional competence and qualifications in being able to contribute a report to the inquiry, as she has done?

Mr Deady—I do not know Dr Dee but I know that she has worked for the Productivity Commission for some time and is now with the ANU. I have no reason to question in any way her capabilities or credentials. But I will say this: I am not sure how familiar she really is with trade negotiations. From some of the things I have read and in listening to Dr Churche, I believe that she does not have a full understanding of the WTO agreements and Australia's commitments under those agreements. I think that does come through in some of the comments that she is now making about the Australia-US FTA in that I think they reflect a misunderstanding of many of the commitments and obligations that we have under the agreement.

CHAIR—But on the first point, you do not question her qualifications and professionalism?

Mr Deady—As I say, I do not know her. But I certainly understand that she is a very highly regarded research economist and I have no reason to question that.

CHAIR—And with a respected career in the Productivity Commission.

Mr Deady—That is what I understand, yes.

CHAIR—Does the department accept—I know your criticisms; we have heard some of them this afternoon—that her piece of work is respectable in terms of the requirement of this committee to do an analysis of the modelling and other elements related to the free trade agreement? I am not asking you to agree with it but just to accept whether or not it is a respectable piece of work that can be regarded as being a worthwhile contribution.

Mr Deady—This is a very complex and complicated agreement, as you all know very well, and Dr Dee's work is a contribution to the analysis and assessment of the agreement. I think, on that basis, it is a valuable input to the exercise. But I will state again that we do believe—as we tried to say in our initial response to Dr Dee—she has misunderstood and got quite a lot of it wrong.

CHAIR—Another piece of modelling work was done by the NIEIR. Has the department bothered to analyse and post a considered criticism of that work?

Mr Deady—Mr Brown might say a few additional words, but certainly we have looked also at the NIEIR piece of work. We have not put a formal response to that analysis. My understanding again is that, just on the hard modelling, it is not dissimilar to the sorts of results that the CIE has come out with. So again it is the additional assumptions that those modellers or researchers go on to make about some of the long-term sovereignty impacts on Australia that will lead to very negative outcomes that we would certainly not agree with at all.

CHAIR—So the department thus far has not chosen to present a public criticism of the NIEIR's work but it did choose to criticise Dr Dee's work in that way. Who for the department decided that it should devote its resources or part of them to giving this criticism?

Mr Deady—With that decision, we looked at Dr Dee's report—we certainly recognised very clearly that it was a report that the Senate committee had asked for—and I considered that clearly the committee would look very closely at and take great notice of this report. I certainly took the view—and I discussed it with senior officers in the department—that, on that basis, we should respond to what we saw in the report as factual errors and trade policy areas we thought were not reflective of reality in terms of trade negotiation or trade policy. We thought we should go on the record in responding to that piece of work.

We have not responded to a vast range of other submissions. We have certainly made ourselves available—we hope—to the committee to answer any questions on any submissions made by others to the committee. As for the status of Dr Dee's report, I honestly believe that we thought the committee had commissioned that report and we wanted to respond to it. We did not take the same view about every other submission that has been passed to the committee.

CHAIR—Who prepared the response?

Mr Deady—The response was prepared by various members of the team. I oversaw the production of the report, which was done by the lead negotiators in various areas. Dr Churche clearly had some input to it; Mr Brown did the area on government procurement; and Mr Bush contributed too. It was done by the department as part of the US FTA team basically out of the Office of Trade Negotiations.

CHAIR—So effectively, if I understand your answer correctly, the response was prepared by the negotiating team.

Mr Deady—That is correct, yes.

CHAIR—In terms of economic analysis, what qualifications does the negotiating team have?

Mr Deady—There is a vast amount of expertise on the team. Mr Brown certainly is responsible in the department, broadly speaking, for economic analysis. There are certainly some very strong economic qualifications in Mr Brown's branch which make us very confident of having the expertise to look at the various models and produce a paper in response to what Dr Dee came up with. The expertise of the various negotiators, I think, also speaks for itself. We understand the agreement, and the Office of Trade Negotiations is responsible for the government's trade policy broadly, so these are the sorts of issues that we thought were quite within our competence to comment on.

CHAIR—I understand the difference between negotiators and the qualifications they bring to bear on this discussion, and people with the qualifications that make them competent to analyse the benefits either way. If this in-house expertise exists in the manner in which you have argued by implication it does, why then didn't that same body of people do the analysis that the CIE was asked to do?

Mr Deady—The CIE certainly has access and expertise to the various models. It was certainly felt that, given the very high level of interest in the US-Australia FTA, we would go out and ask for some independent modelling of the outcome, which you know we did. That drew on the models. But I think it gets to the sort of conversation we were having this morning: there is a whole raft of inputs to the government's consideration of these issues and certainly there is expertise within the department to look at, assess and comment on the models and to review the sorts of reports you have been talking about, like the Productivity Commission reports on various subjects. That is the department's role in dealing with these areas of economic and trade analysis and trade negotiations.

CHAIR—When the department wants to assess what the alleged benefits of this agreement might be, they go to the CIE. When they want to analyse that analysis, albeit critical analysis, they rely on their own resources. Why did you not go to the CIE to ask them, since it was a criticism of their report that Dr Dee was concerned with?

Mr Deady—I do not mean to mislead at all. We saw Dr Dee's report when it was put up on the committee's web site. I have had discussions with Andy Stoeckel about some of the points made in there about the model. So, yes, we did talk to the modellers and, as I said, we talked to Mr Brown's section and we prepared that response. We have done our response in very good faith. We put it up to you and for it obviously to go on the web site in response to the work that

Dr Dee has done. We are very happy, as you are now, to scrutinise those responses. But we certainly stand by them and we do feel that Dr Dee, in looking at the report and producing her own assessment, got quite a few things wrong. I thought that we needed to correct that record for the committee.

CHAIR—But you are not saying, are you, that the expertise that the department brought to bear is of equivalent professionalism to the expertise that Dr Dee brought to bear on her analysis of the CIE model?

Mr Deady—Senator, I am not going to suggest that the department has any less qualification in this area than Dr Dee. I do not agree with that.

CHAIR—Unless I misheard, I thought Dr Churche said in answer to an earlier question that he is not a modeller, and I do understand that modelling is one of the areas of expertise that Dr Dee has.

Mr Deady—It is one of her areas of expertise and, as we have talked about, she is renowned in that area. I believe that we have very competent members in the department who are capable of looking at the assumptions that Dr Dee made and questioning them. That certainly is a common feature of the debate between economists in these sorts of areas. We certainly have people in whom I have great faith who can look at this work. I think the points that Mr Brown made about Dr Dee's treatment of copyright are one example of where we thought she got it completely wrong. We believe, and I still believe, that we had to correct the record on that because it was getting quite a lot of transparency, quite a lot of notice, around the place.

CHAIR—But my question is about the equivalency of professional expertise. The only response I have had from the table—which is not a response I sought; it was a response to earlier questioning—was from Dr Churche that he is not a modeller; nonetheless, he criticises the analytical modelling criticisms made by Dr Dee.

Mr Deady—With respect, I think Dr Churche is certainly commenting in detail on the claims Dr Dee has made about aspects of the services and investment outcomes of the agreement, including our WTO commitments in services and investment. I am happy to go on the record and say that I would certainly believe that Dr Churche has much more expertise than Dr Dee in trade negotiations, in an understanding of GATS and in an understanding of what we have negotiated in the services investment chapter of the US-Australia free trade agreement.

CHAIR—I understand what you are saying, Mr Deady, but you are not contradicting Dr Churche's own assertion that he is not an expert modeller, when we know that Dr Dee is an expert in this field. I would like to go to some of the questions here. In Dr Dee's report there is the question of the procurement issue, which is one of the areas that I am a bit more familiar with than others. Does anyone at the table suggest that Dr Dee is incorrect in her analysis of the weakness of the CIE model in terms of the impact on procurement?

Mr Deady—I disagree with Dr Dee on it. And that is not a modelling issue; that is not a matter of her expertise in modelling. She makes different assumptions about what the outcome of the agreement will be on government procurement. That has nothing to do with her

credentials or strengths as an economic modeller. I do question her assumptions about what the government procurement outcomes of this agreement will be.

CHAIR—Let us go to those assumptions, then. The first assumption is that what is true of the Canadian economy vis-a-vis other economies is that the Canadian economy has a much heavier penetration of the US market than other economies in the world. We do not disagree with that?

Mr Deady—I do not disagree with that.

CHAIR—We do not disagree about the second point—and these may not be in the order in which she makes them—that one of the reasons for that is that there is a whole range of north-south connections between the American economy and the Canadian economy? We do not disagree, do we, that 90 per cent of Canadians live within 160 kilometres of the American border? We do not disagree, do we, that the Canadian economy is 70 per cent bigger than the Australian economy? And we do not disagree, do we, that distance to the market is an element in the ability to penetrate a market and that the Australian market is 30 times more removed from the US market than the Canadian economy is? Do we disagree about any of those things?

Mr Deady—Without picking, I am not sure that the Canadian economy is that much bigger than the Australian economy, but your points are well taken and I do not disagree with them. Yes, those countries are closer, they have a very strong trade relationship and they are certainly bigger than we are. And proximity to the market would be a factor in competitiveness and being able to make sales. I do not question any of those assumptions.

CHAIR—That is the basis on which she comes to her conclusions.

Mr Deady—I agree, but that is exactly what the CIE did. The CIE took those factors into account and discounted Canada's share of the government procurement market to take account of those very factors. It did not assume that we would attract or obtain the same share of the US government procurement market as Canada did, for those very reasons. Dr Dee says, 'We still think the CIE did not discount them enough and that they have exaggerated, still, the gains that would flow to Australia from access to the procurement market.' I do not think she is saying that the CIE did not take those factors into account; she is merely attributing—

CHAIR—She is saying that they wrongly weighted them. They come to a 30 per cent benefit and she comes to a four per cent benefit.

Mr Deady—That is right. I do not know, on the basis of what I have read of Dr Dee's work, that her four per cent has any more credibility than the CIE's 30 per cent. In fact, I can point to a couple of areas where I think she has misunderstood or misrepresented the agreement and where her number is underweighted. One example, as Mr Brown said this morning, is that the numbers in this area for Canada's access to the procurement market in the United States are through their credit corporation. That would not be all of the Canadian industry sales to the US government; in our view it would be a subset of those. Under the agreement, the provinces in Canada are not covered by the government procurement chapter of NAFTA, nor are the US states covered by the government procurement chapter of NAFTA. Now, 28 of the US states and all of the states and territories here are covered by the Australia-US trade agreement. Just by that fact alone we

have a bigger base that we can potentially access. The CIE did not take the states into account either but—

CHAIR—We had better be fair to both of them: the number of states that have signed on is greater now than at the time at which the CIE did its study and the time at which Dr Dee did her analysis.

Mr Deady—That is true.

CHAIR—To the extent that more states have signed on, it distorts both analyses.

Mr Deady—I would like to say something because I think this is important—and I know it is important to you. I am not questioning Dr Dee's capacity or capability as a modeller. I do not know her well enough. I am not comfortable making these comments but I certainly do not know her as a trade negotiator or someone who is really familiar with all aspects of Australian trade policy and the processes of the WTO. We bring to the table the people who have pored over these agreements, been through dispute settlement processes in Geneva and understand these agreements as well as anyone in Australia. That is why it was incumbent on us to respond to those areas where we believe Dr Dee made some errors in her assessment of the US-Australia FTA.

Senator CONROY—You have negotiated a set of words. She has analysed the potential economic impact. They are not the same thing and you are not qualified to pass judgment.

Mr Deady—We have had a long debate on the modelling and you have had many hours with Dr Stoeckel, Dr Garnaut and others talking about these very issues and, yes, there are different assumptions about the modelling but unless I have got this wrong, Dr Dee is going well beyond economic modelling in making her assessment of the Australia-US FTA.

Senator CONROY—You have not negotiated economic outcome; you have negotiated a set of words, on which you are making a range of assumptions on behavioural changes in Australia. You are making a set of judgments but not based on your expertise as a trade negotiator, which is about words. Now you have stepped into behavioural adjustments, which is way past trade negotiation.

Mr Deady—What we are trying to do, and I think what Dr Dee has tried to do in her assessment for the committee, is just that: to not just look at a modelling exercise.

Senator CONROY—Your expertise is in trade negotiation. Her expertise is in analysing behavioural change due to economic variables.

Mr Deady—I would just say that I think that she has looked beyond the model. She has looked at what the agreement means, what the language means. She is the one who has said that there are commitments here that Australia has entered into with the US that do not go beyond what the two countries have agreed and made commitments to in the WTO. That is factually not correct, and I think we do have the responsibility to respond to that and to make it clear. Her assessment is not just an economic model of the agreement; it is an assessment of the agreement, and that is quite appropriate.

Senator BRANDIS—I have one question, Mr Chair.

Senator CONROY—I do not agree to it. We were working on the basis before that you only got to ask a question in your half-hour if everyone agreed.

Senator BRANDIS—I am sorry; I thought you had finished.

Senator CONROY—No, I interrupted Peter. He did not mind. But if you want to interrupt me I am saying wait until our half-hour is up.

Senator BRANDIS—I am happy to wait till the end. I thought you had finished.

CHAIR—I think our half-hour is up, unfortunately.

Senator BRANDIS—No, you have got another nearly 10 minutes, by my reckoning. I finished at 20 past.

CHAIR—In that case, I have a series of questions. I think we are in a quite serious area here. What this country needs, in its national interest, is a robust debate about what the effects of these things are, and the resources to do that are quite limited. I also think that trade agreements are supported when the executive wing and the legislative wing agree. If one wing or the other does not agree they do not happen. Dr Dee's analysis is advice to the legislative wing about information the executive wing have put out, to put it in that context. I see part of the role of this inquiry as trying to work out where the consensus is, if there is one. What I worry about now is that we have taken an adversarial approach to the truth rather than an analytical approach to the truth to try and work it through. It seems to me there is a whole adversarial argument to justify an outcome rather than to explain an outcome so that in a democracy voters can choose based on their interpretation of the facts. If we move down that course then no government can effectively fairly negotiate in the national interest because the legislature will always be extremely critical of government assumptions. There has to be a sharing between both wings of the fundamentals of this; otherwise nothing happens.

That is why a robust but open and frank exchange is very important. That is why to some extent I am offended that we have not yet had—and it is not your fault and I do not in any way make the criticism of you—Dr Dee explain her report and her reasons, and there seems to have been no discussion between either of you. My understanding of Dr Dee's academic competency is that she has studied trade negotiations over a long time. She may not have been a negotiator but, fortunately for all of us who have been negotiators at one time or another, we have other people looking over our shoulders to help us.

Senator BRANDIS—I have a procedural question of you, Mr Chair. This is not a point of order. Would it be proper or appropriate for a person retained by the committee as a consultant to it to be approached by witnesses before the committee, including the gentlemen at the table, to discuss these matters privately any more than whether it would be appropriate or proper for Mr Deady to speak to Mr Holmes sitting here and try to influence the way in which he prepares drafts of the report? That is a procedural issue.

CHAIR—That is a procedural question. Can I respond to it?

Senator CONROY—It is a hypothetical one.

CHAIR—It would be entirely inappropriate for Mr Deady to try and influence the secretariat on how to prepare the chair's draft of the report, because he would be interfering in the process that exists between the chair and the secretariat. As far as the parliament is concerned, we are not front-line negotiators—we assess the outcome of the negotiations. Anything that makes our task easier would be entirely appropriate. I think that what would be appropriate would not necessarily be a private exchange but a public exchange—and I have tried to do this throughout this inquiry by having roundtables—of the formal points of view so they are out there and able to be debated and analysed not just by us but by the people we are accountable to in the parliament and in the community.

I see nothing wrong with the intellectual argument over the merits being discussed by the protagonists, but I would like to hear what that discussion throws up. I do not see this as a court of law in which we are out to prove one side right and one side wrong; I see this as a process of analysis to try and get at the truth. If we take a protagonist's view that we are right no matter what then the ability of a parliament to analyse and get at the truth is limited. Maybe I have a naive view of the political process after all these years in it, but I still think the obligation of the Senate committee is to try and analyse.

I will go to point 17 of Dr Dee's supplementary note. I will not read all of it, because it would be too laborious, but it is something about which, as soon as we finish with this section—and hopefully that will be mercifully soon—we can talk about with the officers that are now assembled in the room. It is about the Pharmaceutical Benefits Scheme. She said:

But the operations of the PBS, with or without its additional review mechanism, are not the only influence on drug prices in Australia. The timely availability of generic drugs is another important influence.

Even when faced with a countervailing market power, the major pharmaceutical companies can increase their profits if they can do two things:

(i) use existing mechanisms (eg those designed to compensate for marketing delays) to extend the term of patent protection on their proprietary drugs; and

(ii) ensure that generic drugs do not enter the market in the meantime.

AUSFTA delivers them precondition (ii). Observing that the pharmaceutical companies have not made extensive use to date of existing mechanisms to extend patent terms is no guarantee that they will not do so in the future. Only with AUSFTA in place will they have the full set of conditions in place to make it worthwhile.

That is a fair, factual observation, isn't it?

Mr Deady—No, I do not think that the second paragraph that you read is a fair observation.

CHAIR—The observation that, 'Only with AUSFTA in place will they have the full set of conditions in place to make it worthwhile'?

Mr Deady—I must admit that I do not fully understand the point that Dr Dee is trying to make there.

CHAIR—Let me go to the concluding paragraph of this point. She said:

So the threat to pharmaceutical prices in Australia dos not lie with the PBS provisions of the agreement, but with the patent provisions. It is notable that the Government is not claiming that AUSFTA will have no effect on pharmaceutical prices in Australia, only that it will have no effect on the operations of the PBS.

It is a fair enough observation.

Mr Deady—I do not think it is a fair observation; I do not agree with it. We have had a lot of discussion about the IP chapter, including article 17.10.4, evergreening of patents and those sorts of issues, which I am sure we will have some time to talk about here. But I do not agree with the claim Dr Dee made in the initial report, which was just a repeat of claims made by certain people that there were going to be delays, as a result of the AUSFTA, in generics entering the market.

CHAIR—Can I interrupt you, Mr Deady. What we all agree on, I think, is that in the agreement there are a set of provisions—three provisions, I think—in article 17(10)—

Mr Deady—Article 17(10)(4).

