

A Voluntary Free Trade Alliance

How to Overcome Hurdles in the Path of Traders and Investors

Wolfgang Kasper

EXECUTIVE SUMMARY

This paper outlines and endorses a new initiative for a Global Free Trade Alliance that would promote free exchanges between nations on a voluntary basis and could become a 'World Trade Organisation Plus' among relatively free economies:

- The Heritage Foundation, an influential free market think tank in Washington D.C., has published a proposal inviting the US Congress to grant free access to traders and investors from fairly free economies. The proposal is based on voluntary cooperation, reciprocity and the understanding that jurisdictions can at any time again leave the proposed Global Free Trade Alliance (GFTA). Members of the Alliance would treat each other's citizens as if they were residents for purposes of trade and investment.
- The Alliance is intended to supplement multilateral, regional and bilateral negotiations to free up trade and investment flows. It is meant to invite parliaments to remove residual barriers to trade and investment, end economic discrimination against foreigners, secure private property rights, and implement efficient, transparent regulations.
- An advantage of this proposal is that membership is not based on the mistaken assumption that free trade and investment are at the expense of the nation. Discrimination against producers or investors, who live beyond the national borders, diminishes the opportunities of national citizens to attain prosperity and freedom. Another advantage is that Congress would give the US administration an open-ended authority, thereby avoiding divisive country-specific ratification. Implementation does not depend on lengthy international haggling. The pace of liberalisation is dictated by the willing.
- A major advantage would be that Alliance membership raises the price for political meddling in the economy, as this could mean expulsion from the Alliance.
- The Alliance would not require a bureaucracy of its own. Occasionally, a network of trade ministers will have to define minimum standards, discuss possible violations and enforce adherence to economic freedom by Alliance governments.
- According to the Heritage scholars, a dozen countries—including Australia and the United States—already meet the preconditions for membership. Many more do not miss the mark by much. The opportunities of huge markets will create pro-Alliance lobbies that will act as a counterweight to protectionist interests.

The GFTA proposal will of course not remedy all ills of political interventionism but, like all measures to open national economies, it would raise the cost of interventionism. It has the potential of becoming a beacon for a more prosperous and freer global community.

Although Australia will soon have fairly free access to US markets, becoming a foundation member of the proposed Alliance would conform to our professed mission as a protagonist of progress, peace and free cooperation in the world. In the long run, our prosperity, influence in the world and security would benefit.

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Free trade and capital flows are in the interest of the vast majority of Australians.

Trade is between people

The Australian government's recent bilateral free trade negotiations with the United States, Thailand and Singapore, as well as successive multilateral rounds of global trade liberalisation, have suffered from an underlying confusion. The presumption always has been that trade negotiators make concessions to foreign interests in exchange for getting improved access to overseas markets or more equal treatment of Australian investors in those markets. They necessarily bluff, delay and cajole—a rather phoney game.

The underlying assumption is wrong. Free trade and capital flows are in the interest of the vast majority of Australians, as we learnt in the wake of the tariff cuts and the deregulation of foreign investment since the 1980s. Both have contributed mightily to our robust economic growth and resurgent can-do optimism. When tariffs and capital controls still loomed large, Australian industry and economic growth lagged further and further behind other OECD countries. As elsewhere, the opening of the economy became an engine of growth.¹

One has to always keep in mind that trade is not between abstract collectives, such as nations, but between individuals and enterprises:

- Japanese housewives may want to buy the cheap rice grown by farmers in the Riverina. The villains are those who prevent them from making a free choice.
- Australian mothers want to buy affordable clothing for their children. Why does our elected government make kids' clothing less affordable than it need be? Why does it damage the market for poor Bangladeshi and Indonesian workers? Why send aid, when the same government prevents poor workers from earning a living by selling their labour through Australian shops?
- European employers and householders want cheap electricity, possibly generated with the relatively clean, competitively priced coal that Queensland miners dig up in opencast operations. How dare European politicians and bureaucrat force them to buy costlier electricity generated with more expensive and dirtier coal from the Ruhr?
- Australians want to buy the best-value-for-money car tyres, whether they are made by workers in Victoria or Ohio. Americans may want to sweeten their coffee with sugar from a farm in Bundaberg, rather than the more expensive beet sugar from the Mid-West. It is unjust not to allow them a free choice.
- Australians want the widest possible choice of films and videos. Many are offended by Mark Latham's and John Howard's recent intervention, after the free trade deal with the US was negotiated, to 'protect' us from the voices of Geoffrey Rush, Toni Collette and Cate Blanchett when they put on American accents in the movies they film in Hollywood or Sydney studios. They do not want to be protected, although many will continue to pay a premium for good Australian entertainment. But let this be their choice.²

