



Customs Legislation Amendment (New Zealand Rules of Origin) Bill 2006

Bronwen Jagers
Law and Bills Digest Section

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Customs Legislation Amendment (New Zealand Rules of Origin) Bill 2006

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House: House of Representatives

Portfolio: Justice and Customs

Commencement: 1 January 2007

Purpose

To amend the *Customs Act 1901* to introduce new rules of origin for goods that are imported into Australia from New Zealand, to give effect to amendments to the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). The amendments will allow goods that satisfy the rules of origin to enter Australia at preferential rates of customs duty.

The Bill also contains complementary amendments to the *Customs Tariff Act 1995* and consequential amendments to the *Customs Tariff (Anti-Dumping) Act 1975* and the *Legislative Instruments Act 2003*.

Background

Basis of policy commitment

ANZCERTA came into effect in 1983 and is now the main instrument governing economic relations between Australia and New Zealand. The objectives of ANZCERTA are to:

- strengthen the broader relationship between the two countries,
- develop closer economic relations through a mutually beneficial expansion of free trade between New Zealand and Australia,
- eliminate barriers to trade between the countries in a gradual and progressive manner under an agreed timetable and with minimum disruption, and
- develop trade between the countries under conditions of fair competition.¹

The Agreement's main method for achieving these goals, at least initially, was through the elimination of tariffs on trade between Australia and New Zealand.

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Under ANZCERTA as it currently stands, access to the preferential tariff rate is only available to goods that are produced entirely from materials sourced in New Zealand or in New Zealand and Australia, or those that have been ‘substantially transformed’ in either or both countries.

The ‘preferential tariff rate’ allows goods to be traded between the two countries at a tariff rate that is lower than that set by the World Trade Organisation.

‘Substantial transformation’ of goods is defined in the ANZCERTA’s Rules of Origin (ROO), and can be summarised as follows:

- the last process in the manufacture of the good must take place in Australia or New Zealand (the last place of manufacture test); and
- at least 50 per cent of the cost of producing the good is incurred in Australia or New Zealand (the ex-factory test).

Since 1990, all goods that meet the ANZCERTA ROO can be traded tariff-free between Australia and New Zealand.

Growing problems with ANZCERTA ROO

Since ANZCERTA was implemented 23 years ago there have been substantial changes to the range and types of products manufactured in each country. Some businesses have claimed that ANZCERTA ROO has acted a barrier to growth and trade – for example, a garment manufacturer outsourced the final stage of the process, adding zippers, labels etc. to an overseas country. This meant that the garment failed the ANZCERTA ROO test (as the last process in manufacture was outside Australia or New Zealand), despite the cost of manufacture incurring in Australia or New Zealand being at least 50 per cent.

Productivity Commission report

In response to the concerns raised above, in 2003 the Australian Government announced that the Productivity Commission (PC) would conduct a study into the economic and administrative problems associated with ANZCERTA ROO. In its final report, released on 11 June 2004, the PC concluded that the ANZCERTA ROO were outdated and acted as a constraint on further trade.

The PC also concluded that trade concessions available under ANZCERTA had declined in value as tariffs had been reduced, and the relevance of origin rules had consequently diminished.

The PC recommended that the basic framework of the ANZCERTA ROO should remain unchanged, but that the ANZCERTA ROO should be liberalised via applying a waiver to provide duty free entry for goods manufactured in Australia or New Zealand which face trans-Tasman tariff differences of 5 percentage points or less, and the implementation of a number of minor amendments to improve operational efficiency.²

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Australian industry generally opposed the recommendations of the PC report, although there was agreement that the ANZCERTA ROO needed review. Australian and New Zealand officials decided to pursue a different methodology to achieve this.

Change of Tariff Classification

As an alternative to the change in ROO, Australian and New Zealand officials considered a Change of Tariff Classification (CTC) approach, which would require imports to undergo a specified 'change in tariff classification'. A good is taken to have undergone 'substantial transformation' if it is classified to a different tariff classification than that of its component materials after production. The CTC uses the World Customs Organisation's (WCO's) Harmonised System of Tariff Codes - the HS Code. The HS Code provides a unique six-digit code for each agricultural good, commodity or manufactured product. Individual countries are free to split and classify sub-groups of products beyond this level for their own trade and statistical purposes, but all WCO members apply the same six-digit classifications uniformly.³

The Explanatory Memorandum explains:

The concept of change in tariff classification only applies to non-originating materials. Goods that have been sourced from outside New Zealand or Australia and that are used in the production of other goods are non-originating materials.

