United States International Trade Commission

U.S.-Australia Free Trade Agreement:

Potential Economywide and Selected Sectoral Effects

Investigation No. TA-2104-11
USITC Publication 3697
May 2004

U.S. International Trade Commission

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PREFACE

On March 3, 2004, the United States International Trade Commission (the Commission), instituted Investigation No. TA-2104-11, U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects. The investigation, conducted in accordance with section 2104(f) of the Trade Act of 2002, was in response to a request from the United States Trade Representative (USTR), (see appendix A).

The purpose of this investigation is to assess the likely impact of the U.S.-Australia Free Trade Agreement on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers. As specified in section 2104(f)(2)-(3) of the Trade Act, the Commission shall submit to the President and the Congress (not later than 90 calendar days after the President enters into the Agreement) a report including

- an assessment of the likely impact of the Agreement on the United States economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the Agreement, and the interests of the United States consumers; and

- a review of available economic assessments regarding the Agreement, including literature regarding any substantially equivalent proposed agreement, and shall provide in its assessment a description of the analyses used and conclusions drawn in such literature and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the Agreement.

The Commission solicited public comment for this investigation by publishing a notice in the *Federal Register* of March 8, 2004 (see appendix B). Interested party views are summarized in chapter 9 of this report.

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U.S.-Australia Free Trade Agreement: Potential
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List of Frequently Used Abbreviations and Acronyms

AAFTAC	American-Australian Free Trade Agreement Coalition
ACIS	Automotive Competitiveness and Investment Scheme
ATAC	Agricultural Technical Advisory Committee
ATC	Agreement on Textiles and Clothing
ACTPN	Advisory Committee on Trade Policy Negotiations
AEM	Association of Equipment Manufacturers
ATPC	Automotive Trade Policy Council
BITs	Bilateral investment treaties
CDs	compact disks
CGE	computable general equilibrium
DEIF	date of entry into force
DFAT	Australian Department of Foreign Affairs and Trade
DVDs	digital video discs
EIC	Entertainment Industry Coalition for Free Trade
FAPM	Federation of Automotive Products Manufacturers
FCOJ	frozen concentrated orange juice
FDI	foreign direct investment
FIRB	Foreign Investment Review Board
FTAA	Free Trade Area of the Americas
FTAs	Free Trade Agreements
GDP	gross domestic product
GTAP	Global Trade Analysis Project
HTS	Harmonized Tariff System
IIPA	International Intellectual Property Alliance
IMF	International Monetary Fund
IPR	intellectual property rights
LAC	Labor Advisory Committee for Trade Negotiations and Trade Policy
MFN	most-favored-nation
MPAA	Motion Picture Association of America
NAFTA	North America Free Trade Agreement
NMPF	National Milk Producers Federation
NTBs	nontariff barriers
NTR	normal trade relations
ROOs	rules of origin
SSGs	Special Safeguards
SPS	Sanitary and Phytosanitary (Measures)
SUVs	sport-utility vehicles
TBT	Technical Barriers to Trade
TCF	textiles, clothing, and footwear
TRIPs	Trade Related Aspects of Intellectual Property Rights

TRQs	tariff rate quotas
USITC	U.S. International Trade Commission
USTR	United States Trade Representative
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

EXECUTIVE SUMMARY

On February 18, 2004, the U.S. International Trade Commission (Commission) received a letter from the Office of the United States Trade Representative (USTR) requesting that the Commission prepare a report in accordance with section 2104(f) of the Trade Act of 2002, to assess the likely impact of the U.S.-Australia Free Trade Agreement (FTA) on the United States economy as a whole, on specific industry sectors, and on the interests of U.S. consumers.[1] Section 2104(f)(3) also requires that the Commission, in preparing its report, review available economic assessments regarding any substantially equivalent proposed agreement, and discuss areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the Agreement.

Study Approach and Scope

The United States and Australia both have open trade and investment regimes and relatively strong protections in place for intellectual property rights. The FTA's quantifiable benefits are related to the immediate reciprocal tariff elimination on a large number of products, both agricultural and manufacturing. While an FTA is designed to eliminate tariffs after it is phased in, this Agreement eliminates virtually all of Australia's manufacturing tariffs on the first day the Agreement is implemented. This is significant to U.S. manufacturers as more than 90 percent of U.S. exports to Australia are manufactured goods. The FTA also provides specific obligations in important areas such as intellectual property, services, investment, and telecommunications, which are more difficult to quantify. Because the agreement will secure these obligations, U.S. companies may be more likely to use Australia as their base for expanded Asian operations. In the U.S.-Australia FTA , the issue of both a common language and culture contribute greatly to the potential for strengthening the existing trading relationship.

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[1] On Nov. 13, 2002, President Bush notified Congress of his intent to initiate FTA negotiations with Australia. USTR announced on Feb. 8, 2004, that the United States and Australia had successfully concluded negotiations for the U.S.-Australia FTA (negotiations began in March 2003). On Feb. 13, 2004, President Bush signed a letter notifying Congress of the intent to enter into the U.S.-Australia FTA; the letter started the process under which the agreement can be signed and sent to the Congress for approval. On March 3, 2004, the draft text of the U.S.-Australia FTA was made available to the general public. U.S. Trade Representative, "United States.-Australia Free Trade Agreement, found at *http://www.ustr.gov/new/fta/australia/text/index.htm.* On March 15, 2004, USTR received reports from 32 trade advisory groups commenting on the proposed U.S.-Australia FTA. U.S. Trade Representative Robert Zoellick and Australian Minister of Trade Mark Vaile signed the FTA on May 18, 2004.

United States - Australia Trade and Investment

The United States has enjoyed a bilateral merchandise trade surplus for a number of years with Australia: $3.9 billion in 2001, $5.9 billion in 2002, and nearly $6.0 billion in 2003. In 2003, U.S. domestic merchandise exports to Australia measured $12.4 billion, while U.S. imports for consumption from Australia measured $6.5 billion. The Australian economy is less than 5 percent the size of the U.S. economy. In 2003, Australia was the second largest U.S. trading partner in terms of positive trade balance position.[2]

By 2-digit SITC classification, the largest categories of U.S. merchandise exports to Australia in 2003 included transport equipment, road vehicles, specialized machinery, industrial machinery, equipment and parts, and miscellaneous manufactured articles. U.S. merchandise imports from Australia in 2003 included meat and meat preparations, beverages, metal ores and scrap, road vehicles, and petroleum and related products (figure ES-1).

U.S. cross-border exports of services to Australia measured $5.2 billion in 2002, resulting in a $2.3 billion surplus in services trade. The majority of U.S. cross-border service exports are transactions between U.S. parent corporations and their Australian affiliates, while 16 percent of U.S. exports comprise receipts of royalties and license fees. Sectors that account for significant portions of cross-border exports to Australia include travel and transportation; business, professional, and technical services; and financial (non-insurance) services. U.S. cross-border imports of services from Australia consist primarily of travel and transportation services, and business, professional, and technical services.

The U.S. stock of investment position in Australia measured $36.3 billion in 2002, and generated $2.6 billion in income. The United States is the leading foreign investor in Australia, and only Japan and Singapore have higher levels of U.S. investment within the Asia-Pacific region. U.S. investment in Australia is broadly based, with manufacturing accounting for about 30 percent followed by mining and finance and insurance (figure ES-2). Australian investment in the United States was valued at $24.5 billion in 2002, with the largest shares in manufacturing (14 percent); real estate, rental, and leasing (11 percent); and finance and insurance (6 percent).

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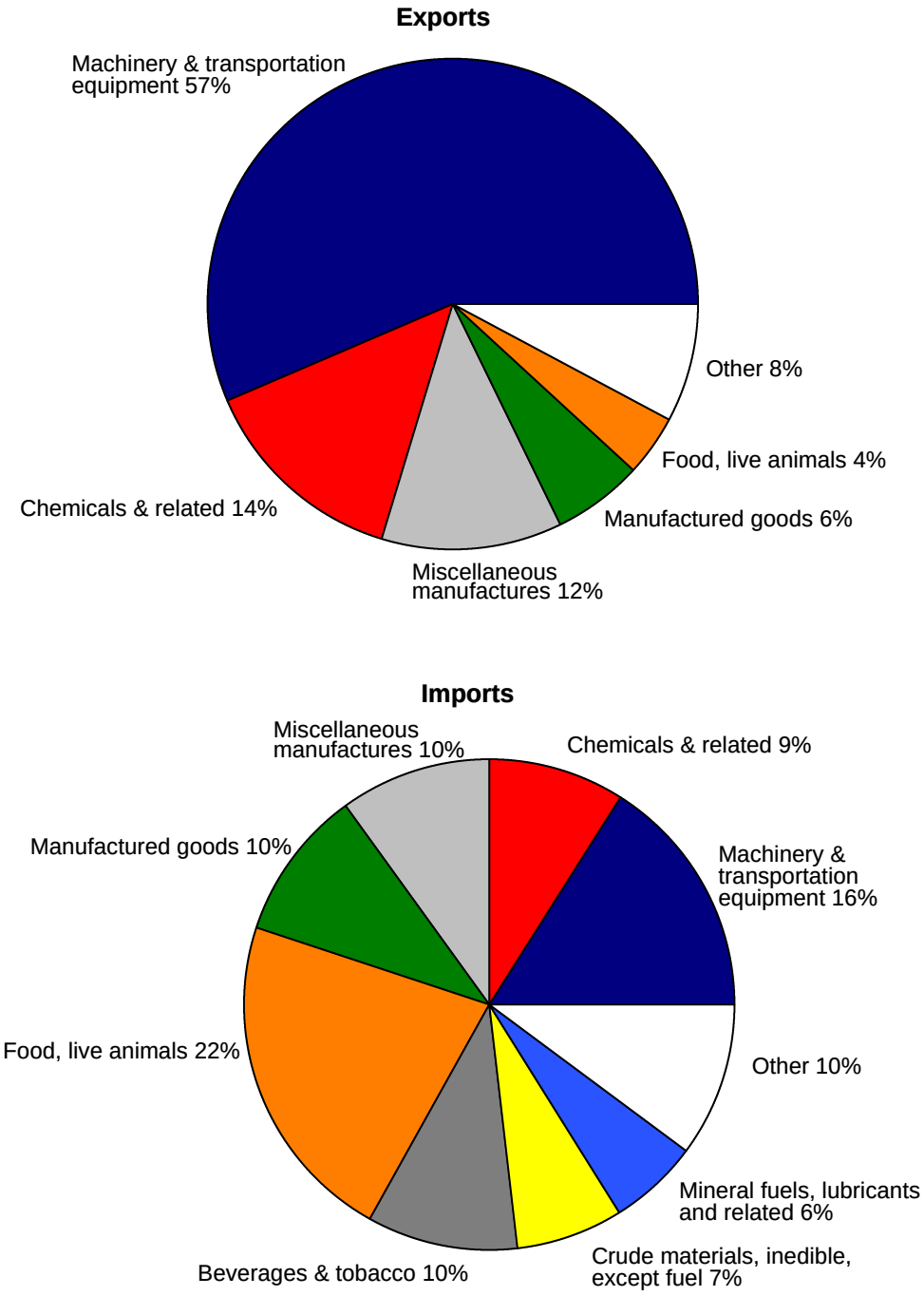
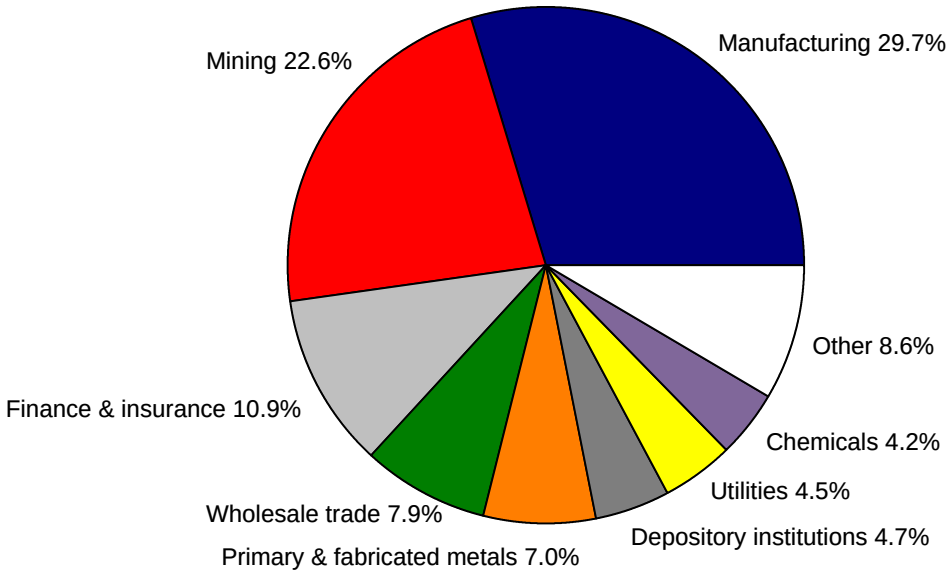
[2] The U.S. merchandise trade balance with Australia in 2003 was second only to the $8.23 billion balance with the Netherlands.

Figure ES-1
U.S. exports and imports from Australia, 2003, by sector



Source: Compiled from official statistics of the U.S. Department of Commerce.

Figure ES-2
U.S. direct investment in Australia, 2002



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* Sept 2003, p. 121.

U.S.- Australia FTA

Under the FTA's market access commitments, originating U.S. exports covered by a majority of HS headings (except textiles and apparel of chapters 50-63 and some motor vehicles of chapter 87) are eligible for immediate duty-free entry into Australia under staging categories A and E; six other staging categories—D, L, T1, Tx, T2 and T3—apply, eliminating duties ranging up to 25 percent ad valorem by January 1, 2015. Australia's exports to the United States are covered by 11 different duty staging categories, with duties phased out over periods of up to 18 years. Tariff-rate quotas apply to some agricultural commodities, and sugar is not included in the agreement. Rules of origin based mainly on specific changes in tariff classification, applicable to third-country inputs, determine eligibility for FTA treatment.

Many of the substantive commitments in the Agreement reflect obligations of the parties under World Trade Organization agreements on the same subject matter (although Australia is not a member of the Agreement on Government Procurement), and the language in this FTA in many places closely parallels provisions in recent FTAs with Singapore and Chile. The language of many Agreement chapters reflects the relatively similar legal and political systems and the comparable levels of development and economic complexity between the United States and Australia. Like other recent FTAs to which the United States is a party, the Agreement includes a bilateral

safeguard provision that allows a party to impose temporary relief measures during the transitional period of the Agreement.

Methodology

To provide the most comprehensive assessment of the effects of the U.S.-Australia FTA on the U.S. economy and specific sectors, the Commission has employed both a quantitative and a qualitative approach. The quantitative assessment is limited to the liberalization of tariffs and tariff-rate quotas only.

The non-quantifiable effects are associated with provisions related to investment, intellectual property rights, services, customs administration, and government procurement. These effects are not readily quantifiable due to the lack of necessary data and the intangible nature of some of these effects. Information to assess the liberalization of the barriers in these areas was obtained from industry and public sources; from testimony presented at the public hearing at the Commission; and written submissions in response to a Federal Register notice. Government sources, both in the United States and Australia, also were utilized to assemble information for the report.

For the liberalization of tariffs and tariff-rate quota (TRQs), the study employs a multicountry model with economywide coverage of merchandise and service sectors (a global computable general equilibrium model). The analysis is static and assumes the U.S.-Australia FTA is fully implemented and its effects felt on January 1, 2005. That is, it assumes that the FTA's provisions will not be phased in over time, or its effects gradually realized over time. The modeled results can be considered to be long-run effects, after all adjustments have worked their way through the economy, of a fully implemented agreement in an economy otherwise identical to the baseline 2005 economy.[3] This simulation liberalizes trade completely in all goods subject to liberalization under the free trade agreement. Sugar is excluded from the Agreement, and therefore this sector is not analyzed. The United States has relatively low tariffs, averaging 1.7 percent ad valorem on imports from Australia. The average applied MFN tariff rate for U.S. goods entering Australia is 4.3 percent ad valorem, down from 5.6 percent ad valorem in 1998. The average for agricultural goods is 1.2 percent ad valorem. The average for industrial products is 4.7 percent ad valorem. It is expected that those sectors that face relatively high trade restrictions will show larger effects from the implementation of the FTA.

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[3] Models are highly simplified descriptions of an economy, dependent on parameter estimates and subject to potential biases due to product and regional aggregations. See Appendix D.

The comprehensive assessment of the FTA has been grouped into four areas: market access, trade facilitation, investment, and regulatory environment. Impact assessments are presented for each of these four areas together with the chapters of the FTA addressing that subject area.

Market Access

Market access relates to the extent to which a good or service can compete with locally-made products in another market. In a bilateral sense, the term relates to the degree of openness or accessibility that foreign-made products experience in another market. The entire array of trade policy measures that a country employs to administer, measure, and support its trade regime affect the ability of a foreign produced product or service to enter another country under non-discriminatory conditions.

The market access provisions provide the principal guarantee of national treatment under the U.S.-Australia FTA for goods in bilateral trade. Relying upon broader commitments of the GATT 1994, the specific obligations in these provisions commit the two parties to progressively eliminate duties on originating goods and to implement a wide array of customs procedures that would enhance this trade. For example, provisions on temporary admission of goods, the treatment of containers, and duty-free entry of commercial samples would ensure consistent customs treatment by both parties. Many of these measures apply already to U.S. imports, under HTS chapter 98, but the Agreement would make the treatment of U.S. exports clear and simple. The Agreement also provides that no new duties or charges would be imposed, that the parties cannot apply import and export restrictions other than in limited cases, that administrative fees relating to trade would be limited to the cost of services rendered, and that merchandise processing fees must be eliminated. A Committee on Trade in Goods will provide institutional support in implementing and maintaining these measures.

Figure ES-3 presents an overview of the potential effects of the U.S.-Australian FTA in the market access area.

Economywide Effects of Tariff Liberalization

The most relevant and comprehensive measure of the impact that the quantifiable components (tariff liberalization) of the U.S.-Australia FTA will have on the U.S. economy as a whole is the change in welfare (i.e., the value to consumers of the Agreement in terms of increased income). It summarizes the benefits to consumers of tariff liberalization, as well as the effects on households in their roles as providers of labor, owners of capital, and taxpayers. According to the Commission simulation,

Figure ES-3
U.S.-Australia Free Trade Agreement: Market Access Effects

Subject negotiated and FTA chapter

Likely economic impact on U.S. economy: *Quantitative Assessment*

Market Access Provisions

Goods, ch. 2
- Tariff elimination on a wide range of goods.

Agriculture, ch. 3
- Tariff elimination on a wide range of agricultural products.
- Improved market access under TRQs for U.S. imports of certain products (dairy, beef).

Textiles, ch. 4
- Duty-free trade for imports that meet rules of origin.

Model based results

Complete implementation, full phase-in of tariff liberalization

Economywide results

Welfare—The effects of tariff removal under the FTA on U.S. economic welfare and GDP are likely to be minimal (less than 0.01 percent of U.S. GDP). Actual simulation result: between $434.8 and $639.4 million.

Exports—After full phase-in of tariff cuts, U.S. exports to the world are likely to be higher by 0.13 percent. For U.S. bilateral exports, the largest increases are expected to be for: coal, oil, gas, etc.; processed food; textile, apparel, and leather products; motor vehicles and parts; ferrous metals; and wood products. Key U.S. exports gain immediate duty-free access.

Imports—After full phase-in of tariff cuts, U.S. imports are likely to be 0.07 percent higher. For U.S. bilateral imports, the largest increases are expected to be for: meat products; processed foods; textiles and apparel; chemicals, rubber and plastic; and motor vehicles and parts. In most cases, the increases in trade with Australia come at the expense of trade with other partners.

Production—Little or no change in U.S. production in distinct U.S. industry sectors. The largest proportional impact is on meat products, output of which decreases by 0.3 percent. The largest positive change is an increase of 0.14 percent in the coal, oil, and gas sector.

Employment—Little or no change in U.S. employment in distinct U.S. industry sectors.

Consumers— Little or no impact on U.S. consumers (household prices).

Sectoral results

Exports—After full phase-in of tariff cuts, U.S. exports to Australia of coal, oil, gas, etc. would likely increase by 533.29 percent; processed foods, 62.43 percent; textile, apparel, and leather products, 87.16 percent; motor vehicle and parts, 43.32 percent; ferrous metals, 34.45 percent; and wood products, 30.19 percent. U.S. exports to Australia as a whole increase by 14.1 percent.

Imports—After full phase-in of tariff cuts, U.S. imports from Australia of meat products increase 55.2 percent; textiles, 57.7 percent (rules of origin will limit the model-simulated gains); processed food, 37.6 percent; chemicals, rubber and plastic, 21.0 percent; and motor vehicles and parts, 21.5 percent. Imports from Australia as a whole increase by 15.5 percent.

Figure ES-3-Continued
U.S.-Australia Free Trade Agreement: Market Access Effects

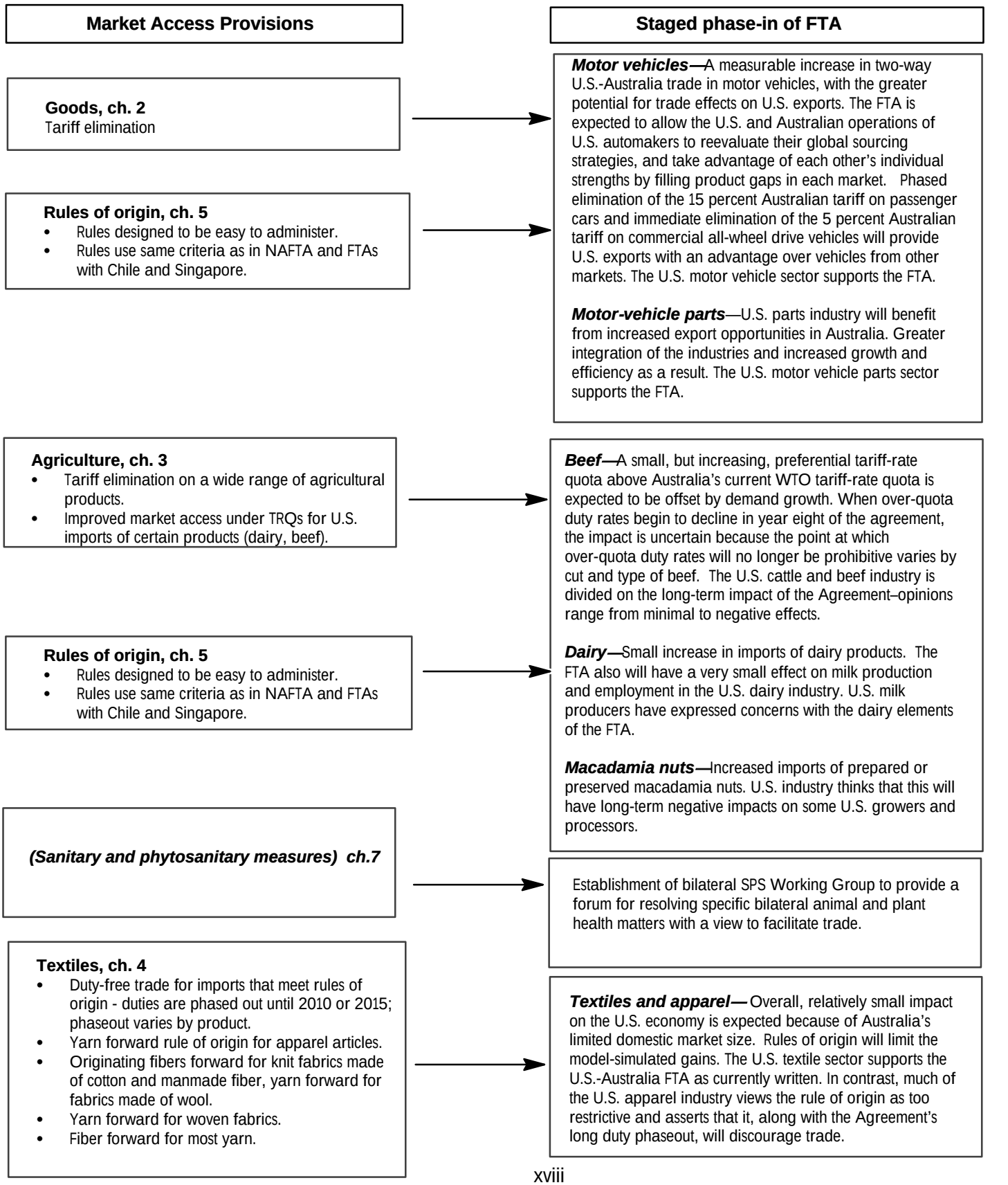
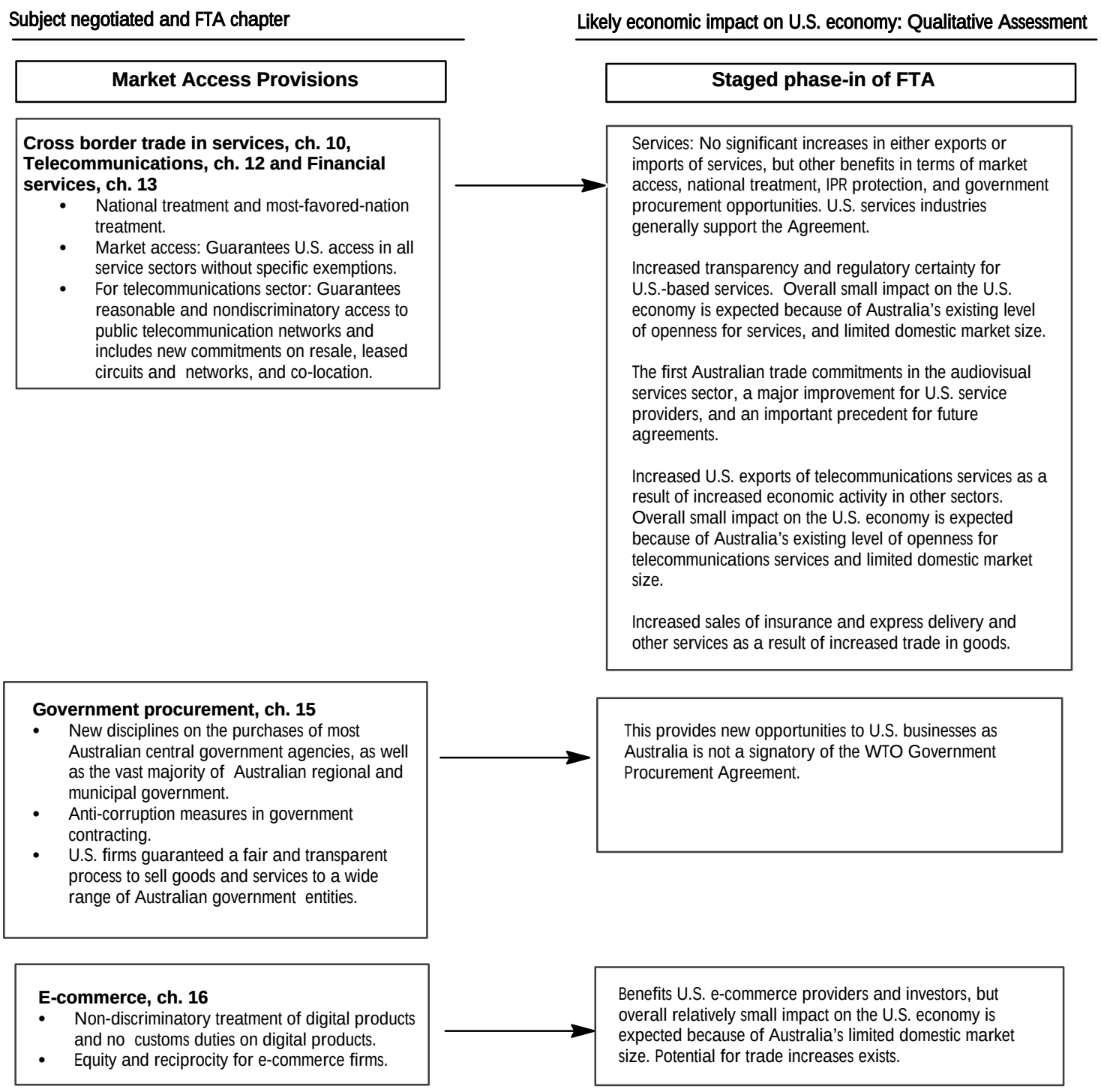


Figure ES-3-Continued
U.S.-Australia Free Trade Agreement: Market Access Effects



Sources: Text of the U.S.-Australia FTA found at *http://www.ustr.gov/new/fta/Australia/text/index.htm*. Impact estimates obtained from USITC estimates and calculations and compiled from multiple sources cited elsewhere in this report, including testimony from the Commission's public hearing for this investigation held on Mar. 30, 2004, written submissions in response to the *Federal Register* notice for this investigation (see appendix B), USITC staff interviews with industry officials, and reports filed by the various U.S. government trade policy advisory committees.

when tariff cuts have been fully implemented and all economic adjustments have occurred under the Agreement, overall U.S. welfare should increase in the range of $434.8 million to $639.4 million. That is, when fully implemented, the FTA would provide benefits to consumers within this range. Exports would increase by $1.5 billion and imports would increase by about $1.2 billion, with minimal impact on employment and output.

Sectoral effects

The largest percentage increases in trade are found in those sectors undergoing the greatest degree of liberalization. According to the Commission analysis, the sectors showing the greatest percentage increase in exports to Australia include coal, oil, gas, and other mineral products; textiles, apparel, and leather products; and other processed food and tobacco products. The greatest value increases in exports to Australia occur in other machinery and equipment, and motor vehicles and parts. U.S. imports of textile, apparel, and leather products; meat products; and other processed foods and tobacco products are expected to see the greatest percentage increases. The greatest increase in the value of imports is estimated to occur in meat products, with an increase of $758 million (an increase of 55 percent over the base level). However, total U.S. imports of meat products (includes beef, pork, and lamb) from the world are expected to increase by about 6 percent, and Australian imports likely would displace some imports from other U.S. sources. As indicated below, the impact of the FTA on beef imports is expected to be relatively small in the short term and uncertain in the long term.

Overall, some sectors of the U.S. economy likely will experience increased import competition from Australia, while other sectors likely will experience increased export opportunities in Australia. However, given Australia's economy and market size, any such increases would be from a small base and thus have a minimal impact on production, prices, or employment in corresponding U.S. sectors.

A more detailed analysis also was conducted for some sectors at a more disaggregated level. These sectors were selected according to their importance in the bilateral trade flows and the potential for the increased export opportunities relative to other foreign suppliers to the Australian market. The assessment was based on the staged implementation of the FTA.

Live Cattle and Beef

Under the FTA, Australia will receive immediate duty free access on all U.S. beef imports within existing WTO tariff-rate quota (TRQ) levels. Increased market access is initially granted in the form of a duty-free preferential TRQ in addition to Australia's current allocation of existing WTO TRQ. The preferential TRQ provisions of the FTA, however, will not be implemented until U.S. beef exports return to their 2003 levels, or the third year of the agreement, whichever comes first. The preferential TRQ increases from 15,000 metric tons in year two of the agreement to 70,000 metric tons in year 18.

A phased reduction of the over-quota duty rate begins in year nine of the agreement, dropping from 26.4 percent to zero in year 18. The agreement will have no immediate impact on U.S. exports of fresh, chilled, or frozen beef (HTS 0201 and 0202) to Australia because these products can currently enter Australia duty free.

The impact of the FTA on total U.S. beef imports in the first eight years of the Agreement likely will be relatively small because the amount by which duty-free entry can potentially increase is known and limited. Thus, the impact of the FTA on beef imports is expected to be small relative to U.S. production and consumption. The preferential tariff-rate quotas do not go into effect until U.S. beef exports exceed the amount exported in 2003, or year three of the agreement, whichever comes first, to allow U.S. beef exports time to recover from export bans related to discovery of a BSE positive cow in the United States. Consequently, the initial impact of the agreement will be elimination of the 4.4 cents per kg tariff on beef imports within the WTO quota, which increases Australian competitiveness vis-a-vis other beef exporters, but does not increase Australian access to the U.S. beef market. The impact during years nine through 18 is less certain because the specific timing and level of increased market access cannot be known.

The impact of the FTA on U.S. beef exports also is expected to be relatively small because most of Australia's beef production is grass-fed and hence Australians have developed a preference for grass-fed beef. In contrast, U.S. production is grain-fed. However, the Australian industry has developed a small, but growing grain-fed segment to supply its high value Asian markets. With increased access to grain-fed beef, Australians may develop a taste for grain-fed beef, resulting in a market for U.S. grain-fed beef exports.

Dairy

Under the FTA pertaining to U.S. imports of dairy products from Australia, 12 separate TRQs were established that cover almost all U.S. dairy imports already subject to TRQs under the WTO Agreement on Agriculture. Under the FTA, quota quantities increase annually and indefinitely by specified compound growth rates that range from 3 percent to 6 percent depending on the TRQ category. Over-quota tariffs on dairy imports from Australia remain at their NTR levels (i.e., there is no staged reduction of over-quota tariffs over time).

The U.S.-Australia FTA likely will result in a relatively small increase in U.S. imports of dairy products from Australia. The Agreement also is likely to have a small effect on U.S. milk production and employment in the dairy industry. This is so because the additional quantities of Australian dairy products entering the U.S. market as a result of the Agreement are relatively small in comparison with current levels of domestic dairy production and consumption. All dairy products exported to Australia currently face no duty rate and are not subject to sanitary/phytosanitary restrictions. Thus, the FTA is not expected to change the trade flows of dairy products into Australia.

Macadamia Nuts

Under the terms of the U.S.-Australia FTA, the current U.S. tariffs on raw shelled and in-shell macadamia nuts will be reduced to zero immediately for imports from Australia. The current U.S. tariff on prepared or preserved macadamia nuts will be phased out for Australia in equal annual stages until year four of the agreement.

The U.S.-Australia FTA will likely result in an increase in U.S. imports of prepared or preserved macadamia nuts from Australia. The current 17.9 percent ad valorem tariff on these nuts has generally kept Australian exports from entering the U.S. market. The U.S. industry thinks that increased imports of prepared or preserved macadamia nuts from Australia will lower the average macadamia kernel price in the United States, reducing farm gate prices, and, in the long term, result in the economic hardship for many growers and some of the smaller processors and manufacturers of value-added product in Hawaii. Australian production of macadamia nuts reached 65.5 million pounds in crop year 2003-04 and in 2002-03 (the most recent year for which export data are available) Australian exports were 51.8 million pounds.

U.S. exports to Australia in 2003 were less than 3 percent of U.S. total exports of macadamia nuts. The Australian tariff of 5 percent on prepared nuts will be eliminated immediately upon the implementation of the FTA, resulting most likely in an increase in U.S. exports, though not a significant one.

Motor Vehicles

The U.S. NTR tariff on passenger motor vehicles, including minivans and sport-utility vehicles, is 2.5 percent; the NTR tariff on trucks, including pickup trucks, is 25 percent; the NTR tariff on road tractors for semi-trailers is 4 percent; and the NTR rate on buses is 2 percent. All U.S. duties on motor vehicle imports from Australia will be eliminated upon entry into force of the FTA. Australian imports of new and used passenger motor vehicles, campers, and mobile homes are subject to an NTR 15 percent customs duty, legislatively scheduled to be reduced to 10 percent in 2005 and to 5 percent in 2010. New and used commercial and all-wheel drive vehicles are subject to an NTR 5 percent customs duty. Under the FTA, Australia would eliminate the 5 percent NTR duties upon entry into force of the Agreement, and reduce the 15 percent NTR duties in equal stages beginning on the date of entry into force of the Agreement, such duties to be eliminated as of 2010.

The U.S.-Australia FTA will likely result in measureable increases in bilateral U.S.-Australian trade in motor vehicles, with the greater effect expected for U.S. exports. Both the U.S. and Australian industries are dominated by the same two companies, General Motors and Ford. The FTA will allow the U.S. and Australian operations of these U.S. automakers to take advantage of each others' strengths by filling product gaps in each market. Australian tariff concessions may spur U.S. automakers to consider the export of U.S.-built products that may be marketable in Australia. Moreover, Australian demand for SUVs and pickup trucks is growing, and U.S. automakers are well-positioned to benefit from enhanced access to the Australian

market. Likewise, these automakers may reevalaute sourcing strategies and decide to source more or new passenger vehicles from Australia. In particular, removal of the 25 percent light truck duty may provide some incentive for automakers to import light trucks from Australia to fill market niches in the United States.

Certain Motor-Vehicle Parts

In the FTA, the United States and Australia both agreed to eliminate their tariffs on certain motor-vehicle parts immediately upon the implementation of the Agreement. The U.S. NTR rate on these motor-vehicle parts is 2.5 percent, and Australian NTR tariff is significantly higher, at 15 percent. Both the U.S. and Australian motor-vehicle parts industries likely will benefit from enhanced export opportunities with the U.S.-Australia FTA, particularly vis-à-vis other import sources lacking similar FTA benefits. The FTA may allow greater integration of the two industries and promote growth and efficiency, in part because of the industries' historic linkages. Moreover, the economic stimulus expected from the FTA likely will lead to an improved Australian market for motor-vehicle parts.

The U.S. motor-vehicle parts industry is likely to experience a net gain as a result of the U.S.-Australia FTA. Because of the relatively small size of the Australian motor-vehicle parts industry and the low level of U.S. tariffs (2.5 percent ad valorem or less) to be eliminated, the FTA likely will result in a small increase in U.S. imports from Australia and a negligible increase in total U.S. imports. However, the immediate elimination of the 15 percent Australian tariff on U.S. imports and the larger size of the U.S. industry likely will boost U.S. exports under the FTA, leading to a measurable increase in U.S. exports to Australia and a small increase in total exports.

Textiles, Apparel, and Footwear

U.S. imports of textiles and apparel likely will experience a small increase as a result of the FTA. Australia is a very small supplier of specialized, higher-end textiles and apparel to the United States. Also, most tariffs on the leading textile and apparel imports from Australia will be phased out over 10 years, thereby reducing the incentive to boost imports from Australia significantly in the short term. In addition following the elimination of U.S. quotas on textiles and apparel from WTO countries on January 1, 2005, Australian apparel exporters will face increased competition in the U.S. market from China and other low-cost exporting countries whose shipments are currently constrained by quotas. Immediate trade opportunities also may reportedly be limited by complicated customs procedures and a complex yarn-forward rule of origin. The model results, which do not reflect the yarn-forward rule, indicate a 57 percent increase in U.S. imports of textiles and apparel from Australia due to the FTA. However, a recent study by Centre for International Economics (CIE)[4] indicates that only about 9 percent of Australia's exports of textiles and apparel to the United States may qualify for tariff elimination under the Agreement's rules of origin. In this case, the Commission estimates that the increase in U.S. imports of textiles, apparel, and leather products due to tariff elimination could be as low as 10 percent.

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[4] Centre for International Economics, Canberra and Sydney, *Economic Analysis of AUSFTA—Impact of the Bilateral Free Trade Agreement with the United States,* April 2004, pp. 53-54.

The increase in U.S. textile and apparel exports to Australia likely will be small. It is likely that the greatest growth in U.S. sector exports will be in textile fabrics, particularly in specialized textiles for industrial use, a sector in which the United States is particularly competitive.

Services

The service sectors in the United States and Australia are substantially open. Therefore, the FTA is not expected to generate significant increases of U.S. exports or imports of services in the aggregate. The Agreement does provide other important benefits, however, particularly for U.S. providers of audiovisual, express delivery, and information technology services. One of the most important benefits is the automatic inclusion of services developed in the future. The FTA includes all services to be developed, unless a service is explicitly exempted in the Agreement (i.e., negative list approach). The FTA includes several important new benefits for service industries, in particular binding existing market access and national treatment in Australia, increased protection of intellectual property rights, increased government procurement opportunities, and additional e-commerce protections, including coverage of new products, and the non-discriminatory treatment of electronically delivered products (reducing or eliminating barriers that impede the use of e-commerce). The Australian commitments on audiovisual services represent Australia's first such commitments in a trade agreement, and are expected to set an important precedent for future U.S. bilateral trade agreements. The United States has a strong trade surplus with Australia in audiovisual services.

The FTA's creation of a Professional Services Working Group is expected to facilitate trade in professional services. The working group is to report regularly on progress in promoting mutual recognition arrangements beyond those in place for certain professions, and the creation of model standards and criteria for licensing and certification. The authority of U.S. states and Australian states and territories to regulate professional services is unaffected by the FTA (e.g., licensing).

Trade Facilitation

The range of activities that directly affect imports and exports-customs procedures, transportation rules and formalities, payments, insurance, etc., are all encompassed by the term "trade facilitation." The simplification and harmonization of such formalities and procedures across national borders constitutes facilitation. With the decline in the significance of duties as a result of successive multilateral rounds of tariff and trade negotiations, and the increased reliance on technology to aid in the international movement of goods and services, the cost of doing business is directly impacted by delays, complicated documentation, lack of automation, and the imposition of government-mandated trade procedures. A free trade agreement can be used by governments to attempt to lessen such costs and inefficiencies.

Under the U.S.-Australia FTA's chapter on customs administration, the parties would ensure that all trade-related legal measures are publicly available and that they are administered in a uniform, impartial, and reasonable manner so as to avoid creating obstacles to trade. An elaborate advance rulings process and access for importers to review procedures would simplify their dealings with customs authorities and at the same time help ensure that the agreement's commitments are carried out. In addition, a clear structure for cooperation in customs matters should assist in implementing the FTA and carrying out its terms. Importers would also benefit from the certainty arising from the FTA's provisions on penalties, release and security, risk assessment, and the treatment of express shipments. The end result should be expedited treatment of goods covered by the agreement.

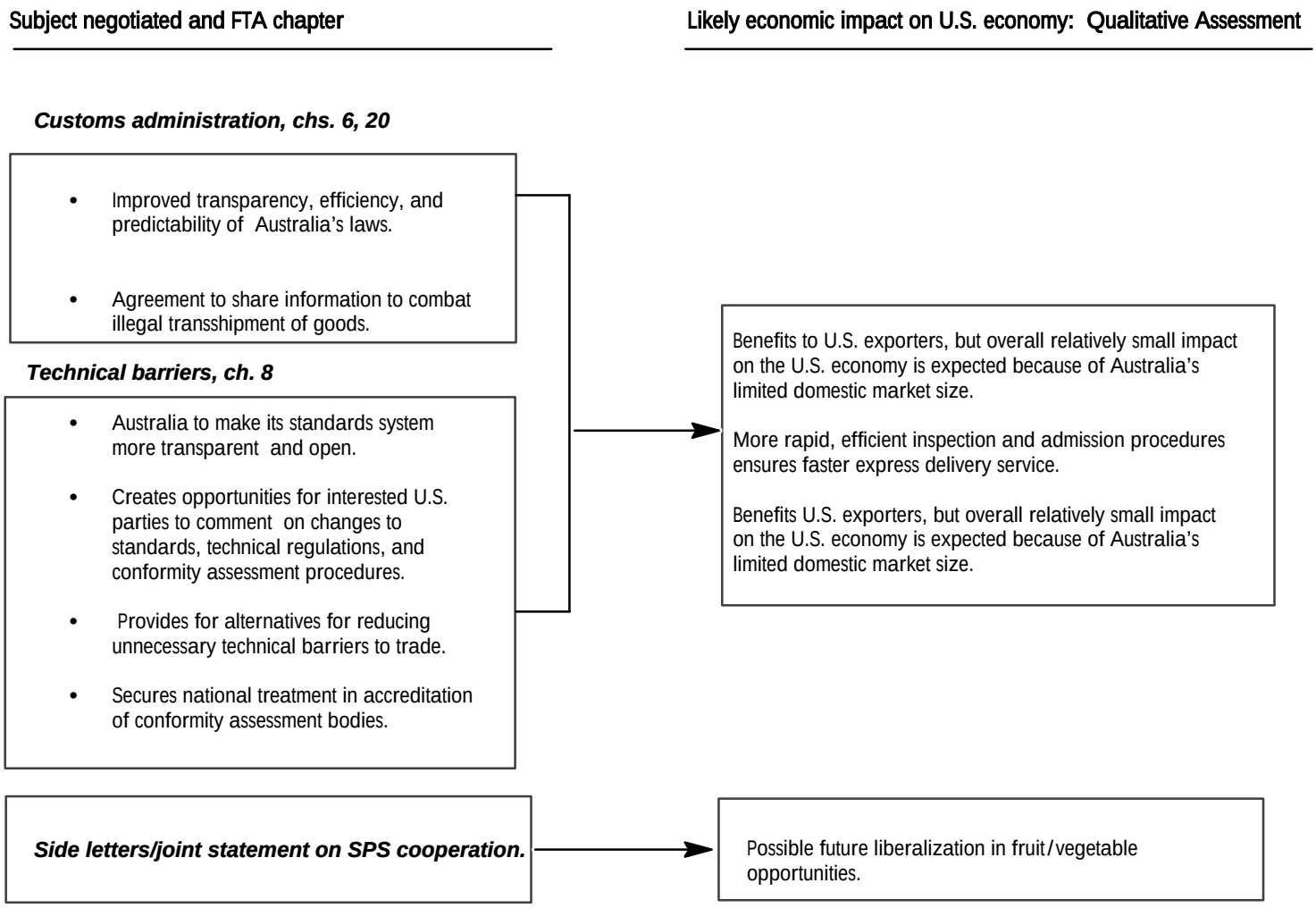
Figure ES-4 presents the likely effects of the U.S.-Australia FTA in the area of trade facilitation. The Commission analysis suggests that the effects of removing non-tariff barriers related to services, intellectual property rights, and investment under the U.S.-Australia FTA will have little impact on related U.S. sectors due to the relatively few existing trade barriers between the United States and Australia. Nonetheless, certain provisions in the FTA may foster trade facilitation in service industries. For example, removal of certain restrictive regulatory barriers may lead to increased U.S. exports in certain specific segments of the insurance industry, as well as greater sales by U.S. bank affiliates and affiliates of U.S. asset management firms in Australia.

Investment

Foreign investment is a primary channel by which businesses lower costs and increase competitiveness, essentially increasing the efficiency with which the world's scarce resources are used. Seen previously as an alternative means for supplying a foreign market, trade and investment are increasingly seen as complementary. As foreign investment grows in importance as an engine of economic growth, the lack of detailed investment rules creates an even greater need for trade agreements to fill this gap.

The U.S.-Australia FTA's provisions on bilateral investment would result in national and nondiscriminatory treatment for all covered activities, and would set a clear minimum legal standard against which the parties' laws would be measured for compliance. This chapter of the FTA would govern the treatment of investments in times of strife and the expropriation or nationalization of covered investment. It would also require that capital and other specified payments relating to covered investments be freely transferrable without delay into and out of the parties' territories. A range of performance requirements would be prohibited, and restrictions on the composition of senior management and boards of directors would likewise be barred. Procedures for dealing with investment disputes would be established, so that investors could know in advance how to manage their dealings with the parties. The chapter contains an annex which outlines the non-conforming measures that would not be covered by certain obligations of the chapter. Overall, the chapter provides investors a higher level of certainty regarding investment rules, which is likely to encourage investment.

Figure ES-4
U.S.-Australia Free Trade Agreement: Trade Facilitation Effects



Sources: Text of the U.S.-Australia FTA found at *http://www.ustr.gov/new/fta/Australia/text/index.htm*. Impact estimates obtained from USITC estimates and calculations and compiled from multiple sources cited elsewhere in this report, including testimony from the Commission's public hearing for this investigation held on Mar. 30, 2004, written submissions in response to the *Federal Register* notice for this investigation (see appendix B), USITC staff interviews with industry officials, and reports filed by the various U.S. Government trade policy advisory committees.

Figure ES-5 presents the effects of the U.S.-Australia FTA on investment. The FTA will add transparency to the investment regimes of the United States and Australia, but it is not expected to generate significant amounts of new investment between the two countries, as the investment environment in each is already substantially open.

The FTA contains some specific benefits for U.S. investors. The threshold for screening of new investments by Australia's Foreign Investment Review Board (FIRB) has been raised to A$800 million (US$519.5 million in 2003) for new investments in most sectors, up from the current threshold of A$50 million. Additionally, the FTA clearly specifies rules for investing in the audiovisual services industry, a first for a U.S. trade program. The U.S. business community, however, would have preferred that the FTA incorporate an investor-state dispute settlement provision,[5] and that Australia completely remove the FIRB investment screening process.

Regulatory Environment

The FTA effects that are attributable to improved regulatory environment are unmeasured and largely intangible but are believed to be significant. Improvements in competition policy and economic regulation affect how the market mechanism operates, the former by setting broad guidelines for how firms operate, the latter by setting in much greater detail the conditions of competition that affect how business operations take place typically using regulatory controls involving prices, quantities, qualities, and rules for entry into or exit from an industry.

The U.S.-Australia FTA would address a wide range of regulatory issues relating to bilateral trade. Additional intellectual property rights protections would be available, most of them immediately effective upon implementation of the FTA. Cooperation and consultations in dealing with anticompetitive business practices would be required; business conduct affecting competition and state enterprises would be subject to control. Protections and procedures applicable to bilateral investment would be provided, with a mechanism for investors to utilize in resolving disputes. With respect to both labor and the environment, effective enforcement of domestic law, efforts to improve national and international standards, and cooperation between governments and with the private sector are required, and the parties agree not to weaken environmental laws to attract investment.

Figure ES-6 presents likely impacts of the U.S.-Australian FTA in a number of areas that are among the most difficult to quantify. Covered are the following areas, most of which are addressed by a separate chapter of the Agreement: intellectual property, competition policy, trade remedies, labor, environment, transparency, and dispute settlement.

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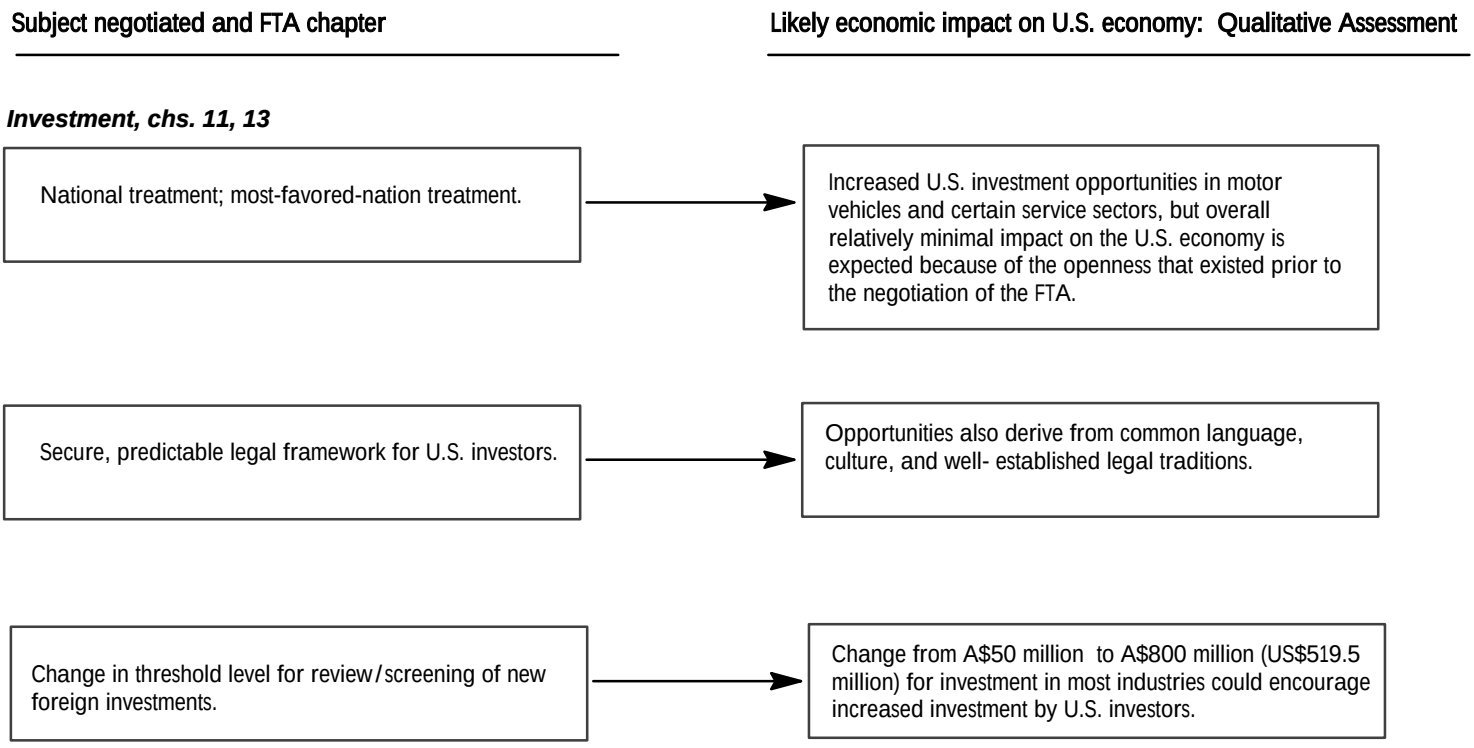
[5] Under an "investor-state" mechanism, foreign investors may settle investment disputes through arbitration directly with the host country government.

Figure ES-5
U.S.-Australia Free Trade Agreement: Investment Effects



Sources: Text of the U.S.-Australia FTA found at *http://www.ustr.gov/new/fta/Australia/text/index.htm*. Impact estimates obtained from USITC estimates and calculations and compiled from multiple sources cited elsewhere in this report, including testimony from the Commission's public hearing for this investigation held on Mar. 30, 2004, written submissions in response to the *Federal Register* notice for this investigation (see appendix B), USITC staff interviews with industry officials, and reports filed by the various U.S. Government trade policy advisory committees.

Figure ES-6
U.S.-Australia Free Trade Agreement: Regulatory Environment Effects

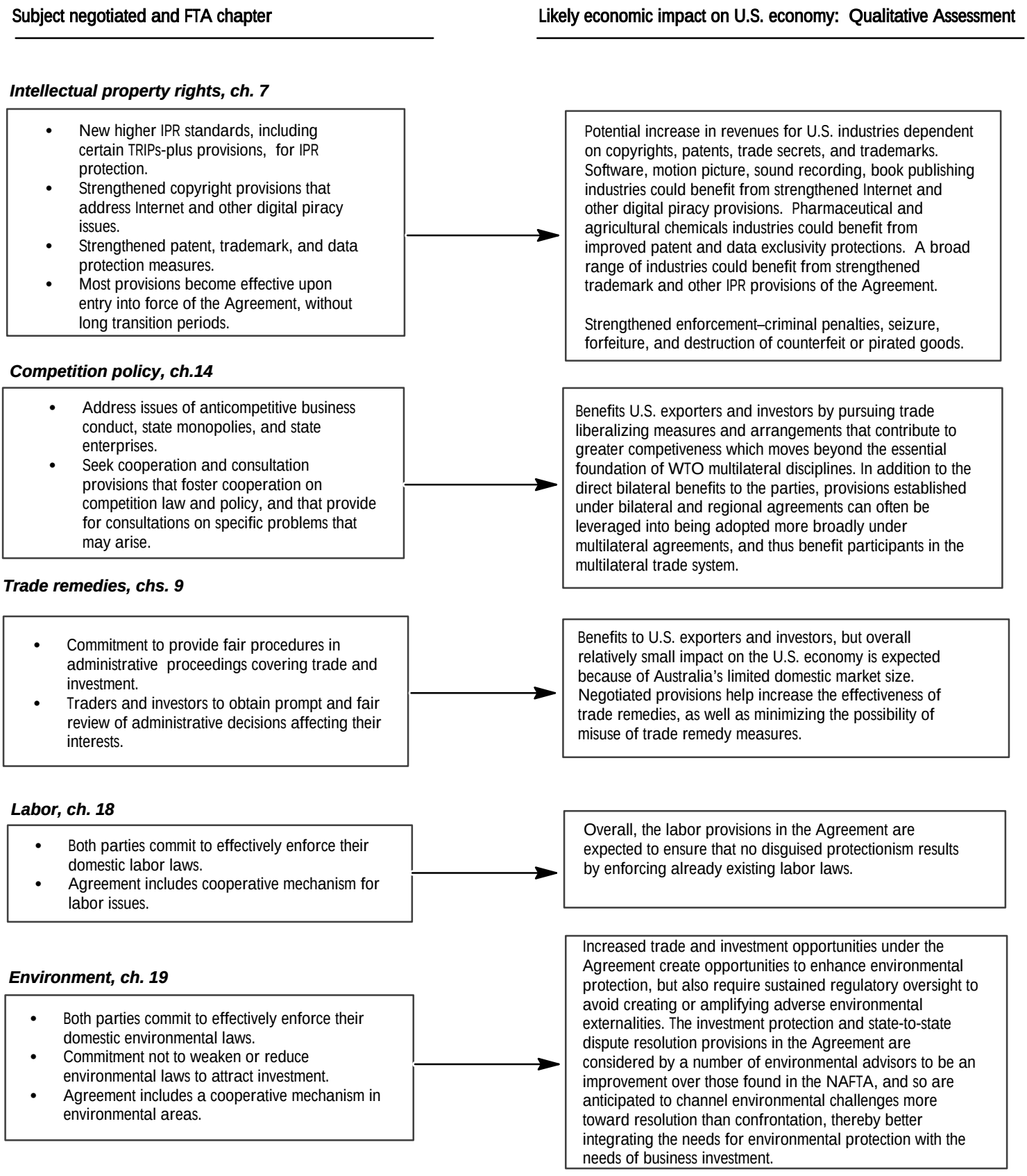


Figure ES-6-Continued
U.S.-Australia Free Trade Agreement: Regulatory Environment Effects

Subject negotiated and FTA chapter	Likely economic impact on U.S. economy: Qualitative Assessment
Institutional Arrangements and Dispute Settlement, ch. 21	
• Encourage the early identification and settlement of disputes through consultation.	Benefits U.S. exporters and investors by ensuring the transparency and predictability of government-to-government dispute settlement, as a prerequisite for competitive business under fair conditions. Benefits business decisionmaking and competitive conditions by focusing on fine-based penalties that are less likely to disrupt trade flows between the parties than a dispute-settlement mechanism that results in trade restrictive measures.
• Seek to establish fair, transparent, timely, and effective procedures to settle disputes that might arise under the agreement.	Strengthening of the overall business climate and the opportunities for increased bilateral trade and investment.

Sources: Text of the U.S.-Australia FTA found at *http://www.ustr.gov/new/fta/Australia/text/index.htm*. Impact estimates obtained from USITC estimates and calculations and compiled from multiple sources cited elsewhere in this report, including testimony from the Commission's public hearing for this investigation held on Mar. 30, 2004, written submissions in response to the *Federal Register* notice for this investigation (see appendix B), USITC staff interviews with industry officials, and reports filed by the various U.S. Government trade policy advisory committees.

The FTA provides for improved protection and enforcement for copyrights and other intellectual property and may lead to increased revenues for certain U.S. industries dependent on intellectual property rights.

The U.S.-Australia FTA goes further than the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) by extending the terms of protection for copyrights, trademarks, patents, trade secrets, and other forms of intellectual property rights.

The U.S.-Australia FTA strengthens enforcement of copyright piracy and trademark counterfeiting, by requiring that certain infringements be considered a criminal offense when engaged in willfully and on a commercial scale. It also requires the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them.

According to U.S. industry representatives, an important achievement of the FTA is that it addresses Internet and other digital piracy, which was not specifically addressed in TRIPs.

The U.S.-Australia FTA is expected to result in increased revenues for U.S. industries dependent on intellectual property protection. U.S. copyright industries that would potentially benefit most from strengthened provisions regarding digital piracy are the motion picture, sound recording, software, and book publishing industries. Industries that could benefit from greater patent and data protection provisions are the pharmaceutical and agricultural chemicals industries. A broad range of U.S. industries should benefit from strengthened trademark and other IPR provisions of the FTA.

Literature Review

Studying the economic impact of FTAs entails investigating static effects, such as trade creation and trade diversion, as well as terms of trade (i.e., the price of exports relative to the price of imports). In addition, related scale effects and nonquantifiable effects have to be considered. The FTA effects that are attributable either to the liberalization of the supply of services, or to FTA provisions regarding intellectual property rights, or investment usually remain unmeasured. As the review of literature shows, these FTA effects could be more significant than the effects of removing tariffs.

A small number of studies have directly assessed the impact on the United States of a hypothetical U.S.-Australia FTA. There are three studies employing computable general equilibrium analysis of a U.S.-Australia FTA that directly assess the impact of such an FTA on the United States. These studies all estimated a very small effect of a potential U.S.-Australia FTA on the United States.

These studies generally estimated the effects of removing all tariffs and selected non-tariff barriers, although one, with the smallest estimated effects, only considered

the removal of tariffs. The welfare benefit to the United States was estimated by these studies to be in the range of 0.01 percent of U.S. GDP to 0.20 percent. The USITC welfare estimate was similarly small and within the range of estimates in the literature.

A study by CIE[6] finds small positive effects, both for Australia and the United States, whereas ACIL[7] finds small negative effects of the Agreement on Australia. Brown, Kiyota, and Stern[8] find larger positive effects for both countries, modeling large effects of liberalization in services, and strong dynamic effects of investment liberalization, among other things.

To compare more directly the outcomes of these other models to that of the Commission, the USITC model was used to prepare welfare estimates using the tariff assumptions of the other models. By applying the alternative trade barriers to the USITC model, the objective was to determine the extent to which the results obtained by other authors depended on the barriers, as opposed to other differences between the models. For the most part, differences did not depend on assumptions related to trade barriers but on the assumptions related to substitution elasticities, investment effects, and scale economies.[9]

Interested Parties

Interested party views of the FTA expressed in direct testimony to the Commission in this investigation, as well as written submissions, have been mixed, but on balance generally positive. The majority of interested parties praised the text and provisions of the FTA, particularly those parties representing the services sector. Specifically, interested parties indicated that the commitments in the FTA provide for enhanced market access, promote a stable business environment for certain service providers, facilitate bilateral trade, and offer a high degree of intellectual property rights protection for firms. With some exceptions, representatives of the manufacturing and

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[6] Leon Berkelmans, Lee Davis, Warwick McKibbin, and Andrew Stoeckel, "Economic Impacts of an Australia-United States Free Trade Area," Centre for International Economics, Canberra and Sydney, June 2001, found at Internet address *http://www.dfat.gov.au/publications/aus_us_fta/aus_us_fta.pdf*, retrieved Apr. 20, 2004. (Cited as CIE 2001.) In 2004 CIE issued a follow-up after the FTA was negotiated. The new study does not report findings for the United States., and it reports slightly higher positive effects for Australia than did the 2001 CIE report. See: CIE, Economic Analysis of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States, Centre for International Economics, Canberra and Sydney, April 2004.

[7] ACIL Consulting, " Bridge Too Far?" An Australian Agricultural Perspective on the Australia/ United States Free Trade Area Idea, Report of the Rural Industries Research and Development Corporation, Canberra, February 2003.

[8] Drusilla K. Brown, Kozo Kiyota, and Robert Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," Feb. 8, 2004, found at Internet address *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved Apr. 20, 2004.

