



Secretary

Australian Government

**Department of Innovation
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Productivity Commission
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Patricia
Dear Commissioner

I write in response to the Productivity Commission Draft Research Report on Bilateral and Regional Trade Agreements released on 16 July 2010.

The Department of Innovation, Industry, Science and Research (Innovation) has been involved in the negotiation of all of Australia's Bilateral and Regional Trade Agreements (BRTAs). The development and review of rules of origin (ROO) for non-agricultural products under preferential trade agreements is the policy responsibility of Innovation. Innovation is involved in the negotiation of ROO in all of Australia's current trade negotiations and in 2009 negotiated the review of the ROO text and product specific rules (PSR) in the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).

Innovation has considered the Productivity Commission draft report and given the department's policy responsibility for ROO, I consider it appropriate to provide you with our views on Draft Recommendation 3.

The Draft Report notes some of the difficulties with regional value content (RVC) rules encountered by Australian industry, as reflected in the submission made by the Department of Foreign Affairs and Trade (Box 13.4). Further to this, based on Innovation's experience, RVC rules tend to favour countries with higher labour costs and can be influenced by fluctuating input commodity prices. As such, it is possible that under an RVC rule a manufacturer in one country can meet the RVC while a manufacturer in another country, using an identical process, may not meet the RVC.

In the interest of creating rules which are consistent, administratively simpler and provide a more objective means to determine origin, Australia has moved away from predominantly RVC-based PSR to rules which are predominantly change of tariff classification (CTC)-based but supported by production process and RVC rules, where appropriate. Innovation supports the predominantly CTC-based approach to PSR, negotiated on a line-by-line basis, as the only methodology which will ensure robust processes of substantial transformation on each product within the Harmonised System (HS).

Innovation is of the view that RVC rules should only be used where it is not possible to negotiate an appropriate CTC rule with a partner country or where the HS is structurally unable to reflect a substantial manufacturing process through a CTC rule.

Draft Recommendation 3 argues that the composite model PSR used in the Association of Southeast Asian Nations-Australia-New Zealand Free Trade Area (AANZFTA) be adopted as the basis for ROO in Australia's future preferential trade agreements. The AANZFTA outcome was reflective of the compromises required in negotiating with 11 other countries with differing levels of economic and political development and should not be interpreted as offering a generalised, one-size-fits-all approach to Australia's future BRTA agenda.

Innovation feels that the Productivity Commission analysis on the impacts of ROO did not distinguish between rules which may result in substitution of materials and rules which reflect a manufacturing process. For example, a product with high-value non-originating inputs subject to an RVC rule would struggle to meet the rule due to lower relative costs of labour and processing, while a CTC rule can confer origin regardless of the value of major input materials. Innovation believes that CTC rules, supplemented by production process requirements, do not encourage the substitution of input materials to the extent that RVC rules can.

Draft Recommendation 3 also argues for a waiver of PSR requirements where the most favoured nation (MFN) tariff differential between Australia and a partner country is 5 per cent or less. Innovation understands that the Productivity Commission has undertaken technical analysis to support this recommendation and awaits its public release. However, at this stage, Innovation has some concerns with this recommendation for the following reasons:

- Innovation has received representations from industry groups to indicate that a 5 per cent tariff is commercially meaningful, particularly for manufacturers and traders of bulk, homogenous commodities;
- experience suggests that a waiver would be difficult to negotiate with a BRTA partner. In the majority of negotiations to date, partner countries have attached a high value to the PSR and have sought strong certification and verification provisions for ROO;
- a waiver is likely to inhibit the level of ambition in market access negotiations. Experience suggests that partner countries will not support ambitious tariff commitments if there is a perceived increased risk of transshipment from third countries;
- a waiver would not treat manufacturers and traders of products equally from an administrative perspective. Manufacturers and traders of products with long phasing periods or restrictive final tariff treatment would be disadvantaged compared to those with relatively short tariff phasing or liberal treatment; and
- Australia's existing preferential commitments concern a number of countries which are major logistical distribution hubs, such as Singapore. A waiver applied to these countries would provide no mechanism for avoiding transshipment and would only require another administrative process to ensure domestic production had taken place.

I would be happy for the content of this letter to be made publicly available on the Commission's website.

Yours sincerely

Mark I Paterson AO

16 September 2010