



Inquiry into the understanding and utilisation of benefits under Free Trade Agreements

Productivity Commission submission

The Productivity Commission acknowledges the Traditional Owners of Country throughout Australia and their continuing connection to land, waters and community. We pay our respects to their Cultures, Country and Elders past and present.

The Productivity Commission

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Introduction

The Productivity Commission welcomes the opportunity to make a submission to the Joint Standing Committee on Trade and Investment Growth inquiry into understanding and using benefits under Free Trade Agreements. This submission relates to terms of reference (TOR) a to d.¹

The submission draws mainly on the Commission's work on trade including reports on the *Nuisance cost of tariffs*, *Bilateral and regional trade agreements*, *Rising protectionism: challenges, threats and opportunities for Australia*, *Modelling Asian trade integration* and the annual *Trade and assistance review* (TAR).

Our submission makes the following key points:

- Preferential Trade Agreements² (PTAs) have evolved from comparatively simple agreements, mainly concerned with reducing at-the-border measures (mainly tariffs and non-tariff barriers) to reduce the costs of trade in goods, to more comprehensive agreements that include chapters that also deal with behind-the-border issues (for example, investment and intellectual property). Beyond liberalising trade in goods, modern PTAs also aim to liberalise trade in services and foreign investment.
- Australia has signed 18 PTAs to date. By further liberalising trade, PTAs can support economic growth and help raise standards of living. However, for Australia, the benefits depend on whether our trading partner competes with, or complements, our products and production processes.
- Businesses' uptake of PTAs is high with an aggregate utilisation of 94% in 2021-22. Australia should strive to increase utilisation even further to maximise the benefits of PTAs.
- The main barriers to accessing the benefits of PTAs are their inherent complexity, including the complexities that arise from rules of origin (RoO). They increase costs for businesses that want to access preferences and eventually consumer costs.
- Beyond tariffs, addressing non-tariff trade barriers would reduce business costs and consumer prices, while ensuring that workers are allocated to their most productive activity.
- Many provisions of PTAs apply indiscriminately to products (goods or services) that originate from regional, diaspora and Aboriginal and Torres Strait Islander communities. Where PTAs deal specifically with products that originate from specific communities, they can provide benefits to these communities. But data on the extent of this effect as well as the costs specific to these communities in accessing PTAs are lacking.
- The recent PTA with the UK include clauses on art products that provide for royalties from their resale. Although not specific to Aboriginal and Torres Strait Islander art, this type of clause can benefit these communities. Looking overseas, the recent Canada-United States-Mexico Agreement includes clauses that are explicitly Indigenous-specific. Without careful assessment, however, community-specific provisions could create additional transaction costs and distortions outweighing their benefits.

¹ The Commission has not produced any work that relates to TOR e or f and cannot comment on them.

² While most of these trade agreements are commonly referred to as Free Trade Agreements (FTAs), it is important to distinguish the effects of these agreements from 'free trade'. Free trade would require the removal of all tariffs, quotas, subsidies and other government measures that distort trade flows. FTAs involve *preferential* arrangements under which tariffs and some other barriers to trade are lowered (although not always eliminated), but only for those countries party to the agreement. The barriers for other countries are not reduced by the agreement (PC 2010, p. 6). As such, the Commission refers to such agreements as 'preferential trade agreements' (PTAs).