[9] For a further discussion of the studies reviewed by the Commission, see chapter 8, "Review of Literature."

commodity goods sectors praised the FTA and felt that implementation of the Agreement will improve commercial trade. Indeed, companies expressed satisfaction that this Agreement eliminates virtually all of Australia's manufacturing tariffs on the first day the Agreement is implemented. They also thought the Agreement will provide for strong IPR protection for U.S. manufacturers. A few parties expressed concern that the carve out for sugar could lead other countries to withhold commitments in future agreements. Dissenting views were expressed by three U.S. Senators and one Congressman. Congressional areas of particular interest were the dairy and beef sectors and the Hawaiian macadamia nut industry. Of the twelve groups or company representatives who appeared before the Commission, ten were positive in their reaction to the FTA, while two expressed a differing opinion on the pact with Australia. Dissenting opinions were expressed concerning the impact of the FTA on the beef and dairy as well as macadamia nuts sectors.

CHAPTER 1
Introduction

Purpose of the Report

This report analyzes the likely impact of the U.S.-Australia Free Trade Agreement (FTA) on the U.S. economy as a whole and on specific industry sectors and the interests of U.S. consumers. The U.S. International Trade Commission (USITC or "the Commission") initiated work on this fact-finding investigation in accordance with section 2104(f) of the Trade Act of 2002 following receipt of a letter of request from the United States Trade Representative (USTR) on February 17, 2004.[1]

As specified in section 2104(f)(2)-(3) of the Trade Act, the Commission shall submit to the President and the Congress (not later than 90 calendar days after the President enters into the agreement)[2] a report assessing the likely impact of the U.S.-Australia FTA on the U.S. economy as a whole and on specific industry sectors, including the impact the Agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the Agreement, and the interests of U.S. consumers.

Section 2104(f)(3) states that the Commission, in preparing its assessment, will review available economic assessments regarding the agreement, including literature regarding any substantially equivalent proposed agreement, and include in its assessment a description of the analyses used and conclusions drawn in such literature and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the Agreement.

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[1] A copy of the request letter from USTR is in Appendix A. The Commission's *Federal Register* notice of institution for this investigation is in Appendix B.

[2] On Nov. 13, 2002, President Bush notified Congress of his intent to initiate FTA negotiations with Australia. USTR announced on Feb. 8, 2004 that the United States and Australia had successfully concluded negotiations for the U.S.-Australia FTA (negotiations began in Mar. 2003). On Feb. 13, 2004, President Bush signed a letter notifying Congress of the intent to enter into the U.S.-Australia FTA; the letter started the countdown for when the Agreement can be signed. On Mar. 3, 2004 the text of the U.S.-Australia FTA was made available to the general public. U.S. Department of Commerce, "U.S.-Australia Free Trade Agreement," found at *http://www.mac.doc.gov/AustraliaFTA/whatsnew.html.* On Mar. 15, 2004, USTR received reports from 31 trade advisory groups commenting on the proposed U.S.-Australia FTA.

Scope of the Report

This report provides an analysis of the likely impact of the U.S.-Australia FTA on the U.S. economy as a whole and on specific sectors and the interests of U.S. consumers. It includes a brief profile of the Australian economy as well as a summary of the proposed U.S.-Australia FTA. It also includes a review of relevant economic literature on the Agreement.

The Commission's analysis examines all 23 chapters of the FTA.[3] A quantitative assessment is conducted for Chapters 2-4 (i.e., liberalization of tariffs and selected nontariff barriers) that increase market access for U.S. products in Australia. This computational analysis is supplemented with a qualitative analysis of the potential impact of increased market access on certain product and service sectors including live cattle and beef; dairy products; citrus fruit; certain fresh and processed fruit; macadamia nuts; motor vehicles; motor-vehicle parts; textiles, apparel, and footwear; agricultural and horticultural machinery; household appliances; and such service sectors as audiovisual services, express delivery services, financial services, information technology services, and education services (Chapters 5, 7, 10, 12, 13, 15, and 16). Due to the data constraints and intangible nature of effects, a qualitative assessment is conducted for negotiated objectives that facilitate trade (Chapters 6, 7, 8, and 20), enhance investment opportunities (Chapters 11 and 13), and improve regulatory environment (Chapters 9, 10, 12, 14, 17-19, and 21).

Approach of the Report

For the quantitative assessment, the study employs a multicountry model with economywide coverage of merchandise and service sectors (a global computable general equilibrium model). This USITC model is based on the Global Trade Analysis Project (GTAP) database, which is described more fully in appendix D. It was used to estimate the likely trade and economic impact of the tariff and tariff-rate quota reductions of the U.S.-Australia FTA for 23 aggregated sectors. The commodity aggregation adopted here identifies sectors that have relatively high domestic-world price gaps due to tariffs and tariff-rate quotas (TRQs) and relatively large trade flows. The economies covered in the analysis included the United States and Australia, as well as 11 regional aggregates representing the rest of the world.

The GTAP database, which represents the global economy in 2001, was adjusted to reflect expected changes in the global economy through economic growth in the world in 2005, the year the proposed U.S.-Australia FTA is scheduled to enter into force. The adjusted database reflects the scheduled removal of textile and apparel quotas under

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[3] Chapters 1, 20, 22, and 23, covering administrative and legal matters surrounding the FTA have not been specifically focused on in this report.

the Agreement on Textiles and Clothing, as well as other international agreements. The data also reflect the FTAs between the United States and NAFTA partners, Israel, Jordan, Chile and Singapore.[4] The analysis is static and assumes the U.S.-Australia FTA is fully implemented and its effects felt on January 1, 2005. In the model, the FTA's provisions are not phased in over time, nor are its effects assumed to be gradually realized over time. A series of simulations was conducted to determine the sensitivity of impacts to the critical parameters that determine the response to changes in trade prices. The analysis and discussion of FTA impacts are based on the ranges obtained from the sensitivity analysis.

The literature review for this investigation includes a description of analyses of the economic effects of other free trade agreements substantially similar to the proposed U.S.-Australia FTA. The economic literature reviewed was drawn from relevant academic, public sector, and private sector institutions.

The qualitative analysis includes an assessment of the potential impacts on U.S. imports, U.S. exports, and the U.S. industry as a whole of specific provisions of the proposed U.S.-Australia FTA. Product and service sectors identified for qualitative analysis were selected based upon a comprehensive examination and consideration of the following: examination of the trade liberalization schedules of the U.S.-Australia FTA to assess the relative liberalization of sectoral trade with respect to tariff and nontariff measures; U.S.-Australia bilateral trade flows; assessments of the apparent sensitivity of specific industries, commodities, and service sectors; and determinations made based on the expertise of Commission industry analysts. Unlike the quantitative analysis of Chapter 3, the qualitative analysis in Chapter 4 assesses the impact of the U.S.-Australia FTA by taking into account the staging process.

Economic models capture many important factors for the question under consideration. However, they are limited in their ability to reflect the degree of complexity evident in the real world.[5] Therefore, qualitative analysis is conducted to supplement the model-based analysis. The major contribution of the model-based analysis is its consideration of all sectors in the U.S. economy, as well as their relative economic importance. The contribution of the qualitative analysis is its consideration of commodity-specific issues.

Data and other information for the study were obtained from industry reports, interviews with government and industry contacts, official reports of the USTR advisory committees, hearing testimony,[6] written submissions to the Commission, and the GTAP database. Other data sources include the U.S. Department of Agriculture; the U.S. Department of Commerce; the U.S. Department of State; the U.S. Embassy in

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[4] The adjusted database also reflects Uruguay Round tariff reductions insofar as they are reflected in trade data projected to 2005. Moreover, the FTAs between Australia and its trading partners are modeled for selected products where necessary data are available. The agreement between Australia and Thailand pertaining to motor vehicles and parts is incorporated.

[5] See Appendix D for a discussion of the limitations related to the modeling framework.

[6] Hearing date: Mar. 30, 2004.

Canberra, Australia; the International Monetary Fund (IMF); the World Trade Organization (WTO); the Australian Department of Foreign Affairs and Trade; and the Australian Productivity Commission.

Organization of the Report

Chapter 2 of this report presents an overview of the U.S.-Australia FTA. Chapter 3 reports quantitative estimates of the likely trade and economywide effects for the United States of increased market access due to the removal of tariff and selected nontariff barriers (for which tariff equivalents were available) in the U.S. and Australian economies. The assessment of the U.S.-Australia FTA reports a number of measures of U.S. economic activity, including exports, imports, production, and employment. Chapter 4 presents the results of a qualitative analysis of the likely impact of the U.S.-Australia FTA on selected sectors. Chapter 5 discusses the investment provisions of the U.S.-Australia FTA and provides a qualitative assessment of the potential impact on the United States. Chapter 6 provides a survey of the intellectual property rights (IPR) provisions of the U.S.-Australia FTA and provides a qualitative assessment of the potential impact on the United States. Chapter 7 addresses the effects of a number of other nonquantifiable facets of the Agreement: e-commerce, government procurement, customs administration, technical barriers to trade, competition policy, trade remedies, labor, and environment. Chapter 8 presents the literature review as well as the comparison between the Commission's findings and the findings from studies reviewed. The report concludes with Chapter 9, an overview of the positions and views of interested parties who responded to the Commission's Federal Register notice inviting public submissions on the impact of the U.S.-Australia FTA.

Country Profile

Figure 1-1 provides an economic profile of Australia, presenting data on recent macroeconomic indicators, important products in Australian world trade, leading trading partners, and the major products in bilateral trade with the United States. The overview provides the main features of the Australian economy relevant to the Commission's assessment of the U.S.-Australia FTA.

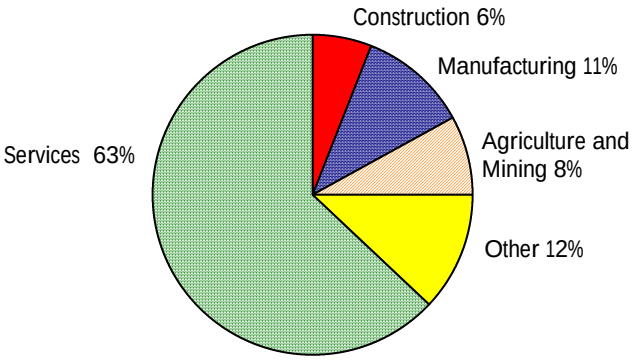
AUSTRALIA

ECONOMIC PROFILE

Economic indicators

	2002	2003
Population (mn)	19.7	19.8
GDP (nominal A$ bn)	734.3	779.7
GDP (US$ bn)	398.9	505.6
Real GDP growth (%)	3.8	3.0
Goods exports (US$ mn)	65,099	69,723
Goods imports (US$ mn)	70,530	83,806
Trade balance (US$ mn)	-5,431	-14,083
Exchange Rate (A/US$)	1.84	1.54
Exchange Rate (US$/A)	0.56	0.75

Origins of GDP (2002)



Source: Economist Intelligence Unit (EIU), "Australia: Economic Structure," *EIU Viewswire,* April 2004.

Main trade commodities, US$ million, 2003

Exports		Imports	
Coal	8,021	Motor vehicles	7,915
Gold	4,325	Petroleum	5,070
Iron ore	3,751	Computers	3,576
Petroleum	3,716	Aircraft	3,334
Aluminum	2,784	Medicines	3,247

Main trade partners, percent of total, 2003

Export markets		Suppliers	
Japan	18.2	United States	15.3
United States	8.8	Japan	12.5
China	8.4	China	11.0
New Zealand	7.6	Germany	6.1
Korea	7.5	United Kingdom	4.2

Source: Government of Australia, Dept. of Foreign Affairs and Trade.

Economic overview

Australia ranks as the 10th largest industrialized economy in the world (based on 2003 rankings of members of the Organization for Economic Cooperation and Development).

Australia's economy is small relative to that of the United States. Australia's gross domestic product (GDP), is 4.6 percent the size of the U.S. GDP. Australia's population is 6.7 percent of that of the United States.

Services account for approximately 63 percent of Australia's GDP. The largest service sector is finance and business services, which accounts for 17.5 percent of Australia's GDP.

Raw materials, primarily metals and minerals, are Australia's largest global exports. Passenger motor vehicles ranked as Australia's leading import in 2003.

Almost 9 percent of Australian exports were sent to the United States in 2003, making the United States Australia's second largest export destination.

The United States was Australia's leading supplier in 2003, accounting for over 15 percent of total Australian imports.

In addition to membership in the World Trade Organization (WTO), Australia is a member of the Asia-Pacific Economic Cooperation (APEC) forum and the Organization for Economic Cooperation and Development (OECD).

Australia's other key bilateral trade agreements include:

- Australia-Thailand FTA (signed October 2003);
- Australia-Singapore FTA (eff. July 2003);
- Australia-New Zealand Closer Economic Relations FTA (1983); and
- Australia-Japan Trade and Economic Framework (2003) to liberalize bilateral trade and investment.

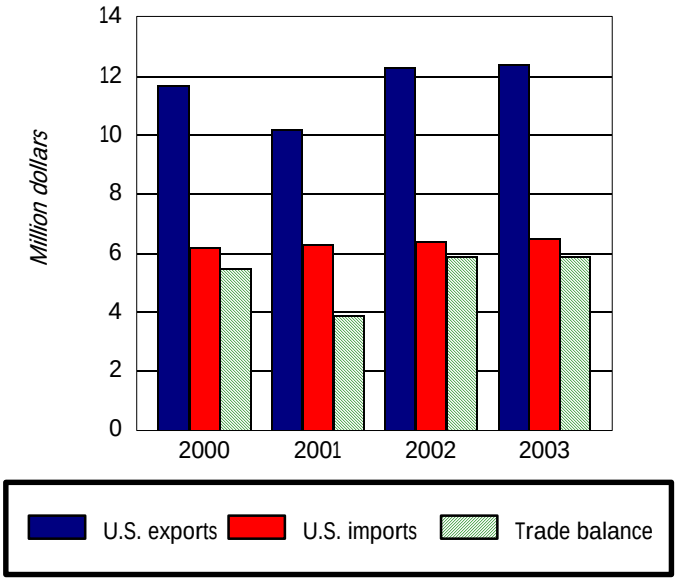
Australia also participates in other regional trade and economic fora, including:

- Association of Southeast Asian Nations (ASEAN)-CER Closer Economic Partnership to expand trade and investment and promote economic integration between Australia and New Zealand and the ASEAN FTA members, and
- The Indian Ocean Rim Association for Regional Cooperation group of 18 Indian Ocean littoral and island states, organized to facilitate trade and investment in the region.

ECONOMIC OVERVIEW-Continued

Selected U.S. exports to Australia, US$ million, 2003

Aircraft	1,614
Aircraft parts	367
Medicines	220
Motor vehicle parts	216
Purebred breeding horses	202
Fertilizers	165
Computer parts	141
Motor vehicles	133
Off-highway dump trucks	131
Medical, surgical, veterinary instruments & parts	122



Source: Compiled from official statistics of the U.S. Department of Commerce.

Selected U.S. imports to Australia, US$ million, 2003

Beef, frozen	726
Wine	615
Crude petroleum	267
Beef, fresh or chilled	163
Aluminum oxide	159
Motor vehicles	140
Sweaters and pullovers, cotton, knitted or crocheted	135
Titanium ores and concentrates	121
Meat of sheep, cuts with bone in, fresh or chilled	110
Airplane or helicopter parts	107

CHAPTER 2
Overview of the U.S.-Australia FTA

Background on Free Trade Agreements

Like other free trade agreements (FTAs) to which the United States is a party,[1] the proposed agreement between the United States and Australia would create a preferential regime with a specific, negotiated range of goods and services measures of mutual benefit or interest to the parties and with commitments covering other trade-related matters. The FTA would cover almost every product in bilateral trade, with rules setting the scope of preferences for goods under each tariff category.[2] The preamble states that this pact would strengthen cooperation and economic ties, set a structure of rules on bilateral trade, reduce barriers between the two partners, and improve the business environment while fostering creativity. The 23 chapters of the Agreement set forth the legal obligations of the parties, together with schedules of concessions, rules of origin, and annex commitments and exceptions, that were negotiated to cover trade-related matters of interest to the parties. Commitments on investment, intellectual property, environment, labor, and similar matters also are included in the agreement.

Brief Summary of Treaty Provisions

Introduction

While the text[3] of the FTA with Australia is largely modeled upon recent FTAs negotiated and implemented by the United States, it reflects that both parties are developed nations with relatively similar legal systems, subordinate governmental entities, and complex business structures. Certain provisions are identical to corresponding provisions in the North America Free Trade Agreement (NAFTA) or FTAs with Singapore and Chile, while others reflect and rely upon multilateral instruments of the World Trade Organization (WTO). For example, the text contains

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[1] Agreements with Canada, Israel, Jordan, Mexico, Singapore, and Chile are already in place.

[2] One product sugar, which is produced and processed in significant quantities in both countries–is not afforded any benefits.

[3] The draft text of the Agreement as of March 3, 2004, as posted on the Web site of the Office of the United States Trade Representative, is the basis of this chapter. See *http://www.ustr.gov/new/fta/Australia/text/index.htm* for the Agreement and its side letters, along with other information.

preferential agricultural tariff-rate quotas[4] (TRQs) based on broader WTO TRQs, as well as provisions relating to intellectual property protections that adopt by reference or draw upon commitments in other agreements. The draft FTA also includes commitments to observe certain WTO agreement obligations between the parties; these bilateral obligations would continue to exist independently even if the WTO agreement provision on the corresponding matter were eliminated or somehow ceased to apply. Other FTA commitments deal with specific aspects of U.S. trade relations with Australia, as is further reflected by numerous side letters on specific matters. Some portions of the agreement–such as those dealing with market access and intellectual property rights–are particularly significant and will be described in greater detail below. The discussion attempts to summarize briefly the text of agreement chapters and is not intended to interpret them or identify the negotiators' intent.

Summary of Tariff Commitments

Under the Agreement and its schedules of concessions, duties on a wide range of eligible goods would be eliminated immediately, while duties would be phased out for more sensitive originating goods of the regions. Most goods produced in the United States (other than textiles and apparel and some motor vehicle products) under the terms of the Agreement's rules of origin[5] would be guaranteed existing duty-free access or be made immediately free of duty. Australia's base duty rates fall into several bands–free, 5 percent, 10 percent, 15 percent or 25 percent–and these duties would be eliminated for originating goods under six staging categories. By contrast, the more complex duty structure of the United States would give rise to 11 duty staging categories for Australia's exports, with duties phased out over periods of 4 to 18 years. Sensitive Australian agricultural shipments to the United States would receive benefits under special tariff-rate quotas; a small number of tariff categories see little tariff reduction until the end of the transition period.

These FTA tariff benefits are given only to "originating goods" under the terms and rules of the Agreement, and the rules are based upon the shared Harmonized System (HS) tariff nomenclature structure. Originating goods are of two types–namely, those

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[4] In a TRQ, two rate lines are minimally required, with one according a lower duty rate to imports up to a specified trigger quantity, and a second one according a higher duty rate to all other shipments. It should be noted that an importer may choose to enter a shipment into the United States under either rate line, until the trigger quantity is filled, and that this might occur where unit values of the good in question vary by country, quality, time of entry, etc. In the Uruguay Round, as of Jan. 1, 1995, TRQs replaced prior absolute quotas imposed under section 22 of the Agricultural Adjustment Act (7 U.S.C. 624) or other measures. The over-TRQ duty rate is intended to be economically prohibitive, thus restricting imports to the in-quota or trigger quantity.

[5] Goods are evaluated to identify the particular country to which they are attributable in the ordinary customs sense so as to determine whether they are eligible for either normal trade relations (NTR) or column 2 duty rates, in the case of the United States. Additional rules, more clearly described as "rules of preference," determine if a good that would otherwise be dutiable at NTR rates can be accorded a special duty rate upon importer compliance with Customs requirements. In the case of our FTAs, a good that meets FTA requirements is referred to as an originating good of the FTA partner in question, and the importer must claim the preference and establish eligibility to Customs' satisfaction.

comprising inputs *only* from the two parties and those complying with rules stating required particular changes in HS chapter, heading, or subheading classification from foreign inputs to finished goods, based upon processing of third-country inputs in a partner country. Thus, not every "product of" a party in the ordinary customs sense or every good shipped from one party to the other would receive preferential tariff treatment, making it unlikely that 100 percent of trade between the parties will enter free of duty even after the transition period. In light of the complexity of the rules, and the difficulty of obtaining information on current input sourcing patterns and types of local processing for every good, it is impossible to take the FTA rules of origin fully into account in this report. For individual products, some of this information may be available and may be usable in an economic model, but for others it may be necessary to assume that importers would claim FTA benefits for all current trade (based on the broader concept of substantial transformation) and then try to assess whether partner countries have any unused production capacity that might add to such trade levels. Rules of origin are discussed below to the extent practicable.

Chapter-by-Chapter Review[6]

Chapter 1: Establishment and Definitions

The chapter states that the parties agree to set up a free trade area that is consistent with the General Agreement on Tariffs and Trade (GATT) 1994, reaffirm that existing bilateral rights and obligations continue to apply, and restate that nothing in the FTA is to be read as altering any legal obligation under another international pact. Various definitions are also set forth as part of the general provisions. Among them, the term "customs duties" includes any customs or import duty[7] and charges but not internal taxes, antidumping or countervailing duties, fees for import services (such as the merchandise processing fee, as to which there are separate obligations), or agricultural safeguard duties. An important definition delineates the territory of each party to which the FTA will apply: for the United States, it includes the customs territory, U.S. and Puerto Rican foreign trade zones, and the undersea international economic zone (the coastal waters under U.S. legal control are presumably included), but not the insular possessions and not any area of outer space. For Australia, the definition is "the territory of the Commonwealth... excluding all external territories other than [several small Pacific islands]" and including [its] territorial sea, contiguous zone, exclusive economic zone and continental shelf" without any mention of any free trade zones or other special customs areas.

Chapter 2: National Treatment and Market Access

The chapter's commitments on national treatment are similar to the corresponding provisions of the GATT 1994 but apply only within the region; thus, the obligations and market access concessions apply only to originating goods of the parties. The parties

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[6] References to chapters and articles in this section are to the corresponding provisions of the Agreement text.

[7] The definition does not specify whether global safeguard duties would be covered.

agree to eliminate their customs duties on originating goods under the attached schedules,[8] to refrain from increasing any customs duty or imposing a new customs duty, and to apply the WTO Customs Valuation Agreement to determine the customs value of goods in trade. Obligations on temporary admission of goods are included in article 2.5, and in article 2.6 each party agrees to facilitate the duty-free access of goods entered for or following repairs or alterations in the other. The parties agree to ban export taxes, but this provision should not require any U.S. legal change because such taxes are prohibited by the Constitution. The parties also are barred from adopting or expanding duty waivers related to performance requirements.

Other provisions in the chapter are similar to those of other FTAs and deal with temporary importations, speedy release of goods, transshipment of goods, vehicles or containers used in international traffic, repaired/altered goods, duty-free entry for commercial samples, etc. These provisions parallel existing U.S. law, perhaps requiring only minor Customs regulatory adjustments. Article 2.9, prohibiting import and export restrictions on trade among the parties, is not found in NAFTA, because the subject matter was first dealt with specifically in the GATT 1994 and the Agreement on Textiles and Clothing (ATC); the provisions and obligations of Article XI of GATT 1994 will control whether a specific measure would be allowed under this agreement. Article 2.9 recognizes that GATT 1994 controls provisions on export price requirements and certain other areas and reiterates that the parties' rights under various WTO agreements, of which both are members, are dictated by those agreements.

In various additional provisions of the chapter concerning trade in goods, merchandise processing fees (the so-called customs user fee) must be eliminated by both parties on imports of originating goods, although certain "administrative fees" directly related to the cost of services (such as filing fees for entries) are allowed. The parties agree that other fees and charges that are not duties or their equivalent will be directly related to administrative services being rendered. The two countries would not be allowed to require "consular transactions, including related fees and charges" with respect to any importation of goods of a party, and this protection should facilitate trade and make its documentation simpler and cheaper. All fees and charges on trade in goods are required to be published on the Internet. A Committee on Trade in Goods is established in section E to promote bilateral trade and address trade barriers with respect to goods. Section F sets forth several definitions related to market access. Annexes set forth each party's exclusions from coverage under the chapter, including U.S. log export controls and the Merchant Marine Act and Australian exemptions on agricultural marketing arrangements for various goods and a few other limited categories; both parties exempt actions authorized by the WTO Dispute Settlement Body.

With regard to scheduled concessions on trade in goods, the U.S. base duty rates are the 2003 column 1-general rates of duty and Australia's 2003 duty rates applicable to

[8] A summary of the thirteen staging categories for goods is provided herein (pp. 2-6 and 2-7).

U.S. goods. Thirteen duty staging categories are established: (A) immediate duty-free entry; (B) four equal annual stages; (C) eight equal annual stages; (D) 10 equal annual stages; (E) continuation of a party's existing most favored nation (MFN) duty; (F) 18 annual stages; (G) delayed onset reductions starting in year 7 and continuing through year 18; (H) delayed onset staging starting in year 9 and continuing through year 18, and (I) duties remaining at base rates: (T1) for covered textiles and apparel with base duties over 3 percent ad valorem, the applicable rate would drop to 3 percent through year 9 and be eliminated as of year 10; (TX) for covered textiles and apparel whose base duty rates are from 3 percent to 5.5 percent, a slight reduction would occur through year 9, larger reductions in years 10-14, and duty elimination in year 15; (T2) the same general pattern of tariff cuts as in category TX would be given to covered textiles and apparel with base duty rates from 3 percent to 8 percent ad valorem; and (T3) the same pattern of tariff cuts would occur for covered textiles and apparel with base duty rates from 3 percent to 15 percent.

Chapter 3: Agriculture

Chapter 3 sets forth provisions governing trade in agricultural products, including the implementation and administration of tariff-rate quotas; it starts with a provision stating that the two parties will work together at the WTO to end barriers to trade and trade-distorting support payments. Under the text, a Committee on Agriculture is created to address barriers to trade, and export subsidies are barred. A major subject of the chapter is agricultural safeguards, the ceiling for which is limited to the lower of the applied MFN duty rate or the MFN applied duty on the day before the date of entry into force of this FTA. An adjustment mechanism is provided for goods subject to TRQs where a party is importing more of a covered agricultural product from third- country sources and then shipping more of its domestic output to the other party. In year 20, the parties are to consult about modifying dairy market access commitments. A U.S. annex sets forth rules for horticulture price-based safeguards, along with quantity-based and price-based beef safeguards.

Chapter 4: Textiles

This chapter treats these products separately for rules of origin and other regulatory purposes, and discusses bilateral emergency actions at some length. An emergency action may only be taken after investigation by a competent authority, written notice, and consultations, if requested. No emergency action may be maintained for more than two years, with a two-year extension, and may not be taken more than 10 years after the elimination of customs duties for that good. The party taking the emergency action must provide trade-liberalizing compensation, and the parties retain their rights to restrain imports in accordance with the WTO ATC or WTO Safeguards Agreement. There are provisions dealing with customs cooperation on textile and apparel matters, verification, and enforcement. Rules of origin ("ROOs") for the sector are subject to consultations and possible adjustment. An annex contains specific rules of origin for Harmonized Tariff System (HTS) chapters 50-63 as well as for the textile goods in chapters 42, 70, and 94. While most of these tariff-shift ROOs are at the two- or

four-digit HS level, the ROOs for chapters 61 and 62 on apparel are primarily at the six-digit level. These textile and apparel rules can be generally summarized as being "fiber forward" or "yarn forward" rules. Yarns must be made of originating fibers to gain a tariff preference. In order for a textile fabric or a good of chapters 61 through 63 made from fabric to be eligible for a tariff preference, the yarn used in such a good must generally be made in one or both of the parties. The same criteria were commonly used in the rules of origin in the NAFTA and in U.S. FTAs with Singapore and Chile.

Chapter 5: Rules of Origin

The duty benefits of the FTA will apply to originating goods, unless otherwise provided;[9] textile and apparel goods are covered by a separate set of provisions in chapter 4, as noted above. Such goods are those wholly obtained in one or both parties, those produced entirely in the territory of one or both parties from originating materials only, or those meeting the requirements of the origin rules in the related annex. The latter category comprises goods in which each nonoriginating material undergoes the applicable tariff change as a result of production within the region, or goods that satisfy value content or other specified requirements. Thus, goods that contain only inputs attributable to the parties would be considered eligible without regard to tariff shifts or other criteria, and the complex rules of the annex apply to those that contain non-party-sourced inputs. Goods containing de minimis foreign content that does not undergo the requisite tariff shifts (limited in the aggregate for all such materials to 10 percent of the adjusted value of the good, with the component-based formula noted above applicable to textile and apparel products) also can qualify as originating, though their value is still counted as nonoriginating when a regional value content test applies. A number of exceptions–all in the agricultural sector and relating primarily to sensitive commodities covered by U.S. TRQs (such as dairy or sugar products)–are not allowed to be made eligible under the de minimis rule, so that third country content not meeting tariff shift or other specified requirements would disqualify the good for preferences.

Several other requirements for determining origin under the FTA are specified. A good resulting from production in both parties will be considered to originate unless it fails to meet specific tests of this chapter. Pursuant to article 5.3, originating goods or materials of one party that are incorporated into another good in the other party will be treated as originating in the latter, and the parties must allow the accumulation of production within the region. Article 5.4 sets forth the rules and formulas for computing regional value content, with two types of computations–the build-down method and the build-up method–designed to take into account all nonoriginating content. Article 5.5 provides the rules for valuing materials and the adjustments that can be made to certain expenses and producer costs. Under article 5.6, a good that originates will not be disqualified because its accessories, spare parts, or tools delivered with it do not originate, if the latter are in customary quantities, invoiced with the good, and the good

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[9] As noted above, during the staging period, in-quota treatment under TRQs is available only to "qualifying goods" (goods meeting agreement ROOs when U.S. contribution is treated as coming from a non-party).

still meets any regional value test (treating the accessories, parts or tools as non-originating). The treatment of fungible materials is covered in a flexible manner in article 5.7, so that either physical segregation or inventory management (averaging, LIFO or FIFO) can be used to track them. Articles 5.8 and 5.9 deal with packaging materials and containers, which are generally to be disregarded in terms of their origin; under article 5.10, indirect materials will be treated as originating. An important rule is contained in article 5.11–namely, that a good that undergoes subsequent production or other operations outside the parties (not counting minor preservation or loading operations) will not be considered originating. Thus, goods in general must be shipped without substantive change from one party to the other in order to qualify for benefits, assisting in the enforcement of the agreement's requirements.

Other provisions of the chapter deal with consultations among the parties and the verification and documentation of origin needed under the agreement. In essence, an importer can claim FTA benefits if he / she knows the good qualifies or if information in his / her possession so indicates, and he / she can be required to submit statements and other evidence to establish qualification if asked by customs authorities. The parties are required to provide that an importer can claim FTA treatment for a good based on direct knowledge or on information in the importer's possession, but they can require an importer to make a statement proving the claim. Benefits will be given to goods covered by such claims unless the parties learn the goods do not qualify and make findings of fact and legal reasons to deny a claim, and they agree not to punish importers who act in good faith or who correct the entry documents and pay necessary duties in one year or a longer period set by a party. Records must be kept for five years after entry to establish the origin of goods. Verification (based on requests for information, visits, and other methods) is governed by article 5.15.

Article 5.16 provides for modifications of agreement rules to ensure their uniform, effective, and consistent application and also to keep them current and make agreed adjustments in the future. This updating or rectification procedure is likewise undertaken under the NAFTA and results in occasional changes in rules (sometimes as a result of HS classification or tariff changes). Regular consultations starting six months after the date of entry into force (DEIF) of the agreement are required on issues relating to the implementation or application of rules. Finally, article 5.18 provides definitions relating to the chapter.

Product-specific "tariff shift" rules at a HS heading or subheading level are set forth in an annex to the chapter. The notes provide that the rule listed next to each heading or subheading is to apply to the goods of such provision, so that goods classified therein can be evaluated; where alternative rules are listed for a heading or subheading, a good need only comply with one of them. The annex then contains the tariff shift and subsidiary rules, which apply only to non-originating materials; if a rule excludes certain provisions, then any inputs in the good that fell within the excluded tariff category or categories must be originating for the good in question to qualify for

benefits. Thus, the rules may limit the availability of tariff preferences actually available.

In the abstract, it is not easy to attempt to determine if the rules are "tight" or not (in terms of the restrictions on input sourcing), given that specific knowledge is needed of the industries in each party, the value of goods and their inputs, and the firms' sources of inputs. For analytical purposes here, it is necessary to assume that all trade reported as "products of Australia" under non-preferential rules (as opposed to "shipments from Australia," which may be merely transshipped or repacked goods) would qualify under these ROOs. A review of any situations where Australia might increase its capacity to make or process foreign-origin inputs, and a comparison of FTA ROOs with NTR ROOs, would suggest the possible impact of the product-specific ROOs in this chapter. In such a context, it would be possible to ask if a required tariff shift involves processing that is costly or technically difficult, and to evaluate what processing Australia currently does or might do in future. However, due to to time constraints and the extensive industry survey that would be required, such a review has not been undertaken and is beyond the scope of this report.

Although the rules themselves do not lend themselves to quantitative analysis, they are the key to understanding the long-term impact of any FTA and the volume of goods for which duties would actually be eliminated. Although specific information is not available about the impact of individual ROOs on related U.S. import categories, the smaller size of the Australian economy may mean the agreement's ROOs by themselves would not have a great impact on U.S. firms. Because Australia is agreeing to make its FTA rates of duty on many originating goods "free" as of the DEIF of the FTA, the rules of origin would immediately play a key role in determining which U.S. exports will receive such benefits. A survey on the same lines described above would be needed to identify exporting industries for which ROOs would be significant.

Chapter 6: Customs Administration

This chapter deals with customs administration, including such subjects as the publication of legal requirements and decisions (article 6.1); administration in a fair and impartial manner (6.2); advance rulings (6.3); review and appeal (6.4); customs cooperation (6.5); confidentiality (6.6); penalties (6.7); release and security (6.8); risk assessment (6.9); express shipments (6.10); and definitions (6.11). These provisions appear to be similar in general to those in other FTAs, and they seem likely to fit easily with current practices in the two countries. The provisions are aimed at facilitating the release of goods under the agreement and at formalizing and perhaps expanding customs cooperation.

Chapter 7: Sanitary and Phytosanitary Measures

This chapter covers the protection of human, animal, and plant health conditions in the parties' territories and the enhancement of the WTO agreement on the same subject. It establishes a Committee on Sanitary and Phytosanitary Matters to serve as a forum for

cooperation regarding trade in originating goods and to provide a regular review of this subject area without dispute resolution authority; technical working groups would likewise be available as needed. An annex sets up a standing working group on animal and plant health measures and directs the development of work plans on an expedited basis when any concerns or issues arise or when technical changes occur.

Chapter 8: Technical Barriers to Trade

This chapter encourages the full implementation of the WTO agreement on the same subject and embodies the same principles and obligations. It rests on enhanced cooperation and consultations and provides that each party must "give positive consideration to accepting as equivalent [the] technical regulations of the other," or in the absence of acceptance, explain why. Several mechanisms to facilitate the acceptance of conformity assessment results are provided, along with procedural requirements for accrediting and licensing conformity assessment bodies. Transparency in the administration of such measures is required, and the parties commit to working with each other to facilitate trade. A coordinator in each country would administer the implementation of the commitments and the cooperative activities under the chapter.

Chapter 9: Safeguards

This chapter provides the legal framework for the imposition of bilateral safeguards with respect to originating goods. Under article 9.1, during the transition period only (10 years, unless the phase-out of duties for the product in question is longer), a party can impose a bilateral safeguard measure by suspending staging or increasing a duty rate to a level not exceeding the lesser of the MFN level or the party's applied MFN rate preceding the DEIF. This action can be taken when imports of an originating good of the other party at a reduced duty rate or free of duty constitute a substantial cause of serious injury or threat thereof to a domestic industry producing a like or directly competitive product. Notification of the other party and of the WTO is required, and parties must cooperate in investigating such situations.

A safeguard can be imposed for two years, plus a possible two-year extension, and only one safeguard can ever be imposed on a particular originating good under article 9.2. That article also regulates the rate of duty to be applied at the end of a safeguard and the recalculation of duty staging. For safeguards in effect for more than 1 year, the parties must progressively liberalize the measures at regular intervals. Provisional safeguards (which can operate for not more than 200 days), compensation, and the relationship to global safeguards are covered by articles 9.3 through 9.5, respectively. The United States already employs the procedures set forth in the chapter under existing law (notice, public hearing, causation and injury, and so on). Moreover, the FTA provisions are in general similar to those of recently negotiated and implemented FTAs, with the addition of the provisional safeguards language. Under article 9.5, each party retains all rights and obligations of the WTO Agreement on Safeguards but gains no additional ones under the FTA; if a WTO safeguard is

being considered, a party can exclude originating FTA goods where they do not significantly injure the domestic industry.

Chapter 10: Cross-Border Trade in Services

This chapter deals with cross-border trade in services. Significantly, the measures covered by the agreement include those by central, regional, or local governments and authorities and also by nongovernmental bodies, but not measures dealing with financial services (chapter 13), air services in most cases,[10] government procurement, subsidies, and grants. No obligation of employment is created, and the provisions do not apply to "services supplied in the exercise of governmental authority" (noncommercial and noncompetitive services). National and most-favored-nation treatment on covered services are guaranteed. No local presence may be required, and the regulation of services and qualification requirements may not be unduly burdensome. Domestic regulation of services must be based on objective and transparent criteria, and there are specific transparency requirements in addition to those set out in the chapter on transparency. The parties may recognize education, experience, licenses, or certifications obtained in a non-party, but neither party is required to recognize education or other qualifications obtained in the other. Transfers and payments relating to the cross-border trade in services are to be freely allowed without delay. The benefits of this chapter may be denied under limited circumstances, if the service supplier is controlled by persons of a non-party. Express delivery services are specifically covered by this chapter,[11] following the precedent of the U.S.-Singapore FTA. An annex to this chapter discusses professional services and temporary licensing and establishes schedules of covered services.

Chapter 11: Investment

Under these provisions, each party would be required to accord to investors of the other party and covered investments treatment no less favorable than that it accords to its own investors and investments, i.e., national and most-favored-nation treatment. Treatment must be in accordance with customary international law, including fair and equitable treatment and full protection and security. Expropriation is allowed only for a public purpose, and it must be nondiscriminatory and occur upon payment of prompt, adequate compensation in accordance with due process of law. Each party must permit all transfers relating to a covered investment to be made freely and without delay. The parties face several limitations regarding investments. For example, they cannot impose or enforce performance requirements: to export a given level or

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[10] Air services are the subject of numerous and interrelated international agreements and have thus been outside FTA regulation, a situation that likely reduces uncertainty for this industry and has not seemed to present difficulties for it.

[11] This area did not receive separate coverage or significant national commitments in the WTO General Agreement on Trade in Services, where it was treated in the "courier services" provisions. In some countries the postal monopolies handle express deliveries, and access by outside private entities has been denied.

percentage of goods; to achieve a given level or percentage of domestic content; to purchase, use, or accord preference to goods produced or sold in its territory; to relate the volume or value of imports to the volume or value of exports or to the amount of foreign exchange associated with such investment; to transfer a technology or proprietary knowledge to someone within its territory; or to control distribution from its territory. Nor can a party require that the senior management of an enterprise of that party or a majority of the board of directors be of a particular nationality. In the event of an investment dispute, the claimant and respondent are initially to try to resolve the dispute by consultation and negotiation, which may include the use of nonbinding third-party procedures. Investment disputes may be submitted to arbitration. The absence of an investor-state mechanism for dispute resolution is unusual in an FTA and reportedly of some concern to U.S. industry, even though there have been no notable problems.[12]

Chapter 12: Telecommunications

Each party must ensure that enterprises of the other will have access to and use of any public telecommunications transport network and service offered in its territory or across its borders. Suppliers of public telecommunication services in each party must provide for interconnection, number portability, and dialing parity. The chapter applies to submarine cable systems and landing stations where a supplier is authorized to operate a submarine cable system as a public telecommunication service. Major suppliers are required to accord suppliers of the other party treatment no less favorable than that accorded its own subsidiaries, affiliates, or nonaffiliated suppliers. Competitive safeguards and resale are addressed, and access to network elements shall be on an unbundled basis. Each party is to ensure that major suppliers in its territory provide interconnection for suppliers of the other party under nondiscriminatory terms, at any technically feasible point, in a timely fashion and of no less favorable quality than that provided by such major supplier for its own or its subsidiary's services or for services of non-affiliated suppliers. Interconnection options are listed, and interconnection offers must be publicly available. The chapter discusses the provisioning and pricing of leased circuit services; co-location; and access to poles, ducts, conduits, and rights of way. It provides for flexibility in the choice of technology and establishes conditions for the provision of value-added services. Procedures for the allocation and use of scarce telecommunications resources must be administered in an objective, timely, transparent, and nondiscriminatory manner. In addition, the chapter provides for the resolution of domestic telecommunication disputes and appeals. Each party must make its licensing criteria, procedures, terms and conditions, and normal timeframes publicly available. It also must ensure that its national telecommunications regulatory body is independent of service providers and that the regulatory body is authorized to enforce compliance relating to the obligations in this chapter.

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[12] Unlike previous FTAs to which the United States is a party, this Agreement does not have an "investor-state" dispute settlement provision to allow individual U.S. investors to bring Australia to arbitration on investment disputes.

Chapter 13: Financial Services

Under this chapter, each party commits to accord national treatment and most-favored-nation treatment to investors of the other party and to provide market access for financial institutions without limitations on the number of financial institutions, value of transactions, number of service operations, or number of persons employed. Cross-border trade in financial services must be allowed, and each party must permit a financial institution of the other to provide new financial services that it would permit its own institutions to provide without additional legislative action.

Neither party is required to furnish or allow access to information related to individual customers or confidential information whose disclosure would impede law enforcement, be contrary to the public interest, or prejudice legitimate commercial concerns. A party cannot require financial institutions of the other party to hire individuals of a particular nationality or require more than a simple majority of the board of directors to be nationals or residents of the party. Provisions are made for nonconforming measures and exceptions. The parties agree that transparent regulations and policies are important, commit to publishing in advance all regulations of general application, and agree to maintain or establish mechanisms to respond to inquiries from interested persons. Where a party requires membership in a self-regulatory organization, such organizations also are subject to some of the obligations of this chapter. The two parties recognize the importance of maintaining and developing expedited procedures for offering insurance services. To deal with these provisions, the chapter establishes a financial services committee. Consultations and dispute resolution are discussed and cross-referenced to the article covering dispute settlement procedures. There is an annex with additional provisions on insurance, banking, and portfolio management.

Chapter 14: Competition Policy

Pursuant to this chapter, each party is required to adopt or maintain measures to proscribe anticompetitive business conduct and to take appropriate action with respect to such conduct. Moreover, each party is required to establish or maintain an authority responsible for the enforcement of such measures. The enforcement policy so adopted cannot discriminate on the basis of the nationality of the subjects of the proceedings and must provide due process and procedures for review. Although article 14.3 states that "designated monopolies should not operate in a manner that creates obstacles to trade and investment" and makes the parties responsible for the conduct of such monopolies, a party may designate a monopoly or establish or maintain a government monopoly enterprise (and the United States would assume certain obligations for sub-federal monopolies as well[13]). Under article 14.5, differences in

[13] Article 14.4 provides that the United States "shall ensure that anticompetitive activities by sub-federal state enterprises are not excluded from the reach of its national antitrust laws solely by reason of their status as sub-federal state enterprises, to the extent that their activities are not protected by the State Action Doctrine." The meaning and scope of this provision would need to be determined. The United States has no bilateral investment treaty with Australia.

pricing in a market or in different markets, where based on "normal commercial considerations," do not themselves violate the chapter's commitments. The chapter provides for cooperation, transparency, information requests, and consultations and emphasizes consumer protection. Article 14.7 provides that monetary judgements on behalf of consumers, customers, or investors will be recognized by the parties and enforced. Article 14.11 expressly bars dispute settlement regarding most of the provisions of the chapter.

Chapter 15: Government Procurement

This chapter is significant in that Australia is an observer, rather than a signatory, with respect to the WTO plurilateral agreement on this subject[14] and thus, unlike the United States, has no obligations under that pact. Obligations in the FTA chapter relate to particular procurements by contractual means for values exceeding the agreed thresholds set forth in annexes on specific subject matter, and a number of other types of purchases are specifically not covered. The parties reaffirm their commitments under their existing reciprocal defense procurement agreement of 1995 and agree to try to improve its operation. Article 15.2 sets forth principles of national treatment and nondiscrimination, consistent with the WTO Agreement on Government Procurement (which treats procurement commitments as being outside the scope of market access commitments[15]), and deals with procurement methods; it also provides that the FTA rules of origin must be applied for procurement purposes under the chapter. Subsequent articles of the chapter provide definitions; requirements for publication of notice of intended procurement; time limits of at least 30 days (with specified circumstances warranting a 10-day lead time) between publication and the submission of tenders; rules on documentation, technical specifications, and tendering procedures; information on awarded contracts; and a mechanism for the review of supplier challenges. The obligations do not appear to cover noncontractual agreements or any form of governmental assistance not specifically covered under the schedules appended to this chapter. Exceptions for public purposes are listed (including a provision authorizing prison and sheltered workshops), and modifications and rectifications are authorized.

Chapter 16: Electronic Commerce

Under this chapter, which deals with subject matter not covered by the WTO in explicit commitments, a party cannot apply customs duties or other duties, fees, or charges on or in connection with the importation or exportation of digital products on a carrier medium or sent by electronic transmission, and the parties must accord nondiscriminatory treatment to digital products. Internal taxes charged on domestic and imported products are allowed if imposed in accordance with the agreement (but

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[14] See *www.wto.org/english/tratop_e/gproc_e/memobs_e.htm* for a list of the members of the WTO agreement, current as of Apr. 12, 2004.

[15] See *www.wto.org/english/tratop_e/gproc_e/gpintr_e.htm* for a discussion of the WTO agreement, related to excerpted legal texts, as of Apr. 12, 2004.

the obligations do not apply to nonconforming measures and other listed matters). A party cannot accord less favorable treatment to some digital products on the basis of the nationality of the author, performer, producer, developer, or distributor of the products or on the grounds that the digital products were created, stored, transmitted, or published outside its territory. Transparency and cooperation are to be the guiding principles.

Chapter 17: Intellectual Property Rights

The provisions of this chapter are quite detailed. Each party affirms that it has ratified or acceded to the Patent Cooperation Treaty, as revised and amended (1970); the Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite (1974); the Protocol relating to the Madrid Agreement Concerning the International Registration of Marks (1989); the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (1980); the International Convention for the Protection of New Varieties of Plants (1991); the Trademark Law Treaty (1994); the Paris Convention for the Protection of Industrial Property (1967); the Berne Convention for the Protection of Literary and Artistic Works (1971); and the WTO Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPs") (1994). Each party agrees to ratify or accede to the World Intellectual Property Organization (WIPO) Copyright Treaty (1996) and the WIPO Performances and Phonograms Treaty (1996) by the date of entry into force of the agreement. Further, the parties agree to make best efforts to ratify or accede to the Hague Agreement Concerning the International Deposit of Industrial Designs (1999) and the provisions of the Patent Law Treaty adopted in Geneva in June 2000. The parties may implement more extensive protection in their respective national laws, and national treatment must be granted by each party to nationals of the other.

For purposes of the agreement, trademarks include service marks, collective marks, sound marks and certification marks and may include geographical marks and scent marks. The owner of a registered mark shall have the exclusive right to prevent third parties not having the owner's consent from using identical or similar signs where such use would result in a likelihood of confusion, with limited exceptions such as fair use of descriptive terms. Article 6bis of the Paris Convention for the Protection of Industrial Property (1967) will apply to "well-known" trademarks. Each party must provide an electronic system for the application, registration and maintenance of trademarks. Registration and renewals will have periods of not less than 10 years, and neither party will require recordation of licenses for trademarks. Each party will require the management of its country code top-level domain to provide public access to accurate information about domain name registrants and to provide dispute resolution processes.

Specific provisions of the Berne Convention are cited for the protection of copyrights and related rights. Authors, performers, and producers are to have exclusive rights to authorize or prohibit all reproductions and all communications to the public of their works. Under the agreement, the term of protection of a work will be not less than the

life of the author and 70 years after the author's death or not less than 70 years at the end of the calendar year of the first authorized publication of the work, if the term is not based on the life of a natural person. The knowing circumvention of effective technological measures to protect works, or trafficking in devices intended to circumvent such measures, will result in criminal and civil liability, while certain noninfringing good faith activities are exempt from sanctions. Removing or altering rights management information or trafficking in works from which the rights management information has been removed or altered likewise must result in criminal and civil liability. Specific exceptions are set out; the terms "effective technological measure" and "rights management information" are defined in detail, and there are specific obligations relating to the performers and producers of phonograms. Encrypted program-carrying satellite signals are protected by criminal and civil sanctions. The parties also agree to maintain industrial design protection systems and to endeavor to reduce differences in law and practice in this subject area.

In terms of patents, the parties must make patents available and exclude inventions from patentability only in specifically defined circumstances. Limited exceptions are set out in the chapter. Patent owners must have the right to assign, license, and transfer the patent by succession. The patent owner may request that a patent term be adjusted to compensate for unreasonable delays in granting the patent. There are additional provisions that apply only to pharmaceutical and agrochemical patents.

Final judicial decisions and administrative rulings pertaining to the enforcement of intellectual property rights must be in writing, published, and made publicly available. Each party is required to publicize information on its efforts to provide effective enforcement. In civil, administrative, and criminal proceedings each party shall provide for a presumption that the natural person or entity indicated as the author is the designated rights holder. In civil judicial proceedings, the rights holder may request destruction of goods that have been found to be pirated or bear counterfeit marks, except in exceptional cases. Judicial authorities shall have the authority to order the infringer to identify third parties involved in the production or distribution of the infringing goods or services and may fine or imprison persons who fail to abide by valid court orders.

In dealing with border authorities, the applicant for customs enforcement must provide adequate evidence to show prima facie infringement and may be required to provide security. The parties' customs services may initiate border measures ex officio and take action against goods passing in transit. Goods determined to be pirated or bearing counterfeit marks must be destroyed. The simple removal of a counterfeit trademark will not be sufficient to permit the release of goods into channels of commerce. The parties agree not to allow the exportation of goods bearing counterfeit marks or of pirated goods.

Each party is obliged to provide appropriate criminal procedures and penalties at least to cases of willful trademark counterfeiting or copyright or related rights piracy on a commercial scale. Parties must provide legal incentives for service providers to cooperate with rights holders and limitations on liability.

Chapter 18: Labor

The parties reaffirm their obligations as members of the International Labor Organization, commit to ensure that their domestic laws are consistent with international standards, and agree to try to enforce these laws and improve those standards. Article 18.2 states that the obligation of a party under the agreement relates to the effective enforcement of domestic laws, in keeping with those standards, and proscribes "a sustained or recurring course of action or inaction" affecting trade between the parties. Article 18.3 requires each country to ensure that "persons with a legally recognized interest" under local law have access to "tribunals" of all types for enforcement, with the proceedings handled on a "fair, equitable, and transparent" basis. The parties must assist in the conduct of these proceedings and promote awareness of labor laws. While the Joint Committee set up under Chapter 21 to administer the agreement would handle most discussions on this chapter, a Subcommittee on Labor Affairs is authorized under article 18.4 to maintain contacts within the member governments and to ensure that the chapter is implemented. Labor cooperation and consultations, under articles 18.5 and 18.6, respectively, are to provide the primary means of implementing the chapter. Article 18.7 sets forth the definition of "internationally recognized worker rights" for purposes of the FTA, and article 18.8 delineates the scope of the commitments by defining the parties' covered domestic laws.

Chapter 19: Environment

Under these provisions, each party must ensure that its environmental protection laws provide for high levels of protection and strive to improve those laws, provide appropriate and effective remedies and sanctions for violations of environmental protection laws, and provide opportunities for public participation. The parties agree to pursue cooperative environmental activities and provide for environmental consultations; they also agree to encourage voluntary mechanisms and incentives as methods of attaining compliance. The Joint Committee set up to administer the agreement will discuss environmental issues and offer public and private parties an opportunity to provide input, and a subcommittee on environmental affairs is authorized. Environmental cooperation is the end objective of article 19.6, and article 19.7 provides for collaborative consultations upon request by one party to the other. If consultations fail, a party can refer a matter to the subcommittee for further discussions and work, with ultimate recourse to the Joint Committee. The parties agree to continue to work toward enhancing other international agreements on environmental matters and to implement such measures.

Chapter 20: Transparency

The subject of this chapter is the abstract concept of "transparency" as it relates to a country's actions and legal measures; it generally provides the structural rules that will govern the application of the agreement, starting with the official contact points in each government and continuing through publication of laws and requirements relating to

the agreement and to the administrative rulings process and review and appeals therefrom. Interested persons are to be given the right to know about actual or future measures in the member countries and to comment on them. Because the domestic legal systems of the parties both operate generally in public and with rights of review, this chapter seems less detailed than its counterparts in some other FTAs. As noted above, other chapters may contain additional transparency requirements tailored to individual subject matter.

Chapter 21: Institutional Arrangements and Dispute Settlement

The chapter sets up a Joint Committee of government officials of the two countries–chaired by the United States Trade Representative and the Minister for Trade for Australia–to supervise the implementation and functioning of the FTA and consider all types of matters raised under it. The Committee is to meet at least annually to examine the operation of the agreement, provide transparency for the public, and address any environmental concerns arising out of the FTA. Section B of the chapter relates to dispute settlement proceedings and their administration; it provides designation by each party of an office to assist the Committee and provides for consultations on labor issues at the request of either party during which a broad range of private and public views would be sought. Dispute settlement panels, their composition and operation, a requirement for reports within 180 days after appointment of a panel chair, and the implementation of panel reports are the subjects of this section. The provisions authorize a suspension of benefits under the agreement, as delimited by the panel, where no other method of resolving a dispute is accepted; monetary assessments are also available under stated rules. Article 21.12 provides that annual monetary assessments of up to U.S.$15 million, adjusted for inflation, can be awarded by a panel if a decision contained in a report is not implemented, subject to a five-year review. No private right of action is given.

Chapter 22: General Provisions and Exceptions

As in earlier agreements dealing with international trade, the chapter sets forth general exceptions, as well as provisions on essential security, taxation, disclosure of information, and corruption, along with specific commitments on expropriation and investment. The provisions appear to follow prior language in other agreements.

Chapter 23: Final Provisions

This chapter contains the legal mechanisms for acceding to the agreement and putting it into force and an article on the legal significance of annexes. Article 23.3 provides that the parties must consult on any changes made in provisions of the WTO Agreement incorporated in this text to determine if the same principle will apply herein. Reservations are allowed only upon written consent of the other parties. Under article 23.4, the FTA would enter into force 60 days after the exchange of written notifications that domestic requirements have been met and other conditions. Any withdrawal would take effect six months after written notice.

Side Letters

A long list of side letters[16] accompanies the agreement on specific subjects, ranging from waivers of customs duties and import without bond to higher education in U.S. states and the privatization of Telstra (an Australian provider of telephone and internet services, business support, and other products). Many of these letters clarify the interpretation of agreement provisions, while others may state effective national reservations to allow a party to continue a particular domestic practice without change. Where individual side letters are relevant to more detailed discussions of subject matter in the agreement or are referred to in submissions, additional text is provided in this report.

[16] See footnote 3 to this chapter.

CHAPTER 3
Simulated Impact of the U.S.-Australia FTA

This chapter provides a quantitative assessment of the likely impacts of those chapters of the U.S.-Australia Free Trade Agreement that provide increased access for U.S. goods and services in the Australian market and for Australian goods in the U.S. market (i.e. chapters 2, 3, and 4). In providing a quantitative assessment under section 2104(f)(2) of the Trade Act of 2002, the Commission is ordered to "...submit to the President and the Congress a report assessing the likely impact of the Agreement on the United States economy as a whole and on specific industry sectors, including the impact the Agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the Agreement, and the interests of United States consumers." The method chosen for quantitative analysis is a computable general equilibrium simulation. The model includes the social accounts and trade patterns for multiple regions of the world economy and for multiple products produced in those regional economies. Employing a simulation permits the Commission to quantify the probable impact of specific components of the negotiated Agreement on individual sectors, labor markets, and exports and imports, as required by the Trade Act of 2002.

The U.S.-Australia FTA provides a broader trade liberalization than is analyzed in this chapter. This chapter focuses only on the liberalization of tariffs and measurable tariff rate quotas of the Agreement. As indicated in chapter 1, a qualitative assessment of selected sectors as well as other provisions and their effects on investments, intellectual property, and other provisions are discussed in chapters 4, 5, 6, and 7 of this report.

This simulation liberalizes trade completely in all goods subject to liberalization under the free trade agreement. There is no implicit or explicit time elapsing in the model. This means, first, that all provisions of the Agreement are assumed to be fully phased in immediately, rather than over any phase-in period embodied in the agreement. Second, it means that all effects of the Agreement are felt immediately, without an adjustment period. The modeled results can be considered to be long-run effects, of a fully implemented agreement in an economy otherwise identical to the baseline 2005 economy after all adjustments related to the agreement have worked their way through the economy.[1] The qualitative assessment of the likely effects of the FTA on selected sectors in chapter 5 considers the short to medium run effects, as well as long run effects, as it is expected to be phased in over an 18-year period.

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[1] If the product is a non-qualifying good under ROO, the model results may be overstated to the extent that the traded good is non-qualifying.

A full list of the initial measured trade barriers in the model is shown in table 3-1. These barriers essentially constitute price gaps, or wedges, between existing "world prices" and "domestic prices," which include the tariffs and other barriers. As tabulated, they consist of tariffs and the portion of tariff rate quotas (TRQs) collected as duties, measured in the Global Trade Analysis Project (GTAP) data base as ad valorem equivalent tariffs. The proposed tariff cuts in the FTA are to be phased in over a transitional period, but for the purposes of the modeling in this chapter they are assumed to enter into force all at once, on January 1, 2005.[2] Note that services are restricted by nontariff barriers, which are not quantifiable in the context of the USITC model. A qualitative assessment of the effects of the FTA on the services sector is provided in chapter 4.

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[2] Implementation of the Agreement is scheduled to be staged over 18 years. See chapter 2 for a discussion of the staging. See chapter 4 for a discussion of the staging in selected sectors.

Table 3-1
Benchmark tariffs (2005)

(Percent)

Commodity	U.S. imports	Australian imports
	Tariffs	Tariffs
Vegetables, fruits, and nuts	4.00	1.00
Other crops	3.00	0
Cattle and horses	2.00	0
Animal products n.e.c.	0.67	0
Coal, oil, gas, other mineral	0	18.31
Meat products	7.99	0
Dairy products	[1]25.00	5.00
Sugar	([2])	([2])
Other processed food and tobacco products	12.85	20.70
Textile, apparel, and leather products	7.76	10.32
Wood products	2.00	5.00
Petroleum, coal, chemicals, rubber, plastic	3.83	3.62
Ferrous metals	2.00	5.69
Metals n.e.c. and metal products	2.00	2.00
Motor vehicles and parts	4.50	9.50
Transport equipment n.e.c.	1.00	0
Electronic equipment	1.00	1.00
Other machinery and equipment	1.00	3.00
Other manufactures	1.47	3.36
Services	0	0.06

[1] To conform to the FTA, the simulation reported in this study partially removes the tariff on dairy products.

[2] To conform to the FTA, the simulation reported in this study does not remove the tariff on sugar.

Source: GTAP version 6, prerelease 1 data and Commission calculations. Note that to conform to the FTA, the simulation reported in this study does not remove the tariff on sugar, and only partially removes the tariff on dairy products. See text.

An important feature of the Agreement, as discussed in chapter 2, is the rules of origin (ROOs) that determine the eligibility of goods for the tariff reductions of the Agreement. As chapter 2 notes, the ROOs themselves are not likely to have a great impact on U.S. firms. The impact of these rules is not explicitly modeled, but the general form of the simulation employed is consistent with the existence of rules of origin. In the simulation, it is assumed that traded commodities are differentiated by country of origin, which implies a limit to the ability of FTA partners to source exports from a third country.

The primary data source is prerelease 1 of the(GTAP) version 6 database, a snapshot of the world economy for 2001. To the extent feasible, the GTAP data are updated to 2005, the year of the earliest probable implementation of the Agreement. Importantly, the 2005 benchmark incorporates the following: the scheduled removal of textile and apparel quotas (under the Agreement on Textiles and Clothing); and the ratified free-trade agreements between the United States and Chile, and the United States and Singapore. The model also incorporates tariff reductions implemented by NAFTA, the Uruguay Round and U.S. Free Trade Agreements with Israel and Jordan insofar as they are reflected in trade data projected through 2005.[3]

The model used in the assessment is based on the core model available in the GTAPinGAMS software developed by Rutherford and Paltsev.[4] The core model has been modified to incorporate the updated 2005 base year, to compute and report those specific items mandated by the Trade Act of 2002, and to perform systematic sensitivity analysis over econometrically estimated trade elasticities. A more detailed description of the methodology and model are presented in appendix D.

Simulation Design

The analysis employs a comparative static framework in which a baseline equilibrium depiction of the U.S. economy, as of January 1, 2005, is derived through a set of balanced accounts of trade, production, consumption, and taxes. Once this baseline has been created, policy shocks are imposed on the balanced model. A policy shock simply means a change in policy, typically a tariff removal or reduction, which is imposed on the model in order to measure its effect. In this model the policy shocks consist of the reduction or elimination of tariffs agreed to in the FTA. Table 3-1 lists the trade distortions (tariffs) incorporated in the model and its data. While a tariff for sugar is listed, the removal of this tariff is not modeled as sugar was not included in the Agreement. Similarly, the restrictions on dairy products were not fully removed. The U.S. quota-based tariff of 25 percent in the database was reduced to 21.6 percent, in

[3] The model has been also modified to take account of provisions of Australia's free trade agreement with Thailand pertaining to trade in motor vehicles and parts, as data allow.

[4] Thomas F. Rutherford and Sergey V. Paltsev, *GTAPinGAMS and GTAP-EG: Global Datasets for Economic Research and Illustrative Models*, Department of Economics, University of Colorado Working Paper, September 2000.

order to simulate the expected long-run effects of liberalization in this sector as discussed in chapter 4. Note that the sectors listed in this table, and their corresponding shocks or trade distortions, represent aggregates. The meat products sector includes pork, lamb, and other meats as well as beef, for example, and the "other crops" category includes such things as coffee, tea, oilseeds, cotton, spices, and tobacco. As a result, the listed trade distortions are averages of the specific trade distortions faced by the individual commodities composing the aggregates. The tariffs listed here include the tariff rate quotas imposed on certain agricultural products. Prerelease 1 of the GTAP version 6 data base,[5] which provides the bulk of the data used in this model, also includes measures of export tax equivalents, primarily measuring domestic taxes or subsidies on exports. These export measures are in general not affected by the FTA, and are not removed in the model.

The trade policies included in the data are shocked by replacing them with new levels (generally zero, except as noted for sugar and dairy products) for the tariffs and tax equivalents of the trade distortions. The model is rebalanced, and new values for trade flows, outputs, employment, welfare, GDP, and other values are generated. The difference between the baseline values of these variables and their new values is interpreted as the estimated impact of the tariff removal under the trade agreement. It is expected that those sectors which face relatively high trade restrictions will show large effects from the implementation of the FTA.

