ENTERPRISING AUSTRALIA - PLANNING, PREPARING AND PROFITING FROM TRADE AND INVESTMENT

Submission to the Trade Sub-Committee of the
Joint Standing Committee on Foreign Affairs, Defence and Trade
by the Department of Foreign Affairs and Trade

February 2001

Contents

Explanatory Note

This submission will comment on each specific term of reference of the inquiry but it should be noted that responsibility for the issues raised in the terms of reference lies with a range of Commonwealth and State and Territory agencies.

Executive Summary

Trade and investment make a substantial contribution to Australia's economic prosperity, not least through the creation of more and better paid jobs. The contribution of regional and national development agencies* to economic expansion is facilitative rather than necessary. The absence of clear and measurable performance indicators means accurate evaluation of the performance of development agencies is very difficult. Economic leadership is best attained through government policies promoting economic and regulatory reform, especially strong and transparent legal systems. Investment and other incentives need to be consistent with World Trade Organization obligations. High demand for Australian professionals internationally indicates very competitive levels of skills and expertise as does increasing numbers of international students attending Australian institutions. The Department of Foreign Affairs and Trade promotes Australia's interests bilaterally, including as an investment destination and source of goods and services, through its overseas posts and in cooperation with other agencies, particularly the Australian Trade Commission. The department also pursues Australia's economic interests through the World Trade Organization and the Asia Pacific Economic Cooperation (APEC) group and is open to concluding regional free trade agreements that deliver meaningful gains in market access across all sectors.

* as defined in the terms of reference and not to be confused with aid agencies.

1. Introduction

Trade and investment make a substantial contribution to Australia's economic prosperity. The consensus of econometric modelling results based on Australian figures is that removing trade barriers, internationally and in Australia, lifts living standards and delivers other benefits to Australia. Australian families, for example, are estimated to have gained an extra $1,000 per year from tariff reductions since 1986-87.[1]

Exports and investment also contribute strongly to employment in Australia. The department estimates that around one in five jobs in Australia is derived from exporting with this ratio increasing to one in four jobs in rural and regional Australia. Recent research also suggests that jobs in exporting industries pay more than those in non-exporting industries while employee conditions, job stability and work safety are also greater in exporting industries.[2] Similarly, inward investment has a positive effect on employment. For example, in 2000 Japanese-affiliated companies in Australia were estimated to employ some 50,000 people directly; a figure which increased to over 200,000 when their supply chains and sub-contractors were accounted for.[3]

The employment effects of foreign investment are complemented by the skills and knowledge transfer such investment facilitates. And, importantly, foreign investment plays a significant role in Australia's export industries. For example, 60 per cent of the Japanese-affiliated companies referred to previously were export-oriented, with the combined value of their exports estimated to exceed $3 billion annually. Similarly, foreign investment has underpinned the development of Australia's automotive industry, which earned some $4.2 billion in export income in 2000.

2. The role of development agencies in economic expansion such as the Industrial Development Agency in Ireland and the Economic Development Board in Singapore[4]

The main objective of the Industrial Development Agency (IDA) of Ireland is to contribute to Ireland's economic development by securing foreign investment, particularly in regional Ireland.[5] While an

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[1] Modelling by the Centre for International Economics cited in *Trade Liberalisation: Opportunities for Australia*, Department of Foreign Affairs and Trade, 1997.

[2] A *Portrait of Australian Exporters: A report based on the business longitudinal survey,* Australian Bureau of Statistics and Australian Trade Commission, 2000.

[3] Survey conducted by the Embassy of Japan, the Federation of Japan Chambers of Commerce and the Japan External Trade Organisation.

[4] Note that the 1997 *Review of Business Programs "Going for Growth: Business Programs for Investment, Innovation and Export"* by David Mortimer examined the role Singapore's Economic Development Board and the Irish Development Agency in attracting foreign investment (p 53).

[5] This section is drawn primarily from the 1999 IDA Annual Report available at www.ida.ie.

independent agency, it works closely with other government departments, local authorities and tertiary institutions. It has 15 offices worldwide and a network of offices throughout regional Ireland. It offers a broad range of incentives and grants to attract foreign companies to invest in Ireland. Entitlement to grants is primarily decided by examination of four-year business plans.

