Rules of Origin under the Australia–New Zealand Closer Economic Relations Trade Agreement

Australian Industry Group submission to the Productivity Commission

10 October 2003

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SUMMARY

The Productivity Commission has been asked to undertake a study of Australia's rules of origin (ROO) arrangements under the Australia–New Zealand Closer Economic Relations Trade Agreement (CER).

This highly successful bilateral agreement has seen the Australia - New Zealand trade and economic relationship, strengthen and deepen over the 20 years since its inception. Two-way trade has expanded some 500 per cent, and over the last 10 years trans-Tasman trade has increased by around 9 percent annually, whereas Australia's trade with the rest of the world only increased by around 8 percent.

The overwhelming majority of Australian manufacturing companies believe that CER promotes a healthy business and trade relationship between Australia and New Zealand. Furthermore, the current ROO test not only supports this outcome, but is indeed seen by Australian industry as a fair test of origin.

It is important to note that Australian industry is not actively seeking any changes to the current ROO test applied under the CER. In general, industry does not experience any difficulties meeting the 50% threshold test, and indeed, there is very little sentiment that the threshold should be reduced.

RECOMMENDATION ONE: the ROO regional content threshold should not be diminished.

Whilst industry is not currently seeking a change to the current ROO methodology, it is conceivable that this might change. With the growing complexities facing traders who must potentially become familiar with different ROO regimes under the various agreements negotiated, or being negotiated by the Federal Government, industry may indeed seek to change the ROO methodology to produce some level of harmonization between the various agreements. Looking toward this eventuality, and recognising that our New Zealand counterparts are seeking some change to the ROO methodology, we suggest that a modified version of the product-specific ROO methodology employed in the US-Singapore Free Trade Agreement (FTA) - specifically Annex 3A of that agreement - be adopted.

RECOMMENDATION TWO: that if the current ROO methodology is to be changed, that it be replaced with a modified version of Annex 3A of the US-Singapore FTA, determined in consultations with industry

BACKGROUND

The Productivity Commission Study

The Australian Government has asked the Productivity Commission to undertake a study of Australia's rules of origin arrangements under the Australia–New Zealand Closer Economic Relations Trade Agreement (CER). The request apparently stems from concerns that Australian and New Zealand companies are having difficulty achieving the minimum content threshold set down under the CER.

In undertaking the study, the commission is to:

a) Identify any economic and administrative problems with the operation and design of the rules of origin.

b) Propose any changes, including design or model changes, to ensure the rules of origin continue to promote the goals of the CER.

c) Assess the costs and benefits, including the regulatory burden, of any proposed changes.

d) Consider relevant international developments.

The CER Agreement

The CER Agreement entered into force in 1983, building on earlier preferential trade agreements between Australia and New Zealand. It has been widely hailed as a model agreement, and indeed a WTO review noted CER was 'recognised as the world's most comprehensive, effective and multilaterally compatible free-trade agreement.'

The objectives of CER are to:

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

Certainly, the results of CER to date have been impressive - total trade in goods has increased by more the 563% since 1983 to AUS$11.3 billion in 1999. Two-way investment between Australia and New Zealand has also increased from $1.5 billion in 1983 to $25 billion in 1998 - a rate of increase almost twice that for investment with the rest of the world.

To elaborate on these very impressive trade results, it is worth noting that over the past 10 years trans-Tasman trade has increased annually by 9% on average, exceeding the average 8.5% annual growth recorded for Australia's international trade and well above the 6.3% annual growth in New Zealand's international trade.

New Zealand is Australia's 5th largest export destination, with A$7,920 million exports in 2002, or 6.6% of merchandise exports. (Imports from NZ represented A$4,874 million in 2002.)

Rules of Origin (ROO)

It is of principal concern that any trade agreement ensures that the Rules of Origin (which determine whether a product qualifies for preferential tariff entry into Australia) do not result in a substantial increase in imports which are largely made outside the zone of the agreement.

In conjunction with protecting these defensive interests, the ROO should also provide fair market access for Australian exports to New Zealand (in this case) at preferential tariff rates.

Without rules of origin, trade agreements could become a de facto unilateral liberalisation, whereby products or components from third country markets could enter Australia via New Zealand. The question is the definition of "origin".

