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Australian Government
Productivity Commission

Trade and Assistance Review 2018-19

Productivity Commission
Annual Report Series



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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).

Foreword

The Commission has a statutory obligation to release annual measures of government assistance to industry. As in past *Reviews*, the assistance estimates in this *Review* relate to the previous fiscal year (in this case 2018-19), while the recent developments in industry assistance and trade policy relate to the period since the publication of the previous *Review* (broadly, the calendar year of 2019).

This report is being released against the background of unprecedented Australian Government measures to support industry associated with the coronavirus (COVID-19) pandemic, none of which are reported in this *Review*. Those measures should not be seen in the same light as many of the assistance measures reported in this and past *Reviews*, as they form part of an economic stimulus to mitigate the supply and demand shocks posed by the pandemic. In any case — as the Commission has emphasised in past *Reviews* — assistance measures should not always be seen as adverse. The Commission will consider the pandemic measures, where relevant, in the next *Review*.

Michael Brennan
Chair

April 2020

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Abbreviations

ABS	Australian Bureau of Statistics
ANAO	Australian National Audit Office
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
DSB	Dispute Settlement Body
EGA	Environmental Goods Agreement
ERA	Effective rate of assistance
EU	European Union
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GNI	Gross National Income
GST	Goods and Services Tax
PC	Productivity Commission
R&D	Research and Development
RCEP	Regional Comprehensive Economic Partnership
TiSA	Trade in Services Agreement
US	United States
WET	Wine Equalisation Tax
WTO	World Trade Organization

Key points

- Australian Government net assistance to industry fell for most sectors of the economy from 2017-18 to 2018-19.
 - Net industry assistance was \$12.1 billion (consisting of about \$2 billion tariff output assistance, \$4.5 billion in budgetary outlays and \$7.4 billion in tax concessions, less \$1.7 billion in tariff input penalties), down from \$12.6 billion in the previous year.
- The decline is the continuation of a long-term reduction in assistance for the manufacturing and agriculture industries, which commenced in the 1970s and mostly stems from lower import tariffs. As a result, Australia has become a more globalised and competitive economy, generating vast benefits for consumers.
- Budgetary assistance (through direct outlays or tax concessions) has grown in recent years, from \$9.1 billion in 2013-14 to \$11.8 billion in 2018-19, driven mostly by new tax concessions for small businesses. Overall, most budgetary assistance is provided to the services sector (which makes up over 80 per cent of the economy) or is unable to be allocated to any particular sector.
- The Commission has highlighted four areas where domestic industry assistance has increased over the past year.
 - Defence procurement from domestic industry has risen, but lacks transparency about costs and a clear policy framework explaining its benefits.
 - Assistance to farmers and farm businesses expanded further with the continued drought and stresses of severe flooding in North Queensland.
 - Government investment in private projects continues to proliferate, carrying with it risks to the Australian taxpayer.
 - Concessions in Australia's alcohol tax system widened further after the introduction of new supports for craft brewers, adding to an already complicated system.
- Progress on international trade policy has faltered.
 - Multilateral and plurilateral agreement negotiations continue, but are slow, with few prospects for their timely finalisation.
- One of the World Trade Organisation's (WTO) key functions, dispute resolution, has ceased because judges have not been appointed to the Appellate body, severely compromising the WTO's role. A temporary dispute body has been set up by 17 members (including Australia).

1 Assistance estimates

The Australian Government assists industries and businesses through a wide array of programs, regulatory instruments and policies. Each year, the Commission updates and publishes estimates of the assistance provided through:

- import tariffs
- subsidies (predominantly grants and concessional loans)
- tax concessions.¹

The following sections present an overview of the 2018-19 assistance estimates. Detailed tables of estimates covering 34 industry groupings and four sectors (primary production, mining, manufacturing and services) are provided in appendix B (online only, available on the Commission's website). The estimates cover:

- aggregate assistance (referred to as net combined assistance), the effective rate of assistance (which indicates the amount of assistance compared to the size of an industry), and trends in these measures of assistance over the past four decades (section 1.1)
- gross and net assistance provided by import tariffs, which mainly assist the manufacturing sector by raising costs to consumers and to industries that use manufactured and other tariff assisted inputs (section 1.2)
- Australian Government budgetary measures — divided into government outlays and tax concessions, and then into seven sub-categories, which confer financial support to the recipient businesses (section 1.3).

1.1 Aggregate assistance level and assistance rates

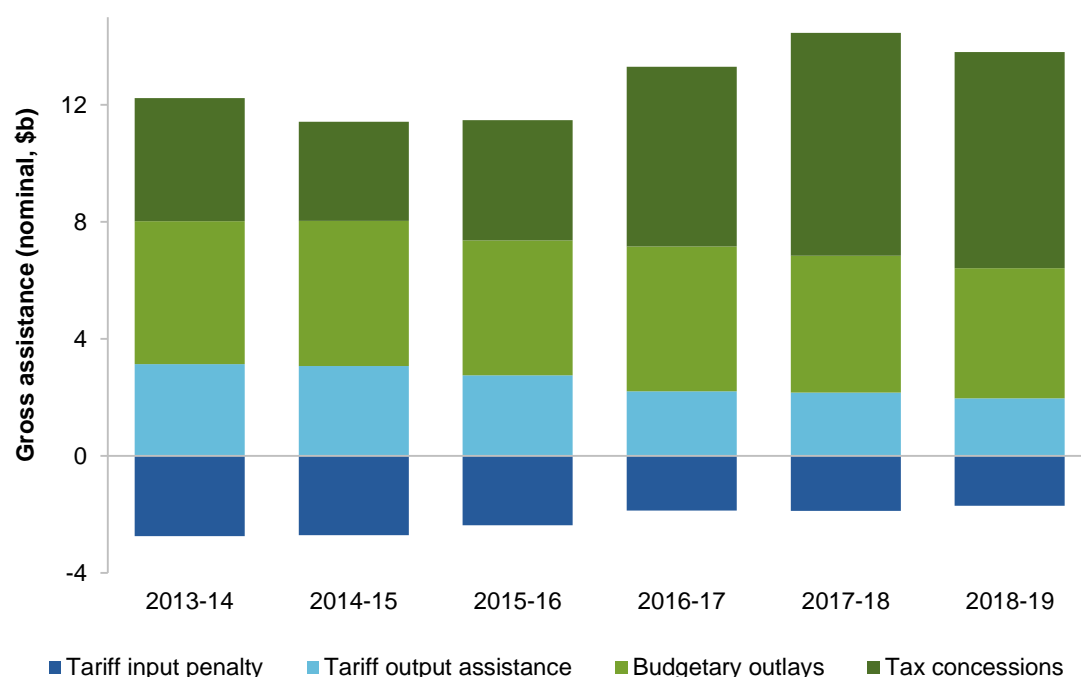
Net combined assistance was \$12.1 billion in 2018-19

In gross terms, readily distinguishable and quantified tariff and budgetary assistance to industry was around \$13.8 billion in 2018-19 — comprising \$2.0 billion in output tariff assistance, \$4.5 billion of budgetary outlays, and \$7.4 billion in tax concessions (figure 1.1). After allowing for the negative effects of tariff assistance on the cost of inputs (the input tariff penalty) of \$1.7 billion, estimated net combined assistance amounted to around

¹ Assistance estimates reported in this year's *Review* cover the period 2013-14 to 2018-19. A user guide on how the assistance estimates are calculated is at appendix A, and detailed technical information on the methodology, program coverage and industry allocation will be provided in a (forthcoming) Methodological Annex.

\$12.1 billion in 2018-19. This was a fall of \$0.5 billion from 2017-18, driven mostly by a fall in tax concessions and budgetary outlays.

Figure 1.1 Aggregate estimates of measurable assistance
2013-14 to 2018-19



Source: Commission estimates.

The incidence of assistance varies across industries

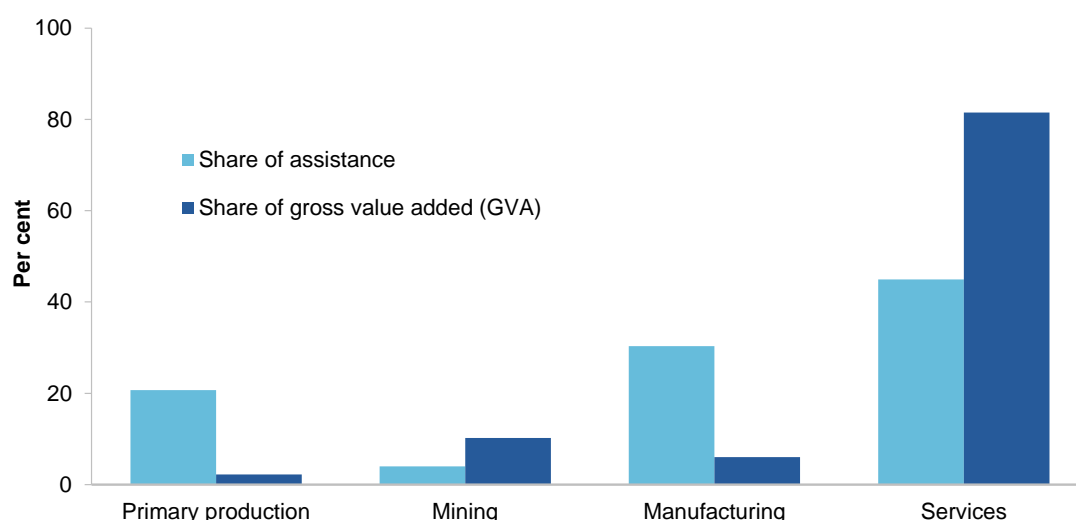
Of the assistance that can be allocated to specific sectors, the primary production and manufacturing sectors receive the largest amount of assistance relative to their size in the economy, while assistance to the services and mining sectors is disproportionately small (figure 1.2).

- The primary production sector (mostly agriculture) received \$1.7 billion in assistance (21 per cent of the total), despite having a value added share of only 2 per cent, with the majority of its support coming from budgetary assistance.
- The manufacturing sector, contributing 6 per cent to the economy, received \$2.5 billion in net combined assistance (30 per cent of the aggregate), of which 54 per cent came from tariff assistance.

Within the component industries of each sector, the greatest level of combined assistance (by value) is provided to the property, professional and administrative services industry,

mainly due to budgetary assistance (table 1.1). Sheep, beef cattle and grain farming also receives a high level of combined assistance, mainly in the form of tax concessions. The highest tariff penalty on inputs is borne by the construction industry.