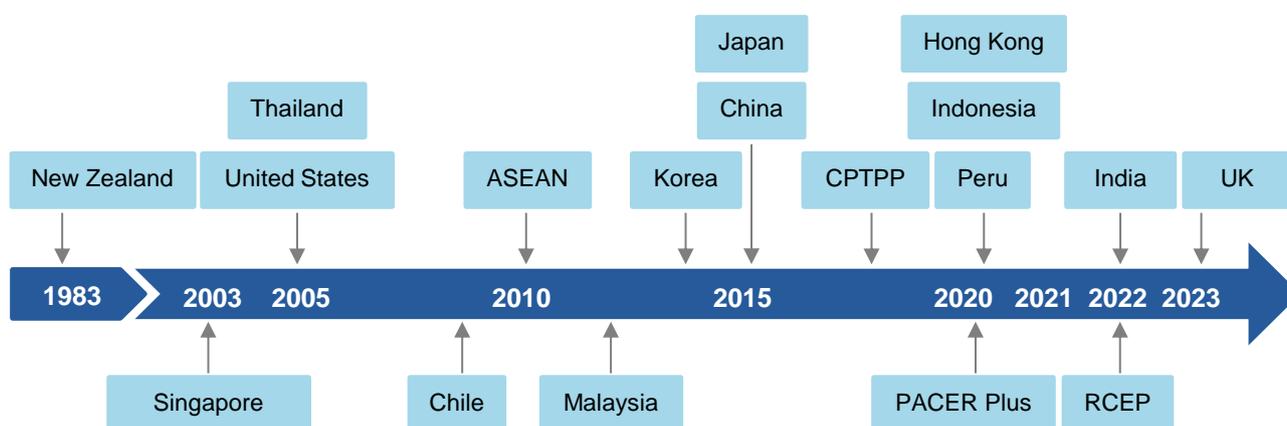
Benefits and use of PTAs

PTAs have evolved over time

PTAs have played an important role in reducing tariffs. Australia's applied tariff rates have declined progressively since the 1970s through multilateral and unilateral action. Starting around 2000, the proliferation of PTAs has become the main mechanism through which Australia and its partners have liberalised their trade on a bilateral and regional basis. Today, Australia has 18 PTAs in force (see figure 1) and is in the process of negotiating additional PTAs with the European Union, India and the United Arab Emirates (DFAT 2024). As a result of PTAs and other reforms, approximately 90% of imports now enter Australia duty free (PC 2022 p. 2).

Figure 1 – Australia's bilateral and regional trade agreements^a

By year entered into force



a. ASEAN = Association of Southeast Asian Nations. CPTPP = Comprehensive and Progressive Agreement for Trans-Pacific Partnership. PACER = Pacific Agreement on Closer Economic Relations. RCEP = Regional Comprehensive Economic Partnership.

Source: DFAT (2024).

PTAs have broadened their scope over time. Early agreements focused on removing tariff and non-tariff barriers to trade in goods. Subsequent agreements broadened to include provisions on investment, intellectual property, trade in services, competition policy and other 'behind the border' matters (PC 2010, pp. 51–62). More recent agreements, such as the CPTPP, have broadened further to include provisions covering digital health, labour, the environment and anti-corruption.

The remainder of this submission provides a discussion of, and evidence in response to, TOR a to d.

TOR a. What level of understanding is present of the social and economic benefits provided by FTAs

The Commission is unaware of studies about the population or businesses' understanding of the social and economic benefits provided by PTAs. That said, many studies have shown the varied benefits of tariff reductions and many other liberalising aspects of trade agreements. The Commission itself has a long history of such studies. This section reviews the main mechanisms behind the benefits of PTAs and a selection of the illustrative results obtained in relevant Commission reports.

Lowering trade barriers and other means of economic integration supports the Australian economy by expanding our access to foreign markets, lowering our import costs (including the cost of intermediate goods), enhancing firm productivity through competitive pressures, and leading to a more efficient allocation of resources to sectors in which Australia has a comparative advantage. Trade agreements enable these benefits for Australian firms and households.

A substantial body of research demonstrates that trade liberalisation (through PTAs and other means) facilitates economic growth and rising living standards. Select studies include the following.