The same applies to foreign investment. If an Australian has built up a firm and wishes to sell a share in the business to a new partner, why should a government bureaucracy reduce his net value by making life harder for foreign investors and job creators? Why should Australian savers not be treated as equals when they put their hard-earned funds into an investment in Malaysia? As technical knowledge spreads in ever more rapid and complex ways and business opportunities arise in unexpected far-away places, the freedom of international capital flows has become increasingly important to productivity and living standards. Unhindered international capital movements have been instrumental in demonstrating to inward-looking policy makers that domestic policies and institutions, which hamper economic freedom, are increasingly costly to uphold in terms of lost growth and job opportunities. International capital flows after the removal of domestic and international capital-market controls and the floating of the exchange rate by the Hawke government in the 1980s, stimulated micro- and macroeconomic reform.

The flat-earth notion that governments are justified to discriminate against foreigners in favour of the well-connected 'Big End of Town' has of course been cultivated by politicians, the government's media clients and the spin doctors in industrial and other

lobby groups. In the era of rampant nationalism, lobbying was publicly accepted. But that was last century. Now we know what economic damage barriers to trade and investment have inflicted.

Proposal for a coalition of willing free traders

An exciting new proposal from the influential Heritage Foundation, a public policy think tank in Washington D.C., addresses the old misconceptions about border-crossing transactions in a direct and creative way.

Heritage President Ed Feulner, together with John Hulsman and Brett Schaefer, propose a 'Global Free Trade Alliance' (GFTA) to accelerate the free movement of goods and capital. They invite the US Congress to permit traders and investors from countries, which are willing free traders, to compete unhindered in the large US market, when and for as long as their governments want and give US residents reciprocal rights.³ The Heritage authors recommend that the US Congress give open access to residents of countries that demonstrate their 'commitment to free trade and investment, minimal regulation, and property rights . . . With no tariffs, quotas or other trade barriers—on the single condition that they reciprocate this access to the US and other members of the GFTA'.⁴

The Alliance is to create a voluntary association of free market economies. Candidates for joining are nations that already enjoy a rather high degree of economic freedom. The Alliance has the potential to become the world's most affluent and biggest economic space.

The Alliance is not intended to replace conventional multilateral, regional and bilateral negotiations to remove obstacles. It is to supplement these mechanisms. The authors argue that removing border obstacles is too important to be left exclusively to trade negotiators. It is made at a time when, after a disastrous start, the multilateral WTO negotiations among 147 governments hang in a precarious balance. Regional free trade projects, such as the proposed 'Free Trade Agreement of the Americas' are held up by recalcitrant foot-draggers, for example Brazil. The forward momentum of international liberalisation has arguably been lost in 1998 when the Multilateral Agreement on Investment was defeated in bureaucratic trench warfare.⁵ The OECD's plans to create free access to foreign investors and guarantee of their property rights in foreign markets was a setback, which signalled that the mutual goodwill of the era of superpower confrontation was not to survive into the 21st century.

The GFTA proposal is to work by voluntary accession of individual countries rather than by group consensus. It is therefore less likely to adopt the lowest common denominator. The Alliance can grow pragmatically from small beginnings. The Heritage plan gives substance to America's officially declared objective of promoting free international exchanges by all available means.

The Alliance proposal is based on the observation that free international trade and investment depend on a relatively free domestic economy. By contrast, border controls and foreigner discrimination are usually the corollaries of domestic political favouritism. For example, the one-sided Australian variations of the recently negotiated Australia-US FTA to impose limits on American-made films and soap operas are a reflection of the subsidies to the Australian industry and the supposed power of Actors Equity.

