Australian Government
Department of Foreign Affairs and Trade

Australian Government
Australian Trade and Investment Commission

TOURISM AUSTRALIA

export finance australia

JOINT STANDING COMMITTEE ON TRADE AND INVESTMENT GROWTH

INQUIRY INTO DIVERSIFYING AUSTRALIA'S TRADE AND INVESTMENT PROFILE

FOREIGN AFFAIRS AND TRADE PORTFOLIO JOINT SUBMISSION

Department of Foreign Affairs and Trade

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Tourism Australia

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CONTENTS

EXECUTIVE SUMMARY

[*The preparation of this submission has been led by the Department of Foreign Affairs and Trade with input from the Australian Trade and Investment Commission, Tourism Australia and Export Finance Australia.]*

Australia's prosperity has been, and will continue to be, underpinned by trade and foreign investment. Australia's open market policy settings, strong institutions, sound economic management and stable regulatory frameworks all contribute to an environment that is conducive to trade and attractive for investment.

While COVID-19 has disrupted some global flows of trade and investment, Australia's open economic settings are important for our economic recovery from the pandemic. Despite the severity of the COVID-19 pandemic, actions taken by Australia earlier (such as increasing the proportion of Australian trade covered by trade agreements from 27% to 70%) and during the pandemic have allowed Australian trade to remain resilient. In 2019 Australia exported more goods and services than ever and recorded its two largest monthly trade surpluses in March and May 2020.

Our export profile reflects our comparative advantages in mining, agriculture and some services, and our proximity to Asia and its rapid growth over the last few decades. The profile is driven by private sector commercial decision making. Australian commodity producers have benefited from rapid economic growth in China over the past 15 years and in Japan and the Republic of Korea in earlier decades. Australian real incomes have risen with the resulting increase in our terms of trade. As the standard of living across Asia has risen, growing demand for high quality food, manufactures, and education and tourism services has also played to Australia's competitive advantage, diversifying our export mix.

Foreign investment is an important source of capital for the Australian economy. While Australia has recently run a current account surplus, historically Australia's investment has exceeded its savings. Foreign capital is an essential source of investment financing, including enabling Australia's surplus endowment of resources to be extracted and exported. Foreign investment also brings knowledge and relationships that allow our agricultural, manufacturing and services sectors to expand to cater for international customers as well as domestic customers. DFAT works closely with the Treasury to implement our foreign investment regime to ensure investment is in the long term national interest.

The COVID-19 pandemic, US-China trade tensions, and recent bilateral trade difficulties have renewed public debate about whether Australia needs to diversify our export markets and the sources of essential products. While the full impacts of these developments on Australia's trade remains unclear, the key drivers determining Australia's trade profile are unlikely to change. Australian businesses will export to markets where Australian products and services are in demand and where profits are highest relative to risks. They will import goods and services from suppliers balancing reliability, quality and cost. Australian businesses have opportunities to expand the markets they trade with, but they will do so only where the benefits justify the cost. Although eager to expand into other markets, it is likely that many Australian businesses will continue to be focused on post-COVID re-engagement with China because its economic recovery is ahead of other major markets, and because of the scale of demand and premiums the Chinese market delivers.

As the global economy changes, Australia's trade opportunities (across geographies and sectors) will continue to evolve. The Foreign Affairs and Trade portfolio seeks to provide Australian business with a range of opportunities in diverse international markets, including through free trade agreements, and helping Australian business navigate changes by: positioning Australian companies to benefit from future growth opportunities; supporting an enabling environment for business to operate in; helping firms understand the risks and benefits associated with exposure to different markets and supporting investors to understand the risks and benefits of Australia's strengthened foreign investment regime. Market-driven diversification will reflect the gradual evolution of business capabilities and relative competitive advantage. In turn this depends on innovation and productivity growth. Government policies can help, but ultimately it is the business sector that determines the pattern and growth of Australian trade.

1. AUSTRALIA'S TRADE PROFILE

Economic fundamentals

Access to global markets allows our businesses to secure economies of scale that are simply not possible with our relatively small population and domestic market. Competition through trade can drive innovation and productivity. It allows our businesses to access the inputs they need at the lowest prices, which in turn helps ensure they remain internationally competitive. Australian consumers benefit too, through having access to greater choice at lower prices.

Trade liberalisation (including through trade agreements) has delivered Australians higher incomes and more job opportunities. Around one in five Australian workers is employed in a trade-related activity and one in seven Australians is employed in connection with exports. Over the twenty years to 2016, real household incomes are estimated to be $8,448 higher because of trade liberalisation[1]. Liberalisation has led to higher economic growth, underpinning 28 years of continuous annual growth in the Australian economy. Without trade, our standard of living would be substantially lower, the prices we pay would be significantly higher, and our choices of goods and services would be more limited.

Australia's trade profile reflects our comparative advantages. We export certain products, particularly mineral and other raw materials, often at lower cost and more reliably than our competitors. Other products (including some agricultural and food products) are competitive in export markets at higher prices because consumers value their quality or environmental or ethical production attributes. These advantages stem from our geographic location, resource endowments, specialised knowledge base and skilled labour force. They are enhanced by our strong institutions, open economy, high living standards and reputation as a reliable trade partner.

We import goods and services that are either not produced in Australia or can be purchased from overseas at a lower price relative to equivalent Australian goods and services. Imports give Australian consumers and businesses more choice than could be produced locally, improve our standard of living and the competitiveness of our businesses, including exporters.

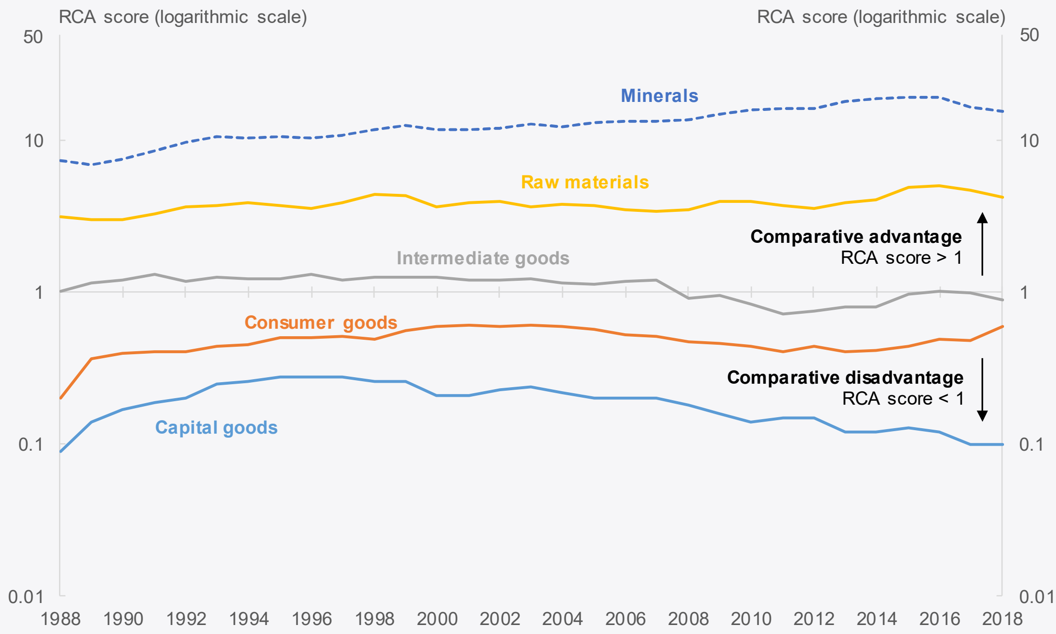
We have been able to capitalise on our comparative advantages because our trade and economic policy settings support access to international markets and allow businesses to make decisions and pursue opportunities based on commercial considerations. This approach has led to the current composition of Australia's exports, which is weighted towards resources, energy and agriculture (Table 1).

