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AUSTRALIA AS A BRANCH OFFICE ECONOMY

By

**Ross Garnaut
Professor of Economics
The Australian National University
Canberra**

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AUSTRALIA AS A BRANCH OFFICE ECONOMY

On the eve of ANZAC Day, 2001, the Australian Government exercised its powers under the Foreign Acquisition and Takeovers Act to prevent a European company, Shell, from acquiring a substantial shareholding in the Australian company Woodside Petroleum Limited which would have resulted in a change of control of Woodside. The Treasurer in announcing his decision said that it was in the national interest for sales from the Northwest Shelf gas project to be promoted in preference to competing sales from projects in other parts of the world. By implication, the Treasurer judged that there was a risk that if Shell controlled the development of the North West Shelf, it may choose to promote sales from other parts of the world in preference to sales from Australia.

The Shell proposal was one of many over the past half dozen years for foreign firms to take control of companies which have responsibility for development of commercially valuable natural resources in Australia. Over this period, the centre of gravity of executive leadership of the two largest mining countries in Australia, which were to become two of the three largest mining companies in the world, shifted from Melbourne towards London. There is current speculation that what had been the third largest mining company based in Australia, with its headquarters also in Melbourne, will soon be subject to takeover offers from firms based in one or other, or both, of the United Kingdom and the United States. Executive control of what has been Australia's largest gold mining company is in the process of moving from Adelaide, South Australia, to Denver, Colorado.

The Australian Treasurer in the Woodside decision was reacting to the circumstances of the case before him, but also to more general anxiety in the

community that Australia was in the process of transition to a branch office economy, in which relatively few senior executive leadership functions were undertaken in Australia. This had become a matter of general concern, but was felt most acutely in the natural resource-based industries in which Australian companies had played major leadership roles.

Similar issues have arisen in the agricultural sector, although less acutely. They will soon rise in profile if the current intergovernmental discussions of a free trade area with the United States move from tentative exploration to negotiation: the Australian Wheat Board's monopoly in the wheat export trade is maintained by use of Commonwealth Government regulatory intervention that would come under strong challenge in the context of serious consideration of a free trade agreement.

The stronger tendency in recent times for Australian resources to come under the ownership and control of foreign companies has its origins in reductions of costs of international transactions, itself the motive force for the phenomenon that is known as "globalisation" in popular discourse.

Does it matter to any Australians, other than those directly involved as shareholders and senior managers and members of Boards, whether the Australian resources sector is managed through branch offices of foreign enterprises? If it matters, is there anything within the influence of Australian Government policy that can cause the process to do more good and less harm? Should we see the Woodside intervention as a mistake, or a model?

In this paper I move lightly over the issues, and use some naive theorising to suggest a few hypotheses. The paper as a whole suggests that these issues are important enough to be represented on the research agenda of the Australian agricultural and resource economics profession. That the issues are of importance beyond the resources sector should be no inhibition. Indeed, it

would be in the tradition of agricultural and resource economics in Australia to work from an issue that had arisen in the resource sector, to conclusions that have significance for the wider national and international economies.

Globalisation and the Australian Resources Sector

There is nothing new about globalisation in the Australian economy, and the Australian resources sector in particular. It was specialisation in production of a few resource-based products, principally gold and wool, the value of which was high enough in comparison to weight and therefore transport costs to Europe, that provided the base for Australia's relatively high standard of living in the nineteenth century. Much of the financial and human capital that was necessary at each new stage of the development of the mining and pastoral industries came from Europe. A high proportion of large businesses in the resource-based industries were owned and controlled from Europe.

Protection within the Australian Federation made economic activity generally less internationally-oriented through most of the twentieth century, but the mining and pastoral industries remained heavily export-oriented. Indeed, protection, by raising costs across the whole economy and destroying international competitiveness in industries in which Australia had positive but weak comparative advantage, caused Australian exports to be concentrated even more intensely in natural-resource-based commodities.

The accumulation of domestic savings and skills and the advantages of locating the main centres of executive management close to the natural resource-based production saw the development of many substantial Australian-owned and controlled businesses in the sector. Some of these became large on a world scale.