Economywide Summary Results

Within the economic simulation, the most relevant and comprehensive measure of the impact that the quantifiable components of the U.S.-Australia FTA will have on the U.S. economy as a whole is the change in welfare. The change in welfare summarizes the impact of the components of the Agreement in a single value and in a manner consistent with economic theory, taking into account all of the income and expenditure changes of U.S. households. It thus summarizes the benefits to consumers of the trade agreement, as well as the effects on households in their roles as providers of labor, owners of capital, and taxpayers. The Commission simulation of these components of

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[5] Version 6 of the GTAP data has not been published or publicly released at the time of this writing. Version 5 is described in Dimaranan, Betina V. and Robert A. McDougall (2002). *Global Trade, Assistance, and Production: The GTAP 5 Data Base*, Center for Global Trade Analysis, Purdue University. Also see the web site, www.agecon.purdue.edu/gtap. There are several advantages to using the prerelease version of the GTAP data base rather than the most recently published version. For one thing, trade flows and national economic data have been updated to a 2001 base year from 1997 (although for this study the Commission has further updated the data to 2005). More importantly, much work has been done to improve the protection data in the data base. Rather than relying for the most part on WTO bound tariffs, the new data makes a strong effort to incorporate actual applied tariffs (generally smaller than bound rates); for this reason, apparent duties on some commodities have declined from those in previous versions of the data set. This is aside from the fact that further implementation of the Uruguay Round and other trade agreements has actually reduced duties. Also, this new version of the data base reflects work that is in progress to develop appropriate methods to quantify tariff rate quotas and nontariff measures. Work remains to be done in these areas, but the current prerelease version 6 of the GTAP data base appears to provide the best available basis for the analyses of current trade policy with appropriate measures of trade and trade policy.

the U.S.-Australia FTA suggests that the welfare value to the United States of the tariff liberalization under the Agreement is $490.8 million. This can be interpreted as stating that, when fully implemented, the FTA would provide annual benefits to consumers worth $490.8 million, in the economy of 2005.[6] Table 3-2 presents the simulated welfare impact of the U.S.-Australia FTA, as well as the simulated impact on gross domestic product (GDP).[7]

The change in gross domestic product is decomposed into specific changes in payments to primary factors of production (land, unskilled labor, skilled labor, and capital) and a change in the net transfer from households to the government. Note that labor and capital income increase as a result of the FTA, but payments to land decline slightly, due largely to increased imports in agricultural products. The transfer from households to the government compensates for the loss of tariff revenue to the government.[8]

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[6] This welfare measure is often referred to as the "equivalent variation."

[7] Unlike the change in welfare, measures of changes to GDP include both price and quantity changes. The general equilibrium model determines only relative prices, however, so a unit of measure for real values must be chosen. Throughout the analysis in this chapter and chapter 8 the Commission uses the true-cost-of-living index as measured by the unit U.S.-household expenditure function, to deflate all nominal results. In this case, using the true-cost-of-living index to deflate GDP yields a measure that is a close proxy for welfare changes. In a simple model without government expenditure and other distortions they would be the same.

[8] Without making up for the government's lost tariff revenue, real government spending and net government indebtedness could not be maintained, and national welfare could not be compared between the benchmark and the counterfactual simulation.

Table 3-2
Summary report on welfare and GDP[1]

Item	Million Dollars	Percent
Welfare	490.8	0.01
Decomposition of GDP:		
Land	-74.8	-0.12
Unskilled Labor	271.6	0.01
Skilled Labor	236.7	0.01
Capital	296.3	0.01
Balance for Lost Tariff Revenue[2]	-241.7	NA
Total GDP	488.2	0.00

[1] Unlike the change in welfare, measures of changes to GDP include both price and quantity changes. The general equilibrium model only determines relative prices, however, so a unit of measure for real values must be chosen. Throughout the analysis in this chapter and the next the Commission uses the true-cost-of-living index, as measured by the unit U.S.-household expenditure function, to deflate all nominal results. In this case using the true-cost-of-living index to deflate GDP yields a measure that is a close proxy for welfare changes. In a simple model without government expenditure and other distortions they would be the same.

[2] This transfer compensates the government for lost tariff revenue in order to hold government expenditure and borrowing constant. Holding fixed the government budget position (and by extension government purchases) is necessary for welfare analysis.

Source: Commission calculations.

Simulated Changes in Trade Volumes

Aggregate U.S. trade with the world is likely to increase as a result of the increased market access due to the U.S.-Australia FTA. Table 3-3 reports the simulated changes in U.S. trade volumes. Total imports increase by $1.2 billion (0.07 percent) on a landed-duty paid basis and total exports increase by $1.5 billion (0.13 percent) on an f.o.b. basis.[9]

The trade volumes with Australia increase substantially more than aggregate trade. Table 3-4 reports the simulated changes in U.S.-Australian bilateral trade. The numbers are reported on a landed-duty paid basis, and thus reflect changes in the value of trade including tariff payments. U.S. imports from Australia increase by almost $1.8 billion. Comparing this to the aggregate change in U.S. imports of less than $1.2 billion, the simulated FTA diverts the difference of about $700 million of trade away from other trading partners. That is, the increase in imports from Australia is offset partially by declines in imports from other sources.

Table 3-4 includes a decomposition of the U.S.-Australian bilateral trade equilibrium by commodity. In general, the sectors facing the greatest trade barriers are the ones experiencing the greatest effects of eliminating the trade barriers. U.S. imports of five categories—meat products[10] (which includes beef); other processed foods and tobacco; textiles, apparel, and leather products; petroleum, coal, and chemicals; and motor vehicles and parts—increase substantially, accounting for $1.5 billion of the total increase in imports from Australia.

The greatest percentage increase in sectoral trade occurs in textiles, apparel, and leather products, with a 58 percent increase in imports from Australia, although this effect may be overstated; see the discussion in the next paragraph. The estimated increase in meat imports does not represent the net increase of U.S. imports of meat products because increased meat imports from Australia would be expected to be accompanied by declines in meat imports from other sources.[11]

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[9] Net capital flows are assumed not to change in the simulated FTA, requiring balance between the change in the value of imports on a c.i.f. basis and the change in value of exports on an f.o.b. basis. The smaller change in imports reported in table 3-2 is due to the lost tariff revenue that is included in imports measured on a landed-duty-paid basis.

[10] It should be noted that the assessment of the impact of the FTA in this section is not based on a staged implementation (over 18 years) of the agreement, but on an immediate full implementation of the Agreement on January 1, 2005. In addition, a broader sector (meat products) is analyzed here because the GTAP database does not measure beef separately. Therefore, the assessment of impacts on beef in chapter 4 is not directly comparable to the assessment of the impact in this section.

[11] For the specific impact of the agreement as it pertains to beef, see the discussion in chapter 4.

Table 3-3
Simulated changes in aggregate U.S. trade volume

Flow	Million Dollars	Percent change
Imports (landed duty paid)	1,160.7	0.07
Exports (free on board)	1,499.3	0.13

Source: Commission calculations. See text.

Table 3-4
FTA partner trade equilibrium: Imports from partner (landed-duty paid)

	United States			Australia		
		Change			Change	
Sector	Base value		Percent	Base value		Percent
	Million dollars			*Million dollars*		
Meat products[1]	1,373.9	758.0	55.21	13.0	0.0	-0.26
Other processed food and tobacco products	824.4	310.2	37.63	295.6	184.5	62.43
Textile, apparel, and leather products	312.6	180.5	57.74	143.5	125.0	87.16
Petroleum, coal, chemicals, rubber, plastic	655.9	137.7	21.00	2,218.5	396.4	17.87
Motor vehicles and parts	591.8	127.1	21.47	1,159.8	502.4	43.32
Metals nec and metal products	695.4	104.0	14.95	84.9	12.9	15.16
Other machinery and equipment	819.6	54.5	6.65	3,828.8	686.8	17.94
Ferrous metals	294.2	32.6	11.08	218.8	75.4	34.45
Other manufactures	233.3	18.6	7.98	546.2	103.7	18.98
Transport equipment n.e.c.	249.7	18.1	7.23	3,349.9	-1.6	-0.05
Dairy products	79.7	13.8	17.35	6.2	0.0	0.39
Electronic equipment	121.4	9.6	7.88	1,322.3	90.3	6.83
Other crops	62.8	8.9	14.14	41.3	0.5	1.21
Vegetables, fruits, and nuts	52.6	5.3	10.13	43.7	1.4	3.18
Wood products	41.9	4.6	11.04	67.6	20.9	30.91
Animal products n.e.c.	82.3	1.2	1.45	15.6	0.3	1.79
Cattle and horses	3.2	0.2	5.72	2.4	0.2	6.59
Grains	0.0	0.0	NA	8.4	0.2	2.47
Sugar crops	0.0	0.0	NA	0.0	0.0	NA
Capital goods	0.0	0.0	NA	0.0	0.0	NA
Sugar	55.6	-0.4	-0.77	0.2	0.0	1.78
Coal, oil, gas, other mineral	798.9	-7.4	-0.92	58.1	309.9	533.29
Services	4023.7	-18.4	-0.46	4647.7	30.2	0.65
Total	11,371.6	1,758.6	15.47	18,072.7	2,539.3	14.09

[1] Meat products include beef, pork, lamb, and other meat products. See text.

Source: GTAP version 6, prerelease 1 data and Commission calculations.

Table 3-4 shows a 57.7 percent increase in imports of textiles, apparel, and leather products from Australia. A major factor in this increase is the elimination of tariffs on this aggregate sector, which in the USITC model are 7.76 percent (table 3-1). As is pointed out in chapter 4, a recent study by CIE[12] finds that the bulk of Australian exports to the United States at the present time (in the absence of the FTA and its rules of origin) would not qualify for tariff elimination under the rules of origin of the FTA, because most Australian exports in this category are made from inputs imported from other countries. CIE states that on average over the past 5 years, 8.8 percent of Australian exports to the United States could be determined to have satisfied the yarn-forward rules of origin for textiles and apparel. CIE notes that they were not able to survey completely the Australian industry, and there may be more exports that in fact qualify under the rules. They further note that under the FTA there would be an incentive for Australian producers to change the source of their inputs, either to domestic Australian sources or to U.S. sources. Nevertheless, it is likely that some large fraction of Australian textile and apparel exports to the United States would not qualify for duty-free treatment, as compliance with the rules of origin might be more costly than the savings to be realized from the preferential tariff treatment.[13] A simple numerical exercise can illustrate the extent to which the rules of origin for textile and apparel products might limit the trade effects of the FTA in these products.

In the USITC model, textiles and apparel are combined with leather products in a larger aggregate sector, in which leather accounts for 9 percent of imports. Assuming leather products satisfy the rules of origin, and assuming that only 8.8 percent of textiles and apparel do (even after Australian producers had adjusted their sources in response to the FTA and its incentives), then 17.0 percent of the larger aggregate sector in the USITC model would qualify for duty free entry. Then the model's tariff of 7.76 percent might be adjusted to an effective rate of 1.3 percent (7.76 times 0.17). An alternative but equivalent way of looking at this is that, while the tariff is 7.76 percent, only 17 percent of it (1.3 percentage points) can be liberalized.

Imports from Australia are less than a quarter of one percent of all U.S. imports in this sector. For a small trading partner a fair approximation of the effect of eliminating the reduced tariff on imports of this sector from Australia can be made, simply by making a proportional reduction in the effect estimated by the model. Thus, the model shows a 57.6 percent increase in imports with elimination of a 7.76 percent tariff. Elimination of a 1.3 percent tariff (17 percent of the 7.76 percent value, as calculated above) would thus cause imports from Australia to increase roughly by only 9.8 percent (17.0 percent of the 57.6 percent value), or about $31 million. Small secondary effects would be observed in other sectors.

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[12] Centre for International Economics, Canberra and Sidney, *Economic Analysis of AUSFTA–Impact of the Bilateral Free Trade Agreement with the United States,* April 2004, pp. 53-54.

[13] See chapter 4 for a discussion of textile and apparel trade with Australia, and the rules of origin governing it.

Table 3-5 puts the information of table 3-4 into the broader context of the effects of the FTA on U.S. trade with the world at large. Note, for example, that under the FTA, U.S. imports of meat from Australia increase by $758.0 million (table 3-4), or 55 percent, whereas U.S. total imports of meat increase by only $383.6 million, or 6.0 percent (table 3-5). Thus, most of the increase in meat imports from Australia is diverted from imports formerly supplied by other countries. Similarly, in the case of other processed food and tobacco products, the $310 million increase in imports from Australia is largely offset by decreases in imports from other countries, leading to a net increase in imports of only $95 million. Further, the $180 million increase in imports of textiles, apparel, and leather products is also largely offset, with a total increase of only $78

Table 3-5
U.S. trade equilibrium: Imports (landed-duty paid) and Exports (fob) with the world

Products	Imports			Exports		
	Base	Change	Percent	Base	Change	Percent
	— Million dollars —			*— Million dollars —*		
Meat Products	6,411.30	383.60	5.98	7,879.30	8.10	0.10
Other processed food and tobacco products	37,301.80	94.90	0.25	20,350.30	189.30	0.93
Textile, apparel, and leather products	126,765.20	78.40	0.06	24,793.80	90.90	0.37
Petroleum, coal, chemicals, rubber, plastic	165,200.00	99.50	0.06	156,842.40	289.20	0.18
Motor vehicles and parts	178,272.90	61.20	0.03	69,089.20	501.30	0.73
Metals nec and metal products	30,370.40	41.80	0.14	18,686.50	1.90	0.01
Other machinery and equipment	249,915.60	108.90	0.04	233,893.50	456.00	0.19
Ferrous metals	49,069.40	39.60	0.08	33,566.90	50.90	0.15
Other manufactures	79,450.80	37.40	0.05	37,818.50	66.50	0.18
Transport equipment n.e.c.	51,579.90	22.40	0.04	71,897.50	-57.60	-0.08
Dairy products	1,893.50	6.90	0.36	860.60	-0.40	-0.04
Electronic equipment	219,645.40	43.60	0.02	165,883.00	-78.60	-0.05
Other crops	10,914.10	2.10	0.02	11,728.10	0.00	0.00
Vegetables, fruits, and nuts	9,198.80	1.50	0.02	4,990.50	0.10	0.01
Wood products	21,545.30	11.40	0.05	6,996.90	14.60	0.21
Animal products n.e.c.	2,871.40	-3.20	-0.11	3,375.60	-1.00	-0.03
Cattle and horses	2,151.40	-6.40	-0.30	842.50	-1.30	-0.15
Grains	1,073.50	-1.50	-0.14	9,954.40	-1.50	-0.02
Sugar crops	6.60	0.00	-0.04	0.00	0.00	NA
Capital goods	0.00	0.00	NA	0.00	0.00	NA
Sugar	1,481.30	-0.30	-0.02	431.20	0.10	0.02
Coal, oil, gas, other mineral	86,585.40	25.40	0.03	8,170.60	193.70	2.37
Services	223,370.80	113.60	0.05	276,862.30	-222.90	-0.08
Total	1,555,074.80	1,160.70	0.07	1,164,913.70	1,499.30	0.13

Source: GTAP version 6, prerelease 1 data and Commission calculations.

million in imports from the world as a whole.[14] Conversely, while imports of services from Australia drop slightly (by $18.4 million), imports from the world as a whole increase by $114 million. Note that no U.S. tariffs or other quantitative import barriers to services were removed in this model. The reported changes in trade and output in services arise from secondary general equilibrium effects, including changes in demand for services by other sectors and changes in supply of services resulting from the reallocation of labor and capital resources to other sectors that are growing more strongly as a result of the policy changes. For a discussion of the changes in trade in services that might be expected from non-quantifiable provisions of the FTA, see chapter 4.

On the U.S. export side, there are substantial increases in the motor vehicles and parts sector; other machinery and equipment; petroleum, coal, chemical, rubber, plastic products; and in the coal, oil, gas, and other minerals sector. While the model shows an increase of $127 million in U.S. imports of vehicles and parts from Australia, Australian imports of these goods from the United States increase by $502 million. On the import side, most imports from Australia are diverted from other countries, leaving a net increase in imports of $61 million. On the export side, however, the increase in exports of vehicles and parts to Australia is essentially all new trade; table 3-5 shows an increase in U.S. exports to the world of $501.3 million f.o.b. Chapter 4 provides specific analyses of products in some of these and other sectors, with additional discussion of the timing of the implementation of the Agreement with respect to them.

U.S. Gross Output and Employment Effects

The U.S.-Australia FTA is likely to result in expansion of industries that experience increased export demand due to the removal of Australian tariffs. In addition, the reallocation of resources and direct competition from Australian goods that are given preferential import treatment into the United States likely will cause some U.S. industries to decline. For example, output in the huge services sector declines by a small percentage, as resources are allocated to other sectors. Price increases for the output of this sector imply that even as its quantity of output declines, its revenue increases slightly. Table 3-6 reports the simulated percent changes in output, revenue, and employment by industry. Changes in gross output should be interpreted as pure quantity changes. Changes in revenues by industry incorporate both the quantity and producer price changes generated in the simulated FTA.

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[14] If the actual tariff reduction in these products is significantly lower than the modeled value of 7.76 percent, as discussed in the previous paragraph, the increase in imports from the world would also be much smaller than the reported $75 million.

Table 3-6
Changes in output and employment in the United States

	Output[1]		Labor quantity impact
	Quantity impact	Revenue impact	
	Percent		
Services	-0.002	0.003	-0.002
Capital goods	0.000	0.000	0.000
Petroleum, coal, chemicals, rubber, plastic	0.021	0.022	0.021
Other machinery and equipment	0.039	0.041	0.039
Other processed food and tobacco products	0.009	0.004	0.007
Motor vehicles and parts	0.098	0.097	0.099
Other manufactures	0.004	0.007	0.004
Ferrous metals	0.021	0.022	0.021
Electronic equipment	-0.044	-0.042	-0.044
Textile, apparel, and leather products	0.014	0.009	0.014
Wood products	0.002	0.004	0.002
Transport equipment n.e.c.	-0.047	-0.046	-0.048
Meat products	-0.304	-0.328	-0.304
Metals n.e.c. and metal products	-0.041	-0.044	-0.041
Coal, oil, gas, other mineral	0.145	0.151	0.146
Cattle and horses	-0.298	-0.314	-0.335
Dairy products	-0.005	-0.011	-0.005
Grains	-0.118	-0.134	-0.155
Other crops	0.001	-0.014	-0.030
Animal products n.e.c.	-0.109	-0.126	-0.146
Vegetables, fruits, nuts	0.009	-0.006	-0.027
Sugar	-0.010	-0.018	-0.010
Sugar crops	-0.010	-0.031	-0.049

[1] The revenue impact reflects changes in the prices as well as the output quantities of the listed sectors.

Source: Commission calculations and GTAP version 6, prerelease 1 data.

Generally, those industries with the largest increases in export demand expand the most, and those industries that face significant import competition contract the most. The sector experiencing the greatest expansion under full liberalization is the motor vehicle and parts industry. This finding is consistent with the relatively high rates of protection on both exports and imports and the substantial vertical linkages within the motor vehicle sector. The pattern of employment impacts across the sectors is generally consistent with the changes in output, because the FTA has little impact on the relative prices of the primary factors of production.

The simulation model abstracts from a great deal of labor market detail in order to characterize the world trade equilibrium. The simulation model does not consider changes in total labor supply nor does it consider potential unemployment impacts; labor supply in the model is assumed to be fixed, and the labor market clears in equilibrium, as do all other simulated markets either for other factors or for goods or services. The model serves to indicate the ways in which a fixed labor supply would be reallocated among sectors in response to trade policy changes. In order to gain insight

on how the overall labor supply and employment level may respond to policy, other information can be applied in addition to the model results.

The model provides an estimated proportional change in the wage rate across the economy. The simulated U.S.-Australia FTA increases the average wage in the United States by 0.01 percent. Assuming a labor-supply elasticity of 0.1, this translates into a 0.001 percent increase in labor supply. With a U.S. labor force of 150 million, the simulation results imply an equilibrium increase in the labor market of roughly 1,500 full-time equivalent jobs. Thus, although employment may fall in contracting industries, the overall small net increase in demand for labor is likely to decrease the economywide unemployment rate.

The increase in GDP due to the FTA also may have an effect on the labor force. Okun's law,[15] which relates an economy's GDP and the actual unemployment rate, suggests that for every one percent increase in GDP there is roughly a one-half percent decrease in the unemployment rate. The 0.01 percent increase in GDP suggests a 0.005 percent drop in the economy-wide unemployment rate. If the equilibrium unemployment rate is 5.5 percent, this GDP change would reduce the rate to 5.495 percent, suggesting that employment would increase by roughly 7,000 jobs, in comparison to the 1,500 jobs derived using the labor supply elasticity above. Both of these calculations indicate the relatively small impact the U.S.-Australia FTA is likely to have on the overall U.S. labor market. It should be noted that these numbers are not findings of the USITC model simulation, but are simple calculations of employment changes based on economic theory that would be consistent with the wage and output changes calculated in the model.

Sensitivity of the Commission Simulated Impacts to the Trade Elasticities

The construction of a simulation of the economy and its response to trade policy depends on many underlying parameters, most of which are obtained from sources outside the model. Appendix D describes the USITC model, its data base, and the parameters upon which it depends. The choice of values for these parameters strongly influences the results obtained by the model. In order to assess and illustrate the model and its sensitivity to the values of the underlying parameters, an analysis has been performed showing how one outcome of the model (the welfare measure) responds to a range of values selected for one set of input parameters (the Armington elasticities).

One of the most important sets of parameters necessary for the model is the set of Armington trade elasticities, which measure the extent to which imported goods are similar to (and substitutable for) domestically produced goods. These parameters directly describe and control the responsiveness of trade flows to changes in trade

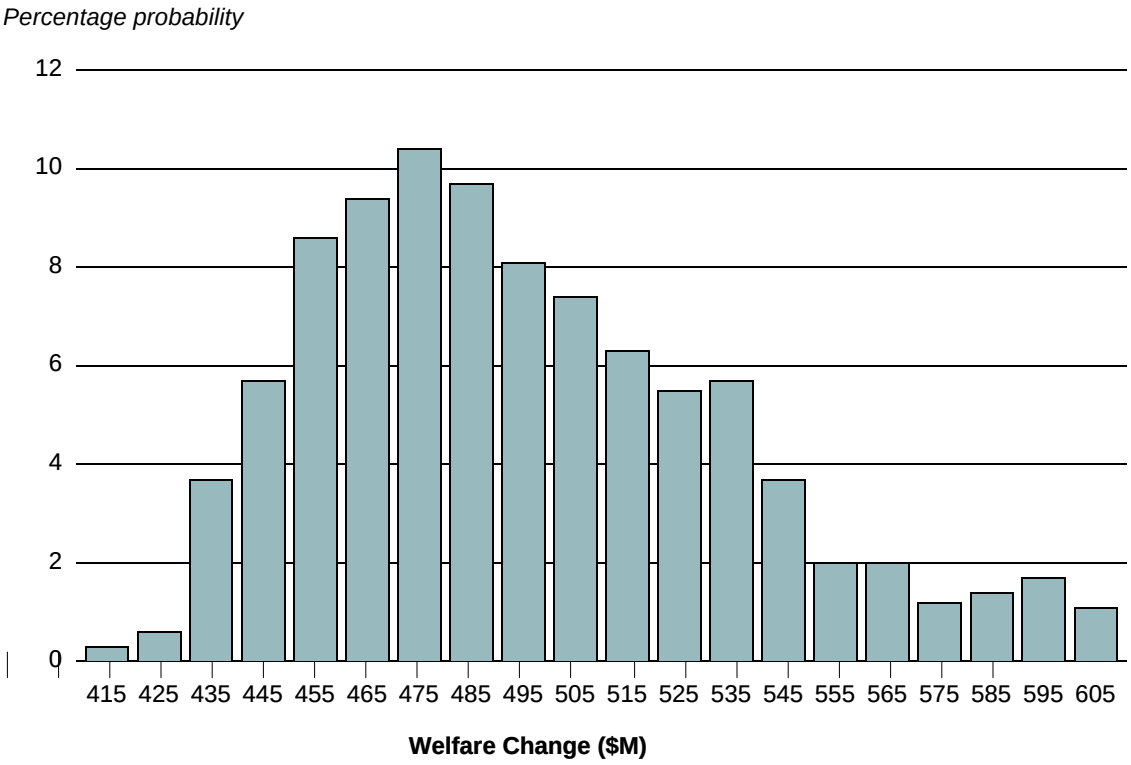
[15] A definition and discussion of economist Arthur Okun's law can be found at *http://economics.about.com/cs/termpaperhelp/a/okunslaw.htm.*

policy instruments (tariffs and other distortions). Because of the sensitivity of the model to these elasticities, and because there is often uncertainty on the values assigned to these elasticities,[16] the Commission has systematically analyzed the sensitivity of its model to the values assumed for the trade elasticities.

Trade elasticities are drawn from the econometric literature (see appendix D) allowing for the incorporation of uncertainty in the values of these estimates in the numeric simulation. Using 1,000 random draws from the published elasticity distributions, the numeric model was run to generate a distribution of the simulated welfare impacts of the U.S.-Australia FTA. This distribution is presented graphically in figure 3-1.

[16] Chapter 8 reviews several analyses of the U.S.-Australia FTA. As is pointed out there, different assumptions on the appropriate values for the trade elasticities distinguish some of the models from each other.

Figure 3-1
Distribution of simulated U.S. welfare impacts of the U.S.-Australia FTA



Source: Commission calculations

The simulations suggest a 95 percent confidence interval of welfare changes between $434.8 million and $639.42 million. In other words, accepting the distribution of the Armington elasticities as described in appendix C, and disregarding other sources of uncertainty in the model and its parameters, one could be 95 percent certain that the true welfare change resulting from the FTA lies in the interval between $434.8 million and $639.4 million. It is important to recognize that, although the trade elasticities are some of the most important parameters, there is unmeasured uncertainty on a number of other parameters (such as demand and supply elasticities) that are required for computation of the model. Furthermore, this confidence interval pertains only to the welfare change, only one of several measures of the effect of outcome measures in the model. Similar analyses could be performed to examine the sensitivity to the Armington elasticities of GDP and aggregate trade flows, for example.

CHAPTER 4
Impact of the U.S.-Australia FTA on Selected Sectors

Chapter 3 quantified the economy wide impact of the liberalization of tariff and tariff-rate quotas of the increased market access to be realized with the implementation of the U.S.- Australia FTA. The discussion in this chapter supplements those results with a qualitative assessment of the impact of increased market access on selected sectors of the U.S. economy. Sectors chosen are live cattle and beef; dairy; citrus fruit; certain fresh and processed fruit; macadamia nuts; motor vehicles; certain motor-vehicle parts; textiles, apparel, and footwear; agricultural and horticultural machinery; household appliances; audiovisual services; express delivery services; financial services; information technology services; and education services. Sectors were chosen based upon a number of criteria, including the extent and speed of trade liberalization and its potential for increasing U.S. trade, the importance of the sector in terms of bilateral trade, increased export opportunities for U.S. producers relative to other foreign suppliers, the views of Commission industry analysts and industry spokesmen, and the apparent sensitivity of certain U.S. industries to trade liberalization. The assessments in this chapter are based on the industry knowledge and expertise of USITC industry analysts. They have also relied on industry sources, the USITC public hearing in this investigation, and the advisory committee reports on the U.S.-Australia FTA, submitted to the USTR.

Table 4-1 shows the relationship between the selected sectors and the corresponding aggregated model sectors analyzed in chapter 3. As seen in table 4-1, there is a close correspondence between the textile, apparel, and footwear sector analyzed in chapter 3 and in chapter 4, while the correspondence between chapter 3 and chapter 4 is relatively limited for macadamia nuts, agricultural and horticultural machinery, and household appliances. In addition, the qualitative analysis in Chapter 4 is based on the staged implementation of the FTA, while the analysis in Chapter 3 assumes the U.S.-Australia FTA is fully implemented and its effects are felt on January 1, 2005. Thus, any seeming difference in the assessment of impacts in these chapters is not unexpected, as different degrees of aggregation and different analytical frameworks have been employed in the chapters. The results in Chapters 3 and 4, while directly related, are not directly comparable.

The U.S.-Australia FTA provides increased export opportunities for U.S. manufacturers by eliminating immediately upon entry into force of the Agreement virtually all Australian tariffs on U.S. manufactured goods exports. The immediate elimination of Australian tariffs on virtually all U.S. agricultural exports is expected to provide greater export opportunities for U.S. farmers. Tariff elimination will likely increase the competitiveness of U.S. manufacturers and farmers in the Australian

Table 4-1
U.S. Imports from Australia: Actual 2002 imports for selected sectors and estimated 2005 imports for model sectors

Chapter 4 sector	Million dollars[1]	Chapter 3 sector	Million dollars[2]	Selected sector share of model sector
				Percent
Live cattle and beef	880.3	Meat products	1,373.2	64.1
Dairy	70.7	Dairy products	79.7	88.7
Citrus fruit	27.7	Vegetables, fruits, and nuts	52.6	52.7
Certain fresh and processed fruit	2.8	Vegetables, fruits, and nuts	52.6	5.3
Macadamia nuts	8.9	Vegetables, fruits, and nuts	52.6	16.9
Motor vehicles	311.4	Motor vehicles and parts	591.8	52.6
Certain motor-vehicle parts	183	Motor vehicles and parts	591.8	30.9
Textile, apparel, and footwear	303.2	Textile, apparel and leather products	312.6	97.0
Agricultural and horticultural machinery	19.4	Other machinery and equipment	819.7	2.4
Household appliances	24.9	Other machinery and equipment	819.7	3.0

[1] Compiled from official statistics of the U.S. Department of Commerce.

[2] GTAP database (see table 3-4).

market not only relative to Australian producers but also relative to other foreign suppliers. The FTA also will reduce Australian nontariff barriers on U.S. agricultural exports.

With respect to services, many of the benefits of the FTA are indirect, such as greater transparency and legal certainty. In certain instances, however, bindings in the FTA are clear improvements over those found in the General Agreement on Trade in Services. In particular, FTA bindings on audiovisual and insurance services appear to represent significant improvements. In addition, the "negative list" format of the FTA, as opposed to the "positive list' format found in GATS, ensures that the provision of the FTA will apply to new products resulting from technological advances and other innovations.

Live Cattle and Beef[1]

Overview

U.S. Industry

A combination of abundant grazing land and access to low cost feed grains helps make U.S. farmers, ranchers, and cattle feeders efficient low cost producers of grain-fed cattle. In addition, a large domestic market has allowed processors to consolidate and build large efficient plants to take advantage of economies of size and scale, which makes them low cost processors of cattle into wholesale and retail cuts of beef. These factors make the United States one of the world's most efficient producers of high quality grain-fed beef. In general, demand for high quality grain-fed beef increases as per capita income increases. Consequently, the United States is a competitive supplier of high quality grain-fed beef to high per capita income international markets such as Japan, and those exhibiting per capita income growth such as Korea and Taiwan.[2] U.S. grain-fed beef competes with pork and poultry in the U.S. market and international markets.

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[1] The primary focus of the FTA is meat of bovine animals, fresh, chilled, or frozen in HTS headings 0201 and 0202, specifically those tariff lines subject to TRQ listed in Additional U.S. Notes to Chapter 2 of the Harmonized Tariff Schedule of the United States. However, U.S. beef packers operate on the margin between wholesale beef prices and slaughter cattle prices. Furthermore, market structure suggests that processors can eventually pass most, if not all, of any decrease in the price of wholesale beef that results from increased import access of Australian beef on to U.S. cattle producers in terms of lower slaughter cattle prices. Therefore, this section addresses the impact of the FTA on the domestic industry from the focus of live cattle producers rather than beef processors. The meat products sector in Chapter 3 includes pork and sheep meat, as well as beef.

[2] U.S. beef exports to most markets are currently suspended as a result of the discovery of a single cow in Washington State with mad cow disease (Bovine Spongiform Encephalopathy or BSE).

The U.S. cattle sector consisted of slightly more than 1 million farming, ranching, and feedlot operations in 2002.[3] Most of these operations (61 percent) were small cow-calf operations with less than 50 beef cows.[4] In 2003, a total of 56.0 million cattle and calves were marketed, generating cash farm receipts totaling $38 billion.[5] As of January 1, 2003, U.S. farms, ranches, and feedlots held $69.8 billion worth of live animals in inventory.[6] Most cow-calf operations rely on unpaid family labor; nonetheless, it is estimated that as many as 517,000 full-time-equivalent workers would be required to care for the U.S. cattle herd annually.[7]

The U.S. beef packing segment of the industry consisted of 706 federally inspected cattle slaughter plants and 268 federally inspected calf slaughter plants in 2002.[8] The 23 largest cattle plants, each processing 500,000 animals or more annually, processed 70 percent of U.S. federally inspected cattle slaughter.[9] An additional 2,326 plants (many with 10 or fewer employees) operated under state inspection systems.[10] On a carcass weight basis, industry shipments were valued at approximately $30 billion.[11] U.S. cattle slaughter operations employed approximately 76,700 persons in 2002.[12]

Australian Industry

Australia is a highly competitive exporter of live cattle and beef. Its large cattle herd (29.2 million animals)[13] relative to its human population (19.5 million),[14] and abundant grazing land contribute to its competitive position. In 2002, Australia's live cattle exports totaled 977,540 animals. Major markets include Indonesia (44 percent), Egypt (15 percent), and the Philippines (12 percent).[15] Record live cattle exports in 2002 were partly driven by severe drought in many of Australia's cattle production areas. Exports averaged 832,000 animals during 1998-2002.[16]

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[3] USDA, National Agricultural Statistics Service, *Cattle*, Feb. 2002.

[4] USDA, National Agricultural Statistics Service, *Cattle*, Feb. 2002.

[5] USDA, National Agricultural Statistics Service, *Meat Animals Production, Disposition, and Income, 2002 Summary,* Apr. 2003.

[6] USDA, National Agricultural Statistics Service, *Meat Animals Production, Disposition, and Income, 2002 Summary*, Apr. 2003.

[7] USITC staff estimate based on cattle numbers and labor requirement estimates.

[8] USDA, National Agricultural Statistics Service, *Livestock Slaughter 2002 Summary*, Mar. 2003.

[9] USDA, National Agricultural Statistics Service, *Livestock Slaughter 2002 Summary*, Mar. 2003.

[10] USDA, National Agricultural Statistics Service, *Livestock Slaughter 2002 Summary*, Mar. 2003; smaller State-inspected processing plants are most likely multi-species plants, which means that they may process hogs, sheep, or poultry as well as cattle. Meat from animals processed in State-inspected plants cannot generally be sold outside of the State in which it was inspected.

[11] USITC estimate based on number of animals slaughtered by class, dressed weight, and cutout values. USDA, National Agricultural Statistics Service, *Livestock Slaughter 2002 Summary*, Mar. 2003.

[12] USITC estimate based on meat packing plant employees and percentage of slaughter.

[13] Based on Jan. 1, 2003 inventory, USDA, FAS, *Australia Livestock and Products Semi-Annual 2003*, GAIN Report #AS3004, Feb. 5, 2003.

[14] Central Intelligence Agency, *The World Factbook* 2002.

[15] Peter Weeks, *Australian Cattle and Sheep, Industry Projections 2003*, Meat and Livestock Australia, Jan. 2003.

[16] Peter Weeks, *Australian Cattle and Sheep, Industry Projections 2003*, Meat and Livestock Australia, Jan. 2003.

Australia's 2002 beef production of 2.1 million metric tons (mt) represented 4 percent of world production.[17] About two-thirds of beef production was exported, which represented 21 percent of world beef exports in 2002.[18] The United States (38 percent) and Japan (34 percent) were Australia's largest beef markets.[19] Australian exports to Japan, however, dropped by 26 percent between 2001 and 2002. The decrease was related to the discovery of mad-cow disease (bovine spongiform encephalopathy or BSE) in the Japanese cattle herd, which, coupled with a beef labeling scandal in which imported beef was mislabeled as domestic beef, caused Japanese beef demand to decrease by 50 percent.[20] Australian beef exports were subsequently diverted to Canada (63 percent increase), Indonesia (51 percent increase), and Korea (41 percent increase).[21] Australian exports of live cattle and beef have been also aided by the low value of the Australian dollar compared with the U.S. dollar and the Japanese yen.[22]

Potential Impact on U.S. Trade Flows

U.S. Imports

The impact of the U.S.-Australia FTA on total U.S. beef imports in the first eight years of the Agreement will be minimal because the amount by which duty-free entry can potentially increase is specifically known, is limited, and is small relative to U.S. production and consumption.[23] The impact in years 9 through 18, however, is less certain because the specific timing and level of increased market access cannot be known.

The preferential tariff-rate quota (TRQ) provisions of the Agreement will not be implemented until U.S. beef exports exceed their 2003 level, or the third year after the Agreement enters into force. Therefore, until either of these conditions exists, the primary result of the FTA is to eliminate the in-quota duty of 4.4 cents per kg on beef imported from Australia within its WTO-allocated quota of 378,214 mt.[24] This will

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[17] Quantities reported here are based on carcass weight. About 90 percent of Australian beef exports to the United States are boneless, frozen, manufacturing beef.

[18] Based on world totals reported by USDA that includes only those countries contained in USDA's official Production Supply and Demand tables. Source: USDA, FAS, *Livestock and Poultry: World Markets and Trade*, Mar. 2003.

[19] Five-year average volume basis.

[20] USDA, FAS, *GAIN Report #JA2008, Japan Livestock Products Semi-Annual 2002*, Mar. 1, 2002.

[21] Peter Weeks, *Australian Cattle and Sheep, Industry Projections 2003*, Meat and Livestock Australia, Jan. 2003.

[22] Peter Weeks, *Australian Cattle and Sheep, Industry Projections 2003*, Meat and Livestock Australia, Jan. 2003.

[23] It should be noted that the assessment of the impact of the FTA on beef imports in this section is based on the staged implementation (over 18 years) of the Agreement and not as in Chapter 3 on the full implementation of the Agreement on Jan. 1, 2005. In addition, the GTAP database used in the model in Chapter 3 includes beef as part of the larger meat products sector, which also includes pork and lamb. This section covers beef only. Therefore, the assessment of impacts in Chapter 3 is not comparable to the assessment of the impact in this section.

[24] While in-quota tariffs of 4 percent and 10 percent exist on some in-quota beef imports, more than 99 percent of Australian beef imports were subject to a duty of 4.4 cents per kilogram.

slightly increase the competitiveness of Australian beef vis-à-vis other exporters within the WTO quota. However, as long as the over-quota duty rate is not changed, and remains for the most part, prohibitive, Australia's access will be limited to its WTO quota amount.

After the preferential TRQ enters into effect, the impact on total U.S. beef imports will continue to be minimal. In the third year of the Agreement, Australia will receive increased market access in terms of a duty-free preferential TRQ of 20,000 mt in addition to its WTO allocation. This amounts to a 5.3 percent increase over Australia's current duty-free access to the U.S. beef market of 398,214 mt. Australia's total duty-free access in year 3 of the Agreement will represent 3.3 percent of U.S. beef production and consumption (based on 2003 levels). This increase is approximately equivalent to an increase in U.S. cattle slaughter of 88,000 animals.[25] This level of increased slaughter represents a 0.25 percent increase compared with actual 2003 U.S. cattle slaughter, which implies a 0.5 percent decrease in the fed cattle price.[26] By year 8 of the Agreement, the preferential TRQ will have increased to 30,000 mt, representing a 7.9 percent increase over Australia's base WTO TRQ. Australian duty-free access would then represent 3.4 and 3.3 percent of 2003 U.S. beef production and consumption, respectively.[27] The 30,000 mt of preferential duty-free access represents an equivalent increase in U.S. cattle slaughter of less than 0.4 percent compared with 2003 U.S. cattle slaughter, suggesting a fed-cattle price impact of less than 0.8 percent.

The preferential TRQ will continue to increase until year 18 of the Agreement,[28] at which time the preferential quantity will be 70,000 mt and Australia's total quota access will be 448,214 mt. This represents an 18.5 percent increase over Australia's base WTO quota. However, Australia's total quota access will still represent less than 4 percent of 2003 U.S. production and consumption levels. The 70,000 mt is approximately equivalent to 309,000 animals, or less than 0.9 percent of 2003 U.S.

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[25] Quantities of meat were converted to a live-cattle equivalent using the USDA boneless to carcass conversion rate of 0.669 and the 2003 average carcass weight for all cattle of 746 pounds. U.S. beef packers operate on the margin between wholesale beef prices and slaughter cattle prices. Market structure suggests that processors can eventually pass most, if not all, of any decrease in the price of wholesale beef on to cattle producers in terms of lower slaughter cattle prices. Therefore, this assumption implies that 100 percent of any price impact on beef at the wholesale level will be passed through to cattle producers.

[26] In testimony before the USITC, R-CALF USA stated that each 1 percent increase in supply decreased price by 1 to 2 percent. Source: Brett DeBruycker, testimony before the USITC, hearing transcript, p. 128. This was confirmed by USITC staff to be the farm level elasticity of demand for slaughter cattle, such that each 1 percent increase in fed cattle numbers would be expected to decrease fed cattle prices by 2 percent. Source: Wayne D. Purcell, *The "Why" of Record-High Cattle Prices and Background for Longer Term Strategic Planning*, Research Institute on Livestock Pricing, Virginia Polytechnic and State University, Department of Agricultural Economics, found at *http://www.aaec.vt.edu/rilp/publications.html*, retrieved on Apr. 13, 2004.

[27] Note that these percentages are based on 2003 production and consumption, which could change significantly by year 8 of the Agreement, and thus significantly increase or decrease these percentages.

[28] After year 8 of the Agreement, the increased level of the preferential TRQ is coupled with decreased levels of over-quota duty rates. This section continues the analysis of the preferential TRQ only. The impact of the over-quota duty reductions is provided later.

cattle slaughter. Based on the fed cattle slaughter demand elasticity, this implies a fed cattle price impact of less than 1.8 percent. Current USDA baseline projections have total U.S. cattle numbers and beef production declining through 2005, and then increasing from 2006 through 2013.[29] The USDA baseline has U.S. commercial beef production exceeding the 2003 level by 2011, which implies that after 2011, the expected impact on U.S. cattle prices of a 70,000 mt increase in Australian market access would be less than the 1.8 percent based on 2003 production.[30] The U.S. industry estimates that given the primary end-use of imported Australian beef (ground beef for the food service industry) and current estimates for domestic growth for food service ground beef, there will be no negative price impacts during the next 10 years.[31] Furthermore, even if demand for lean beef stagnates, the domestic industry estimates that the maximum price impact of the increased TRQ in year 18 of the Agreement would be less than one cent per pound on the live price of utility cows.[32]

Beginning in year 9, the impact of the FTA on the U.S. live cattle and beef industry is less certain because potential increases in imports above the TRQ amounts will depend upon the point at which the over-quota duty rate is no longer prohibitive. This point can be expected to vary based on total demand and supply in the world market and the U.S. market; as well as the relative prices for individual cuts and products, both of which might be expected to change significantly over the life of the Agreement. The over-quota duty rate will be reduced by 6.7 percent annually during years 9 through 13, and by 13.3 percent annually during years 14 through 18, resulting in duty-free access for all Australian beef imports on January 1 of year 18.

While the specific impact of the over-quota duty rate cannot be known, R-CALF USA[33] estimates that "Australian beef imports could well enter the United States with little regard to the tariff level" once the over-quota duty rate drops below 14 to 15 percent – which will occur in year 14 of the Agreement.[34] That is, R-CALF USA believes that Australian access to the U.S. beef market will be essentially unlimited by year 14 of the Agreement as opposed to year 18 of the Agreement as implied by the preferential tariff-rate quotas. USITC estimates have confirmed that the price wedge – the difference between the prices of U.S. imports of Australian beef and comparable domestically produced beef – on about 90 percent of U.S. imports from Australia was

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[29] USDA, Office of the Chief Economist, *Agriculture Baseline Projections to 2013*, Staff Report WAOB-2004-1, Feb. 2004.

[30] In general, this analysis does not account for any displacement of 3rd country imports. Such displacement would mitigate the effects.

[31] "Report of the Agricultural Technical Advisory Committee (ATAC) for Trade in Animals and Animal Products," Majority Opinion of Beef Industry, USTR, Mar. 12, 2004; found at *http://www.ustr.gov/new/fta/Australia/advisor/atac-animals.pdf*, retrieved on Apr. 16, 2004.

[32] "Report of the Agricultural Technical Advisory Committee (ATAC) for Trade in Animals and Animal Products," Majority Opinion of Beef Industry, USTR, Mar. 12, 2004; found at *http://www.ustr.gov/new/fta/Australia/advisor/atac-animals.pdf*, retrieved on Apr. 16, 2004.

[33] R-CALF USA is concerned about the negative impact of granting increased Australian access to the U.S. beef market; for additional detail see the position of interested parties in Chapter 9.

[34] R-CALF USA, post-hearing brief, submitted Apr. 6, 2004.

less than 12 percent;[35] suggesting that the impact of the over-quota duty rate could be significantly diminished in the later years of the Agreement.

In the first eight years of the Agreement, increased market access for Australian beef is clearly small relative to current U.S. production: it amounts to less than 0.4 percent of 2003 production in terms of the number of cattle slaughtered. Therefore, this Agreement would be expected to have a minimal impact on the U.S. live cattle and beef industry in its first eight years. Furthermore, increased demand for U.S. beef could easily offset any increased market access for Australian beef.[36] The impact in the later years of the Agreement is, however, less certain. As the over-quota duty rate decreases after year 8, the degree to which market access will increase is uncertain because the impact will vary among cuts of meat depending on relative prices. However, at some point prior to the end of the Agreement, before the over-quota duty rate actually falls to zero, the over-quota tariffs may not impose any restriction on Australian beef imports. Additionally, changes in U.S. consumer tastes and preferences cannot be known; for example, some U.S. consumers may develop a preference for grass-fed beef.

U.S. Exports

Most of Australia's beef production is grass-fed, compared to the grain-fed U.S. production. However, to increase its competitiveness in the high value Asian markets (primarily Japan, Korea, and Taiwan), which seem to prefer grain-fed beef, the Australian industry has developed a small, but growing, grain-fed segment to supply grain-fed beef to these markets. With increased access to grain-fed beef over the long term, Australians could develop a taste for grain-fed beef, resulting in a market for U.S. grain-fed beef exports. This segment of the Australian industry is very competitive in the Asian markets, however; therefore, it would be expected to also be highly competitive in its own market, which is very limited in size.

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[35] This analysis compared the average unit value of imports under HTS 0202.30.50 to the price of 90 percent lean fresh processing beef, FOB Omaha basis. The U.S. product would be expected to be at a premium to the Australian product because it is fresh, therefore this comparison would tend to overestimate the price gap.

[36] From 1980 to 1998, U.S. beef demand dropped by about 50 percent. However, since 1998, demand has increased by about 10 percent. Source: Wayne D. Purcell, *The "Why" of Record-High Cattle Prices and Background for Longer Term Strategic Planning,* Research Institute on Livestock Pricing, Virginia Polytechnic and State University, Department of Agricultural Economics, found at: *http://www.aaec.vt.edu/rilp/publications.html*, retrieved on Apr. 13, 2004.

Overview

U.S. Industry

The United States is the world's largest milk producer, its output of almost 78.2 million mt in 2003 having accounted for about 15 percent of the world's milk supply.[37] Dairy is the second-largest agricultural sector in the United States, generating about $22 billion in cash receipts in 2003, equivalent to approximately 10 percent of cash commodity farm receipts.[38] According to the National Milk Producers Federation (NMPF), the retail value of dairy products containing U.S.-produced milk reached $90 billion in 2003.[39] The NMPF also reported that about 70,000 commercial dairy farms were in operation in 2003, and that U.S. milk production generates close to 1.2 million jobs both on farms and in dairy processing. Milk production in the United States is experiencing considerable structural change, including (1) a steady increase in production and productivity over time; (2) an increasing share of U.S. milk supplied from a relatively few, very large dairy operations; and (3) a regional shift in production from the Northeast and Upper Midwest to the Southwest and West. In 2002, U.S. milk production costs were in the $10-13 per cwt range, significantly higher than Australia ($2.7-9.1 per cut).[40]

In the United States, milk is marketed under a complex system of federal, state, and local laws and regulations.[41] Programs at the federal level include a dairy price support program,[42] Federal milk marketing orders,[43] income deficiency payments, import controls, and export assistance. These programs are used to influence the use and availability of milk in the domestic market in order to affect the level and reduce the volatility of producer prices and incomes. A consequence of U.S. Government

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[37] Food and Agriculture Organization of the United Nations, FAOSTAT database Feb. 3, 2004 update.

[38] USDA, ERS, Cash receipts from farming, table 33, *Agricultural Outlook*, various issues.

[39] National Milk Producers Federation, submission to the Commission concerning U.S.-Australia Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects (Investigation No. TA-2104-11), Apr. 6, 2004.

[40] International Farm Comparison Network, *Dairy Report 2003*, found at *http://www.ifcnnetwork.org/*.

[41] For a detailed discussion of U.S. dairy policy, see USDA, ERS, *Dairy. Briefing Room*, found at h*ttp://www.ers.usda.gov/Briefing/Dairy/Policy.htm*.

[42] Under the system, market prices for butter, cheddar cheese, and skim milk powder are supported through purchases of domestic surpluses by the Commodity Credit Corporation (CCC). The CCC is a government-owned and -operated corporation within the U.S. Department of Agriculture.

[43] Federal milk marketing orders regulate handlers that sell milk or milk products within an order region, by requiring them to pay not less than an established minimum price for the Grade A milk they purchase from dairy producers, depending on how the milk is used. This classified pricing system requires handlers to pay a higher price for milk used for fluid consumption (Class I) than for milk used in manufactured dairy products such as yogurt, ice cream (Class II), cheese, (Class III), and butter and skim milk powder (Class IV)).

intervention has been the rise of U.S. domestic prices substantially above world market prices.[44]

Owing to the incentives created by the price gap between domestic and world markets, border controls in the form of TRQs have been necessary to prevent imports from lowering domestic dairy prices and undermining government support programs. Dairy imports account for about 2 percent of the value of domestic production. Total U.S. imports subject to TRQs– mainly cheese – amounted to $783 million annually in 2003, while imports not subject to TRQs amounted to $971 million. In 2003, U.S. imports of dairy products from Australia amounted to $93 million, accounting for 5 percent of total U.S. dairy imports. Imports from Australia included $27 million of products subject to TRQs, and $66 million of products not subject to TRQs.

Australian Industry

In 2003, Australia was the world's 14th-largest milk-producing country with production of 10.6 million mt, accounting for about 2.1 percent of world production.[45] However, it ranked third among leading exporting countries, accounting for about 17 percent of the global dairy trade.[46] The Australian dairy industry is the third-most-important agricultural industry (behind the wheat and beef industries), and milk production accounted for about 11 percent of the total value of Australian agricultural production in 2000/01.[47] Further, dairy products accounted for about 8 percent of total Australian agricultural exports in 2002.[48] Australia's pasture-based production system is highly efficient, making Australia one of the world's lowest-cost milk producing countries. Australia's dairy industry is largely dominated by cooperatives, which process about three-quarters of all the milk delivered to factories.[49] Recently, the Australian dairy industry has undergone significant deregulation and there is relatively little government support of the sector.

Low milk production costs and highly modern and efficient processing facilities make Australia highly competitive in international markets, especially in cheese, milk powders, butter, and dry dairy ingredients (such as whey, lactose, milk protein concentrate, casein, and caseinate). In 2002/03,[50] approximately 60 percent of all dairy products manufactured in Australia were exported.[51] The volume is estimated at

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[44] In 2003 the average U.S. price of butter was 80 percent higher than the world price, while U.S. cheese prices were 42 percent higher, and skim milk powder prices were 8 percent higher. USDA, FAS, *Dairy World Markets and Trade*, Dec. 2003.

[45] Food and Agriculture Organization of the United Nations, FAOSTAT database Feb. 3, 2004 update.

[46] Dairy Australia, *Australian Dairy Industry in Focus 2003*.

[47] Agriculture, Fisheries, and Forestry Australia, *Australian Food Statistics 2003*, June 2003, table 1.2, pp. 37-38.

[48] Australian Bureau of Agricultural and Resource Economics, *Australian Commodities*, Dec. 2003.

[49] Paul Kerr, Chief Operating Officer, Murray Goulburn Co-op Ltd, testimony before the USITC concerning Investigation 332-453: *Conditions of Competition for Milk Protein Products in the U.S. Market*, Dec. 11, 2003, transcript p. 371.

[50] Australia's marketing year for milk, ending June 30.

[51] Dairy Australia, prehearing submission, USITC Investigation 332-453: *Conditions of Competition for Milk Protein Products in the U.S. Market*, Dec. 1, 2003, p. 7.

13.8 billion pounds (raw milk equivalent). Australia supplies more than 120 countries worldwide. However, Asian markets account for between two-thirds and three-quarters of total Australian exports, reflecting Australia's proximity to those markets.[52] The United States is also an important market for Australian dairy exports; in 2001, it accounted for about 5 percent of the total value of dairy exports from Australia.

Potential Impact on U.S. Trade Flows

U.S. Imports

The U.S.-Australia FTA will likely result in a relatively small increase in U.S. imports of dairy products from Australia. The Agreement is also likely to have a small effect on U.S. milk production and employment in the dairy industry. This conclusion is based on an analysis showing that the additional quantities of Australian dairy products entering the U.S. market as a result of the Agreement are relatively small in comparison with current levels of domestic dairy production and consumption.

Current U.S. tariff and nontariff barriers in the sector

U.S. tariff treatment of imported dairy products varies considerably by product type. Imports of dairy products including fluid milk and cream (fresh, condensed, and evaporated), butter, cheese, milk powders, whey products, chocolate containing butterfat, infant formula, ice cream, and animal feeds containing milk are subject to TRQs with high over-quota tariffs. In 2003, the over-quota tariffs on an ad valorem equivalent basis for butter and skim milk powder were 84 percent and 53 percent, respectively.[53] In contrast, imports of many other milk protein products, such as milk protein concentrate, whey protein concentrate, and caseinate, face generally low ad valorem or specific tariffs and no quantity restrictions,[54] while imports of casein and milk albumin enter the United States duty-free.

Specific FTA provisions for this sector

The market access provisions under the FTA pertaining to U.S. dairy imports from Australia are shown in table 4-2. Under the FTA, 12 separate TRQs were established

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[52] Dairy Australia, *Australian Dairy Industry in Focus 2003*.

[53] In addition, U.S. imports of dairy products subject to TRQs are also covered by Special Safeguards (SSGs) which take the form of temporary additional duties and are typically applied to products that are particularly "sensitive to trade." Under rules in the World Trade Organization Agreement on Agriculture, SSGs are permissible to prevent low prices or import surges from injuring a domestic industry.

[54] For example, the tariff on milk protein concentrate (HTS subheading 0404.90.10) is $3.70 per mt, less than 0.1 percent on an ad valorem equivalent basis.

Table 4-2
U.S. market access provisions for dairy products under the U.S.-Australia FTA

Product	HTS chapter and additional note	WTO quota	Additional quota		
			Year 1	Year 10	Year 25
			Metric tons		
Milk/cream/ice cream[1]	Ch. 4: 5; Ch. 21: 5	0	7.5	12.7	[2]30.4
Condensed milk	Ch. 4: 11	92	3,000	5,068	[2]12,147
Butter/butterfat	Ch. 4: 6, 9, 14	0	1,500	1,957	[3]3,049
Skim milk powder	Ch 4: 7	600	100	130	[3]203
Other powder	Ch: 4, 8, 12; Ch. 23: 2	56	4,000	5,693	[4]10,253
Other dairy	Ch. 4: 10; Ch. 18: 2	3,016	1,500	2,534	[2]6,074
Cheddar cheese	Ch. 4: 18	2,450	750	979	[3]1,525
American-type cheese	Ch. 4: 19	1,000	500	652	[3]1,016
Swiss cheese	Ch. 4: 25	500	500	776	[5]1,612
European-type cheese[6]	Ch 4: 17, 20, 21, 22	0	2,000	3,103	[5]6,451
NSPF (other) cheese	Ch 4: 16	3,050	3,500	5,430	[5]11,288
Goya cheese	Ch 4: 21	13,481	2,500	3,878	([7])

[1] Million liters.

[2] 6 percent compound growth after year 17.

[3] 3 percent compound growth after year 17.

[4] 4 percent compound growth after year 17.

[5] 5 percent compound growth after year 17.

[6] Includes blue mold cheese, Edam and Gouda, Italian-type cheese, and Gruyere-processed cheese.

[7] Unlimited access after year 17.

Source: U.S.-Australia Free Trade Agreement, Draft, Annex 2-B, Mar. 1, 2004

that cover almost all U.S. dairy imports already subject to TRQs under the World Trade Organization (WTO) Agreement on Agriculture. Under the FTA, quota quantities will increase in the first 17 years in staged amounts, after which they will increase annually based on a compound growth rate (table 4-2).[55] After year 17, quotas will increase by a specified compound growth rate that ranges from 3 to 6 percent depending on the category. Imports up to the FTA quota level will face a tariff rate of zero. However, imports entering beyond the quota amount will continue to face the normal trade relations (NTR) over-quota tariff rate; the Agreement does not include phased reductions in the over-quota tariff on Australian products.[56] For most dairy products not subject to TRQs, tariffs will be eliminated in equal installments over an 18-year phase-out period. Also eliminated are the in-quota tariffs on Australia's country-specific TRQs under the WTO Agreement on Agriculture.[57] After year 20, the FTA allows either country to request consultations with the other to review the dairy market access arrangements.

To gauge the impact of these provisions on the U.S. dairy industry, the additional amount of dairy products entering the U.S. market resulting from the FTA were

[55] Goya cheese is an exception for which the over-quota tariff will drop to zero in year 18 (i.e., the TRQ will be eliminated).

[56] In other U.S. FTAs (e.g., Chile, Jordan, and Israel), over-quota tariffs are reduced over the implementation period.

compared with total U.S. dairy imports and U.S. dairy production. In light of the heterogenous nature of dairy products, an accurate accounting of additional imports cannot be made by simply summing tonnages across products (e.g., combining liters of milk with tons of butter and cheese). A more accurate method of accounting (and one commonly used by dairy analysts) is to convert dairy products into their milk components (i.e., protein, milkfat, and other milk solids (mainly lactose, minerals, vitamins)), which then can be summed and compared. The additional volume of U.S. imports of milk protein, milkfat, and other milk solids derived from additional market access by Australia under the Agreement are compared with U.S. production in table 4-3.[58]

In the initial year of the Agreement, it is estimated that the additional amount of milk protein entering the U.S. market will be about 9.1 million pounds, increasing to 13.8 million pounds in year 10, and to 23.2 million pounds in year 25. The United States produced about 170.3 billion pounds of milk in 2003,[59] equivalent to about 5,620 million pounds of protein (fluid whole milk is assumed to be 3.3 percent protein).[60] Thus the additional quantities of protein imports resulting from the FTA are equivalent to about 0.2 percent of U.S. production in years 1 and 10, and 0.4 percent in year 25 (assuming a 2003 level of milk production) (table 4-3). The analysis also indicates that the FTA would add relatively small quantities of milkfat and other milk solids to the U.S. market, based on 2003 U.S. milk production. After 25 years, additional imports would account for 0.5 percent of domestic milkfat production and 0.3 percent of other milk solids production. These estimates are consistent with the GTAP results reported in Chapter 3.

The USDA has reported that it expects increased trade access under the FTA. TRQs will be equivalent to about 0.2 percent of the annual value of U.S. dairy production. It also believes it unlikely that additional imports will impact the operation of the U.S. dairy

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[57] For example, under the WTO Agreement on Agriculture, Australia has an exclusive access (country-specific quota) for 2,450 mt of cheddar cheese.

[58] The procedure used to estimate the milk components of additional imports under the FTA was as follows. The percentages of protein, milk fat, and other solids contained within each product covered by TRQs were obtained from the USDA Nutrient Database. Using these conversion factors, the additional quantities of milk components imported into the United States under the FTA were calculated for each of the first 25 years of the FTA, based on the growth in TRQs over this period. Total additional imports of milk components were summed across all 12 TRQs and compared with domestic production. For example, cheddar cheese is 25 percent protein, 33 percent milk fat, and 5 percent other solids. Thus every additional ton of cheddar cheese entering the United States under the FTA means an additional 250 kilograms of protein, 330 kilograms of milk fat, and 50 kilograms of other solids in the U.S. dairy market. In year 1 of the FTA, the cheddar cheese quota is 750 mt, implying an additional 187.5 tons of protein, 247.5 mt of milk fat, and 37.5 mt of other solids. By year 25, when the cheddar cheese quota reaches 1,525 mt, additional milk components will amount to 381 mt of protein, 503 mt of milk fat, and 76 mt of other solids. These milk component quantities were summed across all 12 TRQs, and compared with U.S. milk production (about 170 billion pounds, with 3.3 percent protein, 3.3 percent milk fat, and 5.4 percent other solids).

[59] USDA, NASS, *Milk production*, Mar. 2004.

[60] USDA, Nutrient database.

Table 4-3
Estimated additional U.S. imports of milk components from Australia under provisions of the U.S.-Australia FTA, and comparison with total U.S. imports and production in 2003

Item	Protein	Milkfat	Other milk solids
		Million pounds	
Additional imports from Australia:			
Year 1	9.1	12.2	8.9
Year 10	13.8	17.9	13.8
Year 25	23.2	30.4	28.9
Total U.S. production in 2003	5,620	5,620	9,196
		Percent	
Share of 2003 production:			
Year 1	0.2	0.2	0.1
Year 10	0.2	0.3	0.2
Year 25	0.4	0.5	0.3

Note.—Milk component conversion factors are sourced from the U.S. Department of Agriculture's, Nutrient database.

Source: USITC estimates.

price support programs.[61] The NMPF analysis also shows effects of similar magnitude in the out years. For example, by the 10th year, the NMPF expects the cumulated dairy income loss to be $610 million. This represents about 0.25 percent of cumulated farm receipts from sales of milk over a 10-year period based on annual receipts of $23 billion.[62]

U.S. Exports

The United States is not a major dairy-exporting country. In 2003, its dairy exports to Australia amounted to $8.8 million, of which about one-half was infant formula and 20 percent was lactose. All dairy products exported to Australia currently face an NTR duty rate of zero and are not subject to sanitary/phytosanitary restrictions. Thus the FTA is not expected to change the trade flows of U.S. dairy products into Australia.[63]

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[61] USDA, FAS, *http://www.fas.usda.gov/info/factsheets/australia.html*.

[62] National Milk Producers Federation, submission to the Commission concerning U.S.-Australia Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects (Investigation No. TA-2104-11), Apr. 6, 2004, table 2, p. 3.

[63] Report of the Agricultural Technical Advisory Committee (ATAC) for Trade in Animals and Animal Products, Mar. 2004, found at *http://www.ustr.gov/new/fta/Australia/advisor/atac-animals.pdf*.

Citrus Fruit[64]

Overview

U.S. Industry

The United States is a leading citrus producer, importer, and exporter. The value of U.S. citrus shipments (packinghouse-door equivalent) was $2.3 billion in 2003.[65] In 2003, the United States produced 10.5 mt of oranges, most of which were processed into orange juice, and exported 620,000 mt of fresh oranges. U.S. domestic consumption of oranges in 2003 was 1.6 mt, of which imports accounted for about 2 percent, mainly from Spain, South Africa, and Australia.[66] U.S. juice production in 2003 was 898,289 mt, of which exports were 70,000 mt. Imports accounted for less than one-fifth of U.S. domestic orange juice consumption.