Figure 1 shows Australia has a comparative advantage in the export of raw materials (especially minerals), indicating that it is relatively efficient for Australia's economic resources (e.g. labour, capital) to be deployed in that sector. Conversely, Australia has a comparative disadvantage in the production of mass-produced consumer goods as a whole (relatively high labour costs, small domestic market). In general, deploying Australia's labour and capital to areas where it has comparative advantage, such as the production and export of raw materials instead of producing consumer goods, means Australia can maximise its national income.

More recently, our well-educated labour force has led to the growth of Australian knowledge-based exports. This includes education, business and professional, financial and communications services, and other specialised, high skill fields. In addition, our high living standards, safe reputation and natural beauty remain a key drawcard for students and tourists. Our advanced manufacturing sector provides high quality goods in sectors such as medicaments and pharmaceuticals, aircraft parts, spacecraft and parts, and medical instruments.

[1] Centre for International Economics *Australian Trade Liberalisation: Analysis of the Economic Impacts* (available from: https://www.dfat.gov.au/about-us/publications/trade-investment/Pages/cie-report-on-australian-trade-liberalisation)

Figure 1 — Australia's revealed comparative advantage (RCA)[2] for Australia's goods exports to the world



Source: World Integrated Trade Solution (WITS) database.

Table 1 — Australia's top 10 exports and imports (2019), A$ million

	Exports			Imports		
Rank	Commodity	Value	Per cent share	Commodity	Value	Per cent share
1	Iron ores & concentrates	96,173	19.5	Personal travel (excl. education) services	46,698	11.0
2	Coal	63,956	13.0	Refined petroleum	25,141	5.9
3	Natural gas	48,654	9.9	Passenger motor vehicles	21,404	5.0
4	Education-related travel services	40,336	8.2	Telecom equipment & parts	14,894	3.5
5	Gold	23,372	4.7	Crude petroleum	12,285	2.9
6	Personal travel (excl education) services	22,580	4.6	Freight transport services	9,975	2.3
7	Beef[3]	10,809	2.2	Goods vehicles	9,809	2.3
8	Aluminium ores & conc (incl alumina)	9,830	2.0	Computers	9,683	2.3
9	Crude petroleum	9,505	1.9	Professional services	8,002	1.9
10	Copper ores & concentrates	6,161	1.3	Passenger transport services	7,737	1.8

Based on ABS trade data on DFAT STARS database and ABS catalogues 5368.0 & 5368.0.55.004 (Mar 2020)

[2] The RCA score provides a measure of the relative specialisation of a country's export activities in a given industry. It is calculated as the share of that commodity in the country's exports divided by the share of that commodity in the world's exports. A score greater than one indicates a comparative advantage, and vice versa, and the higher the score, the stronger the comparative advantage. An RCA score may be affected by factors that distort trade (e.g. import restrictions, export subsidies), but Australia's relatively open market settings mean its RCA score is unlikely to be distorted significantly.

[3] Covers beef that is fresh, chilled or frozen.

Tourism is a significant export industry, in 2018-19 valued at $39.1 billion (8.2 per cent of Australia's total exports for that year)[4]. Prior to the COVID-19 slowdown, tourism supported one in twelve Australian jobs (either directly or indirectly)[5].

In 2019, China was Australia's largest and most valuable visitor market, with 1.44 million Chinese visitors spending $12.4 billion, accounting for more than a quarter of total international tourism spend. The United States and the United Kingdom were Australia's next most valuable visitor markets, respectively representing eight and nine per cent of total visitor spending. Visitors from the United States had the highest spend per night, an average of just over $300, followed by Singapore and Hong Kong. India is one of Australia's fastest growing inbound visitor markets, recording double digit growth in arrivals and spend every year since June 2017, and tripling in size over the last decade. The 2018 India Economic Strategy found that Australia was on track to welcome nearly 1.2 million visitors from India each year by 2035.

Table 2 — Australia's top 10 overnight visitor markets, 2019 (ranked by total spend)

Rank	Market	Visitors	Visitor nights (million)	Total spend ($ billion)	Spend per night ($)
1	China	1,438,700	57.7	$12.4	$214.90
2	United States	817,900	12.9	$3.9	$302.33
3	United Kingdom	715,800	20.4	$3.4	$166.67
4	New Zealand	1,433,700	13.0	$2.6	$200.00
5	Japan	498,600	10.5	$2.1	$200.00
6	India	399,200	21.6	$1.8	$83.33
7	Korea	280,500	10.5	$1.5	$142.86
8	Singapore	478,500	5.8	$1.5	$258.62
9	Hong Kong	315,100	6.2	$1.4	$225.81
10	Malaysia	384,700	7.4	$1.3	$175.68
	Total International	9,465,800	274.0	$45.4	$165.69

Australian Bureau of Statistics and Tourism Research Australia Data, YE December 2019.

Australia-China trade

Over the past two decades the biggest trade opportunities for many countries, including Australia, have been with China, driven by the size of its population, favourable demographics and its rapid economic development (starting with its opening up to foreign investment in the late 1970s and underpinned by its accession to the World Trade Organization (WTO) in 2001). At least 60 countries in 2018 counted China as their number one merchandise trading partner. For most of this century China's growth in demand for resources has been unparalleled. Two of Australia's most valuable exports illustrate this: iron ore (in 2018, China imported 65 per cent of globally-traded iron ore, of which 60 per cent came from Australia) and LNG (although Japan still imports more LNG from Australia than China, the latter accounted for 35 per cent of global LNG import growth over the past two years, with Australia's LNG exports to China growing by over 50 per cent in that period).

Australia's trade opportunities in China were enhanced by preferential market access secured in the China-Australia Free Trade Agreement (ChAFTA), which entered into force in December 2015. ChAFTA has boosted bilateral trade, particularly for goods where tariff reductions advantaged Australian exporters, including for beef, dairy, wine, wool, coking and thermal coal, and pharmaceuticals (including vitamins and health products). ChAFTA also opened up services trade opportunities, including in health and aged care. The value of Australian goods exports to China grew by 98 per cent in the four years following entry into force,

