



**Senate Foreign Affairs, Defence and Trade
References Committee Inquiry into the Korea
Australia Free Trade Agreement.**

AMWU Submission, August 2014.

Introduction

The Australian Manufacturing Workers' Union welcomes the opportunity to make a submission to the Senate Foreign Affairs, Defence and Trade References Committee Inquiry into the Korea Australia Free Trade Agreement.

The Australian Manufacturing Workers' Union (AMWU) represents approximately 100,000 members working across major sectors of the Australian economy. AMWU members are primarily based in manufacturing industries, in particular; metal, vehicle, and food manufacturing, but also in the industries of mining, building and construction, printing and graphic arts, repair and service and laboratory and technical services. We have nearly 15,000 members employed in Ford, Holden, Toyota and several hundred auto component suppliers who are first, second or third tier suppliers of components and services to Australia's automotive manufacturing industry.

The AMWU has a long and proud history of engagement on trade policy issues. This is largely a result of the significant impacts of trade policy on our members as the vast majority of businesses operating in the manufacturing industry are trade exposed, either through import competition or through export markets.

In addition, as a major trade union representing the interests and values of Australian workers for over 150 years, the AMWU has long played a role in economic policy debates that extends past issues directly concerning industries in which we have members. In the AMWU's view this engagement has led to a more informed and broad based policy discussion in Australia and the AMWU remains committed to playing this role in future.

The AMWU supports the submission lodged by the Australian Fair Trade and Investment Network (AFTINET) of which we are a member. In particular, the AFTINET submission provides a very detailed critique of the labour and environmental chapters of the agreement, the CIE 'national interest test' modelling of the agreement as well as the Investor State Dispute Settlement (ISDS) provision contained in the agreement.

This submission discusses the impact of the Korean agreement on Australia's economy, with a particular emphasis on manufacturing industries. It also provides some commentary on the ISDS provision and the process by which trade agreements are approved and come into law.

In summary, the AMWU does not support the Korean Australian (so called) Free Trade Agreement. We view it as an agreement that favours natural resource endowment sources

of comparative advantage at the expense of more sophisticated, advanced and value adding industries and sources of advantage. As such, it will undermine the complexity and advanced industry basis of the economy, putting the prosperity of all Australians in jeopardy.

In addition, its inclusion of an ISDS provision undermines the sovereignty of the Australian people, places unnecessary and damaging restrictions on future social policies and places Australian firms at a competitive disadvantage as compared to foreign based firms. And finally, it fails to include adequate labour and environmental provisions. For these reasons, it should not be supported by the Australian Parliament.

Bilateral trade agreements and trade policy

In recent decades, Australia's approach to trade policy and in particular bilateral trade agreements (BTAs) or 'free trade' agreements as they are more commonly but incorrectly known, has been driven by an unflinching adherence to the doctrine of free trade. However, the theoretical underpinnings for this doctrine have been subject to substantial scrutiny by the economics profession and the simplistic models that the doctrine is based on have been shown to significantly deviate from the real world context in which trade policy operates. This is reflected in both theoretical work, such as that which earned Professor Paul Krugman his Nobel Prize in economics, as well as a vast and growing body of empirical work. So much so that the currently used graduate text¹ in advanced trade courses at the world's leading university economics departments devotes the majority of its pages to investigating how and when the standard model of free trade breaks down in reality. It investigates the impact of imperfect competition, outsourcing, political economy, multinationals, and endogenous growth as well as knowledge, scale and network effects and the modern organization of the firm on both the operation of international trade and its impact on domestic economies. The conclusions of this work are best summarised as an understanding that the reality of international trade is much more complex and subtle than the simplistic trade models that our "free trade" doctrine is based on. It is clear that trade policy in Australia continues to be based on a doctrine that fails to consider how trade actually operates in the real world, fails to reflect the real economic costs and benefits of trade agreements and other policies and as a result policies fail to generate the benefits that they promise.

The continued failure of Australian governments to incorporate a more nuanced approach to trade (as well as industry) policy that acknowledges a strategic economic role for

¹ Advanced International Trade: Theory and Evidence. Robert C. Feenstra. Princeton University Press.

government in supporting economic development will have an increasingly negative impact on the Australian economy.

As an example, the classical model of free trade simply takes a country's comparative advantage as given. In reality a country's comparative advantage is not only the result of natural endowments, but also of strategic and long term investments in skills, technologies and capabilities. Through investment and with the aid of learning, network and scale effects, a country can build up a comparative advantage in areas such as advanced manufacturing.