CHAIR—Three conditions are set out as to how a patent manufacturer of drugs might take action to have their patent extended.

Mr Deady—No, I do not agree with that. I do not think that is what that article does in the agreement. It sets out what is a requirement under the marketing approval process. The commitment that we have entered into is that, under the marketing approval process now, we will put in place measures that will prevent generic drugs entering the market while there is a patent in place. That is the first part of that provision. The second one is that, if a generic drug producer believes there is a patent in place but is going to market that anyway, they are required to notify the patent holder. That is what the provisions say.

CHAIR—That is the second provision.

Mr Deady—Yes, that is right. They are the two.

CHAIR—There is a third provision.

Mr Deady—No, they are the two provisions in 17(10)(4).

Senator BRANDIS—Can I ask my one question, Chair, as your time has finished?

CHAIR—Let us pick this up and deal with it in the wider discussion later.

Mr Deady—Honestly, Chair, I think that is probably better. This is a complex area.

CHAIR—I will get out my copy of the agreement and go to the figures. Dr Dee in her document refers specifically to this.

Senator BRANDIS—Maybe she is wrong again.

CHAIR—That is what she is linking these remarks with, I believe.

Mr Deady—I have no doubt that she is talking about article 17(10)(4), which is the issue about this notification and linkage, as we call it.

CHAIR—The new language sculpted into the clause enables actions to be taken by patent drug companies or to be advised to them, which can then be used by them to take actions about their patent.

Mr Deady—The additional commitment and requirement that results from the agreement that we have made with the Americans is that, as part of the marketing approval process, if a generic drug producer is going to challenge a patent or says that there is still a patent in place but for some reason they are going to market this product, then they are required to notify the patent holder of that fact. But there are no additional rights—and we have been through this many times—to patent holders under this agreement.

CHAIR—These rights are being spelt out in the agreement for the first time.

Senator CONROY—It is a new thing about the notification.

Mr Deady—It is certainly a new thing. It is an obligation that we have entered into. It is a requirement of the marketing approval process that we have in place measures to ensure that drugs do not enter the market where there is a patent in place. That is the commitment. Under current Australian law, you cannot sell drugs if there are patents in place. They go to the courts now and that is exactly what happened as a result of this.

Senator CONROY—This goes a little further, though. Let us say a patent is going to expire on 30 June and you want to sell from 1 July. Are you required to notify that you want to sell from 1 July?

Mr Deady—If you are not marketing the drug while there is a patent in place—

Senator CONROY—Do you have to notify?

Mr Deady—You have to notify the TGA that you are not intending to market while there is a patent in place. You have to certify; that is certainly a new requirement. If you are not breaching a patent, then there is no requirement to notify.

Senator CONROY—Is the TGA required to notify the patent holder that someone is going to market beyond 1 July, as I called it?

Mr Deady—No.

CHAIR—Senator Brandis wishes to ask a question. That may give rise to further questions, but I indicate from the chair to the inquiry that I am not sure we can take this discussion much further. Certainly I do not think we can until we hear from Dr Dee. Irrespective of whether we

can or cannot, I would like to get onto the next tranche of questions. I do hope fervently that we can wrap this up today. If we have to come back later on, it just makes this whole thing a bit impossible.

Senator BRANDIS—Do you have to be an expert economic modeller to criticise the assumptions, in particular the factual assumptions or the assumptions about the effect of a document, made in the model?

Mr Deady—No, I do not believe that you do. In this case we are making assumptions in at least parts of these areas. Senator Cook gave a very good example. We are making assumptions about what the government procurement agreement means. You cannot just plug a number into a model and come out with an outcome for government procurement; I think we have covered that ground and we are all agreed. You have to inject something different, and that is what the CIE tried to do. So I think it is valid to comment on the assumptions going into the modelling. I go back to the NIEIR and the assumptions made there that lead to very substantial negative outcomes. I feel competent to say that I do not agree with those assumptions for the reason that they attributed things to the FTA that I do not believe are in any way attributable to the FTA. If you make those assumptions you will come out with a result, but I can point to ways that the factual basis of the negotiated outcome does not make those assumptions credible in any way, shape or form.

CHAIR—You are not an expert modeller, are you?

Mr Deady—No, I am not.

CHAIR—But you would agree that the art of modelling is to know what assumptions ought to be made—I can gather that from interrogating you and others who have negotiated these things—and then accurately weighting them to give the correct balance to those assumptions within the system. The artistry is in how you weight the numbers in the model. That is something that expert modeller do talk about.

Mr Deady—That is right.

CHAIR—We may pick this question up at some other time, but, for the moment, we appear to be out of questions. We will now move to intellectual property, audiovisual and PBS issues.

ACTING CHAIR—I am going to ask some questions about the PBS. Dr Lopert, I thought we had all this out on 21 June but I see there are still some loose comments, being made as recently as in this morning's press, by various people saying there are reasons for concern that drug prices under the PBS might rise as a consequence of the FTA coming into operation. So, at the risk of asking you to go over some old ground that I thought was covered very thoroughly and persuasively on 21 June, let us proceed. I will initially direct myself to you, Mr Deady, but you can distribute the call to anybody else you think is the most appropriate respondent to my questions. Please explain to us and the people of Australia, in straightforward language but take as long as you need to, why drug prices under the PBS will not be affected as a consequence of Australia entering into the FTA.

Mr Deady—The agreement that we have reached with the United States on pharmaceuticals is, as you know, reflected in an annexe to the goods chapter and in a side letter.

ACTING CHAIR—Please pause there because I want to get this plainly and on the record so that people can read it and understand. Please tell us what a side letter is and explain to us the status of a side letter in construing the agreement.

Mr Deady—Let me then go back a step. The annexe sets out the general obligations under the agreement, and the commitments there apply to both Australia and the United States. The commitments in the annexe about agreed principles, the medicines working group being established and cooperating on regulatory affairs are clearly commitments by both governments to do these things under the terms of the framework of the agreement. Side letters are a feature of this agreement in many areas. They tend to be an elaboration sometimes of the commitments entered into under the specific areas of the agreement. In others, like in this annexe in the pharmaceuticals area, the side letter explains certain aspects of the annexe, certainly in relation to the independent review. It gives some clarity as to what Australia gives a specific commitment to. It says this is how we will implement one particular area of the agreement and narrows that even further. It then goes on to make what are essentially Australia's unilateral commitments to the United States as part of the agreement. Side letters are an integral part of the agreement. They have the same legal status under international law and under treaty analysis and treaty interpretation as the chapters, annexes, footnotes and every other part of the agreement, so in a legal sense they are completely binding on the government of Australia or the government of the United States.

ACTING CHAIR—If the meaning of words in a clause of the FTA were narrowed and further defined in a side letter, would that have the same effect as though those narrowing, defining words appeared in the text of the FTA itself?

Mr Deady—Yes.

ACTING CHAIR—So, on the ordinary principles of the interpretation of any legal instrument, the more particular, specific words qualify the more general words?

Mr Deady—That is correct.

ACTING CHAIR—And that applies as much to a side letter as it does to anything in the text?

Mr Deady—Yes.

ACTING CHAIR—Okay. Perhaps I can lead you through this. Let us start—

Senator CONROY—Are you going to put words in his mouth?

ACTING CHAIR—No, I am just announcing what I am going to do as a kind of signpost, for the sake of efficiency. Let me lead you through this. The critics of the effect of the FTA on the PBS point to clause 2F of annexure 2C and they say, by a process of reasoning that I will not attempt to convey, that somehow that could lead to higher pharmaceutical prices under the PBS,

though, I might observe, they say that without referring to the side letter. What is the answer to that—the clause 2F of annexure 2C point—please, Mr Deady?

Mr Deady—Clause 2F is an additional commitment by Australia to the United States in the pharmaceuticals area that we agree to establish an independent review process of the PBS system. That is a new commitment that we have given to the United States under the agreement. It is very clear in 2F that we will make available an independent review process that may be invoked at the request of an applicant directly affected by a recommendation or determination, and that refers back to where you have a system like our Pharmaceutical Benefits Scheme. In the side letter on this issue to the United States, we then give effect to that clause by saying that Australia shall provide an opportunity for independent review of PBAC determinations where an application has not resulted in a PBAC recommendation to list. So very clearly we have written there and made a commitment to the United States that, for the purposes of 2F, the independent review of PBAC determinations will be in those cases where an application has not resulted in a PBAC recommendation to list.

ACTING CHAIR—That is the only reviewable decision under that provision?

Mr Deady—That is the new independent review. The only commitment we have to the United States is to provide an applicant with the opportunity to go to the independent review where an application has resulted in a PBAC recommendation not to list. That is the only occasion.

ACTING CHAIR—Dr Lopert, this might be one for you. We went through it last time, but let us just get it on the record as clearly as possible. Is the jurisdiction of PBAC in relation to listing applications conferred by section 101(3) of the National Health Act 1953?

Dr Lopert—Yes.

ACTING CHAIR—That provision is the provision which deals with PBAC's powers and functions when it is seized of an application to list a pharmaceutical on the PBS. Is that correct?

Dr Lopert—Yes, that is correct.

ACTING CHAIR—The jurisdiction of PBAC, as conferred by that provision of the National Health Act, is limited to a decision to make a recommendation to list or not to list. Is that correct?

Dr Lopert—The jurisdiction is to make a recommendation to list or not to list and to make recommendations according to the circumstances in which that listing may be affected.

ACTING CHAIR—Mr Deady, you are quite satisfied that, when the qualifying words in the side letter of 18 May 1994 referring back to clause 2(f) of annexure 2-C speak of the review of decisions not to list, those are decisions of the kind that are provided for by section 101(3) of the National Health Act?

Mr Deady—Yes.

ACTING CHAIR—It is nothing to do with price?

Mr Deady—No.

ACTING CHAIR—It is then said by some people that maybe the general provisions of the dispute resolution chapter—chapter 21 of the FTA—might provide some kind of back-door mechanism or through some process might enable American pharmaceutical companies to get the price of PBS pharmaceuticals lifted. Can you tell us in a general way what chapter 21 of the FTA does and why it is the case—I assume you agree with me; I am following your testimony from 21 June—that that is an untenable argument?

Mr Deady—Yes, it is untenable. The dispute settlement chapter of the agreement provides for issues to be taken up between the government of Australia and the government of the United States if there is a breach of obligations under the agreement. There is nothing in this agreement that provides for private action in these areas and there is no way that a dispute could be mounted under the dispute settlement part of the agreement in relation to the outcome of the deliberations of this independent review committee.

ACTING CHAIR—You are familiar with provisions similar to those in chapter 21 of the agreement?

Mr Deady—Yes, chapter 21—dispute settlement—is a feature of most trade agreements, including the WTO agreements. The dispute settlement chapter of the Australia-US free trade agreement broadly follows those dispute settlement procedures.

ACTING CHAIR—So chapter 21 of the FTA is not only a commonplace agreement in international trade treaties but does nothing more than what Australia is already obliged to do under WTO obligations?

Mr Deady—To clarify, the dispute settlement chapter of the Australia-US free trade agreement clearly deals with issues and commitments entered into under the Australia-US FTA.

ACTING CHAIR—Of course, I understand that. But the machinery is a commonplace machinery under international treaties that already exist?

Mr Deady—Yes, that is right. It sets up a panel process and those panels would look at the commitments taken by the two governments and would look at those under the standards established under international treaty interpretation and the sorts of procedures and rules of the WTO that have been followed.

ACTING CHAIR—So there is no possibility in your expert professional opinion of those provisions being used to appeal drug prices under the PBS?

Mr Deady—No, there is no way that that could happen under chapter 21.

ACTING CHAIR—Some people also point to the provisions of the FTA in relation to a body described as the medicines working group and they say that somehow that could produce upward cost pressures in relation to pharmaceuticals under the PBS. What do you say about that?

Mr Deady—Again, I disagree completely. There is nothing under that medicines working group that would in any way affect the pricing and listing arrangements of the PBS. This is a working group. There are a number of working groups established under many areas of the agreement. This will be government-to-government discussions on issues related to the annex that we spoke about, but it does not have any power in relation to the pricing or listing of the PBS.

Dr Lopert—May I make a comment in addition to that. There is a footnote to the paragraph in relation to the medicines working group which specifically states that nothing in that paragraph will be construed as requiring a party to review or change a decision regarding a specific application.

ACTING CHAIR—All right, thank you. I will deal next with this issue of the evergreening of patents. But before I come to that, may we then be reassured, or may those who continue to publicise 'concerns' about the effect of the FTA on the PBS in relation to any one of the three matters we have discussed—that is, clause 2(f) of annexure 2-C, or chapter 21 or the medicines working group provisions—be reassured that their concerns are utterly groundless?

Mr Deady—Yes, they are utterly groundless. We have been through this many times, as you know. The language, I think, is very clear in the side letters on the operations of dispute settlement. I do not think there is any question now that dispute settlement applies to government-to-government measures. Those concerns are just unfounded by what is in this agreement.

ACTING CHAIR—Can you identify anywhere else in the FTA any other mechanism whereby people could have soundly based concerns that the coming into operation within Australia of this agreement might put upward pressure on pharmaceutical prices under the PBS?

Senator CONROY—Is this a different question to what you have been asking previously of Mr Deady?

ACTING CHAIR—Yes, it is.

Mr Deady—I have said this before, but I will say it again in this way: there is a very clear mandate given to us by the government to ensure the fundamentals of the PBS, and that gets to the pricing and listing structures. There would be nothing that we would agree to that would come out of the FTA with the United States that would impact negatively on that pricing and listing.

ACTING CHAIR—Those were your negotiating instructions from the Australian government.

Mr Deady—That is right.

ACTING CHAIR—And you complied with those instructions?

Mr Deady—We complied with those instructions fully and we certainly did recognise and talk to Australian industry and other stakeholders right through this process. We do understand

the concerns about aspects of the IP chapter. If that had not been negotiated and handled properly, it could have somehow—perhaps on very extreme assumptions but nonetheless—undermined aspects of the pricing and listing arrangements of the PBS. We ensured that did not happen by the nature of the commitments that we entered into under the IP chapter.

ACTING CHAIR—I am going to pass the call to Senator Conroy to pursue that question.

Senator CONROY—I regularly ask in parliament, as you have probably noted, Mr Deady, questions about the cost of the PBS as well as individual drug prices in the PBS. You will also be aware that the government proposed an increase in drug prices which recently passed through the parliament. They argued that on the basis of sustainability of the PBS. If the cost base of the PBS expands because more drugs are listed, is it an unfair assumption that a future government may have to increase a copayment—that is, put up the price of drugs—to maintain the sustainability? The very argument the Treasurer has put forward to protect the long-term viability of the PBS is to put up prices to Australians.

Mr Deady—Dr Lopert might want to comment. She is the expert, of course, on the PBS and all aspects of it. That particular question of what the costs of the PBS may be over time is certainly and obviously an important public policy issue. The ageing of the population, new drugs and all these sorts of things impact on that. What we are about here, or at least what I am about here, is whether there is anything in the free trade agreement that leads to pricing and listing changing, and that is the answer.

Senator CONROY—Sure. Before you throw to Dr Lopert, though, I want to make this point. Frequently when asked whether anything in the agreement would put up the price of drugs, Mr Vaile, the Prime Minister and the Treasurer would say no, much as you are saying. When asked the question 'Will there be an impact on the cost base of the PBS?' they did not give an answer—frequently.

Mr Deady—There is nothing in the free trade agreement that will lead to a change in the cost base of the PBS.

Senator CONROY—When the Prime Minister says that more drugs may be listed because of the FTA, does that have zero impact on the cost base of the PBS? The Prime Minister has said that—I am sure you have noticed that.

Mr Deady—There is nothing in the PBS that leads to, as we have said many times, or that requires—

Senator CONROY—'Requires' and 'leading to an increase' are two different things.

Mr Deady—As we have said all along, there is no legislative change here. If the PBAC determines that certain drugs should be listed at certain prices and the minister for health agrees with that then those drugs will be listed. That is fundamental. That is the structure, that is the pricing and listing arrangement for the PBS, and nothing changes it.

Senator CONROY—I understand that, and I understand the point that Senator Brandis has articulated now—I have lost count how many times—about—

ACTING CHAIR—At least three times.

Senator CONROY—the price. The issue I am getting to is that frequently, when asked about the cost base, Minister Vaile and others did not give the same categorical statement. Now, I can get you transcripts, and I am not asking you to comment on that right now. But equally, and it may have just been a teaser by the Prime Minister, the Prime Minister has suggested that there could be more drugs—he did not say there would; he said there could be more drugs—listed under this new process.

Mr Deady—Senator—

Senator CONROY—If more drugs are listed, the PBS becomes a more expensive operation overall.

Mr Deady—Depending on the—

Dr Lopert—Not necessarily.

Senator CONROY—You do not agree the Prime Minister said that, Dr Lopert?

Dr Lopert—No, I am saying that if more drugs are listed it does not necessarily mean that the PBS becomes more expensive.

Senator CONROY—No, I did not say it necessarily did; I said it could.

ACTING CHAIR—But, Dr Lopert, doesn't the PBS generally tend to become more expensive with the passage of the years, as more drugs are discovered and medical technology develops? I think the phenomenon to which Senator Conroy points is generally true, isn't it, but it has nothing to do with the FTA?

Dr Lopert—That is correct.

Senator CONROY—No, that is not right. The point that Senator Brandis has made is correct, but where he jumps to next is not correct, because the FTA allows a review process on listings. So it is possible that, even if just one more drug got listed because of this review mechanism, the cost base of the PBS would go up—as a result of the FTA's new review process. Just one extra drug getting approved through the review process has to, by definition, all things being equal—and that is all we are looking at here, all things being equal; not that it goes up and down, which is the point that you are trying to make—increase the cost base of the PBS, which is exactly why Minister Vaile would never give that confirmation.

ACTING CHAIR—Come on, Dr Lopert; let the witness answer the question.

Senator CONROY—It may be that not one does, so the word is always 'could', not 'will' or 'definitely should'.

Mr Deady—I think the government have made it clear that the fundamentals and the structure of the PBS were things that we were not changing as part of the agreement; and, as we have said

many times, that is exactly and precisely what we have achieved here. If a recommendation or a report goes back as a result of this independent review and PBAC looks at this information, it is the PBAC that will still make that decision.

Senator CONROY—I am not arguing that.

Mr Deady—Again, Dr Lopert is the expert. But of course there is nothing that stops a drug that has been rejected from the PBS in the first run through from going back and going through again.

