

NSW Government submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade

The following provides an overview of NSW's current trade and investment relationship with the United Kingdom (UK), the NSW Government's future objectives with this market, and the possible impact of the UK's departure from the EU on this relationship. The UK is one of NSW's ten priority markets, underlining the importance of the trade and investment relationship to the NSW economy.

Current trade and investment relationship

Services trade

The UK is particularly important for NSW as a market for our services exports. At a national level, Australia exported \$4.91 billion in services to the UK in 2015-16. Leading services exports were travel (education and tourism), other business services, and financial services. The Australian Bureau of Statistics (ABS) does not provide a breakdown of services exports by state/territory to the UK. According to the ABS, however, NSW is Australia's leading exporter overall in each of these categories.

At a national level, the UK is Australia's primary overseas market for financial services exports. Australia exports more financial services to the UK than it imports (not counting insurance and pensions).

In 2015 there were approximately 348,000 UK tourists in NSW, spending approximately \$739 million. As a group, they ranked the fourth largest cohort of international visitors. In 2015, there were 2,400 international students from the UK in NSW, making the UK the 20th largest source of international students in the state.

Merchandise trade

The UK is NSW's 12th largest merchandise export destination, with \$673.7 million in merchandise exports in 2015-16, a year-on-year increase of 5.3 per cent. Our top merchandise exports were miscellaneous manufactures, meat and meat preparations, and beverages. Merchandise imports from the UK far outweigh our exports. In 2015-16 merchandise imports were valued at \$3.36 billion.

Investment

The UK has traditionally been one of NSW's largest investors. It remains Australia's third largest investor, having been overtaken by Japan for second place as recently as 2015. State-based ABS figures for inward investment stock are not available, but NSW is a recipient of a significant proportion of this investment, particularly in the financial services sector. In 2016, greenfields foreign direct investment (FDI) from the UK into NSW was valued at \$700 million – 8.1 per cent more than in 2015.

NSW engagement strategy for the UK

In 2013 the NSW Government launched its International Engagement Strategy, which outlined the state government's priorities for trade, investment, and government-to-government engagement with 10 priority overseas markets overseas, including the UK.

In 2016, a review of the NSW Government's priority market strategies was completed, resulting in the identification of sectors that NSW Government would focus its trade and investment promotion efforts on. In the UK, these are as follows:

Sector	NSW Government objectives
Infrastructure	To attract investment into NSW's \$73 billion infrastructure program from UK-based major investors, and encourage participation in these major infrastructure projects by leading UK construction and engineering companies.
Technology Innovation	To attract leading UK-based tech innovators, venture capital funds, accelerators and incubators to enhance the talent, density and capital available in NSW's innovation ecosystem.
Professional Services	To promote NSW as a regional hub for financial, legal and other professional services, to Australia and in Asia; and to support the export of high-quality professional services from NSW to the UK.
Renewable Energy	Attract renewable energy companies in the UK to invest in NSW.

Possible implications of 'Brexit' for NSW's trade and investment relationship with the UK

Risks

Brexit has potential to affect NSW's trade and investment interests with both the EU and UK. In 2015, the EU as a whole was ranked the 2nd highest source of foreign direct investment into Australia. NSW's 2015-16 merchandise exports to the EU were three times higher than those to the UK at \$1.8 billion.

In a worst case scenario, Brexit could result in market instability in the UK and EU, accompanied by capital flight. The risk of this appears lower, however, in light of UK economic performance following the referendum result. The UK economy has proved remarkably resilient. In 2016 the UK economy grew faster than any other G7 economy, buoyed primarily by strong household consumption. In February 2017, the Bank of England raised its GDP growth forecast for the UK from 1.4 per cent (the forecast in November 2016) to 2 per cent. In addition, the UK has reaffirmed it will remain a pro-trade and globally-engaged economy and will secure the freest possible commercial ties with Europe.

While the prospect of market instability has receded, there is wide consensus among economists that Brexit will result in loss of GDP through reduced trade. Estimates of the impact vary. The countries of the EU will also suffer losses but to a smaller degree than the UK. Lower overall economic performance will lead to reduced demand for goods and services from NSW.

Brexit's impact on financial services will remain unclear until negotiations on the terms of the UK's departure from the EU are completed. It is possible Brexit will result in the centre of the European financial services sector shifting to the mainland, notably Frankfurt. Many UK-based financial

services firms have begun rebalancing their UK operations towards mainland Europe. This could affect NSW's strong financial services exports to the UK.

Opportunities

Brexit also offers opportunities for the NSW economy. Uncertainty over Brexit may prompt a rebalancing towards Asia's growth markets, presenting an opportunity for NSW to attract greater investment. Anecdotally, a trend toward rebalancing is already apparent. NSW Trade & Investment reports a marked increase in the number of UK firms connecting with it over the 2016-17 period.

