

Trade Policy Review Body

TRADE POLICY REVIEW

Report by the Secretariat

AUSTRALIA

This report, prepared for the sixth Trade Policy Review of Australia, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from Australia on its trade policies and practices.

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Document WT/TPR/G/244 contains the policy statement submitted by Australia.

Note: This report is subject to restricted circulation and press embargo until the end of the first session of the meeting of the Trade Policy Review Body on Australia.

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SUMMARY

(1) ECONOMIC ENVIRONMENT

1. Since its previous Trade Policy Review in 2007, Australia, one of the most open economies in the world, has successfully weathered the global financial crisis without any backsliding on trade liberalization or action to influence the value of its currency. Although the crisis resulted in economic growth slowing from 3.8% in 2007/08 to 1.4% in 2008/09, the slowdown was milder than in most other advanced economies and growth rebounded to 2.3% in 2009/10. The mild slowdown and subsequent rebound in growth were due to, *inter alia*, strong demand for Australia's commodity exports, especially from China, which pushed Australia's terms of trade to its highest level in 60 years; a flexible exchange rate; a healthy banking sector; and a timely and appropriate policy response to the crisis. Although Australia is still considered one of the most competitive economies in the world, it has experienced a marked decline in multi-factor productivity growth owing mainly to special developments in agriculture, mining, electricity, gas, and water. Inflation has been slightly above or within the central bank's 2%-3% target, and the unemployment rate has remained relatively low, albeit rising gradually from 4.5% in 2006/07 to 5.5% in 2009/10.

2. Sound macroeconomic policies and past structural reforms (of which trade liberalization, induced by an exceptionally transparent policy framework, has long been an integral part), together with greatly improved terms of trade, have been among the main factors contributing to Australia's impressive economic performance during the period under review (as well as the past two decades). Nevertheless, as from 2008/09, Australia's fiscal position shifted to a deficit, largely reflecting reduced tax revenues, and spending relating to the implementation of the generous economic stimulus measures. More importantly, however, soaring export prices and low unemployment seem to have reduced the appetite for further structural reforms, which appear to have slowed or failed to deliver during the review period, thereby

possibly affecting the prospects for achieving sustained growth in the future.

3. The responsiveness of the flexible exchange rate to commodity price fluctuations helped stabilize export incomes. In 2008/09, the exchange rate of the Australian dollar against the U.S. dollar depreciated sharply, thus boosting exports and reducing imports, but since then it has been appreciating and negatively affecting Australia's export competitiveness, particularly of agricultural exports. In 2008/09, the trade account turned to surplus, mainly reflecting large increases in commodity contract prices negotiated in early 2008 for iron ore and coal exports, as well as the sharp exchange rate depreciation; subsequently, it returned to a deficit. Net external debt increased, largely reflecting interest and dividends paid to foreign investors in Australia (net of income received on Australian investment abroad).

4. The gradual shift in the pattern of Australia's merchandise trade towards East Asia was further reinforced as a result of the virtual doubling of China's share of total exports. Australia has maintained its open stance towards foreign investment, and has reduced the compliance costs related to notification and removed foreign ownership restrictions in the media sector. It continues to screen large investment projects on the basis of vaguely defined "national interest" criteria restricting foreign ownership in a few sensitive areas (e.g. international aviation and shipping). Nevertheless, screening does not seem to have been a major barrier to inward foreign investment.

(2) TRADE POLICY FRAMEWORK

5. Australia's trade policy framework continues to be characterized by an unusually high degree of transparency. This involves rigorous economic analysis undertaken by government institutions and independent advisory bodies (notably the Productivity Commission), from which policy-makers benefit in formulating cost-effective trade and trade-related policies, including continuing regulatory reforms, aimed at removing barriers

to improved productivity and facilitating (rather than impeding) the reallocation of domestic resources. The Secretariat has once again drawn heavily on publicly available documents from these institutions in preparing its Report for this sixth Trade Policy Review of Australia.

