

Chapter 7

Manufacturing

The Agreement

7.1 Chapters of the AUSFTA affecting the manufacturing sector include Chapter 2 (National Treatment and Market Access for Goods), Chapter 4 (Textiles and Apparel) and Chapter 5 (Rules of Origin).

7.2 Chapter 2 applies to trade in all goods and commits both Australia and the United States to non-discriminatory treatment in trade in goods. Only those goods substantially made or transformed in Australia or the United States, which qualify under the rules of origin in Chapter 5, benefit from the commitments contained in Chapter 2. Chapter 2 consists of 13 Articles, 3 Annexes and an exchange of letters. It includes the following subject matter: national treatment; elimination of customs duties (tariffs); temporary admission; waiver of customs duties; import and export restrictions; and export taxes.

7.3 Under Article 2.2 of Chapter 2, Australia and the United States have agreed to abide by their WTO commitments to provide National Treatment. Essentially this means that Australia and the United States will provide the same treatment to imported goods from each other as they do to domestically produced goods. Under Article 2.3, tariffs on originating goods of the other party will be eliminated. The AUSFTA specifies whether the particular category of good will be duty free from the date the agreement comes into force, or will be subject to removal over a specified period.

7.4 Chapter 5 sets out the rules for determining which goods are originating and therefore eligible for preferential tariff treatment under the AUSFTA. The chapter consists of 17 Articles and an Annex.

7.5 Chapter 4 deals with issues affecting the trade in textiles and apparel. The chapter includes emergency safeguard mechanisms, rules of origin and customs cooperation. An Annex to Chapter 4 sets out the product-specific rules of origin applying to textiles and apparel which vary considerably depending on the particular product. The rules of origin which apply to textiles and apparel are based on a change in tariff classification approach and apply the stringent 'yarn forward' test. However, there are some exceptions to these rules of origin.

7.6 Chapter 18 (Labour) of the AUSFTA reaffirms both countries' obligations as members of the International Labour Organisation (ILO) and strives to ensure that the labour principles and rights stated in Article 18.7 are recognised and protected in domestic law.

7.7 The AUSFTA requires that each country effectively enforces its own domestic labour laws and that there be fair, equitable and transparent access to labour tribunals and courts. The AUSFTA recognises that it is inappropriate to encourage trade or investment that may weaken or reduce the protection afforded in each other's domestic laws.

7.8 There is a significant difference between Australia and the United States regarding the enforcement of labour laws. In the United States, labour laws are Acts of the United States Congress and are enforceable by actions of the federal government. Article 18.8.1 of the AUSFTA contains a definition of labour laws. The Australian Government is not able to enforce state labour laws. Therefore the AUSFTA has defined labour laws to mean Act/s of a parliament of Australia or regulation/s promulgated pursuant to such Act/s, directly related to the internationally recognised principles and rights set forth in Article 18.7. This means that the Australian Government would be responsible for a failure to enforce effectively either state or Federal laws. The Australian Government would be required to consult with the relevant state government should a dispute arise.

7.9 The dispute settlement procedures set out under Chapter 21 of the AUSFTA apply to the Labour Chapter in that the members of the panel chosen to determine the dispute are required have expertise or experience in the matter under dispute. Penalties are applied in the form of fines up to US\$15 million p.a. paid to the Party complained against. Within Chapter 21, dispute provisions in relation to labour only apply to domestic labour laws which have not been effectively enforced. It should be noted that conformity to the ILO obligations are not subject to dispute settlement under Chapter 21.

Impacts of AUSFTA on manufacturing

7.10 It is an inescapable fact, given the prime place of manufactured goods in the trading relationship between Australia and the United States, that the AUSFTA will have significant implications for manufacturing firms and workers in both countries.

7.11 Assessing the impact on manufacturing of the AUSFTA must, from Australia's point of view, embrace both export flows from, and import flows to, Australia. Export oriented businesses in both Australia and the United States have been among the most ardent advocates of the AUSFTA.

7.12 A reason for care in trade agreements is that they are per se are a form of economic legislation. Removing barriers to exports obviously increases the competitiveness of Australian firms in foreign markets and often leads to an increase in the goods and services we can sell overseas and the jobs we create in Australia.

7.13 Conversely, allowing foreign firms to compete in the Australian market increases domestic competition applying downward pressure on prices and upward pressure on quality and efficiency. This has obvious benefits for the nation as a whole. However, greater foreign competition in Australia means market forces shape the

economy, moving it in the direction of greatest efficiency, that is, where it is more competitive. Inefficient firms may lose market share or even go under.

7.14 The immediate increase in competition and unfavourable effect on prices, quality and efficiency will affect Australian industry – particularly Australian manufacturing firms. As a result significant readjustment across industry sectors and individual businesses will be required. This readjustment will mean that Australian businesses will need to invest in research and development (R&D), and skills and training including export skills. This will require a significant culture shift in Australia.

7.15 In the case of private sector investment in R&D, Australia lags behind our competitors, including the United States and significant stimulus from government will be required to ensure companies invest in R&D and that, in the longer term, they will view investment in R&D as necessary for survival.

7.16 Lack of investment in R&D and innovation is particularly stark in the manufacturing sector. The Australian Industry Group says that only one in four manufacturers in Australia invests in R&D and that very few collaborate with a public research institute. They go on to say that most manufacturing firms spend more on their electricity bills than on R&D. This must be readdressed by the government, in partnership with industry, as a priority.

7.17 The adjustment mechanisms to cushion the transitional effects of a shift to a more efficient economy are one of the most important issues in gaining public acceptance for trade agreements. The Centre for International Economics has published a list of where additional jobs will be created and where existing jobs will be lost if this Agreement goes ahead. Both individuals and industry sectors can be adversely affected by the market restructuring an FTA causes. The adjustments required to deal with these adverse effects are appropriate matters for the Select Committee to take into account in arriving at a balanced assessment of whether the FTA, overall, is in the national interest.

7.18 The differences in the economies of scale between industries in the US and Australia are not the only factor that will dramatically impact on Australian industry and Australian manufacturers. There is not a level playing field in the amount of government assistance provided to industry between the two countries.

7.19 The US government and state governments provide significant industry incentives, especially R&D incentives, of a scale such that Australia is currently unable to compete. With over a billion dollars in cuts to industry assistance programs since 1996, it is now imperative, if this Agreement proceeds, that the government increase assistance to industry, particularly by way of a stimulus to encourage investment in R&D.

7.20 The CIE 2004 report notes that Australia's main *exports* to the United States are durable manufacturing products comprising 32 per cent of total exports. Non-durable manufactures and services are the next most significant groups of exports,

each accounting for 28 per cent of total exports. Beef products (\$2 billion), machinery and equipment (\$1.2 billion), manufactures (\$1.2 billion), petroleum (\$1.1 billion), metals (\$1 billion) and automotive products (\$0.9 billion) were the top six commodities exported from Australia to the United States in 2002-03.

7.21 A majority of Australia's *imports* from the United States were durable manufacturing products, comprising 61 per cent of total imports. The top six imported commodities were transport equipment (\$6.4 billion including the significant item of air transport), machinery and equipment (\$6 billion, including medical instruments and earthmoving machinery), chemical, rubber and plastic products (\$3.5 billion), electronic equipment (\$2.2 billion), auto-motive products (\$1.8 billion) and other manufactures (\$1.4 billion). After services, non-durable manufacturing products were the next most significant group of imports into Australia from the United States, accounting for 17 per cent of total imports.