NSW is well-placed to capitalise on opportunities in the UK. Cultural and historical ties between NSW and the UK are deeply-rooted. The largest cohort of overseas-born residents in NSW comes from the UK (approximately 300,000 in 2015). Our system of government and law largely mirrors that of the UK: this, alongside a common language and similar customs, provides UK investors with confidence and familiarity with our market.

In uncertain times, NSW's stable regulatory and governance environment is also a boon. NSW enjoys a AAA sovereign credit rating, and has benefited from a commitment to business-friendly policies: these are reflected in Sydney's consistently high rating for ease of doing business. Moreover, NSW is Australia's largest and most diverse economy.

These attributes also make NSW an attractive platform for UK investors servicing Asia's growth markets. A range of high-quality goods and services can be sourced and developed in NSW; and NSW's three major seaports (Port Botany, Port Kembla and Newcastle) and Sydney's international airport (to be supplemented by a second, 24-hour airport in Western Sydney in the mid-2020s) render NSW uniquely connected to markets in east, south and west Asia. NSW's geography also places it between the business time zones of Europe and Asia, facilitating a range of financial and other services headquartered here.

Merits of an FTA with the UK

The UK's decision to trigger article 50 and exit its relationship with the European Union may present a unique opportunity for Australia to secure better access to the UK market through negotiation of an FTA. NSW would strongly support the commencement of bilateral FTA negotiations between the UK and Australia. Prime Minister May has highlighted her commitment to engaging with other global markets through free trade agreements (FTAs) and has singled out Australia as a country with which an FTA would be sought.

FTAs offer several benefits to the signatories. Firstly, FTAs reduce or eliminate tariffs and, therefore, stimulate the flow of domestic goods and increase competitiveness. The reduction of tariffs and complex regulatory mechanisms also aids in the expedition of the flow of goods. Secondly, FTAs often create the conditions for legal certainty by harmonising regulations between nation-states.

It is generally accepted that greater commercial and legal certainty can create the conditions for several additional economic benefits such as increased knowledge-transfer, a more dynamic competitive environment and the stimulation of innovation. Taken together, these various forces will improve Australia's attractiveness to international markets and investors.

Trade and investment with the UK is subject to relatively low barriers compared to other jurisdictions. According to the 2016 Australian International Business Survey, the UK was the fourth most important market for Australian businesses, and ranked highly in the 'ease of doing business' for Australians.

However, there is still room to reduce tariffs and regulatory hurdles to promote a stronger two-way investment and trade flow. An Australia-UK FTA provides the opportunity to lower trade barriers in sectors such as agriculture where the UK has traditionally been more liberal than other EU members. Through its membership of the EU, the UK continues to impose substantial tariffs on agricultural products. Tariffs on all animal products average 15 per cent, on dairy 33 per cent and on fruit and vegetables 10 per cent.

NSW beef and other agricultural producers strongly support an FTA with the UK that lowers barriers to our exports. To ensure that competitor countries such as NZ and the US do not secure a competitive advantage in this market, producers emphasise the need to be among the first negotiating partners with the UK.

Behind the border, regulatory hurdles continue to impact export opportunities. Currently, import licences are required for a number of items into the UK including agricultural products, plants and animals, foods, medicines, textiles, and chemicals.

FTA negotiations present an opportunity to strengthen access for our services exports. Harmonisation of standards and regulations along with stronger arrangements for mutual recognition of qualifications could support stronger performance in financial and business services. Less intensive visa restrictions would support the freer flow of tourists, students and business professionals. Lowering these restrictions would also promote linkages between the growing technology ecosystems in NSW and the UK.

The significant "head-turning" effect of an FTA also should not be under-estimated. An FTA draws attention to business opportunities in the market, so attracts businesses to considering expanding business links there.

Government efforts to promote trade and investment with the UK

The NSW Government's trade and investment arm ('NSW Trade & Investment') maintains close and mutually-beneficial working relations with DFAT and Austrade.

NSW Trade & Investment is committed to working as 'Team Australia'. In setting our priority market strategies and implementing our work, we regularly consult DFAT and Austrade. Our export promotion function is facilitated by Austrade (through the export development program), and NSW Trade & Investment has tailored its support functions to minimise unnecessary overlaps with export promotion functions delivered more effectively by Austrade.

NSW Trade & Investment has also activated a program with Austrade, whereby several of its Trade and Investment Commissioners overseas are embedded with Austrade posts. This is true in London, where the NSW Government's Director of Trade and Investment in the UK is located with Austrade's offices in Australia House (in the High Commission), and works with Austrade officers while advancing both an Australian and a NSW agenda.

This model is a cost-effective, turn-key operational model enabling the NSW Government to leverage Austrade's well-established network, systems and staff knowledge to generate maximum economic outcomes for the State. This co-located model with Austrade provides significant flexibility for the NSW Government to operate and expand its footprint in the UK (and Europe) while also supporting Austrade's efforts at advancing its national trade and investment agenda.

Working with Austrade and DFAT, the NSW Government provides value to business in identifying and securing business opportunities in the UK. We will continue highlighting business opportunities from Brexit and will work to promote new opportunities under a future Australia-UK FTA.