The experience of the Australia-US Free Trade Agreement: lessons for the Trans-Pacific Partnership Agreement negotiations

Paper presented at the Stakeholders Forum, seventh round of Trans-Pacific Partnership negotiations, June 19, 2011, Ho Chi Minh City, Vietnam

Dr Patricia Ranald, Australian Trade and Investment Network
Research Associate University of Sydney
Summary: This paper examines the experience of the US Australia free trade agreement (AUSFTA) negotiated in 2004, and how that experience and the outcomes of the agreement have influenced the debate on the transpacific partnership agreement (TPPA), and the trade policy recently announced by the Australian government. It discusses the implications for the TPP of the Australian experience and the Australian policy on investor state dispute settlement, medicines pricing policy, and intellectual property rights. It is an updated version of some of the material in the author’s chapter “The politics of the TPPA in Australia” in No ordinary deal: unmasking the Trans-Pacific Partnership free trade agreement, edited by Jane Kelsey, Alan and Unwin, 2010.

The Australia US free trade agreement (AUSFTA) Debate

The Liberal National coalition Australian government led by John Howard decided to negotiate a free trade agreement with the US in 2002, and negotiations took place over 2003-4.

A business coalition was formed to promote the agreement, which included the Australian Chamber of Commerce and Industry, the American Chamber of Commerce in Australia, the Australian Industry Group, the Minerals Council of Australia and the Business Council of Australia (AUSTA 2002). However, the National Farmers Federation was sceptical that the US would agree to any significant expansion in market access in agriculture, and noted that US agricultural subsidies could not be changed through a bilateral agreement (Davis 2005).

A letter from the US Trade Representative to the US Congress alerted Australian unions and community organisations that the US had a much broader agenda than trade in goods and agriculture, and that they would be seeking to change Australian health and social policies. This was based on the agenda pursued in the North American Free Trade Agreement and in other US bilateral agreements. Targets included wholesale price controls on medicines through the Pharmaceutical Benefits Scheme, Australian content laws for audio-visual services, quarantine laws, labelling of genetically engineered food and the Foreign Investment Review Board. These were all seen by the US as barriers to trade (Zoellick 2002). The US also wanted an investor-state disputes settlement process which would give individual corporations the right to sue governments for damages if government policy harmed their investments. Under this provision of NAFTA, US companies have sued the Canadian and Mexican governments for millions of dollars (Tienhaara, 2009).

This attempted negotiation of key social policies outside of the parliamentary process generated public debate and criticism. Community groups feared that the unequal bargaining power between the US and Australian governments would result in these policies being traded away in the hope of increased access to agricultural or other markets. Unions, public health groups, churches, pensioner, environment and other community organisations linked through the Australian Fair Trade and Investment Network (AFTINET) and other community networks campaigned against all of these aspects of the agreement (Ranald and Southalan 2004). The investor-state complaints process was a major target of community campaigning, on the grounds that it would be a dangerous weakening of governments’ ability to regulate for social and environmental goals (Australian Broadcasting Commission, 2003, Henry 2003).
AUSFTA prompted the biggest critical public debate ever held in Australia about a trade agreement. There were hundreds of community meetings, public rallies in many cities, many articles in community, union, local and specialised media, over 700 submissions to parliamentary inquiries in 2004 and thousands of letters, postcards and emails sent to politicians. Two books critical of the agreement were subsequently published (Capling 2004; Wiess et al. 2004).

The claimed economic benefits of the agreement were contested fiercely by many economists, ranging from Australian National University Professor Ross Garnaut and other prominent academics, to economic journalists in Sydney Morning Herald, The Age and The Australian (Ranald, 2006). Most of these predicted that Australia had little to gain from the agreement because the US agribusiness lobby would prevent significant increases in access to its agricultural markets.

There was widespread media coverage about the possible impact of AUSFTA on the price of medicines, including an episode of the ABC National Four Corners television programme (ABC 2004). There was also much debate about the impact of changes to Australian content rules for audio-visual media, with prominent actors and producers challenging the agreement at public events like the Logie television awards and the Australian Film Institute awards (Krien and Byrnes 2004).

