5

National Treatment and Market Access for Goods, Textiles and Apparel and Rules of Origin

Introduction

5.1 This Chapter will consider three related Chapters together: the provisions in the Agreement relating to National Treatment and Market Access, Textiles and Apparel and Rules of Origin. The Annex to Chapter 2 of the Agreement relating to pharmaceuticals is covered in Chapter 6 of this Report.

5.2 Under the Agreement, both Parties have agreed to eliminate customs duties on the import of each other's goods.[1] According to the DFAT Briefing No. 3 2003

> the end product of the market access negotiations on *goods* is a schedule for tariff elimination, listing any items for which there may be transition periods for tariff elimination.

5.3 The Committee understands that under the national treatment obligation each Party is required to

> treat service suppliers and investors of the other Party no less favourably than its own service suppliers and investors in like circumstances. The market access obligation prohibits a number of forms of limitation on market access – such as limitations on the

---

1 Duties will be zero from day one of the Agreement, on 97 per cent of Australia's exports to the US. All tariffs will be zero by 2015, according to the DFAT Factsheet, viewed on 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/04_manufactured_goods.html

number of service suppliers, or on the total value of services transactions or assets.[2]

5.4 Both countries have retained the right to regulate the import and export of certain items, in particular forest products, as well as retain marketing arrangements for wheat, barley, rice, sugar and export arrangements for horticulture and livestock.[3]

5.5 According to DFAT, Australia's trade in non-agricultural goods or merchandise trade with the US was valued at approximately $5.84 billion in 2003. Duty free entry will allow this to grow across all sectors, but in particular autos, metals, minerals, seafood, paper and chemicals.[4] The Committee understands that Australia is already competitive in these areas but has been restricted in its market penetration because of high US tariffs in key products.

Anti-dumping measures

5.6 Both Parties retain their WTO rights to anti-dumping and countervailing action, in the event of unfair trade injury to particular industries.[5]

National treatment and market access for goods

5.7 Chapter 2 of the Agreement applies to trade in all goods between the Parties. Only those goods which qualify under Chapter 5 (Rules of Origin) are able to benefit from the non-discriminatory treatment to which Chapter 2 commits the Parties.[6]

5.8 As a result of liberalisation under the Chapter, over 97 per cent of Australia's non-agricultural exports to the US (excluding textiles and clothing) will be duty free immediately upon entry into force of the Agreement. Remaining tariffs will be phased out. All trade in goods will be duty free by 2015.[7]

---

2 DFAT Briefing No. 3, 2003.

3 DFAT, Factsheet, viewed on 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/04_manufactured_goods.html

4 DFAT, Factsheet, viewed on 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/04_manufactured_goods.html

5 DFAT, Factsheet, viewed on 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/04_manufactured_goods.html

6 DFAT, *Guide to the Agreement*, p. 7.

7 DFAT, Factsheet, viewed on 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/04_manufactured_goods.html

National treatment

5.9 Under Article 2.2, the Parties agree to accord national treatment to each other's goods.

Elimination of duties

5.10 Under Article 2.3, the Parties will progressively eliminate customs duties on goods from the other Party in accordance with their Annex 2-B schedules on tariff elimination.[8] Parties can not increase an existing duty or introduce a new one unless provided for by the Agreement.[9]

5.11 The *Guide to the Agreement* states that

> A large proportion of Australia's exports of non-agricultural goods to the US will be duty free from day one of the Agreement. Apart from agricultural goods, tariffs on a range of textiles and clothing, some footwear, and a small number of other items, will be phased out with all trade in goods free of duty by 2015.[10]

Customs value

5.12 Under Article 2.4, in determining the value of goods, valuation is based upon transaction value and not minimum import prices.[11]

Specific categories of goods

Temporary admission

5.13 Under Article 2.5, the Parties agree to specific arrangements for goods entering the country temporarily, for the use of a resident of the other Party, such as professional equipment or goods intended for use as displays at an exhibition. Such goods are able to enter free of duty.[12] However, the goods must meet a number of criteria, including that they be exported on, or before, the departure of the person using them, or within a reasonable period of time related to the purpose of their admission.[13]

Goods re-entered after repair or alteration

5.14 Under Article 2.6, goods which are re-entered after repair or alteration are able to enter duty-free, as long as the repairs or alterations do not 'destroy

8 AUSFTA, Article 2.3.1.
9 DFAT, *Guide to the Agreement*, p. 7.
10 DFAT, *Guide to the Agreement*, p. 7.
11 DFAT, *Guide to the Agreement*, p. 8.
12 AUSFTA, Article 2.5.1.
13 DFAT, *Guide to the Agreement*, p. 8.

the essential characteristics of the good, or change it into a different commercial item.'[14]

Commercial samples of negligible value and printed advertising material

5.15 Under Article 2.7, commercial samples of negligible value and printed advertising material are allowed to enter duty free.