6. While remaining committed to multilateralism, more emphasis has been placed on exploring the prospects of broadening preferential trade relations through the conclusion or negotiation of comprehensive agreements with major trading partners or regional groups (e.g. the Association of South East Asian Nations and Trans-Pacific Partnership Agreement), despite their negotiating and administrative costs, and uncertain benefits. Commitments under these agreements go beyond WTO Agreements in a number of areas, including services and investment, and in certain cases (e.g. intellectual property rights) are applied to all trading partners.

7. Australia has continued to provide duty-free treatment for imports from least developed countries (LDCs), while preferences to other developing countries are being eroded by MFN and other preferential tariff cuts. It has been an active provider of demand-driven aid for trade at multilateral, regional, and bilateral levels; policy in this area is based on improving market access, and building competitive economies.

8. The Council of Australian Governments (COAG) has continued to facilitate consultation, cooperation, and policy coordination between the Commonwealth, states, and territories with a view to avoiding potential inconsistencies. These jurisdictions remain responsible for a number of trade-related policies, such as standardization, government procurement, and state-trading, and have legislative powers in a number of areas. The COAG Reform Council, which aims to achieve a seamless national economy, is also responsible for implementation of the National Reform Agenda (NRA), which has been rather slow.

(3) TRADE POLICY DEVELOPMENTS

9. The tariff remains one of Australia's main trade policy instruments, albeit a minor source of tax revenue (1.9% of total tax revenues). Unilateral reductions in tariffs (on 1 January 2010), including peak rates, applied to textiles, clothing, and footwear (TCF) as well as to passenger motor vehicles (PMVs), reduced the average applied MFN tariff rate to 3.1%, from 3.8% in 2006; further unilateral reductions are envisaged by 2015. Whereas the average applied MFN tariff for agricultural products is 1.4%, that for industrial products is roughly 3.4%. Some 96% of tariff rates are now within the zero to 5% range. The tariff structure was simplified and now involves seven rates (four *ad valorem*, one specific, one compound, and one alternate). Most tariff rates (99.7%) are *ad valorem*, a feature that contributes to the transparency of the tariff. By contrast, non-*ad valorem* rates tend to conceal relatively high tariff rates, particularly those on used vehicles, which seem to be rarely applied. However, these changes have done little to change the pattern of tariff escalation, which means that effective rates of MFN tariff protection can be considerably higher than nominal rates. Some 96.5% of tariff lines are bound, thereby imparting a high degree of predictability to the tariff. Applied MFN tariff rates currently fall short of bound rates by an average of about 7 percentage points and up to 55 percentage points for clothing items. While the consequent gap between bound and applied MFN rates provides considerable scope for the authorities to increase applied tariffs within bindings, this does not appear to have happened during the period under review.

10. Documentation requirements have remained minimal, and computerized customs clearance has facilitated virtually all imports and exports; trade facilitation has been supported by the Enhanced Trade Solutions programme, and import clearance performance has been measured with a Time Release Study device. The transaction value has been mostly used for customs valuation purposes.

11. Import prohibitions and restrictions in the form of technical regulations and stringent quarantine requirements have remained in place, in principle, to preserve, *inter alia*, public health, the environment, safety, or security. Changes were made to ensure that all standards developers work together, avoid duplication, and work in harmony with international standards, as well as to centralize the Commonwealth Government's power for introducing mandatory product safety and information standards as from January 2011. Although Australia continues to maintain strict SPS measures, which it considers proportionate to its appropriate level of protection, it recognizes that zero-risk is unattainable and launched reforms involving a shift from "quarantine to biosecurity". Whereas the net benefit to the community as a whole (including domestic consumers) needs to be demonstrated in order for the adoption of a standard, SPS measures are taken without similar cost-benefit analysis, including due account of the trade effects of such measures for stakeholders along the supply chain, although import risk analyses are expected to address the issue of economic consequences to relevant stakeholders. Recourse to anti-dumping and countervailing action has been steady with most initiations and measures relating to items originating in Asia. No safeguard measures were adopted during the period under review.