Senator CONROY—And mounting a better case next time. I accept that they can do that.

Mr Deady—So I think, in fairness, that what we are saying here is absolutely accurate and truthful—that there is nothing in this free trade agreement that has altered those fundamentals and the pricing and listing arrangements that are in place under the current PBS.

Senator CONROY—Your definition of 'fundamentals' and mine probably just separate there a little bit, Mr Deady. I am not downing the succinctness and the belief that you have there, but I have a slightly different definition of 'fundamentals'. I know Dr Lopert is dying to jump in and I would not want to deny her the opportunity!

Dr Lopert—Yes. I think there is a disconnect here. That is, principally, that—as Senator Brandis alluded—the provisions in the act specify the basis on which PBAC can recommend a drug be listed on the PBS. It must be satisfied that, if there is a substantial increment in cost, for some patients at least there is a substantial increment in the clinical benefit associated with the use of the drug. So PBAC is required to satisfy itself that for a drug to be listed on the PBS it represents reasonable cost-effectiveness—reasonable value for money.

Now, if PBAC were to reject the listing of a drug and that drug was then the subject of a review and there was some aspect of that review process which highlighted to PBAC that further consideration were warranted, and the PBAC ultimately came to the conclusion that they could recommend the listing of the drug, it would still be on the basis that it had determined it was acceptably comparatively effective and cost-effective. That is the fundamental principle and that has not changed, and that is the way in which the fundamentals are preserved. If PBAC decides on the basis of its consideration or reconsideration of any submission of a drug that it is not appropriately comparatively effective and cost-effective then it cannot under its legislative mandate recommend that it be listed. That has not changed.

Senator CONROY—Sure.

ACTING CHAIR—In fact, I think Mr Deady made the point that there has been no legislative change whatsoever in the package of bills to give a domestic effect to the FTA in relation to the PBS, has there?

Dr Lopert—None whatsoever.

Senator CONROY—I managed to retrain myself during your questions.

ACTING CHAIR—Now that I am in the chair, I am going to abandon Senator Cook's practice of not permitting interruptions. I will politely interrupt you as long as I am relevant.

Senator CONROY—I am used to you chairing committees, Senator Brandis, unlike Senator Cook, so I am used to your frequent interjections from the chair.

ACTING CHAIR—Move to your next question, Senator Conroy; you are going well.

Senator CONROY—I have no experience in this, whereas I know you do, Dr Lopert. How often do companies bring back the same drug once it has been rejected for listing? Is it regular? Is it uncommon? Do they just give up and move on? What happens?

Dr Lopert—It is usually the case that they come back at least once. What generally happens in the process is that, in determining its view about a particular application, the PBAC will articulate those issues which it believes the company should address in any resubmission. Those are very specific and are provided to the companies within a short period of time following the PBAC's meeting.

The PBAC, as I said, will articulate specifically what it believes the company should address in preparing any resubmission and what it might wish to see in any future submission that would enhance its understanding or its consideration of that particular application. The companies then have the opportunity to meet with the chair of PBAC to have further clarification if necessary of what those issues are. They also have the opportunity to meet with departmental officials in order for us to assist them with preparation of any resubmission. A resubmission is then lodged by the appropriate date for a future PBAC meeting, and that happens quite often. To say how many times a particular submission would come back is not possible because it—

Senator CONROY—What is the most persistent?

Dr Lopert—I could not say.

Senator CONROY—Is it three times, four times?

Dr Lopert—It is not that unusual for something to come back four times. It is not common but it has happened. And it has been possible through multiple submissions to PBAC to refine a proposition for listing, if you like, to enable a listing recommendation to go forward. If I could just give an example without mentioning a particular drug—

Senator CONROY—What is the most successful—

ACTING CHAIR—Let her finish her answer. She was going to give an example; let her give the example.

Senator CONROY—I was hoping to get an expanded answer to the example. What in your experience would be the most persistent one that has succeeded? For instance, a drug has been put up four times before it finally gets there. I think that is the way you were going with your example, without naming a drug.

Dr Lopert—I could not without reference to the database give a concrete response to that. However, I can point to a particular example of where it is not uncommon for a drug to be proposed for a very broad indication—perhaps for the entire range of indications to which the drug has marketing approval from the TGA—but only in a subgroup of the population does it represent an advantage over currently available therapies, which are possibly less expensive. Through subsequent resubmissions it has been possible to identify either this population in whom the drug represents the only therapeutic option after other therapeutic options have been exhausted—it is what we call 'last line therapy'—or a population in whom the drug represents a particular benefit for a whole lot of reasons. It may be because of some characteristics of that population or because of other therapies that have already been tried that that population represents a subpopulation in whom the drug is acceptably cost-effective, and listing can proceed on that basis. That is not unusual.

There is a sort of temporal component in this in the sense that over the years companies have become more expert in preparing their submissions to PBAC and in identifying more readily a way forward or understanding that a restriction on the way in which the drug is listed may be necessary to ensure that the drug is listed in a way that represents cost-effective therapy. So it varies. As I said, there will be some drugs for which multiple submissions are not uncommon and there will be others which are recommended for listing after their first appearance.

ACTING CHAIR—Dr Lopert, in order to proceed on a second or subsequent application, the applicant would have to show a new material fact, wouldn't they?

Dr Lopert—Not necessarily. They might have to propose a different population. They might have to propose a way—

ACTING CHAIR—That is what I mean. They could not bring on the same application that has already been resolved.

Dr Lopert—I thought you were referring in that context to new clinical data.

ACTING CHAIR—No.

Dr Lopert—A proposition for a restriction for a drug to be listed on the PBS, a change in the way in which a drug is proposed for listing, may assist. It might be that the company or the applicant presents a new economic model that relies on the same data that was presented to the PBS previously but prevents a more robust understanding of the modelling.

ACTING CHAIR—I do not want to delay on this but that is really what I was getting at. They would have to show a new ground. They could not come back with the same material that has just been rejected.

Dr Lopert—No. As I said, what PBAC wishes to have presented to it in a resubmission is very clearly articulated in its determination on the previous submission. Companies have the opportunity to seek clarification through further meetings if necessary.

Senator CONROY—As always, I appreciate that you are allowed to make helpful interventions to elicit the answers you want but I am not.

ACTING CHAIR—Yes, you are.

Senator CONROY—I do appreciate your contributions from the chair.

ACTING CHAIR—You are free to intervene when I am in the chair and asking questions. You are free to intervene as long as you are relevant.

Senator CONROY—I want to move onto the question of notification and the patents. I am working from the legislation that has been tabled and passed through House of Representatives. I want to go through section 26B certificates required in relation to patents. Not being an expert in this area I wanted to step through existing practice and what is new. Do you have that handy, Ms Harmer? I think it is on page 82. At the moment, if someone wants to put on the market a drug that is running out of patent, is there any notification process required at all?

Ms Harmer—To the patent owner? No.

Senator CONROY—So this whole notification process is a new process?

Ms Harmer—That is correct.

Senator CONROY—I wanted to step through all the bits. There are a couple I have question marks next to. The certificate required by this subsection is either:

(a) a certificate to the effect that the applicant is not marketing, and does not propose to market, the therapeutic goods in a manner, or in circumstances, that would infringe a patent that has been granted in relation to the therapeutic goods;

What is your interpretation of that? I think I know what it means but I want to see what you think it means, Ms Harmer.

Ms Harmer—It is a certification effectively made in the process of a generic seeking marketing approval that they do not intend to place those goods on the market while there is a patent in force in relation to that product.

Senator CONROY—Why do they need to certify that they are not doing something?

Mr Deady—If I could say again, this is a certification to the TGA. It is to give effect to the language of the agreement. As Ms Harmer has said this is a new requirement. What we were required to do here was to provide a measure in our marketing approval process to prevent persons from marketing a product that is claimed for a patent, where a patent is in existence.

Senator CONROY—But they cannot do that now, in reality.

Mr Deady—At the moment, of course, it is illegal under Australian law to market a product that is covered by a patent.

Senator CONROY—It is illegal now.

Mr Deady—But there is nothing in the marketing approval process at the moment that requires any sort of certification. The generic manufacturer goes to the TGA and says, 'We seek marketing approval for this drug,' and the TGA begins that work. They are the current arrangements.

Senator CONROY—So the TGA do not have to check to see if there is an existing patent?

Mr Deady—No, they do not, and they do not have to check under this, either, that there is an existing patent. This is purely a notification process.

Senator CONROY—When we say 'notification', notification to whom?

Mr Deady—To the TGA.

Senator CONROY—Walk me through this: I am a generics manufacturer.

Mr Deady—You now face an additional requirement under the FTA to notify them that you are not intending to market this product.

ACTING CHAIR—Is that just a pro forma?

Mr Deady—It is a certification and there are penalties if that certification is—

Senator CONROY—But there might 5,000 drugs I am not planning on marketing. Do I have to tell them I am not planning on marketing those 5,000 drugs? I am just trying to understand why I have to do this.

Dr Lopert—Could I just clarify the process: the generic manufacturer submits a dossier to the regulatory authority—the TGA—to seek marketing approval of the generic version of a patented product. Under the previous arrangements, the TGA would assess the merits of the application on the basis of bioequivalence with the patented product and, having satisfied themselves of the technical merits of the application, they would then grant marketing approval. Under the current legislation, if the generic manufacturer then places that generic version of the product on the market while the patent is in force, they are in breach of current IP laws. What they are required to do under this process is simply to certify to the TGA that they will not do that. It does not affect the TGA's process of marketing approval; it is merely a certification to the TGA that they will not proceed to actually put the drug in the marketplace until any patents covering the product have expired. To do so under current arrangements would be illegal. This is merely consistent with that current regime. That is not the notification requirement; that is a certification requirement to TGA and to TGA alone.

Senator CONROY—When I put in an application that I am going to market this drug from 1 July, I have to certify that I will not market it prior to 1 July?

Dr Lopert—The details of the way it will be implemented have not been worked out. Whether or not they are required to certify a date is not specified. They merely certify that they will not put it on the market until such time—

Senator CONROY—Until the patent expires.

Dr Lopert—That is correct.

Senator CONROY—Is the TGA required to notify the patent holder?

Dr Lopert—No.

ACTING CHAIR—Do you think this is going to hold the process up? Is there a delay issue here?

Dr Lopert—No.

ACTING CHAIR—Why not?

Dr Lopert—It is a certification requirement.

ACTING CHAIR—That was my point before: it is just a one-page document.

Senator CONROY—I am a bit slow, George. Can I just work through this? We may end up at the same point.

ACTING CHAIR—Sorry, Stephen—Senator Conroy.

Senator CONROY—Sorry—Senator Brandis. Thank you always for your helpful interventions.

ACTING CHAIR—I am jumping ahead a bit here!

Senator CONROY—You are jumping way ahead of me, Senator Brandis; I am much slower than you!

ACTING CHAIR—I think I know where you are going, Senator Conroy.

Senator CONROY—I hope that is not right.

ACTING CHAIR—You would be surprised!

Senator CONROY—Clause 26B(1) refers to:

(b) a certificate to the effect that:

(i) a patent has been granted in relation to the therapeutic goods...

I am the generic manufacturer. What does this point (i) mean that I have to do?

Dr Lopert—I am sorry, could you repeat the question?

Senator CONROY—It was regarding clause 26B(1)(b)(i), which refers to a certificate to the effect that a patent has been granted in relation to the therapeutic goods. So I have to get a certificate from the TGA that says that?

Dr Lopert—No, that is a certification that the generic manufacturer has investigated whether there are any patents in force and has identified that there are.

Senator CONROY—And what about '(ii) the applicant proposes to market the therapeutic goods before the end of the term of the patent'?

Mr Myler—There are actually only two certificates. The first certificate is that captured by clause 26A, which is the certificate that you have just referred to—the applicant is not marketing it and does not propose to market therapeutic goods in a manner which contravenes or infringes a patent. Then there is another certificate, which involves certifying all three elements in subclauses (i), (ii) and (iii). They are not individual certificates. There are two certificates. If you satisfy all three elements of (i), (ii) and (iii) then you would offer the second certificate.

Senator CONROY—So my certificate will say that a patent has been granted in relation to the therapeutic good. The TGA has given me a patent?

Dr Lopert—No, the TGA is not involved in the granting of patents.

Senator CONROY—So the patents office will say that I have been granted a patent?

Dr Lopert—No.

Senator CONROY—Help me out here, please.

Ms Wyers—The system sets out two different certificates. The applicant for regulatory approval from the TGA certifies by giving a certificate under either clause 26A or clause 26B. They are not going to market the products in a way that will infringe a patent, so they give the TGA a certificate under clause 26A. Alternatively, they give the TGA a certificate under clause 26B. That certificate requires the applicant for the therapeutic good approval from the TGA to certify to the TGA that there is a patent in relation to these goods, the applicant for the approval from the Therapeutic Goods Administration is going to market the goods before the patent expires and they have actually notified the patent owner in this case that they are going to do that.

Senator CONROY—So the purpose of getting a certificate under clause 26B is if I intend to market prior to the expiration of a patent?

Ms Wyers—Yes.

Senator CONROY—So I need a certificate under clause 26A if I am going to start on 1 July, or any date after 1 July if I want, and a certificate under clause 26B if I intend to try and market prior to 30 June?

Ms Wyers—Yes.

Senator CONROY—And that would be illegal under Australian law at the moment?

Ms Wyers—Yes.

Senator CONROY—Do we have a lot of that going on?

Ms Wyers—I do not know. It is an infringement of the patent to do it. These requirements are to implement the relevant provisions of the agreement.

Senator CONROY—So I can get one of two certificates. The first is if I am not planning on marketing before the patent expires and the second is if I do intend to try and market it. It is either/or; I do not have to have both?

Ms Wyers—No.

Senator CONROY—I just have to have either A or B?

Ms Wyers—Yes.

Mr Myler—The other element is that the first certificate is for when you do not propose to market in a way that would infringe the patent.

Senator CONROY—This is A?

Mr Myler—Yes. It is not simply that you are going to wait until the patent protection ends.

Senator CONROY—If a patent has expired, how do I infringe a patent?

Ms Wyers—You are just not going to market in a way that is going to infringe the patent.

Senator CONROY—But it has expired. How do I infringe a patent that has expired? Help me—I am not a lawyer.

Mr Myler—You could certify that you are not going to market in such a way that would infringe the patent before the patent had expired if, for example, you did not believe the patent was valid.

Senator CONROY—I need to go back to clause 26A now and gain a better understanding of what it actually says. I thought it was just a date issue. I was asking if it was common that people marketed prior to a patent expiring, but you are suggesting that, from the way this clause is worded, it is possible, if not common. It may happen, but as long as they are doing it in a way that does not infringe patent then in actual fact it is okay.

Ms Wyers—If they are not going to infringe the patent then they can market it under A.

Senator CONROY—What is the legal definition of infringing a patent? I want to know what I could do to market the same drug without infringing the patent.

Ms Wyers—Whether or not you infringe it will really depend on—

Senator CONROY—On the facts of the case, I guess.

Ms Wyers—the facts of the case. It is a question that depends on each particular—

Senator CONROY—If you are aware of any cases, can you give me an example of how I could market a drug that would not infringe and of how I could market a drug that would infringe?

Ms Wyers—Off the top of my head, no, I am not aware of any particular cases but—

Senator BRANDIS—What about with the authority of the patent holder?

Ms Wyers—If you have the authority of the patent holder then you are not infringing.

Senator BRANDIS—That is what I mean. It would be an example of non-infringing marketing of a patented drug if you did it with the authority or by sublicence from the patent holder, wouldn't it?

Ms Wyers—Yes, that is correct.

Senator CONROY—Obviously, with consent it would qualify, but I get the impression that this is a clause designed to deal with situations without consent.

Senator BRANDIS—Is it? I am not sure that that is clear.

Ms Wyers—Yes, you do not have the consent, but you only need the consent of the patent owner if you are actually going to market it in a way that infringes the patent. If you are not going to infringe the patent then you do not need the consent.

Senator CONROY—Generically it is the same drug; it is just in a different packet. A generic drug has the same chemicals; it is just in a different packet, isn't it? Isn't that what a generic drug is?

Ms Wyers—It is, but it also depends on what—

Senator CONROY—If I agree to market it in a different box and with a different name, am I infringing the patent?

Ms Wyers—Not if the patent is for that drug. If the patent is for that particular drug and those particular uses then you will be infringing the patent if you market it before it expires.

Senator CONROY—Okay. So once a patent has expired I cannot infringe on the patent, can I?

Ms Wyers—No.

Senator CONROY—So as long as I want to put my generic drug on the market after 30 June, which is my notional date, and it is after 30 June when I make the application and the patent has already expired, I do not need a certificate, do I? If I rolled up on 1 July and said, 'I want to market this drug,' I would not need a certificate?

Ms Wyers—You may need to have a certificate to say there is no patent.

Senator CONROY—But that is not what these two clauses, or these two certificates, cover.

Mr Myler—A covers that eventuality.

Ms Wyers—A does. What you have done is certified that you are not going to actually market the products in a way that will infringe a patent because there is no patent there to infringe. It just means that when you make an application to the TGA for regulatory approval you have to give a certificate under A or B.

Senator CONROY—You must have A or B?

Ms Wyers—Yes.

Mr Myler—You must have A or B. If there is no patent because it has expired, because there never was a patent or because you are the innovator then you give A, which certifies that you are not going to market it in a way that would infringe a patent.

Senator CONROY—Say I go into the TGA on 1 July and say, 'I want certificate A because any patent on this drug has expired.' I will get a tick there without any problems at all?

Ms Wyers—You do not actually ask for certificate A; you supply the TGA with a certificate under A.

Senator CONROY—That I have got from the patent office?

Ms Wyers—No.

Senator CONROY—Is there a form? I must have got the form from somewhere.

Ms Wyers—Yes. My understanding is that the TGA will develop the form for that. Because it is part of the marketing approval process, you will get the form from the TGA.

Senator CONROY—I think I am with you on A now. I may come back to it but I think I am with you. Clause 26B reads:

(b) a certificate to the effect that:

(i) a patent has been granted in relation to the therapeutic goods ...

Say I have gone to the patent office and they have given me a patent, even though they may or may not realise there is another patent on the same drug—or do the patents office check these things?