Not having a large natural resource endowment to base growth on, Germany and Japan are excellent examples of countries that have invested in and created comparative advantages in advanced manufacturing industries. The policies which supported the development of these industries were not controversial in either country as both countries didn't have any other options if they wanted to attain and maintain advanced economy status and the high living standards such status brought their citizens. However, these policies deviated significantly from those espoused by doctrinal followers of free trade (and 'free market' economics more broadly) and included significant long term government support for innovation, investment, skills as well as significant government involvement in establishing institutions that promoted industry development.

While the manufacturing sector has been under incredible pressure in Australia recently, its importance to Australia maintaining its position as an advanced, high income economy has only become more apparent over time.

We have known that manufacturing is responsible for a disproportionately large share in business Research and Development spending (24%), while only being responsible for less than 10% of output. This is one indication of the central role manufacturing plays in supporting an advanced economy. Other indications are now available.

Relatively recent work by a team of researchers at the Massachusetts Institute of Technology has analysed how the complexity² of a country's economy is related to long run economic performance.³ Their conclusions are startling at first glance, but should not be upon reflection.

² Complexity is measured by the interconnectedness of supply chains that go into the production of goods for export, as well as the goods uniqueness globally. It is effectively a measure of the technological, managerial and skills capacity of an economy.

³ Ricardo Hausmann, Cesar Hidalgo, et al. 2011. ["The Atlas of Economic Complexity"](#). Puritan Press, Cambridge MA.

Economic complexity, which is determined by an economy's diversity, knowledge base and uniqueness in produced products, has huge explanatory power in explaining countries growth experiences. It is closely related to the existence of a diverse and advanced manufacturing sector. The author's state:

"An increase of one standard deviation in complexity, which is something that Thailand achieved between 1970 and 1985, is associated with a subsequent acceleration of a country's long-term growth rate of 1.6 percent per year."

The analysis goes on to compare the explanatory power of economic complexity to the standard variables which economists consider important for determining a country's long run growth prospects; institutional quality, human capital and competitiveness. Of course complexity is influenced by these factors, just as it influences them in return (a fact acknowledged by the authors), but the authors conclude that complexity:

"can account for a significant fraction of the cross-country variation in income per capita and economic growth, and that the ECI (Economic Complexity Index) is a much stronger predictor of growth than other commonly used indicators that measure human capital, governance or competitiveness."

This should not be a surprise to economists and policymakers alike and has been loudly expressed by experts such as Professor Goran Roos for some time. The idea that advanced industries, using advanced technology to produce advanced products generate greater, longer lived and broader economic gains than simple industries producing simple homogeneous products is not revolutionary or surprising.⁴ While it is still opposed by the more dogmatic 'free market' economists that argue 'a potato chip or a computer chip, doesn't matter, they're both chips', most economists and business people now realise that the imbedded skills, technology and international links in an industry do matter for the industry's and the nation's performance.

In Australia's case, where we have a resource based comparative advantage in agriculture and mining, we have had to actively choose to support a broad based economy that included a manufacturing sector. Historically, Australia has chosen to support a manufacturing base because it has been widely recognised that in order to remain an advanced economy and to support high living standards, a reliance on primary production

⁴ For example, see: Hausmann, Ricardo; Hwang, Jason; Rodrik, Dani (2007). "What you export matters". Journal of Economic Growth 12: 1–25.

was not enough. While this support has at some times been stronger than at others, there has been a bipartisan consensus regarding the necessity of this support that has spanned many decades and until recently was not under threat. It was best evidenced through our bipartisan support for perhaps the most advanced mass manufacturing sector globally, automotive production.

The question of whether a particular trade policy or trade agreement is in the long term national interests of a country needs to take into account the interaction of that policy or agreement with processes that lead to the growth and development of new areas of advantage. This was recognised during the Hawke-Keating governments and significant tariff reductions during this period were accompanied by active industry policies to support industry capabilities and growth. However, since the initial opening of the economy, this has rarely if ever been the case, either in the assessment of Australian trade agreements or in their implementation, to the detriment of a more broad based, advanced and competitive domestic economy.

Not only has Australia increasingly failed to take into account this interaction between trade and industry policy, recent developments in industry policy; namely the dismantling of industry specific support and the winding back of innovation, skills and market access support⁵ have come at the same time as a renewed push for new trade agreements.