The Rule of Origin currently applied under CER is often referred to as the "50% ex-factory rule", and can be summarised as follows.

The CER Agreement divides goods into three categories:

1) Goods wholly the product of Australia or NZ (un-manufactured raw products);
2) Goods wholly manufactured in either country from one or more of the following:
    - Un-manufactured raw products
    - materials wholly manufactured in either or both countries
    - materials determined to be raw materials of either or both countries; and
3) goods partly manufactured in the country.

Goods in category 1 and 2 receive preferential rates of duty. Goods in category 3 only receive preferential duty when:

- The last process of manufacture was performed in either country; and
- At least 50% of the factory cost must represent qualifying expenditure.

The last of these is the 50% rule.

KEY RECOMMENDATIONS

Ai Group established a "Special Interest Group" among its membership of companies interested in providing input to the investigation of the rules of origin under CER. (A sample questionnaire completed by the Special Interest Group companies is included in Appendix One.) Their views, together with general feedback received from industry, including our South Australian affiliate, the Engineering Employers Association South Australia, are incorporated in Ai Group's response to the following questions posed by the Commission.

1. What are the effects on business and the wider community of the rules of origin arrangements which underpin CER?

The overwhelming majority of Australian manufacturing companies believe that CER promotes a healthy business and trade relationship between Australia and New Zealand. Furthermore, the current ROO test not only supports this outcome, but is indeed seen by Australian industry as a fair test of origin.

We are not aware of any Australian companies that have difficulty meeting the 50% local content threshold, and therefore surmise that the statement noted on the Productivity Commission for undertaking this study (…"concerns that Australian and New Zealand firms are having difficulty achieving the minimum content threshold set down under the CER.") arises predominantly among New Zealand firms.

- Most companies have no difficulty meeting the 50% content threshold.
- Whilst a very small number of companies noted they would prefer a lower threshold to reflect the fact that many industries rely on imported componentry, these same companies noted that they had no difficulty meeting the current threshold.
- Many companies feel that a higher threshold would be preferable to ensure a genuine New Zealand value-add on imported raw materials and goods.

> ***Sample Company Response*** – (annual exports of approximately $20 million):
> "As an Australian manufacturer, our trade with NZ would be immediately negatively affected by a reduction in local content because our customers in NZ already balance their sourcing requirements from Australia and third country suppliers in order to meet 50% local content."

- The overriding response is that the current ROO test is fair.

RECOMMENDATION ONE: the ROO regional content threshold should not be diminished.

2. To what extent (if any) do CER rules of origin increase trans–Tasman trade at the expense of trade with other countries?

In Ai Group's experience of providing international trade advice to Australian industry, particularly over the last twenty years, we have found the preferential duties offered under CER, whilst an important factor, are not the primary reason for selecting NZ as an export market. (Indeed, with an average applied tariff rate of 3.7% for non-

preferential trading partners, avoiding duties is not the chief concern for many industry sectors.)

Essentially, NZ is seen as an easy first step for new exporters, where they can access a similar market to Australia, and at the same time, learn the skills of export (international finance instruments, insurance, logistics and distribution management and so on.)

Many companies view initiating sales in NZ in the same degree of difficulty as breaking into a new state or territory in Australia. Certainly the close geographical location and historical relationship provides easy access to visit the market, establish and maintain relationships. Each year, over a million Australians and New Zealanders cross the Tasman as tourists, for business purposes, or to visit family members. More than 450,000 New Zealanders reside in Australia and around 50,000 Australians live in New Zealand.

The bottom line however, is that the population of New Zealand, at less than 4 million, is a limited market. Companies that are able to successfully "cut their export teeth" on NZ, are likely to move their focus over time to other markets.

Ai Group does not believe that CER rules of origin produce a trade diversionary effect of any great consequence, if at all.

3. Are there problems with the design and/or administration of the current rules of origin? If so, what is the nature of these problems?

Both the New Zealand and Australian Customs Services work on "verifiable information". Therefore, when examining eligible expenditure to determine if the 50% threshold is met, costs of materials can be verified by the production of copies of invoices, and labour costs can be verified by reference to wage sheets, industrial awards and the manufacturing costing systems maintained by most manufacturers. Any "averages" or "assumptions" need to be well documented before they can be accepted. Where suppliers refuse to provide adequate information, the Customs Service has the legal authority to rule that the goods in question do not qualify for preferential origin.