Ms Wyers—No. This bit is—

Senator CONROY—I thought the patents office said, 'Okay, bang, tick; that's a patent,' and did not go off and search to see whether there were patents.

Ms Wyers—No, the patents office does that. But the process of people applying for and being granted patents is a completely separate process from this regulatory approval process. The patents office will—

Senator CONROY—But I must have a statement from the patent office to get certificate B, which says 'a patent has been granted in relation to the therapeutic goods'.

Ms Wyers—No.

Senator CONROY—The only place I can get a patent granted is from the patents office?

Ms Wyers—No. This is a certificate from the person who is applying for regulatory approval, and they are certifying to the TGA that the patent office has granted a patent. They will have granted it to somebody else; one will have been granted.

Senator CONROY—That is my point.

Ms Wyers—But it is up to the person who is applying for the therapeutic goods registration to do a search.

Senator CONROY—Yes. But my point is that, when I walk into the patents office and I give them my patent, they do not go off and do that search themselves. They just say, 'Okay, here is a patent for you.'

Ms Wyers—The person who applies for the patent has to apply for the patent and go through all the processes that are set out in the patents legislation, and then they get their patent.

Mr Myler—But the generic that is applying for marketing approval does not have a patent, does not get a patent and does not go anywhere near the patents office other than to search to see whether somebody else holds a patent for the chemical formulation that it is trying to get marketing approval for.

Senator CONROY—They do not go in and seek a patent for their generic drug?

Mr Myler—No, they do a search to see whether there is a patent that applies.

Senator CONROY—On my form from the TGA I will tick off that a patent has been granted to, say, GlaxoSmithKline—and I am not trying to be pejorative to anyone—that they have a

patent on this. I propose to market the therapeutic goods for the end of the term of the patent. I am saying that I am going to go to market before 30 June, in my language.

Mr Myler—Yes.

Senator CONROY—The third point is this. The applicant has given the patentee notice of the application for registration or listing of the therapeutic goods under section 23. If I am going to go to market before the patent expires then, to get certificate B, I have to have told them that that is what I am going to do.

Ms Wyers—Yes.

Dr Lopert—Certificate B certifies that you have told them.

Senator CONROY—I would like to go to clause 26B(3), which says:

For the purposes of this section, a patent is taken to have been granted in relation to therapeutic goods if marketing the goods without the authority of the patentee would constitute an infringement of the patent.

I have a huge question mark next to that because I do not understand what it says. I am hoping somebody can explain it to me. It says 'a patent is taken to have been granted'. I would have thought a patent is a patent is a patent and that if you do not have a patent you do not have a patent.

Ms Wyers—Clause 26B(3) explains 26B(1), which says that you have to certify that a patent has been granted in relation to the therapeutic goods. The purpose of B(3) is to say, basically for the purposes of B(1), that marketing the goods without the authority of the patent owner would infringe a patent.

Mr Myler—Essentially, in this situation the confusion develops because there are two therapeutic goods: there is the innovative therapeutic good, which has the patent protection, and there is the therapeutic good for which registration is being sought. The patent—

Senator CONROY—I am sorry, you have lost me there already.

Mr Myler—The generic walks in with their therapeutic good, and the innovator has their therapeutic good and they have the patent. In this situation, clause 26B(1)(b) says with respect to the certificate:

(i) a patent has been granted in relation to the therapeutic goods ...

No patent has been granted to the generic company with regard to the therapeutic good that they are trying to get registered. The patent has been granted to the innovator with regard to essentially the exact same therapeutic good, but it is out there. What 26B(3) is trying to say is, 'We classify a patent as having been granted over a therapeutic good associated with this application when, if you were to put your generic therapeutic good on the market, it would infringe a patent.' It goes to the interaction between the two therapeutic goods and where the patent protection is.

Senator CONROY—To me clause 26B(1) is perfectly straightforward. I stumbled my way through this at the beginning, and you have explained it to me in fairly clear and precise terms inside about five minutes. Clause 26B(1) is perfectly straightforward after having heard your explanation. I do not understand why there is a need for this clarification, because it is a confusing clarification and I do not understand it.

Mr Myler—Without the clarification, it would be impossible for a generic to certify that a patent had been granted in relation to the therapeutic good which is the object of their application—there is none because they are the proponent of that therapeutic good. The question is: what is the difference between the two?

Senator CONROY—It is impossible for a generic to get the certificate, because they will not be able to check to see whether there has been a patent for the original innovator?

Mr Myler—We are just trying to clarify. It is in a sense pre-empting legal debate down the road about which therapeutic good the patent needs to cover. We are saying that there is a therapeutic good that the generic is seeking to register; that there is a therapeutic good out there which is essentially the same therapeutic good, which has the protection of the patent and which is the property of the innovator; and that, if you are going to certify that there is a patent that has been granted in relation to that therapeutic good, it is a drafting device to try and indicate that the patent of course is in the hand of the innovator.

Senator CONROY—The debate about a patent is surely about the substance of the medicine; it is not about the marketing. That is what I am confused about. I think I understand the point you are trying to make that there might be some confusion about whether a patent exists in a legal argument. I just do not understand what it has to do with marketing the goods. The patent argument says, 'Here is the chemical content of the innovator and here is the chemical content of the generic.' It has nothing to do with whether it has been marketed.

Mr Myler—That is the point as well. Essentially what 26B(3) is saying is that that is exactly right. But the reality is that there is a therapeutic good that is already listed on the registrar by the innovator with the patent protection, and there is a new therapeutic good which is coming to the registrar through this application by a generic company. In that context, the certificate about whether there is a patent in existence has to relate to the already existing therapeutic good patent that is being held by the innovator. The issue of marketing is next down in the document and, in effect, paragraph 26B(3) does not—

Senator CONROY—It says 'if marketing the goods without the authority'. They are tied together; they are not separate. You say it is further down. There are not two distinct tests; it is the same test.

Mr Myler—Except that the only way you would show that you were breaching a patent would obviously be by marketing the product.

Senator CONROY—I would have thought you would be if you had registered it. That is what I said. If you go to the TGA, you have to say you have—

Dr Lopert—No.

Mr Myler—The registration of it does not—

Dr Lopert—Registration is not an infringement. The test is if it is marketed.

Senator CONROY—Okay, that makes sense. If I want to get certificate B, as I call it for simplicity, I have to sign a form that will ask whether a patent has been granted in relation to the therapeutic good by the innovator.

Mr Myler—Whether there is a patent that has been granted.

Senator CONROY—There is going to be a box that says, 'Has this therapeutic drug got a patent?' You are going to tick yes or no, I presume.

Dr Lopert—That a patent has been granted to somebody else in relation to the therapeutic drug.

Senator CONROY—Yes, sorry; in relation to somebody else. Again, I am confused as to why section 3 is there. That is now perfectly straightforward. If I have created a generic drug, by definition surely I know I am copying somebody else's drug.

Mr Myler—Not necessarily.

Senator CONROY—You can accidentally create generic drugs?

Mr Myler—No.

Ms Harmer—Ms Wyers can correct this if it is technically not right, but the Patents Act allows in certain circumstances for a generic to do activities that may otherwise be considered an infringement of the patent for the purposes of the generic seeking marketing approval. You may be thinking about other circumstances in which it would clearly be a patent infringement to be using a patent, but the Patents Act contains specific provisions relating to pharmaceuticals which allow a generic to undertake certain activities in order—

Senator CONROY—Would that be, say, the testing and development phases?

Ms Harmer—Yes, and applying to the Therapeutic Goods Administration for marketing approval. They can go to the registration phase and the Patents Act foresees that and allows them to do that. It does not allow them to then go the next phase, which would be marketing.

Senator CONROY—I guess I have been looking at it from the reverse angle to the way that Ms Harmer has described it. What you have actually done is given freedom to develop, test and register, and none of that is an infringement of the patent prior to 30 June. It would be only if I actually put it onto the market. You have codified one area where that would be defined as a breach, but I could do all the other things to prepare. I could have it all boxed up in the back of the truck ready to go at midnight on 1 July.

Ms Harmer—It is not quite that straightforward.

Senator CONROY—Okay, help me out.

Ms Harmer—It is allowing the generic company to do those activities that the Therapeutic Goods Administration requires in order to demonstrate quality, safety and efficacy. You could not go beyond that and start manufacturing commercial quantities; it is merely to allow the generic to obtain the registration so that upon expiry of the patent they can then start immediately making commercial quantities.

Senator CONROY—I guess I could take the commercial risk of manufacturing it and if I got knocked back by the TGA then I would have a truckload of stuff that I could not—

Ms Harmer—The Patents Act only allows you to produce the sorts of quantities that would be necessary to discharge the requirements under the Therapeutic Goods Act to obtain registration. Those are not likely to be large commercial quantities; that is merely to satisfy the requirements under the act.

Senator CONROY—If I wanted to prepare for 1 July and I had my TGA approval certificate A, I could have truckloads sitting there ready to go at 12.01 on 1 July. I would not have infringed anybody because I would not have marketed it yet.

Ms Wyers—You would have infringed. It would be an infringement of a patent. A patent gives the patent owner the right to exploit the patent, which basically means they control the making, selling, using and importing. For a specific set of pharmaceutical patents the Patents Act says it is not an infringement of the patent to basically exploit it—that is, to make it and that sort of thing—for the purposes of getting marketing approval through the TGA. So if you were to make commercial quantities ready to go on the next day you would be infringing the patent.

Senator Conroy—A little earlier, we had a discussion about what constitutes an infringement of a patent. I asked you for examples.

Ms Wyers—Sorry.

Senator CONROY—I guess in my mind you did not classify the example of producing enough so it is sitting on the back of a truck ready to distribute from 1 July. I did not describe it in that way—

Ms Wyers—Sorry, that is the—

Senator CONROY—but those are the sorts of things I am talking about.

Ms Wyers—Yes, that would be an infringement.

Senator CONROY—Why would that be an infringement? I am not marketing; I am just ready to market.

Ms Wyers—Because the rights that you have under the patents legislation are the rights to exploit the patent, which include the rights to make, use, sell and do all those sorts of things.

Senator CONROY—Yes, but I am the generic. I am not marketing at this point.

Ms Wyers—No, but you are infringing the patent because the patent owner has the right to control who makes the product and who uses it, sells it or does otherwise. The fact that you are not selling it does not matter. You are infringing the patent by making it. For the purposes of getting marketing approval there are certain limited exceptions to the infringement. It would otherwise be an infringement of the patent to make the pharmaceutical for the purposes of seeking regulatory approval.

Senator CONROY—Would that be the case now, irrespective of the FTA?

Ms Wyers—Yes.

Senator CONROY—That is the constraint I am faced with now, rather than just under the FTA?

Ms Wyers—Yes.

Senator CONROY—Again, I just want to make sure I understand how broadly in certificate A infringing a patent is dealt with. I would be allowed to manufacture enough to take it to the TGA and say, 'Here's what I intend to do'—to go through that process and provide them with a sufficient quantity. Presumably, before I got to that stage, I would have to do some degree of manufacturing process, testing and those sorts of things just to make sure that the drug is exactly what it is meant to be.

Dr Lopert—You would have to have conducted bioequivalent studies.

Senator CONROY—That would be allowed?

Dr Lopert—Yes, because it is preparation for marketing approval.

Senator CONROY—It is preparation for the TGA process?

Dr Lopert—Yes.

Senator CONROY—That would not constitute an infringement?

Ms Wyers—It would not if the processes were the existing ones that allow you to seek marketing approval in certain circumstances, no.

Senator CONROY—The new regime and the old regime are completely consistent?

Ms Wyers—Yes.

Senator CONROY—Concerns have been expressed about evergreening, which I know you have seen many times, and I know you have heard the debates backwards and forwards about that here. I know Senator Brandis is interested in this as well. Where do those concerns arise

from? In your view do they arise from a misreading of the treaty or because they have not yet seen the legislative package and now that it is out people should be able to see it? I am asking the question generically of Mr Deady, Ms Harmer, Dr Lopert or Mr Myler, of anyone who wants to answer it. It is a generic question and, generically, anyone can take it.

Dr Lopert—I am happy to respond to that, at least initially. The issue of evergreening was raised at the roundtable the other day. I made the point at the time that evergreening is a practice that pharmaceutical companies will pursue if they believe it is in their interests to do so. There is nothing in this legislation which either promotes or discourages evergreening. Evergreening is the practice of registering additional patents as a result of slight changes—that is, changes in additional uses, changes in methods of production or changes in the colour or the presentation that a company may seek in order to prolong the patent protection of a product. This legislation neither encourages it nor prevents it; it does not affect it.

Senator CONROY—Is it the case that there is a limit to an evergreen patent process in the US—that is, that you can try to modify it only once or that you can modify for 100 different things: say, red, blue, green, yellow et cetera?

Dr Lopert—No. As I understand it there is no limitation in the US.

Senator BRANDIS—But there would be a general limitation, wouldn't there, at the suit of a commercial competitor? If the fresh application were obviously made on insufficient grounds, that could be challenged by a commercial competitor?

Dr Lopert—Certainly. Ms Wyers is better able to comment than I am but, as I understand it, there are certain bases that you have to demonstrate in order to be granted the patent. But as I understand it there is no limitation in the law in the US that prevents you from seeking additional patents if you choose to.

Senator BRANDIS—Sure.

Dr Lopert—I think there is a commercial disincentive after a period of time, whereby it would not be in the commercial interests of the manufacturer to continue to seek patents on products which have been superseded by later products which are more profitable, for example.

Senator BRANDIS—My point is that this is not an indefeasible right. You can always seek to evergreen the patent by reregistering it and saying that it is a materially new thing, but that is always challengeable by a commercial competitor.

Dr Lopert—Yes, that is correct.

Ms Wyers—Not only is it challengeable, but you must make sure that it meets the requirements of the patents legislation. It will be assessed and granted in the same way as any other application.

Senator BRANDIS—Can the registrar act of his own motion to refuse the reregistered patent?

Ms Wyers—It would not be reregistered; it would be a completely new application. It would be treated exactly like a new application, so it has to meet the same requirements.

CHAIR—One of the origins of the criticisms about evergreening is that the requirement by a generic producer to notify the patent holder that they want to produce the generic drug can trigger evergreening behaviour by the patent holder. That is the objection as I understand it.

Ms Harmer—It might help us understand the background to some of those concerns to know that the US system, as it is applied domestically, is different to the system we have in the legislation in Australia. Under the US system, the innovator company has certain rights to automatic injunctions in relation to the marketing approval process, but our provisions do not provide those rights to automatic injunctions in the marketing approval process. So I think people's concerns are sometimes about the way the US system works as opposed to the way the provisions are drafted and what is in the legislation.

Senator CONROY—So, now that the legislation is out, it may be that a lot of those concerns are reduced. It may not be the case, but—

Ms Harmer—Yes. I think the origin of some of the concerns is the way the US system works and has been applied.

Senator BRANDIS—Now that we have seen the bill, there will be no automatic injunctions under Australian law? As I recall it, that was one of Dr Faunce's issues.

Ms Harmer—There are no additional rights in that respect.

CHAIR—No 'additional' rights?

Mr Myler—The legislation is also drafted in a way that protects the TGA from injunction.

Senator CONROY—It has also been argued that article 17.9.7 limits the government's capacity to grant generic manufacturers compulsory licences for essential medicines in all but national emergencies of extreme urgency. Is that a fair interpretation or a harsh interpretation?

Ms Harmer—That comment has been made in relation to article 17.9.4. But there are in fact compulsory licensing provisions in the FTA, at article 17.9.7, which would allow the government to exercise compulsory licences in situations of extreme urgency. So I do think that is incorrect.

Senator CONROY—I think the argument that has been put is that the definition has become narrower than it was previously.

Ms Harmer—Article 17.9.4 is a provision that reflects our current springboarding provisions—the provisions we have just been referring to—which allow a generic manufacturer to obtain marketing approval prior to the expiration of the patent, whereas the provisions in 17.9.7 relate to compulsory licensing.

CHAIR—I think Ms Harmer answered my previous question by saying that effectively nothing changes. What purpose does the requirement that a generic drug manufacturer notify the patent holder that they want to go into generic manufacture serve?

Mr Deady—I will try to answer that question. This is certainly an area where we have made some additional commitments to the United States under the agreement that would be a change from our current arrangements, as we have described. As part of the marketing approval process, we have put in place this notification requirement. It was a request of the United States. We negotiated hard to come up with a way that we could provide such notification in these particular circumstances and still ensure that the integrity of our system was maintained. That is what we have done here.

The Americans were looking for something much more prescriptive here in terms of notification. We had to ensure that there was sufficient flexibility in this notification process for us to continue to be able to ensure the operation of our marketing approval process and the legitimate entry of generics into the market. That is what we have tried to achieve through the certification process. Again, the one thing that has not been talked about is that these certifications are meaningful. There are certainly significant penalties attached if those certifications are false or misleading—or whatever the language is. So the purpose is to give effect to this notification and linkage aspect, which was something the Americans were pressing for in the negotiations.

CHAIR—Do I take that answer to mean that an American push for something a lot stronger than this notification was broken down to a point where they accepted that the notification could meet their needs?

Mr Deady—Yes, I think that is right. If you look at this article in other agreements like the Singapore agreement—and, again, Ms Harmer can correct me—you see that the language is different. We negotiated hard on this wording to give us that flexibility, and this is what we came out with. The language in the Singapore agreement is more prescriptive than in the same article under this agreement.

CHAIR—We are clear, then, about what we think it means: it gives us that flexibility. Do we know what the Americans think it means?

Mr Deady—You negotiate these things in good faith, and this was certainly thrashed around for a very long time with the Americans. I take great comfort from the fact that it is different from what they have negotiated in other agreements. We have talked before about the template and the nature of the US approach in this area. Moving away from the template is something that is always at the forefront of their minds. So I think that this is an area where we have negotiated the language. They wanted additional wording in this article which we did not agree to. It stands the way it is; that was the negotiated outcome. I think that is the understanding of the United States. That is the language that was agreed to and that we have now given effect to.

CHAIR—I want to make sure I am clear about this flexibility. This will mean, for example, that any jurisprudence the Americans might set up under their preferred set of words in other bilaterals does not apply in the case of the Australian agreement?

Mr Deady—That is right. In fact, I would go further and say the exact opposite—the very fact that the language is different means that any panel would say, 'Hang on. There must have been a reason why the language is different in this agreement.' We would certainly highlight the language in other agreements, if it ever came to it—and that is what a panel's jurisprudence takes into account in these sorts of disputes.