Figure 1.2 Assistance provided across industries
2018-19



Sources: Commission estimates and ABS, *Australian System of National Accounts, 2018-19*, cat. no. 5204.0 (table 5).

At the aggregate level, assistance for some sectors has fallen dramatically

Over the past fifty years, Australia's economy has undergone profound changes. One of the biggest transformations has been the slow but inexorable reduction in government protection for some key parts of Australian industry. The best measure of this change is the 'effective rate of assistance' (ERA) which reflects the extent to which assistance to an industry enables it to attract economic resources, relative to other industries. It is measured as the value of combined assistance to a particular industry as a share of that industry's unassisted net output (industry value added).²

Over the long run, ERAs for the manufacturing and agriculture sectors have been on a steady downward trend (figure 1.3), which have largely eliminated their reliance on government support for their viability. Instead, Australia has moved towards an outward focused, globalised economy, encouraging previously sheltered firms to expand into international markets and compete with rival imported products, while also generating vast benefits for Australian consumers.

² ERAs are not calculated for the services sector (details in appendix A).

Table 1.1 **Combined assistance by industry grouping, 2018-19**\$ million (nominal)^a

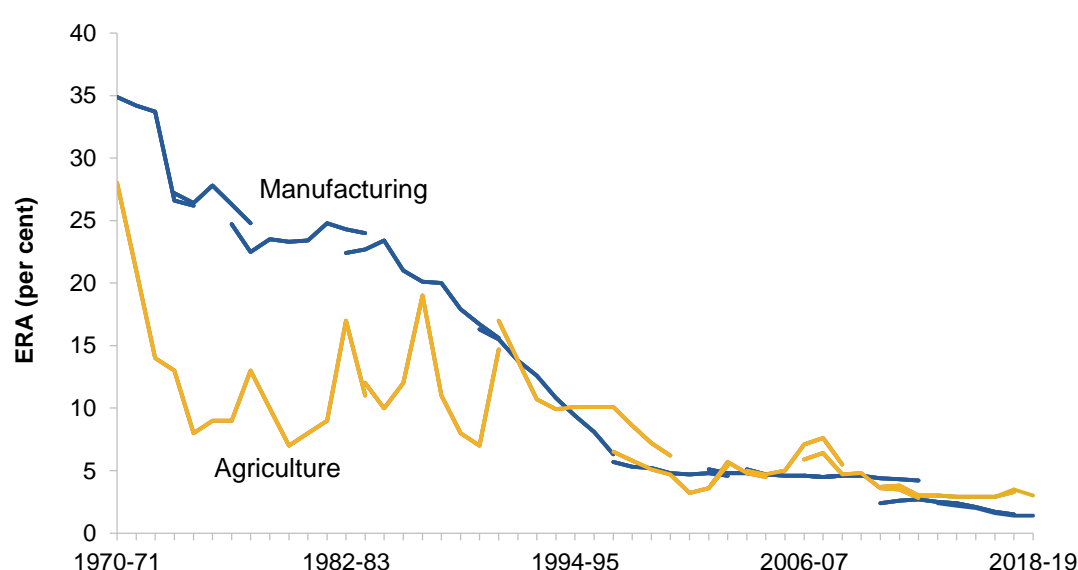
	<i>Tariff output assist.</i>	<i>Tariff input penalty</i>	<i>Net tariff assist.</i>	<i>Budgetary outlays</i>	<i>Tax concess.</i>	<i>Net combined assist.</i>
Primary production	235.0	-48.5	186.5	828.7	716.5	1 731.7
Horticulture and fruit growing	48.7	-4.6	44.0	111.8	81.9	237.8
Sheep, cattle and grain farming	181.2	-22.4	158.7	281.5	478.3	918.5
Other crop growing	0.4	-1.4	-1.0	52.1	49.9	101.0
Dairy cattle farming	—	-5.6	-5.6	27.6	27.7	49.7
Other livestock farming	—	-3.0	-3.0	39.6	22.6	59.1
Aquaculture and fishing	0.2	-3.9	-3.7	87.4	21.7	105.4
Forestry and logging	0.4	-0.5	-0.1	17.7	14.2	31.8
Primary production services	4.2	-7.0	-2.9	9.5	15.6	22.2
Unallocated primary production ^b	—	—	—	201.5	4.6	206.1
Mining	0.6	-56.0	-55.4	192.8	198.1	335.5
Manufacturing	1 732.3	-570.1	1 162.3	876.5	499.4	2 538.2
Food, beverages and tobacco	621.1	-335.0	286.2	49.5	40.6	376.3
Textiles, clothing and footwear	43.2	-13.7	29.5	22.0	6.7	58.2
Wood and paper products	174.0	-32.5	141.5	10.5	9.3	161.3
Printing and recorded media	18.1	-2.8	15.3	43.9	13.8	73.0
Petroleum, coal and chemicals	208.3	-42.1	166.2	187.9	30.5	384.6
Non-metallic mineral products	82.6	-15.8	66.8	15.8	11.1	93.6
Metal and fabricated products	227.8	-41.6	186.2	75.2	103.6	365.0
Motor vehicles and parts	131.2	-30.3	101.0	68.0	27.0	195.9
Other transport equipment	78.0	-19.3	58.7	18.8	8.3	85.8
Machinery and equipment	103.1	-22.3	80.8	190.3	41.1	312.2
Furniture and other products	44.8	-14.8	30.1	28.3	4.1	62.4
Unallocated manufacturing ^b	—	—	—	166.4	203.3	369.8
Services	0.0	-1 028.6	-1 028.6	2 217.3	2 573.1	3 761.7
Electricity, gas, water and waste	—	-20.5	-20.5	90.6	20.2	90.3
Construction	—	-401.6	-401.6	52.0	119.6	-230.1
Wholesale trade	—	-56.5	-56.5	88.4	90.8	122.7
Retail trade	—	-35.4	-35.4	36.1	96.9	97.7
Accommodation & food services	—	-79.6	-79.6	9.2	84.1	13.6
Transport, postal, warehousing	—	-47.6	-47.6	78.4	55.1	85.9
Information & communications	—	-13.9	-13.9	210.4	34.8	231.4
Financial & insurance services	—	-3.4	-3.4	126.9	882.2	1 005.6
Property, professional & admin.	—	-92.4	-92.4	1 059.8	641.7	1 609.1
Public administration and safety	—	-49.1	-49.1	20.7	5.7	-22.7
Education and training	—	-19.2	-19.2	35.5	11.9	28.1
Health care & social assistance	—	-76.2	-76.2	106.6	96.9	127.3
Arts and recreation services	—	-27.7	-27.7	110.7	390.5	473.6
Other services	—	-105.6	-105.6	57.1	42.8	-5.7
Unallocated services ^b	—	—	—	135.0	0.0	135.0
Unallocated other^b	—	—	—	335.4	3 402.7	3 738.1
Total	1 967.9	-1 703.2	264.7	4 450.7	7 389.7	12 105.2

— Nil. ^a Totals may not add due to rounding. See appendix A for a user guide. ^b Unallocated includes programs for which details of the initial benefiting industry cannot be readily identified.

Source: Commission estimates.

While the long-run decline in assistance has eliminated their worst economic inefficiencies, some economic distortions still arise from current policy (section 1.2). Indeed, in recent years, the decline in net tariff assistance has slowed, and been offset for some sectors by increases in budgetary assistance (section 1.3). In particular, while budgetary assistance for the mining and manufacturing sectors has declined, assistance to the agriculture and service sectors has grown since 2013-14.

Figure 1.3 A long-run downward trend in protectionism
Effective rates of assistance (ERA)^a, 1970-71 to 2018-19^b



^a 'Agriculture' refers to selected agriculture activities up to and including 2000-01, and primary production thereafter. ^b Breaks and overlapping series represent a change of methodology and/or data sources.

Source: Commission estimates.

Moreover, assistance across the Australian economy still constitutes a considerable amount of protection, exceeding \$12 billion in 2018-19 (table 1.1 above). Similarly, the average rate of assistance for manufacturing and agriculture hide significantly greater rates of assistance among each sector's component industries, as well as for individual firms, with adverse consequences for efficiency.

Rates of assistance vary between different sub-sectors ...

Within the manufacturing sector, half a century of liberalising reforms (box 1.1) have resulted in most manufacturing industries experiencing steady declines in effective rates of assistance (figure 1.4). All manufacturing industries now have effective rates of assistance below 3 per cent.

Box 1.1 Half a century of manufacturing liberalisation

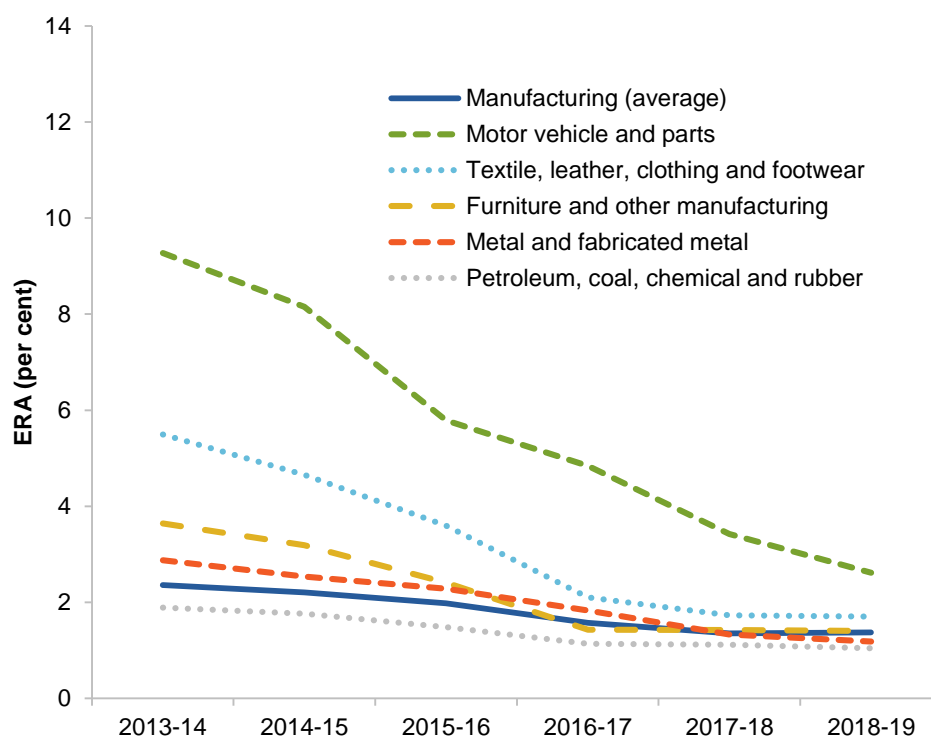
The fall in effective rates of assistance to manufacturing since 1970 began with the 25 per cent across the board tariff cut of 1973. This was followed by the removal of all quantitative import restrictions (except for textiles, clothing and footwear, or TCF) by 1988, and broad programs of tariff reductions that commenced in the late 1980s. Under the *May 1988 Economic Statement*, for example, the Government introduced a program to phase down all tariffs to either 10 per cent or 15 per cent by 1992 (except for on passenger motor vehicles and TCF).