The current government's dismantling of industry policy represents nothing less than the end of the bipartisan consensus regarding the government's role in supporting a broad based economy and is most dramatically evidenced through its pulling of automotive manufacturing support and the resulting closure announcements by multinational automotive producers.

In the AMWU's view, this represents a double blow for the diversity, sophistication, complexity and therefore long term growth prospects of the economy. It creates the real risk that Australia's future prosperity will solely rely on agricultural and mining industries, which are neither value added intensive, labour intensive nor high technology intensive.

As outlined in some detail in the AFTINET submission, the current government's strong belief in the benefits of BTAs is not supported by empirical evidence. This is even the view of

⁵ For example, the 2014 Federal Budget announced the closure of Commercialisation Australia, Enterprise Connect, the Innovation Investment Fund, 10 programs designed to support apprentices, Australian Industry Participation policies, Industry Innovation Precincts, as well as further cuts to the Automotive Transformation Scheme and the Automotive New Markets Initiative.

the economically conservative Productivity Commission⁶, which stated in a 2010 review of Australia's trade policy:

"The Commission has received little evidence from business to indicate that bilateral agreements to date have provided substantial commercial benefits."

and conceded that:

"The increase in national income from preferential agreements is likely to be modest."

The fact that BTA do not in the real world provide the benefits that are attributed to them in simplistic theory and by politicians is also supported by a comprehensive World Bank study⁷, which states:

"Actual experience reinforces that there can be no presumption that a preferential trade agreement will be trade creating"

Yet the costs of BTAs cannot be disputed. Perhaps the most obvious costs in Australia's case have been borne by the automotive manufacturing industry, but these costs are only examples of greater costs borne by the majority of our trade exposed industries and in particular our manufacturing industries.

In the case of automotive manufacturing, the critical role of an increasingly fragmented market and intense international competition in putting pressure on domestic manufacturers is well known. In evidence provided to the Productivity Commission inquiry into the automotive manufacturing industry, then Managing Director of General Motors Holden (GMH), Mike Devereux stated⁸:

"You've taken a duty rate from 15 per cent to 5 per cent to potentially zero if free trade agreements with Thailand, Korea, pending trade agreements potentially with Japan and China go into effect. So we have one of the, if not the most unprotected markets on the planet"

⁶ Productivity Commission 2010, *Bilateral and Regional Trade Agreements*, Research Report, Canberra. Available at: <http://www.pc.gov.au/projects/study/trade-agreements/report>

⁷ World Bank 2005, *Global Economic Prospects: Trade, Regionalism and Development*, Washington.

⁸ Available at: <http://www.pc.gov.au/projects/inquiry/automotive/public-hearings>

The openness of Australia's automotive market was also cited by GMH when announcing their closure decision⁹, which characterised the Australian market as *"the most competitive and fragmented auto market in the world."*

In making their closure announcement, Toyota¹⁰ too singled out the openness and fragmentation of Australia's market and specifically linked this openness to past and future trade agreements, saying:

"(due to) one of the most open and fragmented automotive markets in the world and increased competitiveness due to current and future Free Trade Agreements, it is not viable to continue building cars in Australia."

Likewise, the chief executive of the Federal Chamber of Automotive Industries, Tony Weber, has previously warned:¹¹

"The proposed (Free Trade Agreement with South Korea) will obviously enhance competition because it makes prices of cars imported from those countries cheaper, but that makes it a more difficult environment for domestic producers. Every time you sign a Free Trade Agreement it makes it tougher."

So while the costs of BTAs are clear in placing pressure on trade exposed sectors, their benefits are either non-existent or impossible to verify. Indeed as the testimony cited above makes clear, the Korean BTA can already claim a significant role in closing down Australia's automotive manufacturing industry, even before it has even come into force.

The reasons for this are clear; BTAs do not represent free or fair trade, they cause trade to be diverted rather than generated, they promote increased reliance on resource endowment based areas of comparative advantage (rather than supporting new value added and employment generating areas of comparative advantage), they impede multilateral agreements and they have increasingly been concluded in a policy vacuum that doesn't include an accompanied industry policy that aims to support the development and growth of comparative advantage in advanced, sophisticated and value adding industries.