Cost-reducing technological change in transport and communications gradually expanded the range of commodities based on Australian resources that could be

exported profitably to the world's main centres of internationally-oriented consumption and industrial production. Grain, meat and dairy products--and a few bulk mineral products which were in demand in nearby Asian centres--joined wool and gold in the export lists. Through the second half of the twentieth century, Australia's economic isolation was reduced by the shift in the centre of gravity of world industrial production and consumption towards Australia with sustained industrialisation and economic growth in East Asia. Rapid East Asian growth also led to the emergence of new and bigger export industries based on natural resources, including for the first time large industries exporting such low value-to-weight commodities as coal, iron ore and bauxite.

There was an acceleration of the rate of technological progress in communications and transport leading to reduction in costs of international business transactions in the late twentieth century. These developments established the conditions for the deepening integration of global markets for goods, services, capital and to a lesser extent labour. The technological tendencies were reinforced in many countries by liberalisation of international trade and payments and deregulation of the service industries.

In Australia, the unwinding of the high protection and controls on international payments late in the twentieth century had especially powerful effects, because protection had been higher than in most other developed countries, and because high protection in Australia had compounded what was in any case an extreme (geographic) isolation from the main centres of the international economy. There was rapid expansion in direct investment both into and out of Australia after the abolition of exchange controls in 1983, and in the scale and diversity of exports through the period of falling protection between 1983 and the end of the century.

The increased foreign ownership of major businesses in the Australian resource

sector over recent years is one dimension of the internationalisation of economic activity. The reduction in international transactions costs has reduced the disadvantages of distance in all its dimensions. The evidence of increasing roles for foreign-owned businesses in the resource sector suggests at first sight that the technological change has reduced the costs of distance between corporate head offices and the centres of resource production, more than it has reduced the costs of isolation from product and capital markets.

Location Bias in the Global Economy

The reduction in international trade and transactions costs as well as official barriers to trade and investment has enhanced the profitability of resource-based production in Australia. "Globalisation" has been favourable for expansion for the Australian resource-based industries. This has enhanced the rent value of Australian resource production. In addition, there have been additions to the value of Australian economic activity through the use of various professional skills and services away from the farms and mines. Considerable economic value is added in service activities outside the corporate head offices. Developments in the resource-based industries generally have been favourable for the performance of the Australian economy, and for economic performance in states which are relatively well-endowed with natural resources (Western Australia and Queensland).

Here we focus not on the total economic activity associated with the commercial development of natural resources, but with that associated with the location of corporate executive leadership.

There is a perception that the contemporary developments in communications technologies are unfavourable to the location of high-value economic activity including corporate leadership in small and isolated parts of the world economy. This is an important point of discussion in New Zealand, Tasmania and South Australia, and has been part of the general Australian concern about

the branch office economy.

This perception results from observation of the apparent realities rather than from *a priori* theorising. Casual theorising might have led to the view that the efficient computer and the new communications technologies would make high-value economic activity, based on scarce human capital, more footloose, allowing the people with the most valuable skills to live in places that were preferred for such personal reasons as lifestyle.

What are the possible sources of bias against Australia, or more generally small and relatively isolated economies, in decisions on the location of executive leadership in the natural resource-based industries?

The technological change that has underpinned the increased internationalisation of economic activity has raised the optimal scale of firms involved in production and sale of natural resource-based products. The market-place realities support this generalisation, even though the new technologies have not systematically increased the optimal scale of activity in many other areas of the economy. There are, as a result, a smaller number of firms of substantial scale in the resources sector, and therefore a smaller number of centres of corporate leadership.

This could help to explain why the number of corporate head offices in Australia has fallen, but goes nowhere towards explaining why there has been a reduction in the proportion of major resource companies with headquarters in Australia.