In 1999, the IDA had total income of $407 million[6] of which $306 million was in the form of grants from the Irish Government, $16 million was received from the European Union and $43 million resulted from the disposal of property and investments. In the same period, the IDA paid out some $281 million in grants and expended $47 million on promotion and administration.

According to its own publications, the 1266 IDA-supported companies were responsible for net employment growth of 15,200 jobs in 2000.[7] 96 new projects in manufacturing and services were secured in 2000, either new greenfield projects or expansion of existing projects.

The Irish economy is strong, recording the highest rates of economic growth in the EU for seven consecutive years. However, growth is expected to slow somewhat in 2001, although, at a forecast 7.5 per cent, it will still be the most rapid in the EU. Signs of overheating in the booming economy persist. Of particular concern is the rate at which private debt is accumulating. Should this trend continue, signs of debt stress could emerge by 2002. Additionally, with trade dependence on the US among the highest in the world, a recession in the US could cause a further sharp downward adjustment in economic growth figures. Growth is also likely to slow in response to increasing infrastructure restraints and the strain placed on the economy by the effects of price and availability of suitable development property. Inflation should moderate somewhat as the euro appreciates and oil prices fall, but wage growth is likely to strengthen as the labour market tightens further. Careful fiscal policies should avoid further overheating or any prolonged recession in the near term.

With one of the most generous incentive packages in the EU, Ireland has been highly successful in attracting foreign direct investment (FDI) over the past two decades. However, it should not be assumed that these incentives are the key factor. Ireland remains one of the most pro-business policy environments, both in terms of legislative provisions and the responsiveness of state structures to the needs of business. Its position as a base for the EU market is a natural attraction. Besides the special 10 per cent corporate tax rate for manufacturing and certain other activities, industry has access to

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[6] Financial data taken from 1999 IDA Annual Report and converted to Australian dollars at an exchange rate of IRP 0.46072 = AUD 1.

[7] IDA End of Year Statement 2000 available at www.ida.ie.

many non-tax incentives, the bulk of which are sponsored by the IDA. Packages may include capital grants, interest subsidies and loan guarantees, as well as grants for rent reduction, employment, training, R&D and technology acquisition. The challenge now facing Irish authorities is to sustain recent high levels of FDI in future years.

The Irish Government has allocated around $2 billion to its foreign investment program for the seven-year period ending in 2006. Inward investment efforts will concentrate on underdeveloped parts of Ireland, particularly the border/midland and western regions, which have previously not been successful in attracting FDI. As much as 44 per cent of the seven-year allocation will be directed to these regions. The bulk of investment should come from greenfield activities. A number of "gateway" towns are to be catalysts for overall regional growth, and around $1.2 billion has been allocated for roads and other infrastructure improvements in and around these towns.

In an unprecedented move in February 2001, the EU Economic and Finance Ministers issued a formal reprimand to Ireland over its recent expansionary budget. The budget measures, including tax cuts and capital, health and education expenditure increases are contrary to the European Union's broad economic policy guidelines, which call for members to exercise budgetary restraint. Ireland's Finance Minister rejected criticisms of the 2001 budget, pointing to a projected budgetary surplus of over 4 per cent of GDP. Official estimates suggest that government expenditure will fall marginally as a percentage of GDP from 31 per cent in 2000 to 30.8 per cent in 2001. Government revenue as a percentage of GDP is also forecast to decline from 33.3 per cent to 32.5 per cent in the same period.

The mission of the Economic Development Board (EDB) of Singapore is to promote and develop knowledge-driven industries particularly through attracting foreign investment.[8] The EDB is especially focused on the development of industry clusters through its 10 year plan, *Industry 21*, launched in 1999. The goal of the plan is to establish Singapore as a global hub for knowledge-driven industries. As well as attracting multinational corporations to locate in Singapore, the EDB also seeks to develop promising local enterprises and expand the skills of the Singapore labour force. It also promotes regional investment, particularly through the development of industrial parks in regional countries. It has 16 overseas offices and offers a range of tax incentives, grants, partnerships and other supporting mechanisms.

Complete financial data on the EDB is not readily available although it claims to have brought in around $8.3 billion[9] in total fixed asset investment in Singapore in 1999 which created 21,000 jobs.

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[8] This section is drawn primarily from the 2000 EDB Annual Report available at www.sedb.com.sg.
[9] Figure taken from EDB Annual Report and converted to Australian dollars at an exchange rate of SGD 0.9541 = AUD 1.

