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# The case against economic integration of Australia and the United States

***Submission to Senate Foreign Affairs, Defence and Trade Committee***

***inquiry into the***

***General Agreement on Trade in Services and Australia/US Free Trade Agreement***


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# Proposed agreement for economic integration of Australia and the United States: the case against

Negotiations on a 'Free Trade Agreement' between the United States and Australia have been underway for some time. Thus far, debate has primarily focused on traditional arguments regarding the relative merits of bilateral and multilateral trade agreements.

The purpose of this submission is to argue that the debate thus far has been based on misperceptions about the nature of the proposed Agreement. As the main proponent of the agreement, Alan Oxley of Austa has noted, the use of the term 'Free Trade Agreements' is ' a misnomer in a world of lower tariffs . Oxley writes (http://www.austa.net/reports/report1.htm) 'The World Bank prefers to describe them as regional integration agreements. Free Market Arrangements would be an even more appropriate term'.

In general, an integration agreement involves the adoption of common, or at least compatible, economic policies on a wide range of issues, including intellectual property, public ownership of infrastructure, and competition policy. Ultimately, integration is likely to extend the provision and financing of health care and education.

However, 'integration' is a misleading term in the context of a bilateral agreement between Australia and the United States. Given the relative size of the two countries, and the fact that the United States has adopted a general strategy of seeking bilateral agreements on trade and other issues on a 'pattern bargaining' model, it is clear that any agreement will involve Australia adopting American institutions and not *vice versa.*

This does not represent a difficulty for advocates of an FTA such as Austa. Austa publications indicate a strongly-held belief that the economic and social institutions of the United States are superior to those of Australia, and that we will therefore benefit from an agreement which binds us to replace our existing institutions with those of the

United States.

In the case of the proposed agreement with the United States, there is a further reason why the term ‘Free Trade Agreement’. The most important barrier to trade between the United States and Australia is the set of production subsidies, export subsidies and restrictions on US agricultural imports generally referred to as ‘the Farm Bill’. Although some marginal concessions may be made, there is no serious prospect that the Farm Bill will be repealed or modified in such a way as to eliminate its adverse impacts on Australian farmers.

The purpose of this agreement is to argue that any Free Trade Agreement between Australia and the United States should be confined to the removal of barriers to trade in goods. Issues relating to services and economic integration should be dealt with in a multilateral context and in a manner that does not prejudice the democratic rights of Australians to control their own social and economic institutions.

**Intellectual property**

A major concern with proposals for an economic integration agreement with the United States is that Australia will be compelled to adopt American policies on intellectual property, policies that are economically unsound even in the US context, and entirely adverse to Australian interests.

To see what this might mean in practice, we need to look at the case of Eldred vs Ashcroft, decided recently by the US Supreme Court.

This case was a constitutional challenge to a recent Act of Congress which extended the term of copyright protection from fifty years after the death of the author to seventy years (ninety-five for corporations). The 'Copyright Term Extension Act' is often referred to as the 'Mickey Mouse Act' because of the observation that the term of copyright is extended whenever the Disney copyright on Mickey is about to lapse.

The constitutional challenge failed, but the case did elicit an unusual degree of

interest from American economists , seventeen of whom submitted a brief to the Supreme Court opposing the Act. The list is striking not only because of the eminence of the signatories (five Nobel Prizes and more to come) but because it represents all shades of economic opinion from free-market luminaries like Buchanan, Coase and Friedman to interventionists like Akerlof and Arrow.

Australia still has the term of copyright fixed at fifty years after the author's death and publishers interested in making public-domain works accessible to the general public are increasingly taking advantage of this. There can be little doubt that the negotiating demands of the US in any agreement will include an extension of our copyright terms. The agreement recently negotiated with Singapore required a minimum copyright term of 70 years, but set no maximum.