This debate influenced public opinion. Polls conducted by Hawker Britton showed a steady decline in support for the AUSFTA, from 65 per cent before negotiations started early in 2003 to 35 per cent in February 2004 when the deal was concluded. This lack of support was confirmed by a Lowy Institute poll in February 2005 showing only 34 per cent supported the agreement (Cook 2005; Hawker Britton 2004).

The public debate and decline in support for the agreement prompted the Opposition Australian Labor Party (ALP), and the Democrats and Greens to adopt policies critical of the AUSFTA by the end of 2003. After a fierce internal debate, the ALP parliamentary caucus finally decided to endorse the AUSFTA implementing legislation with some amendments. Community concerns about the cost of medicines and Australian media content rules were reflected in the amendments, which sought to protect current levels of Australian content in film and television and to prevent pharmaceutical companies from making spurious legal claims to extend patents (Latham 2004).

In summary, US negotiators did not achieve all that they wanted in several areas of policy. The exposure of the negotiating process to public debate and lobbying influenced the government to resist some US demands, and the Opposition and minor parties to amend the implementing legislation. The amendments preserved existing Australian content provisions for film and television, and made it more difficult for pharmaceutical companies to use some spurious legal tactics to extend patents. This was the first time any implementing legislation for a trade agreement had been amended in Australia. The wider impact of the oppositional campaigns can be seen in the lack of an investor-state complaints process, the limited changes to the Pharmaceutical Benefits Scheme (PBS), preservation of some local media content policy, and the retention of regulation of genetically engineered food.
Impacts of the AUSFTA

The economic and social impacts of the AUSFTA have been publicly debated since its implementation in 2005.

Economic Impacts: no clear benefits

The economic evidence to date supports the thesis that the AUSFTA resulted in the US gaining more access to Australian markets than vice versa. Australia’s trade deficit with the US has increased every year since the agreement came into force in 2005 (Quiggin 2010). The relative importance of the US as a destination for Australian exports has also declined. This has had no impact on the Australia’s overall economic performance, because of growth in exports to other destinations. Exports to the US grew by only 2.5% per year from 2005-2010, compared with double digit growth in exports to Australia’s Asian trading partners, the largest of which is China, with which Australia has no bilateral trade agreement (Tiffin 2010).

In agriculture, there was no additional access to the US sugar market, and increased access to dairy, beef, lamb and wine markets was to be phased in over 12-17 years. There has been limited access for other Australian products. This has resulted in criticism of the AUSFTA by farmers’ organisations and other sections of business. The Australian Industry Group, the peak body for manufacturing industry, surveyed its members in 2010 and found that eighty per cent said that the AUSFTA was not very effective in improving export opportunities, and eighty-five per cent said it had failed to help in setting up operations in the US. These impacts have been reported regularly in the media (Australian Industry Group 2010; Priestly 2008; Tiffen 2010).

These findings were confirmed by a report by the Australian Productivity Commission, which is an arms-length advisory body set up in 1998 to conduct independent research on a range of economic, social and environmental issues. In 2009, the government requested that the Productivity Commission undertake a study into the impact of bilateral and regional trade agreements on Australia’s economic performance. The Commission received submissions from business, government and non-government organisations and produced a final report in December 2010.

The report concluded that feasibility studies for bilateral and regional trade agreements have produced ‘overly optimistic expectations of their likely economic effects’, citing examples from the feasibility studies of the AUSFTA. The report concluded that the actual economic effects of bilateral and regional trade agreements were ‘modest’ and that ‘business has produced little evidence to indicate that preferential agreements have provided significant commercial benefits’ (Productivity Commission 2010: xxxvi, xxv and xxxv). The Productivity Commission findings were repeated in a Government Treasury report and both reports were debated in the media (ABC Radio 2010b).