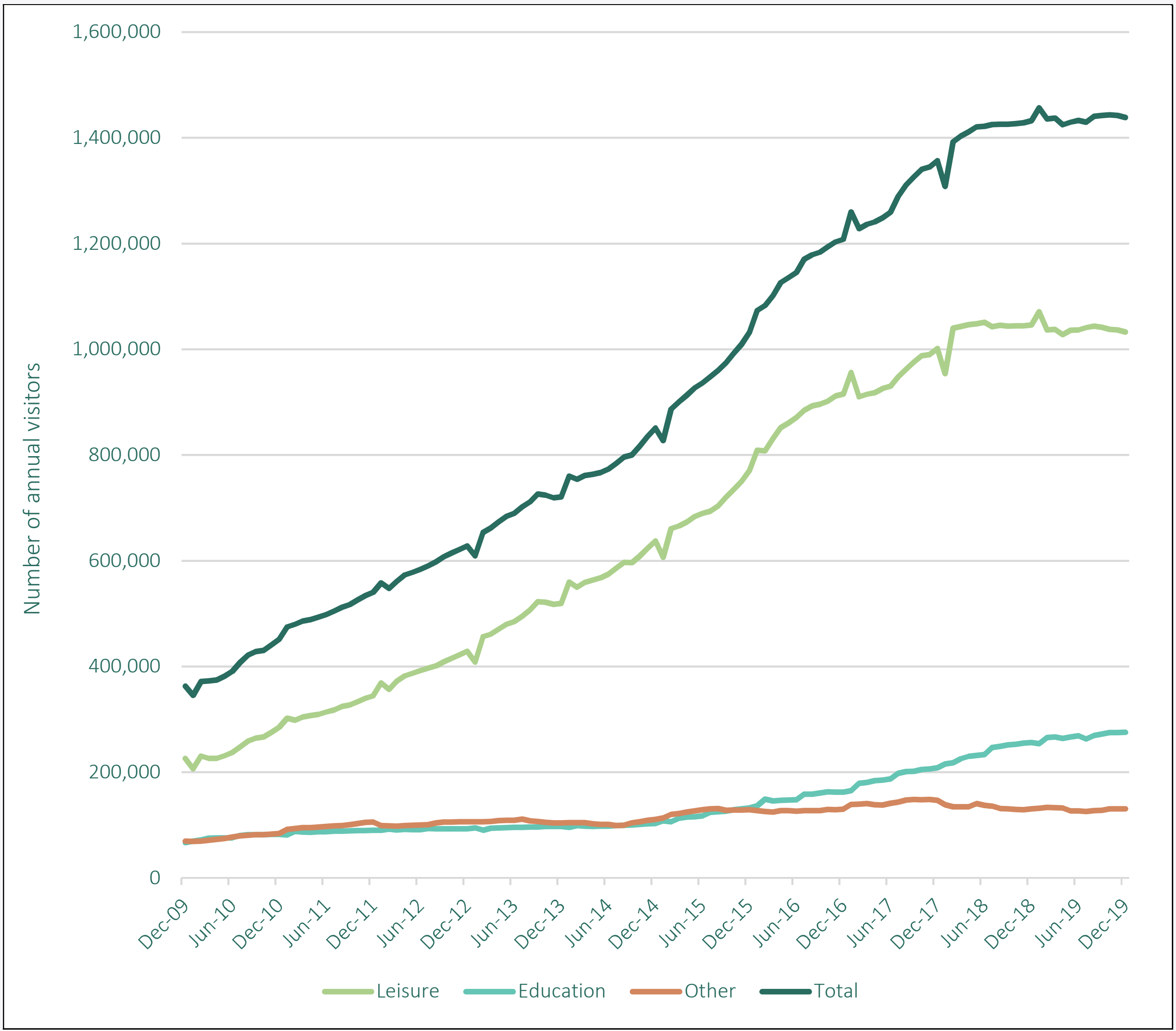
[4] https://www.tra.gov.au/economic-analysis/economic-value/national-tourism-satellite-account/national-tourism-satellite-account (accessed 21 July 2020)

[5] Tourism Australia website – tra.gov.au (accessed 22 July 2020)

compared to growth of 56 per cent in overall goods exports. Over the same period the value of Australian services exports to China grew by 76 per cent, compared to growth of 40 per cent in overall services exports.

As China has opened up and allowed its citizens to travel and study abroad, it has grown to be Australia's largest inbound visitor market. In the past five years, visitor numbers have increased by 69 per cent and total spending has increased by 116 per cent. However pre-COVID-19, Australia was starting to see growth slow, which is typical as a market matures, combined with the impact of China's economic growth slowing. As illustrated by Figure 2, growth in the Chinese market started to slow in 2019.

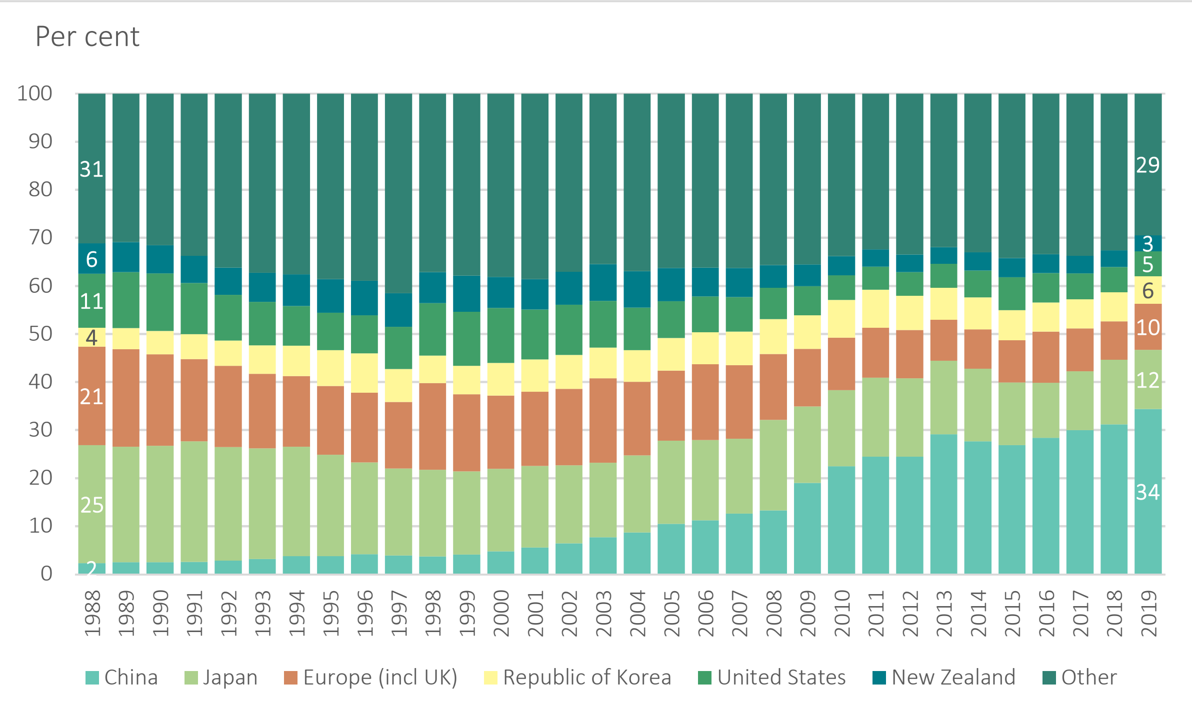
Figure 2 — Short term visitor arrivals from China (12 month rolling totals)



Australian Bureau of Statistics and Tourism Research Australia Data

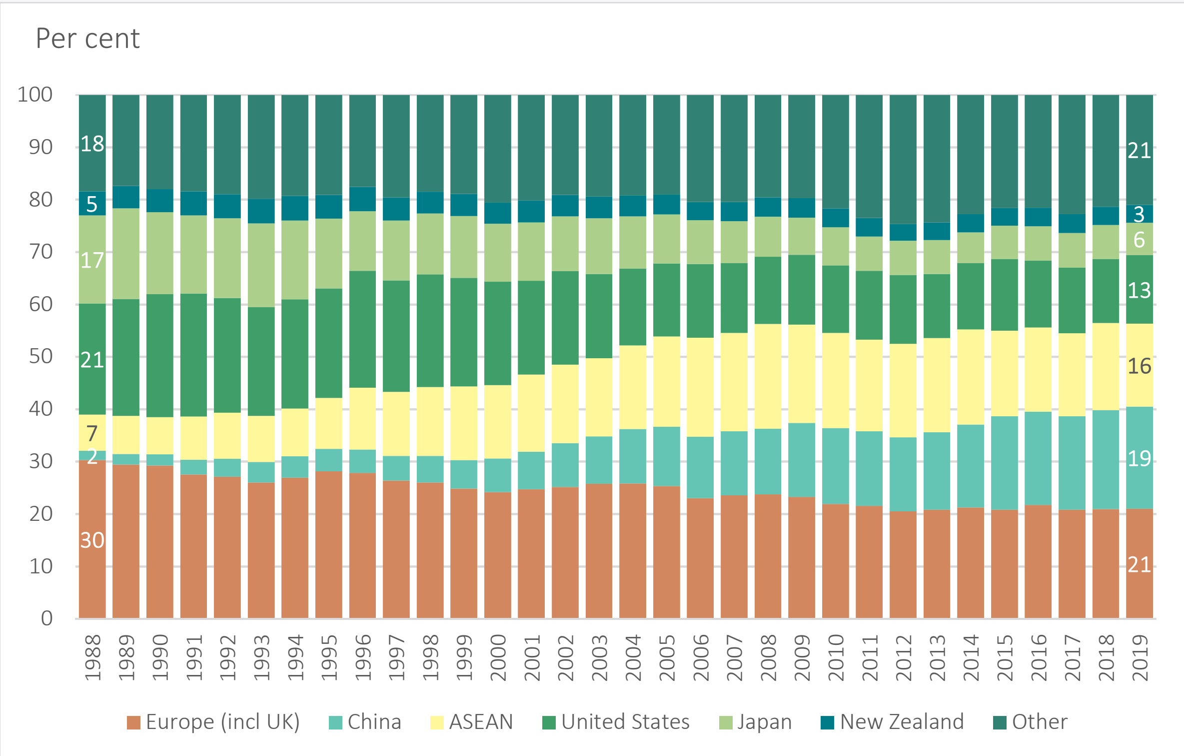
To date, Australia's trade relationship with China reflects Australian businesses' assessment of the attractiveness of the Chinese market and the complementarity of our economies. Australian exports meet many of China's needs (including resources, energy, food and tourism and education services) and we purchase a lot of what China produces (such as consumer goods). Australian companies have capitalised on these opportunities, making China our top export partner (Figure 3) and top source country for imports (Figure 4). On a regional basis, Asia has increasingly grown in importance as both the destination for our exports and the source of our imports. There is considerable uncertainty about the impacts of COVID-19, however, given the fundamentals for economic growth continue to favour the Asian region, this pattern is likely to continue for at least the next decade.