The State of Florida accounts for the majority of U.S. citrus production. Most of Florida's citrus is processed, primarily for orange juice. California produces much of the fresh market citrus, including navel oranges and lemons. Florida accounts for most fresh grapefruit production. There are some 17,000 citrus growers in the United States, most of whom are loosely affiliated through grower associations.[67] For many years the number of growers has steadily declined through consolidation or smaller growers leaving the industry. The U.S. industry has remained competitive through innovation in growing and processing of citrus and because of ideal growing conditions.

World trade in fresh and processed citrus fruit has expanded considerably in recent years as transportation has become more efficient and because consumers desire year-round supplies of fresh produce. For example, the United States imported virtually no orange juice, its principal citrus import, prior to the mid-1980s, but 10 years later was importing over half of its domestic consumption. This partly explains the predominance of many Southern Hemisphere countries (Brazil, Chile, Argentina, South Africa, and Australia) as citrus suppliers because their growing seasons are the opposite of countries in the Northern Hemisphere and thus can supply fresh produce when fresh fruit is out of season in countries such as the United States.

Australian Industry

Australia's principal citrus products, in descending order, are valencia oranges, navel oranges, mandarins, lemons and limes, and grapefruit. The Government of Australia

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[64] Fresh citrus is classified under HTS 0805, while most citrus juices are classified under HTS 2009.

[65] Citrus Fruits 2003 Summary, USDA/National Agricultural Statistics Service, Fr. Nt. 3-1 (03), Sept. 2003.

[66] USDA/FAS, FAS Quarterly Reference Guide to World Horticultural Trade, FHORT 1-04, Jan. 2004.

[67] Based on grower memberships in citrus organizations in Florida and California.

estimates that there were some 3,444 establishments growing citrus fruit in Australia in 2000.[68] Australia's principal exports are fresh navel oranges and orange juice. In 2003, Australia produced 535,000 mt of oranges, of which 150,000 mt were exported as fresh oranges, with the remainder either processed into orange juice or consumed domestically. Australian imports of fresh oranges account for less than 10 percent of domestic consumption.

Australia produced about 18,774 mt of orange juice in 2003, of which 2,000 mt were exported. Australia's imports of orange juice accounted for over one-half of its domestic consumption, with about 98 percent of imports coming from Brazil.[69]

Australia's principal export to the United States is fresh navel oranges. The marketing season for Australian navel oranges is from about July 1 to the end of August. U.S. navel oranges are marketed from November to April; hence, Australian navel oranges do not compete directly with U.S. navel oranges. However, they do compete directly with U.S. fresh valencia oranges, which are marketed in the late spring and summer. The United States was the fourth-largest export destination for fresh Australian oranges in 2001, accounting for about 12 percent of its exports, ahead of Japan but after Hong Kong, Malaysia, and Singapore.

Potential Impact on U.S. Trade Flows

U.S. Imports

The impact of the U.S.-Australia Free Trade Agreement on total U.S. citrus imports is likely to be minimal. U.S. tariff rates on fresh Australian citrus are generally less than 3 percent, ad valorem equivalent, so the immediate removal of most of these duties under the FTA would likely not lead to any appreciable increase in imports. U.S. citrus juice tariffs for Australia are currently relatively high, 30 to 40 percent ad valorem, and most would be phased out over 18 years in equal annual reductions. Australia, however, is not expected to significantly expand citrus juice production.

U.S. Exports

The impact of the U.S.-Australia Free Trade Agreement on total U.S. citrus exports is expected to be minimal. Australian import duties are only 5 percent on frozen concentrated orange juice (FCOJ) and less than that for fresh citrus. U.S. exports of citrus to Australia consist mainly of oranges, lemons and grapefruit. While Australian tariff rates are relatively low, U.S. exporters have stated that phytosanitary restrictions are the main barrier to entry. U.S. industry representative claim that these barriers

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[68] USDA/FAS, *Australia Citrus Annual 2002*, GAIN Report AS2014, May 1, 2002.
[69] USDA/FAS, *Australia Citrus Annual 2002*, GAIN Report AS2014, May 1, 2002.

include excessively strict inspections and rejections of fruit that are not necessarily based on science and which may violate Australia's WTO obligations.[70] However, the U.S.-Australia FTA established a Committee on Sanitary and Phytosanitary Matters. (See text box 4-1.) If Australia's phytosanitary restrictions on fresh citrus were to be resolved, U.S. exports to Australia of fresh citrus fruits would likely increase.

Certain Fresh and Processed Fruit[71]

Overview

U.S. Industry

The United States is a major producer, trader, and consumer of the subject fruit. It ranked fourth in the volume of global production of the subject fruit in 2003, behind China, the EU, and Turkey, and accounted for about 5 percent of the quantity of such production that year.[72] The United States is most prominent among global producers of blueberries (54 percent of the total quantity in 2003), strawberries (26 percent), raspberries (13 percent), peaches and nectarines (11 percent), and cherries (10 percent).

U.S. production of the subject fruit totaled approximately $4.4 billion, farm value, in 2003. The principal items include strawberries (30 percent), peaches and nectarines (13 percent), cherries (9 percent), and avocados (9 percent).[73] The U.S. industry comprises thousands of farms, processing plants, and workers, with major producing areas including California, Washington, Oregon, Florida, and Michigan.

The United States is the leading world producer of canned deciduous fruit, accounting for about 53 percent of the total world quantity in 2002.[74] Production totaled about 1.2 million mt in 2002. Principal products include canned peaches (37 percent of the world total in 2002), pears (75 percent), mixtures (56 percent), and apricots (36 percent). There are seven processors of canned deciduous fruit in the United States, located mainly in California and Washington. The U.S. industry has been

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[70] Based on USITC staff conversation with representative of Sunkist Growers, Apr. 9, 2004.

[71] This sector includes products classified in HTS chapters 8 and 20. The U.S. fruit sector comprises a broad range of fruit items and product forms. The types of fruit of concern in this sector include apricots, avocados, berries, cherries, dates, figs, melons, papayas, peaches and nectarines, pears, plums, and quinces. The principal product forms in the U.S. market are fresh, frozen, and canned.

[72] Data from the Food and Agriculture Organization (FAO) of the United Nations. Data represent primary product forms before processing.

[73] U.S. Department of Agriculture, National Agricultural Statistics Service, *Noncitrus Fruits and Nuts 2003 Preliminary Summary January 2004*, Fr Nt 1-3 (04), available at Internet address *http://usda.mannlib.cornell.edu/reports/nassr/fruit/pnf-bb/ncit0104.pdf*; *Vegetables 2003 Summary January 2004*, Vg 1-2 (04), available at Internet address *http://usda.mannlib.cornell.edu/reports/nassr/fruit/pvg-bban/vgan0104.pdf*.

[74] Not including China, for which data are not available.

Text box 4-1

The U.S.-Australia FTA and Sanitary and Phytosanitary Regulations

Sanitary and phytosanitary (SPS) regulations are measures designed to protect human, animal, and plant health. The U.S. agriculture community has expressed concern that a number of Australian SPS measures, in particular those that affect U.S. exports of pork, poultry, and horticulture products unduly limit trade. The U.S.-Australia FTA established a Committee on Sanitary and Phytosanitary Matters (Committee). The Committee comprises representatives of the agencies who have responsibility for SPS measures in each country. The Committee will work to enhance each party's implementation of the WTO SPS Agreement and enhance consultation and cooperation on SPS matters and facilitate trade between the Parties.

Further the FTA established a Standing Technical Working Group on Animal and Plant Health Measures (Working Group). The Working Group will be co-chaired by the chief administrators of Biosecurity Australia and the Animal and Plant Health Inspection Service of the USDA. The Working Group shall provide a forum for resolving specific bilateral animal and plant health matters with a view to facilitate trade and engage in scientific and technical cooperation regarding animal and plant health matters that affect trade. The FTA outlines the process by which the Working Group will review issues of interest to either the United States or Australia. Committee and the Working Group provide for consultation and cooperation between the United States and Australia but cannot require changes in SPS regulations in either country. Also, the bilateral dispute settlement system contained in the FTA cannot be used to settle SPS disputes between the United States and Australia.

Certain SPS issues regarding U.S. exports have been, or are currently being, resolved. In particular, Biosecurity Australia has issued a final import risk assessment that will permit the importation of processed pork and pork for processing. Further, imports of table grapes from the United States are now permitted, although the U.S. industry believes current risk mitigation requirements still limit trade. Import risk assessments on imports of citrus from Florida and stone fruit from California are expected.

experiencing financial difficulties in recent years, leading to the bankruptcy of the largest processor in 2000. Capacity has decreased recently in response to rising imports, mostly EU products, and a static domestic market, as consumers shift to fresh fruit.

The United States possesses a relatively large amount of quality land, a variety of climates, excellent infrastructure, leading technology, and a large domestic market, all of which are factors aiding the competitiveness of the fruit sector. Mitigating factors include relatively high costs, mainly related to labor, land values, and environmental restrictions. Changes in harvesting, storage, and shipping technology; trade agreements that have lowered tariffs and phytosanitary barriers; structural changes in the food distribution and retail sectors; and demographic shifts leading to changes in consumer tastes have also shifted the competitive landscape for the U.S. fruit sector, both in domestic and international markets.

Australian Industry

Australia's fresh fruit sector is small relative to that of the United States. Australia ranks well behind major global producers of the subject fruit and accounted for less than 0.5 percent of the quantity of world production in 2003.[75] Australian production of the subject fruit was approximately 6 percent of the level of U.S. production in 2003. Principal Australian fruit items include pears, peaches, and nectarines.

Australia is a major global producer and exporter of canned deciduous fruit. In 2002, the country accounted for about 6 percent of global production of such fruit, with production totaling about 131,000 mt.[76] Principal products include canned peaches (4 percent of the world total in 2002), pears (9 percent), mixtures (8 percent), and apricots (7 percent). Australia's share of the quantity of world exports is relatively high for canned fruit mixtures (17 percent) and canned pears (14 percent).[77] Although the Australian prepared or preserved fruit industry exports a significant share of its output, it is oriented toward the domestic market.[78] This mainly is to avoid competition, largely from EU products, in the lower-priced, institutional sector that tends to dominate export markets. Exports have been depressed in recent years as a result of such competition.[79] Australia is increasing efforts to become more competitive in export markets by lowering costs and by developing innovative packaging, such as plastic

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[75] FAO.

[76] Estimated by the U.S. International Trade Commission based on data from the Foreign Agricultural Service of the U.S. Department of Agriculture and from the 6th World Canned Deciduous Fruit Conference. Data are based on the 2001 or 2002 season.

[77] Estimated by the U.S. International Trade Commission based on data from the Foreign Agricultural Service of the U.S. Department of Agriculture and from the 6th World Canned Deciduous Fruit Conference. Data are based on the 2001 or 2002 season.

[78] FAS, USDA, *Australia Canned Deciduous Fruit Annual 2002*, GAIN Report #AS2030, Oct. 1, 2002, p. 6.

[79] FAS, USDA, *Australia Canned Deciduous Fruit Annual 2002*, GAIN Report #AS2030, Oct. 1, 2002, p. 1.

cups as opposed to traditional metal cans.[80] The Australian prepared or preserved fruit industry is highly concentrated, as the largest fruit processor accounts for about 90 percent of output.[81] The firm employs approximately 3,000 during the peak production period.[82] Canned fruit production is affected by weather conditions that determine fresh fruit inputs and can fluctuate significantly on an annual basis.

Australia possesses less suitable land area than the United States and has a similar range of climates. The country is counterseasonal to the United States and can market fresh fruit during periods when U.S.-produced supplies are low. Australia also competes with other Southern Hemisphere sources, such as Argentina, Chile, and South Africa, in the U.S. market for offseason fresh fruit. Favorable competitive factors compared to the United States include lower production costs and the exchange rate. Disadvantages include a relatively small domestic market and a long distance to U.S. markets.

Potential Impact on U.S. Trade Flows

U.S. Imports

The U.S.-Australia FTA likely will result in a minimal increase in U.S. imports of the subject fruit in the short term. While current U.S. tariffs on most of the subject items are relatively high, phytosanitary restrictions apply to most fresh fruit items,[83] and under the FTA, the major imports of concern are subject to relatively long staging periods, TRQs, and safeguard measures. Fresh or dried avocados[84] are subject to a seasonal TRQ, with duty-free imports during Feb. 1-Sept. 15 increasing from zero the first year to 1,500 mt the second year, and 10 percent annually thereafter, becoming unlimited in the 18th year and beyond. Such imports during Sept. 16-Jan. 31 will increase from zero the first year to 2,500 mt in the second year, 10,443 mt in the 17th year, and unlimited in the 18th year and beyond. Price-based safeguards, in the form of additional duties, are provided for imports of prepared or preserved pears, apricots, peaches, and fruit mixtures[85] if the import unit price[86] is below a trigger price by greater than specified

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[80] S.P.C. Limited, *S.P.C. Limited Annual Report 2001*, pp. 15-16, found at Internet address *http://www.spcardmona.com.au/investor/reports/downloads/SPC%20AR%20front01.pdf*, retrieved Mar. 31, 2003.

[81] FAS, USDA, *Australia Canned Deciduous Fruit Annual 2002*, GAIN Report #AS2030, Oct. 1, 2002, p. 7.

[82] S.P.C. Limited, *S.P.C. Limited Annual Report 2001*, p. 22, found at Internet address *http://www.spcardmona.com.au/investor/reports/downloads/SPC%20AR%20front01.pdf*, retrieved Mar. 31, 2003.

[83] Currently, only imports of fresh grapes, strawberries, blackberries (Tasmania only), and raspberries (Tasmania only) are permitted from Australia. U.S. Department of Agriculture, Animal and Plant Health Inspection Service, *Regulating the Importation of Fresh Fruits and Vegetables*, available at Internet address *http://www.aphis.usda.gov/ppq/manuals/pdf_files/20Fruits_and_Vegetables.pdf*.

[84] HTS subheading 0804.40.00.

[85] HTS subheadings 2008.40.0020, 2008.40.0040, 2008.50.4000, 2008.70.2020, 2008.70.2040, 2008.92.9030, 2008.92.9035, 2008.92.9040, and 2008.92.9050.

[86] Determined on the basis of the F.O.B. import price of the good in U.S. dollars.

ranges.[87] The safeguards expire when tariffs are eliminated. Current phytosanitary restrictions remain in place and will be addressed under the FTA through a technical working group to resolve specific bilateral issues within the framework of the current WTO Agreement on the Application of Sanitary and Phytosanitary Measures (the SPS Agreement).

U.S. imports of the subject fruit from Australia totaled about $1.4 million in 2003, representing about 0.2 percent of total imports of such items and a miniscule share of the U.S. market. By far the largest Australian import share is held by prepared or preserved pears, about 7 percent of the total value of U.S. imports in 2003. This share can fluctuate significantly on an annual basis, resulting mainly from weather-related conditions in major competing supplier markets, including the United States.[88] The importance of the United States as an Australian export market varies by product. For canned peaches, Australia's market share varies annually, depending on supply conditions affecting U.S. and other foreign suppliers. For example, the United States was the leading export market for Australian canned peaches in 2001, accounting for 22 percent of the total quantity that year.[89] However, by 2003, the U.S. market accounted for only 2 percent of such exports.[90] For canned pears, the U.S. market generally is more stable for Australian exports. The United States was the second-leading export market for Australian exports of canned pears in 2003, accounting for 22 percent of the total quantity that year.[91]Primary markets for Australian exports of the subject fruit include the EU, Canada, New Zealand, and Japan.

In the longer term, after tariffs, TRQs, and safeguards are eliminated, the U.S.-Australia FTA may lead to increased imports of some of the subject fruit items. Australia generally is a lower-cost producer than the United States for the subject fruit items. Australia could shift exports from other markets in response to substantial duty reductions in the U.S. market. However, Australia is a minor supplier to the United States and some of its competitors (Argentina, Chile, and South Africa) are either negotiating or have negotiated FTAs with the United States, which would negate any competitive advantage conferred by duty-free treatment under the U.S.-Australia FTA. Also, the canned deciduous fruit import market has been dominated by EU supplies, mainly from Greece and Spain. Any increase in imports from Australia could displace

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[87] No additional duty is imposed if the difference between the unit import price and the trigger price is less than or equal to 10 percent of the trigger price. A maximum additional duty of 100 percent ad valorem is imposed if the difference between the unit import price and the trigger price is greater than 75 percent of the trigger price. Trigger prices vary depending on the product and range between $0.32 per kilogram and $1.21 per kilogram.

[88] The same is true for prepared or preserved peaches. U.S. imports from Australia were zero in 2002 and 2003, but were $1.5 million, or about 15 percent of the total, in 1999.

[89] FAS, USDA, *Australia Canned Deciduous Fruit Annual 2002*, GAIN Report #AS2030, Oct. 1, 2002, p. 6.

[90] FAS, USDA, *Australia Canned Deciduous Fruit Annual 2003*, GAIN Report #AS3035, Sept. 30, 2003, p. 7.

[91] FAS, USDA, *Australia Canned Deciduous Fruit Annual 2003*, GAIN Report #AS3035, Sept. 30, 2003, p. 8.

other imports as well as domestic production. The impact of the U.S.-Australia FTA on U.S. production and employment likely will be gradual, as a consequence of the extended phasing-in of tariff reductions. Any impact would be affected by other factors, such as shifts among import suppliers, FTAs with other competitors, the long-term viability of EU production, and U.S. market conditions.

U.S. Exports

The U.S.-Australia FTA likely will result in a nonmeasurable increase in U.S. exports of the subject fruit. Existing Australian duties on imports of the subject fruit are relatively low, generally ranging between zero and 5 percent ad valorem, and are scheduled for immediate elimination. Australia is a relatively small market, possesses a competitive domestic industry, and is a long distance from the United States. Australia maintains restrictive phytosanitary measures that limit U.S. exports of certain fresh fruit. Such measures likely will not change directly as a result of the FTA, as the FTA establishes a technical working group to address the measures within the existing framework of the WTO SPS Agreement. U.S. exports of the subject fruit generally are small compared with production and are mainly destined for larger and more proximate markets, such as Canada, the EU, Japan, and Mexico. U.S. exports of the subject fruit to Australia totaled $10.1 million in 2003, representing about 2 percent of the total U.S. exports of the subject fruit. Major export items included dried plums (36 percent of the total value of the subject exports to Australia in 2003; 3 percent of the total value of item exports to the world), fresh or dried dates (31 percent; 23 percent), and prepared or preserved cherries (12 percent; 19 percent).

Macadamia Nuts[92]

Overview

U.S. Industry

The U.S. macadamia nut industry is concentrated in Hawaii. In crop year[93] 2002-03, approximately 650 growers farmed 18,000 acres in Hawaii, and produced 57 million pounds of nuts (wet in-shell basis), valued at $30.1 million.[94] Sales of processed macadamia nuts are in excess of $150 million.[95] Macadamia nuts are Hawaii's

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[92] In-shell and shelled macadamia nuts are classified in the eight-digit HTS subheadings 0802.90.80 and 0802.90.98, respectively, while prepared or preserved macadamia nuts are classified in the eight-digit HTS subheading 2008.19.90.

[93] The U.S. crop year runs from July 1 to June 30 the following year.

[94] *Hawaii Macadamia Nuts: Final Season Estimates*, Hawaii Department of Agriculture, National Agricultural Statistics Service, July 8, 2003.

[95] Written submission to the Commission by Sandra Lee Kunimoto, Chairperson, Board of Agriculture, Hawaii Department of Agriculture, received Apr. 2, 2004.

fourth-largest agricultural crop and have been described as one of the most successful agricultural value-added enterprises in the state.[96] The United States is the second-largest producer of macadamia nuts after Australia, accounting for approximately 23 percent of global macadamia nut production in 2003-04.[97] As most of Hawaiian macadamia acreage is mature, future production is not expected to increase significantly.[98] U.S. macadamia nut production has fallen over the last five years because of adverse weather, reduced harvested acreage and new plantings, and some reduction in orchard care due to low returns. Rising consumer income and awareness of health benefits of certain nuts continue to spur U.S. consumer demand for nuts in general and macadamia nuts in particular, yet Hawaiian growers face competition from lower-priced imported raw product. Although some large U.S. producers have been able to reduce costs of production to meet import prices,[99] average Hawaiian costs of production are higher than foreign producers', and increased imports have put downward pressure on prices received by Hawaiian growers. National brands and private-label producers of snack nut mixes, the fastest growing segment of the U.S. nut market, have become very active in the market for macadamia nuts and generally use lower-priced, imported kernels.[100]

The United States is the world's largest consumer of macadamias. U.S. food processors have increasingly turned to imported bulk kernels to supplement their U.S. purchases and ensure a steady year-round supply.[101] While other major macadamia nut-producing countries (Australia, South Africa, Guatemala, and Kenya) exported over 75 percent of their production in 2003-04, the United States only exported 20 percent of its domestic production in the same period.[102]

Australian Industry

In crop year 2003-04,[103] Australian production of macadamia nuts was 65.5 million pounds, valued at $59.8 million.[104] Approximately 800 growers farm about 14,000 hectares of 4.1 million commercially bearing macadamia trees mainly in northeastern

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[96] Written submission to the Commission by Sandra Lee Kunimoto, Chairperson, Board of Agriculture, Hawaii Department of Agriculture, received Apr. 2, 2004.

[97] *Macadamia Situation and Outlook in Selected Countries*, Foreign Agricultural Service, U.S. Department of Agriculture, Apr. 2004, found at *http://www.fas.usda.gov/htp/circular/2004/04-02-04.pdf*, retrieved Mar. 30, 2004.

[98] Written statement by David G. Rietow, President, Hawaii Macadamia Nut Association, submitted to the Commission Mar. 30, 2004.

[99] Commission staff communication with U.S. industry representatives, Apr. 1, 2003.

[100] Commission staff communication with U.S. industry representatives, Apr. 1, 2003.

[101] *Situation and Outlook for Macadamia Nuts*, Foreign Agricultural Service, U.S. Department of Agriculture, April 2002, found at *http://www.fas.usda.gov/htp/circular/2002/02-04/Mac.htm*, retrieved Mar. 30, 2004.

[102] *Macadamia Situation and Outlook in Selected Countries*, Foreign Agricultural Service, U.S. Department of Agriculture, Apr. 2004, found at *http://www.fas.usda.gov/htp/circular/2004/04-02-04.pdf*, retrieved Mar. 30, 2004.

[103] The Australian crop year runs from March 1 to February 28 the following year.

[104] *Australia Tree Nuts Annual 2004*, Global Agriculture Information Network Report AS4004, Foreign Agricultural Service, U.S. Department of Agriculture, Feb. 23, 2004.

New South Wales and southeastern Queensland. Roughly 45 percent of the trees are considered mature at 15 years or older, 30 percent are considered in the early bearing stage, and 25 percent are in the pre-bearing stage.[105] Australian production is expected to maintain a steady increase driven by more trees coming into production. Total production is estimated to reach 110 million to 150 million pounds by 2010.[106]

Australia is currently the world's largest producer of macadamia nuts, which are native to the continent. In 2002-03, Australia exported 51.8 million pounds of macadamia nuts, or about 78 percent of its total production.[107] Its primary export markets are Japan, the United States, and the EU. Since its macadamia nut industry is highly dependent on exports, Australia's competitiveness in world export markets and producer returns are greatly influenced by the value of the Australian dollar.[108] Until early 2002, the strong U.S. dollar relative to the Australian dollar rendered Australian exports more competitive in the United States.[109]

Potential Impact on U.S. Trade Flows

U.S. Imports

The impact of the free trade agreement on U.S. imports of macadamia nuts will depend on which tariff is considered. The current U.S. tariffs on raw shelled and in-shell macadamia nuts[110] (0.4 and 0.8 percent AVE, respectively) are low, and therefore their immediate removal is not likely to contribute to a significant rise in imports. However, the U.S.-Australia FTA will likely result in an increase in U.S. imports of prepared or preserved macadamia nuts from Australia.[111] The current 17.9 percent ad valorem tariff on these nuts (which would be phased out in equal annual stages until year 4 of the agreement) has generally been prohibitive, preventing exports to the United States because roasting can be done in the United States as competitively as in Australia.[112] The removal of the duty allows Australian processors to expand

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[105] *Australia Tree Nuts Annual 2004*, Global Agriculture Information Network Report AS4004, Foreign Agricultural Service, U.S. Department of Agriculture, Feb. 23, 2004. There is generally a five to six-year lag between the time a macadamia nut tree is planted and when it reaches nut-bearing age.

[106] Hinton, Brad, *The Australian Macadamia Industry*, Industry Note 062-2002, Rabobank International, June 2002, p. 2.

[107] *Australia Tree Nuts Annual 2004*, Global Agriculture Information Network Report AS4004, Foreign Agricultural Service, U.S. Department of Agriculture, Feb. 23, 2004.

[108] *Australia Tree Nuts Annual 2004*, Global Agriculture Information Network Report AS4004, Foreign Agricultural Service, U.S. Department of Agriculture, Feb. 23, 2004.

[109] U.S. industry representatives indicated that while the exchange rate was not directly responsible for the drop in macadamia prices, it did allow Australian (and other foreign) producers to reduce their prices in the United States without adversely impacting their local currency margins. Commission staff communication with U.S. industry representatives, Apr. 1, 2003.

[110] In-shell and shelled macadamia nuts are classified in the eight-digit HTS subheadings 0802.90.80 and 0802.90.98, respectively.

[111] Prepared or preserved macadamia nuts are classified in the eight-digit HTS subheading 2008.19.90.

[112] The costs involved in growing macadamia nuts do not differ significantly between the two countries.

prepared or preserved production, which currently takes place largely for the domestic market, thereby taking advantage of economies of scale.[113] The potential 3-fold increase in the Australian crop in the next 5 years will likely result in a significant increase in imports from Australia of both raw and prepared or preserved macadamia nuts. As U.S. production does not currently meet U.S. demand, and U.S. purchasers have been willing to accept lower quality imported nuts at lower prices,[114] Australian prepared or preserved imports are likely to gain significant additional U.S. market share (from the very small current base) as a result of the duty elimination under the FTA.

In 2003, U.S. imports of shelled and in-shell macadamia nuts from Australia reached 1,659 mt, or 26 percent of total raw macadamia nut imports. Only 1 mt and 8 mt of Australian imports of prepared and preserved macadamia nuts were recorded in 2002 and 2003, respectively, up from zero during 1997-2001.

There are currently 11 macadamia nut-processing facilities in Australia with a total annual capacity of approximately 88 million pounds.[115] This is believed to be sufficient capacity to handle current production but expected future growth due to more trees coming into production is likely to require expansion.[116] Processed kernel production in Australia is currently limited only by the capacity to produce raw kernels.[117] Reportedly, some Australian processors have already made plans to expand existing capacity in anticipation of production growth.[118]

The Australian industry expects increasing global demand for macadamia nuts in the next few years in Asia, Europe, and the United States based on rising incomes, quality improvements, and increased market research and promotion.[119] Although industry efforts had been made throughout the 1990s to diversify export market opportunities away from the larger markets such as the United States, Australian exporters will likely continue to view the U.S. market as an attractive one. Australian exporters may view the decreased production in Hawaii due to the lack of cost competitiveness as anopportunity to sell more product into the United States.[120] The U.S. industry has

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[113] Andrew Heap, "Macadamia Nut Industry Brief," Australian Macadamia Nut Society News Bulletin, Mar. 2004, p. 22.

[114] Although high quality kernels are produced in Australia, the overall quality of Australian nuts has been described as inconsistent. Commission staff communication with U.S. industry representatives, Apr. 1, 2003 and Brad Hinton, the Australian Macadamia Nut Industry, Industry Note 062-2002, Rabobank International, June 2002,. p. 6.

[115] Commission staff communication with Australian industry representatives, Mar. 14, 2003, and Hinton, Brad, *The Australian Macadamia Industry*, Industry Note 062-2002, Rabobank International, June 2002, p. 6.

[116] Brad Hinton, *The Australian Macadamia Industry*, Industry Note 062-2002, Rabobank International, June 2002, p. 6.

[117] Commission staff communication with Australian industry representatives, Mar. 14, 2003.

[118] Brad Hinton, *The Australian Macadamia Industry*, Industry Note 062-2002, Rabobank International, June 2002, p. 6.

[119] Brad Hinton, *The Australian Macadamia Industry*, Industry Note 062-2002, Rabobank International, June 2002, p. 2.

[120] Brad Hinton, *The Australian Macadamia Industry*, Industry Note 062-2002, Rabobank International, June 2002, p. 2.

stated that increased U.S. imports of Australian prepared or preserved macadamia nuts will lower the average macadamia kernel price in the United States, reducing farm gate prices, and, in the long term, result in the economic failure of many growers and some of the smaller processors and manufacturers of value-added product in Hawaii.[121]

U.S. Exports

Current Australian tariffs on raw and prepared or preserved macadamia nuts are zero and 5 percent ad valorem, respectively. Under the terms of the free trade agreement, the 5 percent tariff will be reduced to zero immediately. The United States is not an important exporter of macadamia nuts; U.S. producers exported less than 20 percent of their 2003 crop. Exports to Australia in 2003 were only 75 mt, or less than 3 percent of total exports of raw macadamia nuts. U.S. exports of prepared or preserved macadamia nuts totaled 1,467 mt in 2003, of which only 30 mt were shipped to Australia. Given that the Australian tariff on prepared or preserved macadamia nuts would be eliminated immediately, it is expected that U.S. exports of these nuts would increase, though not significantly.

Motor Vehicles[122]

Overview

U.S. Industry

The United States is the world's largest single-country producer and consumer of motor vehicles, which includes passenger vehicles and medium- and heavy-duty trucks and buses, typically referred to as commercial vehicles. In 2003, passenger car and commercial vehicle production reached 12.1 million units, and sales were slightly under 17 million vehicles.[123] Passenger vehicles - passenger cars and light trucks-account for approximately 98 percent of the production, sales, and trade in the U.S. motor vehicle sector by units; medium- and heavy-duty trucks and buses account for the remainder. There are two U.S.-based passenger vehicle makers: General

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[121] Written statement by David G. Rietow, President, Hawaii Macadamia Nut Association, submitted to the Commission Mar. 30, 2004.

[122] This sector includes items classified in the HTS under the following subheadings: 8701.20, 8702.10, 8702.90, 8703.22, 8703.23, 9703.24, 8703.31, 8703.32, 8703.33, 8703.90, 8704.21, 8704.22, 8704.23, 8704.31, 8704.32, and 8704.90.

[123] *Ward's Automotive Reports*, vol. 79, No. 4, Jan. 26, 2004.

Motors (GM) and Ford.[124] A number of foreign-based automakers have established a substantial manufacturing presence in the United States;[125] however, GM and Ford are the largest producers in the United States, accounting for 33 percent and 26 percent, respectively, of total U.S. passenger vehicle production in 2003.[126]

The U.S. passenger vehicle industry has a presence in nearly every market in the world. The U.S. industry manufactures and sells its vehicles globally, and has extensive linkages with foreign automakers and foreign parts suppliers. The United States consistently runs a deficit in motor vehicle trade, as U.S. automakers tend to produce in foreign markets instead of relying on exports from the United States. Additionally, the high level of integration and rationalization of automotive production in the NAFTA region, and the popularity of foreign models that are produced overseas or the U.S. production of which is supplemented by imports, contribute to the U.S. motor vehicle trade deficit. However, the United States runs a trade surplus with Australia in motor vehicles. In 2003, U.S. motor vehicle imports from Australia totaled $140.4 million, and U.S. motor vehicle exports to Australia totaled $387.2 million.[127]

Australian Industry

The Australian motor vehicle industry is considerably smaller than its U.S. counterpart, ranking as the 23rd largest vehicle producer in the world in 2002.[128] In 2002, production of passenger cars and commercial vehicles reached 340,466 units,[129] and grew nearly 20 percent in 2003 to reach 408,184 vehicles.[130] The Australian market for motor vehicles ranked 15th in the world in 2002.[131] The Australian motor vehicle market has been growing; sales reached 824,309 units in 2002[132] and hit a record high of over 909,811 units in 2003.[133] Imports currently account for over 50 percent of motor vehicle sales in Australia. Australia's leading sources of motor vehicle imports, in order of magnitude, include Japan, Germany, the United States, Thailand, and Republic of Korea. Australia's motor vehicle imports from the United States totaled

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[124] In 1998, U.S. automaker Chrysler merged with Daimler-Benz of Germany to form a new German-based company called DaimlerChrysler.

[125] In addition to the Chrysler and Mercedes-Benz subsidiaries of DaimlerChysler, foreign automakers with a manufacturing presence in the United States include Honda, Mitsubishi, Nissan, Subaru-Isuzu, and Toyota (Japan); U.S.-Japanese joint ventures Autoalliance International (Ford-Mazda) and New United Motor Manufacturing, Inc. (NUMMI) (GM-Toyota); and BMW and Mercedes-Benz (Germany).

[126] *Ward's Automotive Reports*, vol. 79, No. 2, Jan. 12, 2004.

[127] Based on official statistics of the U.S. Department of Commerce.

[128] *Automotive News, 2003 Market Data Book*, May 26, 2003, p. 44.

[129] *Ward's World Motor Vehicle Data 2003* (Southfield, MI: Ward's Communications, 2003), p. 199.

[130] Ward's Auto Info Bank, email communication to USITC staff, Apr. 20, 2004.

[131] Automotive News, *2003 Market Data Book*, May 26, 2003, p. 47.

[132] *Ward's World Motor Vehicle Data 2003* (Southfield, MI: Ward's Communications, 2003), pp. 199 and 201.

[133] Just-auto.com editorial team, "Australia: Housing boom fuels record vehicle sales in 2003," Jan. 8, 2004, found at *http://just-auto.com*, retrieved Jan. 8, 2004.

A$936.0 million in 2003, accounting for 6 percent of Australia's vehicle imports that year.[134] The Australian market for motor vehicles is a mature one; in 2002 there were 2.0 persons per car in Australia, compared to 2.2 persons per car in the United States.[135] Therefore, future market expansion would be relatively modest.

There are four motor vehicle producers in Australia: Ford, GM/Holden, Mitsubishi, and Toyota. GM/Holden is the largest producer in Australia, accounting for 36 percent of total motor vehicle production in 2002. Ford is the second-leading producer, accounting for 25 percent, followed by Toyota and Mitsubishi, respectively.[136] Mitsubishi is reportedly considering closing its Australian assembly plant.[137] Australian motor vehicle production is concentrated in large passenger vehicles and low-volume, high value-added variants of these platforms in the high performance, luxury, and light truck segments.[138] In fact, Australia has distinguished itself as a low-volume assembly producer for the domestic market and become adept at production of niche vehicles for export.[139]

Over the last decade, the Australian motor vehicle sector has become increasingly competitive, productive, and export-oriented. Exports account for more than one-third of the country's motor vehicle production.[140] Australia's leading markets for passenger vehicle exports, in order of magnitude, include Saudi Arabia, New Zealand, Kuwait, and the United States. Exports to the United States totaled $138.2 (US) million in 2003, accounting for 9 percent of Australia's vehicle exports that year.[141]

Since the early 1900s, the Australian automotive industry has traditionally benefited from significant government protection, including high tariffs and other measures such as import licensing, local content requirements, and market-sharing arrangements.[142] This protection began to be dismantled in 1984; as a result, the industry has become more competitive. Currently, Australian automakers benefit from the Automotive Competitiveness and Investment Scheme (ACIS). ACIS, which replaced the Export

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[134] Department of Foreign Affairs and Trade official, email communication to USITC staff, Apr. 7, 2004.

[135] *Ward's World Motor Vehicle Data 2003* (Southfield, MI: Ward's Communications, 2003), pp. 192 and 198.

[136] *Ward's World Motor Vehicle Data 2003* (Southfield, MI: Ward's Communications, 2003), p. 200.

[137] Just-auto.com editorial team, "Axe again looms over Mitsubishi car plant," Mar. 31, 2004, found at *http://just-auto.com*, retrieved Mar. 31, 2004.

[138] U.S. Department of State telegram, "U.S.-Australia FTA: Motor Vehicles and Components," message reference No. 000372, prepared by U.S. Embassy, Canberra, Feb. 2003.

[139] Just-auto.com editorial team, "Australia's auto industry - smarter working for global markets," Mar. 10, 2003, found at *http://just-auto.com*, retrieved Mar. 12, 2004.

[140] Federation of Automotive Products Manufacturers, "Value of Automotive Exports" found at *http://www.fapm.com.au*, retrieved Mar. 31, 2004.

[141] Department of Foreign Affairs and Trade official, email communication to USITC staff, Apr. 7, 2004.

[142] U.S. Department of State telegram, "U.S.-Australia FTA: Motor Vehicles and Components."

Facilitation Scheme, was established in 2001 and is scheduled to continue as is through 2005; beginning in 2006 the program will be gradually reduced until it is completely eliminated in 2015. ACIS is designed to encourage automotive firms to make long-term investments in Australia based on their production, research and development (R&D), and investment activity by providing them with tradeable import duty credits based on their expenditures in these three areas. ACIS is WTO-compliant, and is not affected by the U.S.-Australia FTA.[143]

With respect to the U.S.-Australia FTA, the motor vehicle industry is unique in that the U.S. industry and the Australian industry are dominated by the same two companies, GM and Ford. These companies will benefit from improved access to the U.S. market for their Australian operations as well as improved access to the Australian market for their U.S. operations. Overall, the U.S.-Australia FTA will likely provide the impetus for increased integration of the passenger vehicle industries in both countries, thereby increasing two-way trade in passenger vehicles. According to one industry official, the FTA will allow the U.S. and Australian operations of U.S. automakers to take advantage of each other's individual strengths by filling product gaps in each market.[144] Further, as the leading producers in both countries, GM and Ford may be motivated by the FTA to further integrate their Australian subsidiaries into their global sourcing strategies, making more efficient use of their Australian operations in meeting global market demands.

Potential Impact on Trade Flows[145]

U.S. Imports

The U.S.-Australia FTA will likely result in a measurable, although small, increase in U.S. imports of motor vehicles from Australia. In 2003, Australia was the 16th-leading source of U.S. motor vehicle imports,[146] with such imports totaling $140.5 million and accounting for 0.1 percent of total motor vehicle imports. Nearly all the motor vehicle imports from Australia were large passenger cars with cylinder capacity over 3,000 cc; in that product category, Australia ranked as the 11th-leading supplier, accounting for 0.2 percent of total U.S. imports in this category in 2003.[147]

The U.S. NTR tariff on passenger motor vehicles, including minivans and sport-utility vehicles (SUVs), is 2.5 percent; the NTR tariff on trucks, including pickup trucks, is

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[143] U.S.-Australia Free Trade Agreement, Exchange of Letters on Waiver of Customs Duties, found at *http://www.ustr.gov/new/fta/Australia/text/text02-letter-customsduties.pdf*, retrieved Apr. 12, 2004.

[144] U.S. industry official, email communication to USITC staff, Apr. 7, 2004.

[145] The scope of the combined motor vehicle and motor-vehicle parts sector is broadly consistent with that of the GTAP model. Motor vehicles and motor-vehicle parts exhibit similar expected effects which closely track the model results.

[146] Based on official statistics of the U.S. Department of Commerce.

[147] Based on official statistics of the U.S. Department of Commerce.

25 percent; the NTR tariff on road tractors for semi-trailers is 4 percent; and the NTR rate on buses is 2 percent. All U.S. duties on motor vehicle imports from Australia will be eliminated upon entry into force of the FTA. In 2003, Mitsubishi accounted for two-thirds of the motor vehicle imports from Australia, with GM accounting for most of the remainder (imports from Ford accounted for less than 1 percent). Mitsubishi sources the Diamante exclusively from Australia. Total U.S. imports of the Diamante in 2003 were 9,174 vehicles, down from 14,352 in 2002.[148] In December 2003, GM began importing the Pontiac GTO from Australia; GM hopes to import 18,000 of these vehicles per year.[149] U.S. imports of trucks that are subject to the 25 percent NTR duty are de minimis.

Removal of the 2.5 percent U.S. duty on passenger cars alone is not likely to have a significant effect on U.S. imports, as the duty is so small. Indeed, should the automakers in Australia reevaluate their global sourcing strategies as an overall result of the FTA, they may decide to source more or new passenger vehicles from Australia, but the 2.5 percent duty savings alone is not likely to be the driving force behind such a decision. One industry official confirms that the greatest potential for trade effects in the motor vehicle sector is on U.S. exports, not U.S. imports.[150]

Removal of the 25 percent U.S. duty on trucks may provide some incentive for Australian automakers to alter their global sourcing strategies to produce and export light trucks to the United States. However, such decisions would be weighed against the automakers' global production strategies as well as their relations and contractual obligations with the United Auto Workers.[151] Moreover, an industry official stated that he does not expect an influx of pickup trucks resulting from removal of the 25 percent duty, because there currently are not any pickup truck products produced in Australia that are geared toward the U.S. market, and the U.S. domestic industry has a competitive advantage in pickup truck production.[152] Indeed, another industry official confirmed that Australia does not currently produce conventional pickups as defined by the U.S. market, but does produce car-derived pickups that are largely targeted for the Australian market; there may be some potential for these vehicles to serve a niche market in the United States.[153] Further, Australian industry sources assert that removal of the 25 percent U.S. duty may induce new light truck production in Australia, "particularly if parent companies decided that such 'niche' vehicles represented a profitable way of broadening product offerings in this important market segment."[154]

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[148] *Automotive News*, Jan. 12, 2004, p. 50. This decline was reportedly due to the appreciation of the Australian dollar versus the U.S. dollar. "Mitsubishi Australia Plant Up for Review?" *Ward's Automotive Reports*, Mar. 22, 2004, p. 5.

[149] Just-auto.com editorial team, "Australia: Free trade agreement with US seen strengthening already 'significant' automotive business," Feb. 9, 2004, found at *http://just-auto.com*, retrieved Feb. 9, 2004.

[150] USITC, hearing transcript, pp. 99-100.

[151] "GM, Holden Discuss More Product Sharing," *Ward's Automotive Reports*, Mar. 17, 2003, p. 3.

[152] USITC, hearing transcript, p. 113. There were 2.7 million pickup trucks produced in the United States in 2003. Ward's AutoInfoBank, email communication to USITC staff, Apr. 7, 2004.

[153] U.S. industry official, email communication to USITC staff, Apr. 13, 2004.

[154] Federation of Automotive Products Manufacturers, "Submission to the Department of Foreign Affairs and Trade on Negotiations for a Free Trade Agreement between Australia and the United States of America – Issues and Implications for Australia's Automotive Components Industry," Jan. 2003, p. 24, found at *http://www.fapm.com.au*, retrieved Mar. 26, 2004.

U.S. Exports

The U.S.-Australia FTA will likely result in a measurable increase in U.S. exports of motor vehicles to Australia. In 2003, Australia was the seventh-leading market for U.S. motor vehicle exports. Motor vehicle exports to Australia totaled $387.2 million in 2003, accounting for 1.3 percent of total sector exports.[155] As with imports, the leading product category in terms of U.S. exports to Australia is large passenger cars with cylinder capacity over 3,000 cc; 35 percent of the value of U.S. motor vehicle exports to Australia were in this product category in 2003. Other important export categories are passenger cars with cylinder capacity between 1,501 cc and 3,000cc (22 percent of value of total exports in 2003), and road tractors for semi-trailers (22 percent in 2003).[156]

Australian imports of new and used passenger motor vehicles, campers, and mobile homes are subject to an NTR 15 percent customs duty, legislatively scheduled to be reduced to 10 percent in 2005 and to 5 percent in 2010. New and used commercial and all-wheel drive vehicles are subject to an NTR 5 percent customs duty.[157] Used vehicles are assessed the applicable tariff plus a $A12,000 levy on vehicles not classified as "specialty or enthusiast" vehicles.[158] Under the FTA, Australia would eliminate the 5 percent NTR duties upon entry into force of the Agreement, and reduce the 15 percent NTR duties in equal stages beginning on the date of entry into force of the Agreement, with such duties to be eliminated as of 2010.

Immediate removal of the 5 percent Australian duty on commercial and all-wheel drive vehicles and the staged phase-out of the 15 percent duty on passenger vehicles may spur U.S. automakers to consider the export of other U.S.-built products that may be marketable in Australia.[159]As previously noted, the FTA is expected to allow the U.S. and Australian operations of U.S. automakers to take advantage of each other's individual strengths by filling product gaps in each market.[160] A U.S. industry official asserts that Australia is already an important export market for U.S. automakers, and that it will become an even bigger market because of the tariff preferences negotiated in the FTA. Moreover, Australian demand for SUVs and pickup trucks – a product segment in which U.S. manufacturers are strong – is growing, so U.S. automakers are well-positioned to benefit from enhanced access to the Australian market.[161]

Australia applies two taxes on motor vehicle purchases: (1) a 10-percent federal goods and services tax (GST), which is levied on the assessed value of the vehicle; and (2) a

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[155] Based on official statistics of the U.S. Department of Commerce.

[156] Based on official statistics of the U.S. Department of Commerce.

[157] U.S. Department of Commerce, International Trade Administration, Office of Automotive Affairs, *Compilation of Foreign Motor Vehicle Import Requirements*, Dec. 2003, found at *http://www.ita.doc.gov/td/auto/tbr2003rev1.pdf*, retrieved Mar. 31, 2004.

[158] U.S. Department of State telegram, "U.S.-Australia FTA: Motor Vehicles and Components." Australia has retained the right to continue assessing this levy on used vehicle imports from the United States. "Guide to the Agreement," found at *http://www.dfat.gov.au/trade/negotiations/us_fta/guide/2.html*, retrieved Apr. 7, 2004.

[159] USITC, hearing transcript, p. 50.

[160] U.S. industry official, email communication to USITC staff, Apr. 7, 2004.

[161] U.S. industry official, email communication to USITC staff, Apr. 7, 2004.

luxury car tax, which is levied on passenger vehicles designed to carry a load of less than two mt and fewer than nine passengers.[162] Australian-built vehicles are also assessed the GST and luxury tax, but there are no import duties included in the taxable amount.[163] Elimination of the luxury tax on U.S.-built vehicles was not part of the FTA, and an industry official states that exemption from the tax was not an objective for the U.S. industry.[164]

With respect to government procurement, the Australian Government's Executive Vehicle Scheme stipulates that government agencies must purchase Australian-made vehicles whenever possible.[165] Most state and local governments follow a similar policy.[166] Australia excluded motor vehicles from coverage in the Government Procurement chapter of the FTA.[167] However, because GM and Ford manufacture vehicles in Australia, inclusion of motor vehicles in the government procurement chapter of the FTA was not an important negotiating objective.[168] Government purchases in Australia account for a much larger percentage of total sales than in the United States.

Finally, while not specifically a nontariff barrier, Australia's standards and certification system for motor vehicle safety and emissions is different from that of the United States, which adds significant cost to automakers that want to export to that market. Mutual recognition of motor vehicle standards was not part of the FTA; at best, the United States and Australia left open the possibility that they each would facilitate "the consideration of a request by a Party for the recognition of the results of conformity assessment procedures, including a request for the negotiation of an

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[162] The luxury tax is a 25 percent tax on the Australian Customs Service-determined customs value of the vehicle, plus international shipping and insurance charges, applicable customs duties, and GST. The 25 percent tax is due on 91 percent of any amount of that sum which is above the tax threshold, which was A$57,009 in 2003.

[163] U.S. Department of Commerce, International Trade Administration, Office of Automotive Affairs, *Compilation of Foreign Motor Vehicle Import Requirements*, Dec. 2003, found at *http://www.ita.doc.gov/td/auto/tbr2003rev1.pdf*, retrieved Mar. 31, 2004.

[164] USITC, hearing transcript, p. 100.

[165] "Under the Federal Government's Executive Vehicle Scheme (EVS), vehicles can be provided to members of the Senior Executive Service as part of a remuneration package. While the Guidelines require that Australian-made vehicles be leased where these are available, they do provide scope to lease certain imported vehicles where the engine capacity of those vehicles is below that of the smallest Australian-made vehicle. Under the Guidelines, imported vehicles are to have an engine capacity of 2000cc or less and be selected from the range of vehicles sold by manufacturers with a local operation in vehicle assembly or component production. . . . The EVS does provide favoured treatment for Australian-produced vehicles." Federation of Automotive Products Manufacturers, "Submission to the Department of Foreign Affairs and Trade on Negotiations for a Free Trade Agreement between Australia and the United States of America: Issues and Implications for Australia's Automotive Components Industry," Jan. 2003, found at *http://www.fapm.com.au/docs/fapmusftasubmission.pdf*, retrieved Apr. 7, 2004.

[166] U.S. Department of State telegram, "U.S.-Australia FTA: Motor Vehicles and Components."

[167] USTR, email communication to USITC staff, Apr. 7, 2004; and U.S.-Australia Free Trade Agreement, Combined Government Procurement Annexes, found at *http://www.ustr.gov/new/fta/Australia/text/text15-annexes.pdf*, retrieved Apr. 7, 2004.

[168] U.S. industry official, email communication to USITC staff, Apr. 7, 2004.

agreement, in a sector nominated by that Party."[169] This was an acceptable outcome for U.S. industry.[170]

The recently concluded FTA between Thailand and Australia may temper potential market gains based on preferential tariff treatment. Thailand is a leading motor vehicle producer in Asia and is likely to build upon its existing market presence in Australia, particularly in light of the fact that Thailand secured immediate removal of Australian tariffs on all motor vehicles, which gives Thai vehicles more preferential tariff treatment than U.S. vehicles.[171] Australia is Thailand's largest export market for motor vehicles, accounting for approximately 50 percent of Thailand's vehicle exports.[172] According to a U.S. industry official, however, Thailand supplies Australia primarily with small pickups, while the United States exports large sport-utility vehicles and minivans – products that are not directly competitive, and products that will both receive immediate Australian duty elimination in their respective FTAs.[173]

Certain Motor-Vehicle Parts[174]

Overview

U.S. Industry

The United States is the world's largest single-country producer of motor-vehicle parts, accounting for an estimated one-quarter ($191 billion[175]) of the world's production in

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[169] U.S.-Australia Free Trade Agreement, Chapter 8, Article 8:9, 1(f). Further, Article 8.8, 1, states that "The Parties shall work co-operatively in the fields of standards, technical regulations, and conformity assessment procedures with a view to facilitating access to each other's markets. In particular, the Parties shall seek to identify bilateral initiatives that are appropriate for particular issues or sectors. Such initiatives may include cooperation on regulatory issues, such as convergence or equivalence of technical regulations and standards, alignment with international standards, reliance on a supplier declaration of conformity, and use of accreditation to qualify conformity assessment bodies, as well as co-operation through recognition of conformity assessment procedures."

[170] U.S. industry official, email communication to USITC staff, Apr. 7, 2004.

[171] "Australia will eliminate upon entry into force of the Agreement the current tariffs on all passenger vehicles, off-road vehicles, goods vehicles and other commercial vehicles of Thai origin. These tariffs are currently 15% for passenger motor vehicles (although the general rate is legislated to fall to 10% on 1 January 2005) and 5% for other vehicles." Australia-Thailand FTA - Trade in Goods - Australian Tariff Commitments, found at *http://www.dfat.gov.au/trade/negotiations/goods_tariff_commitments.html#2,* retrieved Apr. 7, 2004.

[172] Just-auto.com editorial team, "Thailand looks beyond AFTA for next phase of growth," Dec. 22, 2003, found at *http://just-auto.com*, retrieved Apr. 7, 2004.

[173] U.S. industry official, email communication to USITC staff, Apr. 13, 2004.

[174] This sector includes items classified in HTS chapters 84 (motor-vehicle engines), 85 (electrical equipment for motor vehicles), and 87 (motor-vehicle parts).

[175] Includes body manufacturing (NAIC 336211) and parts manufacturing (NAIC 3363) for motor vehicles.

2001. A large supplier network has developed to support the U.S. original-equipment manufacturers' (OEM) motor-vehicle industry, the world's largest, and the aftermarket (replacement parts).[176] Approximately 5,000 U.S. producers[177] manufacture a complete range of motor-vehicle parts, employing 667,400 workers in 2002.[178] Economic weakness and declining North American vehicle production have likely contributed to deterioration of these indicators since that time.

In response to vehicle makers' purchasing requirements, such as just-in-time delivery, global sourcing, and local content, motor-vehicle parts manufacturers have followed their vehicle customers throughout the world. Over 500 Japanese, European, and other foreign parts manufacturers have established operations in the United States to supply U.S.-based motor-vehicle producers; many U.S.-based parts producers have pursued a similar strategy, setting up facilities abroad to supply the global operations of their motor-vehicle customers. Unlike the aftermarket sector, OEM suppliers are under increasing pressure by motor-vehicle assemblers (and other higher-tier suppliers) to reduce price and costs[179] while shouldering greater manufacturing, R&D, and supply chain responsibilities. U.S. component producers have also expanded their product and technological scope through mergers and acquisitions to supply higher-valued modules and systems to vehicle makers.

Although the United States is the world's leading exporter of motor-vehicle parts,[180] it currently runs a trade deficit in these products. The further integration of the North American automotive industry under NAFTA, the growing U.S.-based production by German and Japanese transplants of motor vehicles that incorporate imported components, and increased purchases by U.S. automakers of motor-vehicle parts from China contribute to this trade deficit. Relatively low U.S. tariffs (2.5 percent ad valorem or less) facilitate imports of these products.

Australian Industry

The Australian parts industry is less than 5 percent of the size of the U.S. industry, with 200 firms producing components with 30,000 employees.[181] Australian industry sales of motor-vehicle components are believed to exceed an estimated A$5 billion (US$2.7 billion).[182] The industry is concentrated, with the top four parts producers accounting

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[176] Manufacturers for OEMs supply parts for use in the assembly of motor vehicles or for dealers' service operations, whereas aftermarket producers generally supply replacement parts to retail and non-dealer service outlets.

[177] U.S. Department of Commerce, International Trade Administration, "Automotive Parts," *U.S. Industry & Trade Outlook 2000*, 2001, p. 37-1.

[178] U.S. Department of Commerce, International Trade Administration, Office of Automotive Affairs, *U.S. Automotive Parts Industry/Market Assessment*, May 2003, pp. 1-2.

[179] U.S. Department of Commerce, International Trade Administration, Office of Automotive Affairs, *U.S. Automotive Parts Industry/Market Assessment*, May 2003, p. 4.

[180] U.S. Department of Commerce, International Trade Administration, Office of Automotive Affairs, *U.S. Automotive Parts Industry/Market Assessment*, May 2003, p. 7.

[181] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 11.

[182] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 15.

for 37 percent[183] and the top 20 firms accounting for 75 percent of component production. Up to 80 percent of industry output is destined for the domestic OE and replacement markets.[184] Reflecting the global nature of the motor-vehicle industry, a number of leading world parts suppliers manufacture in Australia, including Delphi and Johnson Controls (United States), Denso (Japan), and Robert Bosch and Hella (Germany). [185] Approximately 50 percent of the Australian market for motor-vehicle parts is accounted for by imports, primarily from Japan and the United States.[186]

With only four motor-vehicle companies, all of which are subsidiaries of Japanese or U.S. motor-vehicle producers, assembling a limited range of models in Australia, the Australian parts industry lacks the large customer base necessary to support cost reductions realized from the scale economies gained from large production runs. Consequently, Australian parts producers emphasize their expertise in flexible manufacturing and smaller production runs, and increasingly seek to expand export sales to leading automotive markets.[187] Implementation of lean manufacturing and greater efficiencies in the supply chain have also improved the competitiveness of the Australian component industry.[188]

As previously discussed in the motor vehicle analysis, the Australian motor vehicle and parts industry is gradually increasing its exposure to the competitive pressures of the global motor-vehicle market. The Automotive Investment and Competitiveness Scheme offers parts producers an investment credit for expenditures on plants and equipment as well as R&D that can be used to offset import duties only.[189] Another feature of the Australian market is the comparatively high tariff structure for motor-vehicle parts. A 15 percent tariff is currently applied to imports of motor-vehicle components, including those from the United States; the tariff is scheduled to drop to 10 percent in 2005 and then to 5 percent in 2010 under the Australian Government's automotive assistance package.[190]

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[183] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 11.

[184] U.S. Department of State telegram, "U.S.-Australia FTA: Motor Vehicles and Components," message reference No. 000372, prepared by U.S. Embassy, Canberra, Feb. 2003.

[185] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 20.

[186] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 11.

[187] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 26.

[188] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 26.

[189] Motor-vehicle component producers can claim an import duty credit equal to 25 percent of quarterly value of new investment in plant and equipment, and 45 percent of the quarterly value of R&D expenses. For more information on ACIS and its implementation, see Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 41.

[190] Submission to the Productivity Commission Review of Post 2005 Assistance Arrangements to the Australian Automotive Industry, Federation of Automotive Products Manufacturers, May 2002, p. 36, and U.S. Department of State telegram, "U.S.-Australia FTA: Motor Vehicles and Components," message reference No. 000372, prepared by U.S. Embassy, Canberra, Feb. 2003.

Australia is a partner in the 1983 Closer Economic Relations Agreement with New Zealand, which resulted in the free trade of goods on July 1, 1990. Australia also implemented an FTA with Singapore in July 2003, and entered into an FTA with Thailand in 2003. In the FTA with Thailand, a major motor-vehicle and parts production center in Southeast Asia, both countries agreed to eliminate or significantly reduce tariffs on motor-vehicle parts.[191]

Potential Impact on U.S. Trade Flows [192]

U.S. Imports

The U.S.-Australia FTA will likely result in a small increase in U.S. imports of certain motor-vehicle parts from Australia and a negligible increase in total U.S. imports. The Australian industry is modest in size and U.S. tariffs are already low (2.5 percent ad valorem or less). However, improved access to the large U.S. market resulting from immediate tariff elimination will provide opportunities for Australian components producers, particularly vis-à-vis other import sources lacking FTA benefits.[193] Although the United States is Australia's leading export market for motor-vehicle parts, the share of total imports accounted for by Australia is small (about $210 million, or less than 1 percent).

The U.S. industry believes that both the U.S. and Australian industries will benefit from enhanced export opportunities with the FTA,[194] and that the FTA may allow greater integration of the two industries, encouraging growth and efficiency, in part because of their historic linkages.[195] The Federation of Automotive Products Manufacturers (FAPM), which represents the Australian industry, recognizes that growth of

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[191] With the Thailand FTA, Australian tariffs on 98 of 146 import items covering automotive parts will decline from 10 or 15 percent to 5 percent on entry into force of the Agreement (expected in 2005), and will be eliminated in 2010. Australian tariffs on the remaining 48 items will be eliminated upon entry into force. All current tariffs of 5 percent or below will be eliminated upon entry into force. Thailand's tariffs on imports of automotive parts components from Australia, which are currently assessed duties of up to 42 percent, would be immediately reduced to no more than 20 percent, and phased to zero by 2010. Thai tariffs on engines would be immediately reduced from 30 percent to 15 percent. Other tariffs on automotive parts that are currently 20 percent or below would also be immediately reduced and phased down accordingly. Information on free-trade agreements from the Australian Department of Foreign Affairs and Trade, found at *http://www.dfat.gov.au/trade/index.html*.

[192] The scope of the combined motor vehicle and motor-vehicle parts sectors is broadly consistent with that of the GTAP model. The motor vehicle and motor-vehicle parts sector exhibit similar trade impact trends, which closely track the GTAP model results.

[193] US official, email communication to USITC staff, Apr. 7, 2004, Washington, D.C., and "Australia-United States Free Trade Agreement – Automotive," Department of Foreign Affairs and Trade, found at *http://www.dfat.gov.au*, retrieved Apr. 8, 2004.

[194] Report of the Industry Sector Advisory Committee on Transportation, Construction, Mining & Agricultural Equipment for Trade Policy Matters (ISAC 16) on the U.S.-Australia Free Trade Agreement (FTA), Mar. 2004, p. 3.

[195] USITC hearing statement of the Automotive Trade Policy Council, Inc., Mar. 30, 2004, p. 2.

Australian exports to the U.S. market is a challenge given the relatively small price inducement resulting from the elimination of U.S. tariffs on these products.[196]

U.S. Exports

The U.S.-Australia FTA will likely result in a measurable increase in U.S. exports of motor-vehicle parts to Australia and a small increase in total exports. The immediate elimination of the 15 percent Australian tariff on U.S. imports and the larger size of the U.S. industry will likely contribute to a boost in U.S. exports.[197] Additionally, the economic stimulus expected from the FTA would likely lead to an improved Australian market for motor-vehicle parts. Vehicle and parts producers may also reevaluate component-purchasing patterns to determine optimal sourcing, which could raise U.S. export volume.[198] This growth potential, however, may be limited by the modest size of the Australian market. Although the United States is Australia's second-largest import source of these components, U.S. exports to Australia represent less than 2 percent (about $758 million) of total U.S. exports of motor-vehicle parts (approximately $40 billion).

The motor-vehicle parts industry supports the FTA agreement with Australia, and cites favorably its market access provisions and customs treatment for remanufactured motor-vehicle parts and the use of simplified rules of origin for motor-vehicle products based on the NAFTA "net cost" calculation.[199] The FAPM acknowledges that U.S. exports to Australia will likely benefit from the greater price advantage resulting from the elimination of Australian tariffs on motor-vehicle parts, with some net inroads into the Australian market expected.[200] Any increase in U.S. exports to Australia would either displace local parts production or imports from other sources, principally Southeast Asia and Europe.[201]

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[196] Submission to the Australian Department of Foreign Affairs and Trade on Negotiations for a Free Trade Agreement between Australia and the United States of America: Issues and Implications for Australia's Automotive Components Industry, Federation of Automotive Products Manufacturers, Jan. 2003, pp. 24-25.

[197] One industry source testified that "opportunities for increasing of parts exports to Australia. . . . probably in the short-term has the highest potential for a fairly significant increase." USITC hearing transcript, p. 79.

[198] This scenario could occur within the broader trend of motor-vehicle and parts firms concentrating production and sourcing of components in only a few regions. USITC hearing transcript, p. 79.

[199] Report of the Industry Sector Advisory Committee on Transportation, Construction, Mining & Agricultural Equipment for Trade Policy Matters (ISAC 16) on the U.S.-Australia Free Trade Agreement (FTA), Mar. 2004, p. 3, and hearing transcript, p. 34.

[200] Submission to the Australian Department of Foreign Affairs and Trade on Negotiations for a Free Trade Agreement between Australia and the United States of America: Issues and Implications for Australia's Automotive Components Industry, Federation of Automotive Products Manufacturers, Jan. 2003, pp. 24-25.

[201] Submission to the Australian Department of Foreign Affairs and Trade on Negotiations for a Free Trade Agreement between Australia and the United States of America: Issues and Implications for Australia's Automotive Components Industry, Federation of Automotive Products Manufacturers, Jan. 2003, p. 25.