The advantages of the Alliance proposal over the familiar model of negotiating multilateral or bilateral deals are:

- If a country is recognised as having a sufficiently free market economy, including a demonstrated commitment to free international trade and capital flows, it can join the Alliance speedily, without diplomatic haggling and horse-trading of petty details. Only the positions of some professional trade negotiators will become redundant.
- As US Congress establishes a general rule; no country-specific deals need to be approved. Accession to the Alliance will be automatic for nations, which qualify, apply for membership and reciprocate. There will be no need for usual noisy lobbying.
- The advantages of being in the large, integrated Alliance market will motivate many parliamentarians to opt for economic freedom when parliaments discuss whether to

A proposal for a voluntary alliance to form a 'World Trade Organisation Plus'.

The proposed Free Trade Alliance has the potential to become the world's most affluent and biggest economic space.

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remove regulations. The pressures to do that will come from national voters, not some foreign hegemonic government.

- As membership is strictly voluntary and national governments are free to leave the Alliance at any time, there is no room for international arm-twisting; sovereignty is unaffected. A newly elected government is free to introduce legislation that confiscates private property rights or slaps new restrictions on foreign investors. But they will have to do so in the knowledge that the country has to leave the Alliance.
- In practice, an authority, such as a grouping of Alliance trade ministers, would certify that a new Alliance applicant meets the necessary requirements in terms of domestic and border-crossing activities. Such an evaluation is similar the proposed 'scoping studies', which is Canberra jargon for establishing whether the People's Republic of China and other Asian countries have become market economies and therefore merit free trade status. They are to establish when Asian countries have become free market economies so that we might offer them a free trade deal.
- There will have to be some penalties for non-compliance by Alliance partners, as well as provisions for expelling members, who no longer meet certain economic freedom standards, after certain periods of non-compliance. Some review and adjudication mechanism will therefore be necessary to deal with possible disagreements over what is deemed a substantial violation of the 'free economy rule'. However, this will not require a permanent bureaucracy, such as is maintained by the World Trade Organisation in Geneva, only a working party of the trade ministers.

Experience with previous trade and capital liberalisation has shown that the citizens of relatively small countries reap the biggest benefits from the widening of markets. A big advantage of the Heritage proposal is that it is based on the empirically well-grounded insight that economic freedom, free trade and worldwide investment are positive sum games.

Lady Margaret Thatcher saw this clearly when she commented on an early conception of the Alliance proposal: 'Not only would the arrangement work to stimulate the members' prosperity: it would also act as a beacon and an example to others'.⁶

Once an Alliance of open economies demonstrates that membership boosts economic growth and liberty, it will influence public opinion. The advances towards economic freedom under the auspices of the GATT and the OEEC/OECD in the post-war era convinced many sceptics that international trade and investment propel economic growth. The proposed Alliance will do likewise, but will do it faster. Opportunistic politicians, secretive back-room dealers and lobby-group operators will have fewer chances to put the brakes on government-to-government negotiations over liberalisation.

Australia already qualifies for membership.

Candidates

Feulner and associates use the assessments of economic freedom by the Heritage Foundation to determine who qualifies for Alliance membership. These assessments have been discussed and published for about a decade; they are in broad accord with other surveys of economic freedom that use alternative methodologies.⁷ Based on the latest, 2004 Heritage report on economic freedom (reproduced in Table 1, p.4 of the proposal), the authors deem that, in addition to the United States, 11 countries make the grade: Australia, Denmark, Estonia, Finland, Hong Kong, Iceland, Ireland, Luxembourg, New Zealand, Singapore, and the United Kingdom.⁸ A further one-and-a-half dozen economies around the world do not miss the mark by much. They could easily reform regulations and enhance property rights, if the reward were access to the Alliance.

Since these countries comprise most of the affluent economies, this has the potential to form a kind of 'World Trade Organisation Plus' among free economies. No one, of course, is compelled to join, so that rapid progress will not be held up by vetoes of unwilling governments. Nor is there any need to consider objections by representatives of interventionist, undemocratic regimes and reactionary defenders of the old, semi-open economic order, who give political power precedence over the prosperity of the citizens.

During the ailing current Doha Round of world-trade negotiations, the defensive manoeuvring of interventionist lobbies and governments—such as over the grossly distorting agricultural policies of the European Union, the US and Japan—will play a major role in determining what can be achieved. One way of giving a fillip to those multilateral negotiations would be to demonstrate that the WTO route is not the only way forward. Indeed, the recent Geneva compromise on a framework for future Doha Round negotiations would probably not have been accepted, were it not for the bilateral initiatives between willing free traders, such as Australia and the United States, which demonstrated that governments of goodwill have alternatives in moving forward.

