Business Council of Australia

Submission to the Joint Select Committee on Trade and Investment Growth: Inquiry into the Business Experience in Utilising Australia's Free Trade Agreements

JULY 2015

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The Business Council of Australia (BCA) is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This submission responds to the Joint Select Committee on Trade and Investment Growth's 'Inquiry into the Business Experience in Utilising Australia's Free Trade Agreements'. It outlines limitations of existing Free Trade Agreements (FTAs), and suggests a range of ongoing barriers that prevent greater economic activity under FTAs. The Business Council supports trade liberalisation as more open markets provide for greater competition and allow Australian companies to improve their international competitiveness.

This submission recommends a range of actions the government could take to better utilise FTAs, which address endemic and systemic issues such as information asymmetry, complex rules of origin, more focused economic integration, encouraging greater investment and collaborating more closely with business through existing institutions and agreement architecture.

Key recommendations

Recommendation 1

The Department of Foreign Affairs and Trade should adopt a country-centred approach to the 'Trade Dashboard', and help companies understand which agreements they should seek to use to gain the greatest competitive advantage internationally.

Recommendation 2

The government should negotiate with existing bilateral FTA partners to establish common rules of origin, including for example, rules of origin agreed under a future Trans-Pacific Partnership Agreement.

The government should allow self-certification for rules of origin to allow traders to manage their own compliance.

Recommendation 3

The government should focus FTA implementation efforts on removing non-tariff barriers to trade and establishing strong cooperation with institutions overseas.

Recommendation 4

The Joint Select Committee should conduct a comprehensive review of the four modes of service delivery – cross-border trade, domestic consumption, commercial presence, and movement of natural persons – and assess whether overseas policies outlined under each mode of delivery impede Australian services exports.

Recommendation 5

The Joint Select Committee should refer to submissions made by the Business Council of Australia on proposals to lower Foreign Investment Review Board (FIRB) investment thresholds for agriculture.

Recommendation 6

The government should task its free trade agreement implementation units to work closely with the government’s industry growth centres.

Together, the implementation units and growth centres could collaborate to develop FTA utilisation plans to ensure the benefits of trade agreements are fully realised.

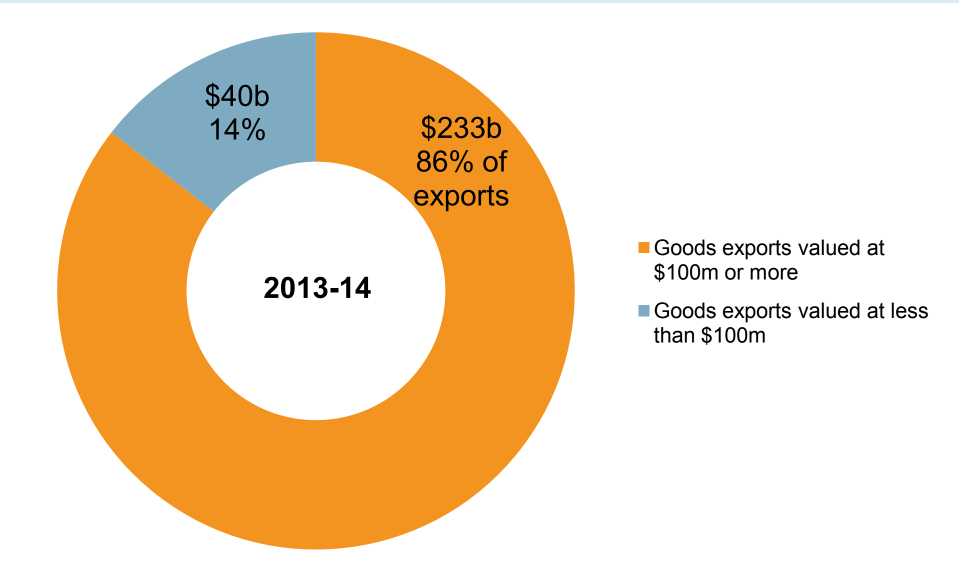
Free Trade Agreements

The Business Council welcomes the government completing the three bilateral North Asian trade agreements with South Korea, Japan and China. These agreements represent a significant opportunity for business and should be transformative in helping Australia to diversify its economy and seek new areas of growth.