Overview

U.S. Industry

The United States is the world's largest importer of textiles, clothing, and footwear (TCF), accounting for an estimated 25 percent of world imports by value in 2002.[202] The framework for U.S. trade in textiles and apparel will be liberalized on January 1, 2005, when the United States, along with other importing countries, eliminates all remaining import quotas on textiles and apparel from WTO countries, as required by the Uruguay Round Agreement on Textiles and Clothing. As such, competition will intensify in the U.S. market, particularly for apparel, which represented 68 percent of U.S. sector imports by value in 2003. The large number of suppliers in the market, rising import penetration, changing consumer tastes, and the growing buying power of large retailers have contributed to the downward pressure on prices that has reverberated throughout the textile and apparel supply chain. Retailers are increasingly sourcing apparel directly from low-cost foreign producers, as are many U.S. apparel companies that have reduced or eliminated domestic manufacturing altogether so as to focus on product design and marketing. As a result, the U.S. textile industry faces shrinking domestic markets for its yarn and fabric output. Faced with difficult market conditions and the prospect of increased import competition following quota elimination in 2005, the textile industry, along with the apparel industry, has undergone extensive restructuring and consolidation. Between 1999 and 2003, the U.S. textile, apparel, and footwear sector posted declines of 15 percent in shipments to $129.6 billion, and 32 percent in employment to 797,600 workers, representing a loss of 374,300 jobs in the period.[203] In addition, during 1999-2003, the sector experienced 274 plant closures.[204]

Australian Industry

Australia's TCF manufacturing sector is much smaller than its U.S. counterpart. In 2002, the Australian TCF sector reportedly had a total output of $5.1 billion and employed about 70,000 people.[205] By contrast, Australian imports of sector goods in

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[202] The latest year for which United Nations data are available on world textile and apparel trade is 2002.

[203] The data are for textile mills (NAICS 313), textile product mills (314), apparel manufacturing (315), and footwear manufacturing (3162). The data are based on official statistics of the U.S. Census Bureau (shipments) and U.S. Bureau of Labor Statistics (employment).

[204] National Council of Textile Organizations, "Textile Plant Closings -as of January 13, 2004," found at *http://www.ncto.org/ustextiles/closings.asp*, retrieved Apr. 14, 2004.

[205] Jason Koutsoukis, "Grim Future For Textile Industry," *The Australian Financial Review*, Apr. 16, 2003, found at *http://newsstore,f2.com/au*, retrieved Apr. 9, 2004. (The output figure of $5.1 billion ($9 billion) was based on the foreign exchange rate for Dec. 1, 2002, of $A0.56 to the U.S. dollar.) Another source reported that Australia's TCF sector in 2001 had shipments of US$4.75 billion and employed 87,000 people. See U.S. & Foreign Commercial Service, "Industry Sector Analysis: Australia - Apparel & Textiles - Textile Fabrics," 2002, found at *http://www.buyusainfo.net*, retrieved Mar. 22, 2004.

2002 totaled $3.9 billion.[206] Nevertheless, Australian production of industrial fabrics has expanded in recent years, reflecting increased demand for filtration products to address environmental concerns, the proliferation of technical textiles in motor vehicle manufacturing, and the increased use of disposable medical products by the medical industry.[207] Australia is the world's largest producer and exporter of wool;[208] it ranks in the top 10 of the world's producers of cotton and is the world's third-largest exporter of cotton.[209]

Australia's trade deficit in sector goods widened by 3 percent during 1999-2002 to $3.4 billion. Australian imports of sector goods rose by less than .05 percent to $3.9 billion and Australian exports of sector goods fell by 12 percent to $487 million in 2002. Exports represented 10 percent of total Australian output of sector goods in 2002.[210]

Australia's TCF sector faces competitive challenges similar to those faced by its U.S. counterpart, particularly rising competition from lower-cost exporting countries both at home and in export markets. Australia does not impose quotas and even if tariff barriers were maintained, Australia's Productivity Commission has warned that Australia's textile and apparel industry will not likely survive competition from China and that "further migration of standardized, labor intensive production offshore is inevitable."[211] To remain competitive, Australian apparel producers have shifted production of basic, high-volume garments to lower-cost countries, particularly China, and now focus on producing high-fashion, seasonal apparel in Australia.[212] The Australian TCF sector employs large numbers of immigrant clothing homeworkers, who reportedly account for as much as 90 percent of the country's apparel production and who earn an average wage of about (US) $1.14 per hour, compared with Australia's minimum wage of (US) $6.47 per hour.[213]

U.S.-Australian trade in textiles and apparel is relatively small and not subject to any quotas. Under an industry development program, however, Australia's tariffs on textiles, clothing, and footwear have been frozen at their current levels (25 percent for apparel, and 15 percent for footwear and linens) until 2005, when they are scheduled to drop again – apparel to 17.5 percent, 10 percent for fabrics and footwear, and 7.5

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[206] Based on United Nations trade statistics.

[207] U.S. & Foreign Commercial Service, "Industry Sector Analysis: Australia - Textile Fabrics," found at *http://www.buyusainfo.net/info*, retrieved Mar. 22, 2004.

[208] USDA Economic Research Service, Cotton and Wool Situation and Outlook Yearbook, Nov. 2003, Appendix table 37–Sheep Population, wool production, and exports, major foreign producing countries, 1995/96-2002/03.

[209] USDA Production, Supply, and Distribution database, FAS, USDA, found at *http://www.fas.usda.gov/psd/*, retrieved Apr. 13, 2004.

[210] All the data in this paragraph are based on United Nations trade statistics.

[211] Jason Koutsouki, "Grim Future For Textile Industry," *Australian Financial Review*, Apr. 16, 2003, found at *http://newsstore.f2.com.au/apps/view*, retrieved Apr. 9, 2004.

[212] U.S. Department of State telegram, "New Efforts to End the Exploitation of Clothing Homeworkers in Australia," message No. 437, prepared by U.S. Embassy, Canberra, Feb. 27, 2003.

[213] U.S. Department of State telegram, "New Efforts to End the Exploitation of Clothing Homeworkers in Australia," message No. 437, prepared by U.S. Embassy, Canberra, Feb. 27, 2003.

percent for linens.[214] The U.S. trade deficit in textiles and apparel with Australia more than doubled from $39 million in 1999 to almost $98 million in 2003, reflecting a 7 percent increase in U.S. imports from Australia, to $208 million, and a 27 percent decline in U.S. exports to Australia, to $110 million. Sector imports from Australia, which accounted for 3 percent of total U.S. imports from Australia in 2003, consisted primarily of apparel, particularly knit cotton sweaters and blouses, followed by wool blouses and sweaters. Sector exports to Australia, which accounted for less than 1 percent of total U.S. exports to Australia in 2003, consisted primarily of intermediate textiles, led by nonwovens, synthetic filament yarn, and woven fabrics of synthetic filament yarn.

Potential Impact on Trade Flows

U.S. Imports

The results of the model used in this study (Chapter 3), which assumed an immediate elimination of all tariffs on U.S. sector imports, showed a 58 percent increase in U.S. sector imports from Australia. The increase will be spread out over time because most tariffs on the leading textile and apparel imports from Australia will be phased out over 10 years, or by January 1, 2015, thereby reducing the incentive to boost imports from Australia significantly in the short term. In addition, Australia is a very small supplier of such goods and primarily competes in specialized, higher-end niches of the U.S. market for these goods. U.S. textile representatives also point out that the shipping distance between the U.S. and Australia in a time-sensitive industry and the relatively high cost of production in Australia will limit trade between the two countries for textiles and apparel.[215] U.S. apparel representatives, in turn, note that immediate trade opportunities will be limited by what they consider to be a complex yarn-forward rule of origin in the Agreement and complicated customs procedures.[216] In addition, according to a recent study by the Center for International Economics (CIE) in Australia,[217] only about 8.8 percent of total current Australian textiles and clothing exports to the United States would satisfy the yarn-forward rule of origin. Australia imports a significant share of the yarns it uses in textile and apparel production, especially polyester/cotton and polyester/viscose yarns,[218] most of which were imported from Asia.[219] The study indicates that it is unclear how many Australian producers would be willing or be able to switch their sources of production inputs to

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[214] U.S. Department of Commerce, Office of Textiles and Apparel, "Australia: Import Tariffs and Taxes," Nov. 24, 2003, found at *http://web.ita.doc.gov/tacgi/overseas.nsf*, retrieved Mar. 3, 2004.

[215] Industry Sector Advisor Committee on Textiles and Apparel (ISAC-15), "The U.S.-Australia Free Trade Agreement (FTA)," Mar. 2004, p. 2.

[216] Industry Sector Advisor Committee on Textiles and Apparel (ISAC-15), "The U.S.-Australia Free Trade Agreement (FTA)," Mar. 2004, p. 5.

[217] Centre for International Economics, Canberra & Sydney, *Economic Analysis of AUSFTA - Impact of the Bilateral Free Trade Agreement with the United States*, Apr. 2004, pp. 52-53.

[218] U.S. & Foreign Commercial Service, "Industry Sector Analysis: Australia-Textile Fabrics," found at *http://www.buyusainfo.net/info*, retrieved Mar. 22, 2004.

[219] Based on United Nations trade statistics. Note: U.N. data combines yarn and fabric imports.

U.S. suppliers to meet the yarn-forward rule because U.S. materials are reportedly around 30 percent more expensive than inputs from Asia and transportation costs would also be higher. It is also unknown the extent to which Australian production of inputs (fiber, yarn, etc.) might increase in response to the policy changes. Based on limited industry information, CIE assumes that the yarn -orward rule will greatly restrict the growth of Australian textile and apparel exports to the United States since only a small share of these exports can meet the yarn-forward rule and thereby take advantage of the preferential tariff treatment under the U.S.-Australia FTA. As discussed in Chapter 3, taking the potential effects of the yarn-forward rules into account substantially reduces the likely increase in U.S. imports of these producers.

U.S. Exports

The results of the GTAP model, which assumed an immediate elimination of Australia's duties, showed an 87 percent increase in U.S. exports to Australia. The actual increase will be spread out over time, however, because although certain products such as silk fabrics, most wadding, cut corduroy, tuiles and other net fabrics, become duty free immediately, most of the rest of the sector goods are staged over a widely varying period and do not become duty free until January 1, 2015.[220] Consequently, there is less incentive for Australian importers to boost their purchases of U.S. goods significantly in the short term. The United States is also a small supplier of sector products to Australia, accounting for only 4 percent of Australia's total sector imports in 2003. It is likely that the greatest growth in U.S. exports to Australia will be in textile fabrics, particularly in specialized textiles for industrial use, a sector in which the United States is particularly competitive; the United States held a 10 percent share of Australia's textile fabric market in 2001.[221] Annual growth of Australia's textile fabric market is "expected to average 4 percent into the foreseeable future."[222]

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[220] U.S. textile manufacturers have stated that because Australia has limited manufacturing infrastructure, the potential to increase exports to Australia as a result of the FTA is encouraging. However, they also pointed out that high freight costs and long shipping times could still hamper their competitiveness with Asian suppliers that have greater proximity to Australia. Peter Mayberry, Director, Government Affairs, Association of the Nonwoven Fabrics Industry (INDA), telephone conversation with Commission staff, Apr. 2, 2004.

[221] U.S. manufacturers are currently major suppliers in the categories of industrial, furnishing, and craft fabrics because of their technological innovations and edge over Asian and other suppliers who represent "modest competition" in this category. See U.S. & Foreign Commercial Service, "Industry Sector Analysis: Australia-Textile Fabrics," found at *http://www.buyusainfo.net/info*, retrieved Mar. 22, 2004.

[222] U.S. & Foreign Commercial Service, "Industry Sector Analysis: Australia-Textile Fabrics," found at *http://www.buyusainfo.net/info*, retrieved Mar. 22, 2004.

Overview

U.S. Industry

The United States is a dominant supplier in the global agricultural and horticultural (including lawn care) machinery industry. U.S. producers, such as Deere & Co., CNH Global N.V. (headquartered in the Netherlands, but with major U.S. brands Case IH and New Holland), and AGCO Corp., offer a wide range of agricultural machinery. Deere and CNH also produce construction equipment, and Deere is also a producer of commercial and consumer lawn care equipment. These firms have either global production facilities or operate a network of brands, with production primarily based in North America and Europe. The U.S. lawn care machinery industry is also a leading global supplier. In 2003, U.S. agricultural and horticultural machinery shipments totaled an estimated $19.9 billion.[223]

Australian Industry

By comparison, Australia has very limited production of agricultural and horticultural machinery, totaling $745 million in 2000.[224] Australian production is limited to sprayers, tillage tools, seeding equipment, and other miscellaneous farm equipment. For 2000, the Australian agricultural equipment market was estimated at $3.4 billion.[225] There is limited U.S. investment in the Australian agricultural and horticultural machinery industry.

Potential Impact on U.S. Trade Flows

U.S. Imports

Most U.S. imports of agricultural and horticultural machinery from Australia already enter the United States free of duty. The few exceptions are agricultural and horticultural sprayers–including irrigation equipment–subject to a 2.4 percent ad

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[223] Estimated based on shipments data for NAICS industries 333111 and 333112, from the U.S. Census Bureau, *Current Industrial Reports: Farm Machinery and Lawn and Garden Equipment, 2002*, MA333A(02)-1, Aug. 2003; portions of *Current Industrial Reports: Construction Machinery, 2002*, MA333D(02)-1(RV), Aug. 2003; and *Annual Survey of Manufactures: Value of Product Shipments, 2002*, Jan. 2003.

[224] U.S. Department of Commerce, US&FCS *Market Research Reports: Farm Machinery*, Mar. 2000, found at *http://www.stat-usa.gov*, retrieved Aug. 6, 2004.

[225] Ibid.

valorem tariff,[226] and parts of nonagricultural tractors[227] not separately provided for that are subject to U.S. tariffs ranging from 1.4 percent to 4.0 percent ad valorem, with most subject to 2.5 percent. U.S. imports of agricultural and horticultural machinery from Australia totaled $22.2 million in 2003, or 0.5 percent of all U.S. imports of these articles. In that same year, estimated dutiable imports of these products, exclusively sprayers, from Australia totaled $194,000, with calculated duties collected of approximately $4,700. It is unlikely that there have been any imports of parts of nonagricultural tractors from Australia. The U.S.-Australia FTA is not expected to result in any measurable increase in imports of agricultural or horticultural machinery.

U.S. Exports

As a result of the FTA, there is likely to be a moderate effect on certain U.S. exports to Australia of agricultural and horticultural machinery that are currently subject to duties. U.S. producers will benefit directly from Australian tariff reductions[228] and access to the Australian government procurement market, as well as indirectly from the inclusion of remanufactured articles in the FTA. In 2003, U.S. shipments of agricultural and horticultural machinery to Australia, the fourth-leading U.S. export market,[229] totaled an estimated $405.5 million, or 8 percent of U.S. exports to all destinations. However, only 37 percent of U.S. exports to Australia were subject to tariffs,[230] as major high-priced products, such as combine harvesters and most types of tractors, already enter Australia free of duty. For 2003, calculated Australian duties on U.S. exports totaled an estimated $7.5 million.[231] U.S. competitors in the products subject to duties are most likely EU and Australian producers of agricultural and horticultural machinery.

Other provisions of the FTA that are likely to benefit U.S. exports are increased access to the Australian government procurement market for utility tractors and equipment, and the treatment of remanufactured parts and components as new equipment. Increased access to the Australian government procurement market for U.S. agricultural and horticultural machinery as a result of the FTA is likely to be small because most types of agricultural and horticultural machinery purchased by governments, such as utility tractors, possibly sprayers, are not produced in Australia.

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[226] HTS subheading 8424.81.90.

[227] These include chassis fitted with engines, bodies for vehicles, and other parts of nonagricultural tractors classified in HTS headings 8706 through 8708.

[228] Industry Sector Advisory Committee 16, *The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Transportation, Construction, Mining & Agricultural Equipment for Trade Policy Matters* (ISAC 16), Mar. 2004, found at *http://www.ustr.gov/new/fta/Australia/advisor/isac16.pdf*, retrieved Apr. 16, 2004.

[229] In 2003, leading markets ranked by value were Canada, the EU, Mexico, and Australia.

[230] In this sector, Australia's tariffs are limited to agricultural dryers, sprayers and irrigation equipment, lawnmowers, certain harvesting and threshing machinery, milking machinery and dairy equipment, most barnyard equipment, one type of low-power tractor, certain parts for tractors, and farm wagons and carts.

[231] Based on U.S. export data from official statistics of the U.S. Department of Commerce and Australian tariff rates under the FTA.

Further, Australian government procurement preferences for small- and medium-sized enterprises are maintained under the FTA,[232] thus Australian government procurement of articles from these firms would likely not change.

Remanufactured parts and components are produced from used parts and components, where key core materials, such as a cast housing, are salvaged. The part or component is disassembled, cleaned, inspected, and new materials added as needed, so that the part or component functions as new, although it is sold at a greatly reduced price. Typical parts that may be remanufactured include engines and transmissions. Data on U.S. production and trade in remanufactured parts are not available. The importance of providing full access for remanufactured parts and components for the U.S. industry is that although their use is increasing, many developing countries prefer not to become prime markets for old machinery and equipment, and generally have limitations on the importation of used machinery and parts. Although there are no issues regarding remanufactured articles in trade with Australia, the inclusion of provisions for remanufactured parts in the U.S.-Australia FTA, carries the potential that such provisions regarding remanufactured parts would be incorporated in future FTAs with developing countries.[233]

Household Appliances[234]

Overview

U.S. Industry

The United States is the world's foremost producer of electric household appliances. The U.S. household appliance market is relatively mature, characterized by modest sales growth and intense price competition. The industry is highly concentrated, with four companies accounting for 96 percent of total production. General Electric

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[232] Australian Department of Foreign Affairs and Trade, Australia-United States Free Trade Agreement: Guide to the Agreement, "Government Procurement," found at *http://www.dfat.gov.au/trade/negotiations/us_fta/guide/15.html*, retrieved Apr. 29, 2004.

[233] William Lane, American-Australian Free Trade Agreement Coalition, Commissin hearing transcript, Mar. 30, 2004, p. 106. See also Association for Equipment Manufacturers, in chap. 9, Position of Interested Parties.

[234] Includes HTS headings and subheadings 8418-8419; 8421-8422; 8450-8451; 8476; 8479; 8509-8510; 8514.20.40-8514.90.40; and 8516. The household appliance industry comprises a wide-variety of major electric appliances and small portable (countertop) appliances. These household appliances are of the type used in homes and do not include electric appliances made exclusively for commercial or industrial application (e.g., commercial and industrial food mixers, and commercial laundry equipment). The important types, or subcategories, of small appliances are vacuum cleaners, and floor polishers, electromechanical and electrothermic kitchen and household appliances, and electric heating equipment. Major appliances consist principally of refrigerators, dishwashers, washing machines, clothes dryers, and electric cooking stoves and ranges.

Appliance Group (GE), Whirlpool Corp., Electrolux (maker of Frigidaire and Westinghouse brands), and Maytag Corp (Maytag and Amana brands) produce a full line of household appliances—cooking, refrigeration, and laundry. There are numerous other medium-sized and small companies specializing in more narrow product lines.

The household appliance market has changed only slightly over recent decades, and there is little to differentiate one manufacturer's product from another.[235] Major appliances already have high penetration levels in the U.S. market, and no breakthrough products are looming on the horizon to create new demand. In addition, the domestic household appliance industry has experienced major industry consolidation (e.g., Maytag's acquisition of Amana) leading to a reduction in the number of duplicative operations, but an increase in the number of brands in specific categories of products.[236] As a result, companies have experienced only a modest change in U.S. market share for these products since 1997.[237] In 2003, the U.S. household appliance industry recorded shipments of approximately $31.2 billion, and employed approximately 131,000 workers.[238] The United States currently maintains a $55 million trade surplus with Australia for these products, despite U.S. exporters encountering a 5 percent duty.[239]

Australian Industry

Australia's household appliance industry[240] is small relative to the U.S. industry, with domestic production totaling $2.5 billion in 2003.[241] The Australian industry is dominated by Electrolux (Sweden), which has an estimated 50 percent share of domestic production. Other leading producers in Australia include Fisher-Paykel (New Zealand) and Whirlpool (U.S.).[242] Electrolux, Fisher-Paykel, and LG Electronics (Korea) are estimated to supply up to 80 percent of the domestic market. U.S. firms, including Whirlpool Corp., GE Appliance Group, and Maytag (through its Amana appliance subsidiary), primarily supply the Australian market through exports. However, Whirlpool also has assembly plants in Australia. Electrolux, Fisher-Paykel, and Whirlpool Corp. reportedly source much of their household appliance componentry from external suppliers and use their Australian production facilities for assembly and as market distribution points.[243]

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[235] Justification for higher prices to the consumer for certain models is based on brand recognition, size, style, and added features, whereas basic functions (cooling, cooking, and cleaning) are comparable.

[236] Eileen M. Bossong,"Industry Surveys: Household Durables," *Standard & Poor's*, Nov. 6, 2003.

[237] "Portrait of the U.S. Appliance Industry," *Appliance Magazine*, Sept. 2002, p. 53.

[238] Shipment data include figures for the following NAICS categories 33521, 33522, and 335228, compiled from Industry Surveys: Household Durables, *Standard & Poor's*, Nov. 6, 2003.

[239] All imports entering Australia are subject to a 10 percent value-added tax. The tax is also applied to goods produced in Australia.

[240] In Australia, the more common term for major household appliances is "white goods."

[241] The value of Australian household appliance production is in Australian dollars, which as of Sept. 21, 2003 was 1.49 to the U.S. dollar.

[242] Rochelle Burbury, "Electrolux to Fill Its Image Vacuum," *Australian Financial Review*, Sept. 21, 2003, p. 46.

[243] Alan Johnston, "Teamwork Keeps Production Work in Australia," found at *http://www.ferret.com/au/article*, retrieved Apr. 6, 2004.

Potential Impact on U.S. Trade Flows

U.S. Imports

The FTA will likely have relatively limited impact on U.S. imports of household appliances or on production and employment in the U.S. industry. Generally, nearly all household appliance products from Australia currently enter the United States duty-free.[244] In 2003, household appliance imports from Australia totaled $69.7 million (less than 1 percent of the total imports and U.S. market share), and consisted primarily of refrigerators and freezers, dishwashers, vacuum cleaners, and miscellaneous appliance parts. Australia's exports of household refrigerators, freezers, and other related freezing equipment to the world totaled $65 million in 2002.[245] Household refrigerators accounted for the dominant share of Australia's exports to the world in 2003. The bulk of major household appliances sold in the United States are manufactured domestically, because of their high ratio of weight to value and therefore high transport cost, and low ratio of labor content of total cost. By contrast, most counter-top appliances having low transportation costs and a higher ratio of labor to total cost, are imported from low labor-cost countries in Asia, especially China.

U.S. Exports

Household appliances are a leading U.S. export to Australia ($125 million in 2003) in the machinery and electrical equipment sector.[246] U.S. exports account for 15 percent of total Australian imports of household appliances and that share is expected to increase. Australian consumers reportedly prefer U.S. household appliances and parts for their quality, innovation, and after-sales service.[247] Elimination of Australian tariffs (4.3 percent in 2003) may provide increased export opportunities for U.S. products relative to those of other foreign suppliers. Major European (e.g., Miele and Asko brands) and Korean (e.g., Samsung, Daewoo Electronics) household appliance suppliers to the Australian market will likely see a diminishing market share when duties on competing imports from the United States are eliminated.[248]

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[244] A limited number of household appliances from Australia, such as absorption-type refrigerators, are subject to duties that range from 1 percent to 1.9 percent rate ad valorem.

[245] International Trade Center, "Commodity Trade Statistics (Comtrade)," *United Nations Trade Statistics*, found at *http://unstats.org/comtrade/*, retrieved Apr. 1, 2004. Data regarding Australia's exports of other appliances to the world are not available from the United Nations.

[246] The Industry Sector Advisor Committee on Consumer Goods (ISAC-4), which included household appliances, reported to USTR that a AUSFTA would deliver important benefits to consumer goods firms in terms of market access, regulatory transparency, and customs procedures.

[247] Fisher-Pakel, representative, telephone interview by USITC staff, Apr. 8, 2004.

[248] Julie Macken, "For a Steal in White Goods, Go to the Source," Australian Financial Review, May 10, 2002, p. 31.

Overview

In 2002, the United States exported private services[249] valued at $5.2 billion to Australia, and imported $2.9 billion, producing a $2.3 billion surplus in cross-border services trade. Australia was the 13th-leading export market for U.S. service providers in 2002.[250] However, the majority of services between the United States and Australia is conducted through overseas affiliates. In 2001, sales of services by U.S.-owned affiliates in Australia totaled $14.7 billion, while services sales by Australian-owned affiliates in the United States totaled $10.7 billion.[251] This discussion will address the expected direct impact of the FTA on U.S. imports and exports of services, primarily based on the provisions of the FTA chapters on services (chapter 10), financial services (chapter 12), and telecommunications (chapter 13). In particular, the discussion will address the effects of the FTA on the service industries addressed separately and distinctly in the FTA text itself: financial services, including banking, securities, and insurance; telecommunications; professional services, particularly education; express delivery services; and audiovisual services. A discussion of the indirect effects of the Agreement focusing on the same service industries also is presented. Several gains from the FTA, over and above Australia's existing commitments under the General Agreement on Trade in Services (GATS),[252] are discussed in greater detail below. In particular, the FTA includes binding commitments on audiovisual services, and provides new branching rights for U.S. insurance companies. In addition, the "negative list" format of the FTA, as opposed to the "positive list" format of the GATS, ensures that the provisions of the FTA will apply to new products resulting from new technology and other innovation.

Although it is not possible to establish an overall quantitative measure for the FTA's effects on trade in services,[253] the FTA is expected to have some impact on services trade between the United States and Australia.[254] First, trade in services will likely increase in some areas as a direct result of increased market access and national treatment for U.S. service providers, resulting from barriers removed by the FTA. For

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[249] Excludes services provided by Federal, State, or local governments.

[250] USDOC, BEA, *Survey of Current Business*, Oct. 2003, pp. 80-81.

[251] USDOC, BEA, *Survey of Current Business*, Oct. 2003, p. 114.

[252] The WTO's General Agreement on Trade in Services (GATS) was signed in 1994 at the end of the Uruguay Round of WTO negotiations. It is the first multilateral trade treaty to include rules for trade in services.

[253] Tables 3-4 and 3-5 of this report indicate that tariff reduction under the U.S.-Australia FTA would cause a very slight modification in services trade between the two countries, and would have a negligible effect on output and employment in the U.S. services sector. However, non-tariff measures typically have a more important impact on services trade than tariffs. At the present time, it is not possible to do a precise quantitative analysis regarding the modification or elimination of non-tariff measures under the U.S.-Australian FTA.

[254] Due to data constraints in estimating the tariff equivalents for such FTA commitments in services as national treatment and transparency, as well as the intangible nature of benefits in the services sector, quantitative assessment was precluded in Chapter 3.

instance, the FTA includes language that permits U.S. information technology (IT) firms to bid on certain government procurement contracts that were previously open solely to Australian firms.[255] Even though much of Australia's services market is already open to foreign trade and investment, the removal of the remaining market access barriers will ensure the openness of this segment of the Australian economy. In cases where barriers were not actually removed, it is possible that the act of binding existing barriers into a trade agreement, thereby enhancing regulatory transparency and providing legal certainty, will lead to increased trade and investment. In the case of audiovisual services, for example, the Australian Government imposes screen quotas requiring that 55 percent of broadcast programming originate in Australia. Even though the FTA has not removed these quotas, it has promised that they will not be increased, or applied to additional means of distribution such as the Internet. This assurance is important to industry's assessment of future trade and investment opportunities.[256]

Second, since services often serve a support role for both trade and investment in manufactured and agricultural goods, it is expected that both cross-border trade and direct investment in services will increase as a secondary result of the increased trade in goods resulting from the FTA's entry into force. In particular, trade in freight transport services, express delivery services, port services, and wholesale trade services stems in large measure from cross-border trade in goods. This indirect relationship holds true for financial services and telecommunications as well. Banks and insurance carriers are not likely to increase significantly their direct business in Australia as a result of the FTA, because Australian financial services markets are largely open, with many U.S. firms currently conducting business there. However, they are likely to see increases in their business with U.S.-based manufacturers or agricultural firms, as they are called upon to finance or insure an increasing amount of goods trade between the United States and Australia. Cross-border trade in telecommunication services may also record increases, as U.S.-based firms from all economic sectors increase communications with counterparts in Australia, or open affiliates there, and Australian firms do the same in the United States.

An important feature of the FTA, in the eyes of U.S. business interests, is the treaty's "negative list" format. Under a negative list approach, all industries are covered by the Agreement, other than those specifically carved out as exceptions in the FTA annexes. This type of approach tends to yield significantly greater coverage than the "positive list" approach employed by the GATS. Under a positive list approach, industries must be specifically included in an agreement in order to be covered. Australia, for example, did not include audiovisual services in its GATS commitments, so trade in that area was not protected by the provisions of the GATS. By contrast, in the U.S.-Australia FTA, Australia took specific, limited exemptions in these areas, leaving other parts of

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[255] William R. Sweeney, Jr., EDS, Commission hearing transcript, Mar. 30, 2004, p. 192.

[256] Laura Lane, Time Warner, Inc., Commission hearing transcript, Mar. 30, 2004, pp. 185 and 207.

the industry to enjoy the benefits of the agreement. For example, the audiovisual services area includes exemptions for transmission quotas requiring 55 percent local content and other specific exemptions that apply to television and radio broadcasting services. However, the FTA extends coverage to other areas of the audiovisual services industry, such as Internet distribution of entertainment, by virtue of not being mentioned in the agreement. This negative list approach is particularly important for high-technology industries such as audiovisual, computer-related, and financial services, where new products are constantly being developed and brought to market. Such new products have automatic coverage under the Agreement, whereas under a positive-list agreement, new products and industries may not be covered unless the agreement is amended to include them.

Further, the FTA features liberal rules of origin in regard to services. Specifically, service providers operating in the United States and Australia are equally beneficiaries of all investment and service obligations irrespective of ownership or control. This assures that the benefits of the agreement can be extended to third parties that wish to enter either market.[257] This could increase investment flows to one or both parties and further intensify competition among leading service providers, which in turn could create greater efficiencies and reduce costs.

Industry representatives would have preferred that the FTA include provisions ensuring the temporary entry of businesspersons. U.S. and Australian multinational companies frequently need to transfer personnel across borders on a short- or medium-term basis, and existing visa procedures for transferring employees can be time-consuming and expensive. Reasons for such transfers include establishing a new foreign affiliate, training at a corporate office overseas, or employing skilled personnel for a particular task, such as drilling an oil well. Temporary entry commitments are particularly important for providers of professional services, including lawyers, accountants, architects, and health care personnel, many of whom provide the bulk of their services by traveling to meet with clients.[258] Trade commitments regarding temporary entry, which are included in the GATS, provide legal certainty and transparency for businesses, with regard to the categories of personnel that they may transfer between affiliates in different countries, and the length of stay that is permitted for each category of employee.[259]

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[257] Centre for International Economic (CIE), *Economic Analyses of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States*, Apr. 2004, p. 16.

[258] "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004.

[259] Under the GATS, countries have the option of scheduling trade commitments under four modes of supply for all service industries. Mode 4 covers temporary entry and stay of personnel.

Potential Impact on U.S. Trade Flows

U.S. Imports

It is unlikely that the U.S.-Australia FTA will have a significant impact on U.S. imports of services, though imports of services that facilitate trade in goods may increase. Although U.S. services markets are among the largest and most liberalized in the world, U.S. services firms are highly competitive globally, and are the leading suppliers of services in a wide variety of industries, including financial services, telecommunications, audiovisual services, and information technology. Further, most Australian-based, multinational firms with commercial interests in the U.S. market are already doing business here.[260] Like the United States, Australia is a developed country with globally competitive services firms in several industries. However, consistent with the smaller size of the Australian economy, fewer Australian firms are competitive on a global basis. Table 4-4 compares the U.S. and Australian markets for selected service industries, and table 4-5 illustrates current levels of U.S.-Australia trade for selected service industries.

The FTA will likely affect the different segments of the service sector in somewhat varying ways. In the financial services industry, for instance, six Australian banks were operating in the United States with $11.3 million in combined domestic assets in December 2003.[261] However, such activities are most likely concentrated in the provision of trade financing to Australian clients exporting goods to the United States, and do not directly compete with U.S.-based banks. Hence, future growth in this industry segment is expected to result from increased trade in goods, due to the FTA between the United States and Australia. In addition, several Australian insurance firms already maintain affiliates in the United States, with recorded U.S. sales of $329 million in 2001.[262]

U.S. commitments as part of the WTO Basic Telecommunications Agreement lifted most foreign investment restrictions in the U.S. market and provided greater regulatory certainty for foreign firms.[263] However, Australian firms have chosen to concentrate more on the Asia-Pacific region rather than make significant investments in the U.S. telecommunication services market.[264] For example, Telstra, the Australian incumbent service provider, has concentrated its foreign investments in Hong Kong and New Zealand. The company continues to evaluate business opportunities in the Asia-Pacific region, where it has "operational experience."[265]

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[260] Industry representatives from several service industries, telephone interviews with USITC staff, Washington, D.C., Mar. 8-23, 2004.

[261] Total domestic assets of Australian banks operating in the United States account for less than 1 percent of all domestic assets of foreign banks operating in the United States. U.S. Federal Reserve, "Structure Data for U.S. Offices of Foreign Banks," Dec. 31, 2003, found at *http://www.federalreserve.gov*, retrieved Mar. 23, 2004.

[262] USDOC, BEA, *Survey of Current Business*, Oct. 2003, p. 118.

[263] The WTO's Basic Telecommunications Agreement became effective Feb. 5, 1998.

[264] An examination of U.S. affiliate transactions indicates that U.S. telecommunication purchases from Australian-based firms totaled $2 million in 2001, compared with U.S. affiliate sales of $687 million. Affiliate transactions entail sales to foreign persons by firms established as joint-ventures or subsidiaries in foreign markets. Such affiliates are funded through foreign direct investment.

[265] Telstra, *2003 Annual Report*, p. 27, found at Internet address *http://telstra.com.au/communications/shareholder/docs/company_overview03fy.pdf*, retrieved Mar. 26, 2004.

Table 4-4
Gross domestic product (GDP) and employment: United States and Australia, selected service industries, 2000

Service industry	United States		Australia	
	GDP[1]	Employment	GDP[1]	Employment[2]
	Billion dollars	*Thousands*	*Billion dollars*	*Thousands*
Electricity, gas and water supply	217.6	857	8.0	64
Construction	367.5	7,007	16.6	466
Wholesale & retail[3]	1,745.2	32,923	36.2	1,586
Hotels & restaurants	66.3	1,979	7.1	391
Transport, storage & communication	637.6	7,232	29.4	494
Financial intermediation	753.1	6,175	20.2	314
Real estate, renting & business activities	1,842.1	16,657	67.2	856
Public administration & defence; compulsory social security	939.0	12,639	12.4	448
Education	61.5	11,829	13.8	585
Health & social work	526.6	13,477	18.3	781
Other community, social and personal service activities	194.6	6,445	13.9	334

[1] In 1995 dollars.

[2] Data are for 1999.

[3] Includes repair of motor vehicles and household goods.

Source: Organisation for Economic Co-Operation and Development (OECD), *National Accounts of OECD Countries: Detailed Tables, Volume II, 1989-2000*, 2002, pp. 20, 21, 26, 27, 730, 731, 736, 737; and International Monetary Fund, *International Financial Statistics*, Dec. 2002, p. 108.

Table 4-5
U.S. and Australian trade data in selected service industries, 2002

Industry	Total U.S. exports	U.S. exports to Australia		Total U.S. imports	U.S. imports from Australia	
	Million dollars	*Million dollars*	*Percent*	*Million dollars*	*Million dollars*	*Percent*
Audiovisual	9,837	325	3.3	153	([1])	-0.7
Financial services	15,859	363	2.3	3,665	95	2.6
Education	12,759	67	0.5	2,466	121	4.9
Express delivery	5,787	109	1.9	4,878	32	0.7
Insurance	2,839	66	2.3	15,348	8	0.1
Business, professional, and technical services	28,799	598	2.1	10,732	200	1.9
Telecommunications (bilateral)	4,137	139	3.4	4,180	49	1.2

[1] Suppressed to avoid disclosure of data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 2003, pp. 85, and 100-101.

Imports of audiovisual services comprise the collection of royalties, license fees, and sales revenues in return for granting rights to display, broadcast, reproduce, or distribute audiovisual works on a variety of media, including prerecorded film reels, video tapes, digital video discs (DVDs), audio cassettes, and compact disks (CDs). Restrictions on trade in both goods and services therefore apply to the audiovisual industry. Tariffs on imports of CDs and DVDs, as well as nontariff barriers such as cinema screen quotas and broadcast quotas, all affect trade in audiovisual services. However, the FTA is unlikely to have a measurable impact on either goods or services imports of audiovisual services, since there is only one existing tariff on such goods,[266] and the FTA will not affect existing nontariff barriers to U.S. imports in the industry.[267]

An aspect of the U.S.-Australia FTA likely to facilitate trade in professional services over time is the creation of a Professional Services Working Group, a mechanism to encourage relevant bodies to develop mutually acceptable standards and criteria for the licensing and certification of professional services suppliers and make recommendations on mutual recognition.[268] The working group is to consider procedures for encouraging development of mutual recognition arrangements and explore the creation of models for licensing and certification.[269] Progress by the working group is to be reported within two years of the FTA's entry into force. The working group mechanism is ultimately likely to facilitate relevant bodies' efforts to establish new mutual recognition arrangements, and preserve or augment such arrangements in place for accountants,[270] architects,[271] and engineers[272] in Australia and the United States.[273]

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[266] The only remaining import duty (7 percent) is on VHS cassettes (all categories - HTS 8524.52.1040 and HTS 8524.52.1080), but this trade is small, due to the advent of new technology (primarily DVDs) and the fact that most VHS tapes distributed in a foreign country are manufactured in that market, from a single master tape exported from the film's country of origin.

[267] Existing restrictions include screen quotas which require 55 percent of broadcast programming to originate in Australia, restrictions on foreign ownership of television licenses, and an investment requirement for subscription television services.

[268] See Annex 10-A of the U.S.-Australia FTA.

[269] Consultations with relevant bodies are to assist in the selection of professions for the working group's consideration.

[270] Two mutual recognition agreements, signed in 1996 and 2002, simplified the process whereby professionals from the United States and Australia could qualify for a similar designation in the other country. "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004.

[271] The Accord on Professionalism in Architecture, signed in 1998 and reaffirmed in 2003 for five years, sets forth cooperation toward inter-recognition of standards to facilitate mutual market opening. In addition, the Protocol for Practice in a Host Nation, established in 2003, allows qualified Australian architects to apply to practice in the United States in association with a licensed U.S. architect. The Royal Australian Institute of Architects, Submission - AUSFTA, found at Internet address *http://www.architecture.com.au/*, retrieved Mar. 10, 2004, and Architects Accreditation Council of Australia, Inc., international news, found at Internet address *http://www.aaca.org.au/internationalissues_2.html*, retrieved Mar. 10, 2004.

[272] The Washington Accord, signed in 1989, provides for recognition of the substantial equivalency in engineering education programs required for accreditation in Australia, the United States, and six additional signatory countries. David L. Curtis, "International Forum Could Eliminate Barriers to Mobility," *Licensure Exchange*, National Council of Examiners for Engineering and Surveying, vol. 7, issue 1, Feb. 2003, p. 11.

[273] "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004.

In terms of restrictiveness, U.S. and Australian markets for architectural, engineering, and accounting services are comparable.[274] By national law, U.S. states are responsible for regulating professional services within their borders. Consequently, market entry for both domestic and foreign providers is deemed complex and subject to diverse regulatory provisions, such as those regarding establishment, nationality, residency requirements, and requirements of reciprocity.[275] The FTA will not change such state regulations, so no direct impact on U.S. imports of professional services is expected.

U.S. Exports

By and large, U.S. service providers report that the Australian markets are already open to trade and investment from U.S. firms, and the FTA is expected to preserve the existing positive environment. Several FTA provisions also create new opportunities for U.S. companies, including insurance and asset management firms. Other provisions bind existing policies within a trade agreement for the first time, including Australia's new commitments on audiovisual services. These changes are likely to lead to small increases in U.S. cross-border exports and U.S. direct investment in Australia, especially over time.

U.S. financial services companies have a strong market presence in Australia. For example, as measured by revenue, six U.S. firms were among the world's 10 largest financial advisers in 2003,[276] and all but one of these firms had operations in Australia.[277] Nonetheless, the U.S.-Australia FTA does include provisions that will further benefit U.S.-based financial services companies already active in or seeking to enter the Australian market. Asset management firms will benefit from the new commitment allowing for cross-border provision of portfolio management services, which will allow them to reduce costs and capitalize on existing resources.[278] U.S. firms will also be able to provide asset management services to the civil service pension system under the national treatment and most-favored-nation provisions of the agreement.[279]

U.S. insurers also report that the Australian market is essentially open to U.S. cross-border trade and investment in the industry, and that most firms with an interest

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[274] Nguyen-Hong, D., *Restrictions on Trade in Professional Services*, Commonwealth of Australia, Productivity Commission, pp. 20, 35.

[275] World Trade Organization (WTO), T*rade Policy Review: The United States*, WT/TPR/S/126, Jan. 2004, pp. 101, 156, 157, found at Internet address *http://www.wto.org/english/ tratop_e/tpr_e/tp226_e.htm*, retrieved Mar. 19, 2004.

[276] These companies are Goldman Sachs, Citigroup, J.P. Morgan, Merrill Lynch, Morgan Stanley, and Lehman Brothers. Standard & Poor's, *Industry Surveys: Investment Services*, Oct. 30, 2003.

[277] Lehman Brothers does not have offices in Australia.

[278] "The U.S.-Australia Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters," Mar. 12, 2004.

[279] Industry representative, telephone interview with Commission staff, Mar. 12, 2004.

in the market already have operations there. Sales by U.S.-owned insurance affiliates totaled $612 million in 2001.[280] Therefore, the FTA is not expected to generate significant additional U.S. exports of insurance services to Australia.[281] However, the FTA does include two specific liberalizations for insurers, who as a result will see greater regulatory transparency and, perhaps, a wider range of business prospects. First, several key cross-border insurance products, including marine, aviation, and transport (MAT) insurance; intermediation (brokerage) for MAT; reinsurance; and insurance auxiliary services are specifically covered by the Agreement, and are not covered by Australia's commitments under the GATS.[282] More important, life insurers will now be permitted to conduct operations in Australia through branches, which was not previously permitted. Establishment through branching, rather than establishing a separately capitalized subsidiary, reduces operating costs and enlarges the number of services that can be provided economically. These improvements may generate some additional U.S. exports of insurance services.[283]

Australia deregulated its telecommunications sector in 1997, so the FTA is unlikely to have any direct impact on U.S. exports of telecommunication services. There are 100 carriers currently registered with the Australian Communications Authority, including U.S.-based WilTel Communications, AT&T, UEComm, MCI, and Sprint.[284] U.S.-owned affiliates such as these generated $687 million in sales during 2001. However, such sales are expected to decline as a result of "intense competition" in the Australian market.[285] Opportunities may exist for U.S.-based firms that provide wireless data, resale, and broadband services, but such opportunities are the result of trends in consumer demand rather than a direct result of the FTA.[286] Provisions in the FTA may provide greater regulatory certainty for firms that provide these services.

In the case of the market for motion pictures,[287] U.S. films already hold a substantial share of the market in Australia.[288] However, the commitments in the FTA will ensure continued access to Australia's audiovisual services market for U.S. firms, albeit subject to a significant number of restrictions. Industry experts expect greater two-way trade in the long term, particularly through co-production and increased distribution opportunities.[289]

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[280] USDOC, BEA, *Survey of Current Business*, Oct. 2003, p. 115.

[281] Industry representatives, telephone interviews with USITC staff, Mar. 8-9, 2004.

[282] World Trade Organization, "Australia: Schedule of Specific Commitments," GATS/SC/6/Suppl.4., Feb. 26, 1998.

[283] "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004; and Laura Lane, Time Warner, Inc., Commission hearing, Mar. 30, 2004.

[284] USDOC, Foreign Commercial Service, Australia Country Commercial Guide, 2004.

[285] USDOC, Foreign Commercial Service, Australia Country Commercial Guide, 2004.

[286] USDOC, Foreign Commercial Service, Australia Country Commercial Guide, 2004.

[287] Specifically, home video entertainment.

[288] Australia is the eighth-largest export market for U.S. motion pictures. Time Warner, Inc. on behalf of the Entertainment Industry Coalition for Free Trade (IEC) and New Corporation, Testimony before the Commission, U.S.-Australia Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects (Inv. No. TA-2104-11), Mar. 30, 2004.

[289] Industry representative, telephone interview by USITC staff, Washington, D.C., Mar. 30, 2004.

Given the substantial current presence of U.S.-based express delivery services firms in Australia, the impact of the FTA on U.S. exports of express delivery services will largely depend on the resulting increase in merchandise trade. Federal Express and UPS already maintain extensive operations in Australia, reflecting the existing liberalization of Australia's market.[290] In fact, UPS was the official express courier and package delivery company of the 2000 Olympic Games in Sydney.[291] Though not measurable in terms of increased exports, U.S.-based express delivery firms will benefit from greater regulatory transparency and legal certainty as a result of new FTA commitments on market access and national treatment. In particular, since Australia did not make such commitments for courier services in the GATS, its FTA commitments are important in ensuring that market access and national treatment provisions apply to express delivery services.

It is likely that U.S. exports of professional services to Australia will increase over time, although the Australian market is considered reasonably open at present.[292] U.S. professional services industry representatives indicate that the above-referenced mutual recognition arrangements in place between the United States and Australia are working smoothly,[293] and believe that the working group set up by the FTA is a positive step, likely to foster closer harmonization and facilitate mutual recognition of professional credentials.[294]

Indirect Benefits of the FTA

Many of the benefits of the FTA for U.S. service firms do not come from the chapters that directly address cross-border trade in services (Chapter 10), financial services (Chapter 13), and telecommunications (Chapter 12). Other important aspects of the Agreement cited by service sector industry representatives include the chapters on investment (Chapter 11), government procurement (Chapter 15), electronic commerce (Chapter 16), and intellectual property rights (Chapter 17). All of these chapters include language that will significantly add to the rights and protections enjoyed by U.S. firms in their trade and investment relationships with Australia, and may very well increase U.S. trade with, and investment in, Australia over the medium and long terms. Although it is difficult to quantify or clearly illustrate the direct effects of these sections of the Agreement on cross-border trade, industry representatives have clearly stated that they consider these provisions of the treaty vital for their business operations in

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[290] Federal Express, *Submission to the Industry Commission of Australia, Enquiry into International Air Services,* Feb. 1998, p. 10; and UPS, "UPS shares the Olympic spirit," *press release*, Sept. 21, 2000.

[291] UPS, "UPS shares the Olympic spirit."

[292] "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004.

[293] U.S. industry representatives, interviews by USITC staff, Feb. 24, 2004.

[294] "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004.

Australia. For example, the government procurement chapter opens new markets for U.S. computer services firms, which had previously been barred from bidding on certain types of Australian Government database contracts. New protections and opportunities relating to electronic commerce will also permit U.S. firms to increase market opportunities in Australia.[295] Representatives of the audiovisual services industry have clearly stated that changes to Australia's intellectual property regime resulting from the FTA are vital to their ability to invest in Australia and retain their profits in that market.[296]

Audiovisual Services

The U.S.-Australia FTA will retain several current restrictions on market access, such as local content quotas on broadcast television and an investment requirement on subscription television. However, the U.S. audiovisual services industry does not consider these overly burdensome. Rather, industry representatives believe that this FTA successfully achieves a balance between Australia's cultural concerns and U.S. industry's future access to the country's audiovisual services market.[297] Australia previously held no audiovisual service commitments in its GATS schedule, so this is an important step forward. In addition, the audiovisual provisions in this FTA are regarded as setting an important precedent for future bilateral and multilateral trade agreements.

The audiovisual services industry specifically highlighted the following provisions achieved in the FTA as beneficial:

- provisions for intellectual property (IP) protections that represent improvements over those in TRIPS,[298] such as implementing the World Intellectual Property Organization (WIPO) Internet Treaties, ensuring that copyright owners have exclusive rights to make works available online, and protecting copyrighted works for extended terms;
- strengthened IP enforcement, which will increase criminal and civil protection against unlawful decoding of encrypted satellite television signals, and authorize seizure, forfeiture, and destruction of pirated products and equipment;
- zero tariffs on entertainment products, including all movies, music, consumer products, books and magazines imported into Australia, and a requirement on customs valuation, basing it on the value of the carrier media rather than projected royalties;

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[295] William R. Sweeney, Jr., EDS, testimony at Commission hearing, Mar. 30, 2004.

[296] Rick Lane, Vice President of Government Affairs, News Corporation; and Laura Lane, Vice President of Global Public Policy, Time Warner, Inc., testimony at Commission hearing, Mar. 30, 2004.

[297] Industry Sector Advisory Committee on Services (ISAC-13)," The U.S. Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC-13)," Mar. 12, 2004.

[298] The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) was signed in 1994 at the end of the Uruguay Round of WTO negotiations. It is the first multilateral trade treaty to include intellectual property rules.

- improved market access, ensuring market access for U.S. films and television programs over cable, satellite, and the Internet;
- free trade in digital downloads and electronic commerce, committing to nondiscriminatory treatment of digital products, and agreeing not to impose custom duties on such products.[299]

Several other IP provisions of the U.S.-Australia FTA are also important to the audiovisual services industry. The Motion Picture Association of America (MPAA) has estimated that audiovisual piracy in Australia cost the United States motion picture industry approximately $45 million in 2003.[300] Although Australia's piracy rate has generally been low, according to international standards, it has recently increased from 5 percent in 2002 to 8 percent in 2004, raising concerns within the U.S. audiovisual industry.[301] Industry representatives have emphatically stated that protecting intellectual property is critical to trade and investment in existing audiovisual services, and in the host of new entertainment services that are based on upcoming technology, and currently under development.[302]

Express Delivery Services

Australian firms involved in cross-border freight delivery will likely benefit from greater regulatory certainty in customs processing. The FTA's customs provisions ensure transparency of administration and rulings, and threaten the imposition of penalties in the case of legal and regulatory violations. Processing and rapid release guidelines for express shipments also provide greater certainty for U.S. and Australian firms, although such guidelines do not result in procedural improvements, as U.S. and Australian customs' processing procedures for express shipments are already efficient.[303] U.S.-based firms receive additional certainty from the FTA's competition policy provisions, including the chapter on competition-related matters and language in the services chapter that limits Australia Post's ability to cross-subsidize competitive services with monopoly-derived profits.[304]

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[299] Time Warner, Inc. on behalf of the Entertainment Industry Coalition for Free Trade (EIC) and News Corporation, Testimony before the Commission, U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects (Inv. No. TA-2104-11), Mar. 30, 2004.

[300] Time Warner, Inc. estimates about $10 billion in lost revenue for global exports in 2003, due to weak intellectual property enforcement.

[301] Motion Picture Association of America (MPAA), "Trade Barriers to Exports of U.S. Filmed Entertainment: 2004 Report to the U.S. Trade Representative," June 2004.

[302] Time Warner, Inc. on behalf of the Entertainment Industry Coalition for Free Trade (EIC) and News Corporation, Testimony before the Commission, U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects (Inv. No. TA-2104-11), Mar. 30, 2004.

[303] Industry representative, telephone interview with USITC staff, Washington, D.C., Mar. 16, 2004; and ACCA, Testimony before the Commission, U.S.-Australia FTA (Inv. No. TA-2104-11), Mar. 30, 2004.

[304] Although Australian firms receive the same assurances from the U.S. Postal Service, their limited participation in the U.S. market reduces the potential benefits of such provisions. Despite their overall support of the FTA, the U.S. express delivery services industry is concerned that the language on cross-subsidies creates a "minimally enforceable commitment that would not fully cover the scope of cross-subsidization that could occur." Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13)," *The U.S.-Australia Free Trade Agreement (FTA)*, Mar. 12, 2004, p. 12.

Financial Services

The FTA provisions regarding regulatory transparency are viewed favorably by the financial services industry, particularly the requirement that regulators state the purpose of proposed regulations.[305] One component of the Agreement viewed negatively by U.S. industry sources is Australia's retention of its requirement that foreign investors obtain investment approval from the Foreign Investment Review Board, which may deny specific foreign investment on the basis of national interest.[306] While branching by financial investors already present in the market has been excluded from the provision,[307] it is believed that the provision could negatively affect market access and portfolio investment for financial service providers.[308] For further information on the provision and its possible effects, see the investment chapter of this report.

Information Technology Services

The most prominent topics related to IT services addressed by the FTA are electronic commerce (e-commerce) and intellectual property rights (IPR).[309] Industry strongly supports the IT-related provisions of the Agreement. With regard to IPR, the Agreement contains vigorous standards of protection and enforcement for copyrights and other intellectual property. Such protection is critical to trade and investment in IT sectors reliant on IPR such as software development.[310]

The electronic commerce chapter proposes that electronically delivered goods and services should receive no less favorable treatment than products delivered in physical form, and that when domestic regulations affect e-commerce, such regulations should be nondiscriminatory, transparent, and as least trade restrictive as possible. As noted, the section covering digital products[311] addresses the valuation of physically delivered digital products, and assures a zero duty rate on digital products transmitted electronically. Such commitments are expected to facilitate an increase in e-commerce.

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[305] "The U.S.-Australia Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters," Mar. 12, 2004.

[306] U.S. Trade Representative, *2003 National Trade Estimate Report on Foreign Trade Barriers*, and industry representative, telephone interview with Commission staff, Mar. 23, 2004.

[307] "The U.S.-Australia Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters," Mar. 12, 2004.

[308] Industry representative, telephone interview with Commission staff, Mar. 23, 2004.

[309] Generally speaking, electronic commerce and IPR are not considered to be IT services sectors. E-commerce is a methodology—a way to shop. IT services directly related to e-commerce exist, such as developing Web sites that sell products online, however, such activities are not the focus of the Agreement. Similarly, IPR are mentioned within the context of IT services only to the extent that they may profoundly affect trade within an IT sector.

[310] William R. Sweeney, Jr., EDS, Testimony before the Commission, U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects (Inv. No. TA-2104-11), Mar. 30, 2004.

[311] The text covering digital products puts forth the need for predictability in how digital products are treated in terms of trade.

Education Services

The U.S.-Australia FTA provides for the recognition of standards or criteria for authorization, licensing, or certification.[312] Education services trade may be affected, in part, by processes within which development of such standards or criteria may be applied to teachers. U.S. industry sources state that the FTA may ease the provision of U.S. services in grade levels other than primary and may also facilitate negotiations outside the FTA in other education service areas, such as testing services.[313] Two side letters to the FTA state understandings with regard to education services. One letter reinforces the U.S. and Australian governments' understanding that the FTA would not interfere with the ability of an education and training institution to maintain autonomy in admissions policies, including the recognition of credits and degrees; nondiscriminatory accreditation and quality assurance procedures; government funding, subsidies, or grants; and compliance with nondiscriminatory requirements as to the establishment and operation of a facility. The second letter concerns an understanding that the U.S. Government will review and report to the Government of Australia measures affecting cross-border trade in higher education services with regard to transparency in 18 particular U.S. States, to be completed within three years of the FTA's entry into force.

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[312] Article 10.9.

[313] "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC-13)," Mar. 12, 2004, found at Internet address *http://www.ustr.gov/*, retrieved Mar. 16, 2004.

CHAPTER 5
Overview of Investment Provisions and the Potential Effect of the U.S.-Australia FTA

Introduction

This chapter presents a description of the bilateral investment relationship between the United States and Australia, and a discussion of Australia's current investment policies. It then summarizes the major provisions of chapter 11 of the FTA, which is related to investment, and the investment-related aspects of Annexes I - IV of the Agreement. The provisions of chapter 11 specify the rights and privileges of U.S. and Australian investors in the territory of the other party. The annexes contain any exceptions to the more general language found in Chapter 11. This chapter concludes with a discussion of the effects of the FTA's investment provisions on the U.S. economy, taking into account the views of U.S. industry representatives. To the extent possible, this discussion considers the potential effects of implementation of the investment provisions of the FTA on U.S. industries and the U.S. economy as a whole.

U.S.-Australia Investment

Both the United States and Australia already have high standards for the treatment of foreign investors. The Australian economy has traditionally been viewed as welcoming to investment by U.S. firms,[1] and the FTA is expected to preserve the existing, positive investment environment. The United States is Australia's largest source of foreign direct investment;[2] only Japan and Singapore host higher levels of U.S. investment within the Asia-Pacific region.[3] In 2002, the U.S. direct investment position in Australia measured $36.3 billion on a historical-cost basis (figure 5-1 and table 5-1), and generated income of $2.6 billion for U.S. investors.[4] U.S. investment in Australia is divided among a wide range of sectors, with manufacturing accounting for 30 percent, followed by mining (23 percent), and finance and insurance (11 percent) (figure 5-2).

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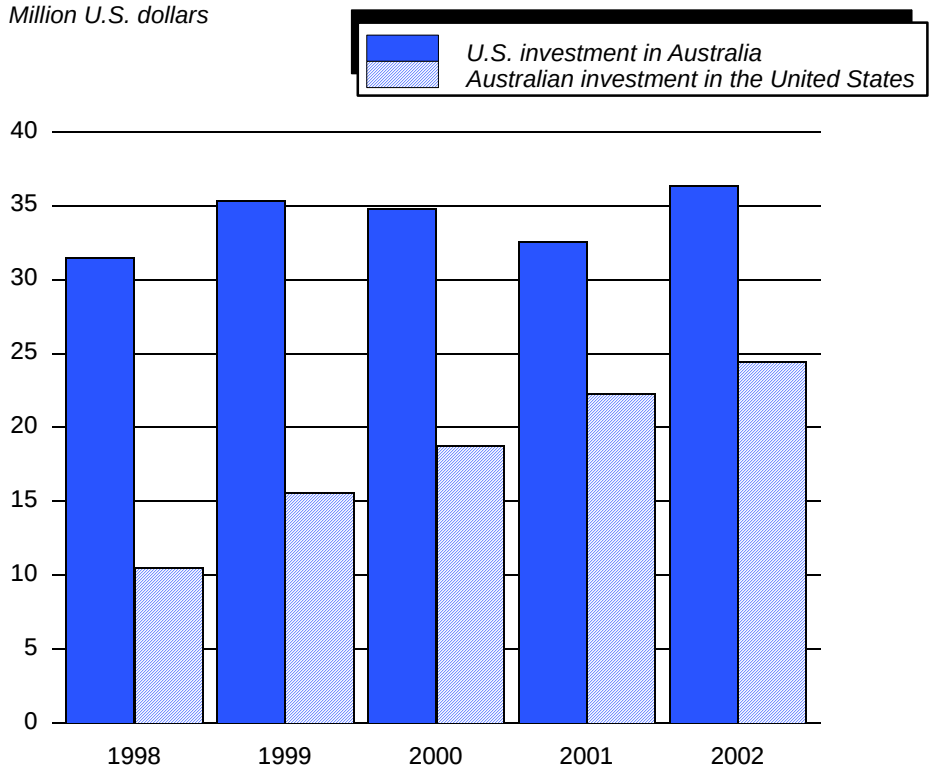
[1] Industry representatives, telephone interviews by USITC staff, Mar. 3-12, 2004; and Emergency Committee for American Trade (ECAT), "ECAT Praises Groundbreaking Tariff Deal in U.S.-Australia FTA," Feb. 13, 2004, found at Internet address *http://ecattrade.org/,* retrieved Mar. 11, 2004.

[2] USDOC, US&FCS, "Australia Country Commercial Guide FY2002," found at Internet address *http://www.stat-usa.gov/mrd.nsf/,* retrieved Feb. 23, 2004.

[3] USDOC, BEA, *Survey of Current Business,* Sept. 2003, p. 144.

[4] USDOC, BEA, *Survey of Current Business,* Sept. 2003, p. 144.

Figure 5-1
U.S. direct investment with Australia, 1998-2002



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 2003, pp. 19 & 144 and Oct. 2002, pp. 64 & 94.

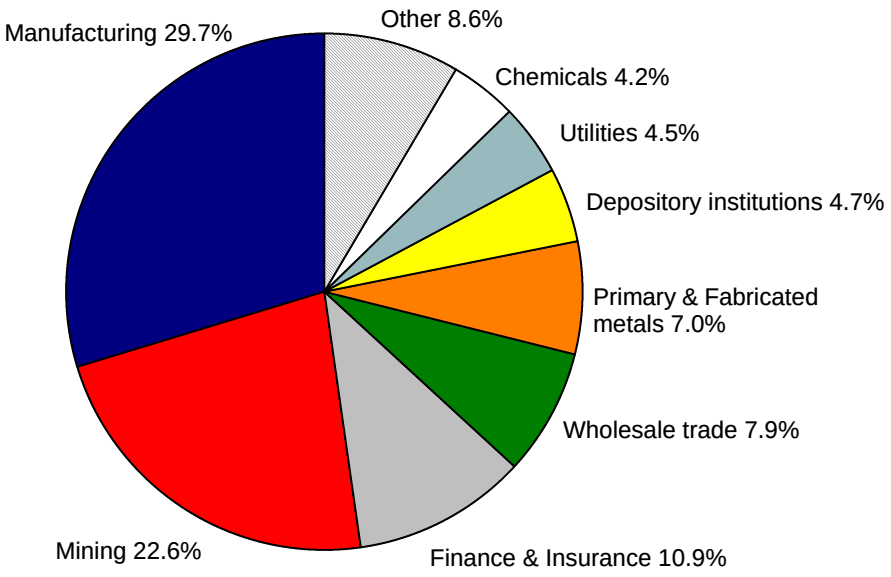
Table 5-1
Foreign direct investment, United States and Australia, 2002

	United States	Australia
Total inbound investment stock (billions of U.S. dollars)	1,351.1	128.7
Inbound investment stock as percentage of GDP	12.9	32.2
Total outbound investment stock (billions of U.S. dollars)	1,501.4	91.2
Outbound investment stock as percentage of GDP	14.4	22.9
Bilateral outbound investment stock (billions of U.S. dollars) . . .	36.3	24.5

Note.—Bilateral outbound investment stock reflects U.S. Government statistics for U.S. outbound direct investment position in Australia on a historical-cost basis, and U.S. inbound direct investment position from Australia on a historical-cost basis.

Sources: UNCTAD, *World Investment Report 2003;* USDOC, BEA, *Survey of Current Business,* Sept. 2003.

Figure 5-2
U.S. direct investment in Australia, 2002



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business,* Sept. 2003, p. 121

As of 2001, U.S. residents controlled about 3,400 operating businesses in Australia, with total employment of 331,000 workers, responsible for approximately $2.3 billion in gross fixed capital formation, and $18.8 billion in value added.[5] Table 5-2 illustrates the sectoral diversity of existing U.S.-owned affiliates in Australia as of June 2001. Wholesale trade services was the single service industry which accounted for the largest number of U.S.-owned affiliates in Australia, followed by affiliates in the manufacturing and financial services sectors. Manufacturing comprised the greatest share of industry value added, followed by mining.[6]

Australia ranks eleventh as a source of foreign direct investment in the United States, and the second most important source from the Asia-Pacific region, after Japan.[7] Australian investment in the United States was valued at $24.5 billion in 2002, with the

[5] Australia Bureau of Statistics (ABS), "Economic Activity of Foreign Owned Businesses in Australia," Jan. 9, 2004, found at Internet address *http://www.abs.gov/au/ausstats*, retrieved May 3, 2004. Conversion into U.S. dollars calculated by the Commission.

[6] Australian Bureau of Statistics, "Economic Activity of Foreign-Owned Businesses in Australia," found at Internet address *http://www.abs.gov.au/ausstats/,* retrieved Mar. 10, 2004.