CHAIR—Your use of the word 'flexibility' is related to the ability for us to interpret it in the manner in which you have described. Is that what you are saying?

Mr Deady—Yes, but I think it is more than that. It could have said something different. For example, it could have said that the TGA was the one required to give this notification to the patent holder. It does not say that; it just says that the parties shall provide the patent holder with information. That language is something that the Americans, very knowingly, agreed to. It could say that the TGA should be the one providing this notification, but it does not.

CHAIR—Provision 26B(1)(b)(ii) in the draft bill says, 'The applicant proposed to market therapeutic goods before the end of the term of the patent'. I might be missing something here, but if an applicant proposes to market a generic substitute before the end of the patent then aren't they potentially exposing themselves to a law suit on the grounds of patent infringement?

Mr Deady—Yes.

CHAIR—So why do we need to actually say that in this bill? It seems to me to be manifestly the case that it would be illegal.

Mr Myler—Essentially, it is to implement the provisions of the agreement.

CHAIR—Because we say it in the agreement?

Mr Myler—In the agreement we provide that if you are going to market in a way that contravenes a patent then there should be a notification mechanism, so we have a notification mechanism here. In the US system, that leads to certain automatic injunctions and the like. In our system the language is different; we have implemented it in a different way and it does not lead to those automatic injunctions.

CHAIR—Am I to understand that this means equal treatment for potential patent infringers on both sides of this agreement? This clause seems to create a secondary offence. The first offence would be that you have infringed the patent—and, if the facts prove that, you are gone. The second offence would be that you did not notify the holder, and so there is a secondary offence.

Mr Myler—They would not necessarily be parallel. I suppose you have a situation where either you certify in compliance with this bill that you have notified, in which case you can expect the innovator to commence action to ensure that their patent is not infringed, or you do not notify and you incorrectly certify here, in which case the innovator will no doubt find out about it anyway in a small market like Australia's and commence proceedings and you will be subject to sanction under this for issuing the wrong certificate. So in a sense there is a hurdle. There is an obligation on generics to do due diligence into whether or not there is a patent in

existence. I think that is the benefit that does flow to innovators here. It does not delay the entry of generic medicines onto the register, but it does provide a clear obligation on the part of the generics to do due diligence into the existence or non-existence of a valid patent.

CHAIR—That provision seems to me to be\ saying, 'I'm a generic producer and I'm going to infringe a patent, but before I do so I have to tell you that I'm going to do it.' If you were going to do it, it would seem to me entirely illogical that you would actually notify someone first so that they could take restraining action against you. This is a very arcane debate, because it is a more transparent market than that seems to suggest.

Mr Deady—The point you raise is an interesting one. I believe Mr Myler summed the issue up. Again, I talked about flexibility. We were very mindful of the interests of both the generics and the innovators in this area—which we know is an area of demand from the United States—and the matter of trying to strike the balance that was critical to us. That is why we have crafted the language the way we have. That was very much the first objective. The implementing legislation to give effect to that does so through this certification method and certainly through the introduction of a new offence.

As Mr Myler has said, this penalty has a maximum of 1,000 penalty units. I understand that is significant. It is something that means there is an additional onus on the generics now which they have to meet. We do not believe it is overly burdensome on them and certainly not such that it will delay the entry of legitimate generics onto the market. Nonetheless, it is an additional impost on them, and that is balanced by the rights of the innovators in this area. That is what we have tried to strike here, and I think that is what we have achieved in the first instance through negotiations with the US. We are now giving effect to that through this legislation.

CHAIR—If a generic producer notifies a patent holder that they want to market prior to the expiry of the patent, what would you expect the patent holder to do?

Mr Deady—It seems to me this would be very much a factual matter. The generic would be doing that, I think, in good faith and believing that, whilst there is some aspect of the patent in place, they are saying they are going to challenge it, effectively understanding that if they are wrong the innovator will take them to the courts.

Senator BRANDIS—Or, as I suggested before, it could be done with consent for the payment of a commercially negotiated fee.

Mr Deady—As I understand it and as other experts here understand it, that is the reality that goes on in the real world out there. This is a business commercial activity and negotiation.

CHAIR—That is a constructive way of looking at it. The defensive way of looking at it, if you think the bottle is half empty, is to say, 'This might spark a bit of evergreen activity,' isn't it?

Mr Deady—All I can come back to is that the current law certainly provides for the innovators. If they believe that these products are entering the market illegally then they have recourse. That does not change. They have that recourse now.

Mr Myler—The innovator is, of course, aware when a patent is coming to a close and, particularly in a small market like Australia's, is aware of what generics might be interested in producing it. But they are certainly aware of when their patent protection will end and will make commercial decisions about what they should do.

CHAIR—We have all been made vividly aware of the longer term objectives of the US pharmaceutical industry. That issue has been canvassed here at considerable length, and no-one disputes their objectives. If you put yourself in their shoes, you can see them as the sorts of objectives you would expect an industry subject to a scheme like the PBS to have. An agreement does not end forever those objectives, but it says that at this moment in time between the parties this is the settlement of those issues. You would expect industry lobbies to continue to press for something in the future. However, they have to live with the settlement of the issues as set out in the agreement as it is now. Do you know what the pharmaceutical lobby's view of these provisions is? Are they happy to say, 'Fine, we'll back off,' or do they intend to continue to argue?

Mr Deady—I do not know. We have certainly had some discussions with both the generics industry and the innovators, if that is the right description, following the release of the legislation. I think it is fair to say that both groups are still looking at it very closely and that they understand—and this is me putting words in their mouths—the balance the government has tried to strike here. Both of them probably see some advantages and disadvantages in this area. Certainly no-one has come to us and said that this is unworkable.

CHAIR—Okay, but I was asking you if you have been made aware of what their continuing interest in changing these terms might be.

Mr Deady—Sorry, I misunderstood. No, no-one has come to us and said that. They seem to be satisfied with where we have got to in the negotiations and, now, with this legislation.

CHAIR—Here we come to the disjunction in administrative authority. You have completed the negotiations. This is an area of considerable public concern, and this is probably a question for Dr Lopert or someone else from the health side. Is there any intention to monitor how this clause works out in practice—that is, to monitor whether there is in fact a slowing down of generics entering the market or whether there is in fact evergreening? Is there some way in which, if we were to ask you in a year's time after this agreement has been in force what the effect of it has been, you would be able to quantify its effect?

Mr Deady—I am not aware of any particular monitoring, but I would say that I am sure that the industry will be looking very closely and will not be afraid of making known to the government any concerns they might have in any of these areas. I would imagine that this would certainly be one area that they will look very closely at.

CHAIR—Again, this question is to you, Mr Deady, or to Dr Lopert. Do I understand from that answer that there are at the moment no particular steps being taken by the bureaucracy to monitor the transitional application of this clause to see whether there is an effect on evergreening or on generic drugs coming into the market?

Mr Deady—No. I do not believe there is any intention there. We think this gives effect to the commitments. There is no particular plan to monitor this area that I am aware of.

Proceedings suspended from 4.32 p.m. to 4.49 p.m.

CHAIR—I want to ask a general question while we have the health officers at the table. It is a question that goes to the issue of the independent review and in a different way to the medicines working group. I think it is an important question. I will preface it this way. When we first started these hearings, in a smaller room further up the corridor, on the first night my colleague Senator Conroy spent a lot of time talking to you about how the independent review mechanism would function. If we go back to the *Hansard*, a question was then put: by the time the bills come to the Senate for a vote, will we know the details of how it will function? By extension, I include in this the medicines working group, although I acknowledge the different role it has. We have since asked that question again at the roundtable. The answer as I understand it is: yes, you would like to be in a position to do so and you are bending your best endeavours to that end, but there are necessary consultations with the stakeholders and you cannot be sure that you will have completed that process in time. So the answer is not a decisive answer—yes, the Senate will have that information before it when it is required to vote on this legislation—but an assurance that you will try to have that information there. Is that still the position?

Dr Lopert—Yes.

CHAIR—Right. Have I accurately portrayed it? I am not trying to get it right or wrong, I am trying to understand it.

Dr Lopert—If I could clarify, that is certainly the case in relation to the operation and implementation of the independent review mechanism. It will not be the case in relation to the terms of reference, for example, or the timetable for the medicines working group, which will presumably not be explored until entry into force of the agreement. It is not anticipated that the medicines working group would meet before that time.

CHAIR—The question is not about when these bodies might be convened but who will be on them, what their terms of reference might be—the more and better particulars request that has been put before you.

Dr Lopert—The composition of the medicines working group will, as we have said, be made up of officials from relevant government departments. The precise way in which the terms of reference will be progressed is not entirely clear but I imagine at the first meeting of the medicines working group it will determine its terms of reference.

Mr Myler—Or certainly when it would finalise. We will not be able to agree terms of reference with the US side of that medicines working group until we have met. We will not meet until after entry into force of the agreement.

CHAIR—I see. That is the intention. It was about three months ago, or it feels like it, that we first put this question to you. It is about a month from now that the Senate will be reconvened at the end of the winter recess. It is for the government to decide when the enabling legislation

comes before the Senate, but it would seem that the government wants to do that promptly, so I imagine we would get the bills in the first week.

Senator BRANDIS—I think that is a pretty safe assumption.

CHAIR—I am trying to make safe assumptions. There is roughly a month between now and when the Senate would be able to deal with the bills. Will you be able to complete your consultations and advise the Senate about the details concerning the independent review by then?

Dr Lopert—A working group has been established, comprising the PBAC, Medicines Australia and a consumer representative, which is working towards a consensus on how this can be implemented. They have already met. They are progressing this and they will meet again shortly. It is as an issue of best endeavours that the working group will complete its deliberations by the end of this month. Further consultation will then take place with a view to having that process finalised within the time frame that you have indicated, but I cannot provide a guarantee that that is the case.

CHAIR—So the answer remains the same, but you will provide us with a bit more information about how the best endeavours are being given effect to?

Dr Lopert—That is correct.

CHAIR—I do not know what the recommendations of this Senate inquiry will be. We have not conferred on whether there is even a possibility of a common recommendation, so I am not in any way foreshadowing what the recommendation might be or what is in the minds of this committee. Let me put it this way: an option for this committee could well be to say that we would support this legislation subject to the information we require about delegated legislation involved in this agreement, which in part goes to the independent review, being made available so that we can understand more fully how that body will function, who will be on it, what their powers will be and the terms of reference. In that case, if the Senate took that view, whether this agreement went ahead would be entirely up to your providing that information. That is an option—we could do that. To allow me to ruminate on that, can you tell us when you expect to be in a position to provide the information we have sought?

Dr Lopert—It is certainly the intention to provide that information within the time frame that you have indicated, but it is a matter of best endeavours.

CHAIR—I know. Can you tell us, though, when you expect to complete this exercise and to be in a position to answer the question we have put?

Dr Lopert—I can only say that the working group that is currently looking at these issues expects to complete its deliberations by the end of July and there will be requirement for some further consultation with the broader array of stakeholders in order to complete that process. But it is understood that that needs to be done in a timely fashion.

Senator CONROY—The Prime Minister has been very critical of the length of time it is taking the Senate committee to reach its conclusions and to present its recommendations. We

have been dealing with the entire agreement—your working group is taking longer than the Senate committee, and you are only dealing with one tiny portion of the agreement.

Mr Deady—I will jump in here. I do not think Dr Lopert can add much more than what she has said. I do know that the health department, and ours to some extent, have been in consultations on this issue almost immediately following our return to Canberra after the negotiations. It has been an important issue right through the discussions both between the JSCOT hearings and reports and your own. As Dr Lopert said, there is a working group already looking at the industry in Australia and at the PBAC. As I understand it—and Dr Lopert said it again—they are making good progress on this. But that is as much as we can say. It is a complex and sensitive area. I do not think it is unreasonable that these things be worked through very carefully, and that is what is going on.

Senator CONROY—As you would know, I was in the US recently and I met with Ambassador Zoellick and our ambassador, Mr Thawley. The best indication two weeks ago was that the deal would go before the US Congress sometime in the first two weeks of July. I understand there have been a few hiccups over in the US. The Senate committee voted, though in a non-binding vote, and that has caused a bit of a stir. What is your best intelligence, rather than your best guess, on when the likely vote in the US Congress will take place?

Mr Deady—It is pretty much as you have described it. I do not think we are getting anything much more than what you have said. It did go through the Ways and Means Committee in the House and the Finance Committee in the Senate. As I understand it, that process was completed before they went off on their 4 July break. As I understand it, the mock mark-ups, as they call them, happened and the next step is for the administration to bring forward the legislation. I understood the intention was to do that immediately following the resumption after 4 July.

It then goes back into the congressional process and it really is for the congress to determine just how and when they will precisely take those things forward. But certainly all the indications that I have seen from Washington are that that is expected to happen in the month of July. Again, I am not absolutely certain of the dates, but I think the Democratic convention is something like 26 or 27 July. So clearly that third week of July would be the last week that they will be sitting, as I understand it.

Senator BRANDIS—So you think it likely that we will know the fate of this agreement in the American Senate before our Senate is next scheduled to meet?

Mr Deady—I believe that is the case. But I always put the caveat here—I think I have to—that it is really for the US Congress.

Senator BRANDIS—Of course.

Senator CONROY—We are just asking for your best intelligence on it.

Mr Deady—Certainly all the indications point to that. You are right: some issues came up more in the US Senate than the US House. But, as I understand it, certainly those were worked through such that the legislation could be brought forward.

Senator CONROY—Do they have a process that it has to go to one of their chambers before the other? Can they both deal with it at the same time?

Mr Deady—I believe that it is the House that deals with it first.

Senator BRANDIS—But the US Senate also votes on the treaty itself?

Mr Deady—Yes.

CHAIR—The problem in that timetable is that it comes up at the end-of-session stampede before a presidential campaign kicks off. There is a lot of other legislation jockeying to be dealt with by the congress at the same time. Ultimately it depends on two things: the willingness of the congress to pass it—and there has been a lot of speculation about that; and the ability to get a slot in the program to be passed. That is the other element to it, which is a bit unreadable.

Mr Deady—It is never certain; I agree with that. All I would say is that very clearly the administration is pushing it very hard. There are obviously discussions going on between the administration and the leadership in both the US House and Senate. The other point I think is that on this one we have seen bipartisan support for the Australia-US free trade agreement being taken up in July. So that is certainly encouraging. As you say, it is not a fait accompli until it happens.

CHAIR—I was interested to see Senator Kerry say that he was in support of it because the US had a bilateral trade surplus with Australia and this would improve it. But let us not get into that debate. All I am saying about the independent review in putting that admittedly hypothetical prospect forward is that I just draw the attention of the government, through the officers, to the large body of argument in the Senate about delegated legislation and the traditional position the Senate takes on that matter. I will also make the perhaps unnecessary observation—but I will, nonetheless, make it in passing—that it looks very odd if there is a major campaign on strengthening Medicare but you cannot answer the question of the composition of the independent working group.

Senator CONROY—I wanted to explore some issues around IP. Concern has been expressed that the IP provisions in the FTA shift the balance of interests away from innovation and consumer rights towards the owners of copyright. Do you have a view on that?

Mr Deady—I believe very much that the aim here was to ensure that that very important balance between the rights of property holders and those of consumers was at the forefront of our mind and there were instructions from the government in these negotiations to ensure that the balance was maintained, including in the IP chapter. We have taken on some additional commitments, certainly, in the copyright area.

Senator CONROY—What are the additional commitments?

Mr Deady—The clearest one is the extension of the copyright term from 50 to 70 years for copyright material. That I think is the single biggest concession that Australia made in the negotiations. There were also some additional commitments in relation to anticircumvention and some of those areas where we have made some additional commitments to the United States.

There were also some changes made to clarify the relationship between ISP providers and copyright holders. That is how I would summarise the three main categories.

Senator CONROY—The 50 to 70 years and the anticircumvention measures sound as if they were to enhance producers' rights, if I could use a very old-fashioned phrase. Where was the balance for consumers? As you seem to have described it, your orders were to maintain the balance. If these two things happen, where are the other things to maintain the existing balance?

Mr Deady—Firstly, dealing with them one at a time, I think the extension of the copyright term clearly is an advantage to copyright holders and owners. We had the debate earlier today about what the costs to Australia will be as a result of that copyright extension. That is a debate that we have had and I will not go back over that ground. The point here, though, when you are talking about the balance, is that we are a net importer of copyright material—and that is not at issue—but at the same time we do have very active creative industries that would benefit from the copyright extension. One example is the audiovisual sector. As you know, there may be some concerns about aspects of the audiovisual outcome amongst the cultural industries but they certainly welcome the extension of copyright term, for example. There are some groups within the Australian community and economy that certainly see some of the benefits that accrue even from something like copyright extension. We had this debate about what are the actual costs. There would be some—there is no doubt about that—with copyright extension, but we do not believe they would be that great, and there are those offsetting gains.

As for the other areas, and I will hand over to the experts if I can, my general comment is that it was about trying to ensure that we did maintain this balance. What we worked very hard to negotiate in the agreement is flexibility through the capacity for Australia to introduce exceptions and to take into account our own circumstances. The IP area, and I said this yesterday over in Perth, was certainly an area in which the US were the demanders. They were pursuing us in this area of the negotiations, so the important thing for us to do was to maintain this overall balance and also to ensure that anything that we did agree to would still allow future Australian governments to maintain that balance. That is what we have worked very hard to do.

Another point that I would like to make here is that it is about reflecting our own circumstances in a situation where the Americans recognise that we already have a strong IP regime and they were not starting from a situation where they had huge problems with piracy or other aspects of Australia's regime. So that is really the starting point and I think that is reflected in the agreement in the way that we have negotiated exceptions: the various footnotes in other parts of the agreement that actually acknowledge that our own system does in fact very much meet the requirements that the US were trying to get. That is what we have tried to achieve. The other area that I should mention is enforcement and some of the additional aspects of that on which we also made some commitments.

Senator CONROY—I accept the point you made about Australia's own circumstances. But, if your instructions were to maintain the balance, presumably therefore the balance was something that people were comfortable with. However, concessions have been made with the change from 50 to 70 years and anticircumvention measures and the balance has been changed, so we have not maintained the balance.