7.22 The degree of significance of manufacturing is further reflected in statistics describing the Australia-US trade relationship. Australia currently has a significant trade imbalance with the United States. The Australian Bureau of Statistics reported that for 2002/03 Australia's merchandise trade deficit with the United States was \$12.13 billion. This was easily the highest merchandise trade deficit that Australia recorded with any trading partner.¹

7.23 Australia's trade imbalance with the United States was most acute in manufactured goods. For example, in the 12 months ended March 2003 the Australian Bureau of Statistics reported that Australia had:

- a \$2,554 million trade deficit in chemical and related products;
- a \$696 million trade deficit in manufactured goods classified chiefly by material;
- a \$10,459 million deficit in machinery and transport equipment; and
- a \$2,267 million trade deficit in miscellaneous manufactured articles.²

7.24 Given the importance of the automotive industry to Australian manufacturing including automotive components, it is appropriate to give additional consideration to the trading relationship between the Australian automotive industry and the United States automotive industry. The latest U.S. Government trade data shows that in 2003 the United States had a massive trade deficit with the rest of the world in the automotive sector, but the country with which the United States had the largest trade surplus in the automotive sector - an amount of \$US 885 million - was Australia. It is notable that in the auto components sector (which is within the broader automotive

1 Australian Bureau of Statistics - International Trade in Goods and Services - 5368.0 - February 2004

2 Australian Bureau of Statistics - International Merchandise Trade - 5422.0 - March Quarter 2003

sector), the United States recorded a \$US 272 million trade surplus with Australia for 2003.³

7.25 The CIE 2004 report has addressed the issue of dynamic productivity gains arising from trade liberalisation. It concludes that in those sectors that are largely free trade already, and hence internationally competitive (typically the agricultural industries), the trade liberalisation undertaken by Australia has a positive effect on output. For those protected sectors (typically in manufacturing), Australian liberalisation may have a detrimental impact on output depending on the relative competitiveness of the United States sectors.

7.26 According to the CIE analysis, the United States trade liberalisation has 'varying effects on Australian industry sectors'. The report states that the impact of United States liberalisation on Australian output levels will depend on whether certain sectors in Australia are favoured more than others by the reduction in United States trade barriers and any resulting competition between expanding Australian sectors for resources. There will also be indirect effects and, depending on the inter linkages between sectors, these could be substantial.

7.27 According to CIE, industries increasing their exports to the United States will likely increase their demand for inputs (unless production is merely diverted from the Australian or other international markets to the US market). Hence, sectors supplying downstream exporting sectors may experience a production increase as a result of the United States trade liberalisation. However, if the increased United States demand results in the price of Australian products increasing, then any (downstream) Australian sector using that product as a production input will be subjected to a cost increase, which may culminate in a decrease in output.⁴

7.28 In short, a clear cut assessment of the impact on Australian manufacturing is not readily available. The CIE report, however, assesses that:

Across sectors, manufacturing and construction are the two largest beneficiaries from AUSFTA in dollar terms... Employment in both sectors is expected to increase.⁵

7.29 The CIE analysis reveals that the output for the majority of Australian sectors 'is estimated to be higher under AUSFTA than otherwise. However, there are some sectors for which AUSFTA is estimated to result in a contraction in output'.⁶ Employment, according to the CIE, will move 'in the same direction and by a similar magnitude as the change in industry output. For around 16 per cent of sectors, the

3 See US Office of Trade and Economic Analysis's "TradeStats Express" website at <http://ese.export.gov>

4 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, p.86

5 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, p.93

6 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, p.84

increase in output is accompanied by a fall in employment. Broadly speaking, this can be attributed to greater capital accumulation in Australia'.⁷

7.30 One econometric assessment that was undertaken specifically to examine the manufacturing impacts of the AUSFTA assessed the overall employment outcomes as negative.

In terms of employment, the expected loss of employment in average annual terms from what would otherwise have been the case is assessed at 57,700. However, by 2025 there is a 2.5 per cent probability that the employment losses will be greater than 195,400 from what otherwise would have been the case. This is balanced by a 5 per cent probability of employment losses in 2025 less than 81,400. This result indicates the extent to which the downside risks are greater than the upside risks.⁸

7.31 Notwithstanding these concerns, many of Australia's peak business and industry groups have warmly welcomed the AUSFTA. These views have been put to the Committee both in submissions and in oral evidence, and in various public statements. The latter are conveniently summarised by DFAT in the following manner.

7.32 The Australian Chamber of Commerce and Industry described AUSFTA as “a high quality agreement which benefits the whole Australian economy, including the manufacturing, services, agricultural, mining and investment sectors”, and which “will give Australian business substantial new market access opportunities in one of the world’s most dynamic and innovative economies.”

7.33 The Business Council of Australia said the agreement “will provide massive opportunities for Australian companies of all sizes to gain access to the world's largest market.” The Chief Executive of Australian Industry Group, the manufacturing peak body stated that “we cannot underestimate the potential benefits of better access to our second largest export market after Japan and the primary source of Australia's foreign direct investment”. The Minerals Council said that the FTA “is just the fillip the Australian minerals industry was looking for from these trade negotiations”.

7.34 While the National Farmers Federation is disappointed with the US's unwillingness to provide early open access for all of the agricultural sector, the NFF has pointed out that the FTA achieves market access gains for a range of agricultural industries - including dairy, beef, horticulture, sheepmeat and wool. The Australian Seafood Industry Council has said benefits of the deal will be felt right across the Australian seafood industry with the abolition of tariffs, and the industry is confident

7 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, pp.86-87

8 National Institute of Economic and Industry Research, A report for the Australian Manufacturing Workers Union (AMWU) *An assessment of the direct impact of the Australian-United States Free Trade Agreement on Australian trade, economic activity and the costs of the loss of national sovereignty* May 2004, p.(v)

it will be able to boost its current exports into America, which are currently around \$150 million a year.

7.35 With respect to the automotive sector, the CIE 2004 report notes that the tariff reductions by both parties 'opens up new opportunities for Australian exporters and introduces possible threats to the domestic motor vehicle industry'.⁹

7.36 In its earlier 2001 report *Economic Impacts of an Australia-United States Free Trade Area* the CIE predicted a worsening of the bilateral trade balance in the automotive sector under AUSFTA and a contraction in output in the industry.

[T]he majority of additional exports from the US to Australia as a result of AUSFTA are manufactured goods ... For example US exports of motor vehicles and parts to Australia increase by US\$525 million following Australia's elimination of bilateral motor vehicle and parts tariffs...¹⁰

However we observe a slight fall in the output of the Australian MVP sector, meaning that the sector's loss of market share to United States MVP imports outweighs any expansion effect brought on by cheaper production inputs and increased export opportunities to the United States.¹¹

7.37 However, in its 2004 analysis of the actual Agreement, the CIE offers considerable comfort from a special case study of passenger motor vehicles and parts, noting that the AUSFTA has been 'well received by the major motor vehicle manufacturers and FAPM [Federation of Automotive Products Manufacturers]'.¹² The CIE report emphasises the opportunities to both vehicle and components manufacturers, and assesses that threats to the Australian passenger vehicle market as a result of AUSFTA are limited.¹³

7.38 This is regarded as cold comfort by the Australian Manufacturing Workers Union, highlighting the recent loss by an Australian parts manufacturer of a major contract.