Companies are required to retain their records for five years in respect of their exports within CER.

In Ai Group's communications with its members, we have not found any aspects of the administration of the current rules of origin to pose any problems.

4. What are the implications of international developments (for example, changes in the pattern of world production, new trade agreements or progress in multilateral negotiations) for Australia's future approach to rules of origin under CER?

While Ai Group strongly supports a multi-faceted trade strategy (involving multilateral, sub-regional and bilateral agreements), we nonetheless have some concern over the growing complexities facing Australian exporters who are now required to comply with different ROO regimes under the various trade agreements negotiated, and

being negotiated, by our Federal Government. The ROO regimes under CER and the Australia-Singapore Free Trade Agreement (FTA) differ. The ROO regimes being discussed under negotiations for FTAs with the USA and Thailand are also vastly different. Indeed, the ROO methodologies being mooted under the auspices of the WTO are likely to be another iteration also.

Attaining some standardisation in our approach to ROO across all bilateral, regional (and when the time comes, multilateral) agreements, is of course a desirable goal. At the same time, we recognise that each country has its own unique agricultural and industrial makeup, and as such needs ROO that reflect this.

In our comprehensive consultation with member companies to assess the US-Singapore ROO model (specifically Annex 3A of that agreement), we have found this product-specific methodology is generally quite acceptable to Australian industry in its general approach – with the important exception of the TCF sector.

The methodology employed in Annex 3A is predominantly based on a Change in Tariff Classification (CTC) test, and supplemented in some cases by a Regional Value Content (RVC) test. The formula and percentage used in the RVC test would have to be negotiated.

The CTC test essentially states that:

the imported inputs and the final exported product must come from *different parts* of the HS Tariff Code nomenclature. "Different parts" relates to one of the following:

1. From a different Chapter -indicated by the first 2 digits in a tariff classification
2. From a different Heading-indicated by the first 4 digits in a tariff classification
3. From a different Sub-Heading-indicated by the first 6 digits in a tariff classification

Once a product satisfies the specific CTC test related to its HS code, substantial transformation is deemed to have taken place, and origin is conferred.

Where a simple CTC test is applied, the administrative/documentary aspect of ROO is least burdensome to exporters.

The advantage of this type of product-specific methodology is that the specific tests, as they relate to specific HS codes, can be adapted to reflect the particular agricultural/industrial needs of the countries that are party to the agreement.

Whilst the Australian Industry Group is not specifically seeking a change to the existing ROO regime under CER at this time, we do support a product-specific methodology, such as a modified version of Annex 3A of the US-Singapore FTA.

It would be our preference however, to continue with the current ROO 50% methodology under CER, until Australia had "road-tested" the product-specific methodology for at least one year under the proposed Australia-US FTA if negotiations reach a successful conclusion. From this position of greater direct experience, Australia would be in a better position to negotiate the modifications required to Annex 3A for the CER agreement.

RECOMMENDATION TWO: that if the current ROO methodology is to be changed, that it be replaced with a modified version of Annex 3A of the US-Singapore FTA, determined in consultation with industry.

5. What is the regulatory and compliance burden of the rules of origin under CER?

The existing evidentiary requirements for ROO under CER are not viewed by industry as difficult to meet. The information-gathering and record-keeping requirements are also seen as no more onerous that the tax records companies are already required to maintain. However, there is likely to be growing costs to companies in administering different systems of rules of origin for each agreement Australia enacts. As such, we recommend that taking up Recommendation Two above would minimise the costs to companies.

6. If participants see a need for changes to current arrangements, what would be the advantages and disadvantages of any changes they propose? What might the regulatory and compliance costs of each option be?

If CER were to employ a product-specific methodology, it would deliver the following:

Advantages

- The ROO for CER would reflect the regime companies would need to become familiar with under the Australia-US FTA, and possibly under other future trade agreements.
- The product-specific tests can be adapted to reflect the particular needs of industry and production structures.
- The paper-keeping requirements are less onerous for the majority of products to which a straight CTC test is applied.
- The product-specific methodology has been tested in several FTAs over the last 10 years between countries of different stages of economic development.