Waiver of customs duties

5.16 Under Article 2.8, the Parties will not adopt any new waiver of customs duties, or expand any existing waiver program where the waiver is only available upon fulfilment of certain performance requirements. Prohibited performance requirements include export outcomes, import substitution, or domestic preferences (including local content thresholds).[15]

Import and export restrictions

5.17 Article 2.9 provides that except in accordance with WTO rights and obligations, Parties may not impose restrictions on the import and export of goods.[16]

Fees, taxes and formalities

5.18 Under Article 2.10, Parties must ensure that any administrative fees charged in connection with goods do not reflect a disguised tax or indirect protection of domestic products.[17]

5.19 Under Article 2.11, the Parties agree not to adopt or to maintain any duty, tax or other charge on the export of goods to the territory of the other Party unless the same charge is applied to goods for domestic consumption.[18]

5.20 Article 2.12 states that customs import and export fees must not be stipulated on an 'ad-valorem' basis, meaning that the fee must not be calculated on the value of the goods.[19]

Committee on Trade in Goods

5.21 Article 2.13 establishes a Committee on Trade in Goods, which will enable Parties to raise issues of concern in relation to tariffs, non-tariff measures, rules of origin and customs administration.[20]

---

14 AUSFTA, Article 2.6.3; DFAT, *Guide to the Agreement*, p. 8.
15 DFAT, *Guide to the Agreement*, p. 8.
16 DFAT, *Guide to the Agreement*, p. 8.
17 DFAT, *Guide to the Agreement*, p. 9.
18 DFAT, *Guide to the Agreement*, p. 9.
19 DFAT, *Guide to the Agreement*, p. 9.

5.22 The Committee heard from the Australian Chamber of Commerce and Industry that

> For the Committee to be effective, it is important that the private sectors from both countries be fully engaged in its work, especially in identifying outstanding problem areas that may be frustrating the fundamental objectives of the free trade agreement.[21]

Tariff reductions

5.23 The Committee heard a mixed response to the prospect of substantial tariff reduction on imports to Australia under the Agreement. The response to the prospect of lowering of US tariffs was positive.

5.24 The Committee notes evidence that Australia has a significant trade imbalance with the US in merchandise trade. Mr Doug Cameron, National Secretary of the Australian Manufacturing Workers' Union (AMWU) stated that tariff reductions will only worsen the trade imbalance.[22] Mr Cameron went on to explain his position

> I think we will have great difficulty competing with the United States in a zero tariff situation, because of a number of the factors we have outlined in our submission: firstly, the economies of scale that the United States has; secondly, the dollar, and the deliberate devaluation of the American dollar; and, thirdly, the technological advantage that the United States has. These are the simple realities of world trade that we are having to face. We have taken a view that, if we simply open up and get rid of the tariffs, there will be significant job losses—and not only for us.[23]

5.25 However, the Committee did hear much evidence supporting tariff reductions. Mr Alan Oxley of the Australian Business Group for a Free Trade Agreement with the United States stated

> Australia has agreed to … reduce all tariffs on imports from the United States from an average of five per cent to zero. That puts Australia in a position where those goods will be cheaper. If they are cheaper, it makes the economy more competitive. That is not a very big cut. In fact, one of the points about this agreement is that the actual average height of trade barriers between Australia and

20 DFAT, *Guide to the Agreement*, p. 9.

21 Australian Chamber of Commerce and Industry, *Submission 133*, p. 1.

22 Mr Doug Cameron, *Transcript of Evidence*, 19 April 2004, p. 47.

23 Mr Doug Cameron, *Transcript of Evidence*, 19 April 2004, p. 53.

> the US in traditional senses, apart from services, are not very high compared to other countries.[24]

5.26 The Australian Chamber of Commerce and Industry submitted that

> The Australia – US FTA is a big win for Australia's manufacturers, especially those already exporting, or looking to export, to the massive United States market. As noted earlier, virtually all of our manufactured exports to the United States will be duty free from the entry into force of the FTA, with the remaining small fraction subject to known phase-out arrangements over the next decade or so.[25]

5.27 In reference to tariff outcomes for manufacturing, Mr Stephen Deady advised the Committee that

> The manufacturing outcome is a very large part of the deal. I think 97 per cent of tariff lines will be zero on entry into force of the agreement. It is an area again where we are talking about two developed countries with quite open trade regimes really—the average tariff for the United States is 2.8 per cent and the average tariff for Australia is 3.8 per cent. So there are tariff cuts there. The openness of the market I think was there before we started. There are some significant differences, though, in the structure of the tariff regime in the United States compared to Australia's. The maximum tariff in Australia effectively now is five per cent, apart from passenger motor vehicles and textile, clothing and footwear. The United States, though, still has a number of tariff peaks well above that five per cent level and well above its average of 2.8 per cent. Some of them are certainly in significant areas of trade importance to Australia. We have flagged a few—and I think they are well known now: the 25 per cent tariff on light commercial vehicles that impacts on exports of Australian utes, the 35 per cent tariffs on canned tuna and the eight, 10 and 12 per cent tariffs on various metals and minerals.[26]

Industry impacts

Automotive industry

5.28 DFAT has stated that, under Chapter 2, customs duties will be eliminated on almost all automotive products upon entry into force of the Agreement.

24 Mr Alan Oxley, *Transcript of Evidence*, 20 April 2004, p. 27.

25 Australian Chamber of Commerce and Industry, *Submission 133*, p. 1.

26 Mr Stephen Deady, *Committee Briefing*, 2 April 2004, p. 70.

Significantly, this includes the removal of the current prohibitive 25 per cent US customs duty on pick up trucks (utes). Australian duties on passenger vehicles will be phased out by 2010.[27]

5.29 The Committee notes that this is expected to benefit Australian manufacturers, as the US represents the world's largest market for autos and auto parts.[28]

5.30 Evidence received from the automotive industry was largely positive. The Committee notes the position of Holden Australia, which is in support of the Agreement.

