



Submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade Inquiry into Access to Free Trade Agreements by Small and Medium Sized Enterprises

The Export Council of Australia (ECA) welcomes the opportunity to make a submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade's (the Committee's) inquiry into access to free trade agreements by small and medium sized enterprises (SMEs).

The ECA is the leading industry body focused on Australia's international businesses, particularly SMEs. Our core activities include research, advocacy, skills development and events.

Our advocacy program aims to make it easier and less expensive for SMEs to engage internationally. To pursue this aim, each year we make trade policy recommendations to the Australian Government. We also make submissions to relevant Parliamentary inquiries. Our recommendations and submissions can be found at <https://www.export.org.au/trade-policy/trade-policy-recommendations>. We develop our policy positions in consultation with members, industry, and the ECA's network of trade policy experts.

We engage with government agencies—Commonwealth, state and territory—to advocate for our members and support SMEs. We sit on several Australian Government consultative committees and working groups, including the National Committee for Trade Facilitation.

Summary

The ECA believes that Australia's long-run economic prosperity can only be achieved through international trade. We strongly support Free Trade Agreements (FTAs) as a means of growing Australia's international trade. But FTAs are only one means of growing trade and should not be pursued in isolation. If the goal is increasing Australia's economic prosperity, FTAs are only part of the solution. There is much to be done to facilitate Australian businesses—particularly SMEs—to enter and grow in international markets, including addressing the 'before the border' challenges they face within Australia.

The ECA supports the government's FTA agenda, but there must be realism about what FTAs can help SMEs achieve in their target markets. FTAs can address a few, specific barriers. There is much that FTAs do not do. They rarely create a market for Australian goods or services. They don't address sanitary or phytosanitary issues or eliminate differences in regulations. SMEs still need to go through the long, hard work of building relationships and brands. Similarly, if a market is a priority for the Australian Government, there must be a multifaceted approach to facilitating trade with that market. An FTA should be just one element of the government's support in-market. The government must ensure its focus is helping SMEs internationalise and find the markets that are the right strategic fit for them, with FTAs just one aspect of this.

FTA utilisation rates are difficult to measure, particularly if looking just at SMEs. Customs data (where available) indicate overall utilisation rates for goods exports are high. But these data are based on the number of consignments, and given a small number of very large companies dominate Australia's exports, the data do not infer high utilisation by SMEs. The Australia's International Business Survey, Australia's largest survey of SME exporters, indicates SMEs do not understand FTAs well.

SMEs have too many reasons to put FTAs in the 'too hard basket' and not use them. There are several things the government can do to enable more SMEs to use FTAs. It has done a good job in raising awareness of specific FTAs, but it does not have the resources or expertise to give SMEs the next layer of information to make the most out of FTAs. SMEs simply do not understand many fundamentals of using FTAs, such as how to assess their goods against rules of origin or what process to go through to realise



access to service markets opened by FTAs. FTAs also contain many trade facilitating provisions that SMEs simply are not aware of, such as certificates of origin that cover long time periods, advance rulings or dispute resolution mechanisms.

The government could do more to facilitate educating SMEs about FTAs, including partnering with private sector providers to develop an online training program that was freely available to businesses. This training program could reinforce the content of the FTA roadshow seminars, as well as providing much more detail on the technical questions about using FTAs.

In addition, there are some concrete steps the government could do to improve FTA utilisation. Better linking government systems would enable technology-based solutions. Linking the Department of Foreign Affairs and Trade's (DFAT) FTA Portal with the Department of Home Affairs' (Home Affairs) and Department of Agriculture and Water Resources' (DAWR) systems could make it easier for Australian businesses to understand they may be entitled to preferential tariffs.

Recommendations

The ECA recommends the Committee:

1. **recommend** that that the government take a more holistic perspective to trade: FTAs are only part of the answer to enhancing Australia's economic prosperity through international trade and there are many other things that should be done to facilitate trade, both in Australia and overseas
2. **recommend** that the government's outreach to SMEs on trade should focus on helping SMEs internationalise and find the right market, with FTA promotion just one aspect of this
3. **note** that while headline utilisation rates for Australian goods exports may be high, FTA utilisation by SME exporters (of both goods and services) is unclear
4. **recommend** that the government continue to help SMEs understand how to utilise FTAs
5. **recommend** the government partner with private sector organisations to provide training to SMEs on how to better utilise FTAs
6. **recommend** the Australian Government invest in technology-based solutions to make it easier for SMEs to claim preferential tariffs.