*Parallel importing*

Australian laws allowing parallel importing of music, books and computer software will be another target of US negotiators. The Singapore agreement appears to preclude parallel importing, with limited exemptions for pharmaceutical products required by the TRIPS agreement (exemptions which the US vigorously opposed).

The key question in the debate over parallel imports of compact discs, is whether multinational companies should be able to act as discriminating monopolies, setting one price for Australian consumers of CDs and another, lower, price in other markets. This kind of price discrimination is possible only if Australian retailers are forced to buy from sources approved by the record companies, and are not permitted to import from countries where prices are low (a practice called parallel importing).

Economists have denounced the ban on parallel imports as anticompetitive and anti-consumer, and have strongly supported the government’s plans to remove the ban. Opposition from within the music industry has been denounced as the response of self-seeking interest groups trying to exploit consumers.

There are, however, arguments in favour of the ban on parallel imports that need to be considered. Populist arguments have focused on the idea that high prices are necessary if Australian musicians are to have any chance of earning a living. There are also arguments in favour of discriminating monopoly as a means of permitting the creators of intellectual property to capture the full social benefits of their innovations. Only with discriminating monopoly prices, it is argued, will the optimal level of investment go into the creation of intellectual property.

Neither of these arguments stand up well in the case of CDs. Except for the most popular artists, the demand for CDs is fairly elastic. This means that high prices reduce total expenditure on CDs, while increasing the amount going to the record companies and the most popular groups. So, discriminating monopoly tends to reinforce the already unequal distribution of income within the industry and reduce the already slim chances for new artists seeking to have their music recorded and distributed.

Most of the gains from price discrimination go to the multinational record companies and to a small number of well-established artists. There are, admittedly, some beneficiaries who may appear more deserving. As with every monopoly, the high monopoly price provides opportunities for competition from small-scale entrants, in this case, independent music producers. But, as with every monopoly, these benefits are only a partial offset to the loss imposed on consumers.

Turning to the intellectual property arguments, the key difficulty here is the failure to recognise the network externalities associated with fashion-driven markets like that for popular music. The popularity of, say, the Spice Girls, is not due to the fact that they are more talented than the next-best group or that their songs are better written, or even that their marketing is cleverer. Rather, the Spice Girls are popular primarily because they are popular. People, especially teenagers, want to listen to the same music their friends are listening to. Allowing record companies to extract the maximum possible rent through discriminatory pricing will not lead to the greater support for new and innovative music.

Rather, it will encourage the dissipation of yet more resources in attempts to capture control of the next big hit.

The question of CD pricing is of important in itself. However, it is even more important as a test case for the bigger issue of computer software pricing. As with CDs, the software market is dominated by network externalities. Bill Gates did not become the richest man in the United States because MS-DOS was the best operating system ever written or because Windows embodied major technical innovations. Rather the market wanted a standard, and Microsoft was in the right place at the right time. So important are network externalities that it is now standard practice to give new programs away for the first few years in the hope of establishing market dominance. Although the Microsoft monopoly is not yet complete, those who want the industry standard machine have no choice but to pay rent to Bill Gates for every PC that they buy. But there is no reason to allow him to charge higher rent to Australians than to citizens of other countries.

The most striking feature of the US position is that it is based, not on the promotion of competition, but on the protection of monopoly rights, dressed up as intellectual property. Far from promoting free trade, the interest groups driving the US negotiating position want to turn Australia into a monopolists' playground.

**Health**

Health, including food safety, is likely to be central to the negotiating demands of the United States. As in the case of intellectual property, the outcome of any agreement will be the replacement of successful Australian policies by economically and socially unsound US policies that benefit only powerful lobby groups.

In relation to genetically modified foods, for example, Australia reached a sensible compromise between the extremes represented by the US and Europe. Under the labelling laws adopted here, consumers are free to choose between traditional and GM foods. The US negotiating position proposes that we should be forced, like Americans, to consume

GM foods without knowing it.