[7] USDOC, BEA, *Survey of Current Business,* Sept. 2003, p. 69.

Table 5-2
U.S. investment in Australia, by sector, FY 2000-2001

Industry	Number of affiliates	Employment	Affiliates' gross fixed capital formation	Affiliates' industry value added
	Estimate only	*Thousands*	*Millions of U.S. dollars*	
Mining	60	6.4	777.3	3,543.9
Manufacturing	373	89.2	629.9	5,872.4
Electricity, gas, and water supply	10	2.6	105.3	715.2
Construction	10	8.3	8.3	352.3
Wholesale trade	949	36.8	111.9	2,151.2
Retail trade	33	39.1	73.7	853.7
Hotels and restaurants	35	8.1	9.4	156.2
Transport, storage, and communication	31	6.5	233.2	435.4
Finance and insurance	308	22.9	NA	NA
Other services	1,630	111.1	1,192.2	3,977.2
All industries[2]	3,439	331.0	2,279.2	18,786.7

[1] Excludes value for cultural, recreational, and personal services, which is not available.

[2] Excludes agriculture, forestry, and fishing. Data originally presented in Australian dollars. Calculation of exchange rates by the Commission.

Source: Australian Bureau of Statistics, "Economic Activity of Foreign Owned Businesses in Australia."

largest shares in manufacturing (14 percent); real estate, rental, and leasing (11 percent); and finance and insurance (6 percent), generating income of $749 million for Australian investors.[8]

Current Investment Policies of Australia

Under the Foreign Acquisitions and Takeovers Act of 1975 and related regulations, foreign investment in Australia is subject to screening by the Foreign Investment Review Board (FIRB). Approval is required for acquisitions valued at A$50 million (US$27.7 million) or greater, and new business establishments of A$10 million (US$5.5 million) or greater, with approval to be granted as long as the proposed investment passes a national interest test. Direct investments by foreign governments or their agencies, or by foreign private investors in the banking, media (broadcasting and newspapers), telecommunications, air transport, shipping, and urban residential real estate sectors, must apply for FIRB approval regardless of size, and investment in these service sectors

[8] USDOC, BEA, *Survey of Current Business,* Sept. 2003, p. 69.

is subject to minority-share equity limits.[9] In the five years preceding the FTA, the FIRB approved all but four investment proposals, out of a total 2,285 applications. The majority of these applications were decided quickly; 93 percent of all applications were approved within 30 days.[10] U.S. investors report no problems with overseas investment or capital repatriation, and acquisitions of domestic firms are generally approved without problems.[11]

Nonconforming Measures of the Agreement

This section provides additional background information on certain investment provisions of the U.S.-Australia FTA that is useful to the analysis of the impact of the Agreement on the United States.[12] The investment chapter of the FTA contains many provisions similar to those in the investment chapters of previous bilateral FTAs, including the agreements concluded with Chile and Singapore. The chapter contains provisions for the treatment of existing or future measures that are inconsistent with certain disciplines (specifically, those concerning nondiscrimination, performance requirements, and senior personnel). Existing measures maintained at the central or regional government level are exempted from these disciplines provided that they are described in Annex I of the Agreement. Reservations to ensure that a party maintains flexibility to impose measures in the future that may be inconsistent with these disciplines are described in Annex II. Nonconforming measures at the local government level are simply exempted without requiring any notation in an annex. The actual content of these reservations varies widely. Some reservations are horizontal in nature, meaning that they address general policy provisions that affect all investments, whereas others apply to specific industry segments.

Australia's horizontal reservations under Annex I address existing nonconforming measures at the regional government level, and the investment notification requirements under the FIRB. The reservation lists the threshold over which investments must be notified to and approved by the FIRB, including the new threshold of A$800 million (US $443.2 million) for many investments – a level that applies to U.S. investors specifically as a result of the FTA. Australia's horizontal reservations listed under Annex II include a measure permitting Australia to adopt measures that favor

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[9] Australian Government, The Treasury, Foreign Investment Policy Division, "Summary of Australia's Foreign Investment Policy," May 2000, found at Internet address *http://www.firb.gov/au/content/_downloads/policysummary.pdf,* retrieved Mar. 12, 2004; and USDOC, US&FCS, "Australia Country Commercial Guide FY2002," found at Internet address *http://www.stat-usa.gov/mrd.nsf/,* retrieved Feb. 23, 2004.

[10] Letter from the Australian Trade Minister to the U.S. Trade Representative, Exchange of Letters on the FIRB, side letter to the U.S.-Australia FTA, Draft, Mar. 1, 2004, found at Internet address *http://www.ustr.gov/,* retrieved Mar. 8, 2004.

[11] USDOC, US&FCS, "Australia Country Commercial Guide FY2002," found at Internet address *http://www.stat-usa.gov/mrd.nsf/,* retrieved Feb. 23, 2004.

[12] A summary of the provisions of the U.S.-Australia FTA is provided in Chapter 2.

indigenous persons or organizations, and a measure that permits Australia to adopt future measures at the federal or regional levels of government that are not inconsistent with its market access obligations under GATS Article XVI. Other horizontal reservations in Annex II refer to foreign investment proposals regarding urban land, and the MFN obligations of Australia with regard to non-U.S. foreign investors, particularly in the areas of aviation, fisheries, or maritime matters, including salvage.

Horizontal reservations taken by the United States under Annex I address the programs of the Overseas Private Investment Corporation and the registration of public offerings of securities, as well as existing nonconforming measures at the state level. Horizontal reservations listed by the United States under Annex II include a reservation that preserves the United States' rights to adopt any measure regarding cross-border services trade or establishment of a service enterprise, so long as it is consistent with obligations undertaken in the GATS. Annex II of the FTA also contains a horizontal U.S. reservation for measures that accord preferential treatment to countries under bilateral or multilateral international agreements that have been signed prior to the entry into force of the U.S.-Australia FTA, including international agreements involving aviation, fisheries, or maritime matters. Annex III contains reservations related to financial services excluding insurance, and Annex IV contains reservations related to financial services including insurance.

The specific sectors for which reservations are listed in Annexes I, II, III, and IV are presented in table 5-3 without attempting to characterize the actual substance of the reservations. In many cases, the reservation represents a measure that imposes a potential constraint on foreign investment that may or may not have any significant bearing on the activities of foreign investors. Consequently, the inclusion of a sector in the annex should not be interpreted to mean that the sector as a whole has been exempted from coverage under the investment disciplines.

Potential Effects on the U.S. Economy

The markets in both the United States and Australia are substantially open to foreign direct investment under current policies. Therefore, according to several U.S. industry representatives, the U.S.-Australia FTA is not expected to have a significant impact on the level of U.S. direct investment in Australia, or the level of Australian direct investment in the United States. The U.S. business community has stated that it supports the agreement's investment provisions insofar as they expand market access and incorporate high standards of protection for investment.[13]

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[13] Industry representatives, telephone interviews by USITC staff, Mar. 3-12, 2004; Emergency Committee for American Trade (ECAT), "ECAT Praises Groundbreaking Tariff Deal in U.S.-Australia FTA," Feb. 13, 2004, found at Internet address *http://ecattrade.org/,* retrieved Mar. 11, 2004; and "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC-13), Mar. 12, 2004, found at Internet address *http://www.ustr.gov/,* retrieved Mar. 16, 2004.

Table 5-3
Industry sectors subject to nonconforming measures in the U.S.-Australia FTA

Australia		United States	
Current measures	**Potential measures**	**Current measures**	**Potential measures**
Information and communications technology		Communications: Radio	Communications
Transportation services: Air and maritime	Transportation services: Air, maritime	Transportation services: Air transportation	Transportation services: Maritime
Banking		Banking	
	Insurance	Insurance	Insurance
	Social services		Social services
Audiovisual services: Broadcasting	Audiovisual services: broadcasting, film and television production		
Advertising services	Advertising services		
Fishing	Education services: Primary education	Atomic energy	
Distribution services		Mining	
Telecommunications		Customs brokerage	
Newspapers			
Health care			

Note.—Nonconforming measures are found in Annexes I through IV of the FTA. Annex I contains reservations for cross-border services, excluding financial services, to preserve existing measures that are inconsistent with the disciplines concerning nondiscrimination, performance requirements, and senior personnel. Annex II contains reservations for cross-border services, excluding financial services, to ensure that a party maintains flexibility to impose measures in the future that may be inconsistent with the disciplines of the FTA. Annex III contains both existing and future nonconforming measures related to financial services excluding insurance. Annex IV contains both existing and future nonconforming measures related to insurance services.

Source: Text of the U.S.-Australia FTA, Annex I, Annex II, Annex III, and Annex IV, found at *www.ustr.gov.,* retrieved March 16, 2004.

The U.S. business community would have preferred that the FTA include an "investor-state" dispute resolution mechanism.[14] Industry representatives view this as a significant shortcoming of the agreement, and an important step back from previous FTAs and Bilateral Investment Treaties (BITs) concluded by the United States.[15] U.S. industry representatives note that they are not concerned with current Australian

[14] Under an "investor-state" mechanism, foreign investors may settle investment disputes through arbitration directly with the host country government.

[15] Industry representatives, telephone interviews by USITC staff, Mar. 3-12, 2004; Emergency Committee for American Trade (ECAT), "ECAT Praises Groundbreaking Tariff Deal in U.S.-Australia FTA," Feb. 13, 2004, found at Internet address *http://ecattrade.org/,* retrieved Mar. 11, 2004; and "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC-13), Mar. 12, 2004, found at Internet address *http://www.ustr.gov/,* retrieved Mar. 16, 2004.

Government policies, but that the FTA does not give them any recourse to enforce the provisions of the Agreement if current policies should change in a manner contrary to the interests of U.S. investors.[16]

U.S. industry representatives would also have preferred to discontinue the investment screening performed by Australia's FIRB. However, the minimum size of most foreign investments that require screening has been substantially raised.[17] In general, U.S. investors in Australia must notify the Australian Government (through the FIRB) of investments only if an investment is valued at more than A$800 million (US $443.2 million).[18] The previous investment threshold was A$50 million (US $27.7 million). The new higher limit applies to investments in most sectors, but does not include the media; telecommunications or transport sectors; defense-related sectors; and the extraction of uranium or plutonium, or operation of nuclear facilities.[19] Industry representatives have stated that the higher limits are an improvement in the investment approval process, particularly when combined with the market access provisions of the FTA, which are expected to create significant market liberalization. However, representatives expressed disappointment at the sectoral exclusions, particularly in the media and telecommunications industries.[20] Industry representatives indicate that due to Australia's fairly liberal existing investment regime, they have been free to invest in most industries despite FIRB screening, and that is not expected to change.[21]

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[16] Industry representatives, telephone interviews with USITC staff, Feb. 26, Mar. 9, and Mar. 11, 2004.

[17] Industry representatives, telephone interviews by USITC staff, Mar. 3-12, 2004; and "The U.S.-Australia Free Trade Agreement (FTA): Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC-13), Mar. 12, 2004, found at Internet address *http://www.ustr.gov/,* retrieved Mar. 16, 2004.

[18] Non-U.S. investors remain subject to the existing A$50 million investment screening limit.

[19] As noted above, investments of any size in the media sector, and investments valued at more than A$50 million in the telecommunications, transport, defense-related, uranium or plutonium extraction, or nuclear facilities-related sectors remain subject to FIRB approval. U.S.-Australia FTA, Draft Text, Mar. 1, 2004, Annex I.

[20] Industry representatives, telephone interviews with USITC staff, Feb. 26, Mar. 9, and Mar. 11, 2004.

[21] Industry representatives, telephone interviews by USITC staff, Mar. 9-11, 2004.

CHAPTER 6
Review of the Intellectual Property Provisions and the Potential Effect of the U.S.-Australia FTA

This chapter analyzes the economic effects of the intellectual property rights (IPR) provisions of the U.S.-Australia FTA (Chapter 17). In general, Australia is considered to have a strong IPR regime.[1] Although U.S. industry representatives have expressed concerns about certain remaining IPR issues in Australia, the FTA addresses almost all of these.[2] The increased level of protection afforded to IPR holders by the FTA likely would result in increased revenues for U.S. industries dependent on copyrights, trademarks, patents, and trade secrets. However, due to the small size of Australia's economy compared to that of the United States,[3] any increases in revenues for the U.S. IPR industry likely would have small effects on the U.S. industry and economy. Further, there would be little, if any, effect on U.S. industries or the U.S. economy based on United States implementation of its FTA obligations. The following sections of this chapter describe the current status of IPR protection in Australia, summarize key provisions of the FTA related to IPR, and describe the potential effects of implementation of IPR provisions in the FTA on U.S. industries and the U.S. economy as a whole.

Current Conditions of IPR Protection in Australia

According to U.S. industry and government officials, Australia has a strong IPR regime providing protection for copyrights, trademarks, patents, trade secrets, and other intellectual property.[4] As a member of the WTO, Australia has assumed obligations

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[1] Hearing transcript at pp. 71 and 193; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[2] Hearing transcript at pp. 181, 182, and 197; Industry Functional Advisory Group (IFAC-3) on Intellectual Property Rights for Trade Policy Matters, *The U.S.-Australia Free Trade Agreement (FTA): The Intellectual Property Provisions*, Mar. 12, 2004, pp. 1-22, found at *http://www.ustr.gov*, retrieved Mar. 17, 2004; and Industry Sector Advisory Committee for Chemicals and Allied Products (ISAC-3), "Chapter 17: Intellectual Property," *The U.S.-Australia Free Trade Agreement (FTA),* Mar. 12, 2004, pp. 9-10, found at *http://www.ustr.gov*, retrieved Mar. 22, 2004.

[3] Central Intelligence Agency (CIA), *CIA Factbook*, "United States," "Australia," found at *http://www.cia.gov*, retrieved Mar. 1, 2004.

[4] Hearing transcript at pp. 71 and 193; International Intellectual Property Alliance (IIPA), Letter dated Jan. 21, 2003 from Steven J. Metalitz, Senior Vice President, IIPA, to Chairman, Trade Policy Staff Committee, Regarding 2004 National Trade Estimate Report on Foreign Trade Barriers, 68 Fed. Reg. 62159 (Oct. 31, 2003), pp. 1-3, found at *http://www.iipa.com*, retrieved Feb. 24, 2004; U.S. Chamber of Commerce, "Testimony - U.S.-Australian Free Trade Agreement," *Press Release*, Feb. 6, 2003, p. 3, found at *http://www.uschamber.com*, retrieved Feb. 24, 2004; U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004; and Nasir Abbasi, U.S. & Foreign Commercial Service (US&FCS) and U.S. Department of State, "Australia Country Commercial Guide 2004," *US&FCS Market Research Reports*, July 22, 2003, Ch. 7, pp. 73-74.

under the WTO Agreement on Trade-Related Aspects of International Property Rights (TRIPs). Nevertheless, U.S. companies indicate that there still is room for improvement in Australia's IPR regime, including enactment of legislation to improve Internet and other digital piracy.[5] In this regard, U.S. government and industry officials indicate that Australia's regime could be improved significantly[6] if the country adopted a number of provisions addressing digital piracy[7] found in the World Intellectual Property Organization (WIPO) Copyright Treaty (WCT) and the WIPO Performances and Phonograms[8] Treaty (WPPT) (see text box 6-1).[9] Australia has not yet signed either, unlike the United States and a number of its other trading partners, which have signed both.[10] Finally, U.S. government and industry officials cite remaining concerns with Australia in the areas of copyright infringement; satellite signal, patent, trademark, and trade secret protection; as well as IPR enforcement.

Copyrights, Trademarks, and Satellite Program Signals

Despite acknowledgment by U.S. industry representatives that Australia has a strong copyright and trademark protection regime,[11] they identify several areas of concern in that country, including importation of piratical and counterfeit[12] video cassettes and digital video discs[13] (DVDs),[14] and other digital, including Internet, piracy.[15] Australia

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[5] U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[6] Motion Picture Association of America (MPAA), "Australia," *Motion Picture Association - 2004 Trade Barriers Report*, 2004, p. 330; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[7] Piracy is a term used to refer to copyright infringement.

[8] Phonograms are sound recordings.

[9] These two treaties are often referred to as the "Internet Treaties" because they provide new international standards for the protection of copyrights and related rights in the digital economy. The United States ratified each treaty and implemented them domestically via the Digital Millennium Copyright Act of 1998.

[10] U.S. industry representatives, in-person and telephone interviews by USITC staff, Washington, DC, Jan.-Apr. 2004.

[11] International Intellectual Property Organization (IIPA), letter dated Jan. 21, 2003, from Steven J. Metalitz, Senior Vice President, IIPA, to Chairman, Trade Policy Staff Committee, Regarding 2004 National Trade Estimate Report on Foreign Trade Barriers, 68 Fed. Reg. 62159 (Oct. 31, 2003), pp. 1-3; found at *http://www.iipa.com*, retrieved Feb. 24, 2004; U.S. Chamber of Commerce, "Testimony–U.S.-Australian Free Trade Agreement," *Press Release*, Feb. 6, 2003, p. 3, found at *http://www.uschamber.com*, retrieved Feb. 24, 2004; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[12] Counterfeiting is a term used to refer to the unauthorized use of a representation or copy of a trademark or service mark, although it is sometimes used to refer to an unauthorized copy of a protected product. In addition to counterfeiting of the packaging, appearance, symbols, and other trademark features of entertainment products contained on such media as video cassettes, CDs and DVDs, such counterfeiting can also affect a broad range of products from a number of industries, including apparel, leather goods, toys, cigarettes, pharmaceuticals, beverages, and auto parts.

[13] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004.

[14] Also known as digital versatile discs.

[15] U.S. industry representatives report that as more Australian consumers obtain computers, "peer-to-peer" piracy, including Internet file sharing, is growing, as "consumers are freely trading billions of dollars of content for free." Hearing transcript at pp. 221 and 224; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

Text box 6-1
The WIPO Internet Treaties

The WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT) are often referred to as the "Internet Treaties" because they provide new international standards for the protection of copyrights and related rights in the digital economy. The two treaties entered into force on March 6 and May 20, 2002, respectively, once the required minimum 30 countries had ratified each.

The WCT provides that traditional means for copyright protection (for such products as books, movies, and software) should apply to works transmitted on the Internet or otherwise using digital media, technology, protections.

The WPPT similarly provides intellectual property protections to producers of sound recordings, as well as performers, with respect to works on the Internet or in connection with use of digital technology and media.

Both treaties clarify that traditional rights of reproduction continue to apply in the digital environment, including the storage of material in digital form in an electronic medium.

The treaties establish the right holders' right to maintain control of their works over the Internet and across other digital transmission media.

The treaties ensure that right holders can use digital rights management technology to protect their rights on the Internet. The treaties' anti-circumvention provisions address security and intellectual property infringement risks by requiring that signatories provide minimum levels of legal protection, including civil and criminal penalties, sufficient to deter the unauthorized circumvention of technical protective measures.

Another provision in the treaties requires signatory countries to prohibit the intentional modification or removal of digital rights management information. This includes prohibitions against interfering with information and data that can be incorporated into the digital code of a protected work and used "to identify the work, its author, performer or owner, the terms and conditions for its use, and any other relevant attributes."

Australia has not yet ratified either of these treaties, while the United States has ratified both. The United States implemented the treaties domestically via the Digital Millennium Copyright Act of 1998.

Sources: Adapted, and parts excerpted, by USITC staff from information provided in the following sources: Chris Gibson, Steptoe & Johnson, LLP, *WIPO Internet Copyright Treaties Coming Into Force*, 2002, found at *http://www.steptoe.com*; and World Intellectual Property Organization (WIPO), "WIPO Copyright Treaty (adopted in Geneva on Dec. 20, 1996)" and "WIPO Performances and Phonograms Treaty (WPPT) (adopted in Geneva on Dec. 20, 1996)," found at *http://www.wipo.org*; retrieved Mar. 29, 2004.

also allegedly allows the parallel importation[16] of goods that are produced for other markets.[17] For instance, Australian entities have copied videocassettes from DVDs programmed for use only in North America[18] allegedly infringing both copyrights and trademarks of U.S. companies.[19] This permits the importation of new entertainment videos and recordings[20] to be sold in Australia before the official release date for such media in that area.[21]

Meanwhile, movie producers indicate that installation of digital technology circumvention tools in DVD players in Australia enables copyright and trademark infringers to produce and distribute videocassettes and DVD recordings of movies in Australia not only several months prior to their scheduled release in that country, but sometimes even before the movie is scheduled to play for the first time in Australian theaters.[22] The U.S. entertainment industry also has expressed concerns about abuses in Internet-delivered programming and theft of movies and television programming through circumvention of encrypted satellite signals.[23] Australian legislation currently does not provide for criminal or civil actions against end-users for the unlawful decoding of encrypted program-carrying television signals.[24]

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[16] Motion Picture Association of America (MPAA), "Anti-Piracy," [undated], p. 6, found at *http://www.mpaa.org*, retrieved Apr. 2, 2004.

[17] Motion Picture Association of America (MPAA), "Australia," *Motion Picture Association - 2004 Trade Barriers Report*, 2004, p. 327; United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[18] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004.

[19] Copyright piracy and trademark counterfeiting can occur with reference to the same product. For example, "videocassette piracy is the illegal duplication, distribution, rental or sale of copyrighted videocassettes." Such "pirate product [s] [are] often packaged in counterfeit videocassette boxes that resemble legitimate packaging." Motion Picture Association of America (MPAA). Anti-Piracy [undated], pp. 1-7, found at *http://www.mppa.org,* retrieved Apr. 2, 2004.

[20] Motion Picture Association of America (MPAA), "Anti-Piracy," [undated], p. 6, found at *http://www.mpaa.org*, retrieved Apr. 2, 2004.

[21] According to U.S. government officials, until 1998, except in limited cases with respect to books, Australian law prohibited importation of copyrighted products without a license from the copyright owner. However, in 1998, "Australia adopted legislation" removing the restrictions on parallel imports of sound recordings, "then books, periodicals, sheet music, enhanced CDs, computer software, and some electronic games" in 2003. Nasir Abbasi, U.S. & Foreign Commercial Service (US&FCS) and U.S. Department of State, "Australia Country Commercial Guide 2004," *US&FCS Market Research Reports*, July 22, 2003, Ch. 7, pp. 73-74.

[22] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Apr. 2003, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 20, 2004; and U.S. industry representatives, telephone interviews by USITC staff, Jan.-Apr. 2004.

[23] Motion Picture Association of America (MPAA), "2003 Australia Piracy Fact Sheet," *MPA Worldwide Market Research*, Dec. 2003, pp. 1-2, found *at http://www.mpaa.org*, retrieved Feb. 24, 2004; MPAA, "Statement on the US-Australia Free Trade Agreement," *Press Release*, Feb. 9, 2004, p. 1, found at *http://www.mpaa.org*, retrieved Feb. 24, 2004; and U.S. copyright industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[24] Economic (CIE), *Economic Analysis of AUSFTA*, (Canberra and Sydney, Australia=CIE, April 2004), pp. 34 and 35.

Patents and Trade Secrets

According to U.S. industry representatives, Australia has a strong overall patent and trade secret protection regime.[25] Nevertheless, there remain lingering problems in both of these areas. U.S. industry and government trade officials are especially concerned that the Australian Government may allow domestic drug producers to conduct trials and produce generic equivalents of patented pharmaceuticals prior to the expiration of the patent holders' rights to the legally sold drugs.[26] This would permit domestic producers' drugs to obtain Australian regulatory marketing approval in advance of patent expiration so that generic equivalents could be sold immediately once the patent had expired occurred.[27] According to the industry representatives, allowing such "spring boarding"[28] would allow Australian companies to manufacture generic equivalents of patented drugs "for export in violation of TRIPs Article 28."[29]

The U.S. industry also criticizes the lack of linkage between Australia's patent office and health care regulatory body, which could result in marketing approval being provided to patent infringing products.[30]

The U.S. agricultural and veterinary chemical industries have expressed concerns regarding unauthorized disclosure of their confidential trade secret information, such as safety and test data. U.S. firms are required to submit such data to government agencies in support of their applications for marketing their products in Australia. Although legislation was enacted in Australia in 1999 to provide five years of protection of test data for the evaluation of new active constituents for agricultural and veterinary chemical products,[31] U.S. Government trade officials state that "Australia does not yet have a system to provide protection for agricultural chemicals,"[32] thus

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[25] Pharmaceutical Research and Manufacturers of America (PhRMA), "Australia," *National Trade Estimate Report on Foreign Trade Barriers (NTE) 2004*, Report to USTR, Dec. 12, 2003, pp. 5-7, found at *http://www.phrma.org*, retrieved Feb. 24, 2004; and U.S. industry representatives, interview by USITC staff, Washington, D.C., Feb. 25, 2004.

[26] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004; and U.S. pharmaceutical industry representatives, interview by USITC staff, Feb. 25, 2004.

[27] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004; and U.S. pharmaceutical industry representatives, interview by USITC staff, Feb. 25, 2004.

[28] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004.

[29] Such exports could also be in violation of the "The WTO Appellate Body's decision in Canada – Term of Patent Protection (AB-1998-3) that struck down a similar Canadian Scheme." Pharmaceutical Research and Manufacturers of America (PhRMA), "Australia," *National Trade Estimate Report on Foreign Trade Barriers (NTE) 2004*, Report to USTR, Dec. 12, 2003, pp. 5-7, found at *http://www.phrma.org*, retrieved Feb. 20, 2004.

[30] Pharmaceutical Research and Manufacturers of America (PhRMA), "Australia," *National Trade Estimate Report on Foreign Trade Barriers (NTE) 2004*, Report to USTR, Dec. 12, 2003, pp. 5-7, found at *http://www.phrma.org*, retrieved Feb. 20, 2004.

[31] Nasir Abbasi, U.S. & Foreign Commercial Service (US&FCS) and U.S. Department of State, "Australia Country Commercial Guide 2004," *US&FCS Market Research Reports*, July 22, 2003, Ch. 7, pp. 73-74.

[32] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Apr. 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004.

limiting the effectiveness of the 1999 legislation; however, such protection is expected to be in place in the near future.[33]

Enforcement

Although Australia's IPR laws are generally comprehensive, U.S. industry representatives argue that, in practice, enforcement at the Australian Federal and State levels requires strengthening.[34] Major problems have been judicial interpretation in State courts and "positions taken by the Australian Federal Police not to pursue criminal prosecution where civil remedies are available,"[35] which have weakened the deterrent effect of IPR enforcement policies.[36] The U.S. copyright industry asserts that the Australian Government needs to make enforcement of copyright protection a higher priority at both the State and Federal levels.[37] That industry further contends that the Australian Government also needs to encourage its judicial system to impose criminal sentences, which provide a greater deterrent than civil penalties accomplish.[38] U.S. industry representatives further assert that Australian customs resources need to be increased for effective border enforcement against imports of copyright and trademark infringing goods, such as pirated DVDs, CDs, and other recordings, and those bearing counterfeit marks, such as apparel, footwear, jewelry, cigarettes, and toys, imported primarily from Asian countries.[39]

Major Achievements in IPR Protection of the U.S.-Australia FTA

The U.S.-Australia FTA reaffirms the rights and obligations set forth in TRIPs, to which both the United States and Australia are bound. However, the FTA goes further than TRIPs by (1) increasing protection of copyrights and trademarks in light of advances in

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[33] U.S. industry representatives, telephone interviews by USITC staff, Feb.-Apr. 2004.

[34] United States Trade Representative (USTR), *2004 National Trade Estimate Report on Foreign Trade Barriers*, Apr. 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 20, 2004; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004. Australia has not enacted legislation necessary to accede to the 1996 WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty

[35] United States Trade Representative (USTR), *2003 National Trade Estimate Report on Foreign Trade Barriers*, Apr. 2003, pp. 10-11, found at *http://www.ustr.gov*, retrieved Feb. 20, 2004; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[36] U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[37] Motion Picture Association of America (MPAA), "Australia," *Motion Picture Association – 2004 Trade Barriers Report*, 2004, p. 328; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Apr. 2004.

[38] International Intellectual Property Alliance (IIPA), letter dated Jan. 21, 2003 from Steven J. Metalitz, IIPA, to Ms. Carmen Suro-Bredie, Chairman, Trade Policy Staff Committee, Office of the United States Trade Representative, p. 2, found at *http://www.iipa.com*, retrieved Feb. 23, 2004.

[39] Motion Picture Association of America (MPAA), "2003 Australia Piracy Fact Sheet," *MPAA Worldwide Market Research*, Dec. 2003, pp. 1-2, found at *http://www.mpaa.org*, retrieved Feb. 23, 2004; and U.S. industry representatives, in-person and telephone interviews by USITC staff, Jan.-Feb. 2004.

digital technology; (2) extending the terms of protection for copyrights, trademarks, patents, and trade secrets; and (3) increasing IPR enforcement for piracy and counterfeiting.[40]

Copyrights, Trademarks, and Satellite Program Signals

According to U.S. industry representatives, an important accomplishment of the U.S.-Australia FTA is that it addresses Internet and other digital piracy[41] by requiring Australia "to ratify or accede to the [WIPO Internet Treaties] by the date of entry into force" of the FTA.[42] In this regard, the FTA provides strict legal protections and remedies against the circumvention of technological measures used by copyright holders to prevent piracy and unauthorized distribution of copyrighted materials over the Internet.[43] Further, the FTA provides that only copyright owners have the right to make their works available online. Such copyright holders retain all rights to copies, including temporary copies, of their works on computers and networks, which precludes unauthorized sharing of copyrighted material (including music, videos, software, and text) on the Internet.[44] In addition, the FTA clarifies the extent to which liability accrues to Internet service providers for copyright infringement by their subscribers.[45] Also, protection for encrypted program-carrying satellite signals is provided to both the signals and the programming, in order to deter piracy of satellite

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[40] Motion Picture Association of America (MPAA), "Statement on the US-Australia Free Trade Agreement," *Press Release*, Feb. 9, 2004, p. 1, found at *http://www.mpaa.org*, retrieved Feb. 24, 2004; U.S. copyright industry representatives, in-person and telephone interviews by USITC staff, Jan.-Feb. 2004; United States Trade Representative (USTR), "Free Trade 'Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov*, retrieved Feb. 24, 2004; United States Trade Representative (USTR) *2004 National Trade Estimate Report on Foreign Trade Barriers*, Mar. 31, 2004, pp. 13-14, found at *http://www.ustr.gov*, retrieved Apr. 2, 2004; Australian Department of Foreign Affairs and Trade, "Australia-United States Free Trade Agreement," *Media Release*, Feb. 8, 2004, p, 1, found at *http://www.dfat.gov.au*, retrieved Feb. 23, 2004; and Albert Yuen, "Australia US Free Trade Agreement–IP Implications," *Country File: Australia* (Sydney, Australia: Coudert Brothers, Global Legal Advisers, Mar. 2004), p. 57, found at *http://www.coudert.com*, retrieved Mar. 10, 2004.

[41] Hearing transcript at pp. 183 and 199.

[42] Industry Functional Advisory Group (IFAC-3) on Intellectual Property Rights for Trade Policy Matters, *The U.S.-Australia Free Trade Agreement (FTA): The Intellectual Property Provisions*, Mar. 12, 2004, pp. 8-10, found at *http://www.ustr.gov*, retrieved Mar. 17, 2004; International Intellectual Property Alliance, written statement to Secretary, U.S. International Trade Commission, Mar. 22, 2004, p. 2; and U.S. copyright industry representatives, in-person and telephone interviews by USITC staff, Jan.-Feb. 2004.

[43] Hearing transcript at pp. 183, 214, and 241; and United States Trade Representative (USTR), "Free Trade 'Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 20, 2004.

[44] International Intellectual Property Alliance, written statement to Secretary, U.S. International Trade Commission, Mar. 22, 2004, p. 2.

[45] Albert Yuen, "Australia US Free Trade Agreement–IP Implications," *Country File: Australia* (Sydney, Australia: Coudert Brothers, Global Legal Advisers, Mar. 2004), p. 57, found at *http://www.coudert.com*, retrieved Mar. 10, 2004.

television programming.[46] To reinforce this provision, both Australia and the United States affirmed in the FTA that they had "ratified or acceded to" the 1974 Brussels Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite.[47] The FTA also requires government involvement related to unauthorized use of trademarked names by non-right holders in Internet domain names.[48]

The FTA extends copyright terms of protection beyond those required by TRIPs[49] and under current Australian law.[50] Under the FTA, in instances where the term of protection of a work (including a photographic work), performance, or phonogram is to be calculated on the basis of a person's life, the term shall be not less than the life of the author and 70 years after the author's death. There are no corresponding terms of protection based on the life of the author explicitly provided for in TRIPs. However, by reference to the Berne Convention, the term of protection in TRIPs is life of the author and 50 years after his or her death.[51] In cases where the term of protection of a work is to be calculated on a basis other than the life of a person, the term in the FTA is 70 years from the end of the calendar year of the first authorized publication of the work. The comparable period of protection in TRIPs is 50 years and does not apply to photographic works. Finally, if there is no such authorized publication within 50 years from the creation of a work, performance, or phonogram, the FTA term of protection is to be not less than 70 years from the end of the calendar year of the creation of the work. Again, the comparable period of protection in TRIPs is 50 years and does not apply to photographic works.

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[46] Hearing transcript at p. 214; and United States Trade Representative (USTR), "Free Trade $Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 20, 2004.

[47] U.S.-Australia FTA Article 17.1 2. (b).

[48] Article 17.3 of the FTA provides, among other things, that each party "shall require that the management of the country-code top-level domain (ccTLD) provide appropriate procedures for the settlement of disputes, based on the principles established in the Uniform Domain-Name Dispute-Resolution Policy (UDRP), in order to address the problem of trademark cyber-piracy."

[49] Hearing transcript at p. 183; Australian Department of Foreign Affairs and Trade, "Australia-United States Free Trade Agreement," *Media Release*, Feb. 8, 2004, p. 1, found at *http://www.dfat.gov.au*, retrieved Feb. 23, 2004; and Albert Yuen, "Australia US Free Trade Agreement – IP Implications," *Country File: Australia* (Sydney, Australia: Coudert Brothers, Global Legal Advisers, Mar. 2004), p. 57, found at *http://www.coudert.com*, retrieved Mar. 10, 2004.

[50] According to Australian legal professionals, copyright protection in Australia currently is "life of the author plus 50 years for copyrighted works, including phonograms." Albert Yuen, "Australia US Free Trade Agreement – IP Implications," *Country File: Australia* (Sydney, Australia: Coudert Brothers, Global Legal Advisers, Mar. 2004, p. 57, found at *http://www.coudert.com*, retrieved Mar. 10, 2004. Also see Nasir Abbasi, U.S. & Foreign Commercial Service (US&FCS) and U.S. Department of State, "Australia Country Commercial Guide 2004," *US&FCS Market Research Reports*, July 22, 2003, Ch. 7, pp. 73-74; and Centre for International Economics (CIE), *Economic Analysis of AUSFTA*, (Canberra and Sydney, Australia=CIE, April 2004), pp. 35-37.

[51] Although the term of protection based on the life of a natural person is not specifically stated in the WTO TRIPs agreement, Article 9 of that agreement specifies that WTO members shall comply with Articles 1-21 of the Berne Convention for the Protection of Literary and Artistic Works (1971). Article 7 of the Berne Convention provides that "the term of protection granted by this Convention shall be the life of the author and fifty years after his death." For more information on the Berne Convention, see *http://www.wipo.org*.

Patents and Trade Secrets

The FTA also extends patent and trade secret protections beyond TRIPs and other applicable international agreements.[52] Patent terms can be restored beyond the 20-year TRIPs requirement when delays in the regulatory approval process result in "an unreasonable consumption of the patent term."[53] The FTA also ensures that government product approval agencies deny marketing approval to patent-violating products. Test data and trade secrets submitted for the purpose of marketing approval are protected against disclosure for 5 years for pharmaceuticals and 10 years for agricultural chemicals.[54] U.S. industry representatives also noted their satisfaction "that the FTA confirms that patents will be available for all products and processes and for any uses or methods of using a known product.... and "validates the importance of extending, without exclusion, broad patent eligibility for biotechnology products," an area of U.S. competitive strength.[55] To reinforce some of these provisions, Australia also affirmed in the FTA that it had "ratified or acceded to" the 1970 Patent Cooperation Treaty and the 1994 Trademark Law Treaty.[56]

Enforcement

Australia's IPR enforcement measures are strengthened by the FTA.[57] For instance, the FTA requires both statutory and actual damages for copyright piracy and trademark counterfeiting.[58] This is expected to deter IPR infringement and allow monetary damages to be awarded even when actual economic harm cannot be calculated.[59] To

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[52] United States Trade Representative (USTR), "Free Trade $Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 20, 2004; and Australian Department of Foreign Affairs and Trade, "Australia-United States Free Trade Agreement," *Media Release*, Feb. 8, 2004, p. 1, found at *http://www.dfat.gov.au*, retrieved Feb. 23, 2004.

[53] *The U.S.-Australia Free Trade Agreement (FTA),* Report of the Industry Sector Advisory Committee for Chemicals and Allied Products (ISAC-3), Mar. 12, 2004, pp. 9-19, found at *http://www.ustr.gov*, retrieved Mar. 22, 2004; and Centre for International Economics (CIE), *Economic Analysis of AUSFTA*, (Canberra and Sydney, Australia=CIE, April 2004), pp. 41-42.

[54] Pharmaceutical Research and Manufacturers of America (PhRMA), "Australia," *PhRMA Special 301 Submission*, Mar. 31, 2003, pp. 5-7, found at *http://www.phrma.org*, retrieved Apr. 8, 2003; and Albert Yuen, "Australia US Free Trade Agreement – IP Implications," *Country File: Australia* (Sydney, Australia: Coudert Brothers, Global Legal Advisers, Mar. 2004), p. 57, found at *http://www.coudert.com*, retrieved Mar. 10, 2004.

[55] Industry Functional Advisory Group on Intellectual Property Rights for Trade Policy Matters (IFAC-3), The *U.S.-Australia Free Trade Agreement (FTA): The Intellectual Property Provisions*, Mar. 12, 2004, pp. 11, found at *http://www.ustr.gov*, retrieved Mar. 17, 2004.

[56] U.S.-Australia FTA Article 17.1 2. (A) and (f).

[57] Albert Yuen, "Australia US Free Trade Agreement –IP Implications," *Country File: Australia* (Sydney, Australia: Coudert Brothers, Global Legal Advisers, Mar. 2004, p. 57, found at *http://www.coudert.com*, retrieved Mar. 10, 2004; and United States Trade Representative (USTR), "Free Trade 'Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 20, 2004.

[58] Hearing transcript at p. 184; and International Intellectual Property Alliance (IIPA), pre-hearing statement to Secretary, U.S. International Trade Commission, Mar. 22, 2004, p. 3.

[59] United States Trade Representative (USTR), "Free Trade $Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 24, 2004.

further deter copyright and trademark infringement, the FTA applies criminal procedures and penalties in cases of wilful trademark counterfeiting or copyright piracy and by making end-use of pirated or counterfeited products a criminal offense. Enforcement stipulations of the FTA also require that provisions be made for the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them.[60] Further, IPR laws are to be enforced not only against infringement originating within each country, but also against goods in transit to deter violators from using their ports or free trade zones to traffic in pirated products.[61] Finally, police and border agents are provided with greater authority to pursue IPR criminal enforcement actions on their own initiative.[62]

Potential Effects on the U.S. Economy

The intellectual property provisions of the U.S.-Australia FTA address many of the most significant concerns that U.S. industry representatives have expressed regarding Australia's IPR regime.[63] The FTA is expected to result in increased revenues for U.S. industries dependent on copyrights, trademarks, patents, and trade secrets. However, owing to the much smaller size of the Australian economy compared to that of the United States, and the relatively small contribution of Australia to U.S. IPR receipts from the world (figure 6-1), any increases in revenues for the U.S. IPR industries likely would have a limited effect on U.S. IPR-related industries and the U.S. economy as a whole.

Among the U.S. copyright industries that would potentially benefit most due to the increased digital technology features of the FTA are the motion picture, sound recording, business software applications, entertainment software, and book publishing industries. Industries that might benefit from the greater patent and trade secret protections, including the protection of confidential data, are the pharmaceutical and agricultural chemicals industries. A broad range of U.S.

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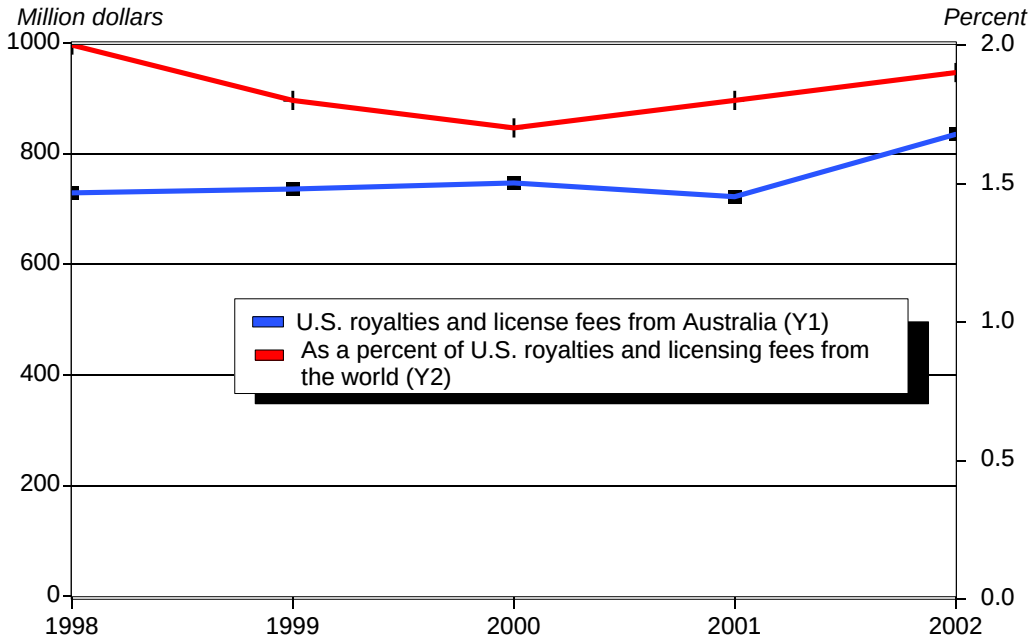
[60] Hearing transcript at p. 184; U.S. industry representatives, telephone interviews by USITC staff, Jan-Apr. 2004; and United States Trade Representative (USTR), "Free Trade $Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 20, 2004.

[61] United States Trade Representative (USTR), "Free Trade $Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 20, 2004.

[62] FTA Article 17.11, 22.

[63] Hearing transcript at pp. 184 and 197; Motion Picture Association of America (MPAA), "MPAA Statement on the US-Australia Free Trade Agreement," *Press Release*, Feb. 9, 2004, p. 1, found at *http://www.mpaa.org*, retrieved Feb. 19, 2004; Recording Industry Association of America (RIAA), "RIAA Applauds Conclusion of U.S.-Australia Free Trade Agreement," *News Release*, Feb. 10, 2004, p. 1, found at *http://www.riaa.com*, retrieved Feb. 19, 2004; International Intellectual Property Alliance, pre-hearing statement to Secretary, U.S. International Trade Commission (USITC), Mar. 22, 2004, pp 1-4; United States Trade Representative (USTR), "Free Trade $Down Under': Summary of the U.S.-Australia Free Trade Agreement," *Trade Facts*, Feb. 8, 2004, pp. 5-7, found at *http://www.ustr.gov,* retrieved Feb. 24, 2004; and Australian Department of Foreign Affairs and Trade, "Australia-United States Free Trade Agreement," *Media Release*, Feb. 8, 2004, p. 1, found at *http://www.dfat.gov.au*, retrieved Feb. 24, 2004.

Figure 6-1
U.S. royalties and license fees from Australia, by value, and as a percent of total U.S. royalties and license fees from the world



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business,* Oct. 2003.

industries should benefit from strengthened trademark and other IPR provisions of the FTA. By comparison, because the United States already meets the relatively high standards of IPR protection and enforcement included in the U.S.-Australia FTA, there would be little if any effect on U.S. industries or the U.S. economy based on U.S. implementation of its obligations under the FTA provisions.

A U.S. trade advisory committee representing a broad range of U.S. IPR interests stated that it strongly supported the U.S.-Australia FTA chapter on intellectual property and believes that, as a whole, it "establishes key precedential provisions to be included in the other FTAs now being negotiated, including the Free Trade Agreement of the Americas (FTAA)."[64] However, committee members said they would have preferred more specific language in the agreement with regard to prohibition and cancellation of trademark registrations and recordals for products that are identical or similar to

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[64] Industry Functional Advisory Group (IFAC-3) on Intellectual Property Rights for Trade Policy Matters , The *U.S.-Australia Free Trade Agreement (FTA): The Intellectual Property Provisions*, Mar. 12, 2004, pp. 1-22, found at *http://www.ustr.gov*, retrieved Mar. 17, 2004.

[65] Industry Functional Advisory Group on Intellectual Property Rights for Trade Policy Matters (IFAC-3), *The U.S.-Australia Free Trade Agreement (FTA): The Intellectual Property Provisions*, Mar. 12, 2004, p. 10, found at *http://www.ustr.gov*, retrieved Mar. 17, 2004.

products with well-known marks. They also would have preferred that the FTA had addressed U.S. copyright owners' requests for a provision requiring each party to prevent distribution of copyrighted products in markets for which they were not intended.[65] Accordingly, they would like the United States to continue to pursue those and several other issues not resolved in the U.S.-Australia FTA in future FTAs. Another trade advisory group, representing the chemical industry and allied products industry, also supported the FTA, including improvements it provides for in trademark, patent, and data protection.[66] Finally, although generally very pleased with the FTA's IPR provisions, U.S. sound recording industry representatives would have preferred that the final FTA had provided for national treatment of U.S. producers of sound recordings with respect to being able to distribute their products and services through traditional broadcasting channels.[67]

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[66] Industry Sector Advisory Committee for Chemicals and Allied Products (ISAC-3), "Chapter 17: Intellectual Property," *The U.S.-Australia Free Trade Agreement (FTA),* Mar. 12, 2004, pp. 9-10, found at *http://www.ustr.gov*, retrieved Mar. 22, 2004.

[67] Hearing transcript at pp. 183, 184, 219, and 220; and International Intellectual Property Alliance (IIPA), pre-hearing statement, U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects, 69 Fed. Reg. 10755 (March 8, 2004), Investigation No. TA-2104-11, Mar. 22, 2004, p. 3.

CHAPTER 7
Other Potential Effects of the U.S.-Australia FTA

The chapters of the Agreement covered in this chapter are: customs administration (chapter 6), technical barriers to trade (chapter 8), trade remedies and safeguards (chapter 9), competition policy (chapter 14), government procurement (chapter 15), electronic commerce (chapter 16), labor (chapter 18), environment (chapter 19), transparency issues (chapter 20), and other institutional arrangements and dispute settlement (chapter 21). Some of the elements of these FTA chapters have been covered elsewhere in this report, when feasible (e.g., IPR, trade in services).

Because of data limitations, the discussion in this chapter relies on the public record for assessments of these elements of the FTA. The chapter sets out U.S. negotiating areas and objectives for the U.S.-Australia FTA, followed by overall judgments on the Agreement rendered by the advisory trade committees established by the U.S. Congress. Views on the Agreement's advantages and disadvantages as raised by panelists at the public hearing held by the United States International Trade Commission on March 30, 2004, concerning the U.S.-Australia FTA are included where germane. See chapter 9 of this report for the positions of the interested parties that testified before the Commission. Where available, other public sources also are reviewed, such as a recent report done for the Australian Department of Foreign Affairs and Trade on the U.S.-Australia FTA.[1]

The U.S. negotiating areas and objectives for the U.S.-Australia FTA were put forward by the United States Trade Representative to the leaders of Congress in the Executive Branch notification to the Congress of intent to pursue negotiation of a bilateral free trade agreement with Australia.[2] Once an FTA has been negotiated, the elements of the U.S. Government advisory committee system submit formal reports regarding the likely effects–both benefits and drawbacks–of the agreement reached.

The advisory committee system was established by the Congress under the Trade Act of 1974 to ensure that U.S. trade policy and trade negotiating objectives adequately reflect U.S. public and private sector interests. At the time the advisory committees were

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[1] Centre for International Economics (CIE), *Economic Analysis of AUSFTA – Impact of the bilateral free trade agreement with the United States*, prepared for the Australian Department of Foreign Affairs and Trade, April 2004 (CIE:Canberra, 2004). The CIE report grapples as well with the difficulty of trying to measure nonquantifiable aspects of the agreement. An overall message that emerges from the report can be broadly stated that the nonquantifiable provisions in the agreement provide an improved legal and business framework, which reduces the transaction costs for firms and increases decisionmaking certainty for firms and investors, which thereby promotes increased investment opportunities by lowering any risk premiums associated with uncertainty over these business transactions.

[2] USTR Zoellick, notification letters to Congress of intent to initiate free trade agreement negotiations with Australia, Nov. 13, 2002, found at Internet addresses *http://www.ustr.gov/releases/2002/11/2002-11-13-australia-byrd.pdf*, and *http://www.ustr.gov/releases/2002/11/2002-11-13-australia-hastert.pdf*.

considering the U.S.-Australia FTA, there existed 32 advisory committees, with a total membership of up to 1,000 advisors. The trade policy advisory system is arranged in three tiers.[3] At the highest tier is the Advisory Committee on Trade Policy and Negotiations (ACTPN), which consists of up to 45 members appointed by the President who are broadly representative of key economic sectors affected by trade. The ACTPN examines U.S. trade policy and agreements from the broad context of the overall national interest. At the second tier, the Policy Advisory Committees are appointed by the USTR or in conjunction with other Cabinet offices. Among these are the Agricultural Policy Advisory Committee (APAC), Intergovernmental Policy Advisory Committee (IGPAC), Labor Policy Advisory Committee (LAC), and Trade and Environment Policy Advisory Committee (TEPAC), where each committee provides advice based upon the perspective of its specific area. At the third tier are 27 sectoral, functional, and technical advisory committees, organized in two areas–agriculture and industry–and appointed by USTR and the Secretary of Agriculture or Commerce, respectively.[4] Where the advisory committees express a view of results achieved (or not achieved), their assessment follows on from the administration's stated negotiating objectives for that area. In negotiating areas that pertain more to public rather than private sector interests–for example, government policy on safeguards or competition policy–the advisory committees at times have expressed little or no opinion.

Customs Administration

U.S. negotiating objectives for the U.S.-Australia FTA were to (1) seek rules to require that Australia's customs operations are conducted with transparency, efficiency, and predictability, and that customs laws, regulations, decisions, and rulings are not applied in a manner that would create unwarranted procedural obstacles to international trade; and (2) seek rules of origin, procedures for applying these rules, and provisions to address circumvention matters that will ensure that preferential duty rates under the FTA with Australia apply only to goods eligible to receive such treatment, without creating unnecessary obstacles to trade.

The ACTPN report addressing the U.S.-Australian FTA concluded that the Agreement makes significant advances regarding customs procedures and rules of origin that are likely to expedite the processing of customs.[5] The specificity of obligations in the Agreement regarding customs procedures set a high standard, particularly when coupled with the commitments to facilitate express shipment and to share information

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[3] USTR, "Trade Policy Development," *2004 Trade Policy Agenda and 2003 Annual Report*, March 2004 (GPO: Washington, D.C., 2004), pp. 233-35.

[4] Each committee provides specific technical advice concerning the effect that trade policy decisions may have on its sector, such as grains and oilseeds or textiles.

[5] Advisory Committee for Trade Policy and Negotiations, *Report to the President, the Congress, and the United States Trade Representative on the U.S.- Australia Free Trade Agreement*, Mar. 12, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/actpn.pdf*, retrieved on Apr. 19, 2004.

to combat illegal transshipment of goods. The Agreement provides steps to ensure transparency and efficiency of these customs procedures. The Agreement also provides for the quick release of goods, within 48 hours where possible. Without making comments applicable to specific industry sectors or products, the ACTPN recommends that all negotiated FTAs include rules of origin that balance the desirability of promoting the sourcing of raw materials within the relevant territory with rules that permit U.S. businesses the flexibility and opportunity to take full advantage of the Agreement.

The Industry Functional Advisory Committee on Customs Matters (IFAC-1) is a more specialized advisory panel reporting to the President and Congress, involved with all aspects of the process of importing and exporting goods through customs services–whether domestic or foreign–and with facilitation of the movement of goods into and out of customs.[6] While a number of areas negotiated as part of the Agreement could have customs implications, the IFAC-1 committee focused on several priority areas of concern: (1) the functions of the import process and how it is administered, which can either make the Agreement more successful for the benefit of traders or, alternatively, can undermine benefits of the Agreement by helping maintain nontariff barriers to that trade; (2) ensuring that the rules and regulations are transparent and understandable to all traders including small- and medium-sized enterprises; and (3) ensuring that the Agreement included a mechanism to keep practices for import and export current with business "best practices."

The IFAC-1 committee highlighted that Australia has a customs regime that is inherently more sophisticated than those of most other nations with whom the United States has entered into free trade agreements. U.S. negotiators met regularly with the committee and solicited advice, as well as responding well to the unsolicited advice from the committee. As a result, the IFAC-1 committee considered that the Agreement provides equity and reciprocity in the customs areas.

Regarding the general provisions of the Agreement, the IFAC-1 committee noted that the FTA contains many of the current "best practices" concepts in the general provisions of the customs section. Such practices include the utilization of risk assessment as a tool to enable customs officials to concentrate on high-risk shipments, and the provision of expedited procedures in connection with express shipments. The Agreement also implements the 48-hour release of goods standard and provides for the use of various surety or security mechanisms (e.g. bonds) in connection with the release of goods. The Agreement also provides for the establishment of procedures to obtain advance rulings, and provides for the review and appeal of such rulings.

Regarding the definitions in the Agreement, the committee noted that the FTA provides clear and beneficial descriptions for the terms temporary admission, waste and scrap,

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[6] Industry Functional Advisory Committee on Customs Matters, *IFAC 1 Advisory Committee Report to the President, the Congress, and the United States Trade Representative on the U.S. –Australia Free Trade Agreement*, Mar. 12, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/ifac01.pdf*, retrieved on Apr. 19, 2004.

used goods, recovered goods, and especially remanufactured products in the definitions section.

Regarding rules of origin, the committee found that the Agreement provides a process for clear rules, ability to request advance rulings, and an avenue for appeal of such rulings. The general provisions also provide for de minimis nonoriginating components and permits use of the concept of accumulation. The Agreement's strong advance ruling provisions permit the use of advance rulings with respect to origin determinations. The IFAC-1 committee noted that it reviewed this section for process, leaving judgment aside on the application of the rules to individual sectors with more specific criteria.

Regarding the certification of origin, the IFAC-1 committee noted that the Agreement contains excellent provisions for handling claims for preferential treatment. Upon request, claims may be made in the form of statements, and need not be made in a prescribed format. Statements may be submitted electronically. Accordingly, these procedures are less burdensome than those in earlier agreements.

Regarding customs valuation, the FTA sets forth the obligation on the part of the two parties to apply the provisions of the WTO Agreement on the Implementation of Article VII of GATT 1994 (the WTO Customs Valuation Agreement). The U.S.-Australia FTA further recognizes the principle that software should be valued on the basis of the value of the carrier media. According to the report, these are both important and longstanding objectives sought by the committee.

Regarding dispute resolution, the committee finds the Agreement's procedure for this is well thought out and appears workable, according to the IFAC-1 committee report.

Regarding trade facilitation, the Agreement includes provisions designed to facilitate the international movement of goods. The committee noted that trade facilitation is an absolutely essential ingredient of trade negotiations, especially given the recent sluggishness in the global economy. The Agreement's provisions focus on the simplification and harmonization of customs procedures and practices. These provisions aim for the procedures to be transparent and predictable. The Agreement also requires the parties to maintain appropriate measures to ensure efficient and fair customs facilitation of goods that are imported and/or exported by express delivery services suppliers.[7]

Regarding other provisions, the committee finds that the FTA includes other provisions as well that address drawback, alteration and repair, remanufactured goods, user fees, import pricing, and licensing–all objectives of the IFAC-1 committee. The committee expressed particular satisfaction that the Agreement retained duty drawback for those who qualify.

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[7] IFAC-1 committee members expressed the view, however, that the agreement's six-hour target for release of express shipments should be reduced, preferably to three hours or less.

Laura Lane, of Time Warner, testified that her company's support for the U.S.-Australia FTA represents the support from members of the Entertainment Industry Coalition for Free Trade–those who produce, distribute, and exhibit creative productions such as motion pictures, television programs, video entertainment, recorded music, and the like.[8] In addition to the Agreement's strong intellectual property protections, she highlighted that rules for customs valuation require valuation of content-based goods, such as films or music CDs, to be based on the value of the carrier media rather than be dependent on an artificial valuation based on projected revenues of the media content of the good. This will set a precedent for similar negotiations with other countries in the region, as well as in the WTO where valuation problems persist.[9]

Stephen Collins, of the Automotive Trade Policy Council, testified that his council's strong support for the Agreement was based in part on the view that greater integration of manufacturing, distribution, sales, financing, service, and related operations would promote growth and efficiency in the markets of both parties to the Agreement.[10] He outlined briefly how the rule of origin specific to automotive products was similar to those included in other FTAs signed by Australia as well as the U.S.-Central America FTA automotive rule of origin.

Frank Vargo, representing the National Association of Manufacturers (NAM), reported that the FTA's customs chapter will facilitate trade between the two countries, as a result of the specific obligations on customs procedures found in the customs provisions, along with the commitments to share information to combat illegal transshipment of goods and to facilitate express shipments.[11] He pointed out in particular the Agreement's provision for the quick release of goods, within 48 hours where possible, which is of particular importance to express delivery services that are often small- and medium-sized U.S. companies.

Technical Barriers to Trade

U.S. negotiating objectives were to (1) seek to have Australia reaffirm its commitments under the WTO Agreement on Technical Barriers to Trade (TBT)–the WTO TBT Agreement, or WTO Standards Agreement–including those relating to labeling requirements for U.S. food and agricultural products produced through biotechnology, and to eliminate any unjustified TBT measures; and (2) seek to

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[8] Laura Lane, Time Warner Inc., submission to the Commission, p. 1.

[9] Ibid., p. 3, par. 5.

[10] Stephen Collins, Automotive Trade Policy Council, submission to the Commission concerning the U.S.-Australia Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects (Investigation No. TA-2104-11), Mar. 30, 2004, pp. 2-3.

[11] Franklin Vargo, National Association of Manufacturers, submission to the Commission concerning the U.S.-Australia Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects (Investigation No. TA-2104-11), Mar. 30, 2004, p. 5.

strengthen collaboration with Australia on implementation of the WTO TBT Agreement and create a procedure for exchanging information with Australia on TBT-related issues.

The ACTPN report concludes that the U.S.-Australia FTA contains provisions for reinforcing the WTO TBT Agreement, and for promoting improvements in bilateral implementation of the TBT Agreement. The ACTPN noted that duty drawback and deferral programs were retained in the U.S.-Australia FTA for the exporters of both countries.

The Industry Functional Advisory Committee on Standards (IFAC-2) provides detailed policy and technical advice, information, and recommendations to the President and Congress, regarding certain trade barriers as well as the implementation of negotiated trade agreements.[12] The IFAC-2 committee sought U.S. negotiations that would (1) reinforce transparency obligations that specifically require agencies to disclose and/or publish along with any final rulings the response to comments received on proposed technical regulations; (2) seek national treatment in a binding sense;[13] (3) seek an opportunity for direct participation on a nondiscriminatory basis in the development of standards-related measures (not covered by WTO rules, but such as found in NAFTA Article 909.7); and (4) seek to establish an informal mechanism for the rapid resolution of disputes. In its report, the IFAC-2 committee found that the U.S.-Australia FTA addresses these goals, providing for equity and reciprocity regarding standards and technical barriers to trade, and thereby effectively promotes the economic interests of the United States overall. The committee noted in particular that the 5-year implementation period for transparency obligations found in the U.S.-Chile FTA was removed from the U.S.-Australia FTA, which provides immediate implementation.

Frank Vargo, representing NAM, noted that the Agreement represents an unparalleled achievement for America's manufacturers.[14] Regarding technical barriers to trade, he pointed out that the FTA reinforces the operation of the WTO TBT Agreement's provisions between the United States and Australia, helping prevent technical standards and regulations from becoming a nontariff barrier to trade between the two countries. He remarked that the U.S.-Australia FTA provides the opportunity to go beyond the WTO TBT Agreement, to find ways to streamline the standards regulating conformity assessment that could be very important to simplifying trade.

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[12] Industry Functional Advisory Committee on Standards, *Industry Functional Advisory Committee on Standards (IFAC 2) Advisory Committee Report to the President, the Congress and the United States Trade Representative on the U.S.-Australia Free Trade Agreement (FTA)*, Mar. 9, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/ifac02.pdf*, retrieved on Apr. 19, 2004.

[13] The IFAC-2 committee was opposed to having any transition period as was negotiated with Mexico under the North American Free Trade Agreement (NAFTA), which the committee sees expressed currently as a weak obligation under WTO TBT Article 6.4, and as a binding obligation in NAFTA Article 908.2. The committee also supported U.S. negotiations to acknowledge alternative approaches to conformity assessment.

[14] Franklin Vargo, submission to the Commission, p. 4.

Trade Remedies/Safeguards

U.S. negotiating objectives were to (1) provide a bilateral safeguard mechanism during the transition period; and (2) make no changes to U.S. antidumping and countervailing duty laws. The completed Agreement provides for a framework during the 10-year transition period (unless the phase-out of duties is stipulated to be longer) whereby the parties can impose a safeguard measure that suspends staged decreases in or increases a duty rate. A safeguard may only be imposed for two years, with the possibility of a 2-year extension. The parties must, however, progressively liberalize such measures and return the duty rate to the level that would have applied without the safeguard by the end point. The United States already employs such procedures under existing law. Under the FTA, each party retains all rights and obligations of the WTO Agreement on Safeguards, but gains no additional rights or obligations.

Competition Policy

U.S. negotiating objectives were to (1) address issues of anticompetitive business conduct, state monopolies, and state enterprises; and (2) seek cooperation and consultation provisions that foster cooperation on competition law and policy, and that provide for consultations on specific problems that may arise. Under the Agreement, the parties would be required to adopt or maintain measures to proscribe anticompetitive business conduct, and to take appropriate action with respect to such conduct. The parties must also under the Agreement establish or maintain an authority responsible for the enforcement of such measures. The U.S.-Australia FTA provides for cooperation, transparency, information requests, and consultations, and it emphasizes consumer protection.

A recent report done for the Australian Department of Foreign Affairs and Trade notes that the competition policy provisions largely reflect existing legislation, but that the value of these measures is to provide additional certainty to firms operating in both countries that these competition measures will be maintained.[15] The report indicates that the agreement also addresses more directly cross-border dimensions of competition and consumers protection, and provides for cooperation on competition-related issues intended to protect firms operating in one another's markets and consumers purchasing goods and services from each market from unfair competition dealings.

[15] Centre for International Economics, *Economic Analysis of AUSFTA*, pp. 48-49.

U.S. negotiating objectives were to (1) seek to establish rules requiring that Australia's procurement practices be fair, transparent, and predictable for suppliers of U.S. goods and services who seek to do business with the Australian government; and (2) seek to expand access for U.S. goods and services to Australian government procurement markets.