...All non-originating materials used to produce other goods may not have the same classification under the Harmonised System as the final good into which they are produced. This means that the goods must be classified under one tariff classification before the production process, and under a different tariff classification after the production process. This approach ensures that sufficient transformation of materials has occurred within New Zealand, or New Zealand and Australia, to justify the claim that the goods originate in New Zealand.⁴

This allows Australian and New Zealand companies to source inputs from overseas, and, provided the manufacture or processing meets the CTC criteria set out in the Regulations, the final product may be considered to be Australian or New Zealand in origin, thus qualifying for tariff-free import. The Regional Impact Statement states that the advantages of a CTC-ROO approach are that it:

- is objective – there is a single, clear rule for each tariff line, providing certainty as to what constitutes 'substantial transformation', regardless of the method used to produce the transformation
- dispenses with the regional value content threshold for the vast majority of products
- improves efficiency by allowing greater use of inputs not produced in Australia or New Zealand without an adverse impact on the ability to claim origin

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- is consistent with Australia's more recent free trade agreements
- does not apply ROO on a "one-size fits-all" approach and
- reduces compliance and administrative costs, removing issues relating to exchange rates, fluctuating world commodity prices or the need to enter into debates over allowable and non-allowable costs, etc.⁵

The CTC method is used in Australia's free trade agreements with the United States (AUSFTA) and Thailand (TAFTA). A secondary requirement, such as a Regional Value Content (RVC) threshold being met, may be included where substantial transformation may not result in a change of tariff classification or where it is agreed that a change of tariff classification is insufficient to confer origin.⁶

DFAT officials considered the CTC approach to be 'simpler, cheaper and more friendly to business'.⁷

In December 2004 Australian and New Zealand Trade, Agriculture and Industry Ministers announced that agreement had been reached on adopting a CTC approach to ANZCERTA ROO, subject to final agreement on sensitive sectors. Ministers also committed to negotiate a CTC model that would be no-less liberal than the current arrangements and that would liberalise all tariff lines over time.

Following a year of industry consultation and negotiations amongst officials, in November 2005 Australian Ministers agreed on a CTC-based schedule that included secondary regional value content (RVC) requirements on a limited number of tariff lines, including:

- an RVC of 40 per cent on a build-down basis for vehicles and vehicle parts; and
- an RVC of 50 per cent (reducing to 45 per cent from 2010) for men's suits and structured apparel (e.g. trousers, blazers and overcoats).

Ministers also agreed to a grandfathering clause which would allow exporters to claim origin under the pre-existing ex-factory/principle place of manufacture approach for a five year period following the adoption of the CTC approach if, for some reason, they were no longer able to claim origin under the CTC ROO, and that a review of the revised ROO be completed within three years after adoption of the CTC approach.⁸

On 3 February 2006 the Australian and New Zealand Ministers for Trade and Ministers for Industry announced their Governments' agreement to amend Article 3 of the ANZCERTA, to give effect to their agreement on the CTC package.⁹

Treaties Committee report

The *Exchange of Letters constituting an Agreement between the Government of Australia and the Government of New Zealand to Amend Article 3 of the Australia New Zealand Closer Economic Relations Trade Agreement* was tabled in Parliament on 28 March 2006. The proposed treaty action was then reviewed by the Joint Standing Committee on Treaties (JSCOT), with a report tabled in Parliament on 19 October 2006.