The windscreen manufacturer Pilkington, has already announced the reduction of its workforce because of the loss of a 70 year old contract with Holden. The contract was lost due to increased import competition arising out of the Australia - Thailand free trade agreement. Previously Pilkington had lost a contract with Ford Australia who chose to source from China. This occurred because increasingly American companies are being required

9 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, p.122

10 Centre For International Economics, *Economic impacts of an Australia - United States Free Trade Area*, June 2001, p.43

11 Centre For International Economics, *Economic impacts of an Australia - United States Free Trade Area*, June 2001, p.40

12 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, p.125

13 Centre for International Economics *Economic analysis of AUSFTA*, April 2004, p.124

to source as much auto components as they can from China to sustain their own position inside that country's booming auto industry.¹⁴

7.39 The Select Committee notes the enthusiastic comments by US automotive industries who regard the AUSFTA as providing an unprecedented opportunity for them to enhance their global market dominance.

This agreement will provide concrete market openings for U.S. auto and auto parts manufacturers, who are already significant exporters to Australia. These expanding trade opportunities are so important for the U.S. economy, and especially the automotive industry, because a strong presence in international markets provides the crucial edge for competitiveness and strength. With a U.S.-Australia Free Trade Agreement, the tariffs we had to pay on our vehicles and parts exports to that country will disappear forever — but they remain in place for our Japanese, Korean and other global competitors. This gives an immediate and major competitive advantage to U.S. automotive products in the Australian market that kicks in the day the agreement is signed.¹⁵

The U.S.-Australia Free Trade Agreement gives our auto companies a real leg up. As a result of this agreement, on January 1, 2005, American auto exports to Australia will cost 10 to 15 percent less than our Japanese, Korean, and European competitors. That means more work building cars for export to Australia for the 600,000 Americans employed by auto companies and the 2 million Americans who work for auto suppliers, as well as the many industries that support those companies. These are real benefits that we will bring to those American workers and many others by passing this agreement today.¹⁶

7.40 The AMWU cites reports commissioned by the Victorian and South Australian governments that both point to likely job loss and contraction in the automotive and components industries. The modelling commissioned by the South Australian Government from Allen Consulting Group found that there would be likely job loss and contraction in South Australia's automotive and auto component industry. Allen Consulting Group noted the uncertainty and disagreement amongst auto and component companies about the agreement:

Some segments of the industry in South Australia see opportunities from the AUSFTA. Others are concerned that the AUSFTA could disrupt plans

14 Bachelard M, "Holden Dumps Its Aussie Glass Firm", *The Australian*, 12 February 2004, p.4

15 Stephen J. Collins, 'Trade pact with Australia will help autos and Michigan' *Detroit News*, 16 July 2004

16 Representative Joe Knollenberg, Speech on United States-Australia Free Trade Implementation Act, US Congress, 14 July 2004

made under previous assistance arrangements implemented by the Commonwealth Government.¹⁷

7.41 The study commissioned by the Victorian Department of Premier and Cabinet from the Centre of Policy Studies came to similar conclusions about the impact of AUSFTA on Australia's auto and component industry:

[T]here are seven industries for which the FTA reduces output to baseline values in the long-run year (2020). Prominent among these is motor vehicles and parts. The Australian motor vehicles industry faces quite strong competition in its local market from USA imports; USA import penetration is at 7.3 per cent. Relative to the level of USA-import penetration, though, its USA-export propensity is quite low (2.6 per cent). The relatively high rate of import penetration, combined with an initially high rate of protection in AUS against USA imports means that when the protection is removed the surge in USA imports causes a relatively significant contraction (relative to base) in the output of the local industry.

7.42 The most obvious weakness is motor vehicles and parts. This sector is projected to experience a 1.12 per cent decline in output at the national level (and in Victoria), compared to a rise of 0.17 per cent in real GDP, and is over-represented in Victoria.

...over 1,100 full and part time jobs will be lost from the Motor Vehicles and parts industry in the long-run year. Of this, around 800 will come from Melbourne and almost 200 from the Barwon region.

7.43 The Committee is very concerned about the impact of the agreement on the automotive industry in both Victoria and South Australia. Should the scenario highlighted by the modelling undertaken by Victoria become reality, significant readjustment measures will need to be implemented by the Government.

7.44 The Select Committee also had its attention drawn to comments in the US press that are alarming for the Australian auto industry. The head of GM North American operations, Mr Bob Lutz pointed out in the *Detroit Press*, that if the Australian manufactured Monaro (which is exported to the US) achieves sufficient volumes and market acceptability, production would be shifted from Australia to the US.

7.45 The Committee is very concerned that the only real gain for the automotive sector out of the agreement is the possible increase in exports of utility trucks ('utes') and that the US companies could easily take this gain away. The Government should undertake, as a matter of priority, analysis of the effect of the Agreement on the whole automotive industry.

17 Allen Consulting Group, "The Australia – United States Free Trade Agreement: Potential Impacts on South Australia", October 2003, p(viii)

7.46 The Federation of Automotive Products Manufacturers appeared before the Select Committee and its views were canvassed on a wide range of issues related to the AUSFTA, ranging from enhanced export opportunities, to employment impacts, to rules of origin. FAPM's Chief Executive summarised his organisation's view as follows:

Certainly I would reiterate my opening remark that the general stance of the components sector was in favour of the United States free trade agreement, without necessarily throwing our hats over the stand. It was seen as positive, but mildly so. Casting that bread on the water, we continued to support it all the way through.¹⁸

7.47 Mr Upton described the overall consequences of successful implementation of the Agreement as 'roughly neutral to slightly positive'¹⁹. As far as the impact on employment was concerned, FAPM regards it as:

... neutral because, generally speaking, over the last 15 years or so in automotive companies, increases in production and output have not been matched by increases in employment. The industry generally operates under a pretty severe cost-down methodology. It does that world wide. In order to compete we have to employ that method in Australia. That is translated into employment on the whole being relatively static and/or declining. I would expect that even with an increase in trade to the United States that may be the continued trend. But it won't be the catastrophe, in our view, that Mr Cameron is painting.²⁰

7.48 In its submission to JSCOT, the Federal Chamber of Automotive Industries said that it recognised that preferential trade agreements 'form a legitimate part of an appropriate and balanced trade policy', and should ensure a 'proportionate strengthening of market access arrangements for Australian exporters, in return for increased access [by the US] to the Australian market'. FACI drew attention to a statement by its President (Mr Polites) concerning the 'significant opportunities' for Australian automotive exports. The submission went on to say that:

...the Agreement would likely result in some additional competitive challenges for the Australian industry. Under the terms of the Agreement, imports of vehicles and automotive components from the United States will receive preferential access to the Australia market. This may have some impact on future trade and investment patterns, although it is difficult to assess how far-reaching any such outcomes may be in the long term.²¹

7.49 The submission went on to say that 'the pattern of benefits and costs will not be evenly distributed across all participants in the industry'.

18 *Transcript of Evidence*, 24 June 2002, p.13 (Upton, FAPM)

19 *Transcript of Evidence*, 24 June 2002, p.13 (Upton, FAPM)

20 *Transcript of Evidence*, 24 June 2002, p.10 (Upton, FAPM)

21 Federal Chamber of Automotive Industries, *Submission* to JSCOT, p.2

7.50 The Committee believes that it is imperative that the Government and industry work together to inoculate the industry against these challenges by creating an innovative culture, stimulating investment in R&D and education and training.

7.51 Closer integration of the Australian automotive subsidiaries of US manufacturers, for example, Holden Australia and General Motors in the US, has been widely canvassed in the submissions and the media as a potential negative impact of the agreement. The Committee expresses concern that closer integration will indeed be a product of the agreement that that this could lead to US companies in Australia purchasing more parts and components from businesses associated with their US head office. This poses very real threats to our local automotive component sector.