Health policy impacts: higher wholesale prices for some medicines

The negative impacts on public policy from the AUSFTA have also been publicly debated. The main example of negative impacts concerns the changes made to the PBS.
The pharmaceutical lobby groups and US negotiators identified the price control mechanism of the PBS as a target from the outset of the AUSFTA negotiations. In the US, the wholesale prices of common prescription medicines were three to ten times the prices paid in Australia (The Australia Institute, 2003). Under the PBS, the Australian government controls the wholesale prices of medicines by using a panel of health experts on the Pharmaceutical Benefits Advisory Committee to compare the price and effectiveness of new medicines with the prices of comparable but cheaper generic medicines whose patents have expired. This is known as reference pricing. The listed medicines are then made available for sale at regulated subsidised retail prices. The difference between the wholesale price and the subsidised price is the cost of the PBS to taxpayers.

US Pharmaceutical companies argued that Australia's system prevented them from enjoying the full benefits of their intellectual property rights by comparing the price of new drugs with cheaper generic drugs (Pharmaceutical Research and Manufacturers of America, 2003).

The strong community campaign outlined above helped to retain the PBS reference pricing system. However AUSFTA resulted in changes that could undermine the effectiveness of the system over time and lead to higher wholesale prices for medicines and therefore higher costs for government.

Annex 2c of Chapter 2 of the AUSFTA, dealing with market access for goods, set up a joint Medicines Working Group of US and Australian government officials based on the commercial principles that contribute to the high cost of medicines in the US. These principles give priority to the ‘need to recognise the value of innovative pharmaceutical products through strict intellectual property rights protection’ (AUSFTA text, 2004). The principles effectively reduce the importance of the Australian public health goal of affordable access to medicines for all. This working group ensured that the US government could continue to influence future policy.

Following the implementation of the AUSFTA, the Howard Government made specific changes to medicines policy that enable pharmaceutical companies to receive higher wholesale prices for some medicines.

The government legislated in June 2007 for two categories of medicines to be listed under the PBS. The F1 category applies to single brand medicines that are judged to have unique health benefits and not to be interchangeable in their health effects with other medicines. These medicines are not subject to reference pricing and higher wholesale prices are paid for them. The F2 category includes single brand medicines that are judged to be interchangeable in their health effects with other medicines, and generic medicines. These are subject to reference pricing to obtain the best value for money. The legislation also included mandatory price reductions for F2 medicines as patents expired. The government claimed that savings from a large number of medicines coming off patent from 2007 would offset the higher prices for the medicines in F1, resulting in net savings to the PBS overall (Department of Health and ageing, 2007).
These proposed changes to the PBS were discussed at the AUSFTA Medicines Working Party held in January 2006, well before the government’s public announcement about the changes. Documents distributed at the meeting obtained under Freedom of Information legislation include an article written by a government Member of Parliament that outlined the F1/F2 changes as a desirable model (Laming, 2007).

These changes clearly open the way for the PBS to allow higher wholesale prices for some new medicines, and there is evidence that this is having an impact on the cost of the scheme as a whole.

A preliminary academic study published in 2010 comparing the prices of key F1 drugs with F2 drugs with similar therapeutic effects since the 2007 changes showed that government ‘has been paying an increasingly disproportionate amount for the F1 classified medication without the necessary expectation (according to the National Health Act 1953) that they are paying for increased cost-effectiveness, or a greater level of objectively demonstrated therapeutic significance’ (Faunce et al, 2010).

A study of the cost of statin drugs, very widely prescribed to lower blood cholesterol levels, published in the Medical Journal of Australia, found that the proportion of more expensive patented statins in the F1 category is a growing share of the Australian market, in contrast with Britain, where the proportion of cheaper generic statins is increasing. The article estimates that savings of at least $3.2 billion could be made on stains over the next 10 years if the British policy of using generic drugs were adopted. The article concludes that

‘The key question is whether the health benefits resulting using statins under patent…justify the substantially higher subsidies from the PBS…while this has been examined in other countries, there has been little consideration of this question in Australia’ (Clarke and Fitzgerald 2010)

A government review of the impact of the 2007 PBS changes published in February 2010 confirmed that F1 category is contributing to higher costs for the PBS than were predicted. The study showed that the actual savings from the implementation of the changes were less than estimated in 2007. This is partly because of implementation costs, but also because of the growing share of the higher cost medicines in the F1 category. The report predicts that the future costs of the scheme will be higher than predicted at the time of the changes, and that this will place increasing pressures on the health budget (Department of Health and Ageing 2010).