Mr Deady—I will try to answer that in this way. Yes, we were certainly trying to maintain balance in this area with flexibility for government to take account of the legitimate interests of both IP rights holders and consumers. That is what I mean when I say we are trying to ensure the capacity of future Australian governments to maintain that balance between those respective rights. When you talk about balance, if you mean balance in the overall agreement that is something that is part of a wider question and at the end of the day that is the decision that the government takes on the basis of the overall negotiations.

As I say, in this area, it is about the consumers and rights holders. I come back to the 50 to 70. Yes, there is some additional cost to consumers as a result of extension from 50 to 70 years. How big that is is something that we can talk about. Equally, though, if you look at the creative industries in Australia they see some gains in that area. So it is very difficult to be very precise in terms of absolutes in this. I think it is a matter of giving future Australian governments the capacity to intervene under an IP regime to ensure that rights are protected and the interests of consumers and universities and other users are also able to be taken into account by governments.

Senator CONROY—Would you say that we have aligned our regime with the US?

Mr Deady—In some of the things that we have done. The 50 to 70 years change is certainly an alignment of our regime with the United States. In certain aspects, yes, we have moved towards the US system, if you like. Again I would say that the 50 to 70 years is not just the US system. That is basically the copyright extension in most of the developed world now—certainly in the EU and other countries. So it was not just that we are moving solely to something that the Americans have identified as a standard or a norm. In other areas I think this is important. I know it is an important question you are asking. I would say that, whilst we have strengthened and made commitments in these areas, the very fact that that goes along with the ability for us to introduce exceptions and other measures to take account of our own circumstances means that we have not imported holus-bolus the US system. I think that is the critical thing. While we have toughened up in certain areas, we have maintained flexibility to ensure that we maintain a strong IP regime. That is important for innovation and other things, but it has to be balanced with the interests of consumers, and that is what we have tried to achieve.

Senator CONROY—Some people are actually arguing that the regime we are going to end up with because of all of these changes is actually a tougher regime than they have currently got in the US.

Mr Deady—I have seen that. I do not understand that. Maybe my colleagues will correct me if I get this wrong. I do not believe that. Firstly, it is an agreement that applies clearly to both countries. It means that we are not importing the US system completely, which we could have done.

Senator CONROY—I think if we had imported the fair use definition, then you would have had a slightly less tough—

Mr Deady—There is nothing that would stop a future Australian government from incorporating that. That is a decision still for the Australian government to take. There is nothing in the agreement that precludes that. It seems to me it is preferable for us to have the flexibility

to look at our own circumstances rather than import completely a system that works for the United States. I believe that is a real plus from the agreement, that we have not just—

Senator CONROY—I think that is what is behind those people that say we have ended up with a tougher regime than in the US, because we do not have as liberal a use as their fair use regime. I think that is what is behind what they say. Maybe I have misunderstood it.

Mr Deady—If they are saying that, I think that they are wrong, because there would be nothing to preclude us from doing exactly that if we—

Senator CONROY—No, they are not suggesting that we are precluded. They are saying the inertia in delivering a fair use has been what leads them to that statement. I will move on. Does the FTA condone the practice of regional coding so that DVDs and DVD players can work together only if purchased in the same region?

Ms Harmer—There is nothing specific in the IP chapter that discusses the issue of regional coding. I know you have asked questions about that, which we have taken on notice and we have outstanding. I think in answering those questions we will probably answer the question that you have just asked. I guess you have put 'condone' there in a positive sense. Does it positively say regional coding is good? No, it does not say that.

Senator CONROY—Are we required under the terms of the agreement to ban the facilitation of such practices—matching them up, buying one overseas, bringing it in, ordering from Amazon.com a DVD and playing it on a DVD that I bought in the US?

Ms Harmer—The anticircumvention provisions really go towards piracy rather than viewing what is a legitimate copy of copyright material. The anticircumvention provisions I think have to be seen in that context. They are not really aimed at stopping people from carrying out legitimate copyright activities.

Senator CONROY—In your view there is nothing in the FTA that would undermine Australia's parallel import scheme for books and CDs?

Ms Harmer—No, there will be no change to Australia's parallel importation laws as a result of the FTA.

CHAIR—I want to go back to the questions you have on notice. It is some time now since they have been on notice. I was a bit surprised they were taken on notice and were not answered at the time. They are on notice; that is fair enough. We want you to be confident about your answers. If they are not given to us in a timely fashion, we cannot examine you on them. If we cannot examine you on them, we get awfully nervous about construing the meaning.

Senator CONROY—Not that we are conspiracists.

CHAIR—No.

Ms Harmer—I understand.

CHAIR—Seriously, this is the biggest chapter in the whole agreement. It is probably the one less tractable than any other to construe, in a way, because I think the headline objectives of the United States are in this chapter. It is not likely to be ameliorated in any way, so we would like to understand more comprehensively how it applies. Is there a time in which you will be in a position to answer those questions?

Mr Deady—Perhaps I should answer that. We are working to complete those questions on notice as quickly as we can. I believe we are in the final stages of doing just that. We will certainly get those to you in as timely a way as we can. We have spent a lot of time on them, and it has involved Ms Harmer and colleagues from other agencies going through and finalising the questions. We do realise the complexity, certainly in this area, and we do want to get the answers complete and comprehensive for you. That is what we are working towards, so we will get them to you as soon as we can.

CHAIR—I do not want to be unreasonable. I want you to have the time to get the answers right, but then we have to have the time to digest the answers, which will help us when framing our recommendations. It might be that if we complete the formal hearings tonight, as I would hope we do, we might have to confer with the government to see whether, when we get the written answers, there is an ability to offstage, if you like, and talk to you in order to obtain a better understanding of what the answers mean, if we are in any doubt about them.

Senator BRANDIS—Speaking as a government senator, Mr Deady, government senators would find it enormously helpful if this issue of concern about alleged delay in providing the answers were taken off the table.

Mr Deady—Yes, we understand and I hear what you are saying. We will get those to you as quickly as we possibly can.

Senator CONROY—I want to go back to the issue of regional coding. I know you have taken them on notice, so you are not saying anything about regional planning. Regional coding is an avenue for undermining parallel importing. Is that a fair description?

Ms Harmer—No, I am not sure that I understand quite how you would see regional coding as undermining parallel importation.

Senator CONROY—If I wanted to import a DVD from the US and I have an anticircumvention device that I want to use that would allow me to play my DVD on my Australian DVD player—

CHAIR—This is one of the elements of the ACCC's concerns.

Senator CONROY—and the FTA impacts on my capacity to use an anticircumvention device—

Mr Creswell—This might sound like I am not addressing front-on what you are asking, but there is no parallel importation of audiovisual material at the moment. It is sound recordings and computer software.

Mr Cordina—It does not cover books either. There is no parallel importing there.

Mr Creswell—There is modified parallel importation of books; it is a more restrictive regime.

Mr Cordina—It is allowed on computer software and sound recordings.

Mr Creswell—Software includes some video games, does it not?

Mr Cordina—Yes.

CHAIR—The question is right, is it not? If area coding of his machine to download those items prevents him from doing so, it thwarts the objective of parallel importing. If he uses an anticircumvention device to get around it, he is probably committing an offence.

Mr Cordina—As Ms Harmer indicated earlier, the objectives in relation to the anticircumvention provisions are aimed at piracy not legitimate imports of non-infringing material.

Senator CONROY—In your view, am I committing piracy if I log onto Amazon.com, import a DVD from the US and have a circumvention device that gets me around the regional code block?

Mr Cordina—It is not aimed at non-infringing copyright material. So if that was created under a licence and it is not pirated material then the obligations of the FTA are not aimed at that type of material. It is aimed more at the pirated material.

Ms Harmer—Perhaps I could just clarify this. In the questions on notice we go into a bit more detail about the regional coding issue and the anticircumvention provisions. I think as a general statement it is fair to say that we do not anticipate major changes to regional coding and how that is treated in Australia. I think that is a fair assessment.

Senator CONROY—I have an example which you might want to take away and come back to me on. At the end of March, the Sony PlayStation game *Harry Potter and the Chamber of Secrets* could be purchased online for $US19.95 from the US or $A99.95 here in Australia. Using the exchange rate at the time, the equivalent price in the US was around $A26.80—compared to what Australians had to pay: $A99.95. If regional coding prevented Australians from buying online from the US, the FTA could potentially—and I accept the point you make about piracy—work against the interests of Australian consumers. What we are looking for is an understanding that this is not going to be the case—that is, that we can employ an anticircumvention device here in Australia to get around the regional coding.

Mr Creswell—I think there are two comments to be made in response to that. As I understand it, what you are talking about is a film rather than a video game.

Senator CONROY—I am talking about a Sony PlayStation game.

Mr Creswell—Okay. There are a couple of other things to be said. First of all, if you order it online so that you downloaded from a US based site then that would not really involve parallel importation because that is concerned with the physical item rather than—

Senator CONROY—Let us assume that I actually ordered a physical copy from, say, Amazon.com. So I order it and they send it to me in the mail. It would be regionally coded because it was bought in the US, and I would not be able to use it on my Sony PlayStation here in Australia, so I would need to employ a circumvention device. Am I in trouble?

Ms Harmer—As I said, the government is not anticipating significant changes with respect to regional coding. I guess that conclusion assumes that circumventing that regional coding in that circumstance would fall foul of the provisions.

Senator CONROY—It would?

Ms Harmer—It seems to me that your assumption is that it would and therefore—

Senator CONROY—I am asking you to clarify whether it would or not. Will the FTA affect my ability to use that circumvention device?

Ms Harmer—I am saying that it is not the government's intention to significantly change our existing provisions relating to regional coding.

Senator CONROY—Is that a yes or a no?

Ms Harmer—It is a no.

Senator CONROY—Will my using a circumvention device in this circumstance be an offence once the FTA has come in?

Mr Cordina—In relation to pirated material, certainly. I think Ms Harmer is saying that the viewing of non-infringing material is still regarded as a legitimate activity, and the intention is not to affect that type of activity; the intention is more aimed at the pirated product.

Senator CONROY—More aimed at?

Mr Cordina—Sorry, I mean that it is aimed at the pirated product.

Senator CONROY—I am not trying to be critical, but you are not being very definitive. You are saying, 'This is the intention.' You could make a statement, 'No, you will not be caught by this and you'll be fine, Senator,' so that I can get back onto Amazon.com and order *Harry Potter and the Chamber of Secrets* tonight.

CHAIR—Or you can point us to exactly how it will be. Can I just say that we often get evidence about what is intended, what the objective is. One of the things that occupies the time of the legislature—inordinately and at length—is whether or not the bills conform to the objectives. One of the big issues about legislation is: are there unintended consequences? This is what the Senate takes seriously. We are simply looking for reassurance that there are no

unintended consequences and an understanding of how the legislative position meets the objective. That is what I think Senator Conroy is asking.

Senator CONROY—That is a fair summation.

Mr Cordina—These will be dealt with more comprehensively in our responses to the earlier questions on notice. I am not sure that there is more that we can add to the statements we have just made.

Senator CONROY—If no-one wants to go any further on that, I am happy for you to incorporate that question with those already on notice so that you can assure Australians that they will be able to buy the Sony PlayStation game *Harry Potter and the Chamber of Secrets* cheaply. In Australia the trend has been towards removing restrictions on parallel importation of things like books, CDs and software. I think they are now all permitted.

Mr Cordina—Not books.

Senator CONROY—I thought we had parallel importation on books.

Mr Cordina—There is a 30-day rule. They cannot be parallel imported for the first 30 days following their publication overseas, then they can be. It is a more limited form of restriction.

Senator CONROY—Article 17.9.4 states:

Each Party shall provide that the exclusive right of the patent owner to prevent importation of a patented product, or a product that results from a patented process, without the consent of the patent owner shall not be limited by the sale or distribution of that product outside its territory, at least where the patentee has placed restrictions on importation by contract or other means.

That is a mouthful, and I am not absolutely sure that I understand it. Does that article prevent future changes to Australia's laws that might permit parallel importation of a product protected by a patent?

Ms Harmer—Previously we were talking about products protected by copyright. This provision does go some way towards the parallel importation issue with respect to patents but only where—

Senator CONROY—Does that mean it goes some way towards blocking the capacity to allow parallel importing?

Ms Harmer—Yes, but in circumstances referred to in that last phrase, where a patentee has placed restrictions on importation by contract or by other means. Ms Wyers can correct me, but I think it is fair to characterise our domestic legislation as going further than that in preventing parallel importation of goods covered by patent.

Ms Wyers—Yes, there is nothing that actually allows it.

Senator CONROY—So we would no longer be allowed to parallel import?

Ms Wyers—You will not be allowed to parallel import where the patent owner has put restrictions on that importation by contract.

Senator CONROY—Would the definition of parallel importing exist if it were not for the fact that there are patents? I am not trying to sound silly, but if you are banning things that are under patent, by definition that is almost entirely what parallel importing is. It is getting round a licence holder domestic monopoly, because they are charging too much, and importing the patented good or licensed good in Australia for a cheaper price from overseas. That is what it is, isn't it? If I am wrong, please help me.

Ms Wyers—The patentee can generally control importation of goods. But there has been consideration to the fact that they do not put a restriction on the goods, when the rights as a patent owner to have them sold has been exhausted.

Senator CONROY—If we can just leave piracy as a separate issue, just say I am the licence holder for Sony PlayStations and I do not want you bringing in ones that have been licensed from the US or anywhere else—but from the US for this purpose. If the government legislates to try to allow importation, I will be able to turn to the provisions of the FTA and say, 'No, you can't import Sony PlayStations from the US, because I've got the licence and the copyright.'

Ms Wyers—If it is protected by patent. This applies only if you have a patent.

Ms Harmer—Not copyright.

Senator CONROY—I just want to make sure I do not have those two things mixed up. I understand that there could be a difference, so please take me through it.

Ms Harmer—This provision applies only to products where there is a patent.

Senator CONROY—So, with CDs, if Mushroom Records release a CD here in Australia and they license somebody else to produce it for them in the US, is that a copyright issue?

Ms Harmer—Yes, that would be a copyright issue.

Senator CONROY—Rather than a patent issue?

Ms Harmer—Yes, that particular sound recording—the CD—is protected by copyright. That is the relevant right that the owner will be seeking to exercise.

Senator CONROY—So the patent right that you are talking about will not cut across or be equivalent to copyright—copyright equalling licensing?

Ms Harmer—A patent protects something different to what copyright protects. A patent protects the invention, whereas the copyright protects the—

Senator CONROY—Senator Cook suggests software. Say I create *Harry Potter and the Prisoner of*—

CHAIR—Parliament House?

Senator CONROY—Thank you. I have a patent on it here in Australia and I let someone license it over in the US—and I am charging $100 for it here. If I order it in from the US, the FTA will stop me. So a consumer cannot get on the Net and order it in and the government cannot say, 'No, we're going to allow that software to come in from overseas'?

Ms Wyers—Not if it is protected by a patent. But you cannot actually do that under our existing law anyway.

Ms Harmer—It is not so much an effect of the FTA; it is an effect of the operation of our existing Patents Act.

Senator CONROY—But the point is that the government will be legislating to allow it to happen—which would mean that it would be changing the act—but, under the FTA, I could not make those changes.

Ms Harmer—At least in circumstances where the patentee has placed restrictions by contract. That is the proviso.

Senator CONROY—I will go from the word 'patent' to licensing—which is the issue I was trying to get to when you drew me to copyright rather than patent. If I have a patent I can license someone. If I say that the only person who can distribute my software in Australia is you, and Senator Cook does not like the price that you are charging and he decides to get it on the Net, he is in trouble at the moment under our existing laws if he tries to import the item en masse. So he could not do it at the moment en masse but, if the government decides that it wants to facilitate Senator Cook importing these products—which are properly licensed in the US—but I can bring them in and sell them at half the price and still make a profit, that will not be allowed because of the FTA provisions. Is that right?

Ms Wyers—That will not be allowed by the FTA provisions if you as the patent owner have put restrictions on what the person who is making them overseas can do with them in terms of being able to license them.

Senator CONROY—So I cannot sell them to somebody who can then import them to Australia? How do I keep control, after I have sold them, over the American customer who buys them from my licensee? How do I enforce what they do with them?

Ms Wyers—You have a contract with them.

Senator CONROY—But they have bought them. Say someone walks in and says, 'I want to buy all your stock.' Do you say, 'I'm not going to sell you all my stock unless you tell me what you are going to do with it'?

Ms Wyers—I am not familiar with how the contracting—

Senator CONROY—You are suggesting that this is a restriction. You are suggesting it, so—

Ms Wyers—I am saying that if the patent owner puts restrictions on importation then that sort of importation is not going to be allowed under the terms of the FTA.

Senator CONROY—That sounds fundamentally uncompetitive.

Ms Harmer—But if the patent owner has not placed those restrictions in that particular contract then parallel importation can occur.

Senator CONROY—It is not the person that he has contracted the licence to that would then be reimporting them. He has just sold them to somebody who has bought his whole stock. Suppose Wal-Mart decided to buy his whole stock of my new Harry Potter game and then decided that they could make a profit by selling them to Kmart in Australia. Wal-Mart is not the person he can sue. The restriction does not apply to Wal-Mart; the restriction applies to the agent he has licensed.

Mr Creswell—I do not know if this bears centrally on what you are driving out, Senator Conroy, but if it is the issue of patent control over software then my understanding is that the more usual forms of consumer—

Senator CONROY—The issue is patent control where the patentee has placed restrictions by contract.

Mr Creswell—Is it software that you are concerned about or patents in general?

Senator CONROY—I picked software just to try to give it a—

Mr Creswell—In the particular case of software, my understanding is that the most software in Australia still relies for intellectual property protection on copyright rather than patents. Ms Wyers can better answer this as regards Australia and the US. Not much of the typical custom software, such as word processing and games applications, would rely on patent protection. In most cases it would be copyright protection.

Senator CONROY—I know that I am not an expert in this area; I appreciate that. Let us say it was a drug, then. Without wanting to wander into the PBS debate, let us say it was a drug and I licensed somebody to produce it in America. This is the cross-border issue that the Americans and the Canadians have. This FTA would stop a company buying the good in the US. The government could not then say, 'Okay, you can import that drug back into Australia.'

Ms Harmer—There is a secondary issue. You cannot sell a drug in Australia without marketing approval. Through the marketing approval process you have to have a sponsor for the drug. So, effectively—

Senator CONROY—I have picked a bad example.

Ms Harmer—the Therapeutic Goods Act would also operate to prevent that.