Reductions in general tariff rates were continued with the 1991 *Building a Competitive Australia* initiative which reduced general tariff rates from 15 and 10 per cent to a single rate of 5 per cent by 1996. As part of the initiative, tariffs on passenger motor vehicles were also reduced to 15 per cent by 2000. Import quotas for TCF were abolished by 1993, with TCF tariffs phased down to a maximum of 25 per cent by 2000. Following the changes during the 1990s, tariffs on passenger motor vehicles were further reduced to 10 per cent in 2005 and 5 per cent in 2010. Meanwhile, TCF tariffs were reduced to 17.5 per cent in 2005, 10 per cent in 2010, and 5 per cent in 2015.

Source: PC (2019).

Figure 1.4 Manufacturing industries have experienced steady decreases in assistance ...

Effective rates of assistance (ERA) in manufacturing, 2013-14 to 2018-19

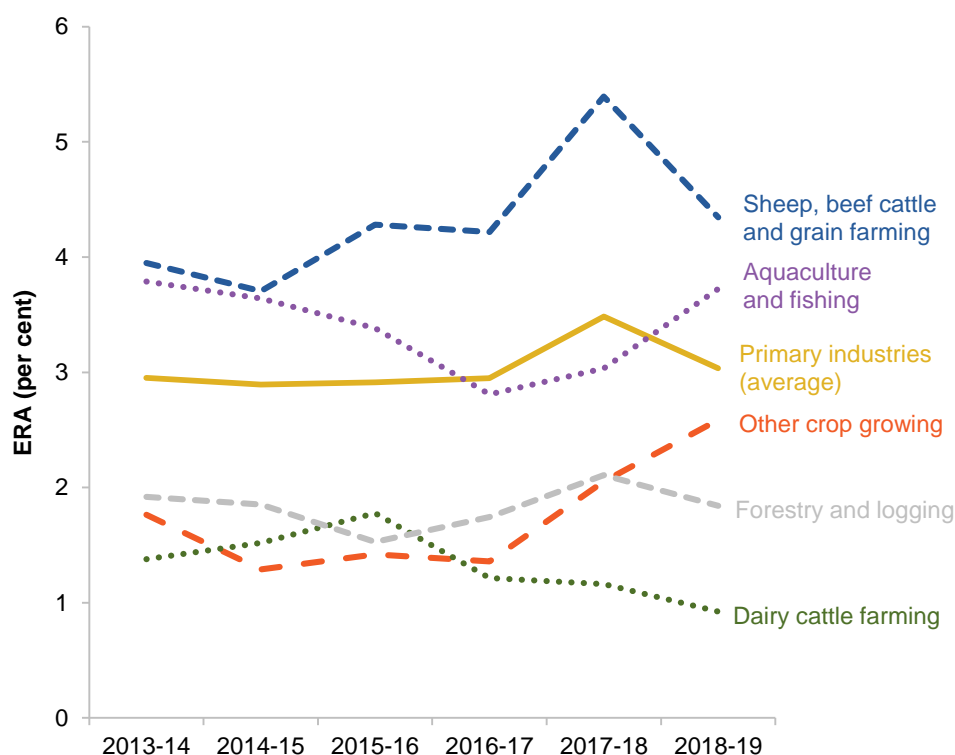


Source: Commission estimates.

In the agricultural sector, by contrast, average rates of assistance have not declined over the past six years (figure 1.5), though they remain low compared to the period before the mid-1990s (figure 1.3 above). While assistance to some industries has fallen (such as for dairy cattle farming), other industries have remained stable (aquaculture and fishing) or even grown over the period (sheep, beef cattle and grain farming). Some of these changes could reflect the underlying volatility of agricultural assistance estimates.³

The ongoing decline in manufacturing assistance has meant that it is now less assisted than agriculture — a break in the long-run pattern. In particular, assistance rates for *all* of the component industries in the manufacturing sector are now lower than the average assistance rate for the agriculture sector. In fact, the rate of assistance to the sheep, beef cattle and grain farming industry is now more than triple that provided to the manufacturing sector on average (4.3 per cent compared to 1.4 per cent).

Figure 1.5 ... while assistance to agriculture industries has varied
Effective rates of assistance (ERA) in agriculture, 2013-14 to 2018-19



Source: Commission estimates.

³ Volatility in agricultural estimates occurs because the assistance benchmarks are affected by variations in domestic support prices and world prices, while the impact of drought and other factors impacts output. The volatility of estimates was particularly acute throughout the 1970s and 1980s (figure 1.3).

... and vary even more at the firm-level

While effective rates for agriculture and manufacturing sectors are at an historic low, the effective rate of assistance for an individual company or project can be substantial. This occurs when budgetary assistance (such as a grant program or subsidy, section 1.3) is targeted at particular firms or activities, providing greater levels of assistance to those firms than others in the same sector or even the same industry (box 1.2).

Providing particular firms or activities with a high degree of assistance confers a large competitive advantage. This can be highly distortionary (both within the relevant industry and at the economy-wide level), as it redirects scarce resources (such as financing, labour or equipment) away from other more productive activities that are not receiving the same level of assistance from government.

Box 1.2 Assistance measures that provide above average levels of support

Unless all firms produce exactly the same products using the same input mix, some will receive effective assistance above or below the average. However, all else equal, policies and programs that target one or a small range of firms (or projects) will generally confer abnormally higher levels of relative assistance. Some examples of government support with the potential to provide substantially higher levels of assistance to select firms include:

- Film industry offsets — government support provided by the producer tax offset (part of the Australian Screen Production Incentive) amounted to \$143 million in 2014-15 (ATO 2017), for an industry that had an estimated value added of around \$3 billion in 2014-15 (Deloitte Access Economics 2016). The film industry also received assistance from state and territory government film support programs and Screen Australia.
- Tasmanian Freight Equalisation Scheme — around 50 per cent of the total amount claimed (\$153 million in 2018-19) went to 10 recipients (PC 2014c).
- Ethanol production subsidy — between 2003-04 and 2013-14, participants in the program ranged from between 1 and 5 firms, with a single firm receiving over 70 per cent of funding over the life of the program (ANAO 2015).
- Co-investment grants — over the three years to 2013-14, nearly \$50 million in co-investment grants was paid to four firms by the Australian Government. These payments can confer high levels of assistance at the individual firm or project level (PC 2015).
- Local submarine assembly — building the proposed submarines locally comes with a reported cost premium of 15 per cent (and perhaps up to 40 per cent) more than an overseas assembly, providing billions in assistance to local defence industry (chapter 2).

1.2 Tariff assistance and penalty estimates

Historically, the imposition of tariffs on imported goods was one of the primary forms of government assistance to industry. The Commission's estimates of tariff assistance are divided into three categories — output assistance, input penalties, and net assistance.⁴

- *Output assistance* — by taxing imported goods, tariffs improve the price competitiveness of domestically-produced goods that directly compete with the imports in the Australian market, allowing the Australian firms to earn greater returns.
- *Input penalties* — the imposition of tariffs also increases the price of local and imported goods that are used as inputs for other firms and sectors, and thus penalises local industries that rely on goods subject to tariffs (although this can be reduced if concessions are available, effectively providing a refund for the embedded tariffs in purchased goods).
- *Net tariff assistance* — calculated as output tariff assistance less the input tariff penalty for each industry.

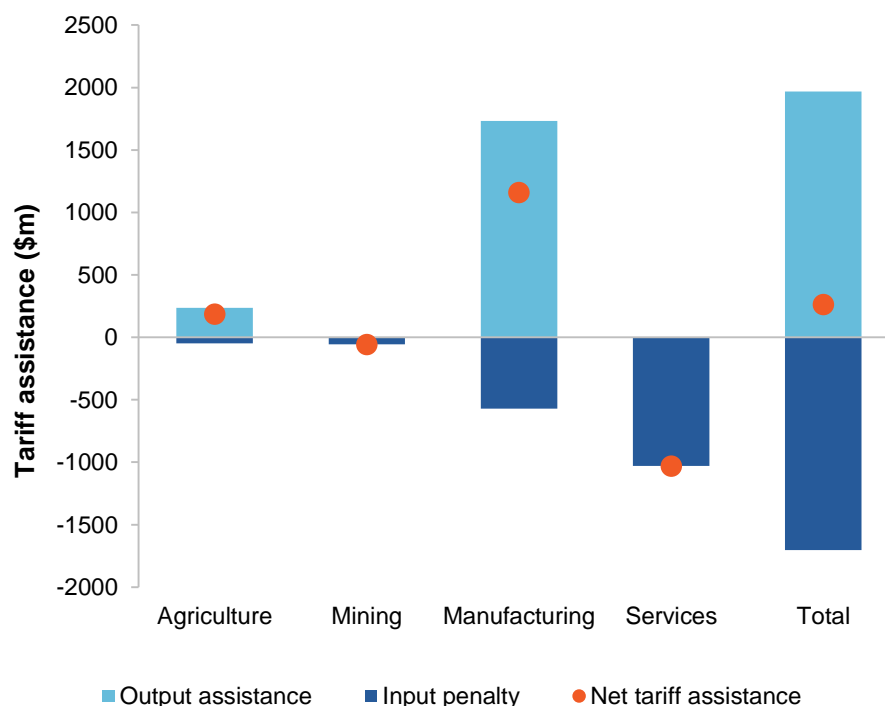
The tariff giveth and the tariff taketh away

The lion's share of output assistance from tariffs went to the manufacturing sector in 2018-19 (at over \$1.7 billion or 88 per cent of the total, figure 1.6). Some manufacturing industries received more output assistance than others, particularly the food, beverages and tobacco (\$621 million), metal and fabricated metal products (\$228 million) and petroleum, coal, chemical and rubber production (\$208 million) industries. Meanwhile, most of the output assistance provided to the agricultural sector went to the sheep, beef cattle and grain farming industry (\$181 million, or about 77 per cent).