The Labor Government attempted to reduce these costs in the May 2010 federal budget by announcing some new therapeutic groups of medicines, which would enable the PBS to apply reference pricing to a wider range of patented medicines, thus effectively bypassing the F1 category, and allowing negotiation of lower wholesale prices. Medicines Australia, which represents the major pharmaceutical companies, made submissions to the Senate References Committee strongly opposing the new therapeutic
groups, on the grounds that that they were a violation of their intellectual property rights (Senate Community Affairs Committee References Inquiry 2010).

This debate shows that the post-AUSFTA changes to the PBS continue to have an impact and are still strongly contested

**Productivity Commission report conclusions on intellectual property and investor-state disputes: not in the public interest**

Other papers in this forum are dealing with intellectual property issues in more detail. In summary, the AUSFTA led to changes to Australian patent law, making it more consistent with US patent law, and giving greater rights to patent holders, including holders of patents for medicines. Copyright was extended from the life of the author +50 years to the life of the author +70 years, with other changes consistent with US law.

The Productivity Commission Report concluded that, since Australia is a net importer of patented and copyright products, the extensions of patents and copyright in the AUSFTA imposed net costs on the Australian economy (Productivity Commission: 259, 260). The Commission also concluded that extension of patent and copyright can also impose net costs on most of Australia's trading partners, especially developing countries:

‘The Commission is not convinced, however, that the approach adopted by Australia in relation to IP in trade agreements has always been in the best interests of either Australia or (most of) its trading partners. Among other things, there does not appear to have been any economic analysis of the specific provisions in AUSFTA undertaken prior to the finalisation of negotiations, nor incorporated in the government’s supporting documentation to the parliament. As noted above, the AUSFTA changes to copyright imposed net costs on Australia, and extending these changes to other countries would be expected to impose net costs on them, principally to the benefit of third parties.

‘Concerns have also been raised about the effects of IP provisions in some other trade agreements that Australia has supported. For example, Australia supported the 1994 TRIPS agreement — which was included in the Uruguay Round single undertaking — and saw Australia extend the term of protection for patents from 16 years to 20 years. Subsequent analysis by Commission staff found that the extension of rights to existing patents could result in a large net cost to Australia.

Some economists have also argued that implementation of TRIPS by developing countries would result in significant net costs to them, costs not offset by the other provisions in the Uruguay agreement … To the extent that ‘emerging international standards’ would extend IP rights further, requiring developing countries to adhere to these standards could do them further harm, again principally to the benefit of business interests in the United States and Europe’ (Productivity Commission: 263).
The Report also recommended against investor-state dispute processes, which give additional rights to foreign investors to sue governments for damages outside the legal system of the host government (Productivity Commission 2010: xxxviii). The report found no evidence that these processes resulted in greater inflows of foreign direct investment. It also found no evidence for some of the key arguments used to justify investor-state dispute processes. For example, it found no evidence of market failure resulting from political risk to foreign investors, and no evidence that regulation is systematically biased against foreign investors (Productivity Commission 2010: 269-70).

On the contrary, the report concluded that that "experience in other countries demonstrates that there are considerable policy and financial risks arising from ISDS provisions" (Productivity Commission 2010: 274)

Australian Responses to the TPPA Negotiations

Government

Labor’s policy differences with the Howard government on the AUSFTA in 2004 were described above. The Australian Labor Party (ALP) came to office in 2007 with explicit trade policies to protect public health systems, local Australian media content, regulation of essential services and to include core labour standards in trade agreements. The policy also committed to improved consultation and parliamentary debate about trade negotiations (ALP 2009).