Location of corporate headquarters close to the main centres of resource-based production seems to have become less important in recent times. London has emerged as the most important single centre of corporate leadership in mining,

over the recent years in which mining in Britain and nearby Europe has shrunk to negligible proportions. Denver has emerged as the headquarters of the world's largest gold-mining company at a time when gold mining is unimportant in Colorado (although the major gold-producing state of Nevada is adjacent to the west).

While location of corporate leadership functions close to the centres of resource-based production may not be critically important, leadership of the production activities themselves, and often of associated marketing activities, have not been taken further from the natural resources. The shift of headquarters to the Northern Hemisphere has often been accompanied by decentralisation of leadership of production closer to the natural resources, for example from Melbourne to Brisbane or Perth.

Are the externalities associated with agglomeration of business leadership in a particular location crucial to the tendency for headquarters of resources companies to shift from Australia to the major economies of the Northern Hemisphere? They are obviously important. Land rents and a range of other costs are higher in the largest centres of global business leadership, and only the largest companies can justify economically the overhead costs of headquarters in them. If these were the only factors determining head office location, we might see a hierarchy of cities and enterprises, with the largest global businesses being based in the largest centres of business leadership. While these considerations are important, but the scale and agglomeration hypothesis leaves unexplained some important phenomena. One puzzle is why, between two businesses in the gold sector of similar size a few years ago, both with ambitions to be major players in the global gold industry, based in cities of similar size and both a long way from the world's main centres of business leadership, the one based in Denver was able to purchase with ease the one based in Adelaide, and so to become the world's largest gold producer.

Is it important for corporate leadership functions to be based near major centres of use of resource-based commodities, or near major centres of commodity trade, or, more generally, near markets? Again, this would seem to be part of the story. If it were the determining part, the disadvantage of Australia's location would be diminishing over time with the shift towards the East Asian hemisphere of the centre of gravity of world use and imports of industrial raw materials.

Is the supply of professional and managerial personnel a critical factor? The relevant skills are many, including the rare talents for effective leadership of large global businesses, the business education and experience of senior management, and a wide range of specialised business services, including amongst many others engineering, management consulting, metallurgical, marketing, financial, economic, legal and accounting. Many of these services are supplied most efficiently from external specialists rather than from within the firm. Some require elements of research, and therefore effective access to high quality research institutions. Major institutions for graduate education and research grow symbiotically with and adjacent to the main cities of business leadership.

How does Australia fare in relation to the supply of professional personnel? People with skills that are relevant to global businesses tend to be highly mobile, so that the attractiveness of a country or city to newcomers, as well as the supply of indigenous skills, is important. Obviously small scale is a disadvantage, which is capable of being modified by factors affecting retention and attraction of professional and managerial personnel. The Australian education and research systems produce large numbers of people relative to population size with skills relevant to global leadership in the resource sector, and in recent years they have been available at relatively low cost. Australia's larger cities are attractive in lifestyle and cost of living, but isolation from the major centres of human civilisation in the Northern Hemisphere is a

disadvantage to many. Official barriers to entry of skilled personnel are annoying and would seem to be capable of reform at low political cost, but as one of the small number of countries of large-scale immigration, Australia is at no disadvantage against all but a few developed countries. The considerable flow of talented and well-educated young people from Asia over the past two decades is a source of competitive advantage. Taxation rates and structure comprise a major disadvantage for Australia relative to its main competitors for corporate leadership, including the United Kingdom and the United States, and in the East Asian Hemisphere, Hong Kong and Singapore.

The recent prominent cases--CRA, Woodside, BHP, Normandy, WMC--suggest an especially important role for the supply price of investment, with companies based in the United Kingdom and the United States seeming to have a substantially lower cost of capital. Companies based in the countries with the world's deepest, most flexible capital markets have their assets valued more highly than equivalent assets owned by companies domiciled elsewhere, and are therefore able to offer higher prices for the assets.

This seems to be the contemporary reality, but it is not at first sight obvious why it should be so. The financial markets are said to be the places where "globalisation" has moved furthest and fastest, the places where information flows are most complete, most rapid and lowest in cost. When pressing the "enter" key gives instant access to the electronic herd from any substantial city at any time of the day or night, why is it a large advantage for an enterprise to be located in one of the countries with the best developed capital markets?