As tariffs do not apply to imported services (only goods), Australia's services sector does not obtain *any* output assistance from tariffs. Yet the services sector bears most of the costs associated with tariffs because they raise the cost of inputs into production. The input penalties faced by the services sector amounted to about \$1 billion in 2018-19. Much of the penalty is concentrated in the construction industry (with \$402 million of additional costs), while the property, professional and administrative services (\$92 million), accommodation and food services (\$80 million) and health care and social assistance (\$76 million) industries also carry significant costs.

⁴ The Commission's estimates of tariff assistance are equivalent to the budget outlay that would be expected to have the same effect on producer prices and volumes of production, not the amount of duty collected.

Figure 1.6 Tariff winners and losers
Output, input and net tariff assistance, by sector, 2018-19



Source: Commission estimates.

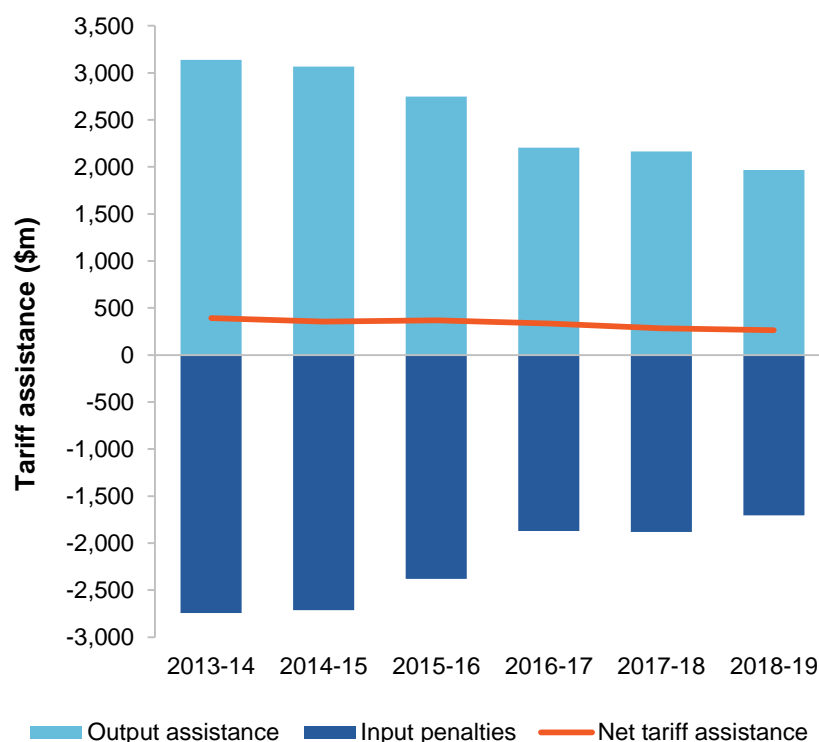
Overall, the size of the input penalties from tariffs are almost as great as the value of output assistance. The net tariff assistance across all sectors in 2018-19 was only \$265 million.

Yet, despite the limited amount of *net* assistance that tariffs bring, they still lead to distortions throughout the economy, as the gross levels of output assistance and input penalties remain material. The imposition of input penalties artificially inflates costs in the services sector, which eventually flows through to higher prices for consumers — from building construction to hospital health care.

However, there has been a gradual decline in both gross levels of output assistance and input penalties since 2013-14 (figure 1.7), slowly reducing the economic distortions that such assistance creates.

Figure 1.7 As output assistance and input penalties both fell, net tariff assistance remained steady

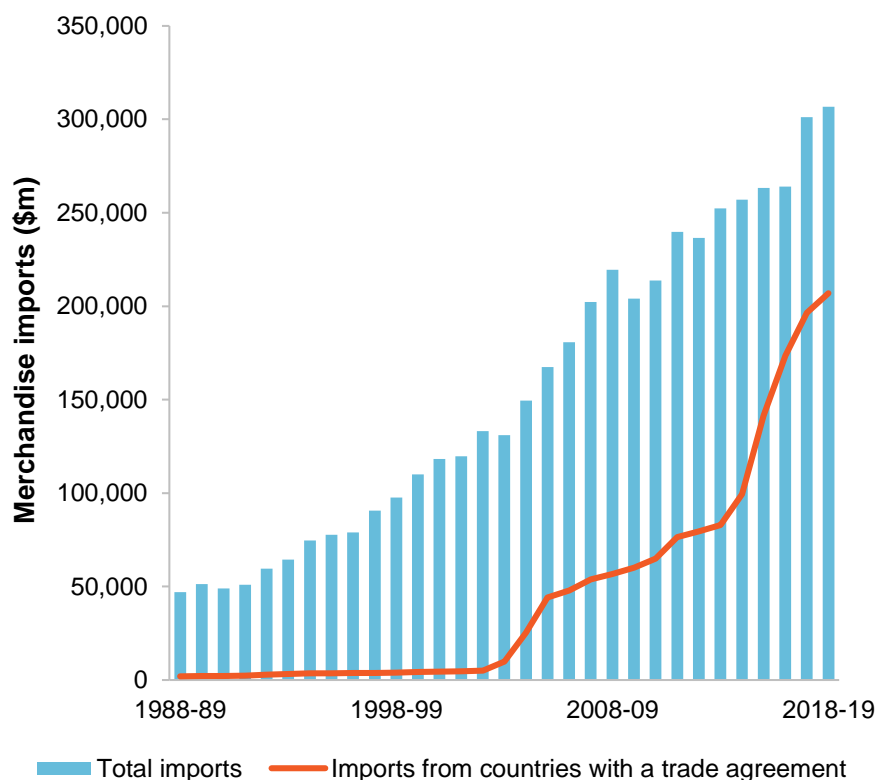
Output, input and net tariff assistance, 2013-14 to 2018-19



Source: Commission estimates.

Part of the recent decline in gross levels of tariff assistance is due to the growing share of Australia's imports covered by bilateral and regional trade agreements. For example, the share of Australia's merchandise imports from countries with which Australia had a trade agreement in force grew from less than 10 per cent in 2003-04 to over 67 per cent in 2018-19 (figure 1.8), largely due to new agreements (such as the Korea-Australia Free Trade Agreement in 2014 and the China-Australia Free Trade Agreement in 2015), as well as a growing share of imports from counterparties to existing trade agreements. Although the Commission has previously expressed concerns that the economic benefits of these agreements are overstated and their risks understated (PC 2010), bilateral and regional trade agreements still tend to result in lower tariffs barriers for the relevant imports, helping to explain some of the decline in tariff assistance.

Figure 1.8 The growth of trade between friends
Australia's merchandise imports, 1988-89 to 2018-19



Source: Commission estimates using ABS, *International Trade in Goods and Services*, Nov 2019, cat. no. 5368.0 (table 14b).

1.3 Budgetary assistance estimates

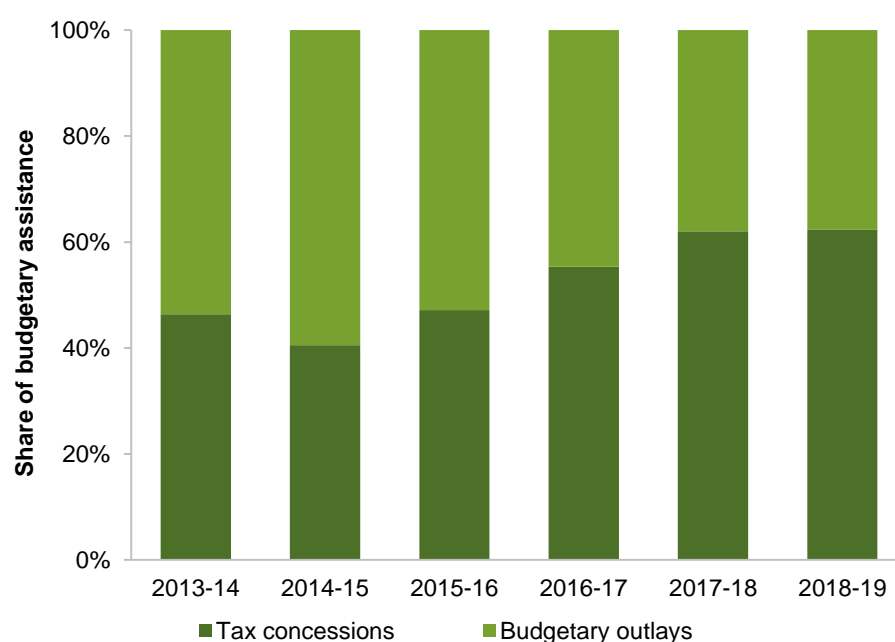
Budgetary assistance is designed to encourage particular activities (such as R&D or exports) or to support particular firms, industries or sectors. Generally, budgetary assistance involves *outlays* (such as grants, subsidies, loans, guarantees or funding for organisations perform commercially beneficial services) or industry-and sector-specific *tax concessions* (such as exemptions, offsets, deferrals and accelerated depreciation). Some of these measures provide financial assistance directly to firms, such as the Automotive Transformation Scheme (\$41.2 million in 2018-19) and R&D tax incentives (\$2.6 billion), while other budgetary support measures deliver benefits indirectly to an industry via intermediate organisations such as through the rural R&D corporations (\$328 million) and the Commonwealth Scientific and Industrial Research Organisation (CSIRO, \$589 million).⁵

⁵ The Commission's estimates do not include the CSIRO's public research functions, such as environmental R&D, some renewable energy R&D and general research towards expanding knowledge in various fields.

In 2018-19, the Australian Government spent over \$11.8 billion on budgetary assistance, of which \$1.5 billion went to the agriculture sector (mostly to the sheep, beef cattle and grain farming industry), \$1.4 billion to the manufacturing sector and \$4.8 billion to services sector. Most service sector assistance went to the property, professional & administrative industry (\$1.7 billion, largely from R&D tax incentives and the small business simplified depreciation rules) or to the financial & insurance industry (\$1 billion, mostly the Offshore Banking Unit concession and the concessional rate of withholding tax).

Among the two components of budgetary assistance, tax concessions have grown faster than outlays over the past few years and in 2018-19 62 per cent of the budgetary assistance was provided through tax concessions (figure 1.9). Small business tax concessions have driven this increase (box 1.3), including the concessional taxation of small businesses (\$1.9 billion), small business capital gains tax concessions (\$1.1 billion) and the unincorporated small business tax discount (\$410 million). These tax concessions apply to small businesses across the economy and so are not allocated to any particular industry.