Similarly, the Pharmaceutical Benefits Scheme will come under immediate attack. As noted by Alan Oxley of Austa in a 3CR interview recently, the PBS has been the subject of vigorous attack by US pharmaceutical companies and their Australian subsidiaries. While the scheme is unlikely to be scrapped in the initial round of a 'free Trade Agreement', its fate will be sealed once the agreement is signed.

Looking ahead, it seems inconceivable that Medicare will be safe from attack under the provisions of an agreement. The private insurance lobby in Australia has opposed Medicare since its exception, and would be strengthened immeasurably by the much large and stronger US industry. The single-payer and bulk-billing provisions of Medicare, already under severe strain, could be rendered unworkable by legal challenges under an FTA.

**Other integration agreements**

A survey of previous integration agreements reveals two basic points that are applicable to the proposed economic integration agreement. First, the scope of such agreements is invariably much greater than is suggested at the time they are originally negotiated. Second, once signed they are effectively immune from political scrutiny. The result is a massive 'democratic deficit', in which citizens lose the capacity to choose or control the economic and social institutions that shape their lives.

The democratic deficit has been recognised as a major problem in the European Union, where it has generated a vigorous debate regarding constitutional reforms to the European Parliament, the European Commission, and the Council of Ministers. In relation to National Competition Policy and the World Trade Organisation, issues of democratic accountability were ignored until the absence of accountability produced a violent backlash.

Whether or not there is a backlash, it seems hard to see how any form of democratic accountability could be imposed on an economic integration agreement between Australia

and the United States, short of Australia seeking to become a US state itself.

*The precedent of National Competition Policy*

Australia has had recent experience of the use of intergovernmental agreements, negotiation behind closed doors as a method of producing binding commitments to far-reaching policy reforms. National Competition Policy, also known as 'Hilmer and related reforms' was introduced in 1995, as a result of the meeting of the Council of Australian Governments (COAG). This meeting resulted in the passage through all Australian parliaments of legislation which fundamentally affected all aspects of Australian life, from the opening hours of shops to the employment conditions of workers. Yet until 1998, the majority of Australians had never heard of National Competition Policy and only a tiny minority were aware of what the policy involved.

This situation changed dramatically with the 1998 Queensland election, where the vote for the One Nation Party was attributed, in large measure, to resentment at the perceived effects of National Competition Policy. In the resulting backlash, critics blamed NCP for everything from unemployment to the decline of country towns.

Unlike previous microeconomic reform initiatives, National Competition Policy was a comprehensive program, which has been imposed from the top levels of government without any consultation with those affected, and which was not subject to significant democratic accountability or control.

Another top-down aspect of National Competition Policy is the strict subordination of local government to State government. The operating arrangements of local government authorities have been removed from the control of the governments concerned and required to conform to policies laid down by State governments in accordance with Competition Policy.

Finally, National Competition Policy has been largely exempt from democratic accountability. It is, of course, open to the Commonwealth Parliament to amend or repeal

the Competition Policy Reform Act. But apart from this theoretical possibility, it does not matter whether policy changes required under National Competition Policy have majority public support or, indeed, any public support at all.

*The WTO*

The debate over the World Trade Organisation has followed a pattern very similar to that of the public response to NCP. The WTO was designed as part of a comprehensive free-market reform agenda for the world economy, replacing the more limited General Agreement on Trade and Tariffs. In the words of its secretary, Renato Ruggiero, it was to provide 'the new constitution of a single global economy'.

The WTO is unelected and its processes are opaque and bureaucratic. Its decisions, affecting government policies on a whole range of issues, are made in secret by panels of trade lawyers. However, since national governments have signed off on the relevant treaties, the WTO claims a democratic mandate.