Figure 3 — Australia's goods and services exports, destination shares over the past 30 years



Based on ABS trade data on DFAT STARS database (Mar-2020 data), ABS catalogue 5368.0.55.004 and unpublished ABS data

Figure 4 — Australia's goods and services imports, source shares over the past 30 years



Based on ABS trade data on DFAT STARS database (Mar-2020 data), ABS catalogue 5368.0.55.004 and unpublished ABS data

2. FOREIGN INVESTMENT PROFILE

Benefits of foreign investment

Foreign investment plays a crucial role in supporting Australia's growth and prosperity. Without it, economic activity, employment and wages would be lower. Foreign investment helps Australia reach its potential by: improving Australian businesses' links to global supply chains; providing capital to finance new businesses and enhance existing businesses; financing infrastructure; and encouraging competition and increased innovation by bringing new technologies and know-how to Australia, which boosts productivity and jobs. Foreign direct investment contributed around 12 per cent of the $454 billion total flow of investment in the Australian economy in 2019.

Australia's need for foreign investment arises from a gap between national investment and national savings. While Australia has run a current account surplus since the June quarter 2019, historically Australia's investment has exceeded its savings – on average by around four per cent of GDP over the past 30 years. Foreign investment has provided the necessary capital to finance this shortfall and enabled Australia to maximise the potential of our vast resources. It plays an important role in linking Australian businesses to global markets and earning export revenue. It also allows Australia to enjoy a share of global economic activity disproportionate to our population.

Foreign investment underpins the jobs of one in 10 workers (employing around 1.2 million people). Direct investment in Australia from the European Union (including the United Kingdom) and the United States contributed to employing over 680,000 Australians in 2017[6].

Types of foreign investment

Investment flows move into and out of Australia. Investment in Australia from overseas is referred to as inward foreign investment, while Australian investment abroad is referred to as outward foreign investment. Foreign investment can be measured in two ways: stocks – the level or value of investment at a particular point in time; or flows – the level or value of investment over the course of a period of time, typically a year.

Foreign investment generally falls into two categories:

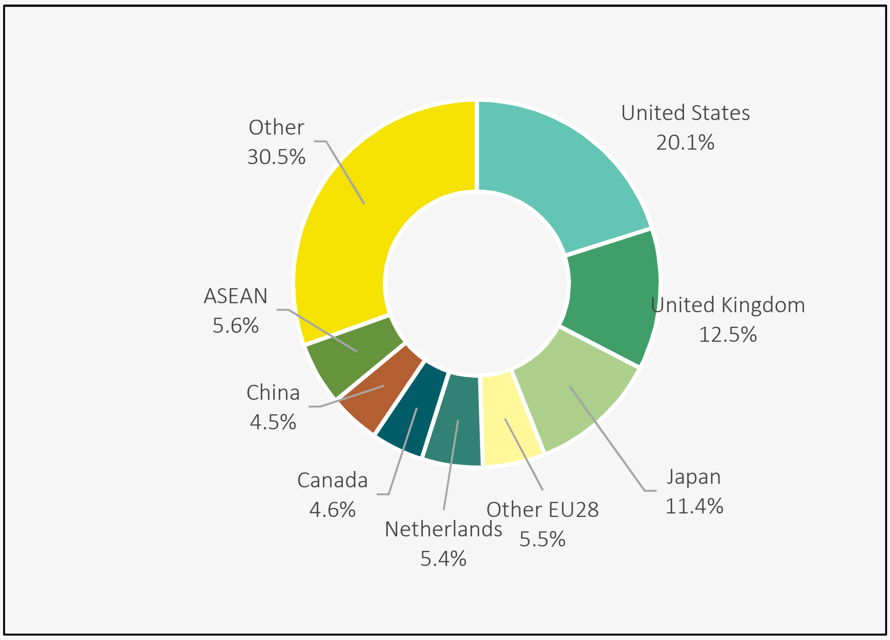
- foreign portfolio investment — the purchase of equity (such as shares) and debt securities (such as bonds), where the foreign investor does not have any controlling interest or influence in the asset or company; or
- foreign direct investment (FDI) — investment in an enterprise or asset where the foreign investor has control or a significant degree of influence over management. Generally, investment is considered to be 'direct' when an investor has 10 per cent or more of the voting power in the company. Direct debt investment is debt between related parties.

Beyond foreign portfolio and direct investment, other more minor forms of investment include derivative instruments and reserve assets.

In Australia, portfolio investment is the largest proportion of both inward and outward foreign investment, close to double the share of FDI. The ability to invest abroad enables savers, whether in superannuation funds or on their own account, to diversify their savings portfolio. For Australian business, outward FDI is a way to grow their markets, acquire new technology, and integrate their businesses into global value chains.

[6] US Bureau of Economic Analysis and Eurostat.

Figure 5 — Foreign direct investment in Australia (stocks), 2019 – top 10 sources by share



Source: DFAT, based on ABS catalogue 5352.0

Australia is an attractive investment destination because of our open, well-regulated and stable economy and sound institutions. Figure 5 shows Australia's sources of inward foreign direct investment profile is diverse with investors from a wide range of regions. Our largest inward investors are those countries which are the main exporters of capital globally. At the end of 2019, our top five sources of foreign direct investment (stock) were the United States (20.1%), followed by the United Kingdom (12.5%), Japan (11.4%), the Netherlands (5.4%) and Canada (4.6%).

Investment flows and source countries vary from year to year. Figure 6 shows the annual net inflows of investment (incoming foreign investment less outgoing foreign investment) from seven of the top eight investment sources for the Australian economy (excluding Bermuda)[7].

Foreign investment and protecting the national interest

Foreign investment in Australia is regulated by a framework that welcomes investment that is not contrary to Australia's national interest. The government, through the Foreign Investment Review Board (FIRB), reviews foreign investment to ensure consistency with the national interest. Over the years, the foreign investment review framework has been adjusted to respond to different challenges that have emerged.

COVID-19 has presented risks to which the government has responded. To ensure appropriate oversight of foreign investment during the COVID-19 pandemic, on 29 March 2020 the government introduced a temporary measure to lower all monetary screening thresholds to $0. This measure applies to all foreign investors, regardless of where they are from, and will remain in place for the duration of the pandemic.

On 5 June 2020, the government proposed broader reforms to the foreign investment framework to strengthen the existing system of review, streamline investment in non-sensitive businesses, and address national security risks. The proposed changes include:

1) A new national security test for direct investments in a 'national security business', regardless of the value of the proposed investment.