> … from 1 January 2005 the tariff will drop to 10 per cent and further tariff phase-downs are scheduled for five years after that. While the local manufacturers' share of the domestic market has been declining as tariffs have declined, the industry has actually restructured and become more competitive by creating opportunities for growth through export. Of course, market access to the large economies, whether they be developed or developing, is crucial to keep that growth going. The US is currently the largest automotive market in the world, and we believe the free trade agreement provides opportunities for the Australian automotive industry to grow by taking advantage of that.[29]

5.31 In relation to the removal of the current 25 per cent tariff on the export of Australian 'utes' to the US, Holden Australia stated that

> It certainly presents an opportunity, though there are perhaps a couple of caveats to that. But there has been a fair amount of publicity around Holden utes going into the United States. Obviously with the 25 per cent tariff that simply was not feasible prior to these negotiations. Whether such an export program goes ahead will depend on a whole range of factors. But removal of the tariff takes away an obvious first barrier.[30]

5.32 The Committee also heard from the Ford Motor Company, which extended its support to the Agreement.

> Ford Australia acknowledges the reductions of tariffs on US vehicles and components imported into Australia under the free trade agreement is likely to result in some additional competitive

27 DFAT, Factsheet, viewed on 18 June 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/12_automotive.html

28 DFAT, Factsheet, viewed on 18 June 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/12_automotive.html

29 Ms Alison Terry, *Transcript of Evidence*, 20 April 2004, p. 106.

30 Ms Alison Terry, *Transcript of Evidence*, 20 April 2004, p. 107.

> challenges. However, the company has a proven track record of developing award-winning vehicles within a flexible and cost-effective manufacturing environment. As such, the company believes it is well placed to meet these new challenges while also looking for opportunities that will come from the opening of the US market.[31]

And

> We also believe that the proposed phasing arrangements for Australia's automotive industry are extremely fair, particularly recognising the fact that the US has agreed to there being no phasing arrangements for its automotive industry.[32]

5.33 The Committee also notes the position of the Federal Chamber of Automotive Industries (FCAI).

> From the standpoint of the Australian automotive industry as a whole, we believe that this agreement offers significant opportunities to automotive exporters. The United States has offered to remove all tariffs on automotive products upon entry into force. Equally, we have acknowledged that the agreement will bring with it some additional competitive challenges. Under the terms of the agreement, imports of vehicles and parts will receive preferential access to the Australian market. It remains to be seen what impact this will have, although I should note that by 2010 the maximum margin of preference will be no more than five per cent.[33]

5.34 Mr Peter Sturrock of the FCAI conceded that, despite benefits, there may be some challenges for Japanese manufacturers Toyota and Mitsubishi as a result of the Agreement.

> I think there is recognition that the US FTA, as it is described, does provide a number of challenges for the Japanese based companies or companies with Japanese sourced products. That is nothing we would necessarily believe to be unusual or a surprise, given the scope of such a potential agreement. The particular companies that you have identified have had discussions with DFAT directly and with the ministers generally about their concerns or anxieties. They relate to particular issues of long-term strategy for the corporations. I think it is useful to note that, broadly, the corporations at head office level, as brands in worldwide trading

31 Ford Motor Company of Australia, *Submission 121*, p. 2.

32 Mr Russell Scoular, *Transcript of Evidence*, 21 April 2004, p. 11.

33 Mr Peter Sturrock, *Transcript of Evidence,* 4 May 2004, p. 35.

> circumstances, are supportive of overall WTO type free trade arrangements. The individual circumstances, region to region and country to country, become another matter and, as I said, are wedded to the particular business plans of those organisations and those subsidiary companies.[34]

5.35 Mr Sturrock also commented on trade diversion generally as a result of the Agreement

> There are some companies that import more from the US versus other sources and there are others that gain more from elsewhere. There may be some opportunities among some of those manufacturers that currently source elsewhere in the region to look at the US as a source. There will be a preferential tariff advantage from doing so but we would be cautious about adopting the interpretation that it is going to result in significant volumes of diversion of trade. It is probably unlikely in the short term, remembering that as we move towards 2010 the actual preferential margin, whether it is on components or vehicles, under this agreement for automotive products will diminish back to a maximum of five per cent.[35]

5.36 In regard to the general impact of the Agreement on the sector, the Committee heard evidence from DFAT that

> if you look at the work that Dr Stoeckel has done in the manufacturing sector broadly but in the auto sector in particular, it shows very strong gains for the Australian industry as a result of the free trade agreement. In fact, it shows increased two-way trade with the United States, certainly showing increased imports from the United States in autos but also in auto parts. They go on to explain that they think most of those increases would be in components, trucks and vehicles other than passenger motor vehicles—where they do not really see competitive pressure from the United States—but also significant growth in Australia's exports and output of autos. That seems to be an area where the FTA delivers significant gains to the manufacturing sector, and the auto sector in particular.[36]

5.37 The Committee notes analysis by the CIE which suggests that the impact of the Agreement on the automotive industry will be generally positive,

34 Mr Peter Sturrock, *Transcript of Evidence,* 4 May 2004, p. 37.

35 Mr Peter Sturrock, *Transcript of Evidence,* 4 May 2004, pp. 38-39.

36 Mr Stephen Deady, *Transcript of Evidence*, 14 May 2004, p. 90.

with a slight increase in outputs (0.2 per cent increase) and a greater increase in exports (7.8 per cent) than the increase in imports (2.5 per cent).[37]

5.38 In response to questions about whether Monaro could be produced offshore, the Committee notes the exchange between Senator Marshall and Ms Alison Terrey from Holden Australia.