ABS data (see box below) demonstrates that one per cent of exporters were responsible for more than 86 per cent of Australia's exports in goods.

To maximise the opportunities from the North Asian free trade agreements (FTAs), the Business Council encourages the government to focus its policy solutions on delivering outcomes for this small group of companies to deliver policy effectiveness. Adopting a suite of targeted policies will maximise consistency and address key impediments to further trade.

While we recognise the government may wish to engage the other 99 per cent of companies to increase trade beyond the 14 per cent, the Business Council argues that dedicating resources to enhancing trade for the top one per cent of companies will yield a much greater positive impact.



Australian Bureau of Statistics (ABS) data from 2013–14 showed that, of Australia's two million companies, only 45,000 export goods to any country. But of these 45,000 companies, only 338 companies were responsible for the export of more than $233 billion of Australia's $273 billion of exports in goods that year.

In other words, less than **one per cent of exporters were responsible for more than 86 per cent of Australia's exports in goods**.

Source: ABS Data – 5368.0.55.006 Characteristics of Australian Exporters, 2013–14
http://www.abs.gov.au/ausstats/abs@.nsf/mf/5368.0.55.006?OpenDocument

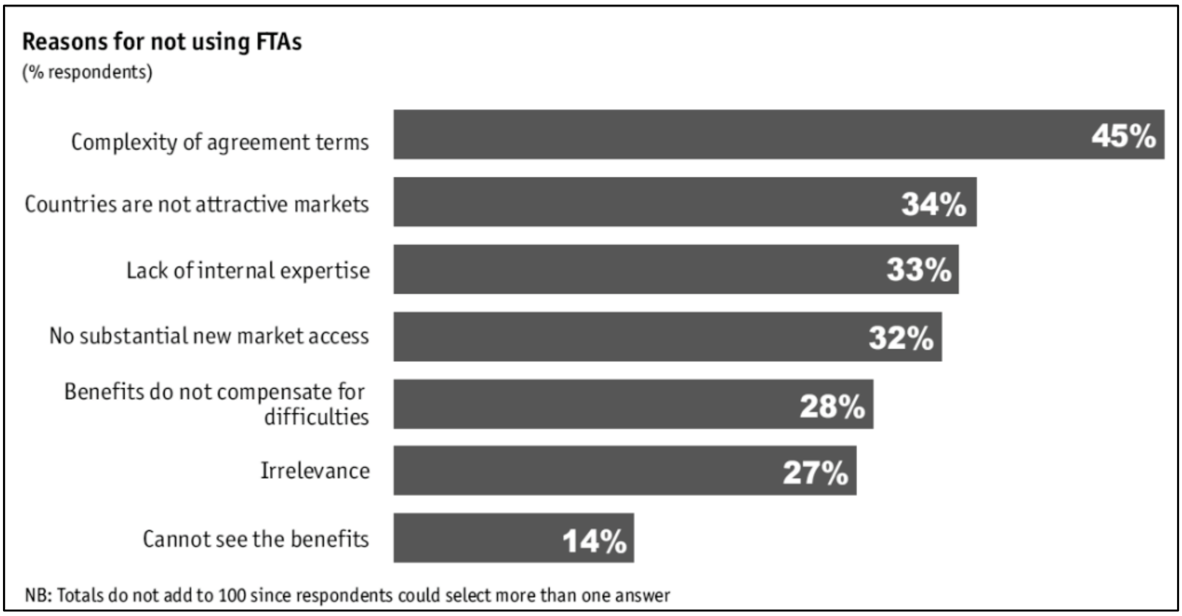
Utilising Free Trade Agreements

Research undertaken by *The Economist* Intelligence Unit found that FTAs help to increase exports for firms that use them. More than 85 per cent of respondents across the Asia–Pacific region reported that their exports to the markets concerned have increased either significantly (23 per cent) or moderately (63 per cent) as a result of the FTAs that they use.[1]

Yet evidence suggests trade agreements are not being fully utilised in Australia. Figure 2 outlines the range of issues cited by *The Economist* Intelligence Unit for businesses not using FTAs.