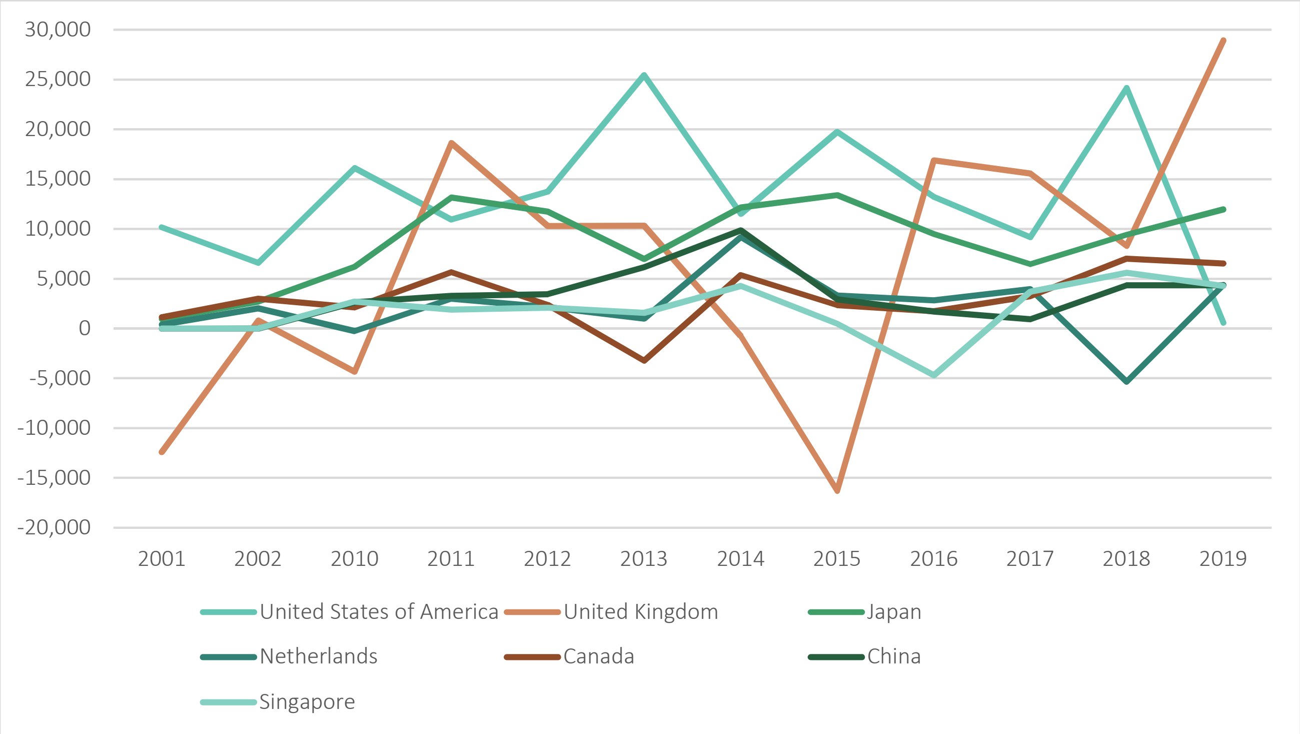
[7] Identifying the foreign ownership of capital is difficult where the companies are registered in countries, such as Bermuda, which does not provide information on the beneficial owner. As at 31 December 2019, the Bermuda stock of FDI in Australia was $41.6 billion.

2) A time-bound 'call in' power to allow investments that would not ordinarily require notification to be called-in for screening on national security grounds.
3) A last resort power which will enable the Treasurer to impose or vary conditions, or, as a last resort, require divestment of any investment approved under the *Foreign Acquisitions and Takeovers Act 1975* where national security risks emerge.
4) Streamlining measures which will allow certain privately controlled and managed investment funds to no longer be treated as 'Foreign Government Investors'. This will enable them to benefit from the higher monetary screening thresholds that apply to private investors.

Investment by foreign government investors

All foreign government investors, including state-owned enterprises, that meet the definition[8], must get approval before acquiring a direct interest in an Australian business (generally at least 10 per cent, or the ability to influence or control), starting a new business or acquiring an interest in Australian land regardless of the value of the investment. Foreign government investors also require approval to acquire a legal or equitable interest in a tenement or an interest of at least 10 per cent in securities in a mining, production or exploration entity.

Figure 6 — Net inflows of direct foreign investment in Australia 2001-2019 (A$ millions), selected countries



Source: DFAT, based on ABS catalogue 5352.0

[8] A 'foreign government investor' is a foreign government or separate government entity, a corporation or trustee of a trust, or a general partner of a limited partnership in which:

– a foreign government or separate government entity holds a substantial interest of at least 20 per cent; or

– foreign governments or separate government entities of more than one foreign country (or parts of more than one foreign country) hold an aggregate substantial interest of at least 40 per cent.

Source: Australia's Foreign Investment Policy (dated 24 April 2020) https://firb.gov.au/sites/firb.gov.au/files/inline-files/2020-FIP-cv.pdf.

Responding to COVID-19

Encouraging investment flows will be crucial for Australia’s economic recovery from the COVID-19 pandemic. However, attracting and retaining FDI will be challenging in an environment in which there is decreased flow of foreign capital. The United Nations Conference on Trade and Development’s World Investment Report forecasts global FDI to drop by 40 per cent in 2020 due to COVID-19.[9] The government’s public health measures to slow the spread of the virus, economic stimulus packages to support businesses and consumers, and strong messaging that Australia remains ‘open for business’, demonstrates Australia continues to offer a safe, stable and welcoming environment for international investors.

[9] World Investment Report 2020: International Production Beyond the Pandemic, United Nations Conference on Trade and Development https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf.

3. WHAT FACTORS WILL AFFECT OUR TRADE PROFILE (AND POTENTIAL FOR DIVERSIFICATION)?

Historical context

Major global developments in the past have had significant effects on Australia's trade profile. After a period of adjustment, Australian trade has continued to grow. Our market access into the United Kingdom was reduced when it joined the European Communities (EC) in 1973. But rapid growth in Japan and Korea offered new opportunities for Australian exporters and increasingly importers. China joining the WTO in 2001 was instrumental in its rapid growth, and has reshaped supply chains across the globe. The size of China's economy, and its role as a major exporting nation, created new opportunities for Australian trade. While China is currently our largest trading partner, three other countries have held this position over the last century (the United Kingdom, Japan and the United States).

Current developments

The effects of COVID-19

Tourism was one of the first industries hit by the coronavirus and will likely be the last to recover completely. The effects of COVID-19 on the industry are already extremely serious, resulting in extensive job losses, businesses closing, and the industry, by one estimate, losing $10 billion a month in revenue[10]. International travel has been reduced to almost zero since Australia closed its borders on 20 March 2020.

COVID-19 has also hit education exports hard, with many international students unable to travel to Australia to resume or commence studies. As of 21 June 2020, 121,707 student visa holders were outside of Australia, comprising 20 per cent of the total number of student visa holders (603,807). The government is looking at ways to facilitate the recovery of education exports.

As the COVID-19 pandemic plays out, the rate of economic recovery in our trading partners will vary. This will affect the demand for Australian exports. Australia's export destinations and import sources may become more concentrated for a period, if demand in some key markets recovers more quickly than in others. For commodities exports (including many agricultural products), even if a major market is closed off, products can often be sold in an alternative market, meaning exports can continue (although usually at a cost to profits). The pace of global recovery will dictate the demand for many commodities and influence their price.

Necessary restrictions on travel to and from Australia will make developing new markets difficult. However, opportunities may open up where Australia's competitors have seen their export capacity affected, or where supply chains shift to new countries. In the longer term, consumer tastes, supply chains and the delivery of services may change. Some countries may adjust social or economic policies. These changes will shift the pattern of trade as they play out, as well as domestic production.