> **Senator MARSHALL—**Following on from that, the committee has been told that the head of General Motors North American operations, Mr Bob Lutz, pointed out to the Detroit press that, if the Australian manufactured Monaro achieved sufficient volumes and market acceptability, production would be shifted from Australia back to the US. Is that the case?
>
> **Ms Terry—**Those comments were made at the New York show, I believe, very recently. It is certainly the case that General Motors operates as a global organisation. The domestic Monaro has always been what we call a niche, brand leader type vehicle. We will sell only between 2,000 and 3,000 domestically this year, obviously with 18,000 going to the United States and small volumes to other markets.
>
> **Senator MARSHALL—**Would that be considered a sufficient volume in the States to move production? I am just trying to work out what level of exports to the States we need to achieve before we lose the whole export market.
>
> **Ms Terry—**That is the way things work when you are working as a global operation. General Motors in the United States have a number of brands under which they sell vehicles. Obviously with a 17 million, 19 million, or whatever it is, domestic market, their domestic production would always be far in excess of ours if that decision were made. The view that we have taken is that, when you go into an export program or, indeed, a domestic program, it is only ever for the life of that model, which might be seven years these days for an all-new Commodore, for example. Nothing is forever. We have a manufacturing facility that has a certain capacity. Our business view would be that, if Monaro were to shift production to the United States or wherever, that would then free up capacity for us to manufacture another vehicle which the US or China were not making.[38]

37 CIE Report, Table 7.2, p. 85.

38 *Transcript of Evidence*, 20 April 2004, p. 109.

Minerals

5.39 The Committee understands that all metals and minerals will be duty free from day one of the Agreement, and notes that Australian aluminium manufacturers currently export $134 million to the US.[39]

5.40 The Minerals Council of Australia considers that there are five key benefits to the minerals industry

- the agreement will enhance Australia's attractiveness as a favourable destination for US investment, increasing the opportunity for new resource projects
- there will be flow on effects to other major trading partners which will enhance trade and investment opportunities for those countries
- tariffs will be eliminated
- there is an enhanced potential for Australian mining technology and service industries to build partnerships with US technology firms in servicing the global industry
- the Agreement does not introduce trade related measures to restrict trade for environmental, labour or other non-trade objectives.[40]

Canned tuna

5.41 The Committee notes the position of the Tuna Boat Owners Association of Australia, which is strongly in support of tariff reductions under the Agreement. The Committee heard that the previous tariff of 35 per cent imposed by the US on canned tuna was prohibitive to any export of Australian canned tuna product to that market. The immediate elimination of a tariff on canned tuna product upon the Agreement's entry into force is strongly welcomed by the Tuna Boat Owners Association.[41] Mention of the impact of the US tariff on Australian canned tuna is also made in Chapter 7 of this Report.

Spirits

5.42 The Distilled Spirits Industry Council of Australia advised the Committee that it welcomes the immediate removal of the 5 per cent ad valorem tariff imposed on the import of US spirits and ready-to-drink products to Australia.[42]

---

39 www.dfat.gov.au/trade/negotiations/us_fta/outcomes/01_overview.html, viewed on 20 June 2004.

40 Minerals Council of Australia, *Submission 134*.

41 Mr Brian Jeffriess, *Transcript of Evidence*, 6 May 2004, p. 10.

42 Distilled Spirits Industry Council of Australia, *Submission 209*, p. 1.

Effect on employment

5.43 The Committee received evidence suggesting that there would be some negative effects on the automotive industry as a result of the Agreement. Based on economic analysis, the AMWU forecast that there would be large job losses in the auto and component industry as a result of fast tariff reductions.[43]

> What then will happen when Australia surrenders its tariff advantage over the United States virtually overnight? The AMWU submits that it is clear that to the extent employers are unable to pass losses directly on to their workers though insecure forms of employment and downward pressure on wages and conditions, increasing numbers of Australian manufacturers will either cease production or move offshore.[44]

And

> In terms of what benefits are there, we agree with the general economic analysis that has taken place: that there will be job losses in manufacturing. That has been said in a clear and consistent voice by independent economic analyses into the US free trade agreement. Even the Productivity Commission in an internal working document indicated job losses in manufacturing as a result of the US free trade agreement. That is why the government will not go to the Productivity Commission. I am not a fan of the Productivity Commission but I certainly think they would give a far more independent position than the manufactured outcome that is being promoted as part of the so-called independent analysis from government.[45]

5.44 Mr Cameron argued that

> If there was a loss of a significant part of the industry, the multiplier effect would move down into the components sector and the industries that supply the components sector. We believe that the basic skills, the fundamental transportable skills, for manufacturing will be lost, and that is a problem not only for the economy but also for the defence of this country. If we cannot maintain our defence capacity through having skilled trades people in this country, because we are not training them up and because we have lost our economic independence as a

43 Mr Doug Cameron, *Transcript of Evidence*, 19 April 2004, p. 49.

44 Australian Manufacturing Workers Union, *Submission 125*, p. 6.

45 Mr Doug Cameron, *Transcript of Evidence*, 19 April 2004, p. 50.

> manufacturing country, then that has not only economic but defence implications for this country.[46]

5.45 However, the Committee notes additional comments in the CIE Report which are attributed to the AMWU.

> However, although the AUSFTA has been well received by thee major motor vehicle manufacturers and FAPM, the … AMWU believes that, although some product substitution may take place, AUSFTA will have no major (additional) impact on employment or production. This is because Australian tariffs were already scheduled to be reduced, and Australian manufacturers will still be faced with non-tariff barriers in the US market.[47]

5.46 The Committee also notes comments from DFAT in relation to claims that the Agreement would result in increased employment in the US, and therefore would impact negatively upon employment in Australia.