The most common reason was due to the complexity of trade agreements.

Figure 2 – Reasons for not using FTAs



Research by *The Economist* Intelligence Unit indicates that there is a lack of awareness of FTAs with some 44 per cent of respondents across the region admitting either to having a limited understanding of one or more FTAs their country has signed, or having never heard of one or more of the agreements. Australian results were consistent with this.

The survey found that just 19 per cent of Australian firms utilised FTAs where they were available, with many deterred by the complexity and regulatory hurdles they face to comply with the agreements.

In the 'Australia's International Business Survey 2014', conducted by Austrade, it found that 71 per cent of respondents reported they exported to a market where Australia had an FTA in place. But the awareness and actual use of the relevant agreements among respondents were mixed.

1. The Economist Intelligence Unit, FTAs: fantastic, fine or futile?, Business views on trade agreements in Asia, 2014.

It found that 40 per cent of respondents said they were uncertain about how and whether the relevant FTA applied to their business, while a smaller but significant share of respondents stated that they did not know that an FTA even existed.

The survey results suggest that there are significant knowledge gaps within the business community on Australia's existing FTAs.

Barriers to utilising FTAs

Low understanding of FTAs

For small and medium enterprises, research suggests a key reason for not utilising FTAs is because of their complexity and inaccessibility. Exporters often need to employ professional firms to explain the agreement. For small enterprises in particular, this acts as a barrier to FTA uptake.

To address these information gaps, the government has undertaken a range of activities to maximise knowledge. Additional resources have been provided to Austrade – the government's trade promotion arm – to maximise the use of FTAs. The government will also invest in a web portal, 'Trade Dashboard', to disseminate information widely.

Trade dashboard

The Business Council supports the government's commitment – through the Department of Foreign Affairs and Trade – to establish a Trade Dashboard with a dedicated tariff comparator. We believe this initiative will assist exporters to understand how their products may be treated in overseas markets and clarify the effects of FTAs.

The Business Council recognises the trade comparator is still being designed and we would encourage it to be country-centred. For example, in Malaysia, the Malaysia–Australia Free Trade Agreement (MAFTA) and the ASEAN–Australia–New Zealand Free Trade Agreement are both in effect. It is important the trade dashboard be designed to compare tariffs under both agreements.

Designing a trade portal with a market focus will be even more important when the Trans-Pacific Partnership (TPP) is adopted in Australia. Under the TPP, Australia has FTAs with eight of the twelve TPP partners. So it is foreseeable that exporters will, in the near future, have to choose between exporting their products under a bilateral FTA or under the TPP. Having a market-centred approach would improve understanding of FTAs for business.

Recommendation 1

The Department of Foreign Affairs and Trade should adopt a country-centred approach to the 'Trade Dashboard', and help companies understand which agreements they should seek to use to gain the greatest competitive advantage internationally.

Rules of Origin

FTAs are negotiated to provide exporters with greater market access overseas. But tariff reductions only flow to Australian companies if goods exported comply with the FTA's negotiated 'rules of origin'.

Rules of origin are conditions that companies must comply with to claim a preferential tariff reduction under an FTA. Where they do not meet requirements for rules of origin, the goods will not be able to access the lower preferential tariff rate.

The conditions for rules of origin vary according to the FTA and according to the goods. Owing to the many FTAs Australia has signed with bilateral partners, there is already a complex web of rules exporters must take into account before they can utilise an FTA. This series of complex bilateral rules has been labelled a 'noodle bowl'.

Depending on the country of origin of inputs used to make a good, an exporter may qualify for preferential treatment under an FTA. Rules of origin can therefore impose a cost. Often the cost of changing existing suppliers to comply with an FTA's rules of origin outweighs the benefits of a tariff reduction.

Generally, large exporters have the capacity to understand FTAs. When they do not have internal expertise, they use professional service firms to assess the benefit of an FTA to their operations.

In general, large companies that export primary goods utilise FTAs more than those that produce manufactured goods. Primary goods require fewer additional inputs and therefore have a higher chance of complying with rules of origin. Companies that operate in global value chains, however, find it difficult to comply with the rules of origin under bilateral FTAs. In many cases, companies that operate in global value chains will not utilise FTAs. Considering 70 per cent of the world's trade operates in global value chains, this indicates a large proportion of trade will not be able to utilise FTAs.