Many countries, including Australia, have put in place temporary measures to deal with the pandemic. There is a risk that a more protectionist policy approach in some countries will result in temporary measures becoming permanent. As a nation that relies on free flows of trade, capital and technology, pushing back on protectionist trends will continue to be in Australia's best economic interests.

China's economic trajectory

Major global economic shifts are underway including China's role in the global economy. China is undergoing a long-term economic transition away from economic growth underpinned by relatively low value exports and fixed asset investment (such as building infrastructure) towards growth led by consumption and services.

[10] Tourism Research Australia's National and International Visitor Surveys

Infrastructure to be built as part of the Chinese Government's COVID-19 economic support package (rollout of 5G networks, data storage and support for e-commerce) will support this transition.

While a long-term shift to consumption-based growth may reduce China's demand for Australia's resource and energy commodities (which accounted for over 80 per cent of Australia's merchandise exports to China in 2019), the gradual pace of change and the size of China's economy means it will continue to be a major market for Australian exports for the foreseeable future. Over time, demand for Australian commodities may grow relatively faster in Southeast Asia. An ageing population and rising wages in China, along with trade tensions between the United States and China, are leading to a shift of some manufacturing supply chains to other countries in Southeast Asia where labour costs are lower. (This process may accelerate if firms actively seek to diversify their supply chains.) On the other hand, some supply chains will remain in China in order to service China's large domestic market. Any movement of supply chains out of China is more likely to shift the composition of trade with China than the value. This is because China's increasing prosperity has the potential to boost demand for our exports of services, agricultural and food products, and manufactures.

US-China trade agreement

If the US-China trade agreement is successfully implemented, some Australian exporters may face increased competition in China from US exporters. However, the Australian economy is likely to benefit from improved global economic confidence associated with the easing of trade tensions between the US and China.

Under the US-China Phase One trade agreement, China has committed to implement a range of technical market access reforms, including lifting bans on imports of US beef and poultry, as well as agreeing protocols for the import of barley and blueberries and recognising a number of US export facilities, including for infant formula, seafood, animal protein and dairy. Australia will monitor the implementation of the agreement closely to ensure that it is in line with WTO norms and commitments and with Australia's national interests.

The scale of additional Chinese purchases of US goods envisaged under the agreement may see some diversion of global trade flows if US exporters prioritise exports to China over those elsewhere. To the extent businesses accelerate adjustments to their supply chains, including to manage risks associated with ongoing trade frictions between the two countries, this may offer opportunities for Australian businesses to adjust their own operations to capitalise on these opportunities.

Opportunities in the Indo-Pacific

As the 2017 Foreign Policy White Paper notes, the economic transformation in the Indo-Pacific has substantially benefitted Australia, and is expected to continue to do so. While we continue to seek out and take advantage of opportunities globally, three countries in our region currently provide strong potential for Australian business to expand trade.

Indonesia, up until COVID-19, was one of the fastest growing economies in South East Asia and, by some estimates, will be the fifth largest economy in the world by 2030 (in purchasing power parity terms). The Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), which entered into force in July, ensures that Australia is well-placed to deepen economic cooperation and share in Indonesia's growth. This will be further supported by a Blueprint for Deepening Australia's Economic and Trade Relationship with Indonesia currently under development.

Vietnam also presents significant opportunities for Australia. In August 2019, the Prime Ministers of Australia and Vietnam agreed to develop an Enhanced Economic Engagement Strategy, with the aim of becoming top ten trading partners and doubling bilateral investment. The Strategy is being developed in consultation with industry over the next 12 to 18 months.

India is already Australia's fifth largest export market, with coal and education accounting for around 75 per cent of exports. In 2019, two-way goods and services trade with India was $30.5 billion, and two-way investment amounted to $36.7 billion. The 2018 India Economic Strategy observed that there is no single market with more growth opportunities for Australian business to 2035 than India, which is projected to become the world's third largest economy by 2030. On 4 June, Prime Minister Morrison and Indian Prime Minister Modi held a virtual summit and announced elevation of the bilateral relationship to a Comprehensive Strategic Partnership (CSP). As part of the CSP, the Prime Ministers decided to re-engage on a bilateral Comprehensive Economic Cooperation Agreement.

In addition to bilateral opportunities, regional engagement will lead to an expansion of Australia's trade opportunities. Australia's established regional free trade agreements (FTAs), the ASEAN-Australia-New Zealand FTA (AANZFTA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) contribute to regional economic integration in the Indo-Pacific, and will support regional economic recovery post COVID-19.

AANZFTA has significantly strengthened Australia's economic engagement with ASEAN since entry into force in 2010. The planned upgrade of the Agreement is an opportunity to ensure AANZFTA delivers additional opportunities for Australian business.

The CPTPP is one of the most comprehensive trade agreements, significantly increasing market access for Australian exporters to a regional free trade area with a GDP worth AUD 13.8 trillion. Australia is working with other CPTPP Parties to ensure the agreement's smooth implementation. The broadening of CPTPP membership through future accessions will further promote regional economic integration. Australia is working with others to sign the Regional Comprehensive Economic Partnership (RCEP) in 2020. After entry into force, RCEP will be a significant addition to the expanding regional economic architecture.

Regional FTAs offer important practical benefits to Australian businesses by having one set of trade rules that apply to multiple markets. For example, this simplifies compliance with rules of origin (which determine eligibility for preferential tariffs) – if a business is able to meet the rule of origin for a specific product, that product will be eligible for the preferential tariff in all parties.

The European Union and United Kingdom

Outside the region, Australia continues to negotiate a comprehensive and ambitious FTA with the European Union. Negotiations were launched in June 2018 and when concluded will improve access to a market of 446 million people. The United Kingdom has signalled interest in establishing closer economic relations with other countries, including Australia, as a result of its decision to leave the European Union. Australia launched bilateral FTA negotiations with the United Kingdom on 17 June 2020.

Changing markets

While change is inevitable, market disruptions, even if foreseeable, have costs. If export opportunities decrease in one market, exporters will seek to divert product to other existing markets (including domestic markets) before seeking out new markets. While existing markets might take more product, it could be at lower prices. Where the exported product was tailored to the preferences of consumers in one market, diverting the product to other markets is more difficult and can require adjustments to production (including packaging), as well as reduced prices.

Seeking to develop a new market (or importing from a new supplier) has additional time and monetary costs. Businesses need to gather information, develop business relationships, tailor product specifications to the market preferences and regulatory requirements, and arrange transport, finance and insurance. Sometimes an additional cost of advertising is needed to build consumer awareness and demand. For almost 10,000 Australian exporters accessing Austrade's Export Market Development Grants (EMDG) scheme over the last 10 years, the average expense in developing new markets for export was almost 15 per cent of the value of annual exports[11]. Once trade is established and volumes grow, the ratio of transaction costs to sales declines

[11] Austrade data. Note the EMDG scheme focuses on small and medium sized enterprises, typically exporting less-fungible goods and services without a global market.

rapidly. It is this fixed cost in establishing new markets that makes businesses reluctant to leave a market if they think that a disruption is temporary.

Our ability to diversify exports geographically depends on our export mix. For example, there are relatively few large markets for Australia's resources and energy exports. The bulk nature of many of these products means that transport costs give Australia a competitive advantage within our region and a disadvantage outside our region relative to producers located closer to Europe or North America.

Our export mix will change over time, as illustrated by the following sectors.