The government supported the US government initiative on the TPPA, and hosted the first round of negotiations in Melbourne in March 2010. Some Australian business organisations saw the TPPA as an opportunity to get greater access to US markets than was achieved under the AUSFTA. The Trade Minister, Simon Crean announced:

‘The TPP will be an ambitious, 21st century agreement that will strengthen economic integration in the region. The Australian Government will be seeking a high standard, comprehensive agreement… The participation of the US is an important signal of the Obama Administration’s commitment to the region, and an encouraging sign of broader US engagement on trade policy issues’ (Crean 2010a)

The Minister also said that Australia would be seeking greater access to US markets than was achieved under the AUSFTA and that ‘everything would be on the table’ in the negotiations’ (Saulwick, 2010).

The debates about the AUSFTA and its ongoing policy impacts analysed above influenced the reaction of Australian unions and other community groups to the announcement of the start of the TPPA negotiations in Melbourne in March 2010 (AFTINET 2010). The reaction was prompted by the news that US business group submissions on the TPPA were raising many of the issues which proved so controversial in the AUSFTA. The US government received public submissions from US industry groups in 2009 indicating that they wanted further changes to Australian policies on the PBS and intellectual property rights (Pharmaceutical Research and Manufacturers of America 2009), media content (Motion Picture Association of America 2009), labeling of genetically engineered food (Biotechnology Industry Organisation 2009), quarantine (National Pork Producers Council 2009) and procurement policies, and that they
supported the inclusion of an investor-state disputes process in the agreement (Coalition of Service Industries 2009). Submissions from agribusiness groups advocated against further opening of US agricultural markets, in the context of high unemployment (US Sugar Alliance 2009). The USTR National Trade Estimate report on Foreign Trade Barriers in Australia in 2010 also listed pharmaceutical price regulation, intellectual property rights protection, treatment of blood products, local media content regulation and government procurement as trade barriers (Office of the United States Trade Representative 2010).

As the negotiations began, over thirty Australian organisations issued a public statement, noting that

‘The government has said that they will try to use the agreement to improve Australian access to US agricultural markets, but the danger is that further changes to the Pharmaceutical Benefits Scheme and the other policies will be demanded as trade-offs’ (AFTINET 2010).

The statement called on the Australian Trade Minister to adopt the following principles in the negotiations:

- ‘No further changes to the Pharmaceutical Benefits Scheme which would reduce affordable access to medicines
- No investor-state disputes process which would give special rights to international corporations to sue governments for damages
- Full rights for governments to regulate labelling of genetically engineered food and to regulate GE crops, including existing moratoria
- No further weakening of Australian Government power to regulate audiovisual media for Australian content purposes
- Retention of the Foreign Investment Review Board, and of its powers to review foreign investment in the public interest
- No weakening of quarantine regulations
- No reductions in the ability to have local content requirements for government purchasing and industry policies that support local employment
- Strong labour clauses that require signatories to enforce the core International Labor Organisation (ILO) standards in the ILO Conventions, with trade penalties for noncompliance
- Strong environmental clauses that require signatories to meet all applicable international environmental standards including those contained within UN environmental agreements, with trade penalties for non compliance’ (AFTINET 2010: 2).

The supporting organisations included the Australian Council of Trade Unions, the Australian Conservation Foundation, the Australian Catholic Social Justice Council, the Australian Pensioners and Superannuants Federation and the Public Health Association of Australia, eleven national unions and several other church community and environment organisations. At the same time, a statement dealing with some of these
issues in an international context was issued by the national peak trade union bodies of Australia, the US, New Zealand and Singapore (Australian Council of Trade Unions 2010). The two statements and the issues they raised were reported widely in the media (ABC Radio National 2010a; Colebatch and Schneiders 2010; Davidson 2010; Faunce and Townsend 2010a; Saulwick, 2010; Tienhaara, 2010).