Figure 1.9 Budgetary outlays and tax concessions
2013-14 to 2018-19



Source: Commission estimates.

By sector, over the six-year period covered by this *Review*, budgetary assistance to the mining and manufacturing sectors declined by nearly 30 per cent. Meanwhile, assistance to the agriculture and services sectors has grown by 17 per cent and 15 per cent, respectively.

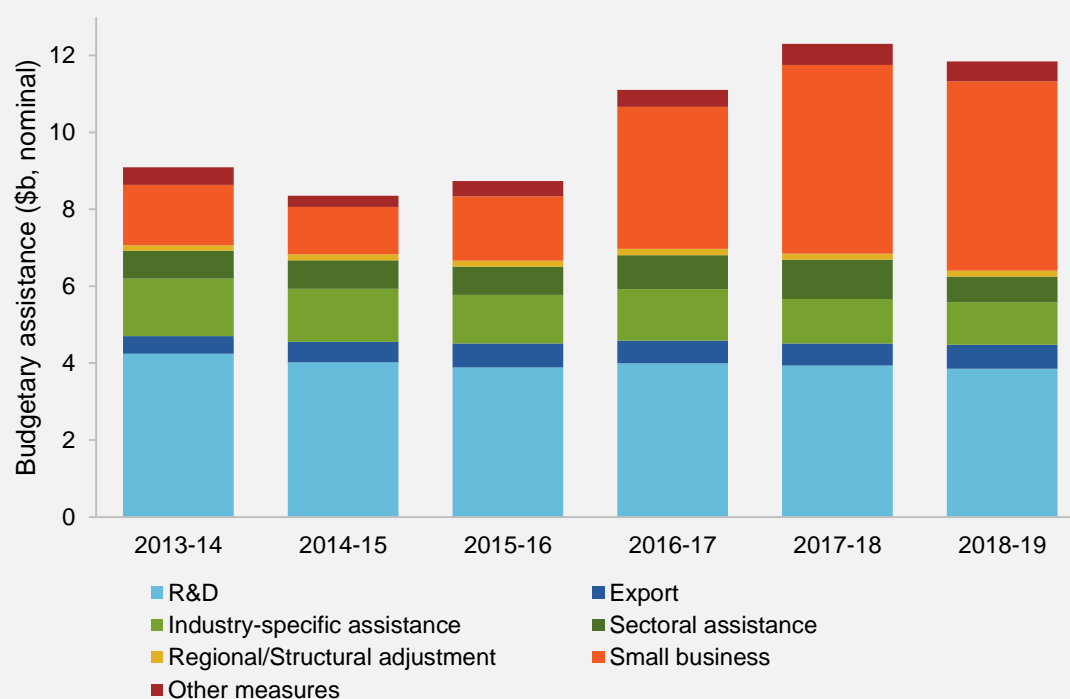
Within each sector's component industries, there have also been dramatic changes over recent years. One of the most substantial has been the fall in budgetary assistance for the

motor vehicle and parts industry, which dropped from over \$400 million of assistance in 2013-14 to less than \$100 million in 2018-19 (a 76 per cent decline), largely due to the winding down of the Automotive Transformation Scheme.

Box 1.3 Small business assistance forms the largest category of budgetary assistance

To facilitate more detailed assessments of changes in the composition and nature of assistance, the Commission categorised its estimates of budgetary assistance into eight groups (figure below). The majority of budgetary assistance in 2018-19 was directed to:

- small business (\$4.9 billion or 42 per cent) — including \$2.2 billion for the Small Business Capital Gains Tax scheme (with over 40 per cent claimed by the services sector, including \$250 million for the property, professional, scientific and technical services industry), \$1.9 billion for the concessional taxation of small business and \$0.4 billion for the Small Business Simplified Depreciation scheme
- R&D (\$3.9 billion or 33 per cent) — including \$2.6 billion via R&D tax incentives, \$125 million for the Cooperative Research Centres program (where about half was directed towards services), and \$589 million for Commonwealth Scientific and Industrial Research Organisation (CSIRO) research, with most CSIRO assistance going to the agriculture sector (\$190 million, of which 40 per cent is allocated to the sheep, beef cattle and grain farming industry) or services sector (\$195 million).
- specific industries (\$1.1 billion or 9 per cent) — including \$310 million for the Offshore Banking Unit Tax Concession (allocated to financial and insurance services), \$328 million for the film industry offsets scheme (allocated to arts and recreation services), \$41 million for the Automotive Transformation Scheme (allocated to motor vehicles and parts).



Source: Commission estimates.

2 Recent developments in industry assistance

The *Trade and Assistance Reviews* selectively report on recent developments in industry assistance, with a focus on announcements of prospective assistance that in time may be included in the Commissions' measured assistance (chapter 1). Notable developments in industry assistance over the past year include:

- the use of Defence procurement as a form of assistance to the manufacturing industry (section 2.1)
- the ongoing response to drought by both the Australian Government and state and territory governments (section 2.2)
- the continuation of government financing vehicles, with new schemes for small business and expanded investment mandates for some existing facilities (section 2.3)
- the expansion of alcohol tax concessions and rebates, specifically the extension of the draught beer concession and the increase in the excise refund for craft brewers and distillers (section 2.4).

2.1 Defence procurement

The Australian Defence Force relies on a vast array of expensive machinery and equipment to defend Australia and contribute to global security. To acquire the next generation of this equipment, Defence's current pipeline of major projects is worth over \$200 billion up to the late 2020s (ANAO 2019; Australian Government 2017).

Australian governments have demonstrated a strong preference for procuring from domestic manufacturers and suppliers. Since April 2018, this preference has been codified in the Australian Government's *Defence Industrial Capability Plan*, which seeks to build a strong defence industry with 'the ability to operate, sustain and upgrade our defence capabilities with the maximum degree of defence and industrial sovereignty', including requirements that 'international companies and partners wanting to do business with Defence ... invest in our country and our industrial capability' (DoD 2018, pp. 13, 16).

Aside from providing support for employment and economic activity in manufacturing hubs (including those affected by factory closures, such as northern Adelaide), there are two other justifications given for this preference — defence preparedness and technological spillovers (box 2.1).

Box 2.1 Buy local? Justifications for domestic defence procurement

The preference towards Australian-based manufacturers and suppliers in the defence industry sometimes rests on claims that a lack of domestic industrial capability would undermine defence self-reliance or the Australian Defence Force's (ADF's) operational capability (for example, if this adversely affected the ability to repair or replace critical weapons systems).

The alternative option — purchasing available equipment 'off-the-shelf' from allied countries — is sometimes criticised as insufficient to meet the unique Australian context or operational requirements of the ADF. This was the justification for partly designing and building the new *Attack*-class submarines in Australia, reflecting the perception that our geographical isolation and unwillingness to operate nuclear submarines requires longer range diesel-electric submarines than available elsewhere.

It is sometimes also claimed that defence industry assistance may create technology and skill spillovers for Australian research and manufacturing, particularly when the project develops or adapts new technology or builds skills that are transferable to industries beyond defence construction. However, there is little evidence that these spillovers are substantial, relative to the assistance provided to the defence industry sector. In general, technology spillovers are less likely when much of the activity of businesses is simply the local assembly of high-tech defence components (developed overseas), rather than development of new products based on novel research in Australia.

Sources: Bourke (2019), Davies and Layton (2009), PC (2016b, pp. 36–38).

However, Australian defence manufacturing often comes with a substantial 'local cost premium'. This additional payment — above what is required to source the same quality and quantity of equipment 'off-the-shelf' from overseas — is a form of industry assistance. It requires higher taxes (or lower Australian Government spending elsewhere) and diverts productive resources (including labour, capital and land) away from other, more efficient uses, detracting from Australian incomes.

This industry assistance runs to billions of dollars for major defence projects. For example, the latest estimates suggest that the 12 *Attack*-class submarines under the *Future Submarine Program* are expected to cost around \$80 billion to construct, the largest Defence procurement in Australia's history (ANAO 2020, p. 20; Hellyer 2019). A report from the Australian National Audit Office suggests that the local cost premium for the submarines could be around 15 per cent (ANAO 2017, pp. 24–25) — equating to over \$10 billion of industry assistance to domestic shipbuilding.⁶ As an employment assistance measure, this would be equivalent to nearly \$3.5 million of assistance for each of the 2800 direct and indirect jobs supported by the *Future Submarine Program* over the course of the project (Hellyer 2019, p. 79; Turnbull and Payne 2016). As with all government spending (other than during recessionary periods), most of these employees would have held alternative jobs in the absence of the program. The costs can also be exacerbated by poor economies of scale and limited production.

⁶ Other sources have suggested the premium on the submarines could be much higher than 15 per cent (Bourke 2019, pp. 10–11), including estimates of 30 per cent (Uren and Nicholson 2016), or even 40 per cent or greater (Birkler et al. 2015, pp. 123–125; DoD 2017, p. 14).

Although piecemeal estimates of the premium are available for some projects, the overall amount of assistance delivered to the defence industry is often difficult to quantify. Partly, this is because the counterfactual of domestic supply in the absence of assistance is often not observable. But another obstacle is that the Government seldom publishes the detailed costings and business cases that would provide sufficient information on the size of the local cost premium. For example, the ANAO was recently prevented from publishing its conclusions on the effectiveness and value for money of the \$2.2 billion acquisition of the Hawkei (Protected Mobility Vehicle — Light) (ANAO 2018, p. 8; Burgess 2019).

As such, local cost premiums on major projects are often unknown, despite their multi-billion dollar price tags. The Commission has previously called for greater transparency of local cost premiums, and pointed to ways to support transparency, while still respecting confidentiality and national security (PC 2014d, pp. 29–31).

There may be valid policy rationales for maintaining a strong Australian defence industry (particularly for operational or capability reasons). However, there is not a clear policy framework setting out where and when this is worthwhile. Nor is there information published about local cost premiums involved with particular projects. This makes it difficult to have confidence that these benefits outweigh the considerable added cost to taxpayers.

2.2 Drought, flood and bushfire assistance for farmers

Over the past year, many Australian farmers, rural businesses, families and regional communities have faced a continued period of hardship due to the ongoing impacts of drought, with the added difficulties of severe bushfires and flooding in some areas. Federal and state governments have responded with a range of initiatives to support affected communities, including new assistance for the Townsville region after the floods of January and February 2019 (box 2.2) and additional supports for drought-affected areas across the country (box 2.3).