7.52 The Government has not undertaken any assessment of this issue and it should have done so before finalising the agreement. As the Supplementary Budget Estimates Hearings found, the failure of the Industry Department to undertake any analysis of the impact of the agreement of the automotive sector is of great concern to the Committee.

7.53 This analysis should be completed as a matter of urgency before the Agreement proceeds, and if it is not done so, a reference should be made to the Productivity Commission immediately for this work to be done.

7.54 The ACTU is concerned about the potential exacerbation effect of AUSFTA on job losses in the manufacturing sector, particularly in the Textile Clothing and Footwear and motor vehicle components industries. The 'yarn forward' rule is to the detriment of Australia's exports, and the Textile Clothing and Footwear Union estimates that around 80% of the industry's goods will not qualify for export to the United States using this rule.

Australia argued for the rules of origin as negotiated with the ANZCERTA to apply that is, 50% value-adding qualifies for free trade. The US system is what is called the yarn forward rule. That is, goods can be made-up overseas (the labour component being the costly part) as long as they are made-up using American yarn. This is how they protect their domestic textile industry.

Despite the lack of agreement on rules of origin, the FTA stipulates that textile and clothing items produced in the US and shipped to Australia will immediately be given a two per cent preference over the general tariff rate.

Under the rules, for example, a five per cent tariff would be reduced to three per cent for qualifying US products. Similarly, a 15 per cent tariff would be reduced to a 13 per cent tariff. This form of reduction will continue until all Australian tariffs on clothing and textile products are eliminated by 2015. Given the failure to change the rules of origin this will be a one-way free trade agreement.

The bulk of Australian TCF industry (up to 80%) cannot meet US yarn-forward rules because much of our yarn is sourced from Asia. Most US companies meet this rule which means that by 2015 the benefits of the FTA will only flow to US companies.

These 'rules of origin' issues are in addition to concerns that large US companies with volume production will be able to flood the Australian market with cheaply made goods in some TCF areas where Australia has traditionally maintained a strong domestic base.²²

7.55 The Regulation Impact Statement, which accompanies the Agreement, states that the regions will benefit from the opportunities created by the Agreement depending on the ability of regional exporters of goods and services to respond to those opportunities. The Committee challenges this assertion, particularly in relation to the TCF industry.

7.56 The TCF sector will be severely hampered by the yarn forward rule, which will not see additional exports to the US. Most of the Australian TCF industry is in regional Australia, in towns such as Devonport, Bendigo, Ballarat, Wangaratta and Wollongong, just to name a few. The committee is most concerned that the agreement will result in significant downsizing of the industry in those regions. Entire towns and regions depend on the TCF sector, and for some towns a TCF business is the only significant employer

7.57 The Australian Industry Group, which has broad coverage of a range of Australian industry sectors, advised the JSCOT inquiry that:

The one area remaining that Ai Group does not endorse is the ROO for TCF products, which virtually ensure the Australian TCF sector does not attain open market access.

...In the case of TCF, very stringent ROO tests, which include the so-called "yarn/fibre forward" rule, effectively excludes a significant proportion of Australian produced apparel as not originating in Australia for the purposes of the FTA, given that most yarn used in production would not have originated in Australia.²³

7.58 The Select Committee is also concerned about the sheer disparity in scale between the US textile industry and its Australian counterpart. According to the TCFUA:

Our industry is tiny compared to the US. We employ 58,000 workers in the regulated sector, whilst the US employs 520,000 clothing workers and 432,000 textile workers. Capital investment in the US textile sector in 2001 (excluding clothing) was \$2.2B US dollars. The equivalent period in Australia saw \$202M (AUD) invested in the entire Australian TCF industry.

Our industry is tiny, it is a minor player in the US domestic market and yet the US FTA is treating us as though we represent the same level of threat that China represents to the US TCF market. In 2002 the US represented 7% of all Australian TCF imports of textiles and 1.6% of clothing. The US

22 *Submission 204* (Textile, Clothing and Footwear Union of Australia) p.1

23 Australian Industry Group *Submission* to JSCOT, pp.8-9

FTA is likely to see an increase of textile imports, especially over time with the continued winding down of tariff rates. At the same time Australia's share of the US domestic market is unlikely to change as a result of the FTA.

Australian companies most at risk are those which are more capital intensive, competing at the higher end of the value chain. These are the very companies the Australian Government has earmarked for survival through their SIPS scheme, but ironically are most likely to face competition from volume production from US plants with new capital equipment, who will now see their tariff rates reduced under the agreement.²⁴

7.59 Representatives of employees in manufacturing generally have insisted to the Select Committee that there are real risks to having Australian firms exposed to the American manufacturing juggernaut – in particular, the larger economies of scale enjoyed by U.S. manufacturers as well as U.S. manufacturing's higher rates of investment in research and development and technology.²⁵

7.60 By way of example, the AMWU provided the following table showing the relative size of a number of U.S. manufacturing sectors compared to the equivalent Australian sectors in terms of each sectors' importance to world production. The figures, which are for 2001, show an Australian manufacturing industry dwarfed by its U.S. counterpart.

	United States		Australia	
	<i>Percentage of World Production</i>	<i>World Rank</i>	<i>Percentage of World Production</i>	<i>World Rank</i>
Food Products and Beverage	22.2%	1	1.8%	12
Wood and Cork Products	24.7%	1	1.8%	14
Printing and Publishing	32.4%	1	1.3%	11
Metal Products	23.4%	1	not available	not in top 15
Basic Metals	19.6%	2	1.7%	14
Transport Equipment	25.9%	1	0.9%	15

24 *Submission 204* (Textile, Clothing and Footwear Union of Australia) p.2

25 *Submission 463* (Australian Manufacturing Workers Union)

7.61 The AMWU argues that the United State's advantages in manufacturing will not disappear overnight, and asks 'What then will happen when Australia surrenders its tariff advantage over the United States virtually overnight?' The AMWU submits that it is clear that to the extent employers are unable to pass losses directly on to their workers through insecure forms of employment and downward pressure on wages and conditions, increasing numbers of Australian manufacturers will either cease production or move offshore.²⁶

7.62 The Select Committee was both impressed and concerned by the submissions and evidence from representatives of the petrochemicals industry. The impact on the industry of the AUSFTA highlights the problems that arise when consultations and negotiations are not sufficiently robust, nor consistent across trade agreements. As a result, even high value-adding, strategically-focused and employment-generating industries can suddenly find themselves significantly threatened.

7.63 The industry employs around 70,000 people and turns over somewhere between \$25 billion and \$30 billion per annum, and there are many thousands of jobs, in SMEs and elsewhere that are integrated into various downstream activities. The following overview indicates the nature and scale of the issues at hand:

As an industry we have a track record of demonstrating that we can make the adjustments necessary to stay internationally competitive. So we are not here as a manufacturing group that is seeking to maintain or even increase protection from the outside world. We face the outside world every day of the week. This industry, not much longer than 10 years ago, in the late eighties, operated behind 30-plus per cent tariffs. Today we have a minimal tariff of five per cent. We have demonstrated that we are more than capable of meeting the challenge of making the adjustments necessary to remain competitive.

We build on typically indigenous feedstock. ... to make high-value products that then go into the downstream processing operations. There is an enormous tooling industry and contracting industry that sits on the back of our businesses as well. So whilst we might employ 1,000 people directly, indirectly each of these businesses employs an enormous number of people through the contracting and tooling industry ...

