Te Mana Arai o Aotearoa

12 October 2003

Mr John Williams
Productivity Commission
PO Box 80, Belconnen
ACT
Australia

Dear John,

Thank you for copying to me the submission you received from Cue Design Pty Ltd concerning the ANZCERTA rules of origin study.

My response to the various matters raised by Cue are attached to this letter.

Yours sincerely

Mark Pigou
Manager, International Trade

COMMENT BY: **NEW ZEALAND CUSTOMS SERVICE**

ON: **SUBMISSION MADE BY CUE DESIGN PTY LTD TO THE [AUSTRALIAN] PRODUCTIVITY COMMISSION REGARDING RULES OF ORIGIN UNDER THE AUSTRALIA-NEW ZEALAND CLOSER ECONOMIC RELATIONS TRADE AGREEMENT**

DATE: **12 OCTOBER 2003**

Relevant Issues

It is acknowledged that there is some inconsistency as between the Customs Services of Australia and New Zealand in their administration of the CER rules of origin (RoO). While, unfortunately, inconsistencies do arise from time to time, both Customs administrations do their best to minimise and resolve them. In this vein the respective Trade Ministers, on the occasion of this years CER 20th Anniversary, agreed to the establishment of a Joint Customs Committee to ensure a harmonised approach to the manner in which the rules were administered.

It is further acknowledged that the nature of the rules (ad valorem) places an onerous burden upon manufacturers to evidence origin - particularly those such as Cue that may have more than 500 different lines (styles) of production in any one year. Equally, to ensure trade in goods partly manufactured within the CER area remains discrete to the CER partners there is a considerable burden placed upon the Customs Services of Australia and New Zealand in auditing imports claiming ANZCERTA preference.

In this connection the rules are complex and provide no ongoing guarantee that a good will continue to achieve CER preference. The rules encourage uneconomic sourcing of manufacturing inputs, limit genuine Australian and New Zealand content from inclusion within qualifying content and are often subject to fraudulent activity such as sham "back to back" arrangements between manufacturers and contractors to those manufacturers.

Definition of manufacture

The CER Agreement does not define "manufacture". Nor does the [Australian] Customs Act 1901 or the [New Zealand] Customs & Excise Regulations 1996 define this term. Judicial determinations on both sides of the Tasman have provided to each Customs administration a common understanding of the term "manufacture". As agreed between the Customs administrations this informal definition has been incorporated in a joint publication issued on the ANZCERTA RoO.[1]

On the other hand, the term "manufacturer" is essentially commonly defined both in Australian legislation and New Zealand regulations:

---

[1] **"Manufacture involves making one thing out of another, the new being essentially different in character, identity, form , function, description and commercial understanding from the other.**
Manufacture must involve a significant change in the form or function of the thing said to be manufactured, compared with its unmanufactured or previously manufactured state.
Essence of making or of manufacture is that what is made shall be a different thing from that out of which it is made. Only where change has occurred as noted above can manufacture said to have taken place.

S 153B (CA1901) – manufacturer, in relation to preference claim goods, means the person undertaking the last process in their manufacture.

Reg 32 (C&E Regulations 1996) - "Manufacturer", in relation to any goods, means the person who operates the factory or works where the last process in the manufacture of the goods is performed.

Both the trans-Tasman Customs administrations identify the "manufacturer" as the maker and, with certain exceptions, such as goods supplied free of charge, both administrations, in determining the factory or works cost (of manufacture), only identify those costs actually and factually incurred by the "maker". It follows that those costs not actually incurred by the manufacturer are not included in the factory or works cost of a good. This interpretation is congruent with Article 3.2 of the CER Agreement.

We agree that, save for materials supplied free of charge (see later comment) non-material inputs [to the manufacturing process] the cost of which is incurred by some person other than the manufacturer (as defined) are excluded from the factory or works cost (fwc) and, ipso facto, from contributing towards qualifying content.

Essentially this scenario has not significantly altered for many years; indeed it existed under the NAFTA Agreement which preceded the CER Agreement.

What was meant by the term "manufacture" was not canvassed at the time of the 1992 CER Ministerial Review but, the changes that did occur at that time witnessed a divergence as between Australian and New Zealand RoO legislation / regulations; a divergence that provided the impetus to the current review and, for this reason, is worth considering.

The 1992 CER Ministerial Review

The 1992 CER Review brought a number of changes to the CER RoO but it was only in respect to materials supplied free of charge (FOC) where an inadvertent divergence occurred in the understanding of each Party of what was intended.