The BCA recommends the government consider assessing each FTA's rules of origin, and explore options to re-negotiate rules of origin across all FTAs so that they are consistent.

Additional flexibility

In developing a consistent approach, we encourage the government to consider, as an additional flexibility, the option of self-certification of rules of origin. As noted previously, 350 companies represent over 85 per cent of goods exported. These companies trade in large volumes and make many transactions in a year. If each transaction required a third-party certifier, this would add cost and administrative burden. Self-certification would assist experienced traders to manage their bilateral trade, and ensure they were consistent with the rules.

With the completion of the TPP nearing, harmonising the rules of origin of existing FTAs with those under the TPP would be a step forward to developing a consistent approach. This reform would enable Australian companies to adopt standardised approaches to rules of origin, and minimise the ability for them to fall foul of rules contained within FTAs.

Recommendation 2

The government should negotiate with existing bilateral FTA partners to establish common rules of origin, including for example, rules of origin agreed under a future Trans-Pacific Partnership Agreement.

The government should allow self-certification for rules of origin to allow traders to manage their own compliance.

Non-tariff barriers

Closer integration is key

According to ABS data, Australian exporters conduct most trade with New Zealand. In 2013–14, New Zealand had around 17,000 exporters conducting over 1,150,000 transactions that year. In value terms however, New Zealand represents around $7.5 billion of exports and was ranked Australia's sixth largest export destination.

In contrast, there were approximately 5,200 Australian exporters to China, and they exported a total of 144,000 transactions. But, in value terms, China was our largest export destination with nearly $100 billion worth of exports that year.

Australian businesses, both large and small, appear to be comfortable trading with New Zealand, perhaps because of the economic, cultural and social similarities Australia has with New Zealand. But part of this comfort can also be attributed to the Australia–New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), signed in 1983, which has been instrumental in deepening trade with New Zealand.

Under the ANZCERTA, the comprehensive FTA has continued to evolve, and Australia and New Zealand have a high level of trust in each other's institutions.

Economic closeness has been achieved through an ongoing and focused program of bilateral dialogue at both official and business-to-business levels. Over 30 years, Australia and New Zealand have managed to complete a range of ambitious proposals to further integrate our economies, resulting even in the free movement of goods, services and people between our two countries.

Our close economic ties result from focused efforts to lower economic barriers between our two countries, particularly in non-tariff barriers. The establishment of Food and Safety Australia and New Zealand (FSANZ) is a good demonstration of how Australian and New Zealand authorities have cooperated to reduce technical barriers to food trade. Food that can be consumed in either market is tested and authorised by the joint authority. When a product complies with testing, it is able to be sold in both markets, effectively increasing the size of the market and facilitating greater trade.

Non-tariff barriers continue to exist in our major export markets

Non-tariff barriers pose a significant hurdle for Australian engagement in the region.

Goods and services are often prevented from entering overseas markets due to a range of non-tariff measures such as quotas and quarantine, packaging and labelling regulations, and licensing requirements.

Non-tariff measures in markets can introduce a complex array of requirements and potential barriers to businesses gaining access to a market. This complexity can be time-consuming for business to understand, particularly small and medium enterprises, and in some circumstances discourages businesses from exporting to the market.

Non-tariff barriers exist in a range of ways.

Decisions by bilateral FTA partners to maintain policies that promote food self-sufficiency continue to act as an indirect non-tariff barrier to trade, since they limit the export of Australian goods. While we understand the public policy reasons for implementing self-sufficiency policies, it is important to recognise these policies come at a cost. These costs are borne by the overseas consumer through higher costs, and also by the exporter who cannot access that market, in spite of lower tariff barriers.

These policies have done little to improve domestic productivity in those countries, and there is evidence those policies push up the price of food. They also have the effect of crowding out the market for Australian goods which compete with those domestic producers.

Technical market access issues, such as the need to complete extensive paperwork, slow down the processing of goods. Labelling standards, food codes and import requirements can also change frequently. Exporters sometimes call these the ‘invisible barriers to trade’.