- Frankel and Romer (1999) investigate the impact of international trade on economic growth, using geography as instruments to estimate trade's effect on national income. They find that a country's geography and its distance from trading partners predict economic growth and that trade influences national income positively.
- Using a similar method, Duncan, Hailermariam and Kiely (2022) found a 0.14% increase in Western Australia's per capita Gross State Product for every percentage point increase in trade intensity with China. They also found a sharp increase in trade intensity between China and Western Australia following the signing of ChAFTA, which has contributed to household income growth in the state.
- Bloom, Draca and Van Reenen (2016) investigated the impact of rising Chinese import competition on European firms from 1996- 2007. They found that import competition led to increased technological adoption among EU firms and to workers moving toward more technologically advanced firms.
- Tuhin and Swanepoel (2017) found that exporting firms are larger, more productive and pay higher wages than non-exporting firms. They also found that growth in exports has contributed to approximately one quarter of Australia's growth in the 25 years to June 2016.

Such studies primarily show the benefits of trade liberalisation in general. The benefits of PTAs depend on whether firms and workers compete or complement the specialities of the country entering into an agreement, as explored in the Commission's *Modelling Asian Trade Integration* (2024) paper (see below).

Selected results

Modelling shows the high costs of rising protectionism

The *Rising protectionism* (2017) report used several simulations to illustrate the effects of various *increases* in tariffs. For instance, a 15 percentage point increase in tariffs globally would decrease median Australian household income by about \$1,500 and reduce employment by about 100,000 (PC 2017, p. 65).

Not all households would be affected equally. Some workers can even benefit from increased trade barriers. Welfare dependent households were sometimes found to benefit because the transfer system was assumed to maintain the real value of transfers. Additionally, the consumption bundles of many of these households contain more non-traded goods so they are less affected by increased tariffs. Some higher income households in less-traded service sectors such as education and health could see increased wages as demand for their services increases.

That said, Commission modelling was clear that most households (80%) would be worse off if tariffs rose globally, and Australia would lose about \$0.64 of economic activity for each additional dollar of tariff revenue (PC 2017, p. 55). The report concludes that Australia's best response, in the face of rising protectionism, is to deepen regional trade integration through PTAs or act unilaterally, as explored further in more recent Commission modelling.

Recent modelling shows limited gains from further tariff reductions

In *Modelling Asian Trade Integration (2024)*, the Commission modelled a variety of tariff reduction scenarios that might form part of various prospective agreements. The report builds on the *Rising Protectionism* report by looking at the benefits of increased regional trade integration and of unilateral action. Though limited to tariff reductions, the simulations illustrated that:

- Further tariff reductions through PTAs offer limited benefits given Australia's already low tariff policy settings.
- Australia gains modestly under most of the trade scenarios assessed due to a reduction of tariffs between Australia and the entrant to the agreement (e.g. India joining RCEP).
- In some scenarios, Australia is worse off, because the acceding country is a competitor in many of Australia's key export markets – for example, when the US and all members of the CPTPP reduce their tariffs bilaterally, they compete directly with Australian exports of wheat and beef.
- Of all the scenarios considered, unilateral reduction of tariffs increased Australia's economic output the most and is the most effective way to progress trade liberalisation in the absence of multilateral trade liberalisation.

However, the modelling only incorporates the effects of changes in tariff barriers to global trade. As discussed, non-tariff barriers make up a significant proportion of the scope of modern PTAs. Commission modelling has not included the many benefits from clauses in PTAs which reduce barriers to trade in services and investment. Even if Australia unilaterally abolished all tariffs, Australia might still benefit from negotiating new trade agreements to reduce various non-tariff barriers to trade in services and investment.³

TOR b. The uptake of economic benefits to Australian businesses created by FTAs across Australia