Australia's variable climate results in periods of drought, fire or flood. Governments at all levels respond with support for the affected communities. Some of this assistance is aimed at local businesses (rather than at affected families and communities), which is a form of industry assistance.

The Commission's most recent work relating to disaster support was the Natural Disaster Funding Arrangements inquiry (PC 2014a). The inquiry was undertaken following the 2009 Victorian fires and a period of flooding and cyclones in Queensland, which significantly increased the Australian Government's outlays on disaster assistance. The Commission found that governments were underinvesting in mitigation and insurance, while over-investing in post-disaster recovery, reducing incentives for businesses and households to manage risks.

In its Government Drought Support inquiry (PC 2009), the Commission found that, while drought assistance programs benefited recipients, they did not help farmers improve their self-reliance, preparedness and climate change management. Rather, the expectation of government support acted like implicit insurance (without a premium), reducing the incentives for farmers to manage the business risks themselves.

The Commission has not reviewed the design of more recent supports for farmers. Over time, they should receive the same scrutiny as earlier programs, including consideration of how they are targeted and whether they support (or undermine) the sustainability of the farming sector.

Box 2.2 **Support for North Queensland in the wake of flooding**

Following the monsoonal floods in North Queensland in early 2019, the Australian Government announced a range of assistance measures worth \$232 million (to be matched by Queensland Government contributions under the Disaster Recovery Funding Arrangements), including:

- *Special Disaster Assistance Recovery Grants* for clean-up and reinstatement costs, up to \$75 000 for farmers and \$50 000 for small businesses and non-profits
- low-interest *Disaster Assistance Loans* of up to \$250 000 for farmers and small businesses (\$100 000 for non-profits) to repair or replace assets that have been significantly damaged
- concessional *Disaster Assistance (Essential Working Capital) Loans* of up to \$100 000 for farmers, small businesses and non-profits, to cover expenses such as wages, rent, credit repayments and fuel or fodder purchases
- low-interest *Exceptional Disaster Assistance Loans* of up to \$1 million (less any other concessional disaster loans) for farms and small businesses with exceptional damage.

Separately, the Australian Government also announced over \$3 billion of additional measures that included:

- \$300 million for *North Queensland Restocking, Replanting & On-farm Infrastructure Grants*, providing up to \$400 000 to farmers (after a 100 per cent co-contribution from the farmer) to restock or replant, and to repair or replace damaged farm infrastructure
- up to \$1.75 billion in loans to authorised deposit-taking institutions to support interest rate relief for existing and new business loans to affected farmers
- up to \$1 billion in concessional *AgRebuild Loans* from the Regional Investment Corporation, to assist farmers through loans of up to \$5 million each
- \$32.9 million over five years to establish a North Queensland Livestock Industry Recovery Agency to coordinate Commonwealth efforts.

Sources: Australian Government (2019a, pp. 62–63, 111), Morrison (2019b, 2019a), RIC (2020), QRIDA (2020).

Box 2.3 **Drought assistance has continued to grow**

During 2019, the Australian Government announced over \$1 billion of new or additional support for farmers, families and communities affected by drought, including:

- \$114.5 million for changes to the *Farm Household Allowance*, including expanding and simplifying eligibility, providing a single rate of payment, and strengthening case management support for farmers. Also provides a one-off relief payment (\$7500 for singles, \$12 000 for couples) to recipients who have exhausted the four year maximum payment
- increased access to concessional loans from the Regional Investment Corporation through the *Drought Loans* (up to \$2 million for farmers) and *Small Business Drought Loans* (up to \$500 000 for farm-dependent small businesses, now called *AgBiz Drought Loans*) programs
- nearly \$600 million for infrastructure and drought-relief projects in 128 local communities affected by the drought, through additional funding for the *Drought Communities Programme*
- over \$300 million for water infrastructure and drought preparedness, in partnership with the state and territory governments
- \$66.7 million for the *Drought Community Support Initiative* to provide up to \$3000 per household for approximately 20 000 farming households and workers
- \$33 million associated with the creation of the National Drought and North Queensland Flood Response and Recovery Agency, which has a wider remit for support and coordination than its predecessor body (the North Queensland Livestock Industry Recovery Agency — box 2.2)
- establishing a *Water for Fodder* program, providing 100 gigalitres of water (purchased from the South Australian Government for an undisclosed sum) at a discounted price for farmers in the Murray-Darling Basin to grow fodder, silage and pasture (Australian Government 2019a, p. 124, 2019b, pp. 192–195; Littleproud 2019; McKenzie 2019; RIC 2020).

State governments have also expanded their drought assistance throughout 2019.

- The New South Wales Government increased the size of the *Farm Innovation Fund* from \$650 million to \$1 billion and expanded the maximum loan size from \$250 000 to \$1 million. It also announced \$170 million for a *Drought Infrastructure Package* and \$185 million for additional on-farm drought support measures (Berejiklian, Barilaro and Blair 2019; Berejiklian, Barilaro and Perrottet 2019).
- The Queensland Government announced \$74.6 million in additional assistance, providing for freight subsidies and emergency water infrastructure rebates under the *Drought Relief Assistance Scheme*, as well as land rent rebates and water licence waivers (Furner 2019).
- The Victorian Government announced multiple assistance packages throughout 2019, including a \$5 million extension of the *On-Farm Drought Infrastructure Grants* program, as well as the establishment of a \$15 million *Farmers' Drought Fund* to provide up to \$3000 financial relief for affected households and to invest up to \$5000 in on-farm drought preparedness and resilience (Agriculture Victoria 2020; Symes 2019a, 2019b).
- In December 2019, the South Australian Government announced a \$21 million *Drought Support Program* to fund rebates on council rates, pastoral lease rent relief, an expansion of rural counselling and rebates of up to \$50 000 for emergency water infrastructure (PIRSA 2019)

2.3 Government project financing

Previous *Trade and Assistance Reviews* noted that the Australian Government has moved towards providing project finance as a form of industry assistance. As the 2017-18 *Review* stated, ‘large-scale finance vehicles have the potential to skew industry assistance to particular firms and projects with minimal public scrutiny until deals are done’ (PC 2019, p. 63).

During 2019, the expansion of project financing vehicles has continued, adding to the level of industry assistance (box 2.4). Although the incremental changes are small, the continued growth and development of project financing vehicles has the strong potential to distort the allocation of resources, as well as imposing hidden costs to taxpayers through non-repayment risks and concessional financing subsidies. In part, the effects depend on the different objectives and justifications of financing facilities.

- Some funds (such as the Australian Business Securitisation Fund) are intended to fill a perceived ‘market gap’ for financing to new or small businesses, providing more favourable terms than commercially available, with the aim of boosting innovation and new business generation.
- Other financing facilities (such as the Northern Australia Infrastructure Facility) are used as an alternate means of infrastructure funding — a core function of government — but need to be subject to the same principles of good project selection and delivery, to ensure value for money for taxpayers (PC 2014b).
- And some financing facilities (such as Export Finance Australia) are used by the Government to ‘pick’ winners (and hence losers) in an industry.

There is an onus on proponents of taxpayer-funded financing of commercial projects to demonstrate how the associated costs are outweighed by the benefits to the public, and that project financing is the best solution to the identified policy problem.

Box 2.4 Project financing changes over the past year

Australian Business Securitisation Fund (ABSF) — provides funding to smaller banks and non-bank lenders to on-lend to small businesses on better terms than available commercially.

- Following the enactment of legislation to create the ABSF in April 2019, the first tranche of funds (\$250 million) was deposited in July. In December, an investment manager (Challenger Investment Partners) was appointed, and the Australian Office of Financial Management began receiving investment proposals. Decisions on the first round of investments are expected to be announced 'late in the first, or early in the second, quarter of 2020' (AOFM 2019c, 2019b, 2019a).

Business Growth Fund (BGF) — makes passive, minority equity investments in small businesses, enabling them to grow without giving up a controlling interest.

- In November 2019, the Government announced that it had agreed terms with six banks (ANZ, CBA, NAB, Westpac, Macquarie and HSBC) to establish the BGF with \$540 million (including \$100 million of taxpayer money). The Government introduced enabling legislation to Parliament in December, stating its 'ambition' for the BGF to grow to \$1 billion as it matures (Frydenberg and Cash 2019b, 2019a).

Northern Australia Infrastructure Facility (NAIF) — a financing facility for infrastructure projects in northern Australia.

- In November 2019, the Government commenced a review of the future of the NAIF and the operation of its legislation. Among other things, the review will 'consider the 30 June 2021 deadline for investment decisions and the benefit of extending this' (Canavan 2019; DIIS 2019).

Export Finance Australia (EFA, formerly the Export Finance and Insurance Commission, or Efic) — an export credit agency, providing non-commercial loans, bonds and guarantees to assist Australian exporters.

- On 1 July 2019, EFA received an extra \$1 billion in callable capital and new powers to finance overseas infrastructure investment, particularly in the Pacific (Birmingham 2019). In November, the Government also announced that the EFA (and its Defence Export Facility) would focus on financing and supporting projects to extract and process Australia's rare earths and critical mineral supplies (Canavan, Birmingham and Reynolds 2019).

Clean Energy Finance Corporation (CEFC) — aims to lower carbon emissions by making commercial investments in renewable energy, energy efficiency and low emission technologies.

- In October 2019, the Government announced a \$1 billion Grid Reliability Fund to support new energy generation, storage and transmission infrastructure investment. The Fund will be administered by the CEFC, following an expansion of its mandate in 2018 to include energy reliability (CEFC 2019; Morrison, Taylor and Cormann 2019; Taylor and Cormann 2019). In November, the Government also announced the reallocation of \$300 million of CEFC funds to support the development of a hydrogen industry in Australia (Taylor 2019).

