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Inquiry Secretary

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Submission to the Inquiry into Australia's trade and investment relationship with the United Kingdom

This submission is in relationship to the following terms of reference for the inquiry:

- The nature of Australia's current trade and investment relationship with the UK;
- Possible implications for Australia's trade and investment relationships with the UK and the European Union consequent to the UK's exit from the European Union;
- Opportunities to expand trade and investment links;
- The merits and risks of a possible bilateral free trade agreement with the UK.

### **Summary**

The trade and investment relationship between Australia and the UK is significant and long-established. There is a high degree of uncertainty surrounding the ultimate outcome of the UK's "Brexit" negotiations with Europe. Regardless of the eventual outcome, it is likely that there will be opportunities for Australia, particularly in the areas of agriculture, education, and tourism. Philosophically, there are strong merits in free trade, however in negotiating a bilateral agreement care will need to be taken that Australia is not locked into a situation that is detrimental to future economic development.

### **The nature of Australia's current trade and investment relationship with the UK**

Australia and the UK have a long-standing trade relationship that dates to European settlement. This relationship is built on historic ties and a commonality in language as well as legal and political systems. As such it is likely that trade links will remain strong regardless of the outcome of the ongoing negotiations between the UK and Europe.

Although Australian trade has tilted towards Asia in recent decades, the UK remains Australia's 7th largest trading partner with the total value of goods and services approaching \$21 billion (DFAT.gov.au). While Precious metals are the most significant good that Australia exports to the UK, tourism is the largest service export. As noted in the terms of reference, the UK is also one of the largest providers of foreign investment into Australia with a total direct investment value of over \$500 billion.

Changes in Australian demography and the rise of economic strength in Asia (particularly China, Japan, and Korea) mean that Australia is much less reliant on trade with the UK. For example, trade with China is valued at more than \$150 billion. As Asian economies continue to grow it is likely that further opportunities will arise in this region rather than in a Europe with slower growth and a declining population. It is therefore important not to lose focus on maintaining trade ties in this region.

### **Possible implications for Australia's trade and investment relationships with the UK and the European Union consequent to the UK's exit from the European Union**

Although the turmoil that many predicted would follow the UK's "Brexit" referendum on has not yet eventuated there is still a significant amount of uncertainty as to the form that Brexit will eventually take.

There is uncertainty as to the submission the UK will make upon triggering Article 50. Given the lack of public discourse from the EU there is also additional uncertainty as to how subsequent negotiations will transpire. The situation is further complicated by the time limit imposed by both Article 50 and the EU parliamentary elections that are due to be held in June 2019. Until those negotiations are underway it is difficult to ascertain how this may impact Australia's trade and investment relationship with either party.

In her speech of 17 January, the British Prime Minister Theresa May, outlined the current view of the UK government regarding its position on prospective negotiations. During this speech, it was made clear that the UK will not seek to replicate the examples of Norway and Switzerland in retaining the benefits of a free trade zone without EU membership. Instead, the UK will pursue a Free Trade Agreement with the EU.

The speech noted that the UK would "have the freedom to set the competitive tax rates and embrace the policies that would attract the world's best companies and investors". The British press interpreted this as implying the UK may hold the threat of becoming a 'tax haven' of sorts during negotiations. In my opinion the UK emerging as a tax-haven is unlikely, but the threat is not negligible.

More competitive tax rates for corporations may well lure companies to Britain that may have otherwise invested elsewhere. There may also be sufficient incentive for companies to re-domicile to Britain. For companies with a dual-listing on the stock market, such as BHP Billiton and Rio Tinto, the motivation to move may be greater. Additionally, more competitive personal tax rates may lure talented individuals to the UK. The federal government will need to monitor this developing situation.

. In the same speech, Theresa May emphasised the desire to implement an "immigration system that serves the national interest". This is likely to have repercussions for staffing levels in several industries – particularly health services, domestic services, and agriculture. It is possible that this will create opportunities for Australians to migrate to fill those roles, to the detriment of the Australian economy. However, it is more likely that any change in UK immigration control will detrimentally impact all migrants and not just those from the EU.

### **Opportunities to expand trade and investment links**

The UK exit from the EU will create a number of opportunities to expand trade and investment links, although not necessarily with either of those parties. The education and agricultural industries are likely to witness some of the greatest long-term changes.

The education sector is increasingly global. Many international students take up a course of study with the implicit understanding that there will be some opportunity to obtain a work visa upon graduation. When Britain is outside of the EU this may reduce some element of attraction to international students, creating an opportunity for the Australian education sector to capitalise. Against this must be set the possible depreciation of the pound sterling that would make the UK relatively more attractive on a cost basis.

It is also possible that a loss of EU funding in scientific research will lead to an increased availability of world class researchers that may be attracted to Australia. This would aid the innovation agenda and ultimately be beneficial to productive capacity in Australia.

Changes in the trade relationship for agricultural products will occur as the UK leaves behind the EU's common agricultural policy (CAP). This policy has created protectionist tariffs and non-tariff barriers that restrict access to non-EU providers, and artificially inflate prices, while been particularly beneficial to the farmers of France and Poland. At the same time, increased immigration controls are likely to adversely impact agricultural production in the UK. Together, these factors suggest that there will be opportunities for Australian producers to exploit.

There may also be implications for the tourism industry. In the short-term, a pound that continues to depreciate makes the UK relatively more attractive to international visitors – reducing the pool of visitors to Australia, and increasing the number of Australians visiting the UK. Should Brexit result in a structural shift in the value of the pound then the relative attractiveness of destinations may become long-term. Once again, specifics on immigration controls may also affect the relative attractiveness for the tourism market.

**The merits and risks of a possible bilateral free trade agreement with the UK**

The advantages of free trade have generally been well understood since at least the days of Smith (1776). By moving production of goods and provision of services to the economy with a comparative advantage there is a benefit to society in terms of higher productivity, faster economic growth and consumers benefit from generally lower prices.

However, a review of economic history is informative in showing that the benefits of free trade do not typically accrue equally to all parties. If one party is exporting high-value goods and services in exchange for low-margin commoditised products then over time there will be a transfer of wealth to the high-value producer. This results in certain economic sectors developing to the detriment of others (for example manufacturing declining during a resource boom). This is reflected in the long-term levels of economic output, income, and the broad skill-base in addition to the keenly followed terms of trade.

In principle I am strongly in favour of negotiating a bilateral agreement with the UK. However, *rushing* to negotiate a deal is the wrong thing to do. By their nature trade deals are complex. In this case, careful consideration also needs to be given as to the outcome of Britain's negotiations with Europe. Care also needs to be taken to ensure that Australian industry does not suffer the ramifications of a trade deal that primarily benefits the UK (or EU) over Australia.

Yours sincerely,

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