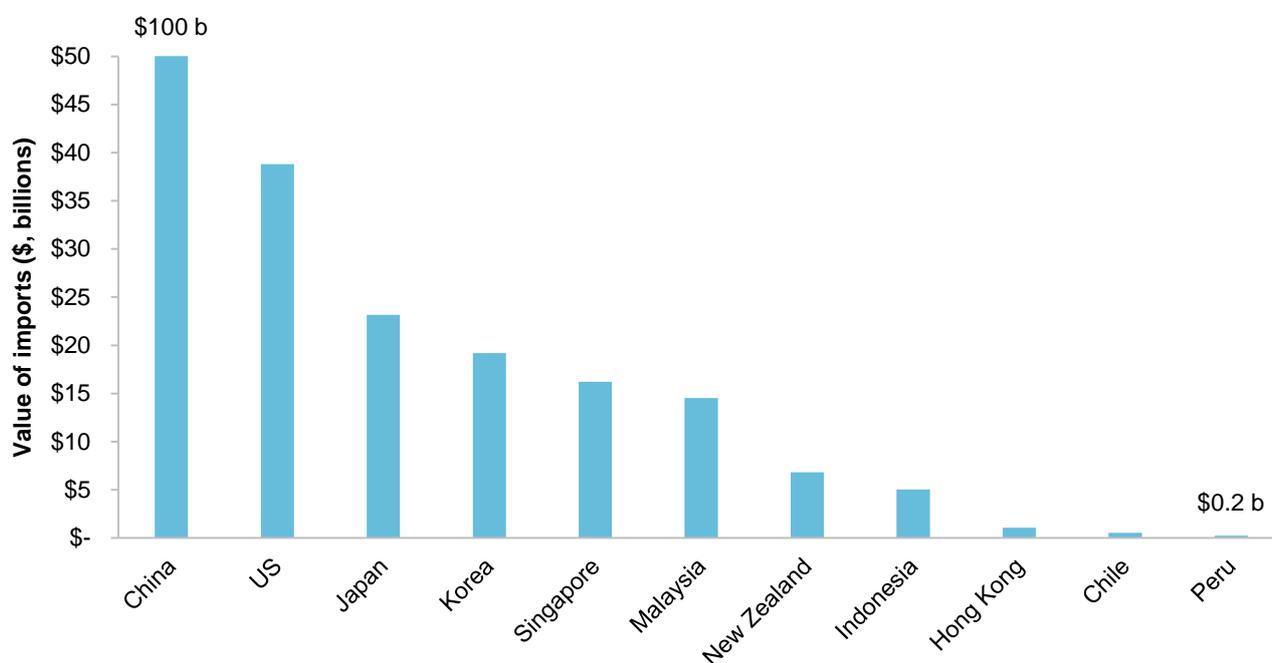
The rate of PTA uptake is high but could be higher. Australia's PTAs had an estimated aggregate utilisation rate⁴ of 94% in 2021-22. Maximising the benefits of a PTA would imply a near 100% utilisation rate. But nuisance costs prevent this from occurring (see discussion under TOR d below). Australian imports primarily come from China, Japan and the US. These countries PTAs' have relatively high utilisation rates between 88% and 96%. For other agreements, like PAFTA, and AANZFTA,⁵ utilisation is quite low standing at only 77% and 69% respectively (see figures 2 and 3). However, Australia imports relatively few goods from these countries by value, so their impact on the aggregate rate is minimal.

³ The Commission estimated the effects of liberalising trade in telecommunications and financial services in a report on *Global gains from liberalising trade in telecommunications and financial services (2001)*. There would be merit in updating this type of investigation given the large changes in technology and global production and trade patterns over the past 20 years.

⁴ Utilisation represents the percentage of times the PTA is used to reduce a tariff on an imported product that is eligible for a PTA concession. Conceptually the utilisation rate is the ratio of the value of imports that used the preference relative to the total value of imports that qualify for the preference. The actual estimate is explained in note a in figure 3.

