



SUBMISSION

by

**EMPLOYERS AND MANUFACTURERS'
ASSOCIATION (N) INC.**

to the

Australian Productivity Commission

on

Rules of Origin under CER

10 October 2003
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Review of Rules of Origin

Submission by Employers and Manufacturers Association (N)

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1. BACKGROUND

This submission is made by the Employers and Manufacturers Association (N) Inc. (EMA). The EMA is made up of approximately 7500 member companies covering the New Zealand region north of Taupo. This membership includes approximately 1500 manufacturers ranging from large to SME.

Within our membership there are a significant number of companies involved in the manufacture supply, distribution and use of products on a Trans-Tasman basis.

The EMA includes in its advocacy role a keen interest in trade (export and domestic issues) and that of compliance costs for our members both within the New Zealand market and under international agreements such as CER and the rules that apply within such agreements.

The EMA has focused its submission on more general issues noting that specific issues will have been raised by industry sector trade associations or member companies that hold an in depth understanding related to their sector products or issues that impact them directly.

EMA has contributed to and as such endorses, the submission lodged by Business New Zealand.

2. CONTACT

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3. SUMMARY COMMENT

The current position of a 50% content rule of origin under CER causes considerable difficulty for businesses to comply with. Factors impacting on this are exchange rates and the disincentive for implementing efficiency gains.

The EMA has consulted with its members and note that some have put forward specific examples of the problems faced under the current rules of origin.

The EMA's preferred option is that of "Substantial Transformation" based on Change of Tariff Headings which will address the specific issues that industries have under either a 50% or lowered "Ad Valorem" rate of 40%.

The lower rate is the EMA's second choice as it does not align with international trends and the 1994 GATT agreement which favours substantial transformation.

The immediate movement to "Substantial Transformation" is strongly encouraged to give both countries the opportunity to maximise the opportunities available under CER

4. SUBMISSION

4.1 Objectives of CER

The EMA supports strongly the objectives set out in the CER agreement and argues that the objectives do not preclude changes to improve market access and workability of the agreement.

We would see reviewing the Rules of Origin as an essential aspect of improving and growing the value of CER to both New Zealand and Australian business. Such reviews are timely given the 20 years since CER was implemented.

4.2 Rules of Origin Options

Essentially there are two forms of rules that are available of “Ad Valorem” and “Substantial Transformation (Change of Tariff Heading)”. CER currently uses the “Ad Valorem” at 50% content.

There is an opportunity to have combinations of these two options and this could be useful when using the latter to help establish rules for those products that are particularly sensitive or have the ability to change heading easily with little content change.

The use of Change of Tariff Heading allows a clearer definition of origin and tends to make black or white the acceptance or exclusion of products where there is a high level of imported material content.

4.3 Problems under the current “Ad Valorem” 50%

The problems cited in this section may equally apply to manufacturers in New Zealand or Australia.

4.3.1 Exchange Rate fluctuations & “Ad Valorem”

Both the New Zealand and Australian currencies tend to move in tandem to the US currency although the differential can vary depending on the relative strengths being displayed in each economy.

The impact of exchange rate movements can dramatically impact on the ability of manufacturers to meet the current content rules.

Most raw materials and many components are purchased in US dollars (although not exclusively) which means that any significant depreciation of the currency against the US increases the imported costs to the manufacturer. The impact of this can be such that the local content can be pushed below the 50% level when no change has occurred at the manufacturing end to change the content. This may mean that one month the content is above and the next it is below making it difficult for all parties to assess whether tariff should apply. The cost of this can be reflected in the final cost of goods and also in the costs the business must bear in order to trade across the Tasman. It certainly has an impact on forward planning and makes quoting on large orders particularly difficult when selling free into store.

While some ability exists to purchase forward cover this is limited and when the period that the US dollar has strong runs over an extended period, this is quickly lost.

Industry sectors that are particularly vulnerable to exchange rates include: Plastics, Textiles, clothing, footwear, Appliance manufacturers (Gas & Electrical) and automotive component manufacturers.