Senator CONROY—I picked a bad example; I accept that.

Mr Deady—There are health policy issues in relation to this—

Senator CONROY—Sure. As I said, I do not want to go back into health; I was just picking an issue. But you have shot me down in flames, so I am going to move on. I do not know that we are going to get anywhere with that. I think that fundamentally the answer is yes.

Mr Deady—Senator Conroy, I probably cannot help. We have had discussions before on this IP area. The sorts of questions you are raising—as Ms Harmer has said, this is getting back to DVDs and regional coding. We are talking about pirated products here, and that is what we are trying to toughen up our regime to fix. There is nothing in the agreement, as I understand—

Senator CONROY—It is not just pirated products. The FTA says:

… at least where the patentee has placed restrictions on importation by contract or other means.

That does not suggest just piracy.

Mr Deady—We are talking about—

Senator CONROY—Unless I am licensing a pirate.

Mr Deady—But we have to identify what the real world situation is, and what are the products that we are really talking about here? I think you have identified the ones that people are concerned about. Okay, it is DVDs and games, which are not—

Senator CONROY—Yes, but this is about an agreement into the future. This is about products that have not been produced yet.

Mr Deady—I still think it would be copyright that we are talking about rather than patent protection. That is where the practicalities of the agreement that we have got with the United States really come to bear on what we have done in relation to copyright that will impact on the ability of Australians to access—as in the sorts of questions you have raised—legitimate product through machines that are bought, purchased and operated in Australia. That, I think, is the question that you started with. As Ms Harmer has said, the way we have negotiated this agreement and the way the legislation and the other things will be put in place, including the development, as I understand it, over the course of the next couple of years the various exceptions that we have the capacity to introduce, we will ensure that where Australians are genuinely using a legitimate copyrighted material they will have the ability to access that non-pirated material. This is about disciplines and strengthening the disciplines on pirated products rather than genuine copyright material. As I understand it, that is what we have tried to ensure through the various clauses of the agreement, including, as I said at the beginning, the exceptions that we have allowed ourselves to be able to make use of.

Ms Harmer—The other point I would add to that is the comment about it being copyright goods that are of concern and not so much patented. That is very much why the domestic debate has been around copyright related products and parallel importation, and we were very careful in the FTA negotiations to ensure that we maintained that ability.

Senator CONROY—So there is nothing in the FTA that prevents an amendment to Australia's copyright acts to allow consumers access to devices that would allow them to enjoy legally obtained software, such as games or DVDs, from overseas both now or in the future? I have asked similar types of questions to that and you have taken them on notice. I am happy if you want to take that on notice, but what you seem to be suggesting is, no, you do not think so; that should be fine.

Ms Harmer—I am saying that the government does not see any significant change in our provisions relating to regional coding. The other point I was making was the one about parallel importation specifically, and that was that we very clearly retained the ability to provide for parallel importation with respect to copyright goods where that was considered appropriate.

Senator CONROY—What advice did DFAT receive from other departments about changes to Australia's IP laws as a result of the FTA? Have you consulted with other departments: Attorney-General's Department, Department of Communications, Information Technology and the Arts?

Ms Harmer—My colleagues from those departments were actually part of the negotiating team, so they were involved throughout the negotiations.

Senator CONROY—Does the FTA prevent interoperability amongst different products thereby preventing consumers from purchasing hardware and software from a range of companies at the lowest price?

Ms Harmer—The anticircumvention provisions of the FTA contain a specific exception for interoperability.

Mr Cordina—They allow reverse engineering of computer software for the purposes of allowing interoperability between various computer software products.

Senator CONROY—They do allow that?

Mr Cordina—There is a specific exception to allow reverse engineering for the purposes of interoperability.

Senator CONROY—'Reverse engineering'—that is a new term for me. You are going to have to help me out.

Mr Cordina—As I understand it, reverse engineering is where you get a computer program in a high-level coding language and you take it back to its lower level language so that you can see the way the software interacts with other software and you get, for instance, interface specifications so you can see what types of keys are necessary to allow that particular software to interact with another piece of software. That then allows you to develop a product which can interface with the original software product.

Senator CONROY—So you can put together a piece of hardware and a piece of software and you can design something in the middle that allows them to work together.

Mr Cordina—The hardware would include some software in it. It would have a chip.

Senator CONROY—So the hardware has a bit of software that it sort of plugs into if they are from the same company, for instance. But if I wanted to go into Dick Smith and buy two different bits, am I allowed to purchase something that allows that interoperability?

Mr Cordina—You are allowed under the exception to reverse engineer the original product so you can develop a competing product, if you like, to interact with that first product.

Senator BRANDIS—I think Senator Conroy's question is simpler than that. Leaving aside the issue of reverse engineering so that you are not talking about developing a new product, among existing products is there anything in the FTA to prevent interoperability?

Mr Cordina—Not that I understand. There is no specific requirement to prevent—

Mr Creswell—If you are not making a copyright use, if you are not making a reproduction of anything, but you are just plugging something in or twiddling with wires or hardware or whatever to make the things work with each other—

Senator CONROY—Probably I am going the next step as well. To make a piece of hardware compatible with a piece of software, can I design some software that allows them to plug in together and, more importantly, can I market that?

Mr Creswell—If it is original, if you have designed the software, then you are the author of that software in the eyes of the copyright law. If you have substantially copied somebody else's then you are perhaps in infringement territory there.

Senator BRANDIS—But you would be anyway, irrespective of the FTA.

Mr Creswell—Yes.

Mr Cordina—That is right, yes.

Senator CONROY—I am not sure who drew the short straw and had to read all of the transcripts of our other Senate committee hearings on this, but this is of concern to the open source industry in particular. They argue that the FTA will enable large US companies to acquire proprietary rights over the code, thereby making open source systems illegal. Does the FTA pose a threat to Australia's open source industries? If you have had a chance to read the *Hansard* on this, can you give us a response?

Mr Cordina—There is a patents and a copyright issue in relation to open source.

Ms Harmer—I may be incorrect, but I think the concern about the proprietary rights in relation to things actually relates to a concern about patents and the open source software industry having a concern that the FTA will allow the granting of software patents where they have not previously been able to be granted in Australia.

Senator CONROY—I think it is something along those lines, yes.

Ms Harmer—In fact, the FTA makes no change to our existing provisions with respect to the granting of software patents by the patents office. They are business as usual in that sense. The FTA is not going to make any change to the way the patents office goes about granting patents or to what is patentable.

Senator CONROY—I am sure it is not going to make any changes to how the patent office determine a patent, but it is a question of what is patentable. In your view, there is no change?

Ms Harmer—No.

Senator CONROY—Software is just codes based on maths; that is my understanding. It has been a long time since I did any of this, but I have very good advisers. Isn't it the case that the EU specifically forbids patenting of software and has continued to defend that position, despite ongoing pressure from US companies?

Ms Harmer—I will ask Ms Wyers to comment on that. I am not much of an expert on EU patent law.

Ms Wyers—No, I cannot. I am sorry. I can find out for you, but I do not know what the EU position is in relation to software patents.

Senator CONROY—But you concur that this agreement, our FTA, does not enable the patenting of software?

Ms Wyers—It does not alter what is patentable. We actually grant patents for software in Australia and have done for some years. Again, that is provided they meet the requirements of our legislation. We do not prevent patenting of software.

Senator CONROY—Are there any provisions in the FTA that could give the open source industry certainty that they will not be affected in any way by the agreement? Or is it just completely silent on this whole issue of patenting software?

Ms Wyers—There is no specific reference to patenting software at all.

Senator CONROY—So there is nothing we can point to and say, 'No, you guys are completely wrong and you've just misunderstood'? It would be easier if there was.

Ms Wyers—On the face of the FTA, no. I think the thing to point to is actually our current Patents Act, which already provides for patents for software, providing they meet the requirements of the act.

Senator BRANDIS—Can we get some reassurance from you, as Mr Deady was able to give me in answer to my questions about the PBS, that these concerns, in your judgment, are simply groundless. The fact that the FTA is silent on them does not mean that the concerns are in any way grounded on any reality at all. In your view, are they groundless concerns?

Ms Wyers—I think they are. Perhaps it is a misreading of whether the FTA actually makes any change, and in fact it does not. I agree that they are groundless.

Senator BRANDIS—In your expert professional opinion, can you give us that assurance that those concerns that Senator Conroy has identified are groundless?

Ms Wyers—Yes, in relation to the concerns about software patents.

Senator CONROY—Are you familiar with the evidence provided by the open source industry? Has anyone had a chance to look at it? As I said, hopefully only one of you has. I would not want all of you to have to.

Mr Creswell—I understood in a general way that they understood, or had the impression, that there was something to fear because there was a change in the patentability of software from the existing approach, rather than that there was any change in the copyright obligations that would interfere with interoperability. Ms Wyers is an expert on the patentability or otherwise of software. I would only say that, as a matter of history, around the world copyright is seen as the most effective protection for most software, though I understand there has been some increase in recent years in the US in applications for patenting of software, but with what result I do not know.

The copyright law review committee looked at the whole issue of the copyright protection of software in the 1990s. I do not think we would have been turning ourselves inside out in the way that we were, in that we had people brought in by IBM and Microsoft from America especially to talk to us, if they did not think that copyright protection was very important and, indeed, vital for software rather than patent.

Senator CONROY—In Senate estimates on 3 June, I referred to work undertaken by the Australian Film Commission about 18 new content delivery mechanisms. You took the question on notice. I appreciate we have had a discussion about questions on notice. Is that in the same batch waiting for answer?

Mr Deady—We have done a lot of work on those questions, and I think they are very close to being finalised as well. Dr Churche might be able to say a little more on that question than I could at estimates.

Dr Churche—When you actually look at the 18 things, some of them are actually services and some of them are actually delivery platforms. If I remember your question correctly, it was particularly about this whole issue of interactive audiovisual services and whether or not these particular activities would come within the scope of that. I think the point to emphasise about interactive audiovisual services and why we chose that particular expression was that it was platform neutral. So it does not matter what the platform is, it does not matter what platforms might emerge in the future, if we are talking about interactive audiovisual services we are covered. There is no limitation at all on the delivery platforms. Any and all of the delivery platforms which are identified in that list of 18 things, to the extent that they are actually used to deliver an interactive audiovisual service, then they are clearly covered, in the same way as any other delivery platform which might emerge in the future which we do not know about.

To the extent that some of those things were services, then again you would have to look—for example, television. Television can be a non-interactive service but in some cases it can also be—and we have certainly seen this emerging through digital TV—an interactive service. Again,

you actually have to look at the particular service and ask whether that is by its nature interactive or not.

Senator CONROY—One area of technology you might have heard me mumbling about previously is mobile phones with cameras in them. In the US they have developed the technology to send one-minute ads to run on those screens. Will we be able to apply local content laws to ads appearing on the screens of mobile phones? At the moment, ads in Australia have certain local content requirements. Will we be able to do that?

Dr Churche—Certainly, if it is an interactive audio or video service—

Senator CONROY—I am asking you: is it?

Dr Churche—In a sense, we are talking about emerging technology and emerging services, about new things that are happening. That is a particular service. It is neutral in terms of the delivery platform. If an interactive audio or video service is being delivered through a mobile phone then we are certainly covered.

Senator CONROY—Is it interactive, though, if it is just an ad that turns up on my screen? It could be, say, Vodafone. They are an international phone company; they are connected internationally. If, say, Coke in America decides to send out a Coke ad to every Vodafone screen—I am making this up—is a future parliament going to be able to regulate that transaction? I am not sure that is interactive. I am not pressing a button. I have not asked for it; it has just turned up on my screen. It is a bit like getting ads on an automatic teller now. By definition, automatic tellers are interactive, but the messages they are pumping out at me from the screen are certainly not interactive.

Dr Churche—Our audiovisual reservation covers a range of different types of services. Interactive audio and video services are in one category. There are other categories such as pay TV, radio and free-to-air commercial television. One would have to look at that. If it did not fall within the category of television—and one can certainly see scenarios in which people are using their mobile phones to watch television—

Senator CONROY—That is coming soon.

Dr Churche—If it is television and that is just a delivery platform that is coming, it would probably be covered by the television part of our reservation.

Senator CONROY—This ad that is appearing on my mobile phone—

Dr Churche—Including the ad.

Senator CONROY—No, I mean an ad that is appearing right now on my mobile phone. I am getting a sense that you are not prepared to commit to saying that it is interactive. Some have argued that having the word ‘interactive’ there has made it too restrictive, that it would be better without that word and that the word ‘audiovisual’ would give it broader coverage. If it just said ‘audiovisual’ then that ad, in my view, would be captured. But, by having the word ‘interactive’ there, you have actually narrowed the definition.

Dr Churche—I think the point to emphasise is that the whole issue of having interactive audio and video services came out of very close dialogue we had with the industry during the negotiations. The local content arrangements we have at the moment are all based on forms of media where the viewer really has no control over what is broadcast. The whole point with free-to-air TV as we have historically known it, or with radio, is that someone else has the role of programming it and the audience has very little role in controlling it. So we have particular types of mechanisms. The whole point of that particular category was to recognise that, yes, the whole environment is changing. We do not even know what type of local content requirements we would use on interactive media. The whole point of the way in which that part of our reservation is worded is that we have deliberately left open what type of mechanisms we would use if governments were to choose to use them. In theory, if all this new technology works—

Senator CONROY—Advertising now has local content rules. We are looking to be able to regulate local content into the future on whatever new media there are. Mr Deady and I had lengthy conversations prior to the completion of this. It was a great weight on Mr Deady's shoulders to have be the person negotiating about what we do not effectively know about in the future. Here is one technology that it is halfway here. The camera phones are here, but the ads that will appear on them have not yet arrived in Australia. I would have thought that these were ads and should be subject to local content rules so that Australian actors get a chance to be in the ads that appear on the phones in the hands of Australians in Australia.

Dr Churche—Again with all these things you have to look at the technology and see how the particular service operates, and I am not familiar enough with it to make a judgment call. But the whole point is that, with a TV service, something is being broadcast generally with some sort of a receiver picking it up. With an interactive audio or video service, there is greater interactivity, including your ability to pick up the service; it is not just something being broadcast generally. It is not clear to me in the example you have given whether you are talking about a general broadcast which is somehow being magically picked up by all telephones around the country or something which involves greater interactivity.

Senator CONROY—I did say 'networked'. It could be that every time I turn my phone on I get an ad; that could be programmed in, not beamed. As I said, I do not have a camera phone, but if I did I could get an ad every time I opened it. There is no consumer interaction; it is just my getting an ad on my phone. It is an ad and, if it were appearing anywhere else, there would be a local content rule.

Dr Churche—At the moment we have local content requirements for advertising on free-to-air TV. That is the only delivery platform where we have a local content requirement on advertising. We do not have a local content requirement for advertising on pay TV.

Senator CONROY—Radio?

Dr Churche—No.

Senator CONROY—Under the FTA, will we be allowed to have a local content requirement on pay TV?

Dr Churche—Our local content requirements for pay TV relate to certain programs, including drama; they do not relate to advertising.

Senator CONROY—I take it that is a no.

Dr Churche—That is a no.

Senator CONROY—Thank you very much. I have to catch a plane. I have asked most of my questions. I think blood plasma is the only issue I did not get a chance to cover.

CHAIR—Senator Brandis, do you have any questions?

Senator BRANDIS—No. I think Senator Conroy has covered the issues well enough.

CHAIR—While it is still relatively fresh in our minds, I will go back to the discussion that Senator Conroy had about circumvention devices. Mr Deady, I think you gave us an assurance that in the phase-in period some of this stuff would be worked out. However, I do not understand how we can make exceptions that allow for the sale of region-free DVD players. It seems to me that in the text we are talking about their use rather than their coding. For example, a DVD player is not allowed to be circumvented to prevent regional coding; that is a circumvention device. Really the question is about the ability to use that rather than to provide region-free DVD codes.

Mr Deady—Let me put it this way—and again I encourage my colleagues to jump in and correct me. It seems to me that there is the capacity for Australia to introduce exceptions to allow for the legitimate use of non-pirated material here. The agreement, I think, certainly allows for that through exceptions, and I think that is accepted. It does put restrictions on anticircumvention devices. But the agreement—I think this is the point that Ms Harmer makes here—does provide the government with the flexibility to introduce these exceptions and then to give effect to those exceptions. There is no point in our agreeing to exceptions to allow the 'fair use'—if that is the right term—of this material with the use of non-pirated material and then having no capacity whatsoever to allow that material to be viewed or used. The whole of the agreement in this area has to be read to give effect to what we are talking about regarding exceptions and giving effect to these commitments. That is certainly how we are viewing and implementing whatever legislative changes are needed and over time will implement exceptions that will be needed to give effect to that. The agreement clearly allows for exceptions for legitimate use; therefore, in order to give effect to that, to allow that to occur, we certainly believe that the use of certain devices is provided for under the agreement.

CHAIR—So you are saying the exceptions are about use, not about manufacture, distribution, or sale of circumvention devices?

Ms Harmer—The exceptions are about use, but I think that Mr Deady is saying that where there is a right to have an exception for use then following on from that is the ability to actually access the tools to do that.

CHAIR—To access the circumvention devices to do that?

Ms Harmer—This is another issue that we do go into in some detail in the answers to questions on notice.

Mr Deady—If we can help the senators we should certainly try and do that. My understanding is that what we are working with in the agreement and what we work through in the negotiations is certainly to provide for exceptions in certain circumstances and then to be able to give effect to those exceptions and to ensure the tools—

CHAIR—And you are going to deal with this more fully in the answers to questions on notice?

Ms Harmer—Yes.

CHAIR—I will ask another question, which is more about trademarks. This was put to me as a real life example last Friday. In Fremantle there is a manufacturer of ugh boots. In the United States there is a registered trademark 'Ugg'. The manufacturer and distributor of ugh boots in Australia has not called his product Ugg boots, but what he wants to advertise is that he sells ugh boots. He believes that under the FTA, because someone has registered the title 'Ugg' boot for their product, he would be unable to actually call his product an ugh boot. I am informed ugh boots are fashionable accessories at the moment.

Mr Quinn—I do not think the issue here is about the FTA; it is actually about the fact that the ugh boot trademarks were sold to a US corporation, the Decker Outdoor Corporation, and now they are the subject of litigation in the United States.