The list of countries, which—according to the Heritage paper—qualify or nearly qualify, covers a number of members of the European Union, as well as candidates for future EU membership. It will no doubt be argued that countries, such as the United Kingdom and Ireland, which already qualify as candidates, can no longer make a sovereign decision to join a US-led Free Trade Alliance. Moves are afoot to ‘harmonise’ national policies in Europe so that external trade and investment policies are increasingly becoming a matter not for the national parliaments to decide, but for the Brussels authorities to decree. Whether the present EU conventions and rules would preclude Alliance membership or not, should, however, not be a concern for Americans or Australians, but for potential Alliance candidates who are EU members. Ways may, however, evolve for EU members to join the Alliance.⁹ After all, the Alliance with its membership benefits is a voluntary club.

The limits of the proposal

The Heritage proposal is not a panacea to heal all problems stemming from interference with the free choices of traders and producers. All governments, even those that preside over relatively free economies, meddle in economic life. They grant producers and investors selective handouts, local monopolies and other preferments. Thus, some American farmers receive massive production subsidies and some industries, like clothing and footwear, seem to be getting sheer endless adjustment subsidies in most industrial countries. Such handouts are a problem for free trade. For example, American farmers and Australian clothing manufacturers are currently receiving an artificial advantage when competing in supposedly integrated Australia-US markets. Australian and American States are offering numerous distorting investment incentives, as is the case in other economies, which the Heritage Foundation deems to be relatively free. All these measures deserve to be condemned on the grounds of pork barrelling and incentive distortion.

However, the Heritage proposal, by advocating a general rule and making membership voluntary, obviates the need to make these delicate political matters the subject of negotiation by trade negotiators. Domestic lobby politicking, which has complicated and delayed progress both under WTO multilateralism and bilateral agreements, is likely to take less hold when a government decides to join the Alliance. Domestic privileges will continue, but foreign-based competitors and investors will be treated as if they were locals; in other words, they too can apply for political preferment. Such foreigner access to domestic subsidies will weaken the political case for interventions. Whether complete non-discrimination against foreigners will in practice always be achieved is doubtful given the addiction of all democratically elected parliaments to pork barrelling. However, Alliance membership will at least create another political mechanism that makes political discrimination less attractive.

It was said during the recent debate about the Australia-US Free Trade Agreement that it does not create perfect free trade. The same can be said of the proposed Alliance. However, perfection is always the enemy of progress. What matters is that the GFTA will push back the boundaries of political rent seeking a little, in one member country after another, including the United States. Anti-foreigner discrimination in trade and investment is an obstacle to economic freedom worth getting rid of, even in a world of imperfect competition.

One problem, which the Heritage proposal does not address, but which needs to be resolved if the proposal is to be implemented is the issue of export subsidies. For example,

The Alliance is no panacea. It will push back the boundaries of rent seeking a little, in one member country after another, including the United States.

By becoming a foundation member, we can enhance our own security and stature in the world.

Free trade and investment empowers the young and the less well organised and promotes economic growth.

a number of American farm products attract subsidies if exported to third countries. There, Australian farmers, even if they produce at the lowest costs, may lose out to subsidised US suppliers—an undisputable violation of free trade principles.

The problem seems intractable in the case of GFTA members that are also in the European Union, which has a long tradition of subsidising exports. If, for example, Britain were a GFTA member, it would be unthinkable to permit the EU-subsidised exports of produce from Britain into the GFTA. The Common Market might then export its entire heavily subsidised surplus via Alliance member Britain, even produce from less free economies that do not qualify for free access.

Concerns about this loophole will induce trade officials to insist on complicated proof-of-origin documentation and customs procedures that hamper the free flow of goods. While one should not be overly concerned about the dangers of cheap supplies and non-reciprocity, major loopholes have to be fixed by proof-of-origin. Free trade runs both ways. Thus, competitive goods made in USA or Australia that freely enter Alliance partner Britain will 'leak' throughout the EU market, ensuring a measure of general reciprocity.

Why should Australians be interested?