The objective of trade policy

It is essential for Australia's future prosperity for Australian businesses to engage—and succeed—in international trade. The objective of Australia's trade policy should be to increase both the value of Australia's international trade and the number of businesses trading internationally.

But Australia currently underperforms in its exports, particularly SME exports. As we pointed out in our 2018 Trade Policy Recommendationsⁱ, Australia's export intensity is well below the OECD average (21% for Australia versus 28% for the OECD) and SMEs' share of exports is well below comparable countries (14% in Australia versus 25% for G7 nations and 35% for the EU).

There are many policy levers by which the Australian Government can, should and largely does help businesses engage internationally. Advocating for an international system based on rules, reducing tariff barriers, reducing non-tariff barriers, advocating the benefits of trade at home and abroad, promoting Australia as a desirable country with which to do business, providing in-market support and facilitating trade are all critical for Australia's international success.

While FTAs are the trade policy area that get the most attention, it is essential to remember that this is one of the many policy areas that are essential for enabling international trade. In our 2018 Trade Policy



Recommendations, the ECA outlined several practical measures the government can implement to increase the value of trade and the number of SMEs trading. The recommendations are

- develop a national strategy to increase the number of SMEs engaged in international trade
- create an SME international trade advisory council to help implement that strategy and give government a better understanding of how policies affect SMEs involved in international trade
- raise awareness of the international opportunities available to SMEs, including a government-led awareness campaign about the benefits and opportunities of trade
- help exporters receive the right services they need to start in international trade, enabling them to connect to both government and private service providers
- enable informal support networks to help SMEs seek and share information and insights on international trade, including through an online portal
- implement quick wins to lower trade costs, including making targeted investments that will lower the cost of common trade documents and simplify processes
- identify and remove structural barriers that act as impediments to trade
- accelerate government-industry collaboration on a single window and trade modernisation to simplify and lower the cost of trade
- improve trade services to SMEs by providing greater transparency about the quality of in-market services and the quality of trade shows and missions
- strengthen the perception of Australian SMEs internationally, including by adequately funding the Export Market Development Grant (EMDG) scheme as well as the reinvigorated national brand.

More information on these recommendations can be found at

<https://www.export.org.au/publications/trade-policy-recommendations-5-0-2018>.

We will not re-prosecute the arguments for the above recommendations in this submission. But it is important to bear in mind that by increasing the number of Australian businesses engaging internationally, particularly SMEs, FTA utilisation will increase.

What FTAs can and can't achieve

When evaluating a market to enter, there are several critical questions an SME must consider. Is there demand for my good or service? Are there any barriers to selling my good or service? How difficult is doing business in this market? Can I be price-competitive while still making a profit? Am I willing to commit to a multi-year investment in building my brand and relationships in this market?

An FTA can positively affect many of the answers to those questions. The following is an indicative (but not comprehensive) list of how FTAs can and can't help.

Demand: FTAs do not directly create demand for Australian goods and services. However, FTAs increase trade and investment flows between partners markets, indirectly increasing demand for services that facilitate these flows, such as legal or investment advice.

Barriers: FTAs sometimes remove major barriers to doing business in a market. Some FTAs (not all) contain provisions to open markets for some specific service sectors, enabling them to sell services that Australian businesses were previously not allowed to sell. For agricultural goods, barriers must be addressed through mechanisms that are outside the scope for FTAs, such as biosecurity protocols.

Doing business: One of the key benefits of an FTA is making it easier to do business in-market. FTAs can make it easier for businesses to set up offices in-market, for example by increasing the length of business visas. They can also give some service sectors the option to service the market from Australia, rather than from an office in-market. By enabling the flow of data across borders, they can reduce a



major impediment to trade. They can facilitate the flow of goods by simplifying customs processes and documentation. They can increase certainty by introducing dispute settlement mechanisms.