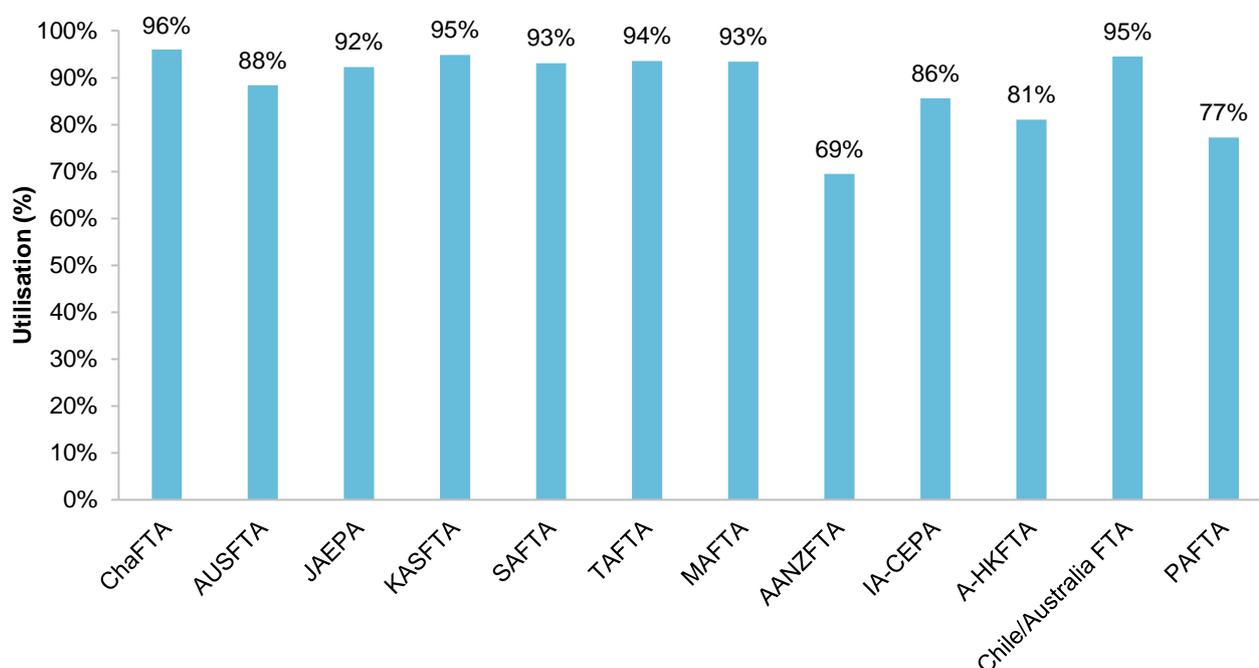
⁵ Note that the Commission has only estimated the AANZFTA utilisation rate for imports from New Zealand.

Figure 2 – Australian imports from some PTA partners dwarfs those of others
Value of total imports to Australia by country, 2021-22



Source: Productivity Commission estimates using ABS (*International Trade in Goods and Services, Australia*, Cat. no. 5368.0).

Figure 3 – Utilisation can vary substantially by PTA trading partner^{a,b}
Utilisation rate of bilateral PTA agreements by country, 2021-22



a. Utilisation rate estimated as the value of goods imported under PTA divided by the sum of this same value and that of goods identified as eligible for a PTA concession that were not imported under the PTA. This method might overestimate the utilisation rate as products with 0% utilisation might be unidentified. **b.** AANZFTA utilisation rate has only been estimated for New Zealand imports.

Source: Productivity Commission estimates using ABS (*International Trade in Goods and Services, Australia*, Cat. no. 5368.0).

TOR c. To what extent regional, diaspora and First Nations communities take advantage of trade opportunities including the benefits created by FTAs

Where PTAs deal with products that originate from regional, diaspora or Aboriginal and Torres Strait Islander communities, these communities can benefit.

Community-specific provisions in agreements are rare. That said, some provisions can be particularly valuable to certain communities. For example, the recent Australian-United Kingdom Free Trade Agreement (A-UKFTA) includes a commitment to making royalty payments for art resales made in the UK. This provision is likely to benefit Aboriginal and Torres Strait Islander artists, as well as other artists (box 1).

Box 1 – The A-UKFTA and its implications for Aboriginal and Torres Strait artists

The A-UKFTA came into effect on 31 May 2023 and lowered trade barriers between Australia and the UK. Beyond eliminating tariffs on more than 99% of Australian exports, the agreement also contains provisions that relate to intellectual property (IP).