The jobs are very high value added. People do get paid enormously well. These industries will not be replaced if they go. They will not be replaced by greenfield operations; they will be gone forever and the country would be thereafter dependent on imported product to replace the outputs that we make as an industry. So we think we make an enormous contribution to the community and to the Australian economy. ... We think we are capable of making the adjustments to remain competitive, but we need time to make those adjustments.²⁷

26 *Submission 463* (Australian Manufacturing Workers Union)

27 *Transcript of Evidence*, 7 June 2004, p25 (Bell, Qenos Pty Ltd)

7.64 The industry considers the immediate reduction of tariffs from 5% to zero to be hugely problematic, giving no time for appropriate restructuring and reinvestment. The history of the Singapore FTA indicates that such an immediate tariff reduction would see a \$50 per tonne reduction in the prices of products in the marketplace that Australian firms had to match to retain their market position. The AUSFTA also undermine agreements recently entered into by Australia with Thailand.

Principally we are concerned about consistency. For the Thailand FTA—and I represented the plastics and chemicals industry in the negotiation of that FTA—we put forward a submission about phasing on a number of products over a period of time, which was agreed to. We had phasing on a broad range of products in the period to 2008. We put forward the same view for the United States trade agreement, but only two months later we get an outcome which says that the tariff on those products will go immediately.²⁸

7.65 The industry also has considerable concerns about the dumping of product on the Australian market, which compounds the difficulties of responding to sudden tariff reductions. The industry is satisfied that Australia's antidumping legislation is sound. The problem, as they see it, is that Australian Customs does not have the resources to implement antidumping measures robustly. Timelines for antidumping cases are a significant problem.

I have just got a case in, and the costs are running at close to \$200,000. I took the decision to lodge that case in May last year. It still has not been initiated. In the meantime I still have to face what I consider to be predatory pricing activities from overseas companies.

The second issue is that we have a range of timelines. We say we will complete a case within 175 days. Cases are routinely given extensions of time—not as a matter of an unusual circumstance but routinely. At one stage last year, 100 per cent of all cases were given extensions of time. So there is a definite problem with the administration of antidumping actions in Australia. ... It is not all Customs' fault. They are asked to do a very difficult job, and they do not have the resources to do it. That needs to be addressed. Equally, some of these are very complex cases, and they do not necessarily have the expertise to deal with them. That is not going to be overcome unless you put some resources in. If we are going to go forward and move tariffs to zero—and we accept that that will be the outcome—we want to make sure that the administration of the one measure that we have available, which is through dumping and countervailing measures, is effective and timely and that the resources and skills that are needed to make pretty complex decisions are available. That is not the case today.²⁹

28 *Transcript of Evidence*, 7 June 2004, p.22 (Winstanley, Australian Vinyls Corporation)

29 *Transcript of Evidence*, 7 June 2004, p.34 (Winstanley, Australian Vinyls Corporation)

7.66 The Select Committee considers that it would be a serious loss to Australia if capable, go-ahead domestic firms were forced to close their doors simply because they had not been given a reasonable time frame to adapt to the conditions imposed by AUSFTA. The example of the petrochemicals industry is a classic case of the problems arising from the way AUSFTA has been negotiated - 'sign in haste, repent at leisure'.

7.67 The question of structural adjustment packages for industries adversely impacted by AUSFTA was raised during the Select Committee's inquiry, prompted largely by the support offered to the sugar industry in the light of its failure to gain access to United States markets. The Select Committee believes that structural adjustment assistance is one of the downstream consequences of significant changes arising from trade liberalisation – especially in the area of tariffs – that governments must take fully into account in assessing the overall benefit to the nation. The costs that government is willing to incur in order to assist industries to adjust appropriately is a proper element to be factored into the AUSFTA equation.

7.68 Work to establish these costs should have been done as part of the economic modelling commissioned by the Government prior to finalising and supporting the Agreement. This work on adjustment costs must now be done as a matter of priority.

Impact of brand recognition

7.69 Brand penetration, which is a natural consequence of an increase in imports of products such as cars, clothing and textiles, will undermine Australian produced goods and services. As imports increase, so too will US brand recognition, leading to a further undermining of Australian manufacturers, Australian brands, and Australian culture.

Rules of Origin

7.70 Of considerable importance to manufacturing is the issue of rules of origin. It is precisely such importance that, according to DFAT officials, ensured that much attention was paid to how AUSFTA would deal with 'ROOs'.

I can say very clearly that we have had a lot of discussions with Australian industry about the rules of origin. Because it was such a change to our usual approach, we did spend a lot of time talking to them. I think we both learned through that process, and I certainly believe from everything I have heard and you have heard from Australian industry that they are very comfortable now with the rules of origin under this agreement.³⁰

7.71 The Select Committee received conflicting advice on whether rules of origin were likely to be problematic. Typical contrary views are the following:

30 *Transcript of Evidence*, July 2004, p.56 (Deady, DFAT)

The other thing I would say as a lawyer is that... the certificate of origin type rules are extremely expensive. It is very easy to underestimate the cost of complying with regulation, particularly for a business that is not a very large business with economies of scale. Lawyers and complex administrators are expensive beasts. This introduces a whole new bundle of rules which will have to be complied with.³¹

It is said over and over again that the rules of origin are extremely costly. The Australian Industry Group, which represents manufacturing, considers that they will not be a significant impediment to trade between Australian companies and US markets, although there is very little empirical work about the actual impact of them. The Productivity Commission recently looked at the impact of rules of origin on the Australia-New Zealand free trade agreement and found something that I think instinctively you would not be surprised to realise: because of the adaptation and use of IT systems it is now relatively cost-effective for businesses to comply with complicated rules of origin because of the capacity use to computerised systems, like we do with customs clearance, to manage them.³²

7.72 According to the government, simple and objective tests apply to rules of origin for manufactured products, which must be substantially transformed in either Australia or the United States before they can benefit from the Agreement. The government also states that rules of origin agreed in the AUSFTA will particularly benefit Australian manufacturers that rely on imported petrochemical products and other goods with fluctuating world prices. Not so, claims other witnesses.

The AMWU rejects the government's claims in its fact sheet on the proposed AUSFTA that the rules of origin in the agreement are "simple and objective". On the contrary, the AMWU submits that the hundreds of pages of product specific rules of origin are extraordinarily long and complex.³³

7.73 The positive view articulated by Chief Negotiator Deady was reiterated in the Regulation Impact Statement prepared by the government:

The rules of origin (ROO) proposed for the agreement, which represented a departure from the existing models used for preferential tariff arrangements by Australia, were the subject of an extensive separate consultation process with all interested industry sectors. The Government's decision to proceed with the proposed system reflected the fact that virtually all sectoral organisations were either positively disposed towards, or prepared to accept, a general rule of origin approach based on change of tariff classification. With the support of Australian industry, the Government also sought to have the latter approach applied to the textiles and clothing

31 *Transcript of Evidence*, 5 May 2004, p.26 (Buckley, Tim Fischer Centre)

32 *Transcript of Evidence*, 5 May 2004, p.26 (Oxley, AUSTA)

33 *Submission 463*, p.22 (Australian Manufacturing Workers Union)

sector rather than the special “yarn-forward” rule proposed by the United States side, but was unable to persuade the US to move from this position.³⁴

7.74 Chapter 5 of the Agreement sets out the rules for determining which goods are originating and therefore eligible for preferential tariff treatment under the Agreement (also Chapter 2). The text comprises 17 Articles and an Annex (5-A). It also refers to Annex 4-A which is part of the Textiles Chapter.