- Services make up over 70 per cent of the Australian economy but only 21 per cent of exports, dominated by tourism and education. The government's Services Export Action Plan seeks to increase and diversify services exports beyond these two dominant sectors. It does so by addressing domestic and international impediments to the competitiveness of sectors such as creative, health, and professional services. A more diverse export profile will expand our markets, as each service sector's comparative advantages will vary across markets. As Australia seeks to expand the export of services, an important element will be digital delivery capabilities.
- Global efforts to reduce emissions also represent a growing export opportunity. The government's Technology Investment Roadmap, released in May 2020, aims to provide a framework for setting stretch goals for priority technologies. To highlight one such technology: Australia's National Hydrogen Strategy, released in November 2019, notes that Australia is well-placed to meet rising global demand for 'clean hydrogen', with the potential for a significant export industry. The location of Indonesia just north of Australia makes it a potential market for renewable power delivered by cables.
- As Australia's Critical Minerals Strategy, released in March 2019, notes, technological change has resulted in an increased demand for such minerals. With significant deposits of some critical minerals, and extensive experience in the extraction and processing of minerals, Australia is well-placed to help meet increasing global demand.

A critical mass of innovative businesses is needed to attract foreign investors into high tech manufacturing and business services industries in Australia. Many of the policy settings to facilitate this critical mass sit outside trade and investment policy.

While our income growth will be driven by developing comparative advantages in delivering services and knowledge-based industries, our resilience will be maintained by continuing to draw on our traditional strengths. Companies in sectors such as health, water management, agritech, cleantech and financial services are expanding into new markets, often building on success in established markets such as China, the United States or the United Kingdom to drive this expansion. But it has been our commodity industries that have delivered record trade surpluses in the first half of this year, despite COVID-19 closing borders to travel, with serious impacts on our service exports (and imports).

The future is inherently uncertain, and recent events have made predictions of business as usual less convincing. Nevertheless, the key principles determining Australia's trade profile are unlikely to change – Australian businesses will export to markets where: we have access; where there is demand for Australian products and services; and where prices and the cost of doing business are commercially attractive. Businesses will weigh the risks and benefits of expanding their export markets and sources of imports – and make their decisions based on commercial considerations. Positive changes come from individual businesses seeing new opportunities and moving out of markets where returns have fallen. Crises that disrupt markets can accelerate change, sometimes with negative consequences but delaying structural adjustment could prolong the economic pain. Policies to ameliorate the social impacts of such change can be important but markets need to adjust if we are to have a more resilient and productive economy.

4. OUR ROLE SUPPORTING AUSTRALIAN TRADE AND INVESTMENT

Australian business already has access to a diverse range of export markets and Australia attracts foreign investment from a range of sources. The government seeks to provide business with diverse options to expand trade and foreign investment opportunities. The Department of Foreign Affairs and Trade does this through the following initiatives.

- Implementing bilateral agreements such as the Indonesia-Australia Comprehensive Economic Partnership Agreement and the Australia-Singapore Digital Economy Agreement to ensure benefits that have been negotiated are realised.
- Negotiation of new free trade agreements, such as those with the European Union and the United Kingdom (see FTA box on page 20), opens up trade and investment opportunities.
- Engagement in the World Trade Organization (WTO) helps to shape global rules that support trade and Australian businesses take advantage of opportunities overseas, including in agriculture, industrial goods, fisheries, services and ecommerce.
    - For example, Australia joined the WTO Agreement on Government Procurement (GPA) in 2019, giving Australian businesses access to the A$2.5 trillion procurement markets of the 47 other GPA members and allowing Australia to influence the opening of markets in major economies seeking to join, such as China and Brazil; we recently launched the Cairns Group's Framework for negotiations to reduce the unfair subsidies which lock Australian farmers out of overseas markets; and we actively participate in negotiations on rules for digital trade to help Australian businesses make the most of the digital economy.
- Participation in WTO plurilateral negotiations on services domestic regulation will increase certainty for Australian services exporters by addressing behind-the-border barriers, increasing transparency and streamlining licensing and qualification procedures.
- Regional engagement in Association of South East Asian Nations (ASEAN) and Asia Pacific Economic Cooperation (APEC) forums encourages greater economic cooperation and trade within the region.
    - In ASEAN, we do this through: working to upgrade AANZFTA to ensure it remains modern, high-quality and relevant, adding greater commercial value for businesses; concluding negotiations for an FTA with RCEP countries; and working towards an early recovery from COVID-19 for the region, including by harnessing potential opportunities, guarding against protectionism, boosting supply chain resilience and maintaining open markets.
    - In APEC, we do this by: boosting support for free and open markets; shaping rules, standards and norms in the region to open further trade opportunities, including by building resilience in supply chains such as through trade and customs facilitation.
- Expanding bilateral economic engagement with India through an initial package of measures in support of the India Economic Strategy. Good progress has been made, including:
    - support for three visits to India by Australian institutional investors, resulting in AustralianSuper's 2019 decision to invest up to USD1 billion in India's National Investment and Infrastructure Fund;
    - a new Consulate General was established in Kolkata in March 2019 to enhance Australia's access to opportunities in India's resource-rich eastern states;
    - the Australia-India Strategic Research Fund, Australia's largest fund for bilateral research, was extended;
    - a second Australian Agriculture Counsellor commenced at our New Delhi High Commission and an Australian expert was seconded to the International Solar Alliance;
    - Tourism Australia and Austrade, funding the Australian Tourism Export Council to develop an 'India ready' training module;

    - conducting an India-Australia International Education and Research Workshop in 2019, to showcase the quality of Australia's education system and identify areas of for collaboration; and
    - a meeting of the Ministerial Champions for the four lead Strategy sectors (tourism, education, agribusiness and resources), as well as the Foreign Minister, in September 2019 discussed progress and forward plans.
- The Non-Tariff Barriers Action Plan which seeks to resolve unjustifiable trade barriers affecting Australian goods and services exporters (see box).
- The Services Export Action Plan is a partnership between government and industry to address barrier to exports of creative, e-commerce, financial, health, METS, and professional services. The Plan aims to grow and diversify the profile and markets of Australia's services exports. It recommends actions by government and industry across three pillars: addressing domestic regulatory complexity; making progress on barriers in overseas markets; and supporting firms as they internationalise. DFAT and Austrade are coordinating across government and with industry to respond to these recommendations.
- Working with Australian professional bodies in negotiating Mutual Recognition Agreements (MRAs) internationally aims to facilitate the mobility of professional services providers through the recognition of qualifications and licensing in key markets.

Tackling Non-Tariff Barriers to Trade

The term 'non-tariff barrier' (NTB) refers to any kind of 'red tape' or rule that unjustifiably restricts the flow of goods and services and is inconsistent with international trade rules.

The government has worked with industry to develop an Action Plan for tackling NTBs hampering Australian exports. The removal or reduction of these barriers helps maintain access to existing markets and creates opportunities to diversify into new markets.

Working with industry remains a key element of the NTB Action Plan, including through a joint government-industry Advisory Group to provide strategic input. Exporters are encouraged to report NTBs they encounter overseas to government via a dedicated NTB Gateway website (tradebarriers.gov.au).

The government is working across agencies to coordinate and track work on more than 300 NTBs in over 70 markets. Since launching the Action Plan, there have been some successes on the back of long-term efforts, including:

- 40 plus agricultural market access outcomes (e.g. better treatment for horticultural exports to India and longer shelf lives for vacuum-packed chilled meats into the Middle East); and
- 15 professional services mutual recognition agreements.

Ultimately, resolution relies on trading partners removing the measures, and progress can be slow, given that NTBs are often applied for political or protectionist goals. Often success in removing an NTB comes following years of industry and government advocacy, including a range of written and in-person bilateral and multilateral representations by government officials and ministers across our global network.

The government also works to help business understand the opportunities and risks of different overseas markets. For example, DFAT and Austrade have delivered over 130 seminars across Australia over the last four years to promote Australian business awareness and use of FTAs.

Austrade works to create opportunities for exporters and attract foreign investment. It does this by opening doors overseas, by sharing knowledge and trusted advice, as well as promoting Australia overseas as a promising place to invest by targeting and attracting investors to specific projects and helping to coordinate investment facilitation activities for federal, state and territory governments, including reinvestment. Austrade assists businesses to achieve their objectives through a variety of initiatives and programs.