Established in 1990, EDB Investments (EDBI) is a wholly owned subsidiary of the EDB and acts as its investment arm.[10] EDBI takes investment positions of up to around 30 per cent in projects which either further EDB objectives or, if off-shore, have the potential to generate economic benefits for Singapore. It assumes a board seat in ventures it invests in, reflecting the more interventionist approach to economic management taken by the Government of Singapore more generally. As at 1 June 2000, EDBI had invested over $2.1 billion in more than 200 projects.

Singapore's recent economic performance has been very strong. GDP growth in 2000 is anticipated to reach between 9.5 and 10.5 per cent underpinned by strong demand in the second half of the year for electronic goods, particularly from the United States. Unemployment is low, as is inflation.

While development agencies such as the IDA and the EDB would claim that they make a real and effective contribution to economic expansion or growth, their role should be seen as more facilitative to growth rather than necessary. While grants and tax and other financial incentives may influence an investment decision at the margin (assuming all other things are equal), an investment reflecting a sustained commitment to a particular market would be made after consideration of the rate of return (a function of risk). Other factors determining investment decisions include profitability, legal and regulatory regimes, infrastructure, proximity to markets and the availability of appropriately skilled labour.

3. Reasons for the success or otherwise of development agencies in establishing countries and regional areas as economic leaders

The absence of clear and measurable performance indicators is a significant impediment to accurate evaluation of the performance of development agencies in establishing countries and regional areas as economic leaders. Both the IDA and the EDB seek to establish Ireland and Singapore respectively as hubs; Ireland as a key European centre for e-Business and Singapore as a global hub for knowledge-driven industries. The IDA also seeks to develop regional Ireland. One measure of "success" could be empirical evidence of numbers of companies in these fields establishing themselves or expanding and export or sector growth. Increased net tax receipts might also serve as a proxy for "success" as might net employment growth and net capital inflow. But the range of factors influencing investment decisions means it is very difficult to apportion how much of that decision (and thus "economic leadership") is due to the activities of development agencies. The opportunity cost and allocative distortion of significant government subsidisation provided by development agencies must

[10] This section based on information available at www.edbi.com.sg.

also be considered in any evaluation of their performance or contribution to "economic leadership". Additionally, the high level of EU subsidies (particularly regional, structural and agricultural) to Ireland further complicates attempts to accurately evaluate the IDA’s role in Ireland’s success in this area.

Rather than active government intervention in the market, which distorts the allocation of resources in the economy, economic leadership is best achieved through policies promoting economic and regulatory reform and accountability, particularly a strong and transparent legal system and corporate governance. Australia's experience during and after the Asian economic crisis of 1997 is illustrative in this regard: relatively open economies with strong institutional frameworks are less affected by regional and international economic downturns.

4. The comparative role of such development agencies in Australia

There is no exact Australian counterpart to development agencies such as the IDA or EDB. Responsibility for programs to encourage inward foreign investment, regional development and export promotion lies with a range of Commonwealth and State and Territory agencies such as Austrade, Invest Australia, the Department of Industry, Science and Resources and State and Territory Departments of Development.

5. Incentives and impediments to foreign investment in Australia such as transport systems, taxation, telecommunications infrastructure, production costs, industrial relations structures, legal systems, federal systems of government and research and development initiatives

Business views will inform the Sub-Committee's opinion on these issues as will the views of Commonwealth and State and Territory agencies with policy responsibility for them. It should be acknowledged, however, that the Australian economy is relatively open and transparent with well-developed institutional architecture and stable political institutions; all of which are important considerations in making foreign investment decisions.

Investment incentives provided by Commonwealth and State and Territory Governments, as with other forms of assistance, need to be consistent with Australia's obligations within the World Trade Organization (WTO). Australia bears the same WTO risks from State and Territory-based incentives as from Commonwealth incentives. Under the WTO, Australia must "take such reasonable measures as may be available to it to ensure observance"[11] of the provisions of the agreements by regional and local governments.

WTO rules do not proscribe industry assistance programs or investment incentives, only those which are contingent on export performance or on the use of domestic over imported goods (so-called local content or import substitution subsidies). In addition to the WTO Agreement on Subsidies and Countervailing Measures, there are other WTO obligations that are of relevance to investment incentives. For example, the national treatment provisions of GATT 1994 and the Agreement on Trade Related Investment Measures (in particular arrangements that discriminate against imported goods, for example requirements to use domestic products). The growth of jurisprudence on subsidies, and prohibited export subsidies in particular, has been prolific within the WTO. This has increased the predictability of the permissibility of subsidies as well as the predictability of how "subsidies" are defined within the meaning of the WTO Agreement on Subsidies and Countervailing Measures.