12. Australia has continued to use government procurement as an instrument of economic policy aimed at fostering industrial development in certain sensitive areas (e.g. real estate property or accommodation, R&D services, and motor vehicles) that are exempt from the mandatory procurement procedures applying to procurement above certain thresholds. The target of sourcing at least 10% of purchase value from small and medium-sized enterprises (SMEs), as well as preference margins for local suppliers and local-content requirements by certain state governments have been maintained and, in certain areas, reinforced but applied in line with FTA commitments. Foreign participation in bidding or the granting of duty concessions

may require the submission of an Australian Industry Participation plan, an element also used for the granting of duty concessions under the Enhanced Project By-Law Scheme. Australia has remained an observer of the WTO Agreement on Government Procurement (GPA) but has followed negotiations on the revised GPA. Its comprehensive FTAs contain chapters committing Australia to principles of transparency and non-discrimination in government procurement.

13. Export controls or quantitative restrictions to, *inter alia*, manage access-related import quotas operated by public sector entities affect certain primary and therapeutic goods to ensure, *inter alia*, adequate domestic supply, and to enforce standards. Exports of merino sheep were liberalized as from January 2010.

14. Export assistance, consisting of direct grants (e.g. through Export Market Development Grants) and tax concessions (e.g. Tradex), has been maintained and revised. In addition to local-content requirements termed as "Australian activity", export finance is, *inter alia*, conditional upon "national interest" criteria. Export credit terms seem to be in line with OECD guidelines.

15. Support for domestic production and trade has been provided through tax and non-tax incentives, with steady, albeit declining, emphasis on R&D spending as well as regulatory restrictions on competition. Some of the industry-specific programmes (e.g. dairy, automotive, pharmaceuticals) were ended or amended during the period under review. The special Luxury Car Tax, which is levied at the same rate on domestic and foreign cars, but nonetheless seems to fall disproportionately on imports, was raised from 25% to 33%. The effective rate of combined assistance (i.e. tariff, budgetary, agricultural pricing and/or regulatory assistance) remained relatively high for TCF, PMVs, grain, sheep and beef cattle farming, and horticulture and fruit growing activities; support for primary production depended on the effects of climate.

In addition to certain commodity export activities, state involvement in the economy involving the provision by government trading enterprises of services in key infrastructure sectors (e.g. water, electricity, ports, rail, urban transport), are not always on a fully commercial basis.

16. Australia has further strengthened protection of intellectual property rights by expanding its international commitments. The competition policy framework, which remains characterized by a long list of special regimes and exemptions, including at the state or territory level, has been updated in several areas with particular emphasis on cartel criminalization. Legislation enacted on 13 July 2010 is aimed at strengthening consumer protection and enforcement at the national level.

(4) SECTORAL POLICY DEVELOPMENTS

17. Despite its relatively small contribution to GDP, Australia's highly market- and export-oriented agriculture remains of fundamental importance. Average applied MFN tariff protection for the sector (excluding forestry) remained negligible, at 1.4 %, compared with 3.4% for manufacturing. Some sensitive items (e.g. cheese, certain vegetables, and certain oils and fats) continue to receive tariff protection, and tariff-rate quotas affect certain types of cheese and curd. Non-tariff measures, such as the strict quarantine and inspection regime, export and/or production levies, and a single-desk arrangement on rice remain in place; similar statutory arrangements for grains, wheat and sugar were dismantled during the review period although entities that operated under these arrangements remain active. A new bilateral agreement on wine trade relating to geographical indications was signed with the EU. Despite a wide range of assistance programmes, the sector's overall level of support has remained relatively low, equivalent to 0.1% of GDP; the majority of this assistance was delivered in the form of non-trade-distorting budgetary outlays, and was within Australia's *de minimis* WTO

commitments. Since 2009, no industry-specific support has been provided to the dairy sector. A policy has been put in place to address the profitability and sustainability of Australian fisheries as well as illegal fishing.