Some of Australia’s agricultural exports are traded through state trading systems overseas. These entities are primarily state-owned enterprises that impose duties other than tariffs, including mark-ups, surcharges and levies on goods traded with them. So although tariffs in goods have reduced, the additional surcharges and levies are subject to change, and could be levied in spite of the completion of an FTA.

Recommendation 3

The government should focus FTA implementation efforts on removing non-tariff barriers to trade and establishing strong cooperation with institutions overseas.

Services barriers to trade

The specific barriers to services trade depend on the type and manner in which a service is delivered. The World Trade Organization (WTO) identifies four specific modes for service delivery. Each mode of service faces different barriers to trade, and depends on a range of defined policy decisions. The following provides a range of key factors that contribute to whether service trade flows between two countries.

Generally, open trade in services exists when Australian companies operate on equal terms to domestic companies overseas. The following table outlines some of the impediments faced under each mode of service trade.

Mode of service	How the service is delivered	Key barriers that impede trade
Mode 1 Cross border trade	Cross-border trade is defined as delivery of a service from the territory of one country into the territory of another country. e.g. legal, professional, and engineering services.	• National standards and testing: Differences in national testing methods are a major impediment in the delivery of engineering services. The harmonisation of technical standards, e.g. regulations of health, safety, and environmental protection of consumers is a key area where overseas standards may impede Australian companies from being able to participate in that market. • Recognition of Australian qualifications: The recognition of Australian qualifications is critical for the delivery of a service across a border. Mutual recognition of qualifications is fundamental to Australian businesses delivering services overseas under mode 1. Mutual recognition is often regulated by non-government bodies, such as Law Societies. Under these circumstances, it is up to individual bodies to negotiate with each market's regulating body. However, the incentives for mutual recognition are low, as regulating bodies are comfortable with the existing level of competition.
Mode 2 Consumed domestically	Consumption abroad – this mode covers supply of a service of one country to the service consumer of any other country. e.g. tourism and higher education providers.	• Recognition of Australian education qualifications overseas: The key driver of Australia's education exports is whether the qualification is recognised in the host country. If a qualification is not recognised, it is highly unlikely there will be a sufficient demand for that service. • Visas: Tourism visa requirements have a large bearing on the ability of our tourism industry to attract overseas visitors. Where tourism arrangements are flexible, it increases our attractiveness as a destination for overseas consumers of our tourism industry. • Domestic regulations that are not competitive with other countries or that do not meet consumer expectations.

Mode of service	How the service is delivered	Key barriers that impede trade
Mode 3 Commercial presence	Commercial presence – which covers services provided by a service supplier of one country in the territory of any other country. e.g. a bank's investment in a financial service company in Asia.	• Investment rules: Certain restrictions including percentage ownership rules limit the capacity for Australian businesses to operate overseas. In some countries, a joint venture partner is required, or an investment limit is specified. For some investments to be commercially viable, it may require investment limits to be removed. • Limitations to investment: Where investment is impeded in certain sectors, this prevents Australian operators from delivering a service in that sector. For example, adopting a list of industries where investment can be made, can also act as an impediment to investment.
Mode 4 Presence of natural persons	Presence of natural persons – which covers services provided by a service supplier of one country through the presence of natural persons in the territory of any other country. e.g. advisory services delivered on a fly-in, fly-out basis.	• Visa arrangements: A major impediment to the delivery of services under mode 4 is the visa arrangements stipulated for each visa class. The period and cost of the visa both have an impact on whether a service can be delivered effectively in another country. If the cost of a visa is too high, the incentive to deliver the service is eroded. In contrast, if a visa period is too short, it may not be possible to deliver the service within the designated time. These factors could require travel and visa costs to be compounded.

Recommendation 4

The Joint Select Committee should conduct a comprehensive review of the four modes of service delivery – cross-border trade, domestic consumption, commercial presence, and movement of natural persons – and assess whether overseas policies outlined under each mode of delivery impede Australian services exports.

Investment

With our relatively small population, Australia relies on foreign capital to supplement domestic savings. Foreign capital has helped Australia become the world's 12th largest economy despite its small population – ranked the world's 53rd largest population.