CHAIR—But 'ugh boot' is a common term in Australia—it is a generic title. Who can sell a generic title to someone and how can that person complain that it is a trademark and you cannot then call your product an ugh boot?

Mr Quinn—In relation to ugh boots, there were some registrations in Australia—in, I think, 1971. The question of whether it is a generic term or not needs to be tested in the courts. To date, there has not been any testing of that in the courts. It is a matter for private litigation. That is the case in the United States as well.

CHAIR—This bloke is a small businessman. Small businesses classically struggle with their overheads all the time. If he has to protect his business by taking legal action to do so that is an extra cost for him. So what do we tell him? Do we say, 'You have to go off to the court to establish your right to call your product by its generic name'?

Mr Myler—The point again is that the FTA does not have any impact on this at all. These legal issues that exist with regard to the trademarks covering ugh boots flow from a registration in 1971 and have received some prominence recently through the sale of the trademark to the US company. But that was all completely independent of this FTA. Obviously, parallel to that, for some unknown reason there has been an increase in the fashionableness of ugh boots as well, which has led to the export opportunities et cetera. But this is all completely independent of the FTA and any provisions under the FTA.

CHAIR—We are a bit off the FTA inquiry by talking about this but I am trying to think of another example. The only one I can think of is a slightly silly example. Bush bands have what they call a lagerphone, which is a piece of stick with bottle tops nailed onto it. You hit it and it makes a rattling sound. If someone comes along and registers the title 'Lagerphone', despite the generic title of this instrument they can then sell that registration to an American corporation. If lagerphones became as popular as ugh boots then the lagerphone producers in Australia would have to take legal action to protect themselves. Is that what you are saying? Is that an analogous example? I can think of half-a-dozen other Australian things like that but if someone goes off and decides to patent that they have a good that they can on sell.

Ms Wyers—It depends on what you are wanting to do. If somebody wants to register 'Lagerphone' as a trademark they need to register it in relation to specific goods and services, and that is what that will then apply to do. It is open to anybody to challenge the registration of that by saying that they have got pre-existing rights and that people should not be granted those particular rights because it is a generic term. That is my understanding. It will then not proceed to registration as a trademark.

CHAIR—If all the lagerphone producers are busy creating the bottle tops and not paying attention, then when it is registered as a trademark their ability to reach back and fix it up has gone. Is that correct?

Ms Wyers—No.

Mr Myler—The trademark registration is subject to revocation.

CHAIR—What about when it is ratified? If they do not take action at the time it is being sought and they become aware of it two or three years down the track after it has been registered, what are their rights then?

Ms Wyers—We do not have our trademark experts here.

Mr Myler—My understanding is that you can take action to have the trademark revoked. You would have to go to litigation.

CHAIR—This goes to the area of local knowledge or generic knowledge. If someone comes along and takes some tribal medicine and registers it then the local tribal community can later apply to have that registration disallowed because it is theft of their intellectual property. Is that correct?

Mr Myler—That is an analogous situation. Yes. This is the case currently. Where something is registered there are, much like the case with patents and trademarks, avenues for revocation of those registrations. The problem arises when the trademark happens to be on sold to a very large US corporation. Obviously it is going to be a long and arduous battle.

Senator BRANDIS—None of these issues has got anything to do with the FTA.

Mr Myler—No.

Senator BRANDIS—It does not affect the rights arising under any of the hypotheticals Senator Cook has given you.

CHAIR—We established that at the beginning. I am talking about it because I have a constituent and he is going to sell the story to the local media as the big reason why the FTA is discriminating against Australian small business.

Senator BRANDIS—Thank goodness you have squared that away, no doubt even to his satisfaction.

CHAIR—I do not think I have squared it away to his satisfaction. He is now being told that he may have to take action against a large American corporation.

Senator BRANDIS—Not because of the FTA.

CHAIR—I would like to go to the phase-in period concerning effective technological measures. Article 17.12 provides that Australia has two years to comply with the requirements of article 17.14.7 of the agreement. That is the effective technological measures part. Why is that section singled out over all the others in the chapter to provide a phase-in for Australia?

Ms Harmer—That is a section we assessed would require some considerable consultation to ensure the exceptions we put in place were appropriate to the Australian circumstances. Therefore, we felt that having a two-year phase-in would give us time to do the consultations and hold a review necessary to ensure that, at the same time we were putting in place further restrictions relating to anticircumvention measures, we were putting the exceptions in place that were appropriate in the Australian context. It was really to give us time to do a proper consultation with stakeholders.

CHAIR—I understand that. Will you have to come back to the parliament to get parliamentary approval, either by amendment to an existing act or by regulation, to implement any changes that you might wish to now introduce under the phase-in provisions?

Mr Cordina—It is certainly very likely that there will need to be amendments to the Copyright Act to implement our obligations in relation to the technological protection measures. The way the open-ended exception obligations, which provide the ability to introduce further exceptions, are described in the regulations is that they can be introduced through a review process, which requires a credible demonstration in legislative or administrative review or proceeding. But the main implementation of those obligations—for instance, in looking at the definition of effective technological protection measures and so forth—will require legislative amendment to the Copyright Act.

CHAIR—If you would not mind, could you provide a written note on this point? This is one of those areas of delegated legislation that I want to be careful about. The more you can tell us about it the better. Do we need to clear whatever we might do here with the United States first?

Ms Harmer—No.

CHAIR—We don't? Will it require reference to the joint committee?

Ms Harmer—No.

CHAIR—Was any consideration given to including the requirements of 17.4.7 in the implementing legislation?

Ms Harmer—That is currently in the current bill?

CHAIR—Yes. For example, defining the date on which you would bring it into force, or something like that.

Ms Harmer—No, because in article 17.12 the two years is triggered from the date of entry force of the FTA, so that gave us the marker for the time frame.

CHAIR—Do you have any comments to make about the exclusion of ETM from the implementing legislation? Does that remove the defence of acquiescence for Australia in the event of an interpretation dispute over the issue?

Ms Harmer—I am sorry; I am not sure that I completely follow the question. Are you suggesting that by not including legislation in relation to effective—

CHAIR—By not referring to it ahead of the implementation of the agreement, we remove a defence for ourselves later if there is an interpretation dispute.

Ms Harmer—No. I cannot see any circumstances where that would the case.

Mr Myler—Given that the actual terms of the agreement specify that we have a two-year window of opportunity to resolve this issue, I do not think there would be any argument that we would acquiesce to a particular interpretation.

CHAIR—We have just been through the regional coding argument to some extent but I have a couple of questions on it. Just reading through my questions I see that most of them are waiting for your written answers. I might feed these questions to you so that you can take them on board when you give your written answers.

Ms Harmer—That would be appreciated.

CHAIR—Article 17.4.7(e) provides a list of exceptions to the ban on circumventing effective technological measures and 17.4.7(f) describes which activity each exception applies to. It appears that only the act of circumvention—that is, activity defined in 17.4.7(a)(i)—is subject to all the exceptions. Is that right?

Ms Harmer—Sorry, that is actually a question that we already have taken on notice—or very similar to a question that we have on notice—so I propose that we deal with it when we deal with the question of—

CHAIR—All right, you will deal with that. I will provide you with all the other questions that flow from that as well, so that will enable you to deal with those. On digital rights management,

I take it from the implementing legislation that there are no new legislative requirements from article 17.4.8; is that right?

Mr Cordina—We have actually proposed making limits to copyright action in relation to rights management information—that is, strengthening the protection provided to rights management information, primarily by providing owners with the rights to information which was attached to copyright material but was then removed from that material. So they would provide restrictions on dealing, for instance, with that material once it has been removed, consistent with the obligations in the agreement.

CHAIR—When are you going to bring that forward?

Mr Cordina—It is in the current bill.

CHAIR—Can you direct me to where in the bill?

Mr Creswell—It is part 7 of schedule 9.

CHAIR—Can you give us the page number?

Mr Creswell—It is page 140.

CHAIR—All right. I cannot do it here, but I will have to look at that and put those questions through to you if I think they are worth persisting with in the light of that. Can I just go back to article 17.9.6 of the agreement—this is about generic drugs again. You may have seen an article in the *Canberra Times* on 30 June headlined 'Fear FTA will stop vital drugs' which raised concerns that the FTA will prevent Australia from exporting generic drugs patented in Australia, even though they may not be covered by a patent in the country of destination. Is that a correct interpretation of this section?

Ms Harmer—I am sorry; would you repeat that?

CHAIR—If we say, 'Okay, we don't have a market for the generic drug in Australia, but country X has a market for that generic drug,' from reading this clause, it appears that we cannot therefore export to that market because that drug is not allowed to go to generic form in Australia.

Ms Harmer—Whilst it is under patent in Australia?

CHAIR—Yes.

Ms Harmer—That is correct in relation to article 17.9.6, except, for example, in a situation where a compulsory licence was exercised under 17.9.7.

CHAIR—You have to obtain a licence, then?

Ms Harmer—It is a compulsory licence. So, if the patent is still afoot in Australia then the generic cannot be exported from Australia to a country where perhaps there is not a patent,

except for the purposes of obtaining marketing approval in that overseas country—to go through the same process of obtaining the equivalent of Therapeutic Goods Administration approval in that other country.

CHAIR—Yes. Let us put this in a real-life circumstance—say it is South Africa, say the drug is somehow or other related to the treatment of HIV-AIDS, but it is under patent in Australia. We are capable of manufacturing it. Are we not allowed to, subject to the South African administration approving that generic?

Ms Harmer—I suppose if we were to be providing it to a country in those circumstances then there are various ways that the government may do that. One may be to simply purchase it and to send it in that way. The other way that is, I suppose, generally discussed as the way that we would do that, were we to do that, if we were not able to come to some arrangement with the innovator, would be to look at a compulsory licensing situation, which would then fall under 17.9.7 not 17.9.6.

CHAIR—We are talking about drugs that might go to diseases like HIV-AIDS or diseases arising from poverty where there is a sense of altruism about the need to get those drugs to the market rather than a profit motive. Where they can be part of our aid program, we can still manufacture those even if they are patented in Australia and you are telling me that the way around it is for the government to purchase the drugs and export them.

Ms Harmer—I will ask Mr Quinn if he has anything. There are various ways the government could do it. They could simply purchase the product from the innovative pharmaceutical company and send them over in that way. By doing so, they could seek to come to some sort of pricing arrangement with the innovative pharmaceutical company. Alternatively, there is a provision—

CHAIR—The generic manufacturer cannot go direct to the South Africans or whoever it is.

Ms Harmer—While it is under patent in Australia?

CHAIR—Yes.

Ms Harmer—No, unless a compulsory licence sort of arrangement were exercised or the innovative company agreed to go on a licence to the generic company.

CHAIR—It seems to me that the test should be: is the drug legal in the market in which it is going to be used? If it is not legal in Australia, that ought not necessarily mean that we cannot manufacture generics for other markets where it might be legal. If we are limited in doing that, then that is a limitation on our ability to compete in the global generic market. That is the odd part about this.

Mr Quinn—We did see that article in the *Canberra Times*. Australia can and does provide life-saving pharmaceuticals to developing countries under its aid program. Our capacity to provide assistance is unaffected by the FTA. We are also a strong supporter of the WTO declaration on TRIPS in public health. There is nothing in the FTA which affects our ability to implement the declaration on public health under TRIPS. Specifically, we have retained the

capacity to manufacture patented pharmaceuticals under a compulsory licence and to export these drugs to any eligible country in accordance with the terms of the declaration in the event of a request from such a country, so that goes to your South Africa example, I think. A compulsory licence granted under the WTO declaration must be on the basis of a request from a country without sufficient manufacturing capacity of its own, and to date Australia has not received any such request. So in a nutshell we do not see any significant implications coming out. There is nothing in the FTA that stops us from complying with that declaration. As Ms Harmer said, we would be relying upon paragraph 7 of article 17. 9 which gives us the capacity, in certain circumstances, to make compulsory licences including, for example, in circumstances of extreme urgency.

Senator COOK—That goes to what I might call aid drugs, basically, or the drugs that are relevant to the treatment of diseases prevalent in poverty stricken countries or diseases arising from poverty. Just coming back to the more general proposition, does this prevent us from manufacturing generic drugs in Australia which you cannot market in Australia but which have a market in some other country where the patent limitation has been lifted? Is that what it does?

Mr Deady—Yes, it does. That is the current arrangement in place in Australia. The critical thing in this particular article was to ensure that, as Ms Harmer has said, a generic drug manufacturer in Australia could export for marketing approval, so it could begin that process overseas. But this does not allow manufacture for export on a commercial basis while there is an existing patent in Australia, nor do our current arrangements. In the view of the Department of Foreign Affairs and Trade, the current WTO obligations limit us from doing that. So there is nothing new here beyond our current arrangements and what is reflected here is consistent with our WTO obligations.

CHAIR—It does beg the question why. If the drug is legal in the market into which we are exporting, why are we prohibited from exporting it?

Mr Deady—As I said, this is part of the TRIPS agreement. Mr Quinn may know the history of those negotiations.

Mr Quinn—As Mr Deady said, it is not allowed under our current Australian law. There are grave concerns—

CHAIR—I heard all that and I understand it. You are telling us that you cannot do it, but I am asking what the rationale is for not being able to do it. Frankly, it seems to me, on the face of it, to be a way of keeping Australian generic drug producers out of a global market. And why are we doing that?

Mr Quinn—Ms Wyers might be able to provide some further clarification on that.

Ms Wyers—It comes back to how the patent system operates. The Australian generic manufacturers are in no different position from the US generic manufacturers or any of the other manufacturers. Patents are granted and enforced at a domestic level. The rights of the patent owner are to make, use and sell the patent. So, effectively, if you were to allow manufacture for export, you would be limiting the rights the patent owner would otherwise enjoy, which is to

control who makes the patented product in Australia. It is not only generic; it is not only pharmaceuticals. It applies across the patent system generally.

CHAIR—I understand what you have said, but I must say I do not understand why we have imposed the ability to be locked out of foreign markets—where it is all perfectly legal—onto Australian companies. It is not interfering with the rights of the patent suppliers in Australia. I do not understand why we would do that as a matter of policy. It may be a matter of policy, I do not know.

Mr Myler—I think the point is that the patent gives the patent holder the right to deal with the manufacture and sale, not to deal with the consumption. So, the body of rights that you are restricting are to do with licensing, making and selling—including selling overseas—and not to do with consuming. I think there is confusion there in that you are saying that we should be able to take advantage of consumers who are entitled to consume this drug in another market. Well, no, because the patent holder has the ability to control who makes the product within that particular geographic area that is covered by the patent in that particular country; hence you get the economic benefits of having a patent and being able to license production and the like. Without that, you undermine what a patent is.

CHAIR—It sounds awfully protectionist to me, Mr Myler. I have no further questions but I do have those other questions that I will submit to you. Senator Conroy asked me to ask some questions on blood plasma. I apologise for leading you to think that we were about to finish when we have about another 10 minutes or so to go. The FTA commits the government to reviewing the current arrangements for the supply of blood fractionation services by no later than 1 January 2007, ending the CSL's monopoly on blood fractionation services by no later than 30 December 2009. Is it possible that the review of current arrangements by 2007 could lead to the importation into Australia of fresh blood supplies from the US?

Mr Deady—There is nothing in the agreement that would lead to that outcome. In fact, the agreement is very clear that we are talking about Australian blood in any of these fractionation services that might be conducted in the future. So that is an issue of policy and there is nothing in the agreement that would lead to the importing of US blood.

CHAIR—Either the Red Cross or Baxter Healthcare gave us the advice that we already import some blood plasma products. Do we know if these imported products are all derive from Australian blood?

Mr Deady—I really should take that on notice. Certainly, we import a large amount of reconstituted blood products, as I understand it, subject to the TGA health and safety issues. I thought that the fractionation services were done on Australian blood. So it is more the blood substitutes, if that is the right terminology, that we are talking about.

CHAIR—That is the right terminology, because you actually make blood substitutes out of blood from cattle. I do not know whether it means that they are products created in Australia, sent overseas for processing and then brought back or whether certain rare blood groups, which we cannot get sufficient supplies of in Australia, are imported. That is what I do not know.

Mr Deady—I cannot answer that question directly, I am sorry. The policy is for self-sufficiency in blood. That remains the policy of the government in this area.

CHAIR—Is it possible that, under the new arrangements, blood plasma products imported into Australia could be sourced from non-Australian blood? I guess that is the key question.

Mr Deady—There is nothing under the agreement, and this is very clear in the exchange of letters here. It says:

5. A Party may require that blood plasma products for use in its territory be derived from blood plasma collected in the territory of that Party.

So it recognises very clearly that particular question. It certainly permits Australia, in this case, to insist that blood plasma products be derived from Australian blood. That is recognised by the Americans.

CHAIR—Do we have to put any measures in place to ensure that that is the case?

Mr Deady—If we are talking about the blood fractionation processes then they would certainly be subject to the regulation and scrutiny of the TGA in terms of the health, safety and efficacy of those products. Any measures that were required to ensure the health, safety and efficacy of Australian blood supplies would be fully consistent with the agreement. There is nothing there that would preclude us from putting in whatever measures are necessary to ensure the health, safety and efficacy of the products.

CHAIR—So if Australian blood is fractionated in the US, it has to be done according to Australian standards in Australian-approved conditions?

Mr Deady—Yes.

CHAIR—Has any assessment been done as to whether, given that the fractionation of Australian blood would be only a percentage of the fractionation carried out by a US based fractionation service, there is less security because of the more constant use of those facilities by US users?

Mr Deady—Again, the Australian authorities and the TGA would have the absolute right, and obligation, to ensure that any measures necessary to ensure health, safety and efficacy were put in place and required if we were to have fractionation done in, say, the United States by a fractionation service there. There is no limitation on the measures. They cannot be trade restrictive or discriminatory, but they can certainly be measures necessary for health, safety and efficacy reasons. So there are no limitations on us there.

CHAIR—How can we be certain that Australian blood will not be exposed to HIV or Creutzfeldt-Jakob disease, the human variant of mad cow disease, if we source blood plasma products from the United States?

Mr Deady—The TGA, the responsible authority, would ensure that whatever fractionation services were going on in the United States fully met Australia's health and safety concerns. So

whatever measures were necessary to ensure that could not happen would be put in place and monitored by the TGA.

CHAIR—We do have a number of questions on notice which we will provide to you, but I think that concludes today's hearing. Thank you all very much for attending.

Committee adjourned at 6.39 p.m.