This important matter requires a closer look.

Does Being a Branch Office Economy Matter?

Increased competition for ownership of Australian natural resources, including from companies with lower supply cost of capital, superior access to markets

or professional personnel, or which are better organised to maximise value, could be expected to raise the rent value of the resources. It would tend to make the Australian resource-based industries more competitive relative to alternative suppliers and in the process to expand Australian output. Increased economic activity would tend to raise Australian employment and incomes. If the increased competition were focussed on shares in companies which own Australian resources, it would increase the wealth of Australians who own shares directly or through superannuation funds.

These are all unambiguously favourable consequences for Australia of tendencies towards globalisation of corporate ownership. Are there other consequences that could work in the direction of lowering Australian benefits, perhaps exceeding the positive effects?

Three possibilities warrant consideration.

First, head office functions, and the purchases of services with which they are inevitably associated, are large economic activities in themselves, associated with exceptionally high value added per person employed in them. Taxation of personal and corporate incomes deriving from the head office functions are considerable. Their loss is associated with a significant reduction in economic value to cities and countries in which they had been located.

Second, there are large community externalities associated with the employment of large numbers of professional people including many with high organisational leadership qualities. The major Melbourne-based resource companies contributed considerable leadership to the Australian debate about economic policy, to public administration (part-time through membership of advisory bodies and Commissions, and full-time in the major wars). They provided leadership for such professional and community organisations as the Academy of Technological Sciences, the Institute of International Affairs, the

Asia-related societies, and the Universities and specialist institutions for scientific and economic research. On retirement from executive employment in the resource sector, they provided executive and non-executive leadership to many other Australian businesses.

A third possible cost of the branch office economy would arise if a foreign company took different business decisions from one that was owned and controlled in Australia. There is inevitably bias towards purchase of professional services, and towards support of educational and research institutions, from near the head office. These are probably more realistically considered amongst the inevitable consequences for local economic activity of branch office status. Less certain is the possibility of a foreign company taking decisions that lead to lower prices or output from Australian resource industries. This is the basis of Australian Government intervention to protect Australian ownership of Woodside and the export monopoly of the Australian Wheat Board.

The case for the Wheat Board monopoly is based on the possibility of realising higher export prices through the exercise of market power. The markets for most resource-based products are characterised by large numbers of buyers and sellers, with little opportunity to raise prices through the use of monopoly power on a global scale. To the extent that there are opportunities for the use of market power, they will be utilised by large private companies in the industry, with the usual sharing of rents between the company controlling the development and the Governments and communities that own the resources. A profit-maximising company, limiting supply below competitive levels to raise prices, would draw supplies from lowest cost sources. Australia, like other suppliers, would receive a share of the price benefits of restriction, while losing some production and exports depending on the extent to which it was a relatively high-cost source. Government enforcement of a monopoly over

exports from Australia would only raise world prices if Australia were overwhelmingly the main supplier and if there were no close substitutes in use. It is doubtful whether Australia occupies that position in any of the resource markets. It certainly does not occupy that position in the natural gas or wheat markets. There are of course efficiency losses when a single firm is placed in a monopolistic position in any part of an important economic activity, and monopoly over exports involves some transfer of monopoly rent from competing suppliers of product to the monopolist.

Even where there is no opportunity significantly to influence world prices of a commodity, there may be rents of favourable location that are in principle available for distribution between importers and favourably located suppliers. If there were competition amongst both exporters and importers, the location rents would be disbursed through market processes. Monopoly at one or other end of the sales relationship introduces the possibility of shifting location rents towards the monopolistic party. Monopoly at both the importing and exporting ends leads to complex patterns of bargaining.