6. The adequacy of a skilled workforce in Australia particularly in new growth areas such as, though not limited to, financial services, information technology, E-business, education, pharmaceuticals and health care, and the competitiveness of that workforce

Again the views of business and other Commonwealth and State and Territory agencies will inform the Sub-Committee's views on this issue. Australian professionals are in high demand internationally, particularly in the information technology, medical, education, legal and accountancy fields which suggest the level of skills and expertise in these sectors is very competitive internationally. This is supported by latest services trade statistics, where Australian exports of services rose from $26.8 billion in 1999 to $31.6 billion in 2000.[12] International perceptions of Australian skill levels may also be gauged by the increasing numbers of foreign students studying at Australian institutions.[13] One further attraction in terms of the Australian labour force for potential foreign investors in Australia is the ready availability of multilingual employees.

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[11] Article 22.9, DSU (the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes).

[12] ABS Catalogue No 5368.0, *International Trade in Goods and Services, December 2000*. The contribution of the Olympic and Paralympic Games to services exports in 2000 should not be underestimated, not least in increased inbound tourist expenditure and sales of foreign broadcast rights.

[13] Australian Education International estimates around 182,000 international students attended Australian institutions in 2000, an increase of 15 per cent on 1999 (*2000 Preliminary International Student Numbers, DETYA, February 2000*, available at www.detya.gov.au).

7. Opportunities for encouraging inward investment and promoting export sales

The Department of Foreign Affairs and Trade has primary responsibility for the promotion of Australia's interests internationally, including as an investment destination and as a source of increasingly diverse goods and services. Continuing development of Australia's export industries requires that those industries have free and competitive access to foreign markets. However, Australian exporters continue to face a range of tariff and non-tariff barriers which prevent or impede their access to overseas markets. Eliminating or reducing substantially those barriers is a key priority for the Government. The Government has adopted a pragmatic and integrated approach, working closely with Australian business, to achieving this goal incorporating multilateral, regional and bilateral strategies.

The highest priority in the Government's trade policy is the launch of a new round of multilateral trade negotiations in the World Trade Organization. Comprehensive multilateral negotiations, across all sectors and involving the entire WTO membership, offer the best prospect to achieve improved market access and more favourable trading conditions worldwide for Australian exporters.

Australia has sought to rebuild, and sustain, broad international support for the launch of a new round, not only through the WTO, but also through other international economic fora such as UNCTAD, OECD and APEC. The potential benefits from a comprehensive new round are enormous: modelling suggests a 50 per cent reduction in protection globally in agriculture, services and manufacturing would deliver an annual gain to the world economy of over US$400 billion; if barriers were completely eliminated the annual gain to the world economy would be around US$750 billion.[14] In June 2000, Australia hosted the APEC Meeting of Ministers Responsible for Trade in Darwin, which provided a boost to efforts to launch a new round. The outcomes from the Darwin meeting provided the basis for a strong message of support for a new round by APEC leaders in Brunei in November 2000.

The Department has strengthened resources and institutional structures for maximising the leverage of the WTO dispute settlement system to secure access improvements, through bilateral channels and, where necessary through formal WTO dispute settlement machinery.[15]

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[14] Modelling conducted by the Centre for International Economics for the study conducted by the Department of Foreign Affairs and Trade, *Global Trade Reform 2000: Maintaining Momentum*, 1999, p 25.

[15] Detail of Australia's involvement in WTO disputes is at Appendix One.

Australia continues to contribute strongly within the Asia Pacific Economic Cooperation group towards further progress in reaching it goal of open and free trade in the Asia-Pacific region. APEC built on its work in providing services to business throughout 2000. Australia developed a new web site for business, *BizAPEC.com*, which provides on-line access to a wealth of information to assist businesses navigate the administrative requirements of APEC's different economies (www.bizapec.com). The APEC Business Travel Card was extended to more member economies - the card, available from the Department of Immigration and Multicultural Affairs, can now be used to facilitate business travel to ten APEC economies, removing the usual visa requirements and simplifying entry administration. To highlight the work APEC has done for business, Australia compiled the publication *APEC - Getting Results for Business*, which details how APEC has improved and simplified the processes of doing business in the region.