> The first point I would make is that it does not follow that, because there is an increase in jobs in the United States from increased exports of manufactured products to Australia, there is a corresponding loss of jobs in this country. We look at the vast range of factors that I think you have to take into account here. The first is that we do have low levels of protection in this country already. The Americans have that trade surplus with Australia largely because we want to import those products. They are competitive suppliers in the market, and many of them do not compete with existing Australian production. To the extent that there are any tariffs on those, they will actually be a benefit to Australian manufacturers and lower the costs of Australian industry.[48]

Rules of Origin (ROOs)

5.47 Chapter 5 provides for the determination of which goods are originating, and therefore eligible for preferential tariff treatment under the Agreement.[49] The Chapter consists of 17 Articles and Annex 5-A.

---

46 Mr Doug Cameron, *Transcript of Evidence*, 19 April 2004, p. 51.

47 CIE Report, p. 125, citation to 'Jones, I., AMWU, personal communication, 5 April 2004.'

48 Mr Stephen Deady, *Transcript of Evidence*, 14 May 2004, p. 87.

49 DFAT, *Guide to the Agreement*, p. 29.

5.48 Under Chapter 5, any manufactured product that includes imported inputs must be 'substantially transformed' in either Australia or the US before it can benefit from the Agreement. Where it is difficult to demonstrate that a product has undergone substantial transformation, an additional or alternative local content threshold test will be applied, under which domestic materials and processes will need to form a set proportion of the final value of the product.[50]

5.49 Mr Deady explained to the Committee that the rules of origin under this agreement are different for those used in a preferential agreement and certainly different to those in ANZCERTA and the Singapore FTA where there is 'essentially a 50 per cent final stage of processing value added concept'.

> The objectives of the rules are much the same, though: to ensure sufficient substantial transformation of the product in either Australia or the United States to qualify for the preference. The US does it a different way. The basic way is a change of tariff classification. If an imported product in one tariff classification gets exported in a different classification, then it passes the rules of origin. We spent a lot of time explaining that to Australian industry throughout last year, and I think there is strong support and acknowledgement within Australian industry that that is in fact an easier way to monitor the rules of origin and ensure that they are met. The complication there is that the US system is a bit of a hybrid. They still have some value added elements, some product lines which are still subject to value added elements and where bookkeeping is still required—but that bookkeeping is familiar to Australian industry through the processes of New Zealand and Singapore. This is broadly the picture. It is a very big deal on manufactured exports in both directions.[51]

5.50 The Committee notes concerns from the NSW Government that

> The Rules of Origin provisions contained in the proposed AUSFTA could potentially impose significant market barriers and administrative costs on NSW manufacturing firms wanting to export to US markets.
>
> The purpose of the Rules of Origin provision is to confine access to tariff concessions to goods originating in Australia and the US, respectively. The proposed AUSFTA, however, appears to adopt the current US regime for Rules of Origin, which is highly

50 DFAT, Factsheet, viewed on 18 June 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/16_rules_of_origin.html

51 Mr Stephen Deady, *Committee Briefing*, 2 April 2004, p. 71.

> prescriptive and very complex. This approach could potentially restrict the ability of NSW-based firms to gain access to the AUSFTA's tariff concessions for manufactured goods, particularly in relation to textiles, clothing and footwear, as well as the automotive components sector.
>
> The differences between Rules of Origin requirements for Australia's free trade agreements with the US, Thailand and Singapore could potentially increase compliance costs and create confusion and uncertainty among Australian exporters of manufactured goods.[52]

5.51 The AMWU stated that

> While the AMWU is still analysing the relevant clauses, the AMWU's preliminary view is that in many cases the rules of origin clauses in the agreement appear insufficient to ensure that only products which are substantially produced in Australia or the United States obtain concessional entry under the agreement. The AMWU is particularly concerned that not only will the rules of origin in the proposed AUSFTA grant concessional access to products for which a significant proportion of their manufacture took place in a country that has not granted reciprocal access to Australian producers but that it will also grant concessional access to products for which a significant proportion of their manufacture has taken place in a country or countries with a very low commitment to environmental or labour standards.[53]

And

> The AMWU also notes that the rules of origin appear to largely operate on a self-assessment basis. Although there is some capacity for requiring the production of records after the event, the AMWU is concerned that the agreement will in practice be difficult to monitor and enforce.[54]

5.52 However, the Committee notes evidence from Holden Australia that

> From Holden's perspective, our first preference was to ensure that, in developing a free trade agreement with the United States, consistency was maintained with other arrangements and while this has not been achieved, the rules for determining origin