The ACTPN report concludes that the FTA makes significant advances in providing access for U.S. companies to a considerable part of Australia's government procurement market. The Agreement allows U.S. firms competitive entry to procurement by Australian central government entities. The report indicates that this is an especially important accomplishment since Australia is not a signatory to the WTO Agreement on Government Procurement, meaning that these advantages are not available to competitors in the Australian market. Importantly, Australia will no longer apply provisions for local manufacturing or local content requirements to U.S. firms. Australia will also restrict its use of selective tendering provisions, which will improve U.S. suppliers' ability to compete fairly for government contracts.

The Intergovernmental Policy Advisory Committee (IGPAC) provides overall policy advice on trade policy matters that relate to the affairs of State and local governments within the United States. Regarding government procurement, IGPAC members support the goal of improving the transparency of government procedures and regulatory decisions related to procurement in the United States, while preserving the independent authority of State and local governments to adopt legislation, standards, and procedures consistent with their experience and interests.[16]

William Sweeney, Jr., of EDS, pointed out that U.S. companies were now able under the Agreement to compete for a broad range of Australian public sector contracts, including in the database services sector, where no business was possible previously because Australia had made no liberalization commitments in the area of government procurement.[17]

Frank Vargo, representing NAM, highlighted the advantage presented by the Agreement for U.S. firms to compete in the procurement market of Australian central government entities, an opportunity previously unavailable because Australia is not a signatory to the WTO plurilateral Agreement on Government Procurement.[18] He

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[16] Intergovernmental Policy Advisory Committee, *Advisory Committee Report to the President, the Congress and the United States Trade Representative on the US-Australia Free Trade Agreement*, Mar. 12, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/igpac.pdf*, retrieved on Apr. 19, 2004.

[17] William R. Sweeney, Jr., EDS, submission to the Commission concerning the U.S.-Australia Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects (Investigation No. TA-2104-11), Mar. 30, 2004, p. 4.

[18] Franklin Vargo, submission to the Commission, p. 5.

pointed out also that U.S. firms will no longer be subject to Australian local manufacturing or local content requirements under provisions of the agreement.

The report done for the Australian Department of Foreign Affairs and Trade expresses the view that, although the agreement includes some important changes in the functioning of government procurement, whether any significant impacts result from these changes will depend on how firms in the two countries respond to the new business opportunities and challenges developed by these changes.[19]

Electronic Commerce

U.S. negotiating objectives were to (1) seek to affirm that Australia will allow goods and services to be delivered electronically on terms that promote the development and growth of electronic commerce, and (2) seek to ensure that Australia does not apply customs duties in connection with digital products or unjustifiably discriminate among products delivered electronically.

The ACTPN report concludes that the Agreement's provisions on e-commerce and digital products provide state-of-the-art recognition of the increased importance of this issue regarding global trade, and include the principle of avoiding barriers that impede the use of e-commerce. The ACTPN finds that the e-commerce provisions and the liberal treatment of services in this Agreement are especially important to ensure future U.S. market access in these critical growth areas. The committee draws particular attention to the fact that the FTA establishes guarantees of nondiscrimination and a binding prohibition on customs duties on products delivered electronically, and creates a favorable environment for the development of increased e-commerce.

In its report, the Industry Functional Advisory Committee on Electronic Commerce for Trade Policy Matters (IFAC-4) found that the e-commerce provisions in the Agreement promote the economic interests of the United States and provides equity and reciprocity for electronic commerce firms.[20] The electronic commerce chapter in the Agreement introduces the concept of "digital products" as reflected by digital product development over the last two decades. Continuing the use of the definition as found in previous agreements promotes needed predictability for how digital products are

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[19] Centre for International Economics, *Economic Analysis of AUSFTA*, p. 43.

[20] Industry Functional Advisory Committee on Electronic Commerce, *Report of the Industry Functional Advisory Committee on Electronic Commerce (IFAC-4)*, Mar. 8, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/ifac04.pdf*, retrieved on Apr. 19, 2004. The IFAC-4 committee provides advice on trade policy matters involving electronic commerce negotiating priorities, data privacy, taxation, standards, consumer protection, authentication, and security and content, in bilateral, regional, and multilateral forums, including the World Trade Organization (WTO), Free Trade Area of the Americas (FTAA), Organization for Economic Cooperation and Development (OECD), Asia-Pacific Economic Cooperation forum (APEC), and Trans-Atlantic Economic Partnership (TEP). The IFAC-4 committee seeks to nullify any e-commerce trade barriers that would undercut the flexibility and seamlessness of this medium.

treated in international trade. The committee noted that the e-commerce chapter in the Agreement affirms the importance of avoiding unnecessary e-commerce barriers and the applicability of WTO rules. The chapter prevents the application of customs duties on electronically delivered digital products, ensures the nondiscriminatory treatment of digital products, addresses the valuation of physically delivered digital products, and provides commitments to cooperate on electronic commerce policy. The parties to the Agreement agree not to impose customs duties on digital products transmitted electronically. This provision is similar to the moratorium on customs duties on electronic transmissions in force in the WTO. Australia agreed to nondiscriminatory treatment of digital products providing broad national treatment and nondiscriminatory treatment (so-called "most-favored-nation," or "MFN") provisions. This is a step forward in securing liberal trade treatment of digital products. With respect to the physical delivery of digital products, Australia agreed to apply customs duties on the basis of the value of the carrier medium. Presently countries use different methods to apply customs duties. With respect to the ongoing WTO Electronic Commerce Work Program, which is focused primarily on the classification debate of electronically delivered goods and services, the IFAC-4 committee indicated that the e-commerce provisions in the U.S.-Australia FTA will spur debate. The United States has developed a method for treating digital products in terms of trade that should advance discussions in the WTO in the long term.

William Sweeney, Jr., of EDS, testified that his company's endorsement of the U.S.-Australia FTA reflected the support of virtually every company in every sector of the technology community in the United States.[21] Regarding electronic commerce, he highlighted the major steps taken under the Agreement toward the long-term liberalization of trade in digital products, including the definition of digital products, the assurance of a continued zero duty rate on digital products, the strong language conferring nondiscriminatory national treatment and most-favored-nation treatment for digital products, as well as provisions in the Agreement addressing digital authentification, consumer protection, and paperless trading. Such provisions would provide incentive for cost and productivity improvements in business transactions that would help business firms from the two parties to the Agreement remain competitive. He also commended the adoption of a comprehensive "negative list" approach to liberalization of computer and related information technology services, where all new services and applications are covered by commitments under the Agreement unless specifically exempted. This approach is critical to the technology industry owing to the rapid rate of innovation in the field and the need to keep measures that liberalize trade up-to-date in these areas.[22]

Laura Lane of Time Warner testified in support of the Agreement's strong e-commerce provisions, the commitment to nondiscriminatory treatment of digital products, and the continuation of a zero duty rate on digital products.[23]

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[21] William R. Sweeney, Jr., EDS, submission to the Commission, p. 2.
[22] William R. Sweeney, Jr., EDS, submission to the Commission, p. 3.
[23] Laura Lane, Time Warner Inc., submission to the Commission, p. 3.

U.S. negotiating objectives were to (1) seek an appropriate commitment by Australia to the effective enforcement of its labor laws; (2) establish that Australia will strive to ensure that it will not, as an encouragement to trade or investment, weaken or reduce the protections provided under its labor laws; and (3) establish procedures for consultations and cooperative activities with Australia to strengthen its capacity to promote respect for core labor standards, including compliance with ILO Convention 182 on the worst forms of child labor.

The ACTPN report concludes that the Agreement incorporates labor and environmental protections into the body of the Agreement, requiring both parties to enforce their domestic environmental and labor laws, and that these obligations are enforceable through the FTA's dispute-settlement procedures. With the exception of the International Brotherhood of Teamsters, which voiced a dissenting opinion, the ACTPN representatives believe that the Agreement fully meets the labor objectives in the Trade Act of 2002, and believe that the text of the Agreement provides an effective and balanced means of implementing the negotiating objectives regarding labor issues. The committee indicated that the labor provisions meet the Trade Act's requirements while still providing strong assurances that the provisions cannot be used as a means of disguised protectionism. After lengthy debate, the United States Congress decided that dispute settlement in labor matters should be limited to a failure to enforce existing laws. The ACTPN believes that the U.S.-Australia FTA faithfully implements that requirement. The ACTPN representative of the International Brotherhood of Teamsters disagreed, and opposed the labor language in the Agreement.[24]

The Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC) concluded that the Agreement neither fully meets the negotiating objectives laid out by Congress nor promotes the economic interest of the United States, in its failure to meet some Congressional negotiating objectives and in its barely meeting other objectives.[25] The LAC considers that the Agreement repeats many of the same mistakes

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[24] The International Brotherhood of Teamsters sets out in its dissent to the ACTPN report a number of reasons for why it considers that: (1) Australia's labor laws fail to protect the workers' right to join a union; (2) Australia's labor laws undermine collective bargaining; (3) Australia's labor laws undermine the workers' right to strike; as well as the Teamsters' belief that (4) the USTR failed to protect U.S. and Australian workers in negotiating the agreement.

[25] Labor Advisory Committee for Trade Negotiations and Trade Policy, *Report to the President, the Congress and the United States Trade Representative on the U.S.-Australia Free Trade Agreement,* Mar. 12, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/lac.pdf*, retrieved on Apr. 19, 2004. The LAC provides information and advice with respect to negotiating objectives and bargaining positions before the United States enters into a trade agreement with a foreign country, with respect to the operation of any trade agreement once entered into, and with respect to other matters arising in connection with the development, implementation, and administration of the trade policy of the United States. The LAC includes unions from nearly every sector of the U.S. economy, including manufacturing, high technology, services, and the public sector, and represents more than 13 million American working men and women.

of the NAFTA, and is likely to lead to the same deteriorating trade balances, lost jobs, and workers' rights violations that, in its opinion, NAFTA has created.

The LAC report also concludes that labor provisions of the U.S.-Australia FTA will not protect the core rights of workers in either country, and represent a retreat from the U.S.-Jordan FTA, as well as unilateral U.S. trade preference programs.[26] The report asserts that the enforcement procedures in the U.S.-Australia FTA completely exclude obligations for governments to meet international standards on workers' rights. The LAC report also asserts that provisions on investment, procurement, and services constrain U.S. ability to regulate in the public interest, to pursue responsible procurement policies, and to provide public services. The LAC considers that the Agreement's provisions on intellectual property reduce the flexibility available under WTO rules for governments to address public health crises. The LAC report also asserts that the rules of origin and safeguards provisions will invite producers to circumvent the intended beneficiaries of the U.S.-Australia FTA, and will fail to protect workers from the import surges that may result. The LAC recommends that the President not sign the Agreement until it is renegotiated to fully address the concerns raised by the LAC's report, or that the Congress reject the Agreement should it be presented by the President.

Environment

U.S. negotiating objectives were to (1) seek to promote trade and environment policies that are mutually supportive; (2) seek an appropriate commitment by Australia regarding the effective enforcement of its environmental laws; (3) establish that Australia will strive to ensure that it will not, as an encouragement to trade or investment, weaken or reduce the protections provided under its environmental laws; and (4) seek to develop ways to work with Australia, including through consultative mechanisms, to address environmental issues of mutual interest.

The ACTPN report concludes that the FTA's environmental provisions provide effective and creative ways of contributing to environmental improvement. It notes that the streamlined nature of the environmental provisions of this Agreement recognizes that both countries have highly developed economies and a history of significant, positive, environmental regulation. However, it asserts that, given the country-specific conditions that support streamlining, these provisions should not be used as a model

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[26] The committee report considers that (1) the Agreement's enforcement procedures exclude the "obligations for governments to meet international standards on workers' rights;"(2) the Agreement's provisions on investment, procurement, and services constrain U.S. ability to "regulate in the public interest, pursue responsible procurement policies, and provide public services;" (3) the Agreement's intellectual property provisions reduce the "flexibility available under WTO rules for governments to address public health crises;" and (4) the "rules of origin and safeguards provisions invite producers to circumvent the intended beneficiaries of the trade agreement and fail to protect workers from the import surges that may result."

for all agreements. The ACTPN report also notes that concern has been expressed by some nongovernmental organizations about the environmental impact of the sugar carve-out, given the impact of sugar production on sensitive environmental resources in the United States. The ACTPN members in their report said that they believe the Agreement meets the requirements of the Trade Act of 2002 by requiring, in an enforceable manner, that neither country fail to enforce its environmental laws in a manner that could affect trade. The ACTPN states that it is important that the Agreement extends obligations on environmental laws at the State and territory level because much environmental regulation takes place at this level of government.

A majority of Trade and Environment Policy Advisory Committee (TEPAC) members support the conclusion that the Agreement provides adequate safeguards to ensure that Congress's environmental negotiating objectives will be met.[27] The report notes that Australia has a strong and positive record regarding environmental regulation, which the committee believes is likely to be atypical for other likely FTA candidates; thus, the report recommends that the environmental provisions in the Agreement are not well suited as a model for other free trade agreements. The report notes that Australia's strong record with regard to environmental regulation is unusual with respect to other likely FTA candidates and thus should not serve as a model for future agreements. The report states that the committee finds that the environmental provisions still appear to strike "a proper balance between the extensive commitments in the Agreement to cooperate on environmental matters" and "the need to ensure that both countries commit the requisite resources to enforce domestic environmental laws and regulations." The report notes that committee members were very concerned about the Agreement not addressing tariff reductions regarding sugar, beef, and dairy. Overall, however, the report concluded that this Agreement is likely to meet Congress's objectives regarding environmental regulation between the United States and Australia, although it should not be seen as a model for future FTAs.

Transparency

U.S. negotiating objectives were to (1) seek to ensure that Australia's procedures for administering trade-related measures are fair and transparent, including ensuring that interested parties have timely access to information on these measures and Australia's procedures for administering them; and (2) seek to ensure that Australia applies high standards that prohibit corrupt practices affecting international trade, as well as enforce such prohibitions.

The ACTPN report concludes that the Agreement is an "unparalleled accomplishment" that "serves as a shining example of what is possible" in that over 99 percent of U.S.

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[27] Trade and Environment Policy Advisory Committee, *Report to the President, the Congress, and the United States Trade Representative on the U.S.- Australia Free Trade Agreement*, Mar. 12, 2004, found at Internet address *http://www.ustr.gov/new/fta/Australia/advisor/tepac.pdf*, retrieved on Apr. 19, 2004.

exports of consumer and industrial goods to Australia will become totally duty-free as soon as the U.S.-Australia FTA enters into force. Such market-access gains are likely to be reinforced by improved transparency and efficiency in administering customs procedures, including measures for facilitating express delivery shipments, which are an important means of exporting for small- and medium-sized firms.

Other Institutional Arrangements and Dispute Settlement

U.S. negotiating objectives were to (1) encourage the early identification and settlement of disputes through consultation; and (2) seek to establish fair, transparent, timely, and effective procedures to settle disputes that might arise under the Agreement.

The ACTPN report concludes that the FTA continues the innovation of an option to use monetary fines for needed enforcement under the Agreement's provisions, which reduces the need to resort to trade restrictions that can cause significant trade dislocations if used as an enforcement mechanism. The report concludes that the Agreement provides for new consultation mechanisms to expand possibilities for improving trade cooperation and heading off disputes, including consultations to address technical barriers to trade.

The ACTPN report asserts that effective dispute-settlement provisions are essential to ensure that trade agreements are actually implemented and enforced. It states that these provisions must permit timely and effective resolution of disputes, as well as enforcement mechanisms, to provide an adequate incentive for compliance. The ACTPN members conclude in their report that suspension of tariff benefits under the Agreement is available for all disputes as a last resort, including disputes over the enforcement of labor and environmental laws, but that there is a clear preference that fines be used as an enforcement mechanism instead of trade restrictions where consultation fails to resolve a dispute.

The ACTPN report views this as a particularly good feature in bilateral trade agreements, since no bilateral agreement can override the parties' WTO commitments, e.g., the maximum U.S. trade retaliation could only be a snap-back to its bound tariff levels in the WTO. As the average U.S. tariff rate under the WTO is only 1.6 percent, fines are a potent alternative that do not distort trade.

The ACTPN report states that retaliatory trade measures should be taken as a last resort, for they have the capability of interfering with trade and causing considerable economic disruption. The report also states that the best way to deal with trade disputes is through consultation and mutual understanding, and expresses the committee's support for the provisions in the Agreement that seek such amicable resolution of disputes. The report also concludes that the Agreement also sets high standards of openness and transparency for dispute-panel procedures, including provisions allowing interested third parties to provide their views.

The ACTPN (save for the Teamsters' dissenting view) believes that the dispute-resolution provisions fully meet the requirements of the Trade Act of 2002, and that they provide equivalent enforcement for all parts of the Agreement–including the new labor and environmental provisions. The committee endorses the dispute-settlement provisions and considers them to advance the "state-of-the-art" in trade agreements.

The IGPAC members of State and local government representatives support the dispute-settlement provisions of the Agreement as well, because these provisions recognize State and local authority as well as the modern and transparent legal systems of both the United States and Australia. IGPAC members are pleased that the FTA provides submission and arbitration provisions, clarifies language on expropriation, and excludes investor-state dispute-settlement procedures.

CHAPTER 8
Review of Literature and Comparison With Commission Findings

Introduction

This chapter reviews the academic and policy literature pertaining to a U.S.-Australia FTA. Prior to reviewing the studies assessing the estimated impact on the United States of the U.S.-Australia FTA , a discussion is presented on the conceptual issues regarding free trade agreements. The final section of this chapter makes an analytical comparison between the results obtained by the USITC model described in chapter 3 and selected modeling results from the reviewed literature.

General Effects of Trade Agreements

Studying the economic impact of a FTA entails investigating static effects such as trade creation and trade diversion as well as terms of trade. In addition, issues related to scale effects and non-quantifiable effects have to be considered. A discussion of these issues is presented below.

Static Effects: Trade Creation and Trade Diversion

Trade liberalization can in general be undertaken in two different manners. First, it can be based on the "most favored nation" (MFN) principle where better market access is granted to all trading partners equally. The classical "gains from trade" argument asserts that such trade liberalization would help consumers to have access to more goods at lower prices, and producers to have more sources for their inputs and more markets for their products (for which they may receive higher prices). Second, it can be done in a *preferential* way, with better market access granted to one partner but not to others. It should be noted that better market access can result not only from bilateral tariff removal but also from other negotiated provisions in the areas of cross border trade in services, telecommunications, e-commerce, and government procurement, the effects of which are not readily quantifiable. An FTA, such as the one between the United States and Australia, is an agreement in which preferential liberalization is undertaken reciprocally between participating countries.[1]

[1] It should be noted that, while negotiated bilaterally, some FTA provisions such as those related to customs administration or labor and environment tend to be applied in a non-discriminatory manner and are closer to the MFN principle.

To the extent that FTAs are designed to liberalize trade, they are likely to engender economic gains similar to those of an MFN liberalization. However, given their discriminatory nature, studying the economic impact of FTAs involves additional issues that are not present in an MFN liberalization. The traditional way to study an FTA is to categorize the FTA-induced trade expansion into trade creation or trade diversion.[2] Trade creation improves welfare and occurs when partner country production displaces higher cost domestic production. Trade diversion reduces welfare and occurs when partner country production displaces lower cost imports from the rest of the world.[3] The combined effect of an FTA on intra-bloc trade will then reflect trade creation as well as trade diversion. Whether the trade-creation (welfare enhancing) or the trade-diversion (welfare reducing) effects dominate depends on a variety of factors, including external trade barriers, cost differences, and relative supply and demand responses and other domestic policies. From that point of view, the overall welfare impact of an FTA is not unambiguous, making its determination an empirical issue.

Static Effects: Terms of Trade

The impact of an FTA also can be studied from a "terms of trade" (i.e., the price of exports relative to the price of imports) viewpoint. If the participating countries are large enough to be able to affect import and export prices by their actions, the establishment of an FTA is likely to affect the terms of trade of a given FTA member in three different manners. First, by increasing the demand for its partner's products, the country's own preferential trade liberalization may increase the (pre-tariff) price of its imports from the partner country leading to a deterioration in its terms of trade. Second, tariff reduction by the partner country could increase the demand (and the price) for the FTA member's exports and improve its terms of trade. Finally, the decreased demand for imports originating from non-member countries tends to decrease their price and improve the FTA members' terms of trade. Therefore, the impact on economic welfare will depend on whether the terms of trade have improved or deteriorated for a given partner country.

Scale Effects

To the extent that FTAs integrate (and, hence, enlarge) markets, some would argue that they offer firms an opportunity to exploit economies of scale (or increasing returns to scale) and to lower costs by expanding production. Moreover, by increasing the intensity of competition, an FTA can potentially induce firms to make efficiency

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[2] The seminal works on this issue are J. Viner, *The Customs Union Issue*, New York: Carnegie Endowment for International Peace, 1950 and J. Meade, *The Theory of Customs Union*, Amsterdam: North Holland, 1955.

[3] Losses from trade diversion occur when lost tariff revenue associated with changes in the pattern of trade exceeds efficiency gains from the decline of the prices paid by consumers. These losses will be larger the higher the FTA's margin of preferences (i.e., the trade barriers facing non-members relative to intra-FTA barriers).

improvements in order to raise productivity levels.[4] It has, for instance, been pointed out that firms in Canada have long argued that U.S. market access would enable them to exploit economies of scale, and that this access would allow them to increase their exports not only to the countries in North America, but also to the rest of the world.[5] Increasing returns also affect the volume of trade in inputs and intermediate goods used by increasing return industries because as firms expand production and exploit economies of scale, they need to purchase more inputs and intermediate goods. These goods may be imported from inside or outside the FTA.

The enlarged FTA market also may attract investment, including foreign direct investment (FDI), especially investment for which market size is important.[6] It should be noted that the higher the FTA's margin of preference, the more attractive it will be as an FDI destination. In the long run, changes in trade flows can lead to substantial changes in the location of production between member countries of an FTA. These relocations may be determined by comparative advantage (i.e., the removal of barriers might lead each country to produce the goods at which it is best). Alternatively, sectors with strong backward or forward linkages may all relocate to one country and take advantage of the preferential access to cater to the whole FTA market from there. These agglomeration effects are stronger in the presence of economies of scale. The impact of an FTA will depend on the increased level of economic activity within the FTA and on the distribution of the effects among members.

Nonquantifiable Effects

In addition to the generally quantifiable effects discussed so far, regional integration can provide other potential benefits that are more difficult to evaluate. A World Bank publication discusses a variety of additional effects (or classes of effects) that may result from regional integration agreements.[7] One such effect is enhanced security (either against nonmembers or between members).[8] Another potential benefit is that by forming a unit and pooling their bargaining power, FTA members can negotiate more efficiently in international forums. Regional integration can also be useful in "locking in" domestic (trade or other policy) reforms by raising the cost of policy reversal. Another possible gain is the increased possibilities for cooperation in environmental or technological assistance projects. The non-quantifiable effects pertaining to the U.S.-Australia FTA are associated with market access provisions

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[4] A closely related gain comes from increased competition as firms are induced to cut prices and to expand sales, benefitting consumers as the monopolistic distortion is reduced.

[5] H.J. Wall, "NAFTA and the Geography of North American Trade," *Federal Reserve Bank of St. Louis Review*, vol. 85, No. 2, Mar./Apr. 2003.

[6] In addition to the effects of strictly tariff liberalization, many FTAs have explicit investment provisions (such as improved and secure investment environment) that would further enhance these effects.

[7] The World Bank, *Trade Blocs,* New York: Oxford University Press, 2000, p. 66.

[8] For more on this, see Maurice Schiff, and L. Alan Winters. "Regional Integration as Diplomacy." *World Bank Economic Review*, 1998, 12(2): 271–96. As has been mentioned above, the impact of negotiated commitments of an FTA related to intellectual property rights and customs administration and services is not readily quantifiable.

related to cross border trade in services, telecommunications, government procurement; trade facilitation provisions related to customs administration and technical barriers; investment related provisions; and regulatory environment provisions related to intellectual property rights, trade remedies and labor and environment.[9]

Table 8-1 illustrates the territory in which economists tend to focus their analytical efforts. It shows how limited the area is where effects of trade policy are discernible. A cell marked "yes" indicates that the given effect of the given policy is generally measurable (or can be modeled in a simulation) and / or has been measured. Note that these occur mainly in the static economic effects. The fact that relatively few cells are marked as measurable does not mean that other effects are not important. By focusing attention on a selected number of FTA effects, analysts provide important insights into specific aspects of trade agreements, but it is possible that other non-quantifiable effects dominate.

Impact on the United States of the U.S.-Australia FTA

As shown in chapter 1, the Australian economy is small relative to the U.S. economy. Given the low tariff levels and relatively small bilateral trade and investment flows, economywide effects of trade liberalization on the United States resulting from the U.S.-Australia FTA are expected to be small. A small number of studies have directly assessed the impact on the United States of a U.S.-Australia FTA.

There are three studies employing computable general equilibrium (CGE) analysis of a U.S.-Australia FTA that directly assess the impact of such an FTA on the United States. It should be noted that since most of the studies were done before the U.S.-Australia FTA negotiations were final, their assessments are for a hypothetical FTA and not the actual FTA.[10] The first of these three considered below, prepared for the Australian Department of Foreign Affairs and Trade (DFAT) by the Centre for International Economics (CIE) in 2001,[11] focused exclusively on a U.S.-Australia FTA. The second, by

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[9] Chapters 4 through 7 in the study provide a qualitative assessment of the impact of the U.S.-Australia FTA on these negotiated objectives.

[10] Section 2104(f)(3) requires the commission to review available economic assessments regarding the agreement, to provide a description of the analyses used and conclusions drawn in such literature, and to discuss of areas of consensus and divergence among reviewed literature, including those of the Commission. The Commission notes that it conducted one classified study at the request of the USTR concerning a potential U.S.-Australia FTA. USITC, U.S.-Australia Free Trade Agreement: Advice Concerning the Probable Economic Effect, Investigation Nos. TA-131-24 and TA-2104-4, June 2003. Consequently, for the purpose of this report, the Commission discussion consists only of external economic assessments and the Commission's present study.

[11] Leon Berkelmans, Lee Davis, Warwick McKibbin, and Andrew Stoeckel, "Economic Impacts of an Australia-United States Free Trade Area," Centre for International Economics, Canberra and Sydney, June 2001, found at Internet address *http://www.dfat.gov.au/publications/aus_us_fta/aus_us_fta.pdf*, retrieved Apr. 20, 2004.

Table 8-1
Quantifiable FTA effects

Effects	Quantifiable
Static economic effects:	
Trade creation and diversion	Yes
Terms of trade	Yes
Scale effects:	
Pro-competitive effects	Some
Efficiency	Some
Investment (including FDI)	Yes
Industrial location	Some
Political Effects:	
Enhanced security	No
Increased bargaining power	No
Locking in reforms	No
Cooperation	No

Source: Compiled by the Commission.

Gilbert in 2003, considered a number of potential U.S. FTAs with minimal analytical discussion.[12] The third, by Brown, et al., in 2004,[13] considered U.S. FTAs with Central America, Australia, and Morocco with only slightly more analytical discussion than Gilbert. Another study (the ACIL study in 2003) focused exclusively on a U.S.-Australia FTA, but only reported effects for Australia.[14] In yet another study, in late April 2004, CIE produced an update that focused exclusively on a U.S.-Australia FTA, but only reported effects for Australia, except for three instances where effects on the United States are reported or can be inferred.[15]

In the 2001 CIE study, Berkelmans, et al., analyze the economic impacts of a hypothetical United States-Australia FTA using two models–the APG-Cubed model and the Global Trade Analysis Project (GTAP) model.[16]

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[12] John Gilbert, "CGE Simulation of U.S. Bilateral Free Trade Agreements," Background Paper for the *Free Trade Agreements and U.S. Trade Policy* conference, Institute for International Economics, Washington, DC May 7-8, 2003. FTA partners considered include the CER (Australia and New Zealand), ASEAN, Chile, East Asia (Korea and Taiwan), and some African countries.

[13] Drusilla K. Brown, Kozo Kiyota, and Robert Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," Feb. 8, 2004, found at Internet address *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved Apr. 20, 2004.

[14] ACIL Consulting, "A Bridge Too Far? An Australian Agricultural Perspective on the Australia/ United States Free Trade Area Idea," Report of the Rural Industries Research and Development Corporation, Canberra, February 2003.

[15] CIE, Economic Analysis of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States," Centre for International Economics, Canberra and Sydney, April 2004.

[16] The APG-Cubed model is a product of the McKibbin Software Group (MSG), Pty. Ltd. (Australia). "The Asia Pacific G-Cubed multi-country model is based on the theoretical approach taken in the G-Cubed model but with a focus on a country and sectoral dis-aggregation relevant for the Asia Pacific region." The G-Cubed model "has been constructed to contribute to the current policy debate on environmental policy and international trade with a focus on global warming policies, but it has many

The APG-Cubed model combines aspects of computable general equilibrium models and dynamic intertemporal macroeconomic models, integrating both financial and goods markets in a dynamic framework. The APG-Cubed model uses the GTAP (version 4, 1995 base year) database, aggregated to include 18 countries/regions and 6 sectors. The authors do not specify assumptions about type of competition or returns to scale, but do specify that product differentiation by country of origin (the Armington assumption) is assumed. The authors simulate a 5-year phase-in of the removal of tariff barriers and selected nontariff barriers (NTBs) starting in 2000 and subsequent adjustments in the modeled economies to 2020. The authors do not specify any adjustments (such as provision for Uruguay Round liberalizations) they may have made to the data from 1995 (the base year for the GTAP version 4 database) to 2000. The services sector is "represented as a domestic cost reduction" of 0.35 percent for Australia and 0.02 percent for the United States whereas the usual practice in CGE modeling is to remove a price wedge on imports of services.[17] Modeling consists of a simulated dynamic baseline (which starts in 2000) and comparisons of the FTA scenario to the baseline. The authors present welfare impacts in two ways. First, the authors report the welfare impact on the United States to be 0.02 percent higher real GDP relative to the (dynamic) baseline in 2006, when trade barriers are completely removed in their simulations. Second, they find real consumption (their preferred welfare measure) to be 0.016 percent higher relative to the baseline in 2006. Total U.S. exports are estimated to be 0.1 percent higher relative to the baseline in 2006 and total U.S. imports are estimated to be 0.04 percent higher relative to the baseline in 2006. Sectoral effects are generally not reported.

The second of the analyses of a U.S.-Australia FTA in the 2001 CIE study is a static analysis using the GTAP CGE model and database (version 4). In the analysis, the model is aggregated to include 16 countries/regions and 24 sectors, allowing for more detailed sectoral analysis than is possible with the APG-Cubed model. The model assumes perfect competition, constant returns to scale, and product differentiation by country of origin. Version 4 of the GTAP database, based on 1995 data, was "updated to 1998-99 so as to reflect changes that have occurred since 1995."[18] The three services sectors included in the GTAP simulations (Utilities and other services, Trade and transport, and Financial, business, and recreation services) appear to be accounted for as a domestic cost reduction as in the APG-Cubed simulations. The authors report that they "doubled the Armington elasticities found in the standard

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16—*Continued*
features that will make it useful for answering a range of issues in environmental regulation, microeconomic and macroeconomic policy questions." From the MSG website, found at Internet address *http://www.msgpl.com.au/wmhp/home1.htm*, retrieved Mar. 26, 2004. As indicated in ch. 3, GTAP is the modeling framework developed as part of the Global Trade Analysis Project at Purdue University.

[17] The authors do not explain exactly how the "domestic cost reduction" was modeled.

[18] CIE, 2001, p. 32.

GTAP model."[19] In a static analysis, the authors simulate a one-time removal of tariffs and selected NTBs. They report the welfare effect on the United States of a U.S.-Australia FTA to be 0.02 percent higher GDP. They report estimates of U.S. export prices being 0.03 percent lower and export volume being 0.10 percent higher as a result of an FTA, and of U.S. import prices being 0.05 percent lower and import volume being 0.12 percent higher.

Estimates from the GTAP analysis of the 2001 CIE study of the effects of a U.S.-Australia FTA on U.S. sectors are shown in table 8-2. Estimated effects are small, with only one sector–sugar– experiencing a reduction in output of over 1.0 percent. The sector with the largest estimated increase in output is motor vehicles and parts. Estimated effects on U.S. imports from or exports to Australia are much larger in percentage terms, with a few sectors estimated to increase by over 100 percent, most likely because they are measured from small bases.

CIE updated its analysis in late April, 2004, taking the actual negotiated agreement into account, updating the database to GTAP version 5, and incorporating additional effects not quantified in its 2001 report. Specifically, the dynamic analysis in the 2004 CIE study includes estimates of gains from a reduction in the equity risk premium in Australia for investment and gains from dynamic productivity improvement associated with trade liberalization, in addition to the gains in allocative efficiency from trade liberalization that are usually estimated in CGE analyses. The updated study includes extensive reports of estimated effects of the FTA on Australia, including results of dynamic analysis using the APG-Cubed model and static, more disaggregated analysis using the GTAP model. The only reported estimates of effects on the United States are for GDP and gross national product (GNP) under the dynamic analysis, and U.S. national income and trade with Australia under the static analysis. The study reports that "[r]eal GDP and real GNP in the U.S. will be 0.013 and 0.014 percent higher than the baseline level ten years out" under the dynamic simulations.[20] U.S. net national income is estimated to be higher by $432 million,[21] U.S. imports from Australia higher by $3.3 billion[22] and U.S. exports to Australia higher by $6.5 billion[23] under the static simulations.

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[19] CIE, "Australia-United States Free Trade Agreement: Comments on the ACIL report, Centre for International Economics," Canberra and Sydney, March 2003, p. 5. Further, the authors say "This was done on the basis of work conducted by other researchers–including the developers of the GTAP model itself–which suggested that the Armington elasticities used in the standard GTAP model are too low and need to be doubled."

[20] CIE, Economic Analysis of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States," Centre for International Economics, Canberra and Sydney, April 2004, p. 80.

[21] CIE, 2004, p. 83.

[22] CIE, 2004, p. 89. Reported as change in Australian exports to the United States. Changes in trade flows are also reported by sector.

[23] CIE, 2004, p. 90. Reported as change in Australian imports from the United States. Changes in trade flows are also reported by sector.

Table 8-2
United States sectoral changes, CIE GTAP analysis

(Percent)

Sector	US exports to Australia	US imports from Australia	Total export volume	Total import volume	Domestic output
Grains	1.87	3.31	0.07	-0.06	-0.02
Other crops	3.47	5.36	-0.01	0.05	-0.01
Sugar cane, beet	na	na	na	na	-0.23
Animal products	1.04	-1.18	0.11	-0.03	-0.01
Raw milk	na	na	na	na	-0.16
Forestry and fishing	0.40	-0.22	-0.11	0.06	0.00
Mining and energy	0.85	1.58	-0.02	0.04	0.00
Meat products	0.63	7.77	0.00	0.86	-0.02
Other food products	9.21	6.60	0.11	0.04	0.01
Dairy	38.13	354.30	1.94	16.38	-0.18
Sugar	72.07	2,550.81	16.91	20.02	-1.47
Beverages and tobacco	28.42	9.24	0.06	0.17	0.01
Textiles, clothing and footwear	104.50	75.48	0.83	0.19	0.04
Wood and paper products, publishing	19.48	2.45	0.21	0.08	0.01
Chemicals, rubber and plastics	8.62	8.26	0.08	0.14	0.01
Other mineral and metal products	24.14	10.52	0.08	0.12	0.00
Ferrous metal products	25.24	15.41	0.05	0.13	-0.01
Motor vehicles and parts	46.60	10.33	0.78	0.11	0.12
Other transport equipment	4.52	5.69	-0.06	0.11	-0.01
Electronic equipment	0.80	6.75	-0.12	0.07	-0.03
Other manufacturing	13.30	6.48	0.07	0.09	0.00
Utilities and other services	-0.15	0.38	-0.22	0.10	0.00
Trade and transport	-0.02	0.59	0.12	-0.01	0.05
Financial, business and recreational services	-1.54	3.56	-0.11	0.06	0.00

Note.–na: Not applicable as there is no, or an insignificant amount of, trade in these commodities.

Source: Leon Berkelmans, Lee Davis, Warwick McKibbin, and Andrew Stoeckel, "Economic Impacts of an Australia-United States Free Trade Area," Centre for International Economics, Canberra and Sydney, June 2001. GTAP model simulation, from table 4.5, p. 39 and table 4.6, p. 41.

Gilbert, in a background paper prepared for a conference in May 2003, presents CGE simulations of a number of potential U.S. bilateral free trade agreements.[24] Gilbert's analyses are based on the GTAP CGE model and database (version 5), aggregated to include 22 countries/regions and 19 sectors. The model assumes

[24] John Gilbert, "CGE Simulation of U.S. Bilateral Free Trade Agreements," Background Paper for the Free Trade Agreements and U.S. Trade Policy conference, Institute for International Economics, Washington, DC, May 7-8, 2003.

perfect competition, constant returns to scale, and product differentiation by country of origin (i.e., the Armington assumption). The tariffs used are those in place in the base year, 1997. All import tariffs are assumed to be reduced to zero in the participating economies on a preferential basis in a static simulation. Although reporting is organized in terms of groupings of countries with which the United States might form FTAs (for example, ASEAN, Australia-New Zealand FTA), results are reported in terms of bilateral FTAs between the United States and individual countries in those groupings. Gilbert reports that data limitations do not allow substantive treatment of services sector liberalization. Gilbert reports the welfare impact (in terms of equivalent variation[25]) on the United States of a U.S.-Australia FTA to be 0.01 percent higher GDP.[26] Gilbert also reports estimates of the value of total U.S. exports to be 0.15 percent higher and the value of total U.S. imports to be 0.14 percent higher.[27]

Gilbert's estimates of the effects of a U.S.-Australia FTA on U.S. sectors are shown in table 8-3. Estimated effects are small, with no sector experiencing a change in output of over 0.2 percent. The sector with the largest estimated increase in output is Motor vehicles, and the sector with the largest estimated decrease in output is Other transportation equipment.

Brown et al., in a February 2004 paper, present estimates of the economic effects of the three most recently negotiated U.S. bilateral trade agreements–those with five Central American countries and the Dominican Republic, Australia, and Morocco. The authors use the Michigan Model, a CGE model that allows for increasing returns to scale, monopolistic competition, and product variety[28] in a static analysis.[29] The version of the model used has 18 sectors and 22 countries / regions and uses data from version 5.4 of the GTAP database as well as data derived from other sources. The GTAP version 5.4 (base year 1997) database is projected to 2005, incorporating the Uruguay Round liberalizations and the accession of China and Taiwan to the WTO. The authors report the welfare effect of a U.S.-Australia FTA to be 0.20 percent higher

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[25] The equivalent variation measures the welfare impact of a policy change in monetary terms and it is defined as the amount of income that would have to be given to (or taken away from) the economy *before* the policy change in order to leave the economy as well off as the economy would be *after* the policy change. A positive figure for equivalent variation implies that the policy change would improve economic welfare (see H.R. Varian, *Intermediate Microeconomics: A Modern Approach*, Fifth Edition, W. W. Norton & Company, New York, 1999, pp. 252-253)

[26] Gilbert, tab. 3.1a, p. 30.

[27] Ibid.

[28] An example of this would be restaurant meals. Most consumers who eat out frequently also will switch between restaurants, one day eating at a Chinese restaurant, another day at a Mexican restaurant, etc. If all consumers share the same love of variety then the aggregate market will sustain demand for many varieties of goods simultaneously. If a utility function is specified that incorporates a love of variety, then the well-being of any consumer is greater the larger the number of varieties of goods available. Thus, in this case, the consumers would prefer to have twenty varieties to choose among rather than ten.

[29] Increasing returns to scale, monopolistic competition, and product variety are elements of the "New Trade Theory."

Table 8-3,
Estimated changes in value of the sectoral pattern of U.S. production and exports as a result of a U.S.-Australia FTA, Gilbert

(Percent)8

Sector	Production	Total exports	Exports to Australia	Imports from Australia
Grains	-0.04	0.00	4.14	1.98
Other crops	-0.03	0.00	9.84	47.27
Animal products	-0.05	0.07	4.23	3.00
Forestry and fisheries	-0.03	-0.10	1.35	6.44
Processed food products	-0.05	0.16	28.43	67.36
Lumber	-0.01	0.10	27.00	8.76
Pulp and paper products	0.00	0.12	9.43	1.21
Textiles and apparel	0.10	1.27	137.97	79.29
Coal, oil and gas	-0.02	-0.06	0.29	1.51
Petroleum and coal products	0.01	-0.04	-0.10	9.55
Chemicals	0.03	0.21	12.51	13.51
Metals	0.00	-0.01	17.33	3.32
Metal products	0.03	0.31	37.52	18.81
Electronic equipment	-0.08	-0.09	4.39	13.48
Motor vehicles	0.19	1.38	105.83	26.44
Other transportation equipment	-0.11	-0.23	2.52	6.57
Machinery NEC	0.04	0.25	18.24	15.38
Manufactures NEC	-0.01	0.16	19.48	8.30
Services	0.00	-0.14	0.43	-0.51

Source: From John Gilbert, "CGE Simulation of U.S. Bilateral Free Trade Agreements," Background Paper for the Free Trade Agreements and U.S. Trade Policy conference, Institute for International Economics, Washington, DC May 7-8, 2003, tables 3.2a and 3.3a, pp. 31 and 32.

GNP, of which 0.17 percent higher welfare comes from services liberalization.[30] Changes in total U.S. exports and total U.S. imports are not reported, although changes in U.S. exports and imports by sector are reported.

Brown et al.'s, estimates of the effects of a U.S.-Australia FTA on U.S. sectors are shown in table 8-4. Estimated effects are small, with all but one sector (leather products and footwear) experiencing changes of 0.15 percent or less in absolute value.

Two other studies have dealt either primarily or secondarily with a U.S.-Australia FTA, but did not report extensive estimates of effects on the United States. The ACIL report[31] is partly a counter to the CIE report. It was commissioned by the Rural Industries

[30] Brown et al., p. 15. "The services barriers are based on financial data on average (price-cost) margins constructed initially by Hoekman (Bernard Hoekman, "The Next Round of Services Negotiations: Identifying Priorities and Options," *Federal Reserve Bank of St. Louis Review*, July/August 2000, vol. 82, pp. 31-47.) and adapted for modeling purposes in Brown, Deardorff, and Stern (Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "CGE Modeling and Analysis of Multilateral and Regional Negotiating Options," in Robert M. Stern (ed.), *Issues and Options for U.S.-Japan Trade Policies*. Ann Arbor: University of Michigan Press, 2002).

[31] ACIL, 2003.

Table 8-4
U.S.-Australia FTA: Change in exports, imports, output, and employment, by sectors, Brown et al.

(Percent)

	Exports		Imports		Output		Employment	
	United States	Australia	United States	Australia	United States	Australia	United States	Australia
Agriculture	0.06	-1.18	0.05	2.78	0.01	-0.11	0.01	-0.12
Mining	0.19	-3.10	-0.04	2.15	0.12	-2.16	0.08	-1.84
Food Beverages & tobacco	0.19	1.84	0.75	3.22	-0.01	0.60	-0.03	0.10
Textiles	0.61	1.61	0.05	2.62	0.12	0.04	0.09	-0.64
Wearing apparel	0.37	4.25	-0.08	1.72	0.10	0.68	0.07	-0.21
Leather products & footwear	0.50	0.00	-0.04	1.39	0.22	-0.29	0.19	-0.94
Wood & wood products	0.26	-0.85	-0.04	2.99	0.03	0.20	0.01	-0.29
Chemicals	0.37	-1.26	-0.06	3.71	0.08	-1.09	0.06	-1.42
Non-metallic min. Products	0.51	-0.78	-0.06	4.84	0.09	-0.47	0.07	-0.91
Metal products	0.25	-2.31	-0.05	3.10	0.09	-1.27	0.06	-1.53
Transportation equipment	0.32	-0.09	-0.06	3.63	0.11	-0.65	0.08	-1.24
Machinery & equipment	0.28	-0.94	-0.06	2.09	0.13	-1.75	0.12	-2.31
Other manufactures	0.35	-2.29	-0.07	2.39	0.15	-2.10	0.12	-2.40
Elec., gas & water	0.09	-1.97	-0.04	2.22	0.03	0.07	0.00	-0.10
Construction	0.07	0.09	-0.01	2.01	0.01	0.32	0.00	-0.10
Trade & transport	0.04	15.81	1.70	0.14	-0.02	1.66	-0.03	0.44
Other private services	0.04	11.73	1.17	1.12	-0.01	0.95	-0.01	0.27
Government services	0.77	13.83	1.50	27.64	0.01	0.42	0.00	-0.08

Source: Computations by Drucilla K. Brown, Kozo Kiyota, and Robert Stern, “Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco,” Feb. 8, 2004, found at Internet address http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf, retrieved Apr. 20, 2004, table 9.

Research and Development Corporation. The ACIL report does not report any estimates of effects on the United States, but it does report small negative effects for Australia in contrast to the small positive effects for Australia reported in the CIE report.[32]

A study by DeRosa[33] applies parameter estimates from gravity modeling to analysis of a number of potential U.S. bilateral FTAs and possible expansion of trade led by these FTAs. The major contribution of the study is the application of the estimate in a gravity model by Rose[34] that bilateral trade between FTA partners is 118 percent higher than without an FTA.

There are a number of other papers dealing with the prospect of a U.S.-Australia FTA–mostly policy papers, but their analytical contribution is minimal, with most referring to one or more of the above studies with regard to quantitative estimates of the effects of such an FTA.[35]

A summary of methodology and model assumptions in the major analytical studies is presented in table 8-5.

Alternative Policy Experiments

This section asks, just how different are the findings of the different models, given that these findings are based on different model structures and policy assumptions? It makes an analytical comparison between the results obtained by the USITC model described in chapter 3 and selected modeling results from the literature review above. Specifically, the purpose of this exercise is to help determine the extent to which differences in outcomes reported by the various models are driven by different assumptions about the trade barriers or shocks being modeled, and the extent to which these differences depend on other structural differences among the models in, for example, trade elasticity parameters, the characterization of capital formation, returns to scale, and product variety effects. As will be seen, the differences between results found in the USITC analysis and those found in others can be attributed to all of these different factors.

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[32] The response to the ACIL report by CIE is footnoted above, but since no additional estimates are presented, the CIE response is not reviewed separately.

[33] Dean A. DeRosa, "Gravity Model Calculations of the Trade Impacts of U.S. Free Trade Agreements," Institute for International Economics, Mar. 29, 2003.

[34] Andrew K. Rose, "Which Institutions Promote International Trade?," University of California, Berkeley, mimeo, 2003. Coefficients estimated by Rose include those for the effects of size of the trade partners' economies and the distance between the two (standard variables in gravity models); membership of trade partners in a regional FTA; as well as a number of others such as membership in the WTO, IMF, or OECD, currency union, common language, etc.

[35] See, for example, *An Australia-United States Free Trade Agreement - Issues and Implications*, A Report for the Department of Foreign Affairs and Trade by The Australian APEC Study Centre, Monash University, August 2001, found at Internet address *http://www.dfat.gov.au/publications/aus_us_fta_mon/aus_us_fta_mon.pdf*, retrieved Apr. 20, 2004.

Table 8-5
Methodology and model assumptions: Selected economic literature on a hypothetical U.S.-Australia FTA

Author/year	Model	Database, base year	Returns to scale/ competition	Product differentiation	Type (static, dynamic, other)	Type of experiment	Welfare effect (percent of U.S. GDP or GNP)[1]
Berkelmans, et al./2001[2]	APG-Cubed	GTAP-4, 1995: simulations start with 2000	Not specified in report	Armington	Dynamic	Tariffs, selected NTBs, and services	Real GDP–higher by 0.02
Berkelmans, et al./2001[2]	GTAP	CIE version of GTAP-4, 1995, updated to 1998-99	Constant/Perfect	Armington	Static, GTAP	Tariffs, selected NTBs, and services	Real GDP–higher by 0.02
Gilbert/2003[3]	GTAP	GTAP-5,1997	Constant/Perfect	Armington	Static, GTAP	Tariffs only	Real GDP–higher by 0.01
Brown, Kiyota, and Stern/2004[4]	Michigan	GTAP-5.4, 1997, projected to 2005	Increasing/Monopolistic (except Agriculture)	Product variety	Static	Tariffs, services	GNP–higher by 0.2
ACIL/2003[5]	Tasman Global	GTAP-5, 1997	Constant/Perfect	Armington	Dynamic (appears to be sequential solutions)	Tariffs, possibly services	Lower GDP for Australia–no estimates reported for U.S.

[1] These results include liberalization of sugar. However, sugar was not included in the U.S.-Australia FTA.
[2] Leon Berkelmans, Lee Davis, Warwick McKibbin, and Andrew Stoeckel, "Economic Impacts of an Australia-United States Free Trade Area," Centre for International Economics, Canberra and Sydney, June 2001.
[3] John Gilbert, "CGE Simulation of U.S. Bilateral Free Trade Agreements," Background Paper for the Free Trade Agreements and U.S. Trade Policy conference, Institute for International Economics, Washington, DC, May 7-8, 2003.
[4] Drusilla K. Brown, Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," Feb. 8, 2004.
[5] ACIL Consulting, "A Bridge Too Far? An Australian Agricultural Perspective on the Australia/United States Free Trade Area Idea," Report of the Rural Industries Research and Development Corporation, Canberra, February 2003.

Source: USITC summarization.

Some of the most important inputs into the simulation models are the magnitudes of the simulated changes in trade policy. The studies reviewed above were prepared in advance of the actual agreement and hence do not accurately reflect the actual changes in these magnitudes. They therefore include products, such as sugar, that are excluded from the Agreement, as well as dairy products that were subject to minimal liberalization.To put the Commission analysis in the context of these other studies, simulations are performed to examine how different assumptions about the policy experiment influence model outcomes.

The alternative simulations use the USITC model with its underlying structure unchanged; in particular, Armington elasticities (i.e., trade substitution elasticities) and other parameters remain at the values assumed for them in the analysis presented in chapter 3. That is, simulations are run applying the assumed tariff and nontariff barrier shocks used by other authors on the USITC model. The CIE study used Armington elasticities that are generally double the size of those included in the standard GTAP model and also used by ACIL. The Armington elasticities in the USITC model are derived independently by Hertel, Hummels, Ivanic, and Keeney[36] (2003), and are generally higher than the standard GTAP values.

The scenarios considered are those of ACIL, CIE, and Brown, Kiyota, and Stern (BKS), discussed in the previous section of this chapter. Table D-3, in appendix D, lists the commodities modeled in the alternative scenarios, and the tariff and nontariff trade measures assumed to be removed by the U.S.-Australia FTA in those scenarios. All three studies report their trade measures as a combination of tariffs and the tariff equivalent of nontariff measures. No export taxes or export tax equivalents of export quotas or quantitative restrictions are modeled by any of the studies reviewed or by the USITC analysis. Because each of the alternative models uses commodity data aggregated in ways that differ from the USITC model, it was necessary to reaggregate the commodities to correspond to those in the USITC model.

The alternative policy shocks as applied to the USITC aggregation also are given in the table. In matching the alternative policy shocks of other authors to the sectors in the USITC model, the following simple procedures were used. Where one sector in an alternative model includes more than one USITC sector (such as the BKS agriculture sector, which includes the USITC sectors grains, sugar crops, other crops, and vegetables, fruits and nuts) the shock from the alternative model sector was applied to each of the USITC sectors. Where more than one alternative model sector matches a USITC sector (such as the BKS sectors apparel, textiles, and leather products and footwear, all of which are contained in the single USITC sector textiles, apparel, and leather products), a simple average of the shocks in the alternative model sectors was applied to the USITC sector. One exception to this is in the transfer of the CIE services shocks to the USITC model, where CIE's value for financial, business, and recreation services was applied to the USITC services sector. Note again that all three studies

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[36] Hertel, Thomas, David Hummels, Maros Ivanic and Roman Keeney, *How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?* GTAP Working Paper No. 26, 2003, available at *http://www.gtap.agecon.purdue.edu/resources/*

assumed the elimination of trade barriers in sugar, which was not included in the FTA itself or the USITC analysis. Also, CIE and ACIL fully liberalized dairy trade, while BKS did not consider this sector separately (including it with food, beverages, and tobacco). As noted above, the USITC model analysis did not fully remove the duties on dairy products. Also, the USITC analysis did not estimate the impact of services liberalization due to unavailability of necessary data on non-tariff barriers.

Table 8-6 provides an illustration of the magnitude of the differences in the estimated changes in U.S. welfare found by the other authors, compared to the welfare change when the alternative scenarios are applied using the USITC model.

ACIL did not publish a measure of the change in U.S. welfare, but found a small negative effect for Australian welfare. The USITC model found a very small but positive effect for Australia. The ACIL study employs the set of Armington elasticities used in the GTAP version 5 data base, which are half the values of those used in the CIE model and also much lower than those used in the USITC model.

Chapter 3 presents a discussion of the sensitivity of trade models to the values of these Armington trade elasticities. In general, lower values embody an assumption that trade flows are relatively insensitive to changes in tariffs and other trade barriers. It is likely that most of the difference between the ACIL estimate of (Australia's) welfare change, and the estimate produced by the USITC model using ACIL's policy shocks, is attributable to the different assumptions about the values of the Armington trade elasticities.

In comparison to the results obtained by Brown, Kiyota, and Stern (BKS), the USITC model implementation of their shocks generated a far smaller welfare impact from the same liberalization scenario. Their reported welfare gain from liberalization is $19.4 billion compared with $2 billion using the USITC model with the BKS shocks, and with $0.49 billion obtained from the USITC model as reported in chapter 3. While BKS et al. do not report simulated changes in bilateral trade flows, it should be noted that the benchmark U.S. imports from Australia for 1997 equal $8.0 billion, while exports equal $14.6 billion reported in the BKS model. The Commission's 2005 benchmark is $11.3 billion in imports and $18.1 billion in exports. Given these trade flows, BKS's simulated gains from liberalization are very large relative to the overall bilateral flow of trade between the United States and Australia. The gains equal 85 percent of the benchmark trade flow ($19 billion welfare gain, divided by the sum of $8 billion U.S. imports and $14 billion exports); the increase in welfare is actually larger than their benchmark level of U.S. imports from Australia, while the Commission model with the BKS scenario yields a gain equal to 7 percent of benchmark trade flows ($2 billion welfare gain, divided by the sum of $11 billion in U.S. imports and $18 billion exports); and an increase in U.S.-Australian trade of 132 percent.

This result suggests that the preponderance of the BKS welfare gains come from the new trade theory aspects of their model, which emphasize ways in which trade promotes increases in productivity (through exploitation of returns to scale and increased product variety among other things). Those gains, in turn, are most likely

Table 8-6
Comparison of U.S. welfare changes for different scenarios

	Welfare change			
		Million dollars		
Scenario:	**USITC**	**ACIL[1]**	**CIE**	**BKS**
Implementation:				
Author's	490.8	-139.9	[2] 1,231.1	19,400.0
Alternative scenarios[3]	490.8	297.0	518.3	2,031.7

[1] ACIL does not report a welfare effect for the United States. The figures given for both implementations in this column apply to Australia. They represent reported percent changes of -0.05 percent (ACIL) and 0.10 percent (USITC) applied to the baseline welfare level in the USITC model.

[2] CIE reports a percentage change in welfare of 0.016 percent in 2006. This percentage is applied to the baseline welfare level in the U.S. model.

[3] The alternative scenario uses the USITC model with its underlying structure unchanged and applies the assumed tariff and nontariff barrier shocks used by the authors.

Source: Commission calculations and cited reports by CIE, ACIL, and Brown et al. (BKS).

focused in the services sectors, which are modeled as featuring increasing returns to scale and undergoing substantial liberalization. Further, the services sectors trade barriers themselves are quite large, and as the authors acknowledge, are "...possibly subject to overstatement."[37] In comparison to the BKS liberalization scenario, the Commission benchmark liberalization does not model either the United States or Australia as removing substantial barriers to services as a result of the FTA. In the BKS model the United States has ad valorem equivalent barriers against imports from all countries of 27 percent in trade and transport; 31 percent in other private services; and 25 percent in government services, which represent relatively high levels of trade restrictions. As was mentioned in chapter 3, removing large barriers leads to large effects. The BKS model consists of removing those barriers against Australia (and likewise Australia's barriers against the United States).

The CIE model simulated effects of a reduction in protection in the transportation industry in the form of enhanced productivity in this sector. The USITC replication of their model adopts a similar approach. CIE employs two models to estimate the effects of the FTA, as noted earlier in this chapter. The CIE implementation of the GTAP model does not yield estimates of welfare changes for either the United States or Australia, while the CIE implementation of the APG-Cubed model imposes tariff policy shocks at a very high level of aggregation (only six sectors). The Commission's attempt to implement the CIE policy assumptions makes use of the CIE shocks as aggregated by CIE for the GTAP model, and then linked to the slightly different aggregation used in the USITC model (see table D-3). The USITC implementation yields a U.S. welfare gain of $490.8 million. CIE, in their APG-Cubed model, find a U.S. welfare gain of about $1.2 billion.

[37] Brown, et al., p. 7.

The CIE approach as implemented in the APG-Cubed model is fundamentally different from the approach of the USITC model. As described above, APG-Cubed has dynamic features which incorporate investment and capital growth over time. The figure of $1.2 billion actually represents the growth in welfare of 0.016 percent reported by CIE for the year 2006, a year after implementation of the FTA. This percentage growth is applied to the base level of welfare in the USITC model to derive the $1.2 billion change in U.S. welfare. In comparison, the USITC model's U.S. welfare change is derived from a static model with no capital growth. It represents the "instantaneous" effects of full implementation of the FTA. This structuring of specific gains from dynamic capital formation is evidently the source of the larger welfare effect obtained by the CIE analysis. As reported earlier in this chapter, CIE published a study in late April 2004 with updated information.[38] While they did not report a welfare number for the United States, their new report shows a long-run increase in GDP of 0.013 percent, a bit larger than the change of 0.01 percent found in the USITC analysis, but not substantially different.

To summarize, the differences between results found in the USITC analysis and those found in others can be attributed to different factors. In comparison with the USITC model, the BKS study assumes much higher barriers in the services industries, but this accounts for only a small part of the difference in welfare effects. The remainder of the very large difference in welfare effects is most likely due to the large scale economies and other unique features of the BKS model. The ACIL model, while closer to the USITC model than the BKS, makes use of small trade substitution elasticities (Armingtons), and thus produces a very small (and negative) welfare effect for Australia. The CIE results are qualitatively rather close to the USITC model implementation of their tariff removals; the difference is largely due to the CIE APG-Cubed model's dynamic treatment of investment and capital formation.

[38] CIE, Economic Analysis of AUSFTA: Impact of the Bilateral Free Trade Agreement with the United States," Centre for International Economics, Canberra and Sydney, April 2004.

CHAPTER 9
Summary of Views of Interested Parties

The Honorable Russell D. Feingold, United States Senator from Wisconsin[1]

Senator Feingold thinks that the U.S.-Australia FTA will not be good for the dairy producers in Wisconsin. Increased market access to dairy products from Australia will lead to rapid growth in dairy products entering the U.S. market. Senator Feingold quotes a USTR estimate that additional dairy imports from Australia could amount to $40 million in the first year of implementation, and notes that increased quota access will result in a threefold increase in imports from Australia. As more dairy products are imported, prices will fall, forcing dairy farmers out of business. Senator Feingold also is concerned about the impact the Agreement will have on cheese manufacturing in his state. He notes that the Administration missed an opportunity to "close the tariff loophole" that enables milk protein concentrate to be imported in the United States with minimal duty. Senator Feingold has heard from his constituents in the Wisconsin dairy industry who feel that they are being harmed by unfair free trade agreements. Senator Feingold states that the U.S.-Australia FTA comes at a bad time when the dairy industry is recovering from a period of very low prices and incomes.

The Honorable Tim Johnson, United States Senator from South Dakota[2]

Senator Johnson thinks that while Australia stands to benefit substantially from a free trade agreement with the United States, there are limited opportunities and benefits for the U.S. livestock industry and agricultural sector. Therefore, Senator Johnson indicates that he cannot support an agreement that poses a significant threat to South Dakota agriculture, and more specifically threatens South Dakota cattle producers. South Dakota cattle producers have expressed significant concern about the FTA to Senator Johnson and think that the provisions must be revisited and reviewed. Senator Johnson states that the United States should not enter into trade agreements with Australia, or any other country, that would further damage U.S. agriculture and place economic hardship on rural communities.

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[1] Russell D. Feingold, U.S. Senate, letter to the Chairman of the Commission, Mar. 30, 2004.
[2] Tim Johnson, U.S. Senate, letter to the Chairman of the Commission, Apr. 6, 2004.

The Honorable Charles E. Schumer, United States Senator from New York[3]

Senator Schumer is concerned that the U.S.-Australia FTA will adversely affect the U.S. dairy industry, especially over the long term. While he is pleased that the Agreement does not lower over-quota tariffs on dairy products, he is concerned about the impacts of additional imports from Australia that will face a zero in-quota tariff. Recently, dairy farmers have engaged in a voluntary supply control program in an effort to raise prices and incomes. Senator Schumer thinks that it would be a "travesty" if the effects of this initiative were to be erased by additional imports from Australia.

The Honorable Ed Case, Member of Congress from Hawaii[4]

Congressman Case represents Hawaii's second district, which encompasses the Islands of Hawaii, Maui, Kahoolawe, Lanai, Molokai, Oahu, Kauai, and Nihau, and Northwestern Hawaiian Islands. Congressman Case states that the Hawaiian macadamia nut industry is highly vulnerable to foreign imports because foreign growers ship a generally lower-quality product, which could flood the U.S. market and displace Hawaiian growers. According to the Congressman, over the past 10 years the Hawaiian economy has endured the job losses associated with the closing of sugar plantations and the downsizing of the pineapple industry; he states that the loss of a third major agriculture industry - macadamia nuts - would be a critical blow to the state's agricultural economy.

His Excellency Michael Thawley, Australian Ambassador to the United States

Ambassador Thawley called the U.S.-Australia FTA "an extraordinary achievement," referring to it as "laying the foundation for integrating more closely two modern and sophisticated economies." He cited the Agreement's two-sided potential for an increase in trade and investment, faster economic growth, more and better jobs, and higher living standards for both partner countries. He stated that "Of all the countries with which the United States could realistically negotiate a trade agreement, Australia has the largest economy, [is] the fastest growing and the most open."

Areas of significant importance in the FTA were highlighted in the Ambassador's testimony before the Commission--manufactures, with the largest one-time and immediate reduction in industrial tariffs ever achieved in a bilateral agreement;

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[3] Charles E. Schumer, U.S. Senate, letter to the Chairman of the Commission, Apr. 6, 2004.
[4] Ed Case, U.S. House of Representatives, letter to the Secretary to the Commission, Mar. 16, 2004.

foreign investment--where procedures will be liberalized to encourage capital; trade in services--with increased freedom and greater legal certainty for a sector that accounts for over 70 percent of each partner economy; and intellectual property, which will be more closely harmonized in order to bring both further benefits and greater predictability into segments of the service sector.

The Ambassador emphasized the importance of the agricultural concessions that were secured by the FTA. While Australian dairy and beef sectors stand to gain under the Agreement, he pointed out that the overall impact of these increases on the United States "is minimal in the context of total U.S. production and imports." He also pointed out that while a number of the benefits of the FTA are unquantifiable, "they help explain why trade and investment growth under high quality FTAs ... has dramatically outstripped the gains predicted by economic modeling."