As in the Australian debate over competition policy, the advocates of the free market had most of the running at first. A steady stream of articles, speeches and books pointed out that in the new world of the single global economy there was no alternative to comprehensive reform and the abandonment of old-fashioned policies of government intervention. In particular, the new economy necessitated wholesale privatisation, 'the end of welfare as we know it' and the abandonment of restrictive labour market policies like minimum wages and unfair dismissal laws. Environmental and food safety policies, seen by the free-marketeers as pretexts for rent-seeking and protectionism, came in for particular attention. An article in the pro-WTO Brookings Review, commenting on a WTO decision striking down part of the US Clean Air Act, expressed the hope that trade reform and domestic policy reform would go hand in hand.

The turning point came with the semi-secret attempt to negotiate a Multilateral Agreement on Investment, which would have required signatory countries not to

discriminate against foreign investors. As the example of the WTO showed, this would have meant that any policy that adversely affected a multinational company (whether or not any discrimination was intended) could be challenged and overturned in closed tribunals. National governments began demanding exemptions in areas where they were unwilling to accept MAI dictation - culture for France, indigenous rights for Norway, and so on. The growing list of exemptions simply pointed up the all-embracing nature of the proposed agreement, and swelled the international wave of protest until the MAI was abandoned.

*The European Union*

The European Union is noted by Austa as a model for integration agreements. It illustrates the tendency for the scope of such agreements to expand over time and the difficulty of resisting such expansions. The original European Coal and Steel community was established in 1951, with the aim of preventing a recurrence of war between France and Germany,

As late as the 1980s, the then European Community was, for practical purposes, a Western European customs union whose main policy initiative was the Common Agricultural Policy. These were managed by an unelected Commission, analogous to the WTO, and a Council, in which each national member had one representative and an effective right of veto.

In 2002, the customs union, the Commission and the CAP are still there, but the European Union is more like a federal government than a trade bloc. New members of the European Union must implement 31 chapters of the treaty, covering everything from fiscal policy to the protection of workers rights. In effect, the treaty requires its signatories to become social democracies.

The anti-democratic features of the gradual loss of national sovereignty in the European Union have been a source of much concern. The response has been to convert

Europe from a trade bloc to something approaching a federal state (the term 'confederation', used by the American colonies before the adoption of the Federal US constitution is perhaps more appropriate. Europe already has many of the standard trappings, including a flag, a currency, passports, a parliament and the beginnings of an army. The directly-elected European Parliament is still weak, but its power and legitimacy is growing. The replacement of the national veto by 'qualified' majority voting is gradually changing the character of the Council, from a venue for intergovernmental negotiations, to something more like the original version of the US Senate.

No such response will be available in the context of the democratic deficit associated with economic integration with the United States. The US jealously guards its national sovereignty and has shown itself unwilling to cede any, even to its NAFTA partners, Canada and Mexico. Australia, a country of which most Americans are barely aware, will have even less capacity to influence events.

**Bilateralism and multilateralism**

Concerns about the relative merits of bilateral and multilateral agreements have been raised in relation to trade in goods and services.

The issues are much sharper in relation to economic integration agreements. In principle, Australia could negotiate separate agreements with, say, the US, ASEAN and the EU to remove tariffs and other barriers to trade in goods and services. By contrast, the natural outcome an economic integration agreement creates a bloc. If Australia has an economic integration agreement with the United States and New Zealand does not (as seems likely) there will come a time when the requirements of the US agreement are inconsistent with those of Closer Economic Relations with New Zealand.

**Concluding comments**

As has been noted by its strongest proponents, the term ‘Free Trade Agreement’ is a completely misleading description of the proposals currently under negotiation. Many of these proposals will be economically harmful to Australia. But even if they are not, they should be subject to vigorous public debate rather than being negotiated behind closed doors. At present, the vast majority of Australians are either unaware of the existence of the proposed Free Trade Agreement or are under the impression that, as its name implies, it is concerned primarily with such issues as tariffs barriers to agricultural trade. As with National Competition Policy, there is likely to be a severe backlash if and when Australians discover that secret negotiations have made radical economic and social reforms a *fait accompli.*