2.4 Alcohol tax concessions and rebates

Alcoholic beverages in Australia are subject to a complex and uneven tax regime (table 2.1). Most drinks, including beer and spirits, fall under the excise duty (or excise-equivalent

customs duty) regime, with taxes levied on the alcohol content in the beverages (a ‘volumetric’ tax) at one of several different rates, depending on the type and purpose of the drink. Wine, by contrast, is taxed under a separate regime — the Wine Equalisation Tax (WET) — at 29 per cent of the wholesale value, regardless of the alcohol content (a ‘value’ or ‘ad valorem’ tax).⁷

Table 2.1 The alcohol tax system — pick your poison

Non-GST taxes on alcohol, as at 3 February 2020

Classification	Purpose	Method	Current duty rate (\$ per litre of pure alcohol)
Beer: < 3 per cent ^a	Commercial	Container > 8L	8.81
		Container < 8L ^b	44.05
	Non-commercial	Brew-on-premises ^c	3.10
		Home-brewed ^d	Nil
Beer: 3 – 3.5 per cent ^a	Commercial	Container > 8L	27.59
		Container < 8L ^b	51.31
	Non-commercial	Brew-on-premises ^c	3.57
		Home-brewed ^d	Nil
Beer: > 3.5 per cent ^a	Commercial	Container > 8L	36.14
		Container < 8L ^b	51.31
	Non-commercial	Brew-on-premises ^c	3.57
		Home-brewed ^d	Nil
Brandy			81.16
Spirits			86.90
Ready-to-drink (alcopops)			86.90
Cider (with additives)			86.90
Cider (traditional)			29 per cent of wholesale value
Wine			29 per cent of wholesale value

^a Beer excise is only applied on alcohol content above a concentration of 1.15 per cent. ^b Small container rates also apply to alcohol in individual containers of 8 to 48 litres that are *not* designed to connect to a pressurised gas or pump delivery system. ^c ‘Brew-on-premises’ is beer produced for non-commercial purposes using commercial equipment (such as renting out industrial brewing facilities for own consumption). ^d ‘Home-brew’ is beer produced for non-commercial purposes in non-commercial facilities.

Sources: ATO (2020) and *Excise Tariff Act 1921*.

The current system includes a range of concessions to the main rates of alcohol excise, resulting in 10 different rates of duty, applied across 16 different excise categories. There are also WET rebates available to some winemakers, as well as excise refunds for select brewers and distillers. The stated purpose of many of these tax concessions and rebates is to provide industry assistance to winemakers, brewers and distillers, and to the hospitality

⁷ The WET regime also covers cider, perry, mead and sake, as long as they do not contain additives.

industry serving alcoholic beverages (box 2.5). Taken together, the four assistance measures equated to nearly \$2 billion of forgone tax revenue over the past four fiscal years (table 2.2).

The level of industry assistance grew from 1 July 2019 as the Australian Government implemented changes that:

- extended the draught beer concession to cover smaller kegs of 8 litres or more⁸
- increased the maximum excise refund from \$30 000 to \$100 000 per annum.

Together, the two changes were expected to cost \$85 million in foregone revenue over the first three years (Australian Government 2018, pp. 19–20).

The added support in 2019 was introduced ‘to assist the thriving craft brewing sector’ (Robert 2019). Craft brewers had argued that the draught beer concession was inequitable, as it discriminated against their smaller-scale un-mechanised operations and greater use of non-concessional 20 or 30 litre kegs for smaller-sized brewing batches, which also appeal to smaller venues (such as cafés) (Robert 2019; Sammartino 2017).

The steady expansion of industry assistance through the alcohol tax system has increased the complexity of that system, which may lead to further calls for assistance to compensate for the growing complexity or for other introduced anomalies or inequities. The Commission has previously flagged the need for broader reform of Australia’s alcohol tax system, describing it as ‘a mess, with alcohol content taxed at multiple rates, with no rhyme or reason for the variations, bar history and vested interests’ (PC 2017b, p. 74).

Table 2.2 Revenue forgone is not small beer
Alcohol tax revenue forgone, 2016-17 to 2019-20 (\$ millions)

<i>Assistance measure</i>	<i>2016-17</i>	<i>2017-18</i>	<i>2018-19</i>	<i>2019-20</i>	<i>Total</i>
Draught beer concession	165	165	170	170	670
Brandy concession	4	5	5	5	19
Brewer and distiller refund	6	10	10	35	61
Wine tax rebate	340	330	290	280	1 240

Source: Treasury (2020).

⁸ Through the *Excise Tariff Amendment (Supporting Craft Brewers) Act 2019*. However, to prevent kegs sold directly to consumers from being eligible for the concession, only containers between 8 and 48 litres that are designed to connect to a pressurised gas or pump delivery system are eligible.

Box 2.5 A cocktail of concessions

Draught beer concession

Introduced on 4 April 2001, the 'draught beer' concession applied a lower rate of excise to beer packaged in large containers (kegs) of over 48 litres (Webb 2006, p. 28). The concession is supported by the hospitality industry. The Australian Hotels Association argues that the draught beer concession assists employment in the hospitality industry and delivers social benefits through improved public safety from consumption in licensed venues, rather than 'unregulated' environments (AHA 2013, 2017).

Brandy concession

Brandy has been subject to excise since Federation, generally at a concessional rate compared to that on other spirits. Since 1979, the concession has been explicitly intended as industry assistance for grape growers in regional areas. Currently, the concession is equivalent to a 6.6 per cent discount on the excise rate applied to other spirits (IC 1995, p. 257; Webb 2006, p. 28).

Excise refund for craft brewers and distillers

Breweries and distilleries can access a refund of 60 per cent of the excise paid on alcoholic beverages, up to a maximum of \$30 000 per year. To be eligible, the brewery or distillery must be independent of any other alcohol manufacturer that has received a refund (ATO 2019b). On 1 July 2017, eligibility for the refund was extended from sales of beer directly from a brewery, to cover all sales, and was also extended to independent distillers to cover sale of spirits. The stated purpose was to 'assist the domestic distillery industry to innovate and grow' and 'create a more even playing field' (McCormack and O'Dwyer 2017; O'Dwyer 2017).

Wine equalisation tax (WET) rebate

The WET producer rebate was introduced in 2004 to replace an administratively burdensome cellar door rebate and provide broader relief to small regional wineries. The rebate entitled wine producers to claim 29 per cent of the wholesale value of eligible Australian sales, up to a maximum of \$500 000. After allegations of improper access to the scheme by non-winemakers, eligibility as a 'producer' was tightened from 1 July 2018 and the maximum cap reduced to \$350 000 (ATO 2019a; Cormann 2017; Treasury 2015).

3 Trade policy developments

This chapter reports on trade policy developments since the *2017-18 Trade and Assistance Review* (published in June 2019).

While it is widely acknowledged that the benefits of trade liberalisation are greatest when undertaken on a multilateral, ‘Most Favoured Nation’ basis, progress on multilateral negotiations at the World Trade Organization (WTO) have proved difficult and slow. Indeed, strained trade relations between China, the United States and Europe, and the complexities associated with Brexit have disrupted the world trading system. Since the *2017-18 Review*, the institutional foundations for a rules-based trading system have come under further pressure. The blocking of judge appointments to the Appellate Body means that the WTO is unable to offer binding resolutions to trade disputes, severely compromising the WTO’s role.

Although the WTO system is under strain, there are still comprehensive agreements in progress (section 3.1). The Commission has previously indicated that there is value in Australia (and other like-minded countries) continuing to intensify trade liberalisation efforts, with an emphasis on large-scale ‘plurilateral agreements’ covering particular trade topics (PC 2017a). Agreements in the works include:

- the Trade in Services Agreement (TiSA)
- the Environmental Goods Agreement (EGA) (DFAT 2020a).

Progress on these negotiations continues, but at a slow pace.

While plurilateral negotiations provide the greatest prospect to reduce trade costs over time, regional and bilateral agreements provide a second-best alternative (section 3.2). Major developments in the last year include:

- Australia and the European Union launched negotiations for a free trade agreement on 18 June 2019
- the Pacific Alliance Free Trade Agreement commenced negotiations on 30 June 2019
- the Regional Comprehensive Economic Partnership (RCEP) countries announced the conclusion of all 20 chapters on 4 November 2019 and is now ready for signature, although India remains a holdout
- the United Kingdom and Australia are set to start negotiations on a post-Brexit free trade agreement (DFAT 2020a).

Since 1995, Australia has also been the complainant in and respondent to a number of different trade disputes at the WTO (section 3.3), while Australia’s anti-dumping and

countervailing activity measures have been the subject of a recent dispute with Indonesia that may result in wider implications (section 3.4).

3.1 Multilateral and plurilateral agreements

The rules-based system that operates through multilateral and plurilateral agreements at the WTO has recently come under threat, which has left the system under the greatest strain since the 1930s (PC 2019). This trend has continued since the 2017-18 *Review*, with the dispute settlement body left paralysed after the blocking of new appointments to the WTO's Appellate Body.

There has been limited progress on multilateral and plurilateral agreements in recent years. The Trade Facilitation Agreement (agreed in 2013 and came into force in early 2017) was a substantial exception.

The WTO's dispute body loses its teeth

The US Government has blocked appointments of new judges to the WTO's Appellate Body since 2017. This came to a head on 10 December 2019 when the terms ended for two of the last three judges on the Appellate Body, leaving it effectively non-functional as it is unable to rule on new dispute cases. The WTO's lower court is still able to hear cases, but if a party appeals to the higher court then there is no body to make a ruling on the appeal (Beattie 2019).

The blocking of new appointments reflected disenchantment by the US Government with the rulings and processes of the WTO. This emanated from concerns that cases were taking too long to resolve, the panel was overreaching in its rulings, the WTO did not effectively protect against Chinese trade practices, the United States was taking on a disproportionate burden due to the many challenges of US law, and countries could obtain concessional treatment by self-declaring as a 'developing' country (USTR 2020).

In response to the effective shutdown of the WTO's dispute body, 17 countries including the European Union, China and Australia have agreed to establish a temporary dispute settlement body to bypass the blockage at the WTO (Brunsden 2020).

Trade in Services Agreement (TiSA) negotiations bogged down

Australia has taken a lead role in the negotiation of this services-only trade agreement between a subset of 23 WTO members. The agreement is aimed at building upon the General Agreement on Trade in Services (GATS), while also incorporating elements from free trade agreements. The most recent negotiation round was held in 2016 and no future rounds have been scheduled — the negotiations remain stalled following the 2016 US election (DFAT 2020d).

Environmental Goods Agreement (EGA) is progressing slowly

The EGA is being negotiated by 46 WTO members to reduce tariffs on goods that benefit the environment. The agreement aims to build on the list of 54 environmental goods that APEC leaders agreed for tariff reduction in 2012. It is the largest agreement currently being negotiated at the WTO.

Australia chairs the EGA negotiations. Other participating WTO members include Canada, China, Costa Rica, the European Union and its 28 member states, Hong Kong, Iceland, Israel, Japan, Republic of Korea, New Zealand, Norway, Singapore, Switzerland, Chinese Taipei, Turkey and the United States. The last negotiation meeting was in 2016, with no further negotiations scheduled (DFAT 2020b).