All of these industry sectors use significant quantities of imported raw materials, partially manufactured materials or components and parts sourced from outside of either New Zealand or Australia.

4.3.2 Efficiency Disincentive

When manufacturers are aware of the need to maintain a minimum level of content there is a clear disincentive to improving efficiencies in the manufacturing processes where these might reduce the local content. This becomes particularly so when the local content is close to the threshold.

Ultimately this impacts on investment and places the business in a long term disadvantage against international manufacturers who are able to make efficiency gains through technology or process changes.

4.3.3 Investment decisions

Evidence of investment decisions being affected solely by the Rules of Origin and in particular the current 50% content rule, are not possible to separate out from the overall decision making on investments.

Those companies that have expressed an opinion on this forming part of the investment criteria from New Zealand have tended to also cite other criteria as contributing to their decision. Appliance manufacturing would be a good example of this and has seen some movement already on investment into Australia.

It is certain that this would be at least one of the criteria for new investment and decisions on where manufacturing should occur for New Zealand based companies looking to sell products into Australia.

4.3.4 Movement of the threshold to 40%

There has been some suggestion that the Rules of Origin should remain as “Ad Valorem” but the threshold should change to rates between 25 and 40%.

While this would solve some issues for some companies by making it possible to use more content from outside of New Zealand or Australia it may not solve issues raised when significant movements of exchange rates occur or significant productivity gains are realised in the manufacturing process. Moving the goal posts ultimately does not address the problems that currently confront some companies in the textile, clothing and footwear industries. Same problems, just a lower level of compliance!

This is not the EMA’s preferred option but would be a fall back position should the preferred option not be pursued.

4.4 Change to Substantial Transformation (Change of Tariff Heading)

The argument to move to substantial transformation using change of tariff heading as the key indicator has been suggested as a fairer and simpler method to implement Rules of Origin under CER by a range of business organisations.

The EMA supports this concept and while there will still remain some complexities around certain product types and the use of just tariff headings; this is consistent with the international trend being employed by USA under NAFTA and in line with the 1994 GATT agreement.

Such a change will remove the issues of content from areas such as Plastics, Appliances and textiles.

This change would allow alignment with any Free Trade Agreements (FTA's_ underway or with future FTA's to provide both New Zealand and Australian manufacturers with a consistent set of Rules of Origin.

Likewise this would resolve any issues surrounding the exclusion of intermediate goods from the value equation.

While there is a general movement under APEC to removing tariffs this is by no means certain and the timeframe in which this may happen may vary considerably depending on decisions yet to be made. It is therefore the EMA's recommendation that movement to Substantial Transformation be made as soon as possible to allow both countries to extract the maximum benefits from the CER arrangement.

4.5 Examples scenarios

Example 1

A textile bonding company's primary material enters New Zealand duty free and the same material (cotton) would also enter Australia duty free. Once the bonding process in New Zealand is completed, the finished product has changed to a new tariff heading which does incur a tariff in Australia. Since the primary material content is not from New Zealand it means this product does not qualify for duty free access to Australia. The reverse is also likely to apply.

Resolution to this example: Substantial transformation based on change of tariff heading would resolve this case completely.

Example 2

An appliance manufacturer imports the mother board, the electrical components, the polymers for plastic fittings, insulation foam and the electric motor for their appliances. The balance of the process of press moulding, injection moulding of the plastic fittings and full assembly is done in New Zealand. The labour content is limited due to a highly mechanised operation.

The cost of the materials and component parts all of which are able to enter both New Zealand and Australia without duty, comes to 49%

All components and materials are purchased from international suppliers in US dollars.

A 2% movement in the US dollar exchange rate can move this company from 51% New Zealand content to 49% overnight.

Resolution of this example: Substantial transformation would solve this case completely and a lowering of the rate to 40% would reduce the risk considerably.

Note: With this last example, a similar situation would apply for many Australian Appliances entering New Zealand.