But there also are many challenges to doing business in-market that FTAs do not address. While they encourage processes to recognise Australian qualifications and standards in the partner market, these processes are done separately. There are often complex in-market regulations that impede trade that FTAs usually don't address, such as regulatory standards, labelling, minimum residue limits or halal certification. And FTAs will never address the fundamental challenges of different business cultures and consumer preferences.

Price: Through preferential tariffs, price is the other area where FTAs truly help. Depending on the FTAs a partner market already has in place, an FTA with Australia can give Australian exporters a price advantage or reduce the price advantage competitors have in that market (or a combination of both).

Lower prices can have indirect benefits in-market for the exporter, especially where the tariff cut is substantial. Where lower prices lead to higher volumes, these higher volumes mean the exporter can enjoy economies of scale and negotiate lower freight and logistics costs. This means that not only does the exporter enjoy increased sales, but also increased margins on those sales.

But it is important to bear in mind that for most products, tariffs are historically low. The World Bank estimates that globally in 2012, goods faced a weighted average tariff rate of around 2.9%ⁱⁱ (although this average includes trade conducted under both preferential and non-preferential tariffs). For Australian exporters, who generally have to compete on value rather than price, the tariff reductions on many product lines will be welcomed but not transformative. And for those sectors that do gain a significant price advantage due to an FTA, it is important to remember that advantage will inevitably be time-limited.

Building a brand and developing relationships: FTAs can have a 'head-turning effect', with in-market media coverage about an FTA with Australia generating good publicity about Australian goods and services. But such an effect is transitory, and when it has faded businesses must continue the hard slog of building a brand and developing relationships with customers in-market.

While the above shows that FTAs can improve the business environment in a partner market, the fact is that there is so much more to international trade. This leads to two important conclusions.

First, for priority markets, FTAs are valuable, but not sufficient for SMEs' international success. The government needs to take a comprehensive and strategic approach to providing support that addresses the full spectrum of challenges SMEs face in-market.

Second, businesses must select markets based on the strategic fit—not because there are FTAs in place. The focus of the government's outreach to business should therefore be helping businesses internationalise and find the right markets. FTA promotion should just be one aspect of this.

Business utilisation of FTAs

While FTAs are just one aspect of doing business internationally, helping businesses (particularly SMEs) understand how to utilise them is important. For too long the government demonstrated a 'set and forget' mentality towards FTAs. Once an FTA came into force, there was very little follow-up to help SMEs understand how to use them. FTAs are complex legal documents, which are virtually impenetrable to SMEs. The ECA had long called for the government to increase the support it provided SMEs to help them



utilise FTAs. We applaud the government's focus over the last few years on increasing utilisation including through the FTA seminars and the excellent FTA Portal.

Many studies have been done into FTA utilisation, and each yields a different answer. In February 2018, PWC released a study on FTA utilisation, commissioned by the Department of Foreign Affairs and Trade (DFAT). The study used international data sources to determine FTA utilisation rates in 2016 for FTAs with China (83% utilisation), Japan (95%), Republic of Korea (Korea, 80%) and the United States (US, 88%).ⁱⁱⁱ We understand this was calculated by taking the number of consignments imported into that country under an FTA tariff. This number was divided by the overall number of consignments imported into that country from Australia minus the number of consignments that went into the country under a zero tariff or other mechanisms for tariff relief.

$$\text{Utilisation rate} = \frac{\text{\# of consignments using FTA}}{\text{(total \# of consignments - \# of consignments with zero tariff or other tariff relief mechanism)}}$$

However, the 2017 Australia's International Business Survey (AIBS), a survey of 941 internationally-active businesses, had some findings that seemingly contradict the above. The AIBS was published by the University of Technology Sydney and commissioned by the ECA with support from Austrade and Efic. A relatively low proportion of respondents saw benefits from FTAs: 40% for China, 22% for Japan, 32% for South Korea and 20% for the US.^{iv} It also found that a large proportion of goods exporters did not provide the documentation necessary to utilise FTAs: 55% for China, 71% for Japan, 60% for Korea and 72% for the US.^v

While the PWC and AIBS figures seem contradictory, there are several factors that are likely to give rise to the differences. This highlights the complexities of understanding FTA utilisation.