These issues were analysed for the Australia-Japan trade in mineral raw materials in the 1970s. Japan at this time was overwhelmingly the main import market for steel-making raw materials in Northeast Asia. The Japanese steel mills purchased their raw materials cooperatively, and in the absence of cooperation amongst Australian suppliers were in a position to gain a high proportion of the rents of Australia's favourable location. This case, in which the rents of location were exceptionally important, has been transformed by the emergence of Korea, Taiwan and mainland China as major importers of iron ore and coking coal. Any surviving elements of monopoly in Northeast Asian purchases have been counterbalanced by increased concentration of ownership at the Australian end.

The case for the Wheat Board export monopoly would seem to depend on the

presence of rents from Australia's favourable location as a supplier to some markets. The relatively small ratio of transport to total supply costs in the wheat trade reduces the potential importance of location rents. The considerable competition amongst East Asian importers of wheat reduces the importance of monopoly power on the purchasers' side. It seems unlikely that the opportunity for raising Australian export prices by excluding multinational firms from the trade outweighs the efficiency and income distribution costs of monopoly, but definitive conclusions would require empirical research.

Concern about a different kind of distortion in the trade decision-making process lay behind the decision to block the takeover of Woodside. Here the concern was that a European company with the capacity to draw gas from a range of international sources may favour non-Australian supplies. An Australian company with resources only in Australia would be certain to utilise the Australian resource if it were able to secure the market.

We would expect the European firm, concerned to maximise global profits, to draw gas from Australian reserves if Australia were the lowest cost source of supply, but not if Australian costs were higher. What is not clear is why the Australian firm would be expected to secure the supply contract if its costs were higher than the alternative sources.

The one circumstance in which a profit-maximising multinational firm might utilise higher-cost non-Australian ahead of Australian resources would arise if global demand was lumpy and markets were imperfectly competitive, if supply from either location were profitable, and the company owned a larger share of the non-Australian resource by a wide enough margin to compensate for lower unit profitability. This circumstance depends on the low proportion of the European firm's ownership of the Australian resource. It is not impossible that this circumstance could arise in reality, but the conditions that would justify intervention from the Australian national viewpoint would rarely be present.

Their presence was not demonstrated in the Woodside case.

Can Policy Help?

The hypothesis from the preceeding section is that it matters if Australia is only or mainly a branch office economy. What matters is not that foreign-owned companies take different business decisions affecting unfavourably the extent and pricing of production of resource-based development in Australia. Rather, it matters because business leadership, and the purchase of high-value services with which it is associated, is a large and highly valuable economic activity in itself, and because it is associated with external benefits that can materially influence the quality of the economy, polity and society.

It matters, but can anything be done about it that does more good than harm?

Discussion here is focussed on two kinds of policy intervention. One is regulatory, using Government powers to block the purchase of Australian assets and to protect Australian enterprises from foreign competition in other ways. The other is policy change to diminish the disadvantages and enhance the advantages of locating business leadership functions in Australia.

The regulatory interventions are in their nature conservative and defensive. They try to hold what has already been established in Australia. They are not helpful to building larger Australian-based companies of international importance. They are not completely successful even in their defensive aims, as regulation is formal in its requirements, and there can be shifts in the locus of real business leadership despite formal requirements to maintain the head office or the residence of specified senior office-holders in Australia.

And regulatory intervention comes at a cost. It may confer benefits on the holders of senior offices in the company at the time of the intervention.

However, it reduces the value, according to their own assessments, of Australian shareholders' assets. By curtailing the opportunities eventually to sell business assets at a maximum price, it reduces the incentive for Australians to build new companies that may later be of interest to foreigner buyers.

Decisions to use regulatory powers against foreign takeovers are invariably made in a highly charged political environment. Such circumstances are not conducive to careful assessment of whether the narrow conditions are present, under which such intervention might confer net benefits on Australia.

Policy change to enhance the advantages and to moderate the disadvantages of business leadership in Australia is more promising. There is no prospect of established global companies with their headquarters in the major business leadership centres of the Northern Hemisphere re-locating to Australia. The challenge is to provide a congenial environment for the growth of Australian companies into major global businesses while holding their business leadership functions in Australia.

Here the policy agenda is not very different to the reform agenda for improving Australian economic performance more generally.