⁹ Available at:
http://media.gm.com/media/au/en/holden/news.detail.html/content/Pages/news/au/en/2013/Dec/1211_National_Sales_Company.html

¹⁰ Available at:
https://www.pressroom.com.au/press_release_detail.asp?clientID=2&prID=7225&navSectionID=2

¹¹ South Korea Free Trade deal could crush car industry. Carsguide, 5 December 2013. Available at:
<http://www.carsguide.com.au/car-news/south-korea-free-trade-deal-could-crush-car-industry-23267>

The current Korean BTA is no exception to this trend and in fact represents a worrying development in terms of an agreement that is even more removed from the goal of supporting an advanced and diverse economic base than most.

Korean BTA and timing of closure of Australian automotive manufacturing

The announced closure of Ford, Holden and Toyota manufacturing in 2016-17 does not guarantee any company will continue operating till 2016-17. The timing of closure will largely depend on volumes up to 2016-17, with a significant drop off in volumes potentially causing an early departure of one or all three manufacturing operations.

It is important for several reasons that early closure be avoided.

Early closure would undermine policies designed with a three year lead time to mitigate the impacts of closure (even though in the AMWU's the currently proposed policies fall far short of what is required to mitigate negative closure impacts). It would rob workers of the necessary time to have their skills recognized or to gain new skills through training programs that can run concurrently with employment. In addition, it will not provide supply chain firms with the necessary lead time to implement diversification into new areas of business resulting in greater closures of these businesses than otherwise would occur, increasing the economic and employment cost of the industry's closure.

It is known from historical evidence that a closure announcement has a negative impact on demand for cars. Some may conclude this is evidence of irrationality on the part of consumers as there is no evidence imported car owners suffer from a difficulty in obtaining service or parts for their cars. However, a more generous interpretation is that this is evidence of a 'made in Australia' premium that is withdrawn by the consumer once a closure announcement has been made. Regardless of the reasons, it is a fact that once closure announcements are made, car sales tend to suffer.

As a result, it is crucial that the Government not compound this fall in demand by policy decisions that will further damage volumes and increase the likelihood of an early closure.

Yet the implementation of the Korean BTA and the possible concluding of BTAs with Japan and China will certainly impact on the competitiveness of Australian made cars prior to 2016-17 and will contribute to a decrease in volumes that may result in an early closure of the industry.

The Korean BTA has a three to five year car tariff phasing (depending on the classification of the cars in question), which will impact on volumes from commencement of the agreement. This means that the competitive impacts of the Korea BTA will be felt before the announced closure time for all three remaining automotive producers.

Given the crucial importance of maintaining volumes till closure, there is a very real and present danger that this agreement (which has already played a significant role in closure decisions as outlined above) will trigger the early closure of one or more of the automotive producers. This will in turn lead to a cascading impact on the entire automotive supply chain, hundreds of Australian manufacturing firms and tens of thousands of workers, who with very little help from the government are currently trying to diversify their businesses to new products and markets. In addition, the uncertainty that the Korea BTA has caused regarding the possibility of early closure has only served to increase the difficulty of automotive supply chain firms in accessing the required finance to fund their diversification efforts, again making mass closures and layoffs more likely than they need to be.

The broader manufacturing context and trade policy

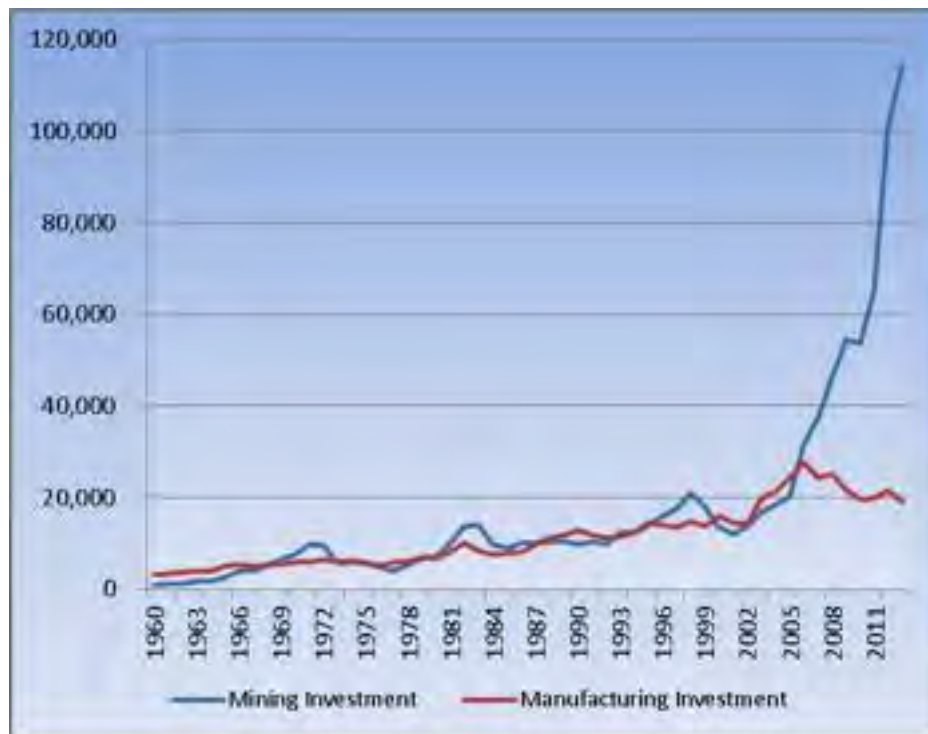
The Australian manufacturing industry continues to experience incredible pressure from broader macroeconomic sources. The same sources of pressures which are responsible for the difficulties of the automotive industry are exerting themselves on the broader manufacturing industry. These pressures can be divided into two inter-related categories; the impact of Dutch disease, or pressures resulting from the mining boom and pressures resulting from an uneven trading environment.