Before the negotiations the Australian Trade Minister responded in answer to questions that ‘everything was on the table’. However, in a letter written in response to issues raised in the community organization statement he wrote that there was no intention to negotiate changes to the PBS (Crean, 2010 b). A further qualification was made on the investor-state dispute process: with the Minister reported as saying:

‘We continue to have serious reservations about the inclusion of investor-state dispute settlement provisions … and Australian negotiators will be making this clear’(Saulwick 2010).

These reservations were strengthened by the reaction of the Philip Morris Company in May 2010 to the Australian Government announcement that it would follow a World Heath Organisation recommendation to legislate for plain packaging of cigarettes. Philip Morris had already used an investor-state dispute process to sue the Uruguayan Government for damages when that government introduced similar legislation, and the company threatened to take similar legal action against the Australian government. Currently it is unable to do so because the AUSFTA has no investor-state disputes process. If the Australian government did agree to an investor-state dispute process in the TPPA, it would be handing the company a weapon for legal action against its own plain packaging legislation (International Centre for Trade and Sustainable Development 2010; O’Malley, 2010, Davison 2010).

New Australian Trade Policy 2010

A review of Australia's trade policy was conducted by the new Trade Minister Craig Emerson following the 2010 election. The outcome of this review, announced in April 2011, was the adoption of many of the recommendations of the Productivity Commission Report on Bilateral and Regional Trade Agreements, including the Commission’s conclusion that the economic benefits of bilateral agreements had been exaggerated. The policy also stated that the Australian government would assess trade agreements on the basis of clear economic benefits for Australia.

The policy review has three important implications for the TPPA, which are responses to the submissions and campaigning from community organizations to the Government, and the government responses to Productivity Commission Report. Firstly, the policy now rejects the inclusion in trade agreements of investor state dispute procedures which give foreign investors greater legal rights than domestic investors. It states

‘The Government does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses. Nor will
the Government support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses…In the past, Australian Governments have sought the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice. If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries’ (Emerson, 2011: 20).

Secondly, the policy makes it clear that changes to health policies and the Pharmaceutical Benefits Scheme will not be negotiated in trade agreements.

‘The Government has not and will not accept provisions that limit its capacity to put health warnings or plain packaging requirements on tobacco products or its ability to continue the Pharmaceutical Benefits Scheme’ (Emerson, 2011: 20).

Thirdly, the policy adopts the Productivity Commission recommendations against the strengthening of intellectual property rights through trade agreement negotiations (Emerson 2011 26). As discussed above, these are three of the major US demands in the Trans-Pacific Partnership agreement.

**Implications of the Australian experience for the TPPA negotiations**

The experience of the AUSFTA, which was negotiated in a period of US economic expansion, but achieved very limited market access to US markets for agriculture and other goods, underlines the difficulties of achieving any significant market access to US markets in the TPPA negotiations. The impact of the global financial crisis and continuing high levels of unemployment in the US, and continued lobbying by US agribusiness groups against increased market access for competitors, mean that increased access to US agricultural or other markets for the TPPA negotiating countries seems unlikely.

The adoption by the Australian government of clear policies against changes to the Pharmaceutical Benefits Scheme, against an investor state dispute process and against the strengthening of intellectual property rights means that it will be difficult for the Australian government to agree to these key demands of US negotiators in the TPPA negotiations. The Australian policy may also encourage other governments which have not conceded to these demands in previous trade negotiations, to resist US demands.

Overall, the Australian in experience of AUSFTA, and the adoption of new Australian trade policies in 2010, indicate that it may be difficult for Australia and other countries to achieve increased market access in the US, and for the US to achieve some of their key demands. This means the TPPA negotiations may prove more difficult than initially predicted.
References


Davison, M. (2010) ‘Big tobacco’s huff and puff is just hot air’, the Age, 4 May, p.11.


Priestley, M. (2008), Australia’s Free Trade Agreements, Background note prepared by Australian Parliamentary Library.