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The Committee received evidence from an Australian chemical company, Albright and Wilson (Australia), opposing the amending agreement. Albright and Wilson (A&W) produces a key component of washing detergents, sodium tripolyphosphate (STPP). A&W exports \$7 million worth of STPP to a New Zealand detergent manufacturer (Unilever Australasia), who then exports the finished detergents packed for retail sale back to Australia.¹⁰

A&W claimed that if the ROO is changed to use the CTC calculation, it is likely that Unilever Australasia would use STPP from other sources at a cheaper price, such as China, and the finished detergents would still qualify for duty free entry into Australia. Exports of STCC to New Zealand account for some 20 per cent of A&W's Yarraville factory operation. Without these sales, the Yarraville factory may be forced to close, with the potential loss of some 65 jobs.¹¹

In evidence to the Treaties Committee, A&W stated that in July 2006 Unilever Australasia had given them six months' notice that it would terminate its contract for STPP, as a result of the change to ROO requirements.¹²

A&W requested that the current RVC method for determining ROO be retained for the particular tariff line pertaining to its detergent products (tariff line 3402.20).

The Committee also received evidence from Unilever Australasia, supporting the proposed changes. Unilever Australasia argued that its detergent arm had been operating under a financial disadvantage in comparison to its major competitor (Colgate), because of the RVC method for determining ROO under the current ANZCERTA.¹³

The Committee was concerned that A&W did not become aware of the proposed treaty changes until after the negotiations were concluded. DFAT outlined its consultation processes, including newspaper advertisements, talks with industry associations, and notification on departmental websites. However, the Committee recommended that for future treaty negotiations, Austrade should make greater use of its database of businesses to consult at a business level, as was done for negotiations of the US Free Trade Agreement.¹⁴

The Committee asked the Minister for Trade if it were possible to negotiate an exemption for A&W's tariff item 3402.20, as had been done for the automotive industry and mens' apparel. The Minister replied that the matter had been discussed at the CER Ministerial Forum on 20 September 2006. New Zealand Trade Minister Mr Goff advised Minister Truss in writing that New Zealand would not renegotiate the CTC ROO for the A&W tariff line. The New Zealand minister indicated:

...the negotiations on the new ANZCERTA ROO had been long, complicated and at times sensitive, and had included wide consultations with industry. New Zealand was not fully satisfied with every aspect of the final agreement, but accepted it as a package because the CTC ROO conferred significant benefits on both economies. He

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noted that one of the key reasons for adopting a CTC-based ROO was to allow manufacturers of finished export products more flexibility to source inputs globally, thus making them more internationally competitive.

...the request had implications which went beyond the case of the particular company. Any delay [to the implementation date] would...have a detrimental impact on firms which had made business decisions, such as investment and purchasing, on the basis of the proposed new ROO.¹⁵

The Committee recommended that binding treaty action be taken. However, there was a Dissenting Report from the ALP members of the Committee (Kim Wilkie MP, Deputy Chair, Dick Adams MP, Bernie Ripoll MP, Senator Carol Brown, Senator Glenn Sterle and Senator Dana Wortley).

While the ALP members supported binding treaty action, they also recommended:

that negotiations between Australia and New Zealand commence immediately to secure agreement on retention of the RVC method of calculating ROO under the current ANZCERTA for tariff line 3402.20 before the Amending Agreement comes into force [1 January 2007].¹⁶

Position of significant interest groups/press commentary

DFAT consulted a number of industry groups during the negotiation phase of the treaty. The JSCOT heard evidence from the Australian Food and Grocery Council supporting the proposed changes:

Global companies that have operations in Australia and the surrounding region have increased capacity to source and distribute products through world-wide networks and alliances. This development has been driven by the significant price squeeze pressures that are placed on our industry. Organisations must be able to take advantage of lowest cost supply and distribution chains to ensure they remain globally competitive.¹⁷

Pros and cons

Industry lobbyists have highlighted a number of ways in which the proposed changes to ANZCERTA ROO are likely to result in increased trade opportunities for some Australian industries. The amendments will allow some industries the opportunity to source inputs from countries other than Australia and New Zealand, and still qualify for tariff-free status for exports to New Zealand. The amendments also provide a simpler system for determining ANZCERTA ROO.