7.75 Technically, the rules of origin for the Agreement mean that there must a change in tariff classification i.e. the inputs move the product from one tariff code to another. Manufacturers need only be aware of the tariff codes for imported inputs and final products.

7.76 Where it is difficult to demonstrate that a product has been 'substantially transformed' through the tariff change rule, an additional or alternative local content threshold test will be applied, under which domestic materials and processes will need to form a set proportion of the final value of the product.

7.77 The AMWU is not persuaded that this approach is effective:

[T]he partial reliance on the change in tariff classification approach used in the AUSFTA incorporates a significant element of arbitrariness into the tariff treatment of many products. The arbitrariness arises in part because the Harmonised System was not designed for the identification of origin but for the presentation of trade statistics. As the Productivity Commission has noted when recommending against a proposal to change the rules of origin under the Australia - New Zealand CER Trade Agreement to a tariff classification approach, "the extent of transformation involved in a change in tariff classification would vary between classification levels and between categories at each level". Merely because a good may have changed (or may have not changed) tariff classification in a country does not mean that a product was (or was not) substantially produced in that country.

On its present analysis the AMWU is not satisfied that the additional requirements attached to some products will be sufficient to remedy this problem.³⁵

7.78 Rules of origin were discussed at considerable length during both the Select Committee inquiry and at Senate Estimates hearings. Chief Negotiator Stephen Deady summed up the position as follows:

We have made the point before that we have adopted a different set of rules of origin under this agreement with the United States. It is a change from the normal arrangements that Australia has in place in the CER with New Zealand and what we did with Singapore, but we believe that the rules of origin are in fact a very efficient way of dealing with this issue of

34 *Submission 161, "Regulation Impact Statement", p.22 (DFAT)*

35 *Submission 463, p.22 (Australian Manufacturing Workers Union)*

substantial transformation. ...A large amount of the trade actually takes place at zero [tariff], so the amount of preferential trade is only a subset of the total trade and, of that subset, most of it in fact does take advantage of the rules of origin and the preferences.

In the case of the dealings with the United States, a vast amount of Australian product is going into the United States, including all the agricultural products and a large amount of the manufacturing products, and—and this has come not just from us but from industry—there is no real concern or doubt that Australia will meet those rules of origin. The one exception to that is the textiles and clothing area, where we acknowledged right from the start that the rules of origin were unfavourable to Australia. That was fully taken into account by Dr Stoeckel in the methodology and calculations, and we stand by the way the CIE calculated this, by rightly assuming that the vast amount of Australian product could meet the rules of origin established under the FTA quite easily.

...Our view, which is supported by Australian industry, is very strongly that that is not the case. A change of tariff classification is in fact a simple way, at minimal cost to Australian industry, to meet those rules of origin. Where there is a value added component, Australian industry is very familiar with such value added components. That is the approach that we use in the CER and, again, they could meet those rules of origin to meet the tests of the US-Australia FTA.³⁶

7.79 The Select Committee raised the issue of rules of origin with the automotive peak bodies in particular. The Federal Chamber of Automotive Industries addressed the matter as follows:

I want to briefly comment on the rules of origin, which are a significant part of the agreement as well—and they are obviously an area of key interest to the Australian car industry. The rules of origin in this agreement do represent a significant departure from those adopted in other preferential agreements which Australia has entered into. Under the longstanding Australia-New Zealand Closer Economic Relations Trade Agreement and the more recent Singapore-Australia Free Trade Agreement, for example, the rules of origin for most manufactured goods are based upon the uniform requirements that the last process of manufacture should have occurred within the free trade area. Also, at least 50 per cent of the allowable cost of manufacture—or ex-factory cost, as it is sometimes referred to—must represent qualifying expenditure.

In contrast, the rules of origin in this agreement are based on different criteria, which can vary in application from product to product. In most instances, the rules of origin require that items have undergone a change in tariff classification from one heading or a related group of tariff headings to a completely different heading. For many items the agreement also provides that origin may be conferred if a minimum level of regional value content is achieved. In most instances in the agreement, regional content is measured

³⁶ *Transcript of Evidence*, 6 July 2004, pp:55-56 (Deady, DFAT)

on the basis of a transaction value of the final product calculated using either a build-down approach or a build-up method. However, for a number of key automotive products—vehicles, engines, bodies, chassis and many key components—regional content is determined in this agreement using an alternative net cost method. In principle, this is quite similar to the ex-factory cost approach, although there are some differences in what is and what is not included in the measure.³⁷

7.80 Automotive component manufacturers agreed that specifically automotive rule of origin 'is approximately the same as the Australia-New Zealand 50 per cent ex-factory cost method'.

[O]n the whole my membership was convinced that it was a fairly straightforward and reasonable rule to adopt. It did not ameliorate entirely the concern that we now face quite a number of rules of origin. There is a different one in the Singapore free trade agreement, a different one in the Thai free trade agreement and a different one yet again in the New Zealand free trade agreement, and some of them require different accounting standards to be adequately met. The NAFTA net cost rule is basically resolved when there is a dispute under the general agreement on accounting procedures that the Americans account under, the NYSE. There is a little bit of familiarity to be gained in there and no doubt some dispute, but the rule will operate as an either/or—if there is a change in tariff classification you can opt for that and if there is not a change in tariff classification then you need to prove local content. It is one or the other. We think that is not too bad.³⁸

7.81 The Select Committee acknowledges the problems posed by the 'yarn forward' rule in the TCF area and that this will have a significant impact on the industry's ability to export to the US. Conversely, it will assist US exporters and there is a fear that Australia will be flooded with US made clothing and textiles. This will undermine Australian brands leading to job losses.

7.82 It is clear from both the submissions and the testimony that the ROOS for other industry sectors are complex and costly. However it seems that most industries believe they are, in the words of FAPM, "workable".

Ai Group initially objected to adopting the US product-specific methodology, given its prima facie complexity, unfamiliarity to Australian exporters and potential for manipulation to protect a party's national interests. After months of careful analysis and consultation with Australian industry (see the Section above on "Ai Group and the consultation process") Ai Group changed its position to one of general support for the ROO methodology.³⁹

37 *Transcript of Evidence*, 24 June 2004, p.49 (McKellar, FCAI)

38 *Transcript of Evidence*, 24 June 2004, p.4 (Upton, FAPM)

39 Australian Industry Group *Submission* to JSCOT inquiry, p.8

Government procurement

7.83 Chapter 15 of the AUSFTA covers government procurement. It requires each government to afford the suppliers, goods and services of the other country the same treatment that applies to domestic suppliers, goods and services.

7.84 Australia's government procurement process is already largely unrestrained. The United States, however, has two pieces of legislation which currently impact upon Australian companies' ability to supply goods and services to the United States government: The *Trade Agreements Act* of 1979 (which prevents United States Federal Government agencies from accepting bids from Australian companies because Australia is not exempt under the Act); and the *Buy America Act* of 1933, which imposes a 6% penalty on the supply of foreign goods to the United States Federal Government. The AUSFTA would remove the impact of these two Acts on Australian suppliers.

7.85 There are, however, a range of exceptions included in the AUSFTA, particularly in the areas of defence, and in policies designed to favour procurement from small and medium firms, and from minority groups in each nation.