The department also published *Open Economies Delivering to the People: APEC's Decade of Progress* in 2000, which demonstrates the clear evidence from the experience of the APEC economies from 1988 to 1999 that if the opportunities of globalisation are taken up, they can lead to significant and sustained increases in living standards.

Through its global network of 83 overseas posts, as well as supporting its multilateral and regional objectives, the department conducts high level bilateral advocacy through its Heads of Mission overseas and other senior officers to advance Australia's economic and other interests, makes representations on specific market access and commercial and investment issues as appropriate and monitors local developments affecting our trade and investment performance, including those which offer opportunities to improve it. The department follows a whole of government approach, working closely with Federal and State and Territory agencies, in pursuing Australia's economic interests. It works closely with the Australian Trade Commission and Invest Australia overseas to promote Australian exports and Australia as an investment destination.

A key export and investment promotion mechanism is the Market Development Task Force, chaired by the Secretary of the department and reporting to the Minister for Trade. The Task Force coordinates and focuses a whole of government approach to access, development and investment priorities in markets where there is significant potential for gains to Australia within a 12 month period. The department is also engaged in communicating the benefits of trade to the broader Australian community, especially to rural and regional Australia.

The Government is also open to concluding regional free trade agreements (FTA) that deliver meaningful gains in market access across all sectors, and which cannot be achieved in a similar timeframe elsewhere. For these reasons, Australia has entered into negotiations for a FTA with Singapore based on complementarities in existing trade.

As well as the gains in market access conferred by a comprehensive FTA, such agreements also have a positive effect on inward foreign investment. Trade liberalisation under an FTA results in more efficient use of resources and improved market access; both of which lift productivity and incomes in signatory economies. In turn, improved efficiency and gains in the terms of trade increase the return on capital in those economies. Funds in global capital markets, all other things being equal, flow to where the highest return on capital can be achieved. Thus a comprehensive FTA would be expected to also increase a signatory economy's attractiveness as an investment destination.[16]

Apart from the direct economic effects of FTAs on export growth and increased capital flows, such agreements also lift the profile of signatory economies within their FTA partner's business community. In some cases, it may well be that the benefits of such a heightened profile equal or exceed the direct benefit of increased export sales and inward investment.

Closer economic integration promoted by FTAs and other agreements such as mutual recognition of standards and qualifications and harmonisation of regulations, all of which the department pursues as appropriate with particular countries, also facilitates inwards investment through improving and simplifying the regulatory and institutional frameworks of signatory countries.

[16] See *Economic benefits from an AFTA-CER free trade area, Year 2000 study*, Davis, McKibbin and Stoekel, Centre for International Economics, June 2000, especially chapter four.

Appendix One

Australia's Involvement in WTO Dispute Settlement

Since the inception of the WTO dispute settlement system in 1995 Australia has been involved in 25 disputes as a complainant, a respondent or as a third party:

Disputes involving Australia as a complainant (5)

United States - Continued Dumping and Subsidy Offset Act of 2000 (WT/DS217)

United States - Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia (WT/DS178)

Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef (WT/DS169)

India - Quantitative Restrictions on Agricultural, Textiles and Industrial Products (WT/DS91)

Hungary - Export Subsidies in respect of Agricultural Products (WT/DS35)

Disputes involving Australia as a respondent (5 involving 3 separate matters)

Australia - Anti-dumping Measures on Coated Woodfree Paper Sheets (WT/DS119)

Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126, WT/DS106)

Australia – Textile, Clothing and Footwear Import Credit Scheme (WT/DS/57)

Australia – Measures Affecting the Importation of Salmonids (WT/DS21)

Australia – Measures Affecting Importation of Salmon (WT/DS18)

Disputes involving Australia as a third party (18)

In these cases, Australia has actual or potential market access interests at stake or has broader systemic interests in the possible outcomes, such as where rulings on important WTO principles and interpretations of WTO agreements may have important implications for other cases in which we are involved or for our trade policies more generally.

Australia also monitors other disputes in which it has a more general interest because of opportunities that may open up for Australian exporters, implications for Australian domestic legislation or a systemic interest in the functioning of the dispute settlement mechanism in the WTO.