The exchange of letters and attachments thereto between the respective Ministers during late 1992 was the means to confirm a joint understanding (JU) as to, inter alia, how goods supplied FOC would be treated.

The genesis to the CER discussions on this subject revolved around growth in Fijian production of apparel for export to Australia and New Zealand pursuant to the SPARTECA (Agreement) to which both Australia and New Zealand are party. Under that scenario, Australian or New Zealand entities supplied FOC materials to Fijian manufacturers who, thereafter, exported the Fijian made apparel back to the CER partners. At that time, there was a practice by some entities who supplied the materials to either inflate the cost of those materials (where they were made in either Australia or New Zealand), or reduce the cost where they were otherwise sourced – this to ensure the garments qualified for entry to Australia or New Zealand under Forum Island (SPARTECA) preference.

Inter alia, the JU stated:

> "Where any material has been supplied free of charge, or at a reduced cost, the expenditure on that material will be determined in accordance with sub-

paragraph 1(b) of Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade."

For Australia, this understanding was enacted by section 153E(6)(b), Customs Act 1901, which limits valuing such materials only to circumstances where they have been supplied free of charge or at a reduced cost by a person who will be the importer of preference claim goods in which those materials are incorporated.

In consequence, materials that are supplied by a person FOC to a manufacturer (such as a cut make and trim (CMT) contractor) can only be valued where that person (who originally supplied the materials) is also the importer of the finished goods. In all other instances the materials cannot be valued and must thus be excluded from the FWC
On the other hand, New Zealand's regulation 38 provides for the valuation of FOC materials whether or not the eventual importer of the goods constructed from those materials supplied the materials or did not supply the materials.

Fabric and Accessory Sourcing

Review of manufacturers supply chains would seem to confirm Cue's comment.

Exchange Rate

Cue's comments are relevant and confirmed.

Effect on Business and Trade

Refer earlier comment. The nature of the CER RoO places significant cost burdens on importers and manufacturers to evidence compliance. Factors such as choppy FX movements force manufacturers, particularly those that marginally achieve the 50% thresh-hold, to constantly revise manufacturing costs. There are, for example, recorded instances where a size 10 garment will qualify but a size 12 >16 will not. Indeed, for small to medium enterprises (SME's) anecdotal evidence suggests the administrative burden is a disincentive to dipping their toes into trans-Tasman manufacturing or simply declaring their goods to be Australian - Non Qualifying. Equally, the RoO also impose a significant burden on the Customs administrations to ensure compliance - that foreign goods are not unlawfully introduced, that domestic manufacturers receive the protection afforded by the respective tariffs and that accurate statistics are gathered.

Cue's Position

Both Australian and New Zealand Trade Ministers agree there needs to be changes to legislation dealing with the treatment of outsourced or contracted manufacture and in this respect officials are currently contemplating rules that should pick up Cue's concerns regarding the exclusion of genuine local content from qualifying content.

.

The manner in which the New Zealand Customs Service administers the CER RoO is not primarily related to collection of revenue. In fact, the quantum of revenue gained as a result of enforcing the rules is very insignificant in relation to total government taxation streams. In enforcing the rules the prime outcome sought is to give effect to the intent of the Agreement by ensuring that preferential trade between Australia

and New Zealand remains discrete and that manufacturers receive the assistance and protection the tariff affords them.

Interpretation of Legislation

The manufacturer is defined, in both Australian and New Zealand legislation, as the person who operates the factory or works where the last process in the manufacture of goods is performed.[2]

All RoO related to manufactured goods revolve around the concept of substantial transformation and in the case of the CER RoO the Customs administrations have jointly agreed that the last process of manufacture "is the last activity undertaken in respect to an article that finally transforms it into an article different from its component parts or materials and a new article is therefore manufactured.[3]

In those instances where Cue actually cuts panels from which garments are sewn the New Zealand Customs Service would, under current regulations, regard this process as a process of manufacture -–as would the cost of the designs that led to the manufacture of patterns to which the panels were cut.

Where designs and other similar overhead costs (as defined) are supplied FOC to the manufacturer they cannot be included within the FWC. Both Australian and New Zealand legislation / regulations are congruent on this exclusion.

The NZCS includes the cost of all materials in the FWC – whether or not supplied FOC – see previous comment.

[2] See S 153B Customs Act 1901 and r 32 Customs and Excise Regulations 1996.
[3] See Fact Sheet No 20 jointly issued by the Aul/NZ Customs Services – Para 6.