7.86 In practice, the most significant impact on Australian government purchasing will be the imposition of new tender requirements, as set out in Articles 15.7 and 15.8 of the AUSFTA. Under these requirements, there is likely to be a larger number of open tenders (as opposed to selective or invited tenders) for Australian government procurement. The AUSFTA will also impose standards for the advertising of tenders, and requirements for the time between the announcement and the close of tenders.

7.87 The measures in Chapter 15 will be integrated into the existing Commonwealth procurement framework. In general terms, this framework requires agencies and their officials to conduct their procurement activities efficiently, effectively and ethically. The integration of the measures will mainly occur through revision of the CPGs.

7.88 The Australian Government Solicitor has prepared a very useful edition of its *Commercial Notes* dealing with government procurement aspects of AUSFTA, and the Select Committee considers it helpful to reproduce here some of the AGS commentary.⁴⁰

7.89 The key messages for agencies arising from Chapter 15 of the FTA are:

- Many of the measures are consistent with the existing procurement framework applicable to agencies, and reflect current policy and practice in how agencies conduct their procurement. However, there will be some changes.

40 Australian Government Solicitor, 'Australia-United States Free Trade Agreement' *Commercial Notes* Number 10, June 2004

- Agencies will be required to approach their procurement activities in a more structured, planned and careful way, including publishing an annual procurement plan.
- There is a presumption that agencies will use an open tender process for the conduct of their procurement activities.
- The ability of agencies to use other than open tendering processes will be more circumscribed under the measures. In particular, agencies will not be able to issue a restricted tender based simply on their knowledge of the market.
- Agencies will be more limited in their ability to include industry development requirements in tender documents.
- Technical standards will need to reflect international standards where they are available.
- Agencies may not be able to award contracts to tenderers that do not conform to 'essential requirements' at the time that tenders are opened.
- Agencies may be required to include more information in tender documents about how tender evaluation will be undertaken.
- Agencies will be required to include details of their method of procurement in gazettal notices of contracts.

7.90 Some of the core anxiety around the government procurement chapter lies with those aspects that are seen to inhibit government's capacity to adjust industry policy settings, to support local initiatives, or to expose governments to expensive and time consuming challenges to tender decisions.

7.91 The AMWU has produced a detailed response to the government procurement provisions of AUSFTA which captures all the relevant concerns that have been variously expressed. That response argues strongly that the CIE and DFAT (in its National Interest Assessment) have overstated the potential benefits and ignored significant dimensions of the potential costs.

The problems with the CIE's analysis are highlighted by the following propositions:

According to the CIE Canada wins 0.3% of the U.S. Federal procurement market and Australia will win 0.1%. So Australia will win one third of what Canada wins. However Canada's economy wide share of U.S. imports of goods and services is 16.7% and Australia's 0.7%. Why will Australia win one third of what Canada wins in the procurement market when we only win 4% of what Canada wins economy wide (0.7% is 4.2% of 16.7%)?

The CIE also suggests "most" of Australia's additional wins through exports will be to the \$25 billion GSA procurement market. If "most" means say \$75 million that amounts to 0.3% of \$25 billion. Why will Australia win 0.3% when the CCC (in the same paper quoted by CIE)

says Canada only wins 0.1% of the U.S. non defence Federal procurement market?

The CIE study provides no insights into the consequences of State Government participation on either side of the agreement; and it fails to provide any meaningful analysis of the consequences of changing the Australian Federal procurement market and limiting the capacity of the Commonwealth to pursue industry development objectives.⁴¹

7.92 A similar view was conveyed in the analysis prepared for the Select Committee by Dr Philippa Dee.

Empirical research has shown that Canada tends to trade significantly more than normal with the United States on all fronts, not just on government procurement... Wall (2000) notes that the United States trades as much with Canada as it does with all 15 countries of the European Union combines, and that its trade with Ontario exceeds its trade with Japan. This is not surprising, given that nearly 90 per cent of the Canadian population lives within 160 kilometres of the United States border, a border that stretches over 6400 kilometres.

There is a long history of econometric work that has quantified the effects of distance on the volumes of trade between countries. Such models, which are based on an analogy with the law of gravity in physics, show how trade volumes tend to increase with the size of the importing and exporting countries, and decrease with the distance between them. The Canadian economy is about 70 per cent larger than the Australian economy. And the Australian economy is almost 30 times further from the United States (using the standard gravity model measure of the distance between largest cities). Even using a relatively conservative estimate of the effect of distance, such as the recent one from Anderson and Wincoop (2003), Australia's trade with the United States could be expected to be 4 per cent as large as that of Canada, on account of these two factors. This is a more appropriate basis for estimating Australia's likely penetration into the United States government procurement market.⁴²

7.93 The AMWU analysis referred to earlier concludes that better access to United States Federal and State procurement markets is likely to lead to Australian firms winning less than \$100 million worth of procurement contracts (they already win \$50 million now without the agreement). By 2010, or shortly thereafter, the AMWU contends that Australia will lose in the vicinity of \$400 million to imports as a result of changes to local procurement policies. In support of these estimates, the AMWU's analysis provides detailed reasons why the proposed procurement policies in the AUSFTA are likely to result in only limited gains to Australian suppliers.

41 AMWU *Discussion Paper: The implications of the AUSFTA for Government Procurement: What Will Australia Win and Lose* pp:4-5

42 Dee, P *The Australia-US Free Trade Agreement: An Assessment*, Paper prepared for the Senate Select Committee, July 2004

7.94 The Australian Government Solicitor's *Commercial Notes* on government procurement states that many of the Chapter 15 measures will be 'business as usual', but it does highlight some notable features of the AUSFTA requirements.

7.95 On the somewhat vexed issue of 'domestic industry involvement' policies in procurement, the Government Solicitor's comments are similar to those of the AMWU.

On its face, Chapter 15 could have major implications for Australia's industry development program... This is because, in the future, an agency will not be permitted to 'seek, take account of, impose or enforce' offsets in its procurements (Article 15.2.5). Accordingly, Australia will need to revise its current industry development policy, and in particular the requirement for agencies to develop model industry development criteria for inclusion in major procurements.⁴³

7.96 The AGS notes, however, that the operation of Article 15.2.5 is:

...circumscribed in a couple of respects. First, Australia has expressly reserved the right to maintain the Australian Industry Involvement and successor programs for Defence procurement (Annex 15-A, Section 1, note 3(d)). Second, Australia's small and medium enterprise (SME) policy is preserved because of a reservation that Chapter 15 does not apply to any form of preference to benefit SMEs (see Annex 15-A, Section 7). Accordingly, agencies' 'model industry development criteria' may need to be limited to the extent of SME participation in a tenderer's tender.⁴⁴

7.97 The AMWU argues that this Article will affect a wide range of existing procurement practices. For example for information/ communication/ technology (ICT) tenders in excess of \$250,000 in Queensland there is currently a requirement to provide industry development statements on the benefits to local industry and this counts for at least 10% of the weight of the tender. This would not be allowed if Queensland signed up to the AUSFTA procurement agreement.

More importantly these restrictions on offsets (while partly but not exclusively excluding SME's) would prevent or at least seriously constrain future Australian Governments from designing local industry participation programs not in existence today that aimed to ensure local industry benefits from participation in new technologies or new emerging products through the use of Government purchasing.⁴⁵

7.98 Again, the AGS paper expresses similar concerns:

43 Australian Government Solicitor, 'Australia-United States Free Trade Agreement' *Commercial Notes* Number 10, June 2004, p.9

44 Australian Government Solicitor, 'Australia-United States Free Trade Agreement' *Commercial Notes* Number 10, June 2004, p.9

45 AMWU *Discussion Paper: The implications of the AUSFTA for Government Procurement: What Will Australia Win and Lose*, p.15

Given the restriction on 'offsets', it may therefore be difficult for agencies (and government) to take account of regional policy considerations in the future when evaluating and awarding tenders.⁴⁶

7.99 The Select Committee is particularly concerned about the impact of the government procurement provisions on Australian small and medium sized enterprises. Most State and Territory government purchasing policies include specific provisions for assisting SMEs in winning government contracts. These cannot be undermined as they will seriously affect thousands of SMEs that rely on government contracts.