However, some companies may find it difficult to compete. The EM states that 'Any increased trade resulting from the implementation of this proposal is likely to have some competitive impact on the domestic industry of the importing party. For example, the

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Australian clothing industry is likely to see some additional competition from New Zealand clothing imports.¹⁸

ALP position

As noted above, the ALP members of the JSCOT made a dissenting report in the Committee's report on this treaty. While supporting binding treaty action, the ALP members recommended that negotiations commence immediately to secure a variation in the Agreement for tariff line 3402.20 (relating to the Albright & Wilson case), before the Amending Agreement comes into force (1 January 2007).

The matter was also raised in the House by Nicola Roxon MP, whose electorate of Gellibrand includes the Yarraville factory of Albright & Wilson.¹⁹

There has been no comment to date from other parties or independents.

Financial implications

The Explanatory Memorandum states that the cost of the arrangements is expected to be negligible.

Main provisions

Part 1 amends the *Customs Act 1901* (the Customs Act) by inserting new **Division 1E** into Part VIII of the Act. Division 1E defines the rules for determining whether goods are New Zealand originating goods, and therefore eligible for preferential customs rate under the *Customs Tariff Act 1995* (the Customs Tariff Act).

This is the key section which gives effect to the changes to Article 3 in ANZCERTA, as agreed by the two countries in February 2006.

Under the Customs Tariff Act at present, goods are given preferential tariff rates if they are deemed to be "the produce or manufacture of New Zealand". This phrase is to be replaced by the phrase "New Zealand originating goods". New Division 1E of the Customs Act will define what will qualify as "New Zealand originating goods".

Subdivisions B and C of Division 1E outline the rules in relation to goods that are wholly obtained in New Zealand or New Zealand and Australia. Subdivision B covers goods that are wholly obtained in New Zealand, – eg, minerals, plants, live animals or animal products, fish, or goods produced entirely from this category, such as pork sausages made from New Zealand originating pork and New Zealand grown herbs and spices, etc.

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Subdivision C covers goods produced entirely from originating materials from New Zealand or New Zealand and Australia.

Subdivision D concerns goods produced in New Zealand or in New Zealand and Australia using non-originating materials. This is where the CTC classification is relevant.

New Section 153ZIE of the Customs Act will allow goods to be classified as New Zealand originating goods, and therefore have a zero tariff rating, if:

- They are classified under a heading or subheading of the Harmonized System specified in the *Customs (New Zealand Rules of Origin) Regulations 2006* (yet to be tabled); and
- They are produced entirely in New Zealand, or in New Zealand and Australia, from non-originating materials or from non-originating materials and originating materials; and
- Each requirement that is specified in the regulations to apply in relation to the goods is satisfied.

These new rules allow New Zealand manufacturers to use inputs from countries other than New Zealand and Australia, and providing they meet specifications set out in the Regulations, the end product may be classified as “New Zealand originating goods”, thereby attracting a preferential rate of customs duty.

The Regulations may specify that each non-originating material used or consumed in the production of the goods is required to satisfy a specified CTC, and they may state when that non-originating material is taken to satisfy the CTC.

If one component of a product does not pass the CTC test as set out in the Regulations, then the product may still be taken to be produced in New Zealand if the value of that particular component does not exceed 10 per cent of the customs value of the goods.

Section 153ZIE (5) also provides for a Regional Value Content (RVC) to be specified within the regulations for certain goods. As outlined above, the Australia and New Zealand governments agreed that a RVC would be specified for vehicles and vehicle parts (40 per cent on a build-down basis); and for mens’ suits and apparel (50 per cent, reducing to 45 per cent from 2010).

Section 153ZIF excludes packaging materials from the CTC requirements, except if the goods are required to have a RVC, then the packaging materials must be taken into account as originating or non-originating materials, when working out the RVC of the goods.

Subdivision E allows goods that are standard accessories, spare parts or tools, to be considered New Zealand originating goods if they are genuine accessories, parts etc – ie they are standard accessories for such goods, they are imported into Australia with the other goods, are not invoiced separately, and are not imported solely for the purpose of

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artificially raising the RVC of the other goods. For example, if a pair of mens' trousers was made of 40 per cent New Zealand produced wool, it would not qualify for preferential tariff rate, under the RVC negotiated as part of the treaty. New Subdivision E prohibits the manufacturer from attempting to get to the 50 per cent requirement by adding on a New Zealand-made belt, which it would then buy back from the importer.²⁰

Subdivision F allows New Zealand manufactured goods to be considered New Zealand originating goods if they are made from unmanufactured raw products; materials wholly made in Australia or New Zealand or both countries. The Customs CEO may also determine that some materials imported into New Zealand are manufactured raw materials of New Zealand. This subdivision is re-stating the current rules in relation to manufacturing.