52 NSW Government, *Submission 66*, p. 6.

53 Australian Manufacturing Workers Union, *Submission 125*, p. 21.

54 Australian Manufacturing Workers Union, *Submission 125*, p. 22.

> provide an adequate test to ensure that preference is only being given to the parties to the agreement.
>
> Holden was particularly supportive of the requirement to have both a change of tariff classification ***and*** a 50% minimum regional value content requirement based on the net-cost methodology, to ensure that the Australian market is protected from a possible influx of cars, particularly used cars, originally manufactured outside the US.[55]

Originating goods

5.53 For the purposes of the Agreement, originating goods are those that

- are wholly obtained or produced entirely in the country, such as minerals extracted there, vegetable goods harvested there, and live animals born and raised there
- are produced in the country wholly from originating materials, or
- are produced in the country partly from non-originating materials. In this case, the non-originating materials must meet the requirements of the origin rules in the Annex 4-A (Textiles - see Chapter 4 of the Agreement) and Annex 5-A (Goods other than Textiles). These Annexes contain the product-specific changes in tariff classification that non-originating materials must undergo for the finished goods to qualify as originating. The goods must also satisfy all other applicable requirements.[56]

Change in tariff classification approach to ROOs

5.54 In regard to change of classification under the AUSFTA, the *Guide to the Agreement* states that

> The concept of change in tariff classification used in the Annexes means that inputs sourced outside the territories of the FTA may not come from the same tariff item as the good in question nor from a defined set of related tariff items. This approach ensures that sufficient transformation has occurred within the US or Australia to justify a claim that the good is a legitimate product of the US or of Australia. The exact nature of the change of tariff classification required for a specific good can be found by referring to the rule in the Annexes covering that good.[57]

---

55 Holden Australia, *Submission 148*, p. 9.

56 DFAT, *Guide to the Agreement*, p. 29.

57 DFAT, *Guide to the Agreement*, p. 29.

Accumulation

5.55 Under Article 5.3, materials originating in the territory of one Party that are then used in the production of a good in the other Party are considered to originate in the territory of that other Party.[58] A good is considered an originating good when it has been produced in the territory of one or both Parties, by one or more producers, provided that the good satisfies requirements under Chapters 4 and 5 of the Agreement.[59]

Regional value content

5.56 For some products, the change of tariff classification rule is supported by a local content threshold, or regional value content (RVC) requirement. This means that domestically sourced materials and processes must represent a certain proportion of the final value of the product.[60]

5.57 The Agreement provides for 3 formulas to determine the RVCs

- the Build-Down method, where the RVC threshold is determined by calculating the value of the final product after subtracting the cost of non-originating materials and comparing this to the value of the exported product.[61] [45 per cent]
- the Build-Up method, under which the RVC threshold is based on the proportion of the value of the final product represented by locally sourced materials.[62] [35 per cent]
- a Net Cost method that is applied only to certain automotive products.[63] [50 per cent][64]

5.58 The Committee notes comments by Mr Andrew McKellar of the FCAI in relation to this provision.

> For some items the agreement also provides that origin may be conferred if a minimum level of regional value content is achieved. In most instances regional content is measured on the basis of so-called transaction value of the product calculated using one of two methods—either a build-down approach in which the value of non-originating materials is subtracted from the final value or a

58 AUSFTA, Article 5.3.1.
59 AUSFTA, Article 5.3.2.
60 DFAT, *Guide to the Agreement*, p. 30.
61 AUSFTA, Article 5.4.1(a).
62 AUSFTA, Article 5.4.1(b).
63 AUSFTA, Article 5.4.2.
64 DFAT, *Guide to the Agreement*, p. 30.

> build-up method in which the value of originating inputs is added up and calculated as a proportion of the final value of the goods.[65]

De Minimis

5.59 Under Article 5.2, if all inputs which fail the ROOs test for a particular product account for a total of less than 10 per cent of the total product value, the final product is still considered to be an originating product.[66] This is known as the 'de minimis' principle.

5.60 This provision does not apply to certain products, including dairy, citrus fruit, certain animal or vegetable fats or sugars, and some alcohol products where used in the production of other specified alcohol products.[67]

Specific products

Essential tools and spare parts

5.61 Under Article 5.6, a product that otherwise qualifies for preferential treatment will not be disqualified purely because any essential tools, accessories or reasonable quantities of spare parts shipped with the product do not pass the test of origin for those products.[68]

Fungible goods and materials

5.62 Article 5.7 states that in determining whether fungible goods or materials are originating, they can be tracked either by means of physical segregation or by inventory management.[69] Under Article 5.18.3, fungible goods or materials are defined as those that 'are interchangeable for commercial purposes and whose properties are essentially identical', such as fasteners used in metal manufacture.[70]

Packaging materials and containers

Retail sale

5.63 Under Article 5.8, in terms of their origin, packaging materials and containers for retail sale are disregarded, and so do not affect the treatment of goods concerned in terms of change of classification rules.[71]

---

65 Mr Andrew McKellar, *Transcript of Evidence*, 4 May 2004, p. 36.
66 DFAT, *Guide to the Agreement*, p. 31.
67 DFAT, *Guide to the Agreement*, p. 31.
68 DFAT, *Guide to the Agreement*, p. 31.
69 DFAT, *Guide to the Agreement*, p. 31.
70 DFAT, *Guide to the Agreement*, p. 31.
71 DFAT, *Guide to the Agreement*, p. 31.