7.100 There is no doubt that United States firms see considerable potential in having access to the Australian procurement market. In testimony before the United States Congress' Ways and Means Committee, the spokesperson for the United States Chamber of Commerce declared:

Under the agreement, Australia agreed to allow U.S. firms to bid for Australian central government contracts. As Australia is not a signatory to the WTO Government Procurement Agreement, this will give U.S. firms a significant advantage over competitors who are not afforded similar treatments. Australia also agreed to no longer subject U.S. firms to local manufacturing and local content requirements. The Chamber looks upon these steps as favorable as they should lead to more business opportunities for U.S. companies.⁴⁷

7.101 The government nevertheless insists that the exclusions to the provisions banning offsets are 'significant exclusions, in particular policies that assist small and medium enterprises, overseas development assistance, and procurement of research and development services. For Australia, there are also exclusions for programs assisting indigenous people; defence procurement; procurement of motor vehicles; blood plasma fractionation; and government advertising'.⁴⁸

7.102 The Select Committee notes that not all US states are covered by the Chapter on government procurement. It is up to each state to decide whether to participate and the level of its specific commitment.

7.103 There seems to have been considerable reluctance on the part of many states of the US to cooperate with the government procurement provisions both in WTO agreements and in FTAs. The USTR has produced a fact sheet aimed at encouraging the reticent states to come on board.

46 Australian Government Solicitor, 'Australia-United States Free Trade Agreement' *Commercial Notes* Number 10, June 2004, p.9

47 David Sundin, President and Chief Executive Officer, DSI Fluids, Tyler, Texas, on behalf of the U.S. Chamber of Commerce. *Testimony Before the Full Committee of the House Committee on Ways and Means* June 16, 2004

48 DFAT, *AUSFTA - Frequently Asked Questions*

7.104 The USTR fact sheet provides many reassurances to the reluctant states, which in turn convey the extent of the resistance being shown by them. In September 2003, the U.S. Trade Representative sent letters to all state Governors asking whether they would permit the coverage of some state government procurement under FTAs that were being negotiated by the United States.

7.105 Only 28 of the US states have agreed to be bound by the AUSFTA. This falls considerably short of the 37 U.S. states that had agreed voluntarily in the early 1990s to cover some of their state procurement under the WTO Agreement on Government Procurement.

7.106 The USTR fact sheet is at pains to point out that coverage of a state's procurement in an FTA does NOT affect the procurement of any local or municipal (city or county) government in that state. USTR has not asked any cities or counties to cover their procurement under these trade agreements.

7.107 USTR reassures the states that covering procurement under FTAs would not force states to comply with "draconian constraints" on domestic purchasing policies and undermine state authority to make purchasing policies, including promotion of local development. State governments can decide the extent to which a state's government procurement would be covered under the FTAs. It is up to each state to designate the agencies they want to cover, and to identify any goods or services they want to exempt.

7.108 For example, when the 37 states signed on to the WTO GPA, many reserved a number of sensitive procurement areas such as motor vehicles, construction-grade steel, printing, and construction services. If any new states choose to sign on to the procurement agreements, they would also be able to decide whether they want to reserve any sensitive procurement areas, such as measures to promote local economic programs for small businesses, distressed areas, minorities and women are excluded from the agreements.

7.109 USTR also pointed out to US state governments that :

... in the negotiations for an FTA, Australia had been unwilling to cover its states and territories unless the United States covers a significant number of states. Non-discriminatory access to the procurement of Australian states and territories is a high priority for U.S. suppliers of goods and services.⁴⁹

7.110 In short, it seems that while US firms are keen to make inroads into government procurement in Australia, nearly half of the US's own state governments are holding out against such access to their procurement markets by Australian firms.

7.111 The Select Committee does not believe there has been adequate analysis by the government of the effect on the regions through changes that will be necessary to

49 Extract from <http://www.ustr.gov/new/fta/2004-04-factsheet-gp.pdf>

government purchasing policies. Prior to the agreement being agreed to by the parliament, there is a need to analyse the restrictions of local content specifications and the impact on regional Australia.

7.112 Most the States and Territories have specific regional content provisions as part of their government purchasing policies. The 'Ten Devils in the Detail' pamphlet put together by AFTINET says 'some state governments also have purchasing scheme which require foreign contractors to give preference to local products or to form links with local firms to support local employment. These will not be permitted under the USFTA...Regional Employment studies are needed to assess these impacts'.

7.113 The Select Committee regards the area of government procurement as a very important one, and is concerned by the contrary advice that agitates debate over the costs and benefits arising from the AUSFTA provisions of Chapter 15. The Committee notes that the Chapter provides for a review of the government procurement provisions every two years. This indicates that the provisions of the agreement are not seen to be ideal and this further causes the Committee considerable concern.

7.114 Given the serious reservations expressed in both the submissions and the testimony heard by the committee, the biennial review will provide an opportunity for further detailed analysis of these provisions - but the Committee believes this should have been canvassed before the Agreement was signed. This analysis work should be undertaken prior to the Agreement proceeding, or if this is not possible, at the very least be referred to the Productivity Commission for an in depth inquiry.

Technical and Quality Standards

7.115 Critical to the capacity of Australian firms to compete in the United States market is their capacity to deliver goods and services at the necessary standard of technical and quality assurance. Potentially, this could represent quite a challenge, and the AUSFTA has sought to address the question of commensurability of standards in a variety of ways.

7.116 The AUSFTA devotes a Chapter to technical standards, commencing with the affirmation that both Australia and the United States affirm their existing rights and obligations to each other under the WTO Technical Barriers to Trade (TBT) Agreement where such issues as standards, technical regulations and conformity assessment procedures are addressed.

7.117 There are many entities in the United States which develop standards in both the government and private spheres as well as at the federal and sub-federal/state levels. Exporters can find it very difficult and costly to meet these different standards and technical regulations. Both Parties have therefore agreed to use, to the maximum extent possible, international standards.

7.118 Both Parties have agreed to give positive consideration to accepting, as equivalent, each other's technical regulations, provided they are satisfied that they

adequately fulfil the objectives of their own regulations. This is important because sometimes the technical regulations of the Parties may be different but achieve the same result.

7.119 For example, if a United States technical regulation stipulates that a product must contain certain features and pass certain tests to ensure safety, and this technical regulation is different from Australia's regulation covering the same product, the United States will give positive consideration to accepting Australia's technical regulation. The result is that the Australian product, subject to United States agreement would enter the United States market without changes to production methods or the characteristics of the end product.

7.120 Products often need to be tested to determine whether relevant standards and technical regulations have been met before they can enter the market. In many cases the tests are carried out in the country from which they are being exported. If the importing country does not accept the results of the test it may require further testing which can significantly add to costs.

7.121 Both Parties have therefore agreed to facilitate the acceptance of each other's conformity assessment procedures. Where they are rejected, the Parties must explain the reason for the refusal in detail. In some cases it may be possible to establish working groups involving practitioners to resolve the problem.