- The Export Market Development Grant (EMDG) scheme, which supports Australian businesses to raise their profile and expand into new markets by helping with trade promotion expenses. Over 3,980 exporters were assisted by EMDG grants in 2019-20, and in April 2020 the government announced an extra $49.8 million to assist exporters meet costs of expanding exports.
- Ministerial led business missions, such as the Australia-India Business Exchange in February 2020 that included more than 100 Australian businesses, helping to strengthen economic ties and attract high quality FDI.
- Facilitating sector-specific business delegations to attend international events, promoting Australia to global audiences and encouraging Australian businesses to export their products and solutions, or diversify their international business interests.
- The TradeStart network, delivered in partnership with state and local governments, business chambers and industry groups, supports Australian businesses, especially from regional areas, with advice on securing existing export opportunities and expanding to new markets.
- Workshops for SME exporters to explore new export pathways, consumer segments and markets using digital channels with a strong focus on ASEAN, connect current and potential exporters with global e-commerce experts and platform operators.
- Austrade has introduced a suite of new client-centric services that include expanded digital offerings and tailored advice to assist business find new markets, such as the Trade Information Service.

Austrade has assisted businesses through digital outreach covering a wide range of markets. Webinars covering the Americas, ASEAN, Northeast Asia, Middle East and North Africa, and Europe, have focused on keeping exporters and interested parties updated on market disruptions due to COVID-19, as well as information on new market opportunities. Partnering to deliver these events with business are key activities to promote Australia internationally and encourage Australian businesses to enter exporting or diversify their international business interests.

Tourism Australia focuses on increasing the economic contribution that international visitors deliver to Australia by targeting resources towards the markets that present the best growth prospects. It is active in more than a dozen markets that present the greatest value and potential for growth, including: China, the United Kingdom, the United States, Germany, Hong Kong, Japan, Malaysia, Singapore, Canada, France, Italy, South Korea, India and Indonesia.

Tourism Australia is working to support Australia’s economic recovery, including the reactivation of aviation capacity and determining the most appropriate type of campaign activity in a post-COVID-19 world. This work includes identifying the markets and travel segments that have the greatest pent up demand and are therefore most likely to travel first once international borders re-open. It has launched a Green Light Project to track metrics such as forward bookings, flight searches and consumer sentiment across markets, in order to assess the best time to return to individual markets. Tourism Australia is looking at consumer marketing activities in New Zealand in the coming months, which will play an important role in the COVID-19 tourism recovery strategy.

Export Finance Australia is the Australian Government’s export credit agency. It helps viable Australian exporters and export-related businesses with commercial financial solutions. Export Finance Australia’s loans, bonds and guarantees help exporters expand into new export markets when financing from commercial banks is unavailable. This helps businesses to diversify their trading profile. Export Finance Australia’s COVID-19 Export Capital Facility is also supporting previously profitable exporters with business saving loans to enable them to bounce back after the pandemic.

While not the responsibility of the Foreign Affairs and Trade portfolio, we note that government policies in areas such as investing in skills, education and knowledge, encouraging innovation, research and development, and ensuring a sound business environment, supported by macroeconomic policy, all impact on Australian businesses’ ability to take advantage of trade opportunities. Sound policies in these areas will increase our competitiveness and resilience, and make us a more attractive destination for foreign investment.

The role of FTAs in enabling trade

Australia currently has 14 free trade agreements (FTAs) in force, providing preferential market access to 20 economies. This includes our new FTA with Indonesia, which entered into force in July.

FTAs are a central part of Australia's trade policy because they provide many benefits, including:

- greater access to overseas markets through lower or zero tariffs;
- increased access to overseas services and investment markets;
- an avenue to address behind-the-border trade barriers in other economies affecting Australian goods and services exporters;
- improving certainty and transparency for business to conduct trade in overseas markets on issues such as intellectual property, e-commerce and government procurement;
- reducing the transaction costs for Australian exporters;
- enhancing people to people links;
- strengthening broader bilateral/regional relationships; and
- promoting regional economic integration

The government's active free trade agreement agenda will result in greater trade diversification in the future. Australia is currently in FTA negotiations with the European Union, the Pacific Alliance (Chile, Colombia, Mexico and Peru), Regional Comprehensive Economic Partnership countries, and the United Kingdom. In additionthe Australian and Indian Prime Ministers have agreed to re-engage on FTA negotiations. Should all these negotiations result in FTAs coming into force, along with the PACER Plus FTA (with certain Pacific Island countries and New Zealand, which is signed but not yet in force), Australia's FTAs will cover a further 39 economies, bringing the proportion of Australia's two-way trade (goods and services) with FTA partners to around 87 per cent (based on 2019 trade). This compares to 70 per cent of trade in 2019 with current FTA partners and 27 per cent of trade in 2013 with FTA partners at that time.

The government actively promotes Australian business awareness and use of our free trade agreements. This includes maintenance of DFAT's FTA Portal, which is a free and easy-to-use website providing information on the goods and services export opportunities under our free trade agreements, and a series of FTA seminars and webinars reaching out to businesses to promote FTAs.

Investment and FTAs

FTAs agreed by successive governments over nearly two decades include provisions aiming to:

- attract beneficial investment by showcasing Australia as an open and attractive investment destination;
- preserve the operation of Australia's foreign investment framework, which allows screening of investment; and
- facilitate greater access to overseas markets for Australian investors.

The 2005 Australia-US FTA is an example of Australia's approach and includes strong investor protections to attract additional investment from the United States. It also promotes productive foreign investment in Australia by liberalising the threshold for screening of foreign investment proposals in non-sensitive sectors. It balanced this by including safeguards that protect the operation of our foreign investment framework, such as ensuring the government can examine significant sensitive foreign investment proposals at a lower threshold. This feature has been replicated in subsequent FTAs struck since then.

5. CONCLUSION

Australia's trade and investment profile is a result of business exploiting our comparative and competitive advantages. These are driven as much by Australia's knowledge base and skilled labour as its resource endowments. Trade and foreign investment have resulted in a higher standard of living for Australians. The government is contributing to maximising the benefits by reducing barriers to trade and investment and providing information to Australian business to assist it to make sound decisions.

6. ANNEX 1: TERMS OF REFERENCE FOR THE INQUIRY

Pursuant to the Committee's resolution of appointment, the Joint Standing Committee on Trade and Investment Growth resolved to inquire into the 2018-19 annual reports of the Department of Foreign Affairs and Trade (DFAT) and the Australian Trade and Investment Commission (Austrade). DFAT's and Austrade's annual reports stand referred to the Committee under the Schedule presented by the Speaker. The focus of the Committee's inquiry will be to understand whether there is a need for Australia to diversify its trade markets and foreign investment profile including;

- Consider if Australia is too reliant on any one market for exports. If so, what factors are contributing to this dominance;
- The advantages and disadvantages, including in relation to the national interest and national economic risk, to an over reliance on any one market;
- Consider if Australia is too reliant on foreign investment. If so, what factors are contributing to this dominance;
- The advantages and disadvantages, including in relation to the national interest and national economic risk, to an over reliance on foreign investment, especially foreign investment by state-owned enterprises;
- The impact of global crises including trade disputes and political disputes on Australia's relationship with countries we are reliant upon for trade and investment purposes;
- The impact of bilateral trade agreements on Australia's exports and whether they contribute to concentrated export markets;
- The impact of bilateral trade agreements on Australia's domestic market and whether they contribute to an over reliance on foreign investment;
- Analysis of industry and government preparations to diversify its trading partners and secure new markets for Australia's exports, including through further free trade agreements; and
- Analysis of industry and government preparations to ensure the Australian economy is not overly reliant on foreign investment.