5.64 If the good is subject to an RVC, the value of the packaging materials is considered in calculating that RVC.[72]

Shipment

5.65 Under Article 5.9, packaging materials and containers for shipment are disregarded in determining both their origins and for RVC calculations.[73]

Third country transportation

5.66 Under Article 5.11, a good will not be considered to be an originating good

> where it undergoes subsequent production or any other operation outside the territories of the Parties, other than unloading, reloading or any other operation necessary to preserve it in good condition or to transport the good to the territory of a Party.[74]

Claims for preferential treatment

5.67 Under Article 5.12, the importer bears the onus for making a claim for preferential treatment for a product. The Committee notes that this differs from current practice under SAFTA and ANZCERTA, which both place this onus on the exporter.[75]

5.68 In relation to making such a claim, the *Guide to the Agreement* states that

> This Agreement does not require that the importer provide a certificate of origin in support of a claim preference. However, importers claiming a preference for a good must be prepared to submit, upon request by Customs authorities, a statement setting out the reasons that the good qualifies, including pertinent cost and manufacturing information. No particular format for such a statement is specified in the Agreement.
>
> Customs officials can require importers to maintain documents relating to purchases and costs for up to five years after importation should investigation and verification of claims be required. Customs officials can also seek information from exporters in verifying claims.[76]

72 DFAT, *Guide to the Agreement*, p. 31.
73 DFAT, *Guide to the Agreement*, p. 31.
74 AUSFTA, Article 5.11.
75 DFAT, *Guide to the Agreement*, p. 32.
76 DFAT, *Guide to the Agreement*, p. 32.

Textiles and Apparel

5.69 The Regulatory Impact Statement states that 'around 30 per cent of tariff lines for textiles and apparel will be duty free on entry into force with the remaining lines in this sector to be phased out by 2015'.[77] The Committee notes statements from DFAT that the outcome on textiles and apparel was due to US insistence on maintaining the 'yarn forward' rule, which operates in a more restrictive manner than other rules of origin.[78]

5.70 The Committee heard evidence concerning the disparity between the Australian and US textiles and apparel industries.

> Our industry is tiny compared to the US. We employ 58 000 workers in the regulated sector, whilst the US employs 520 000 clothing workers and 432 000 textile workers.
>
> Capital investment in the US textile sector in 2001 (excluding clothing) was $2.2 billion US dollars. The equivalent period in Australia saw $202 million (AUD) invested in the entire Australian TCF industry.
>
> Our industry is tiny, it is a minor player in the US domestic market and yet the US FTA is treating us as though we represent the same level of threat that China represents to the US TCF market.
>
> In 2002 the US represented 7% of all Australian TCF imports of textiles and 1.6% of clothing. The US FTA is likely to see an increase of textile imports, especially over time with the continued winding down of tariff rates. At the same time Australia's share of the US domestic market is unlikely to change as a result of the FTA.[79]

Safeguard Mechanisms

5.71 Article 4.1 provides for a safeguard mechanism to protect domestic industry adversely affected by a 'sudden growth in imports flowing from a tariff reduction'. If an increase in imports threatens or results in serious damage, then the importing country is permitted to raise tariffs back to the most favoured nation rate applying at the time of action.[80]

5.72 Under Article 4.1.6, in the first ten years after a tariff has been eliminated, emergency action can be taken for a maximum of two years, followed by one-off extension (a further two years). After this time, no emergency

77 Regulation Impact Statement, p. 5.

78 Regulation Impact Statement, p. 5.

79 Textile, Clothing and Footwear Union of Australia, *Submission 8*, p. 2.

80 DFAT, *Guide to the Agreement*, p. 25.

action is permitted. The Committee notes that emergency action over a particular product can only be used once. On conclusion of action, the rate of duty will return to pre-action levels.[81]

5.73 According to Article 4.1.7, a Party imposing emergency action is required to provide liberalising compensation, preferably to a level on other textile products equivalent to the negative effects caused by the action. If mutually acceptable compensation cannot be found then the exporting Party is permitted to impose tariff penalties on product equivalents.[82]

5.74 In regard to the effectiveness of the safeguard mechanism to protect the Australian industry, the Committee notes evidence from the Textile, Clothing and Footwear Union of Australia (TCFU) that

> what has been agreed to is not only insufficient but potentially damaging to other TCF exporters. The safeguard mechanism, which can be put in place for two years, can only be used once for any particular product. Thereafter, regardless of any surge in imports, this product cannot be protected.
>
> Another aspect of the safeguard mechanism which will cause major problems for the industry is the requirement that the country imposing an emergency action will [be required to offer compensation].
>
> In other words, if the safeguard mechanism is used by an Australian firm, (and given the restrictive basis of the rules of origin the only likely user of this mechanism is Australia because so few Australian TCF exports will ever reach the US market), another Australian firm will suffer. This will be either a TCF firm, or if there is no TCF firm, then another Australian company in another industry.
>
> The most likely implication of this 'safeguard' mechanism is that it will never be used by Australia because there will be immediate retaliation by the US with our TCF or other exports.[83]

5.75 However, Council of Textiles and Fashion Industries of Australia (TFIA) offered some support for the mechanism.

> While unlikely to be used given the marginal tariff preference the TFIA and its members support the inclusion of safeguards in the agreement. As provided for in the draft text they will offer a valid

81 DFAT, *Guide to the Agreement*, p. 25.

82 DFAT, *Guide to the Agreement*, p. 25.

83 Textile, Clothing and Footwear Union of Australia, *Submission 8*, p. 3.

> and reasonable means for companies in one party to redress exploitative behaviour by companies from the other party.[84]

Rules of Origin – the 'yarn forward' rule

5.76 Article 4.2.1 states that the ROOs applying to textiles and apparel are based on a change in tariff classification (CTC) approach and are set out in Annex 4-A.