Australia's disadvantage in building and holding business leadership activities centres on its small scale and isolation from the main centres of global economic activity in the Northern Hemisphere.

Economic distance can be reduced by improving and reducing the costs of international communications and transport. There has been considerable movement in these directions through economic reforms since the mid-1980s. But there is still a large gap between best practice and the Australian reality, as revealed in recent public discussion of the regulatory framework and infrastructure affecting broadband telecommunications. The removal of most

Australian protection has made a large contribution to reducing Australia's economic distance from the rest of the world. The removal of the remaining protection would add to the contribution.

The rest of the world's protection also increases economic distance from Australia. Australia is not a decisive influence on other countries' trade liberalisation decisions. But neither is it irrelevant to them. Effective trade diplomacy, made credible by commitment to trade liberalisation at home, had some influence on the favourable outcome in the Uruguay Round of Trade negotiations. Closer to home, Australian diplomacy, including through the formation and development of Asia Pacific Economic Cooperation, was helpful to the rapid reductions in protection in all substantial Western Pacific economies between the mid-1980s and the financial crisis of 1997-8. Australia's support in many ways was helpful to China's efforts to join the World Trade Organisation, from the beginnings of discussion in 1986 to success in 2001. It is an additional benefit of support for trade liberalisation in Asia that it helps to sustain the strong economic growth in Australia's own region that itself has contributed to reduced relative isolation in the world economy.

Economic size can only be changed substantially over long periods. But the difference in size between the Australia that would result from the consistent application over half a century of policies that were favourable to rapid growth in population and labour productivity, and from those that inhibited growth, is large enough to affect perceptions of Australia as a location for business leadership. Markets anticipate future developments, and bring to account expectations of future change before they are current realities.

Even more important than growth outcomes, would be the effect that expectations of strong growth would have on perceptions of Australia as a favourable place for young, talented and ambitious people to build their careers

and their lives. There is some circularity here between the conditions that are conducive to economic growth, and those that are conducive to making Australia attractive as a location for business leadership.

Amongst the particular impediments to Australia being an attractive location for global business leadership two, including what preliminary analysis suggests is the most important of all, are amenable to Australian policy choice.

The most important of the impediments is the higher cost of capital for Australian companies, reflected most importantly in the higher stock exchange valuation of assets owned by United States and British companies. The abolition of exchange controls and easing of regulatory restrictions on direct foreign investment has reduced these costs, but lack of familiarity within the Australian institutional environment remains a barrier to entry. Here the most effective remedy would seem to be adoption of the accounting standards (suitably reformed after Enron!), stock exchange listing rules and corporate regulation of the United States.

The adoption of United States rules and standards would look like the surrender of a degree of Australian sovereignty. To the extent that it was, it would be the surrender of sovereignty in an area that is unimportant to most Australians, to gain substantial enhancement of sovereignty in ways that matter a great deal to Australian living standards, and quality of life.

The second substantial opportunity to reduce impediments to location of business leadership in Australia relates to generation, retention and attraction of high quality professional and managerial personnel. The rates and structure of taxation on personal income is a weakness that in principle is easily remedied, although it is constrained politically by perceptions that reform would be inequitable to the distribution of after-tax incomes within Australia. The political leadership challenge is to develop the acceptable, wider set of

policies of which the reform of taxation on professional incomes was part. On attraction of professional personnel, it would be helpful if there decisive steps towards further liberalisation of immigration rules for people with good education and professional skills.

The domestic generation of professional skills depends on the quality of institutions for graduate education and research. The main weakness in the established structures derive from the Australian community distaste for competitive processes that allow successful institutions to draw resources from the unsuccessful. Reforms mooted by the immediate past Commonwealth Education Minister were in the right direction, and need to be supported by the adroit political leadership that would facilitate their implementation.