Firstly, the AIBS figures on exporters seeing benefit from FTAs includes not only goods exporters but also services exporters (or businesses that export both). The PWC study does not quantify FTA utilisation for services exports. (FTA utilisation for services is conceptually very different to goods.)

Secondly, a large number of AIBS respondents could be exporting to that country under a zero tariff or another mechanism for tariff relief (and hence would not see value in the FTA).

Thirdly, the PWC utilisation rates are based on the overall number of consignments, but the AIBS figures are based on number of respondents. In addition, AIBS respondents were overwhelmingly SMEs (88%), while the PWC rates are based on all consignments. In 2015-16, Australian businesses with total exports over \$100 million accounted for 82% of goods export transactions^{vi}, and it is highly likely a large proportion of the consignments utilising FTAs were exports by large businesses. In addition, smaller businesses are likely to use the services of a consolidator, which could mean multiple exporters per consignment. Where this occurs, what is counted in the utilisation figures as one consignment will be counted in the AIBS as many exporters.

Finally, SME exporters may not know their goods are being imported under a preferential FTA tariff. There are many possible reasons for this:

- the exporter's service provider (freight forwarder and/or customs broker) is responsible the FTA paperwork
- the importer may be responsible for the customs clearance, in which case they would provide the paperwork



- for Korea, the exporter may have provided a blanket certificate of origin (the paperwork required to realise an FTA tariff preference) covering exports for up to two years, and simply have not realised or forgotten about it
- for the United States, which does not require a specific template for certificates of origin, the exporter might not realise they are providing the necessary information to claim an FTA tariff.

Even if the exporter doesn't need to prepare any documentation to utilise the FTA themselves, it is important that they understand there is a tariff benefit for their export. This understanding will make them better placed for negotiations with the importer. In some cases, the preferential tariff will translate to higher profit for the importer, and the exporter may be able to negotiate a share those profits.

Improving utilisation of FTAs

While the actual FTA utilisation rates by SMEs is unclear, anecdotally there are significant gaps in SMEs' understanding of FTAs. These gaps can be broken into four areas: goods, services, business facilitation and dispute resolution.

For goods exporters, there is a lack of understanding around rules of origin (RoOs), certificates of origin (CoOs) and the ways different FTAs interact.

RoOs are the tests that determine whether there is sufficient value created in the FTA partner markets to qualify a good for preferential tariffs under an FTA. RoOs can be complicated, with different FTAs having different thresholds and methodologies. While the government's FTA outreach talks about RoOs, there is no advice about how to calculate them.

CoOs certify that a good meets the RoO for a particular FTA. Exporters can pay an issuing authority (e.g. Ai Group or state business chamber) to issue a CoO, plus there are many instances where exporters can generate their own CoO (or 'self-certify'). However, in the instances where an exporter can self-certify, many feel unqualified to do so, and will instead pay for an issuing authority to provide the CoO. In addition, several FTAs (e.g. KAFTA and the TPP-11) allow blanket CoOs—one CoO covering a long time period (two years in the case of KAFTA)—which many exporters are unaware of. This is an area where some additional training could deliver ongoing savings to SMEs.

Overlapping bilateral and regional FTAs add choice, but also complexity for SMEs. While this is not a reason for Australia to stop pursuing additional FTAs, it is something that needs to be recognised and addressed. For example, Singapore and Australia are both parties to SAFTA, AANZFTA and TPP-11, and both involved in RCEP negotiations. Different FTAs will meet different businesses' requirements, but there some confusion about how they interact. The DFAT FTA Portal goes some way to helping, but other questions remain, such as if an Australia business imports from Singapore under SAFTA then exports to Vietnam under the TPP-11, does the value added in Singapore count towards the TPP-11 rules of origin?

For services exporters, there is much misunderstanding about what FTAs actually deliver. The messaging about FTA 'wins' often give the impression that there is significant new market access created. This is not often the case. More commonly FTAs guarantee existing access for service sectors, locking in the current market access regimes.

When there is new market access under an FTA, the terms of that access and processes for utilising it can be unclear. For example, businesses need to understand what specific services are covered in these provisions, what constitutes an Australian business for the purposes of an FTA, and what the process is for engaging regulators in-market to utilise that market access.