Dutch disease refers to the adverse impacts of a mining boom on industrial sectors, through both exchange rate effects and input price effects. There is no doubt that the Australian manufacturing industry has been experiencing pressures from both of these sources over recent years. Input costs as well as a persistently elevated Australian dollar has meant Australian manufacturing has struggled to compete with imports and in export markets, leading to the continued relative decline of the sector.

Chart 1 below clearly shows the divergence in investment between the mining and manufacturing sectors, which is symptomatic of classic Dutch disease. It also clearly shows the magnitude of the current mining boom in comparison to the mining booms of the past; in particular the early 70's boom, the early 80's boom and the late 90's boom. It is the sheer size of this boom, and its unmitigated impacts on the manufacturing sector, that has lead the AMWU to repeatedly warn that without significant and urgent policies to support the

manufacturing sector, the mining boom risks totally hollowing out our manufacturing sector, with devastating long term impacts for the economy.

Chart 1: Mining and Manufacturing Investment (\$m)



Source: ABS

The second category of pressures impacting the manufacturing industry is the uneven trade playing field. As countries around the world attempt to recover from GFC recessions, they have increasingly sought to expand exports and improve import competitiveness. This has lead to a flood of under priced imports being dumped into Australian markets, currency manipulations which further re-enforce the impacts of Dutch disease, and behind the boarder trade barriers which effectively lock out Australian exports.

With the exception of the *Plan for Australian Jobs* announced during the previous government's final term, no coherent policy response to these pressures has been announced or implemented by any Australian government. And to make matters worse, the previous government's *Plan for Australian Jobs* has been systematically dismembered by the current government even though it was developed in close consultation with industry and unions and received significant support from both groups. In addition, no comprehensive policy package has been announced to replace it.

Rather than address the current pressures facing the manufacturing sector, as outlined above, the current government has embarked on a dogmatic policy of signing as many BTAs as possible, regardless of their impact on struggling Australian manufacturers. These agreements, including the Korea BTA, will only serve to increase the pressures on Australian manufacturing as they further undermine the ability of Australian businesses to compete in an already uneven trading environment.

In the AMWU's view, and as we have expressed in numerous government and other submissions, what is needed is a manufacturing strategy that addresses the short term pressures placed on the sector by the mining boom (and the high dollar), as well as the longer term need for innovation, investment skills and market access support and a more even trading environment.

The continued neglect of this policy agenda by the government, and the continued backward steps on trade policy as evidenced through the Korean (and Japanese) BTA put in grave jeopardy the advanced status of Australia's economy and the future prosperity of all Australians.

Investor State Dispute Settlement

In the AMWU's view, Investor-State Dispute Settlement (ISDS) provisions represent an unjustified threat to Australia's sovereignty, they undermine the legitimacy of Australia's political and legal institutions and they represent biased treatment of corporations based on their country of origin.

These provisions have their origins as mechanisms to protect foreign investors who chose to invest in countries with under-developed legal systems and were prone to political risk. Their acceptance by Australia is fundamentally unnecessary to ensure robust legal protection of investment and property rights as our legal and political system is based on sound principles of the common law and democracy, is very mature and very stable.