18. Mining, which operates in a competitive market environment with seemingly no industry-specific restrictions on foreign investment and little government support compared with other sectors, remains critical to Australia's economic performance despite the pronounced decline in its multi-factor productivity. Despite reforms aimed at creating a nationwide energy market and strengthening price signals *vis-à-vis* consumers, Australia's electricity generation, transmission, and distribution remain segmented geographically; generation capacity is largely owned or controlled by the Government and ceilings on retail electricity rates remain in place. A National Strategy on Energy Efficiency is being implemented, and renewable power generation has been the focus of government assistance to the sector. Some state governments provided subsidies at the retail level to reduce the price of unleaded petrol and diesel; domestic producers of ethanol and biodiesel used in transport also receive a government subsidy.

19. Manufacturing policy has been largely focused on innovation as a means of, *inter alia*, improving productivity, and thus international competitiveness, and in order to reap benefits from rapid economic expansion in overseas markets. The average applied MFN tariff rate on industrial products has declined slightly as a result of unilateral tariff cuts. Budgetary assistance for manufacturing as a share to GDP is estimated to have remained steady at 0.1%, albeit an increase in value terms; the TCF and leather industries, and motor vehicles and parts activities continued to benefit from relatively high effective rates of protection, i.e. more than double the manufacturing sector's average and the highest of all goods industries. Some programmes for the automotive industry have been complemented with elements reflecting a

persistent interventionist approach to adjustment.

20. Services remains the largest and fastest growing sector of the economy. Budgetary assistance to the sector, mainly delivered through tax expenditures, rose considerably and in 2008/09 was equivalent to 0.28% of GDP. Australia's GATS and bilateral RTA commitments remain unchanged; its RTAs generally provide for greater commitments on trade in services to signatories than those under its GATS commitments. Financial services reforms (e.g. prudential rules, Basel II) have been pursued in several areas and policies to mitigate the impact of the global financial crisis allowed Australia's banks to cope well with the financial turmoil. Action is being undertaken to remove impediments to Australia's position as a financial services centre in the Asia Pacific region. In telecommunications, the formerly government-owned Telstra has been able to retain considerable market power, an issue of concern in several areas, including broadband services; efforts to address these issues include the passing of new legislation to reform the telecommunications regulatory regime and the possible establishment of a government-owned National Broadband Network company. Support to domestic advertisement and film producers has been maintained through local-content requirements in television broadcasting as well as film production funding. Efforts have been undertaken to drive the development of a long-term coordinated approach to national transport infrastructure planning and investment, and to identify priority projects aimed at coping with a variety of shortcomings and coordination of transport infrastructure development between the federal government, the states and territories, and the private sector. A new comprehensive policy framework for the development of the aviation industry has been established. A new strategy and additional support have been provided to promote innovation, infrastructure development, and growth in the tourism sector.

(5) OUTLOOK

21. Australia's economic growth is expected to remain strong. Despite sound macroeconomic management and relative economic strength, downside risks to the economic outlook relate, *inter alia*, to the withdrawal of the economic stimulus package, the global economic and financial fragility, as well as Australia's increasing exposure to commodity prices, its reliance on short-term external debt, and the high and growing indebtedness of households. Australia's growing dependence on mining may amplify the business cycle, as the economy will become more vulnerable to swings in its highly favourable terms of trade. A major economic challenge confronting Australia, with potential trade policy implications, is to formulate appropriate macroeconomic and structural policies to facilitate rather than impede adjustment to the effects of its greatly improved terms of trade owing to the mining boom and the associated appreciation of the Australian dollar. The latter is likely to reduce the competitiveness of import-competing activities and non-mining exports, unless productivity in these activities can be improved. This will have far-reaching implications for the pattern of growth and structure of the economy by necessitating a reallocation of domestic resources. Significant structural adjustment by the non-mining economy will be required. Market-driven structural adjustment and reforms underpinning productivity growth should enable Australia to strengthen its international competitiveness, provide the basis for sustained growth, and address the longer term challenge of a growing but ageing population, climate change, and technological change, which is arguably the main determinant of multi-factor productivity growth in the long run. The authorities consider that Australia's approach to trade policy should be reviewed against the principles of unilateralism; non-discrimination; transparency; and "the grand unifying principle of" trade policy as an indivisible part of overall economic reform.