The Agreement was characterized as excellent and balanced, one that offers the citizenry of both countries "a much more open and predictable economic and regulatory environment."

Air Courier Conference of America International (ACCA) [5]

ACCA represents the express delivery service industry, which specializes in fast, reliable transportation services for documents, parcels, and freight. ACCA's members include large integrated express delivery companies, such as FedEx Corp., United Parcel Service (UPS), DHL Worldwide Express, and TNT U.S.A., Inc.; as well as local and regional couriers and messengers. ACCA members employ 800,000 people worldwide and generate annual revenues of over $50 billion.

ACCA supports the U.S.-Australia FTA and states that express delivery operators will benefit from increased merchandise transport volumes as a result of increased trade between the two countries. Additionally, the U.S.-Australia FTA includes trade facilitation provisions that will improve customs processing in Australia and enhance the operating environment for express delivery firms. The Agreement builds on earlier FTAs to provide important commitments for the industry and to define the express delivery industry in such a manner that all entities providing the service are subject to the provisions of the Agreement, thereby reducing the potential for discriminatory treatment. ACCA is further encouraged that the FTA includes a standstill provision, which halts the implementation of trade-impeding measures, thereby providing greater regulatory certainty for providers of the service. The Agreement includes language that ensures that the chapter on competition policy applies to express delivery services, helping to address cross-subsidization concerns. ACCA also states that the competition chapter will further reduce the potential for anitcompetitive monopoly behavior in such areas as licensing, operational limitations, and taxes.

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[5] Susan Presti, Executive Director, Air Courier Conference of America, International.

American-Australian Free Trade Agreement Coalition (AAFTAC)[6]

The AAFTAC is a coalition of over 260 organizations and businesses representing a broad spectrum of industries and economic interests in the United States. Members include manufacturing firms, service firms, agricultural businesses, chambers of commerce, and trade associations. AAFTAC supports the U.S.-Australia FTA, stating that it will provide significant economic benefits to the U.S. economy. AAFTAC notes that Australia is an important trading partner of the United States. The FTA will immediately eliminate Australian tariffs on virtually all U.S. manufactured goods exports, providing increased export opportunities for a wide range of U.S. industries. U.S. farmers, ranchers, and food processors will benefit from immediate duty-free access to the Australian market for many U.S. agricultural products and processed foods. According to AAFTAC, the FTA provides greater access to the Australian market for U.S. services such as telecommunications, financial, professional and technical, and travel. AAFTAC states that other areas of the FTA beneficial to the United States include national treatment for U.S. investors and the exemption of most screening for new U.S. investments in Australia; the opening up of the government procurement market in Australia to U.S. firms; new commitments on e-commerce providing for nondiscriminatory treatment for digital products; and additional protections for U.S. trademarks, copyrights, and patents. AAFTAC notes that the United States and Australia have been friends and allies for over 100 years; the FTA will bind the two countries together for a common economic future that will improve the economic well-being of their citizens.

American Dehydrated Onion and Garlic Association[7]

The American Dehydrated Onion and Garlic Association (ADOGA), comprising two firms that account for the majority of domestic dehydrated onion and garlic production, opposes a U.S.-Australia FTA. ADOGA states that, although there were no imports of the subject products from Australia prior to 2002, Australia poses a serious threat to the U.S. industry because of its favorable climate for raising onions and garlic and because of its existing capacity for dehydrating vegetables. Most of the ADOGA firms' production is sold to institutional and food-service buyers for use, in very small amounts, as an ingredient in other processed foods. With the cost of dried onions or garlic accounting for a very small share of the cost of the end product in which it is used, demand for these products is derived by end-product producers. ADOGA states that any imports from Australia would place additional downward price pressure on the U.S. products and further exacerbate the competitive position of

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[6] William Lane, Co-Chairman, American-Australian Free Trade Agreement Coalition.

[7] Irene Ringwood, Ball Janik LLP, Washington, D.C., counsel for the American Dehydrated Onion and Garlic Association, submission Mar. 31, 2004.

the U.S. industry. Finally, ADOGA states that there is the possibility of dried onions and garlic being transshipped through FTA countries including Australia from China, the world's largest supplier of onions and garlic.

American Sugar Alliance[8]

The American Sugar Alliance (ASA) is a national coalition of sugar cane, sugar beet, and corn farmers, processors, suppliers, and other workers involved in the U.S. sweetener industry. ASA supports the exclusion of sugar from the U.S.-Australia FTA and supports the provisions of Article 3:1 of the FTA that call for Australia and the United States to work within the WTO to address issues such as State trading enterprises. ASA also states that the FTA in its treatment of sugar, should serve as a template for future FTA agreements.

Association of Equipment Manufacturers[9]

The Association of Equipment Manufacturers (AEM)—a trade association representing U.S. and Canadian producers of construction, agricultural, mining, forestry, and utility equipment—supports the U.S.-Australia FTA. AEM states that U.S. producers will benefit from immediate elimination of Australian tariffs, access to Australian Government procurement, and inclusion of remanufactured parts and components in the Agreement. U.S. exports of many types of construction, agricultural, mining, forestry, and utility equipment products face Australian tariffs of 5 percent. The elimination of a 5 percent tariff on heavy equipment is significant, as prices on such equipment range from a few thousand dollars to more than a million dollars. U.S. exporters expect to realize increased sales in the Australian market as a result of tariff elimination enhancing their price competitiveness, particularly against European and Asian competitors. The Australian market is significant for U.S. exporters of this heavy equipment, and ranks among the top five destinations for U.S.-produced heavy equipment in the world.

The FTA also will benefit U.S. exporters by increasing access to the Australian Government procurement market. This is important for U.S. producers of construction and utility equipment. AEM notes that the FTA also defines and includes remanufactured parts and components and provides for remanufactured parts to be treated the same as new parts. Remanufactured parts and components are produced from used parts and components, where key core materials, such as a cast housing, are salvaged. The part or component is disassembled, cleaned, inspected, and new

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[8] Jack Roney, Director of Economics and Policy Analysis, American Sugar Alliance.
[9] Megan Carpentier, Manager of Government Affairs, Association of Equipment Manufacturers.

materials added as appropriate, so the part or component is sold and functions as new, although at a greatly reduced cost. Typical parts that may be remanufactured include engines and transmissions. Many developing countries do not desire to be prime markets for old machinery and equipment, and generally have limitations on the importation of used machinery and parts. Since remanufactured products function as new and are increasing in use, AEM thinks that by including provisions for remanufactured parts in the U.S.-Australia FTA, the Agreement continues the model set in the U.S.-Chile and U.S.-Singapore FTAs, thereby increasing the likelihood that remanufactured parts will be incorporated in future FTAs with developing countries. AEM notes that there are no issues regarding remanufactured articles in trade with Australia.

Automotive Trade Policy Council, Inc.[10]

The Automotive Trade Policy Council (ATPC) is a Washington, D.C.-based nonprofit trade association that represents the common international economic, trade, and investment interests of its member companies: General Motors Corp., Ford Motor Co., and DaimlerChrysler Corp. ATPC supports the U.S.-Australia FTA, asserting that it will benefit the U.S. industry by allowing for greater integration of its members' operations, promoting growth and efficiency in ATPC members' operations in both the United States and Australia.

ATPC states that Australia is an important export market for the U.S. automotive industry, and may be the only industrialized country with which the United States has a trade surplus in automotive products. According to ATPC, automotive products account for almost 10 percent of total U.S. merchandise exports to Australia.

According to ATPC, the primary benefit of the FTA would be the removal of Australian tariffs on automotive products, which are currently 15 percent on imported motor vehicles and motor-vehicle components, and 5 percent on commercial vehicles. Any remaining Australian duties will be eliminated by 2010.

ATPC asserts that the FTA is likely to result in increases both in local production by its members and in exports from the United States to Australia. ATPC expects that the FTA will have a greater effect on U.S. exports as opposed to U.S. imports. The potential for increased exports of motor-vehicle parts is expected to be more significant in the short term than exports of vehicles, because of the relatively larger size of the U.S. parts industry, the complementarity of products between the United States and Australia, established export patterns, and the global trend of companies tending to concentrate the sourcing of parts in as few areas as possible. While the local content of Australian-built vehicles is high, recent efforts to liberalize the automotive sector have resulted in increased market share for imported parts; this likely will continue under the FTA, according to ATPC.

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[10] Stephen J. Collins, President, Automotive Trade Policy Council, Inc.

With respect to vehicles, the reduction or elimination of Australian tariffs are likely to spur U.S. automakers to consider exporting other U.S.-built products that may be marketable in Australia. ATPA notes that imports account for the majority of passenger vehicle sales in Australia. While conceding that the Australian motor vehicle market, as compared to other major markets, is limited, ATPC asserts that the FTA will give the United States a competitive advantage because the major import competition does not have preferential trade agreements with Australia. ATPC states that it does not expect a large influx of light trucks from Australia despite the removal of the 25 percent U.S. tariff on these vehicles.

Another issue of importance to ATPC is the automotive rule of origin. ATPC states that the negotiated rule, which is slightly different from the generalized product rule, is simplified and fair. ATPC states that the Australian luxury tax on passenger vehicles was not an important objective for the U.S. industry, and was not addressed in the FTA.

ATPC contends that the U.S.-Australia FTA is an important step in the effort of the U.S. Government to improve market access for U.S. products in the Asia-Pacific region. Moreover, ATPC also believes that passage of the FTA will provide an impetus to the United States' trading partners to move forward to complete the Doha Round.

The Boeing Company[11]

The Boeing Company manufactures civil and military aircraft, spacecraft, and helicopters; is active in leasing and air traffic management; and provides Internet-based connectivity to aircraft in flight. It employs over 156,000 people in over 145 countries worldwide.

Boeing has been doing business in Australia for over 75 years. Two of Australia's airlines operate more than 150 Boeing aircraft, with an additional 100 aircraft on order. Boeing employs over 3,000 people at its facilities located in Australia, with direct investments totaling over $A650 million. Boeing forecasts demand for commercial airplanes and related services in Australia at $20 billion over the next 20 years.

The Boeing Company states that the expansion of international trade is vital to the national security of the United States, and critical to the economic growth of the United States. Therefore, Boeing supports the U.S.-Australia FTA. According to Boeing, reducing trade barriers between the two countries and expanding two-way trade through the FTA will facilitate a faster rate of economic growth and prosperity.

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[11] Rudy F. de Leon, Senior Vice President, The Boeing Company.

Distilled Spirits Council of the United States[12]

The Distilled Spirits Council of the United States (DISCUS) is a national trade association representing producers and marketers of distilled spirits in the United States. DISCUS member companies represent a substantial portion of U.S. spirits production and include leading multinational producers of spirits. The association states that Australia is a leading and growing market for U.S. exports, accounting for nearly $60 million or 10 percent of total U.S. spirits exports in 2003. DISCUS supports the U.S.-Australia FTA, which will eliminate Australian tariffs of 5 percent ad valorem on U.S. distilled spirits.

DISCUS maintains that the five percentage point tariff advantage for U.S. spirits, relative to EU and other competitors' products, will save U.S. spirits producers $3 million annually, and is projected to lead to an immediate 4 percent increase in the volume of U.S. spirits exports to Australia. DISCUS states that bulk shipments of whiskey, used in the growing ready-to-drink products category, likely will experience the greatest benefit under an FTA. DISCUS states that bottled U.S. whiskey that competes directly with Scotch and Irish whiskies also will benefit from the competitive advantage of duty-free treatment. Moreover, DISCUS argues that tariff elimination under an FTA will "level the playing field" as U.S. NTR tariffs on most spirits are already free of duty.

DISCUS further notes that the U.S.-Australia FTA will provide explicit recognition that "bourbon" and "Tennessee whiskey" are distinctive products of the United States. The association contends that such protection is important because there have been "numerous instances" in Australia and other markets where product labels and trademarks have improperly used these terms. DISCUS argues that explicit recognition of these distinctive U.S. products will protect U.S. producers and ensure Australian consumers that products labeled "bourbon" and "Tennessee whiskey" are manufactured in accordance with U.S. standards.

Electronic Data Systems[13]

Electronic Data Systems (EDS) is a global information technology services company with more than 130,000 employees worldwide, serving more than 35,000 business and government clients in 57 countries. EDS reported revenues of $21.5 billion in 2003, with over 40 percent of the revenues coming from overseas business. EDS has played an integral role in the Australian services market since 1985 and, currently, close to 6,000 EDS employees provide a broad range of computer and related

[12] Christine A. LoCascio, Director, International Issues and Trade, Distilled Spirits Council of the United States.

[13] William R. Sweeney, Jr., Vice President, Global Government Affairs, Electronic Data Systems.

services to both Australian public-and private-sector clients. EDS supports the U.S.-Australian FTA. The firm states that the FTA addresses issues so as to benefit EDS and the worldwide information technology services market in general. Further, EDS contends that the FTA will lead to greater economic integration between the United States and Australia, which will create opportunities for EDS, its U.S. competitors, and its Australian counterparts. FTA components that garnered specific endorsement include the Agreement's adoption of a comprehensive "negative list" approach to liberalization. Specifying only the exemptions to liberalization leaves trade in all unspecified sectors unrestricted, which is particularly useful in the information technology industry because it competes on innovation and rapidly brings new products to market. Without this approach, new services and applications risk not being covered by the Agreement's commitments.

EDS identified electronic commerce and IPR as two topics covered by the FTA that are of particular importance to the information technology sector. EDS supports provisions within the FTA that ensure liberal and open trade transacted via information technology. EDS supports provisions that provide for the nondiscriminatory treatment of electronically delivered products, avoid barriers that impede the use of electronic commerce, and those that prohibit customs duties for digital products delivered electronically. With regard to IPR, EDS supports the FTA's vigorous standards of protection and enforcement for copyrights and other intellectual property. Such protection is considered critical to trade and investment in IT sectors reliant on IPR such as software development.

Family Dairies USA[14]

Family Dairies USA (FDUSA) is the sixth-largest dairy cooperative in the United States headquartered in Madison, Wisconsin. It has 4,200 member farms and processes 5.5 billion pounds of milk annually. FDUSA opposes the U.S.-Australia FTA and states that it will be a detriment to all producers. FDUSA notes that Australia will be able to increase its current quota access three-fold in the first year, which will then increase 5 percent per annum indefinitely. The Agreement not only increases access to products currently subject to TRQs, but also establishes new TRQs on products that currently are excluded from the U.S. market (such as milk, ice cream, and certain types of cheese). Additional market access to Australian dairy products comes at a particularly bad time for U.S. dairy farmers who are recovering from a period when milk prices were at their lowest levels in decades. FDUSA notes that the additional access to Australia's product is equivalent to the amount of product removed from the U.S. market under a new producer-operated supply control scheme (the CWT Program). FDUSA explains that additional imports have a significant effect on prices because of the inelastic demand for milk and dairy products; that is, small changes in supply of imports typically lead to

[14] Stewart G. Huber, Vice-President/Board of Directors, Family Dairies USA.

relatively large changes in dairy prices and revenues. Other concerns raised by FDUSA are the apparent lack of rules of origin or transhipment regulations and the overvaluation of the Australia dollar.

Hawaii Department of Agriculture[15]

The Hawaii Department of Agriculture (HDOA) opposes the inclusion of macadamia nuts in the U.S.-Australia FTA, asserting that it will result in severe negative consequences to the U.S. industry based in Hawaii. The HDOA's opposition is based on its contention that the current import tariffs have allowed U.S. producers and processors to remain relatively competitive in the global market for macadamia nuts and products. The HDOA states that worldwide increases in production will be significant as Australia's already large macadamia nut production increases in the near future when recently planted trees reach their full production potential.

The HDOA states that the advantages of the Hawaiian industry's 50-year commitment to research, development, and marketing to improve nut varieties, increase yields, establish nutritional claims, and develop the U.S. market will be given away to its foreign competitors if the proposed Agreement is adopted. According to the HDOA, macadamia nuts are important to Hawaii's local economy as they represent one of the most successful agricultural value-added enterprises in the State. The HDOA states that the sector that further processes macadamia nuts in Hawaii offers expanded opportunities for employment in factories, delivery services, and sales. In addition, the HDOA maintains, over 96 percent of Hawaii's production of macadamia nuts takes place on the Island of Hawaii, where most employment is dependent on the agriculture sector.

Hawaii Macadamia Nut Association[16]

The Hawaii Macadamia Nut Association (HMNA) opposes the U.S.-Australia FTA, which it asserts will have a severe negative impact on Hawaii's macadamia industry. The HMNA claims that the removal of import tariffs on macadamia nuts and macadamia nut products from Australia will result in a lower average macadamia kernel price in the United States decreasing the return to Hawaii's growers. According to the HMNA, lower prices will severely weaken Hawaii's macadamia nut industry -the fourth-largest agricultural commodity in Hawaii -and its economic contribution to the State.

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[15] Sandra Lee Kunimoto, Chairperson, Board of Agriculture, Hawaii Department of Agriculture.
[16] David G. Rietow, President, Hawaii Macadamia Nut Association.

The HMNA notes that Australian macadamia nut production currently exceeds that of Hawaii and is expected to grow because a significant amount of its planted acreage is in the pre-bearing stage and that new plantings are ongoing. The U.S. market is viewed by producers as a high volume market so that any increased production is expected to be directed to the United States. According to the HMNA, most of these additional sales are expected to be to the low-end retail business. The HMNA contends that increased imports of Australian macadamia kernel and manufactured products will increase pressure on Hawaii's producers to increase spending on market development initiatives that distinguish Hawaii's macadamia nuts from imports. This will increase the average cost of production for Hawaiian kernel and retail products relative to Australian imports.

International Intellectual Property Alliance[17]

The International Intellectual Property Alliance (IIPA) is a coalition of six trade associations representing almost 1,100 U.S. companies that produce and distribute materials protected by copyright laws throughout the world. Copyright-protected materials produced by companies represented by these associations include all types of computer software, including business applications and entertainment software; theatrical films, television programs, home videos and digital representations of audiovisual works; music, records, CDs, DVDs, and audiocassettes; and textbooks, tradebooks, reference and professional publications, and journals in both electronic and print media. IIPA supports the U.S.-Australia FTA provisions on intellectual property protection.

Among the highlights of the FTA reported by IIPA include requirements that (1) require Australia to fully implement provisions of two international treaties that address Internet and other digital piracy, (2) extend the terms of protection for all protected subject matter to terms more closely approximating those available under U.S. law, (3) ensure that Australian government agencies use only legal software, (4) forbid the unauthorized circumvention of encrypted program-carrying satellite signals, and (5) strengthen Australia's enforcement of intellectual property rights.

A major disappointment to IIPA was that the FTA did not provide national treatment to U.S. producers of sound recordings that would ensure their ability to take advantage of traditional broadcasting channels available to domestic firms. In general, however, IIPA is pleased with the intellectual property provisions of the U.S.-Australia FTA and urges the Agreement's early adoption.

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[17] Steven J. Metalitz, Senior Vice President, International Intellectual Property Alliance.

National Association of Manufacturers[18]

The National Association of Manufacturers (NAM) is the largest industrial trade association in the United States. The NAM represents 14,000 members and 350 member associations serving manufacturers and employees in every industrial sector and all 50 states. Most of NAM's members are small and mid-sized companies. NAM supports the U.S.-Australia FTA because virtually all of Australia's duties on U.S. manufactured goods will be eliminated the moment the FTA comes into force. With manufactured goods accounting for 95 percent of total U.S. exports to Australia, the FTA will provide immediate benefits to a wide range of U.S. manufacturers. The NAM estimates that the elimination of Australia's 4.7 percent average industrial tariff on U.S. products would lead to an annual increase in U.S. exports of manufactured goods to Australia of about $1.8 billion. Much of this gain in exports would come from displacement of EU-manufactured goods' exports to Australia.

The NAM notes that the FTA will provide greater market access for U.S. manufacturers by (1) helping to ensure that Australian technical standards and regulations for manufactured products do not act as barriers to U.S. exports; (2) allowing U.S. firms to compete for business from Australian government entities, a market previously closed to them; and (3) improving customs procedures, through, among other things, greater transparency, efficiency, and the faster release of goods. Finally, the NAM notes that the FTA will further solidify the strong partnership between the United States and Australia, thus helping to open world markets and strengthening the world trading system.

National Farmers Union[19]

National Farmers Union (NFU) is a general farm organization with a membership of nearly 250,000 farm and ranch families throughout the United States. Its primary goal has been to sustain and strengthen family farm and ranch agriculture. The NFU believes that the U.S.-Australia FTA poses a serious threat to many sectors of the U.S. agricultural sector, while providing no opportunities for additional exports. With respect to wheat, the NFU is concerned that the Australia Wheat Board still operates as a State trading enterprise that does not act competitively in the market. With regard to beef, the NFU notes that the effect of the Agreement is 250-400 million pounds of additional beef imports from Australia within the first nine years of the Agreement. This could have a significant effect on both U.S. beef and dairy producers. With regard to dairy, the NFU expects that the Agreement will result in the displacement of U.S. dairy products of about US$40-45 million, equivalent to the production of about 15,000 dairy cows. There is also concern about transshipment of product from New Zealand

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[18] Franklin Vargo, Vice President for International Economic Affairs, National Association of Manufacturers.

[19] Joaquin Contente, President, California Farmers Union on behalf of the National Farmers Union.

as a result of Fonterra's merger with the Australian dairy processing company, Bonlac Foods Ltd. Finally, the NFU voices concern over how the Agreement deals with sanitary/phytosanitary issues; instead of the creation of a working group to review SPS issues, NFU would have preferred a specific timetable for removal of SPS restrictions on U.S. products exported to Australia.

National Milk Producers Federation[20]

The National Milk Producers Federation (NMPF) is a national organization that represents the interests of dairy farmers and cooperatives throughout the United States. The NPMF opposes the U.S.-Australia FTA. In its view, the Agreement will result in lower milk prices and farm income, and lead to the loss of numerous U.S. dairy farms. Further, the Agreement will bring no new opportunities for exports. The NMPF estimates that the Agreement will lead to 55 million pounds of additional imported milk products and to a drop in dairy farm income of US$237 million in the first year after implementation. Although most of the impacts are expected to be felt in the first year of the Agreement, losses will continue to mount over time, and accrued dairy income losses resulting from the Agreement after 25 years will exceed $1 billion.

News Corporation, Inc.[21]

News Corporation, Inc. is a diversified international media and entertainment company, operating businesses in filmed entertainment, television, cable network programming, direct broadcast satellite television, magazines and inserts, newspapers, and book publishing. News Corporation, Inc. supports the U.S.-Australia FTA. News Corporation, Inc. asserts that this FTA will benefit major U.S. media companies and smaller content companies in both countries. Additionally, News Corporation Inc. expresses the opinion that this FTA will provide legal infrastructure -encompassing effective laws and rigorous enforcement-that will facilitate investment, including investment in new technology and distribution methods. Consequently, News Corporation, Inc. anticipates increased production in filmed entertainment as well as greater use of digital technologies as a result of the FTA.

News Corporation, Inc., in conjunction with the Entertainment Industry Coalition for Free Trade (EIC), specifically highlights the following beneficial provisions achieved in this FTA: (1) TRIPS-plus provisions for intellectual property protections, such as implementing the WIPO Internet Treaties, ensuring that copyright owners have exclusive rights to make works available online, and protecting copyrighted works for extended terms; (2) strengthened intellectual property enforcement, which will

[20] Peter Vitaliano, Vice President, Economic Policy and Market Research, National Milk Producers Federation.

[21] Rick Lane, Vice President, Government Affairs, News Corporation, Inc.

increase criminal and civil protection against unlawful decoding of encrypted satellite television signals, and authorized seizure, forfeiture, and destruction of pirated products and equipment; (3) zero tariffs on entertainment products, including all movies, music, consumer products, books, and magazines exported to the country, and a requirement that customs valuations be based on the value of the carrier media rather than projected royalties; (4) improved market access, ensuring distribution of U.S. films and television programs over cable networks, satellite networks, and the Internet; and (5) free trade in digital downloads, including commitments that ensure nondiscriminatory treatment of digital products and preclude the imposition of customs duties on such items.

Overall, News Corporation, Inc. praises the achievements of this FTA, stressing that this Agreement will serve as a model for future FTAs, specifically in terms of intellectual property protection.

Ranchers - Cattlemen Action Legal Fund-United Stockgrowers of America[22]

Ranchers-Cattlemen Action Legal Fund – United Stockgrowers of America (R-CALF USA) is a national trade association that represents approximately 9,000 individual members in 46 states and has 50 local and state-level affiliates. R-CALF's original position concerning the U.S.-Australian FTA was that cattle and beef should be excluded; because, in general, R-CALF believes that bilateral FTAs with major agricultural producing countries with small internal markets do not address the global beef market distortions that restrict opportunities for U.S. beef exports. Consequently, R-CALF is concerned that the U.S.-Australia FTA grants increased access for Australian beef exports to the United States, while there is limited benefit to the U.S. cattle and beef industries.

Although R-CALF recognizes that the 18-year phase-in period acknowledges the import sensitivity of the U.S. cattle and beef sector, it nevertheless believes that without additional access for U.S. beef exports to third-country markets, even small increases in import volumes will have significant adverse effects on U.S. cattle producers, and lead to further erosion in the profitability of the U.S. cattle industry. R-CALF is concerned that the Agreement does not address artificial advantages provided to Australian beef producers that distort production decisions and result in more Australian cattle and beef production for export than would otherwise occur. R-CALF reports that these artificial advantages include lower feed grain prices resulting from state-trading operations and numerous business development programs operated by various State governments. R-CALF believes that the safeguard provisions included in the Agreement represent only the minimum necessary level of protection, and believes

[22] Brett DeBruycker, International Markets Vice Chairman, Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America.

that these provisions should be implemented on an automatic rather than discretionary basis. Moreover, R-CALF believes that the safeguard should have provided for automatic snap-back to the full MFN rate rather than 65 percent of the MFN rate. R-CALF is very concerned about granting Australia additional access to the U.S. market since benefits to the U.S. cattle industry are limited and the potential exists for significant negative impact on U.S. cattle producers.

Time Warner, Inc. on Behalf of the Entertainment Industry Coalition for Free Trade (EIC)[23]

Time Warner, Inc., is a leading media and entertainment company, operating in filmed entertainment, interactive services, television networks, cable systems, and publishing. Time Warner, Inc. supports the U.S.-Australia FTA. Time Warner, Inc. lauds the market access commitments incorporated in the Agreement in that they promote continued access to the Australian market. Although Australia will retain several existing restrictions on market access, U.S. industry does not find them to be unduly burdensome.

Time Warner Inc., on behalf of the EIC, specifically highlights the following beneficial provisions achieved in this FTA: (1) TRIPS-plus provisions for intellectual property protections, such as implementing the WIPO Internet Treaties, ensuring that copyright owners have exclusive rights to make works available online, and protecting copyrighted works for extended terms; (2) strengthened intellectual property enforcement, which will increase criminal and civil protection against unlawful decoding of encrypted satellite television signals, and authorized seizure, forfeiture, and destruction of pirated products and equipment; (3) zero tariffs on entertainment products, including all movies, music, consumer products, books, and magazines exported to the country, and a requirement that customs valuations be based on the value of the carrier media rather than projected royalties; (4) improved market access, ensuring distribution of U.S. films and television programs over cable networks, satellite networks, and the Internet; and (5) free trade in digital downloads, including commitments that ensure nondiscriminatory treatment of digital products and preclude the imposition of custom duties on such items.

Overall, Time Warner Inc. praises the achievements of this FTA. However, U.S. industry expresses disappointment in Australia's denial of national treatment to U.S. producers of sound recordings with respect to their ability to exploit their products through traditional broadcasting channels. Time Warner Inc. also expresses hope that the U.S. Government might address movement of persons in future FTAs.

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[23] Laura Lane, Vice President, Public Policy, Time Warner, Inc.

U.S. Chamber of Commerce[24]

The U.S. Chamber of Commerce ("the Chamber") is the world's largest business federation, representing more than 3 million businesses, nearly 3,000 state and local chambers, 830 associations, and more than 90 American Chambers of Commerce abroad. The Chamber strongly supports the U.S.-Australia FTA because it offers American companies greater access to the Australian market, advances trade and prosperity with Australia, increases U.S. competitiveness in the Asia-Pacific region, and contributes to U.S. and Australian global and regional trade liberalization objectives.

The Chamber notes that the FTA will immediately eliminate tariffs on over 99 percent of U.S.-manufactured goods exports to Australia, providing greater export opportunities for U.S. firms. The FTA provides greater protection for U.S. investment in Australia, including raising the threshold for screening acquisitions by U.S. investors in Australia to A$800 million. The Chamber notes, however, the absence of investor-state dispute settlement provisions in the FTA. The opening up of the government procurement market in Australia to U.S. firms will give them increased business opportunities, while more transparent and fair procedures in Australian customs administration will expedite the entry of U.S. goods into Australia. According to the Chamber, the intellectual property rights provisions of the FTA will require a higher degree of protection for U.S. patents, trademarks, copyrights, and Internet domain names in Australia. Finally, the Chamber states that the FTA will provide increased access into the Australian market for a variety of U.S. services industries, including advertising, architecture, audiovisual services, education services, electronic commerce, express delivery services, and financial services.

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[24] Myron Brilliant, Vice President, Asia, U.S. Chamber of Commerce.

APPENDIX A
REQUEST LETTER

EXECUTIVE OFFICE OF THE PRESIDENT
THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON, D.C. 20508

FEB 17 2004

'04 FEB 18 P2:55

RECEIVED
OFC OF THE SECRETARY
US INTL TRADE COMM

The Honorable Deanna Tanner Okun
Chairman
U.S. International Trade Commission
500 E Street, S.W.
Washington, D.C. 20436

Dear Chairman Okun:

As you know, the United States and Australia have just completed negotiating a bilateral free trade agreement (FTA). We greatly appreciate the advice that the U.S. International Trade Commission ("Commission") has provided throughout this negotiation.

On February 13, 2004, the President notified Congress of his intent to enter into an FTA with Australia. Pursuant to authority delegated to me by the President and in accordance with section 2104(f) of the Trade Act of 2002 (Trade Act), I request the Commission to prepare a report as specified in section 2104(f)(2)-(3) of the Trade Act assessing the likely impact of the FTA on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers.

I would greatly appreciate it if the Commission could issue its report as soon as possible. USTR staff will provide the Commission with details of the FTA and will be available to answer questions or provide additional information. We are working to make the text of the Agreement available to the public by the end of this month.

Thank you for your continued cooperation and assistance in this matter.

Sincerely,

Robert B. Zoellick

Robert B. Zoellick

APPENDIX B
FEDERAL REGISTER NOTICE

contain new factual information and must otherwise comply with section 207.30 of the Commission's rules. All written submissions must conform with the provisions of section 201.8 of the Commission's rules; any submissions that contain BPI must also conform with the requirements of sections 201.6, 207.3, and 207.7 of the Commission's rules. The Commission's rules do not authorize filing of submissions with the Secretary by facsimile or electronic means, except to the extent permitted by section 201.8 of the Commission's rules, as amended, 67 FR 68036 (November 8, 2002).

In accordance with sections 201.16(c) and 207.3 of the Commission's rules, each document filed by a party to the investigation must be served on all other parties to the investigation (as identified by either the public or BPI service list), and a certificate of service must be timely filed. The Secretary will not accept a document for filing without a certificate of service.

Authority: This investigation is being conducted under authority of title VII of the Tariff Act of 1930; this notice is published pursuant to section 207.21 of the Commission's rules.

Issued: March 3, 2004.

By order of the Commission.

Marilyn R. Abbott,

Secretary to the Commission.

[FR Doc. 04–5160 Filed 3–5–04; 8:45 am]

BILLING CODE 7020–02–P

INTERNATIONAL TRADE COMMISSION

[Investigation No. TA–2104–11]

U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects

AGENCY: International Trade Commission.

ACTION: Institution of investigation and scheduling of public hearing.

SUMMARY: Following receipt on February 17, 2004 of a request from the United States Trade Representative (USTR), the Commission instituted investigation No. TA–2104–11, U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects, under section 2104(f) of the Trade Act of 2002 (19 U.S.C. 3804(f)).

Background: As requested by the USTR, the Commission will prepare a report as specified in section 2104(f)(2)–(3) of the Trade Act of 2002 assessing the likely impact of the U.S. Free Trade agreement with Australia on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers. The report will assess the likely impact of the agreement on the United States economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the agreement, and the interests of United States consumers.

In preparing its assessment, the Commission will review available economic assessments regarding the agreement, including literature regarding any substantially equivalent proposed agreement, and will provide in its assessment a description of the analyses used and conclusions drawn in such literature, and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the agreement.

Section 2104(f)(2) requires that the Commission submit its report to the President and the Congress not later than 90 days after the President enters into the agreement, which he can do 90 days after he notifies the Congress of his intent to do so. The President notified the Congress on February 13, 2004, of his intent to enter into an FTA with Australia.

The Commission has begun its assessment, and it will seek public input for the investigation through a public hearing on March 30, 2004 (see below).

EFFECTIVE DATE: March 2, 2004.

FOR FURTHER INFORMATION CONTACT: Thomas Jennings, Project Leader, Office of Economics (202–205–3260). For information on the legal aspects of this investigation, contact William Gearhart of the Office of the General Counsel (202–205–3091 or *william.gearhart@usitc.gov*). For media information, contact Peg O'Laughlin (202–205–1819). Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal on (202–205–1810).

Public Hearing: A public hearing in connection with this investigation is scheduled to begin at 9:30 a.m. on March 30, 2004, at the U.S. International Trade Commission Building, 500 E Street SW., Washington, DC. Requests to appear at the public hearing should be filed with the Secretary, no later than 5:15 p.m., March 16, 2004 in accordance with the requirements in the "Submissions" section below. In the event that, as of the close of business on March 16, 2004, no witnesses are scheduled to appear at the hearing, the hearing will be canceled. Any person interested in attending the hearing as an observer or non-participant may call the Secretary (202–205–2000) after March 16, 2004, to determine whether the hearing will be held.

Statements and Briefs: In lieu of or in addition to participating in the hearing, interested parties are invited to submit written statements or briefs concerning the investigation in accordance with the requirements in the "Submissions" section below. Any prehearing briefs or statements should be filed not later than 5:15 p.m., March 22, 2004; the deadline for filing post-hearing briefs or statements is 5:15 p.m., April 6, 2004.

Submissions: All written submissions including requests to appear at the hearing, statements, and briefs, should be addressed to the Secretary, United States International Trade Commission, 500 E Street SW., Washington, DC 20436. All written submissions must conform with the provisions of section 201.8 of the Commission's Rules of Practice and Procedure (19 CFR 201.8); any submissions that contain confidential business information must also conform with the requirements of section 201.6 of the Commission's Rules of Practice and Procedure (19 CFR 201.6). Section 201.8 of the rules require that a signed original (or a copy designated as an original) and fourteen (14) copies of each document be filed. In the event that confidential treatment of the document is requested, at least four (4) additional copies must be filed, in which the confidential information must be deleted. Section 201.6 of the rules require that the cover of the document and the individual pages clearly be marked as to whether they are the "confidential" or "nonconfidential" version, and that the confidential business information be clearly identified by means of brackets.

The Commission intends to publish only a public report in this investigation. Accordingly, any confidential business information received by the Commission in this investigation and used in preparing the report will not be published in a manner that would reveal the operations of the firm supplying the information.

The Commission's rules do not authorize filing submissions with the Secretary by facsimile or electronic means, except to the extent permitted by section 201.8 of the Commission's Rules (19 CFR 201.8) (*see* Handbook for Electronic Filing Procedures, *ftp://ftp.usitc.gov/pub/reports/electronic_filing_handbook.pdf*).

Persons with questions regarding electronic filing should contact the Secretary (202–205–2000 or *edis@usitc.gov*).

Issued: March 3, 2004.

By order of the Commission.

Marilyn R. Abbott,

Secretary to the Commission.

[FR Doc. 04–5159 Filed 3–5–04; 8:45 am]

BILLING CODE 7020–02–P

DEPARTMENT OF LABOR

Office of the Secretary

Child Labor Education Initiative

AGENCY: Bureau of International Labor Affairs, U.S. Department of Labor.

ACTION: Notice of intent to solicit cooperative agreement applications.

SUMMARY: The U.S. Department of Labor (USDOL), Bureau of International Labor Affairs (ILAB), intends to award approximately U.S. $29 million to organizations to develop and implement formal, non-formal, and vocational education programs as a means to combat exploitative child labor in the following regions and countries: the Middle East (Lebanon, West Bank and Gaza, and Yemen), Africa (Ethiopia, Mozambique, Rwanda, and Zambia), and Panama. ILAB intends to solicit cooperative agreement applications from qualified organizations (*i.e.*, any commercial, international, educational, or non-profit organization capable of successfully developing and implementing education programs) to implement programs that promote school attendance and provide educational opportunities for working children or children at risk of starting working. The programs should focus on innovative ways to address the many gaps and challenges to basic education found in the countries mentioned above. Please refer to *http://www2.dol.gov/ILAB/grants/main.htm* for an example of a previous notice of availability of funds and solicitation for cooperative agreement applications.

DATES: Specific solicitations for cooperative agreement applications will be published in the **Federal Register** and remain open for at least 30 days from the date of publication. All cooperative agreements awarded will be made before September 30, 2004.

ADDRESSES: Once solicitations are published in the **Federal Register**, applications must be delivered to: U.S. Department of Labor, Procurement Services Center, 200 Constitution Avenue, NW., Room N–5416, Attention: Lisa Harvey, Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT: Lisa Harvey. E-mail address: *harvey.lisa@dol.gov*. All inquiries should make reference to the USDOL Child Labor Education Initiative—Solicitations for Cooperative Agreement Applications.

SUPPLEMENTARY INFORMATION: Since 1995, USDOL has supported a *worldwide technical assistance program* implemented by the International Labor Organization's International Program on the Elimination of Child Labor (ILO–IPEC). ILAB has provided over $270 million to ILO–IPEC and other organizations for international technical assistance to combat abusive child labor around the world.

In its FY 2004 appropriations, in addition to funds earmarked for ILO–IPEC, USDOL received $37 million to provide bilateral assistance to improve access to basic education in international areas with a high rate of abusive and exploitative child labor. All such FY 2004 funds will be obligated prior to September 30, 2004.

USDOL's Child Labor Education Initiative nurtures the development, health, safety, and enhanced future employability of children around the world by increasing access to basic education for children removed from child labor or at risk of entering it. Eliminating child labor will depend in part on improving access, quality, and relevance of education. Without improving educational quality and relevance, children withdrawn from child labor may not have viable alternatives and may return to work or resort to other hazardous means of subsistence.

The Child Labor Education Initiative has the following four goals:

1. Raise awareness of the importance of education for all children and mobilize a wide array of actors to improve and expand education infrastructures;

2. Strengthen formal and transitional education systems that encourage working children and those at risk of working to attend school;

3. Strengthen national institutions and policies on education and child labor; and

4. Ensure the long-term sustainability of these efforts.

When working to increase access to quality basic education, USDOL strives to complement existing efforts to eradicate the worst forms of child labor, to build on the achievements of and lessons learned from these efforts, to expand impact and build synergies among actors, and to avoid duplication of resources and efforts.

Signed at Washington, DC, this 2nd day of March, 2004.

Lawrence J. Kuss,

Grant Officer.

[FR Doc. 04–5074 Filed 3–5–04; 8:45 am]

BILLING CODE 4510–28–P

DEPARTMENT OF LABOR

Employment And Training Administration

[TA–W–53,709]

Alfmeier Corporation Seating Comfort Systems, a Subsidiary of Alfmeier Prazision, Dandridge, Tennessee; Notice of Revised Determination on Reconsideration

By letter postmarked January 6, 2004, a petitioner requested administrative reconsideration regarding the Department's Negative Determination Regarding Eligibility to Apply for Worker Adjustment Assistance, applicable to the workers of the subject firm.

The initial investigation resulted in a negative determination issued on December 12, 2003, based on the finding that imports of lumbar seating prototypes did not contribute importantly to worker separations at the subject firm. The denial notice was published in the **Federal Register** on January 16, 2004 (69 FR 2622).

To support the request for reconsideration, the petitioner supplied additional information to supplement that which was gathered during the initial investigation.

Upon further review and contact with the company official, it was revealed that the company shifted its production of lumbar seating prototypes to Germany with the intent to import lumbar seating prototypes back into the United States. The investigation further revealed that employment declined at the subject firm.

In accordance with section 246 the Trade Act of 1974 (26 U.S.C. 2813), as amended, the Department of Labor herein presents the results of its investigation regarding certification of eligibility to apply for alternative trade adjustment assistance (ATAA) for older workers.

In order for the Department to issue a certification of eligibility to apply for ATAA, the group eligibility requirements of Section 246 of the Trade Act must be met. The Department has determined in this case that the requirements of section 246 have been met.

APPENDIX C
HEARING PARTICIPANTS

CALENDAR OF PUBLIC HEARING

Those listed below appeared as witnesses at the United States International Trade Commission's hearing:

Subject: U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects

Inv. No.: TA-2104-11

Date and Time: March 30, 2004 - 9:30 a.m.

Sessions were held in connection with this investigation in the Main Hearing Room (room 101), 500 E Street, S.W., Washington, D.C.

EMBASSY APPEARANCE:

His Excellency Michael Thawley, Australian Ambassador to the United States of America

ORGANIZATION AND WITNESS:

PANEL 1:

The American-Australian Free Trade Agreement Coalition (AAFTAC) Washington, D.C.

William C. Lane, Co-Chairman

National Association of Manufacturers (NAM) Washington, D.C.

Frank Vargo, Vice President, International Economic Affairs, International Trade Policy

ORGANIZATION AND WITNESS:

PANEL 1 (continued):

Automotive Trade Policy Council
Washington, D.C.

Stephen J. Collins, President

Association of Equipment Manufacturers (AEM)
Washington, D.C.

Megan Carpentier, Manager, Government Affairs

Distilled Spirits Council of the United States (DISCUS)
Washington, D.C.

Christine LoCascio, Director, International Issues and Trade

PANEL 2:

National Farmers Union
Washington, D.C.

Joaquin Contente, President, California Farmers Union

Ranchers-Cattlemen Action Legal Fund (R-CALF USA)
Billings, MT

Brett DeBruycker, Vice Chairman, Trade Committee

ORGANIZATION AND WITNESS:

PANEL 3:

Time Warner Inc.
Washington, D.C.

Laura Lane, Vice President, Public Policy

EDS
Washington, D.C.

William R. Sweeney, Jr., Vice President,
Global Government Affairs

News Corporation
Washington, D.C.

Rick Lane, Vice President, Government Affairs

Air Courier Conference of America, International (ACCA)
Falls Church, VA

Susan M. Presti, Executive Director

–END–

APPENDIX D
Technical Appendix

APPENDIX D
TECHNICAL APPENDIX

The general equilibrium modeling system employed to simulate the free trade agreement is built around the GTAPinGAMS software developed by Rutherford and Paltsev.[1] The GTAPinGAMS data system was modified to accommodate the most recent prerelease 1 of the GTAP version 6 data. In addition, the actual GTAPinGAMS multi-region comparative-static simulation model was expanded to include appropriate behavioral structures and to report elements relevant to the study. This appendix outlines the important methodological and structural assumptions of the model.

There are several advantages to using the prerelease version of the GTAP data base rather than the most recently published version. For one thing, trade flows and national economic data have been updated in the new data to a 2001 base year from 1997 (although for this study the Commission has further updated the data to 2005). More importantly, much work has been done to improve the protection data in the data base. Rather than relying for the most part on WTO bound tariffs, the new data reflect a strong effort to collect data on actual applied tariffs (generally smaller than bound rates); for this reason, apparent duties on some commodities have declined from those in previous versions of the data set. This is aside from the fact that further implementation of the Uruguay Round and other trade agreements has actually reduced duties. Also, this new version of the data base reflects work that is in progress to develop appropriate methods to quantify tariff rate quotas and nontariff measures. Work remains to be done in these areas, but the current prerelease version 6 of the GTAP data base appears to provide the best available basis for the analyses of current trade policy with appropriate measures of trade and restrictions.

Model Scope

The simulation model represents the world trade equilibrium, and the production and consumption structures of the world economy. The trade equilibrium is defined by the bilateral trade flows between 15 economies over 23 aggregate commodities, listed below. These regions and commodities are aggregated out of the regions and commodities available in prerelease 1 of the GTAP version 6 database. The commodity and regional aggregations were driven by the Commission's intention to include the most relevant sectoral detail considering the policy shocks included in the U.S.-Australia FTA and the benchmarking to the 2005 base year.

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[1] Thomas F. Rutherford and Sergey V. Paltsev, *GTAPinGAMS and GTAP-EG: Global Datasets for Economic Research and Illustrative Models*, Department of Economics, University of Colorado Working Paper, September 2000.

Regions	
Australia	New Zealand
Canada and Mexico	European Union 15
Chile	Morocco
Mercosur	Southern African Customs Union
Rest of the Americas	Rest of Subsaharan Africa
Singapore	United States
East Asia	Other Countries
Rest of Asia	

Commodities	
Grains	Wood products
Sugar crops	Petroleum, coal, chemicals, rubber, and plastic products
Vegetables, fruits, and nuts	Ferrous metals
Other crops	Metals n.e.c. and metal products
Cattle and horses	Motor vehicles and parts
Animal products n.e.c.	Transport equipment n.e.c.
Coal, oil, gas, and other minerals	Electronic equipment
Meat products	Other machinery and equipment
Dairy products	Other manufactures
Sugar	Services
Other processed food and tobacco products	Capital goods
Textiles, apparel, and leather products	

Structure of the Regional Economies

Each region of the model is characterized by three components. First, primary factor endowments determine the overall capacity of the economy. Primary factors include land, labor, and capital. Households earn net of tax income from the primary factors and are assumed not to change the total supply of primary factors across the simulation.

Second, a region is characterized by its production technologies. These production technologies determine the ability of the economy to transform primary factors and intermediate inputs into valuable output. The model employs a nested constant-elasticity-of-substitution production structure. Primary factors are combined in a Cobb-Douglas nest. The primary factors aggregate is then combined with intermediate inputs in a Leontief nest. The resulting production function exhibits constant returns to scale and firms are assumed to be competitive such that marginal cost equals the output price.

Third, a region is characterized by its preferences for commodities. The model is static, and thus abstracts from changes in the aggregate mix of final demand on investment and government spending. Households do react to policy-induced price changes,

however, by changing the mix of goods and services consumed. Household welfare is assumed to be Cobb-Douglas and maximized subject to market prices and income earned from ownership of primary factors.

Trade Equilibrium

Consistent with the objectives of the Commission analysis, substantial detail is built into the mechanisms by which the different regions interact through international trade. Goods and services that are traded are assumed to be differentiated by their respective region of origin. Each region has a set of technologies for combining these differentiated goods and services into a composite that may be consumed or used as an intermediate input. The technology is a nested constant-elasticity-of-substitution aggregation; imports from different sources are combined in a lower nest, then the import aggregate and the domestic variety is combined to produce the composite. This is a standard structure adopted by most contemporary trade simulation models.

The trade equilibrium is sensitive to the particular substitution elasticities assumed for the differentiated goods aggregation. Table D-1 reports the central estimates of the substitution elasticity between import varieties, and their respective 95 percent confidence bounds. The central estimates are the trade-weighted averages from disaggregate (GTAP level) econometric estimates presented by Hertel, Hummels, Ivanic, and Keeny.[2] The confidence bounds are generated by making 1,000 random draws from the implied probability density functions of the econometric estimates and then computing the trade-weighted average for the aggregate commodity. Rank ordering these 1,000 draws per commodity, the 95 percent lower bound is the 25th draw and the 95 percent upper bound is the 975th draw. Three commodities did not have reliable econometric estimates and were therefore assigned a default elasticity of 7. Conditional on the integrity of the estimating procedure, it is likely that the true value of the substitution elasticity for the other commodities falls within the 95 percent confidence interval. Consistent with standard practice, the substitution elasticity between the domestic variety and the import aggregate is set to one-half the import variety substitution elasticity.

The policy instruments that are relevant for the trade equilibrium include import tariffs and export taxes. Table D-2 reports the 2005 benchmark trade policy between the United States and Australia. The benchmark policies include those distortions included in version 6 of the GTAP database and modified to include relevant policy changes between 2001 and 2005.

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[2] Thomas Hertel, David Hummels, Maros Ivanic and Roman Keeney, *How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?* GTAP Working Paper No. 26, 2003, available at *http://www.gtap.agecon.purdue.edu/resources/working_papers.asp*

Table D-1
Substitution elasticities and confidence intervals

Sectors	Central	Lower 95 percentile	Upper 95 percentile
Grains	6.327	2.273	10.762
Sugar crops	7.000	NA	NA
Vegetables, fruit, and nuts	3.700	2.847	4.454
Other crops	5.830	5.068	6.519
Cattle and horses	4.000	2.656	5.291
Other animal products	3.912	3.155	4.672
Coal oil, gas, and other minerals	12.281	6.107	18.804
Meat products	8.382	6.550	10.208
Dairy products	7.300	5.751	8.866
Sugar	5.400	1.724	9.402
Other processed food and tobacco products	3.788	3.524	4.033
Textiles apparel and leather products	7.567	7.371	7.762
Wood products	6.800	6.425	7.202
Petroleum, coal, chemicals, rubber	6.266	5.987	6.549
Ferrous metals	6.676	6.324	7.041
Metals n.e.c. and metal products	8.400	7.652	9.185
Motor vehicles and parts	5.600	4.969	6.159
Transport equipment n.e.c.	8.600	7.840	9.352
Electronic equipment	8.800	8.402	9.168
Other machinery and equipment	8.100	7.896	8.309
Other manufactures	6.757	6.474	7.026
Services	7.000	(1)	(1)
Capital goods	7.000	(1)	(1)

[1] Not Applicable.

Source: Hertel et al.

Updating the Database

Version 6.1 of the GTAP database has a benchmark year of 2001. In order to better reflect the world economy as of the time of implementation of the U.S.-Australia Free Trade Agreement, the database was projected to reflect the 2005 economy. This was done by imposing on the database additional data and projections on trade from the U.S. Department of Commerce and the World Bank. In addition, trade flows and barriers were updated to reflect the free trade agreements between the United States, its NAFTA partners, and Israel, Jordan, Chile, and Singapore, as well as all policy measures ratified under the Agreement on Textiles and Clothing of the Uruguay Round, and other Uruguay Round provisions insofar as these are reflected in the trade data.

Table D-2
Benchmark tariffs (2005)

(*Percent*)

Commodity	U.S. imports	Australian imports
	Tariffs	Tariffs
Vegetables, fruits, and nuts	4.00	1.00
Other crops	30.16	0
Cattle and horses	2.00	0
Animal products n.e.c.	0.67	0
Coal, oil, gas, other mineral	0	18.31
Meat products	7.99	0
Dairy products	25.00	5.00
Sugar	17.00	15.00
Other processed food and tobacco products	12.85	20.70
Textile, apparel, and leather products	7.76	0
Wood products	2.00	5.00
Petroleum, coal, chemicals, rubber, plastic	3.83	3.62
Ferrous metals	2.00	5.69
Metals n.e.c. and metal products	2.00	2.00
Motor vehicles and parts	4.50	9.50
Transport equipment n.e.c.	1.00	0
Electronic equipment	1.00	1.00
Other machinery and equipment	1.00	3.00
Other manufactures	1.47	3.36
Services	0	0.06

Source: GTAP and Commission calculations. Note that to conform to the FTA, the simulation reported in this study does not remove the tariff on sugar, and only partially removes the tariff on dairy products. See text.

Solution Technique

In comparative static experiments, such as the one conducted in this report, trade is liberalized completely in all goods subject to liberalization under the free trade agreement. There is no implicit or explicit time elapsing in the model. This means, first, that all provisions of the Agreement are assumed to be fully phased in immediately, rather than over an 18-year period. And second, it means that all effects of the Agreement are felt immediately, without an adjustment period. The modeled results can be considered to be long-run effects of a fully implemented agreement, in an economy otherwise identical to the baseline 2005 economy.

The analysis employs a comparative static framework in which a baseline equilibrium depiction of the U.S. economy, as of January 1, 2005, is derived through a set of balanced accounts of trade, production, consumption, and taxes. Once this baseline has been created, policy shocks are imposed on the balanced model. These policy shocks consist of the reduction or elimination of tariffs, TRQs and quotas agreed to in the FTA.

Having imposed the policy shock by imposing the new levels of the tariffs and tax equivalents of the trade distortions, the model is rebalanced, and new values for trade

flows, outputs, employment, welfare, GDP, and other values are generated. The difference between the baseline values of these variables and their new values is interpreted as the estimated impact of the tariff removal under the free trade agreement.

Model Limitations

Economic models attempt to capture the most important factors for the question under consideration. However, they are limited in their ability to reflect the degree of complexity evident in the real world. One source of possible bias in virtually any quantitative analysis of economic data arises from data aggregation. International trade occurs in thousands of different products and services. The United States collects trade data under about 17,000 statistical categories and over 10,000 tariff rate lines. For most general equilibrium analysis, these groupings represent far too much detail to be tractable computationally, or to be linked with more aggregate data on production and consumption processes. The aggregation into broader categories introduces two general sources of bias into a modeling exercise.

One source of bias involves the calculation of tariffs for aggregated product categories. In this study, trade-weighted average tariffs were calculated, using the value of imports in a tariff line to weight the tariff in that line. This procedure tends to mask the importance of those products within the aggregate that have particularly high tariffs, and which therefore face a greater barrier to imports than would be the case if all goods within the aggregation had the same average tariff. The relationship between the effect of an import-weighted average tariff and the effects of the individual tariffs of goods within the group depends on the correlation between the level of these tariffs and the price responsiveness of final demand. The effect of a high tariff in a highly price-responsive good will be understated because the high tariff itself will cause less of the good to be imported, giving it a small weight in the trade-weighted average tariff of the aggregate.

Another source of aggregation bias is due to the fact that goods within an aggregate may not be close substitutes for one another. In particular, imported goods of a particular category may be quite dissimilar to the domestically produced product in that category, due among other things to a different mix of the individual goods in the aggregate. Thus a model may overstate the responsiveness of domestic production in response to a given tariff reduction.[3]

Despite these limitations, model simulations such as those performed here can be useful in providing insights on the effects of an FTA on measures of the economy. They present a unified and consistent framework within which to assess the policy.

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[3] Empirical trade models such as the one used here often apply the Armington assumption, which treats commodities produced in different countries as imperfect substitutes, with the degree of substitution described by the Armington substitution elasticity. This can reduce this type of bias.

Chapter 8 discussed the comparison of alternative models of the U.S.-Australia FTA. Among the ways in which this study approaches the comparison is by asking, essentially, what results would be obtained in the USITC model if it made the same assumptions made in other models regarding the tariff shocks to be eliminated. If the same tariff shocks could be imposed in the USITC model as were imposed in other models, remaining differences between the results could be attributed to other assumptions and structural differences among the models.

In fact, the different tariff shocks could not be directly applied to the USITC model. Because each of the alternative models uses commodity data aggregated in ways that differ from the USITC model, it was necessary to reaggregate the commodities to correspond to those in the USITC model. Table D-3 shows the alternative policy shocks applied in each of the three alternative models (CIE, ACIL, and Brown, Kiyota, and Stern, or BKS). The table also shows the shocks as applied to the USITC aggregation.

Table D-3
Alternative policy scenarios

(*Percent*)

	CIE policy shocks	
CIE commodity	**Australian tariffs & non-tariff measures**	**U.S. tariffs & non-tariff measures**
Grains	0.04	0.36
Other crops	0.38	0.63
Sugar cane, beet	0.00	80.00
Animal products	0.00	0.08
Raw milk	0.00	0.00
Forestry, fishing	0.00	0.02
Mining and energy	0.14	0.35
Meat products	0.06	1.99
Other food products	2.21	1.45
Dairy	3.20	23.90
Sugar	0.00	80.00
Beverages & tobacco	4.80	1.40
Textiles, clothing, and footwear	11.69	8.46
Wood & paper products, publishing	4.85	0.33
Chemicals, Rubber, Plastics	2.70	2.00
Other mineral & metal products	4.47	1.73
Ferrous metal products	4.40	2.50
Motor vehicles & parts	9.30	1.40
Other transport equipment	1.30	0.90
Electronic equipment	0.20	1.10
Other manufacturing	2.99	0.91
Utilities & other services	0.00	0.00
Trade & transport	0.18	0.08
Financial, business, rec services	0.94	0.03

Source: CIE 2001, table 4.2, p. 33.

Table D-3—*Continued*
Alternative policy scenarios

(*Percent*)

USITC commodity	CIE policy shocks	
	Australian tariffs & non-tariff measures	U.S. tariffs & non-tariff measures
Grains	0.04	0.36
Sugar crops	0.00	80.00
Vegetables, fruits, and nuts	0.38	0.63
Other crops	0.38	0.63
Cattle and horses	0.00	0.08
Animal products n.e.c.	0.00	0.08
Coal, oil, gas, other mineral	0.14	0.35
Meat products	0.06	1.99
Dairy products	3.20	23.90
Sugar	0.00	80.00
Other processed food and tobacco prods	3.50	1.42
Textile, apparel, and leather products	11.69	8.46
Wood products	4.35	0.33
Petroleum, coal, chemicals, rubber, plastic	2.70	2.00
Ferrous metals	4.40	2.50
Metals nec and metal products	4.47	1.73
Motor vehicles and parts	9.30	1.40
Transport equipment nec	1.30	0.90
Electronic equipment	0.20	1.10
Other machinery and equipment	2.99	0.91
Other manufactures	2.99	0.91
Services	0.94	0.03

Source: CIE and Commission calculation.

Table D-3—*Continued*
Alternative policy scenarios

(*Percent*)

ACIL commodities	ACIL policy shocks	
	Australian tariffs & non-tariff measures	U.S. tariffs & non-tariff measures
Rice	1.00	5.34
Wheat	0.80	2.55
Other grains	0.80	0.61
Other agricultural products	2.12	4.61
Sugar cane and beet	0.00	0.65
Cattle, sheep	0.75	1.07
Raw milk	0.00	0.00
Forest, logging	0.21	1.19
Coal	0.00	0.00
Oil	0.00	0.40
Gas	0.00	0.00
Other minerals	0.07	0.18
Cattle, sheep meat	0.10	5.29
Other processed agricultural products	5.82	6.38
Milk	7.35	42.49
Processd sugar	13.89	53.45
Textiles	12.64	9.47
Apparel	23.76	9.65
Leather	12.63	5.17
Wood, pulp, paper	3.20	0.88
Petroleum, coal products	0.00	2.44
Chemicals, rubber, plastic	3.39	3.17
Iron, steel	4.80	3.16
Motor vehicles and parts	8.52	2.19
Other manufacturing	2.82	1.16
Electricity	0.00	0.00
Gas distribution	0.00	0.00
Water	0.00	0.00
Construction	0.00	0.00
Trade	0.52	0.00
Transportation	0.00	0.00
Communication	0.00	0.00
Other services-private	0.12	0.00
Other services-government	0.00	0.00

Source: ACIL, table 4, p 40.

Table D-3—*Continued*
Alternative policy scenarios

(*Percent*)

USITC commodity	ACIL policy shocks	
	Australian tariffs & non-tariff measures	U.S. tariffs & non-tariff measures
Grains	0.86	2.83
Sugar crops	0.00	0.65
Vegetables, fruits, and nuts	2.12	4.61
Other crops	2.12	4.61
Cattle and horses	0.75	1.07
Animal products n.e.c.	2.12	4.61
Coal, oil, gas, other mineral	0.02	0.14
Meat products	0.10	5.29
Dairy products	7.35	42.49
Sugar	13.89	53.45
Other processed food and tobacco prods	5.82	6.38
Textile, apparel, and leather products	16.34	8.1
Wood products	3.20	0.88
Petroleum, coal, chemicals, rubber, plastic	3.39	3.17
Ferrous metals	4.80	3.16
Metals nec and metal products	2.82	1.16
Motor vehicles and parts	8.52	2.19
Transport equipment nec	2.82	1.16
Electronic equipment	2.82	1.16
Other machinery and equipment	2.82	1.16
Other manufactures	2.82	1.16
Services	0.12	0.00

Source: ACIL and Commission calculation.

Table D-3—*Continued*
Alternative policy scenarios

(*Percent*)

BKS commodities	BKS policy shocks	
	Australian tariffs & non-tariff measures	U.S. tariffs & non-tariff measures
Agriculture	1.40	0.70
Mining	0.00	0.20
Food, beverages, tobacco	3.80	1.80
Textiles	12.00	2.00
Apparel	3.60	9.80
Leather products & footwear	9.30	5.30
Wood, wood products	3.10	0.40
Chemicals	3.40	3.10
Non-metalic mineral products	2.10	1.50
Metal products	4.50	0.10
Transport equipment	4.20	0.30
Machinery & equipment	3.00	1.10
Other manufacturing	3.70	0.50
Electricity, gas, water	0.00	0.00
Construction	4.00	9.00
Trade & transport	0.00	27.00
Other private services	0.00	31.00
Government services	21.00	25.00

Source: Brown, Kiyota, and Stern, table 1.

Table D-3—*Continued*
Alternative policy scenarios

(*Percent*)

USITC Commodity	BKS policy shocks	
	Australian tariffs & non-tariff measures	U.S. tariffs & non-tariff measures
Grains	1.40	0.70
Sugar crops	1.40	0.70
Vegetables, fruits, and nuts	1.40	0.70
Other crops	1.40	0.70
Cattle and horses	1.40	0.70
Animal products nec	1.40	0.70
Coal, oil, gas, other mineral	1.05	0.85
Meat Products	3.80	1.80
Dairy products	3.80	1.80
Sugar	3.80	1.80
Other processed food and tobacco prods	3.80	1.80
Textile, apparel, and leather products	8.30	5.70
Wood products	3.10	0.40
Petroleum, coal, chemicals, rubber, plastic	3.40	3.10
Ferrous metals	4.50	0.10
Metals nec and metal products	4.50	0.10
Motor vehicles and parts	4.20	0.30
Transport equipment nec	4.20	0.30
Electronic equipment	3.70	0.50
Other machinery and equipment	3.70	0.50
Other manufactures	3.70	0.50
Services	6.25	23.00

Source: BKS, and Commission calculation

In matching the alternative policy shocks of other authors to the sectors in the USITC model, the following simple procedures were used. Where one sector in an alternative model includes more than one USITC sector (such as the BKS agriculture sector, which includes the USITC sector grains, sugar crops, other crops, and vegetables, fruits and nuts), the shock from the alternative model sector was applied to each of the USITC sectors. Where more than one alternative model sector matches a USITC sector (such as the BKS sectors apparel, textiles, and leather products and footwear, all of which are contained in the single USITC sector textiles, apparel, and leather products), a simple average of the shocks in the alternative model sectors was applied to the USITC sector. One exception to this is in the transfer of the CIE services shocks to the USITC model, where CIE's value for financial, business, and recreation services was applied to the USITC services sector. Note again that all three models assumed the elimination of trade barriers in sugar, which was not included in the FTA or in the USITC analysis of the FTA. Also, CIE and ACIL fully liberalized dairy trade, while BKS did not consider this sector separately (including it with food, beverages, an tobacco). In comparing the alternative scenarios, only the aggregate welfare effects are examined. These are discussed in Chapter 8.