Finally we should recognise that Australia's prospects depend on the quality of private institutions as well as on policy. The establishment of a stronger institutional base for high quality graduate education and research depends on the national policy environment, but even more on Australian institutions designing their internal structures to maximise value. Similarly, Australia's success in global business leadership can be facilitated by policy, but depends as well on the quality of private business organisation and effort. It is not obvious that Australian corporate leadership has made the best possible use of the advantages of Australia's business environment, including its location on the edge of a region that contains a substantial proportion of the world's economically valuable natural resources, and in the East Asian hemisphere which has continued to experience stronger economic growth than the rest of the world since the East Asian financial crisis.

Would Free Trade Agreements Help?

It is currently fashionable to favour Australian entry into “free trade areas” with limited numbers of other countries as a means of overcoming the disadvantages of small size, if not of isolation. There have been recent negotiations on a free

trade agreement between Australia-New Zealand and the Association of Southeast Asia Nations. There are discussions of varying intensity currently under way with Singapore, Thailand and, most importantly, the United States. Would free trade areas with these or other countries strengthen Australia's role in international business leadership?

Free trade would help, most of all if Australia completed the trade liberalisation that went a long way in the late twentieth century. Reductions in other countries' protection would add to the gains. But would the negotiations of bilateral or regional free trade agreements move Australia towards free trade?

Not necessarily. Probably not if the regional or partner did not represent a high proportion of Australia's potential foreign trade. And especially not if the arrangements did not remove all barriers to trade in goods and services amongst participating countries. A regional or bilateral free trade area retains barriers to trade with third countries. It therefore introduces the tensions associated with trade discrimination against third countries and increases transactions costs in all foreign trade through the need to monitor rules of origin. These problems could be avoided by Australia removing all of its own protection against all countries as it entered the limited free trade area, in which case the main gains would come from Australia's own trade liberalisation.

In relation to free trade agreement with the United States, the potential gains from liberalisation of merchandise trade, beyond those deriving from Australia's own liberalisation, would be concentrated in the farm sector. The United States Congressional discussion has made it clear that substantial farm trade liberalisation is unlikely in the context of a bilateral free trade agreement with Australia.

The reality that clean, bilateral free trade in goods and services with the United States is unlikely has been recognised more clearly in recent times. In

response, the focus of advocates for a free trade area has shifted more strongly to the potential gains from integration of Australian and United States capital and labour markets within a free trade agreement.

This paper has argued that there are advantages for Australia in deeper integration into international markets for capital and professional personnel. In the case of capital, the advantages are especially large in relation to integration into the United States markets. Would policy change to produce these outcomes be more likely in the context of a free trade agreement with the United States?

Three points need to be made in response to this important question. First, the main policy changes to ease the flow of capital and professional personnel between Australia and the United States will occur in Australian policy above. Second, to the extent that there was a possibility of reciprocal policy adjustment in the United States, progress could be made in harmonisation of capital and labour market regulation through negotiation of a bilateral Economic Agreement independently of negotiations on a conventional free trade area. Third, the political tensions in both countries that would be associated with attempts to negotiate an agreement for free trade in goods and services would complicate rather than facilitate harmonisation of policies for movement of capital and professional personnel.

The Research Agenda

A quick flight over the territory has, I hope, established that the location of business leadership is a significant issue, and a worthwhile focus for economic research.

Empirical research might confirm some hypotheses presented in this paper, and raise doubts about others. It would inform us about the scale of effects that seem to be of some importance.

Empirical research would undoubtedly reveal a differentiated picture. It may show that even with good policy in all areas, Australia would be the efficient location for relatively few of the largest global companies, but the natural focus of executive leadership for medium-sized companies specialising in production in Australia and nearby countries in Asia and the Southwest Pacific. It would help to define the conditions in which such medium-sized companies could compete effectively with the global giants in Australia's region. A more differentiated picture, too, would reveal benefits from Australia being an efficient location for executive leadership functions that can be separated geographically from corporate headquarters.

As a long-term participant in the Australian debate about internationally-oriented economic reason, I should declare an additional interest in bringing the branch office economy within the scope of economic research in Australia. I suspect that closer analysis of the branch office economy would provide yet one more reason for completing the internationally-oriented reform, the partial progress on which did so much to raise Australian productivity in the last decade of the twentieth century.