Article 15.61 gives artists of both countries an inalienable right “to receive a royalty based on the sale price obtained for any resale of the work, subsequent to the first transfer of the work by the author”.

DFAT reference this provision in their advice to Aboriginal and Torres Strait Islander businesses on the A-UKFTA, as their advice notes that most of the eligible resales would be among Aboriginal and Torres Strait Islander resellers. While Article 15.61 does not explicitly pertain to Aboriginal and Torres Strait Islander IP, its design provides some benefits for these communities.

Source: (DFAT 2021, 2023)

An important caveat is that creating community-specific provisions could create new transaction costs for the relevant businesses. Further, these businesses could become dependent on these provisions in the long term. The provisions are also likely to distort resource allocation, generating economy-wide costs. As such, assessing the costs and benefits of a community-specific provision before its inclusion in a PTA is vital.

The Commission has not undertaken research into the PTA utilisation rate of different communities and is unaware of any research in this area. Other researchers have, however, highlighted the gap in our understanding of how these communities make use of PTAs. The Indigenous Land and Sea Corporation noted that there was a need to “further examine ‘Indigenous inclusions’ within trade arrangements” (ILSC 2022, p. 5). Our understanding of regional businesses is somewhat better – a 2018 DFAT-commissioned report determined that large businesses with a regional presence had the highest level of PTA awareness, and were less likely to rely on customs brokers or freight forwarders for PTA management (PwC 2018). But gaps in our knowledge remain.

The Commission supports the need for future research into how regional, diaspora and Aboriginal and Torres Strait Islander communities benefit from PTAs.

One avenue could be to explore how similar communities in other countries benefit from their PTAs. The Canada-United States-Mexico Agreement (CUSMA), for example, includes a general exception that allows the Canadian government to adopt or maintain measures necessary for fulfilling its legal obligations to their

Indigenous peoples (Van Duzer and Mallet 2021). The CUSMA also includes preferential treatment for predominantly-Indigenous industries – one provision states that handcrafted Indigenous textile and apparel goods are eligible for duty-free treatment following a special process (Government of Canada 2019). Examining how these provisions operate in practice (including potential disputation) could improve our understanding of how Aboriginal and Torres Strait Islander communities might benefit from PTAs and what potential gains or losses still exist.

TOR d. What difficulties are faced by Australian businesses, workers and communities in accessing the benefits created by FTAs, including non-tariff trade barriers

Compliance costs reduce utilisation rates

There are several stages for a business to access the benefits of PTAs:

- being aware that a PTA can offer benefits
- accessing specific information about relevant PTAs and their potential benefits
- absorbing the costs associated with accessing the potential benefits.

The Commission reviewed the nature of these costs in its report on *Nuisance costs of tariffs* (2022).

When businesses apply for preferential or concessionary treatment, they incur compliance costs. Australian importers who access a preference may incur administration costs in demonstrating that their goods are compliant with the PTA's rules of origin (RoO) – especially importing their goods under the handful of PTAs that require an authorised certificate of origin (PC 2022, p. 36). Foreign exporters, meanwhile, may rearrange their production processes and interact more frequently with the tariff administration to comply with a change in tariff classification requirements. If all imports were simply subject to the statutory rate, then these costs would not exist — but businesses that currently use preferences or concessions would then be relatively worse off.

The Commission estimated that compliance costs in 2019-20 ranged between \$0.7–2.2 billion (PC 2022, p. 47). Some historical costs may have reduced with the diminishing restrictiveness of RoO (PC 2022, p. 12), but an impost persists on Australian businesses and communities.

These compliance costs prevent businesses from accessing the full benefits of PTAs. Ensuring that their goods and services qualify for preferential treatment increases costs for businesses, which they then pass on to households. When nuisance costs exceed 5% (the amount of the tariff), importers likely choose to pay the tariff, foregoing the tariff-free rate on offer through the PTA.

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