Business facilitation is a key area where FTAs add value, but is an area rarely understood by SME exporters. FTAs can facilitate business through provisions that can include: making customs processes easier (including by requiring customs services to provide advance rulings), improving visas, removing data localisation requirements, and setting common and transparent rules.

All of these can increase the attractiveness of a potential market, or make it easier to do business in a market an exporter is already in. Many of these provisions require the business to actively know about them. But SMEs rarely understand what an FTA entails beyond the headline market access provisions (reduced tariffs or services access). SMEs largely find out about these sorts of provisions by accident, rather than any pro-active effort by government.

Dispute resolution is an often overlooked area where FTAs are valuable to businesses. FTAs have provisions meant to provide certainty for businesses trading and investing with partner markets—including certainty that changes in political relationships, or changing regulations or procedures, will not impede trade. But certainty can only be there if businesses know their rights and how to enforce them, and again very few businesses are aware of this aspect of FTAs.

While the government has done substantial work to improve SMEs' basic awareness of FTAs as they come into force, these important but more technical benefits of FTAs are largely unknown. It is also important to note that while there is value in emphasising particular FTAs when they entered into force, an FTA may only become relevant to a business many years after its entry into force.

Given the importance of Australia's FTA network, it is essential that the government develop a long-term, sustainable model to helping SMEs understand what is included in FTAs and how to utilise them. The current FTA seminar series delivered by Austrade and DFAT helps with awareness of new FTAs and gives a good 'helicopter' view of how to use them, but is not sustainable indefinitely and leaves attendees with as many questions as answers.

The government could partner with private sector providers to develop an online training program freely available to businesses. (Partnering with the private sector because while the government has deep subject matter expertise, officials rarely have the time or expertise to provide this sort of training.) This training program could reinforce the content of the FTA roadshow seminars, as well as providing much more detail on the technical aspects of FTAs mentioned above.

In addition, there are steps the government could take to prompt businesses to consider utilising FTAs. This could involve better linking government systems, such as DFAT's FTA Portal with Home Affairs' and DAWR's systems.

Home Affairs requires export consignments with a value over \$2000 to have an accompanying export declaration, which has fields including HS code (a system of classifying products) and the destination country. This is the same information used by DFAT's FTA Portal to help businesses find out the FTA benefits they may be able to access. By linking the two systems an exporter entering an export declaration could be alerted to the potential ability to utilise an FTA. By doing so, the government would 'nudge' businesses into utilising FTAs more.

Similarly, when exporters seek certificates as to health or condition from DAWR, they also need to enter HS code and destination country. This another opportunity for the government to nudge exporters into utilising FTAs.



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- ⁱ Export Council of Australia, 2018 Trade Policy Recommendations, page 5, <https://www.export.org.au/publications/trade-policy-recommendations-5-0-2018> (accessed 25 May 2018)
- ⁱⁱ World Bank, World Development Indicators: Tariff Barriers, <http://wdi.worldbank.org/table/6.6#> (accessed 25 May 2018)
- ⁱⁱⁱ PWC, Free Trade Agreement Utilisation Study, Page 11, <http://dfat.gov.au/about-us/publications/trade-investment/Documents/free-trade-agreement-utilisation-study-pwc-report.pdf> (accessed 25 May 2018)
- ^{iv} University of Technology Sydney, Australia's International Business Survey, Figure 3.10 page 44, https://www.austrade.gov.au/ArticleDocuments/5720/2017_AIBS_report.pdf.aspx (accessed 25 May 2018)
- ^v University of Technology Sydney, Australia's International Business Survey, Figure 3.11 page 45, https://www.austrade.gov.au/ArticleDocuments/5720/2017_AIBS_report.pdf.aspx (accessed 25 May 2018)
- ^{vi} Australian Bureau of Statistics, Characteristics of Australian Exporters 2015-16, Table 2.2, [https://view.officeapps.live.com/op/view.aspx?src=http://www.ausstats.abs.gov.au/ausstats/subscribe.nsf/0/12B345CAEE08E0CACA25814C007CFD86/\\$File/536805500602.xls](https://view.officeapps.live.com/op/view.aspx?src=http://www.ausstats.abs.gov.au/ausstats/subscribe.nsf/0/12B345CAEE08E0CACA25814C007CFD86/$File/536805500602.xls) (accessed 25 May 2017)