It may be asked why Australians, just having successfully negotiated a bilateral agreement with the US, should be interested in a global Alliance. It is true that direct access of Australian traders and investors to the United States markets would not be greatly enhanced, if at all. We would, of course, also gain free trade status in other countries that join the Alliance. And there is a further benefit: The Australian government has concluded other bilateral trade deals and proposes to negotiate more. No expert can yet predict and no amount of administrative fine-tuning (and paperwork for Customs) will be able to reconcile inconsistencies between the various deals. It would be much easier, therefore, to place Australia's present and future preferential alliances with fairly free economies, such as New Zealand and Singapore, within the Global Free Trade Alliance. There, all club members play by the same ground rules.

Being part of the Alliance, Australia can play a positive role in our region by demonstrating what a genuinely open and free economy can achieve. Our international stance has in recent decades become more and more enterprising and outward-looking and we have a long tradition of being constructive in shaping the international order. It would therefore be appropriate to become foundation members of the 'alliance of the willing and the free'. To the extent that this promotes international cooperation, prosperity and general freedom in the world and in our region, our stature and security will be enhanced.¹⁰ Why not stand up for something we believe in?

Last, but certainly not least, Alliance membership hinges on continuing adherence to the principles of a free economy in domestic policy. It will make it harder for political opportunists and lobby interests to extract freedom-destroying privileges from any government of the day. And it will be easier for those politicians who believe in freedom to resist such pressures by pointing to the Alliance benefits. The price for interventionism will go up. Free international exchange, founded on a free domestic economy, will in due course create its own interest groups, a counter-weight to self-seeking supplier interests. This may also assist in convincing trade negotiators, most of whom tend to be lawyers whom only understand zero-sum games, that free trade and investment create win-win situations.

Openness has always allowed the rejuvenating winds of market competition into established regimes. For ordinary citizens, the young, the not-so-well organised and connected, for those with a stake in economic growth, this would be a considerable boon.

Endnotes

- ¹ Unilateral trade liberalisation, as for example during post-war Germany's economic miracle, has always been a sign of confidence and non-corrupt government. Haggling over reciprocity is in reality a concession to the asymmetric political influence of organised producer lobbies. Much political propaganda tries to justify preferments to politically organised groups, who contribute to party coffers.
- ² While the public no longer readily accepts protectionism in favour of a particular industry or union, there seems little public criticism of the supposed protection of 'our cultural identity'. The above-mentioned actors, who returned to Australia to lobby against the Australia-US FTA on behalf of Actors' Equity, assumed that more American movies and TV serials will prejudice Australian culture, which has in recent years been a flourishing and widely-exported commodity.
- ³ E.J. Feulner, J.C. Hulsman, and B.D. Schaefer, 'Free Trade By Any Means: How the Global Free Trade Alliance Enhances America's Overall Trading Strategy', *Heritage Foundation Backgrounder* #1786 (Washington D.C.: The Heritage Foundation, 10 August 2004), accessed 24 August 2004, <http://www.heritage.org/Research/TradeandForeignAid/bg1786.cfm>
- ⁴ Feulner et al. (as above) p.1.
- ⁵ Compare W. Kasper, *Open for Business? Australian Interests and the OECD's Multilateral Agreement on Investment (MAI)*, Issue Analysis No. 1 (Sydney: The Centre for Independent Studies, 27 April 1998).
- ⁶ M. Thatcher, *Statecraft* (London: Harper Collins, 2002), p.405.
- ⁷ J. Gwartney and R. Lawson, *Economic Freedom of the World, 2004 Annual Report* (Vancouver, B.C.: The Fraser Institute, 2004). The report rates Iceland and Denmark as marginally outside the 'Top Dozen' (p. 11), but includes Canada, the Netherlands and Switzerland, whose economic freedom still has some minor defects according to the Heritage assessments.
- ⁸ M.A. Miles, E.J. Feulner and M. A. O'Grady, *2004 Index of Economic Freedom* (Washington D.C., Heritage Foundation and Dow Jones & Company, 2004). See also Feulner et al. (see n.3), Table 1, p.6.
- ⁹ Compare J. C. Hulsman and S. Koochekzadeh, 'The Global Free Trade Association: Preserving and Expanding the Special Relationship in the Twenty-First Century', adapted from a speech given in London, November 3, 2001, private communication.
- ¹⁰ The Alliance concept—a unilateral invitation of qualifying neighbours to drop all economic border controls—could be adopted by the Australian and New Zealand governments to forge a regional free trade area in the Pacific.

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