International capital has enabled Australians to enjoy far higher rates of economic growth, employment and standards of living than many countries with comparable populations.

Foreign direct investment brings additional benefits

By exposing local businesses to international standards and best practices, foreign direct investment encourages competition and innovation and drives productivity growth. By bringing in new businesses with connections in different markets, investment opens up additional export opportunities and boosts our overall export performance.

Once committed, foreign direct investment is less liquid than foreign debt and foreign portfolio investment. In difficult economic times, these other forms of foreign capital are more able to move overseas. It is more difficult to divest foreign direct investment because companies generally do not wish to discount or abandon physical assets.

The government has recently completed free trade agreements with three of our top four trading partners and has stated publicly that Australia is 'open for business'. The Business Council encourages it not to compromise this stance by imposing measures that would unnecessarily hinder the foreign direct investment flows to Australia from FTA partners and other countries.

Foreign investment and free trade agreements

One of the greatest benefits flowing from the Australia–United States Free Trade Agreement (AUSFTA) has been the dramatic increase in US capital flowing to Australia since the agreement's completion. US direct investment in Australia more than doubled – from the 2006 AUSFTA signing till 2013 – from US$67 billion to US$149.5 billion.

Raising the Foreign Investment Review Board (FIRB) investment screening threshold for the United States provided US private investors with the flexibility to invest, without regulatory pre-approval, in assets worth less than $1.078 billion. This encouraged a greater level of US investment interest in Australia.

Over 99 per cent of applications to the FIRB are approved. The introduction of new lower thresholds for foreign investors in Australian agribusiness and for Australian rural land introduces an additional hurdle for potential investors. It sends a strong negative message about Australia's attitude towards foreign investors, particularly to FTA partners South Korea, Japan and China. This risks having a chilling effect on future investment. [2]

The Business Council notes the government has made various policy commitments to lower the FIRB thresholds for agricultural land and agribusiness and we have made

[2] http://www.bca.com.au/publications/submission-to-the-governments-options-paper-strengthening-australias-foreign-investment-framework.

various policy recommendations arguing that the government should proceed cautiously and not undermine the benefits of free trade agreements.

Recommendation 5

The Joint Select Committee should refer to submissions made by the Business Council of Australia on proposals to lower Foreign Investment Review Board (FIRB) investment thresholds for agriculture.

Collaborative approach

To maximise the benefits of FTAs for Australian companies and address the barriers to utilising them, the Business Council recommends the government adopt a collaborative approach with industry to address these issues.

To provide the government with direct feedback, the Business Council recommends the Australian Government's recently established free trade agreement implementation units be tasked to work closely with the government's industry growth centres.

Each growth centre will already focus on delivering growth in its sectors and the centres are set up with broad industry representation. Their mandate is to focus on maximising the competitiveness of each sector, including through trade.

Having the government's FTA implementation unit work closely with the industry growth centres would further drive information sharing, greater understanding and synergies for the sector.

Together, the implementation units and growth centres could collaborate to develop FTA utilisation plans to ensure the benefits of trade agreements are fully realised.

Government's implementation units

We recommend the government's implementation units include representation from the Department of Foreign Affairs and Trade, Austrade, the Department of Agriculture, and the Department of Industry.

The implementation units should:

- include members from the negotiating team to ensure policy continuity
- be supported by an industry reference group (including representation from the industry growth centre) to seek and test implementation ideas
- report to the Minister for Trade and Investment and the Minister for Industry on a six-monthly basis
- formalise mechanisms to receive feedback from industry (businesses, representative bodies and the industry growth centre) on non-tariff barriers which inhibit market access. The identified non-tariff measures should be included in a report to the Minister for Trade and Investment and the Minister for Industry.

Implementation plans

The government's implementation units and industry growth centres should be tasked with developing implementation plans for each major trade agreement.

Implementation plans should identify the actions required from both business and government in order to take advantage of trade agreements.

Recommendation 6

The government should task its free trade agreement implementation units to work closely with the government's industry growth centres.

Together, the implementation units and growth centres could collaborate to develop FTA utilisation plans to ensure the benefits of trade agreements are fully realised.

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