ISDS provisions only serve to shift investment risk that rightly should be held by investors, to the public. It is not the case that these investment provisions provide the public with access to the payoffs of this risk. They only enable corporations to seek compensation for costs incurred due to risk. This is effectively socialising the costs of private investment while keeping the benefits private. To the detriment of the public good across the world, this type of legal/policy innovation has been seen across a range of sectors in recent decades, including in the financial sector through the public bailout of institutions that are deemed

‘too large to fail’. However, in no other instance is such a change as unwarranted as it is in the case of ISDS.

ISDS are neither necessary to secure foreign investment, nor necessary to conclude trade agreements that are in the nations interests. They effectively place the interests and rights of foreign corporations above both domestic corporations and the general public good as represented by democratically elected governments. No amount of ‘carve outs’ can fully mitigate their risks. They should not be included in any Australian trade agreements and their inclusion in the Korea BTA represents an extremely dangerous and unfortunate precedent.

The process for approving trade agreements

This submission has outlined a history of trade agreements (in particular bilateral trade agreements) and their imposition in an increasing industry policy vacuum. As outlined above, the AMWU believes that both a lack of industry policy in itself and the negotiation and implementation of trade agreements with little regard for accompanying industry policy represent a fundamental danger to the future economic development of Australia.

In addition, trade agreements have become increasingly tilted towards the interests of large multinational firms, as is best evidenced by the inclusion of the ISDS provision in the Korean BTA; a provision that actually places the rights of foreign firms above those of both Australian firms and the Australian people as represented by their democratically elected government. It is no wonder that an increasing number of Australians are becoming disillusioned with the direction of trade policy, as is evidenced by the over 3,000 signatures that AFTINET have obtained from ordinary Australians signalling their disapproval of ISDS provisions.

Part of this dissolution and the disconnect between trade and industry policy is no doubt the result of the process by which trade agreements are made into law. In short, this process involves secretive negotiations between governments on the treaty text, which is followed by a parliamentary rubber stamp process in which parliament can either approve the draft treaty in its entirety or reject it in its entirety. Unlike the USA and other countries, our parliament has no option to amend the text of the treaty prior to approval. This process dilutes community and stakeholder engagement in consultation processes such as the current inquiry, as the agreement is presented as a *fait accompli* and no possibility of adjustment is possible. In addition, it robs both MPs and the Senate of their rightful role in approving and where necessary amending legislation.

While acknowledging it would increase the time needed to implement any final agreement, the AMWU is of the strong view that parliament should have an opportunity for proper consultation with the community and stakeholders on draft trade treaties as well as the power to make amendments to treaty text.

The importance of trade treaties, both in terms of economic impact and increasingly in terms of social, legal and property rights impacts, justifies real community and stakeholder engagement, even at the cost of making such treaties more time consuming to implement. If the parliament, based on community and stakeholder consultation, believes amendments are important enough to pursue, then the added cost of further negotiations is justified.

In the AMWU's view, it is unjustifiable to have such an important aspect of policy bypass the regular parliamentary and community scrutiny that all other aspects of public policy rightly receive. We urge the Joint Standing Committee on Treaties and the Government to correct this situation and allow the Australian people as well as parliamentarians their rightful engagement in trade policy by allowing parliamentarians the opportunity to make amendments to all trade treaties, to be put to a vote just as in other areas of policy.

Conclusion

The Korean BTA represents the triumph of a dogmatic belief in 'free trade' over sound economic policy. While it may well provide benefits to some primary producers in many years time, it has already contributed to the loss of Australia's most advanced manufacturing industry, with the cost of tens of thousands of direct jobs. In addition, it threatens the early closure of our automotive industry, effectively ripping away any chance that innovative supply chain firms can adapt to new markets and save tens of thousands of jobs in the process.

More broadly, it represents a betrayal of advanced, high employment, value adding industries for the interests of low employment, primary production industries and as such undermines the longer term diversity, complexity and prosperity of the economy. This is especially the case in the current macroeconomic context and in the absence of broader industry policy designed to support the growth of high tech, advanced, value adding sectors of the economy. The purported benefits of the agreement are based on highly contestable

modelling while the costs will be felt by Australian manufacturers and other businesses as soon as the treaty comes into force.

In addition, the lack of robust labour and environmental provisions undermine fundamental fairness in our trade relationships while the ISDS provision represents a dramatic and dangerous abrogation of principles of competitive neutrality and more importantly democratic sovereignty. We urge the Joint Standing Committee on Treaties to reject this treaty.

The AMWU urges the Committee to recommend rejecting the KAFTA agreement as it is not in the long run interests of Australia.