Disadvantages

- Companies are not yet familiar with this methodology, whereas they are with the current CER 50% threshold test.
- Apart from companies, customs agents and freight forwarders would also require considerable training to ensure the product-specific tests for origin are well understood.
- Revising the ROO under CER may have a knock-on effect: the Singapore-Australia FTA may need to be reviewed to reflect this approach to ROO.
- The specific ROO tests can be manipulated to protect national interests such that free trade is not achieved.
- The ROO tests can also be manipulated to encourage production within the free trade area, rather than the best sources of supply.

Costs

- The long-term burden on Australian Customs is not likely to increase significantly, however there will no doubt be costs associated with instituting new systems and practices.
- There is a cost to business (possibly ameliorated by Government) in becoming informed of their rights and obligations under a new ROO regime.

- The regulatory/compliance costs for business will be reduced for the majority of products that have a simple CTC test. Adaptation of record-keeping will be required for those products which also have a regional content test.

APPENDIX ONE: SAMPLE QUESTIONNAIRE

Review of Rules of Origin under the Australia-New Zealand Closer Economic Relations (CER) Trade Agreement

The Australian Government has asked the Productivity Commission to examine the Rules of Origin (ROO) arrangements under the Australia-New Zealand Closer Economic Relations (CER) Trade Agreement. The request stems from concerns that companies are having difficulty achieving the minimum threshold content set down under CER.

The purpose of ROO is to ensure only goods that are wholly or partly produced in the CER area benefit from preferential tariffs. For goods not wholly of CER origin, Australian origin is conferred when Australia is the location of the last process of manufacture and 50% of eligible expenditure is undertaken within CER.

When considering the impact of ROO on your company, please bear in mind ROO are a double-edged sword: whatever conditions apply to Australia goods' access to NZ, the same conditions will equally apply to NZ goods' access to Australia. If the ROO threshold is too high, companies miss out on qualifying for duty free access. On the other hand, if the ROO threshold is too low, products with very little CER origin will qualify for duty free access.

The Commission is required to present an interim report to Government by 28 December 2003 and a final report by 28 May 2004. As an Ai Group member company with an interest in trade with New Zealand, we are interested in hearing your views, to inform our submission to the Commission, which must be submitted by 10 October 2003. I would therefore very much appreciate the return of this completed survey by **Tuesday 7 October 2003**.

Individual company names will not be mentioned in Ai Group's submission, and all information will be kept strictly confidential. Your contact details are requested in the event that clarification of information is required.

The following questions relate to your company's trade with New Zealand.

1	Company Name	
2	Contact Name	
3	Telephone	
4	Key products exported to NZ	
5	Key products imported	
6	Value of your company's exports/imports with NZ last year	Exported A$…… Imported A$……
7	Value of your company's exports/imports with NZ this year (to date)	Exported A$…… Imported A$……
8	Do you have difficulty meeting the current ROO?	
9	Do you think the 50% CER content threshold should be higher or lower, and if so why?	

10	Are there any problems with current ROO administration/ documentation requirements?	
11	Is it difficult to meet the evidentiary requirements?	
12	How onerous are the information-gathering and record-keeping requirements?	
13	What are the costs to your company in administering the current ROO?	
14	How would you view the proposed Australia-US FTA methodology* being employed under CER?	
15	Would you prefer any other ROO methodology? Eg. Industry-specific ROO?	
16	Are there growing regulatory and compliance costs to you as a result of different ROO tests for each of Australia's bilateral agreements?	
17	Any other comments?	

* The proposed Australia-US FTA methodology predominantly relies on a Change in Tariff Classification (CTC) test, with a local content threshold additionally applied to some tariff lines. A CTC test essentially stipulates that the imported inputs and the final exported product must come from different parts of the HS Tariff Code. If you have not assessed the proposed US ROO, please contact Jacky Millership for information on the specific ROO for your product(s).

To reiterate, it would be very much appreciated if you could return this completed questionnaire to me by **Tuesday 7 October**. Thanking you in advance for your input on this very important matter,

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