5.77 The ROOs apply a 'yarn forward' test, under which

- fabrics produced for export be made up of yarns wholly formed in one or other of the Parties to the Agreement
- apparel for export be produced from fabrics entirely formed in one or other of the Parties using yarns wholly formed in one or other of the Parties. The apparel must also be cut or knit to shape or otherwise assembled in one or other of the Parties. [85]

5.78 The Committee notes evidence from the textiles and apparel industry which claims that

> these rules negate the bulk of Australian TCF products from preferential access under the agreement by virtue of the fact that the fibre or yarn for much of these products is not produced or wholly formed in Australia being generally imported from third countries outside of the agreement. While it would be possible to source US fibres and yarn or commence production in Australia this would place the price of the finished Australian products well above those of equivalent US products and third country imports in the marketplace.[86]

5.79 The *Guide to the Agreement* states that there are exceptions for certain products, for example, that cotton and man-made fibre spun yarns and knitted fabrics must be produced from fibres grown or formed in one or other of the Parties.[87]

5.80 Textile and apparel ROOs are product-specific and vary depending on the particular good. Specification of which test to apply is contained in Annex 4-A.[88]

5.81 Under Article 4.2.3 there is a mechanism for consultation between the Parties to reconsider the ROOs applying to individual products and to amend these ROOs as appropriate.[89]

---

84 Council of Textile and Fashion Industries, *Submission 111*, p. 2.

85 DFAT, *Guide to the Agreement*, p. 26.

86 Council of Textile and Fashion Industries, *Submission 111*, p. 2.

87 DFAT, *Guide to the Agreement*, p. 26.

88 DFAT, *Guide to the Agreement*, p. 26.

5.82 Article 4.2.6, which is a *de minimis* provision, provides that a product will not forfeit its originating status if any non-originating fibres or yarns used in the production account for less than seven per cent by weight of the textile or apparel good. This provision does not apply to elastomeric yarns for which there is zero tolerance for non-originating yarn.[90]

5.83 Article 4.2.8 provides that where a product for export consists of a set of products, e.g. clothing and accessories, any non-originating goods in the set must be no more than 10 per cent if the set is to preserve its originating status. [91]

5.84 The Committee notes evidence from the textiles, clothing and footwear union on the maintenance of the yarn forward rule and its effect on the Australian industry.

> Whilst there was potential for considerable benefits to the Australian TCF industry from this agreement, the US insistence on maintaining 'yarn forward' rules of origin has significantly reduced, if not eliminated, any potential up-side for industry and created a considerable down-side.[92]

5.85 The TCFU submitted to the Committee that

> the bulk of Australian TCF industry (up to 80%) cannot meet US yarn-forward rules because much of our yarn is sourced from Asia. Most US companies meet this rule which means that by 2015 the benefits of the FTA will only flow to US companies.
>
> These ‘rules of origin’ issues are in addition to concerns that large US companies with volume production will be able to flood the Australian market with cheaply made goods in some TCF areas where Australia has traditionally maintained a strong domestic base.[93]

5.86 In reference to the impact of the rule on the industry, Mr Deady advised the Committee that

> The structure of our industry is different. We do not produce the yarn ourselves, or we import it from countries in the region, so we would never meet the rule of origin; therefore, we would never meet the standard to qualify for the preference. As a result of that, despite many attempts to modify the rule of origin—to identify

---

89 DFAT, *Guide to the Agreement*, p. 26.

90 DFAT, *Guide to the Agreement*, p. 26.

91 DFAT, *Guide to the Agreement*, p. 26.

92 Textile, Clothing and Footwear Union of Australia, *Submission 8*, p. 1.

93 Textile, Clothing and Footwear Union of Australia, *Submission 8*, p. 1.

> particular products and sectors where we could, even within a limited range of products, have that rule of origin adjusted—that was something the Americans could not agree to. At the end of the day, as a result of that, we phased out our tariffs over a 10-year period. So the impact on the industry will be very minimal either way as a result of the deal. Some Australian products certainly will benefit from the preferences, but it is a limited range of products.[94]

Customs Cooperation (Article 4.3)

5.87 The Agreement allows for Customs authorities in both countries to cooperate to ensure compliance with the rules. Customs of importing countries may request the authorities of exporting countries to verify a claim. Imports of suspicious goods may be suspended by the importing country while a matter is being investigated.

5.88 There will be a special transitional safeguard measure for textiles and clothing to address any undue interruption to the industry in either country.[95]

Concluding observations

5.89 The Committee received little evidence with regard to the general principles of market access. Much of the evidence was focussed on specific tariff lines such as passenger motor vehicles (PMV), textiles, clothing and footwear (TCF) and canned tuna.

5.90 Both Australia and the US have relatively low average tariffs with a maximum tariff of 5 per cent except for PMVs and TCF. As proposed under the Agreement, both items will have phase-ins of five years for PMVs and ten years for TCF. The Committee has carefully examined evidence received from these two industries.

94 Mr Stephen Deady, *Committee Briefing*, 2 April 2004, pp. 71-72.

95 DFAT, Factsheet, viewed at 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/04_manufactured_goods.html