Subdivision G allows goods that have the last process of their manufacture in New Zealand to be considered New Zealand originating goods, provided the expenditure on that last process is at least 50 per cent of the factory cost of the goods. The CEO of Customs may lower this expenditure amount to 48 per cent in 'unforeseen circumstances'.

Subdivision H states that goods are not New Zealand originating goods if they are transported through a country or place other than New Zealand or Australia; and they undergo subsequent production or any other operation in that country or place (excluding unloading, storing, repacking etc that is necessary to keep them in good condition or to transport them to Australia).

Part 2 inserts **new Division 4D** of Part VI into the Customs Act, which outlines administrative matters associated with exportation of goods to New Zealand, such as record-keeping obligations, and the power of government officials to verify the origin of goods for export to New Zealand.

Part 3 of the Bill repeals sections of the Customs Act relating to the current rules of origin, which are being replaced by the Bill's new Division 1E. Other amendments are made to the Customs Tariff Act, the *Customs Tariff (Anti-Dumping) Act 1975*, and the *Legislative Instruments Act 2003*.

Part 4 of the Bill outlines application and transitional provisions.

Concluding Comments

As highlighted by industry groups, the proposed changes to ANZCERTA ROO are likely to result in increased trade opportunities for some Australian industries, the opportunity to source inputs from countries other than Australia and New Zealand and still qualify for tariff-free status for exports to New Zealand, and a simpler system for determining ANZCERTA ROO.

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Endnotes

1. Regional Impact Statement, Australia-New Zealand Closer Economic Relations Trade Agreement: Changes to Article 3 (Rules of Origins Provisions), available at: http://www.aph.gov.au/house/committee/jsct/28march2006/treaties/anzcerta_ris.pdf, accessed 15 November 2006.
2. Productivity Commission Research Report: *Rules of Origin under the Australia New-Zealand Closer Economic Relations Trade Agreement: Key Points*, June 2004, available at: <http://www.pc.gov.au/study/roo/finalreport/keypoints.html>, accessed 14 November 2006.
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4. Explanatory Memorandum, Customs Legislation Amendment (New Zealand Rules of Origin) Bill 2006, p. 25.
5. Regional Impact Statement, op. cit, p. 36.
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7. Peter Hooton, Department of Foreign Affairs and Trade: Evidence to the Joint Standing Committee on Treaties, *Transcript of Evidence*, 8 May 2006, p. 33.
8. Regional Impact Statement, op. cit, pp. 29-30.
9. Hon. Mark Vaile, MP, Minister for Trade, and Hon. Ian Macfarlane, MP, Minister for Industry, Tourism and Resources: *Joint Media Release: 'Government Slashes the Red Tape on Exports to New Zealand'*, 3 February 2006.
10. Albright & Wilson (Australasia) Limited, *submission to Joint Standing Committee on Treaties*, 17 July 2006, available at: <http://www.aph.gov.au/house/committee/jsct/28march2006/subs/sub6.pdf>, accessed 20 November 2006.
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13. Joint Standing Committee on Treaties, *Report 80: Treaties Tabled 28 March (4) and 5 September (2) 2006*, Parliament of Australia, 19 October 2006, p. 15.
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16. Joint Standing Committee on Treaties, *Report 80: Treaties Tabled 28 March (4) and 5 September (2) 2006*, op. cit., p. 30.
17. Australian Food and Grocery Council, *Submission to the Joint Standing Committee on Treaties*, 13 September 2006.
18. Explanatory Memorandum, p. 15.
19. Nicola Roxon, 'Adjournment Debate', House of Representatives, *Debates*, 14 August 2006, p. 89.
20. Explanatory Memorandum, p. 27.

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