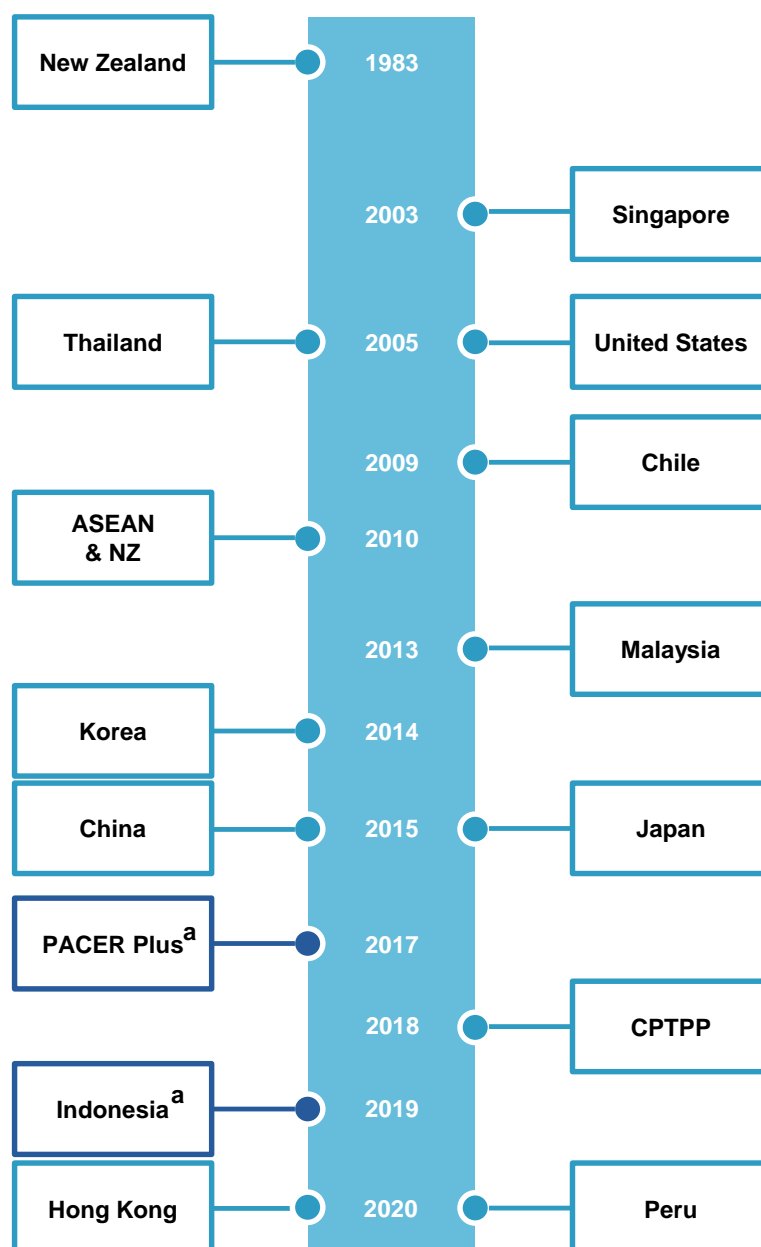
3.2 Bilateral and regional agreements

Australia has signed 15 bilateral and regional preference agreements, 13 of which are in force, with the remaining two proceeding through the ratification process (figure 3.1). Since the 2017-18 *Review*, Australia has not concluded any new agreements, but has had two previously concluded agreements come into force.

- The Australia-Hong Kong Free Trade Agreement was signed on 15 November 2018 and entered into force on 17 January 2020. The agreement provides certainty for Australian businesses, rather than immediate changes in costs. Hong Kong agreed to bind all tariffs at zero, which eliminates the risk that Hong Kong could otherwise increase tariffs to their current WTO non-zero bound rates in the future.
- The Peru-Australia Free Trade Agreement entered into force on 11 February 2020. The agreement is aimed at complementing the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), of which both parties are participants, and includes elimination of some tariffs, encouraging foreign investment and services liberalisation, such as minimising non-tariff barriers and recognition of Australian degree qualifications.
- The Indonesia-Australia Comprehensive Economic Partnership Agreement was signed on 4 March 2019 and is expected to enter into force shortly. The Agreement will allow 99 per cent of Australia's goods exports to enter Indonesia either duty free or with significantly improved preferential arrangements and streamline issuance of import permits for products such as live cattle, frozen beef, sheep meat, feed grains, rolled steel coil, citrus products, carrots and potatoes. Import licences are a major irritant for many Australian exporters into Indonesia. All of Indonesia's goods exports will enter Australia duty free.
- Australia and the United Kingdom are set to begin negotiations for a post-Brexit free trade agreement (DFAT 2020a).

There are also a bilateral agreements under negotiation with India and the EU. In addition, regional agreements such as the RCEP, Australia-Gulf Cooperation Council (GCC) Free Trade Agreement are currently under negotiation.

Figure 3.1 Australia's bilateral and regional trade agreements
By year entered into force



^a Concluded but not yet in force (date refers to year the agreement was signed).

Source: DFAT (2020a).

The Regional Comprehensive Economic Partnership (RCEP) countries agree on all chapters, but lose India

The RCEP is an ASEAN-centred proposal for a regional free trade area, which would initially include the ten ASEAN member states and those countries which have existing free trade agreements with ASEAN — Australia, China, India, Japan, Republic of Korea and New Zealand. RCEP negotiations were launched in November 2012. The 16 participating countries account for almost half of the world's population, almost 30 per cent of global GDP and over a quarter of world exports (DFAT 2020c).

At the 3rd RCEP Summit in Bangkok on 3 November 2019, 15 of the 16 participating countries concluded all 20 chapters of the RCEP agreement and essentially all market access commitments on goods, services and investment — Australia will work towards a signature in 2020. India remains the major stumbling block in negotiations and pulled out of the agreement in November 2019 with a number of issues outstanding (details are unknown due to the closed nature of the negotiations).

3.3 Australia's WTO disputes

Dispute settlement is a central element of the WTO, which helps make the global trading system more secure and predictable. The arrangements are the responsibility of the Dispute Settlement Body (DSB) and are based on clearly defined rules. Since 1995, there have been 595 disputes lodged by WTO members (WTO 2020b). Not all proceeded past the formal 'requests for consultations' to the establishment of a dispute panel. Australia has been a complainant in nine cases, and a respondent to 16 complaints (tables 3.1 and 3.2). It currently has two cases as a complainant in progress — against Canadian restrictions on the sale of imported wine and against Indian sugar subsidies — with no outstanding cases as a respondent.

Table 3.1 Australia as the complainant

The nine cases Australia has brought as a complainant

<i>Year</i>	<i>Country</i>	<i>Issue</i>	<i>Outcome</i>
2019	India	Measures Concerning Sugar and Sugarcane.	Panel composed.
2018	Canada	Measures Governing the Sale of Wine.	Panel composed.
2003	European Communities (EC)	Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs.	The EC changed its regulations in March 2006. Australia informed the WTO that it did not consider that the DSBs recommendations had been fully implemented.
2002	EC	Export Subsidies on Sugar.	In favour of Australia.
2000	United States ^a	Continued Dumping and Subsidy Offset Act of 2000.	In favour of Australia. In December 2004 Australia reached an understanding with the United States with respect to the dispute.
1999	United States	Safeguard Measure on Imports of Fresh, Chilled or Frozen Lamb from Australia.	In favour of Australia. Implementation notified in November 2001.
1999	Republic of Korea	Measures Affecting Imports of Fresh, Chilled and Frozen Beef.	In favour of Australia. Implementation completed by September 2001.
1997	India	Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products.	Mutually agreed solution before request for a panel.
1996	Hungary ^b	Export Subsidies in respect of Agricultural Products.	Mutually agreed solution in 1997 after a panel was established. Hungary was required to seek a waiver of certain WTO obligations.

^a Joint complainant with Brazil, China, European Communities, India, Indonesia, Japan, Republic of Korea and Thailand. ^b Joint complainant with Argentina, Canada, New Zealand, Thailand and the United States.

Source: WTO (2020a).

In the last year, the cases as a respondent against anti-dumping duties on Indonesian paper and tobacco packaging involving the Dominican Republic and Honduras have been finalised.

- The panel found in favour of Indonesia that Australia's anti-dumping actions were inconsistent with WTO commitments and should be brought into conformity. The consequences of this decision extend beyond this case, discussed in section 3.4.
- The panel on tobacco product labelling was found in favour of Australia, with no further action required.

Table 3.2 Australia as the respondent

The 16 cases where Australia has been subject to dispute settlement action

<i>Year</i>	<i>Country</i>	<i>Issue</i>	<i>Outcome</i>
2017	Indonesia	Anti-Dumping Measures on A4 Copy Paper	Indonesia was successful in its appeal and the Panel recommended Australia bring its obligations into conformity with the WTO rules.
2012/2013	Indonesia, Cuba, Dominican Republic, Honduras, Ukraine ^a	Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging	Panel report in favour of Australia. The Dominican Republic and Honduras appealed the Panel's decision. The Panel reports in the disputes initiated by Cuba and Indonesia were adopted by the DSB on 27 August 2018.
2007	New Zealand	Measures Affecting the Importation of Apples from New Zealand	Panel report and Appellate Body report in favour of New Zealand. Implementations notified 2011.
2003	European Communities	Quarantine Regime for Imports	Panel established in 2003 but did not proceed. Mutually agreed solution notified in 2007.
2002	Philippines	Certain Measures Affecting the Importation of Fresh Pineapple	Philippines did not pursue beyond consultations.
2002	Philippines	Certain Measures Affecting the Importation of Fresh Fruit and Vegetables	Panel established in 2003, but not composed. Philippines did not pursue dispute beyond panel request.
1998	United States	Subsidies Provided to Producers and Exporters of Automotive Leather	Panel report in favour of the United States. Mutually agreed solution reached in 2000.
1998	Switzerland	Anti-Dumping Measures on Imports of Coated Woodfree Paper Sheets	Mutually agreed solution notified in 1998, after Australia terminated the measures in dispute.
1997	United States	Subsidies Provided to Producers and Exporters of Automotive Leather	Panel established in 1998, but US request withdrawn to pursue parallel complaint (above).
1996	United States	Textile, Clothing and Footwear Import Credit Scheme	Not pursued beyond the 1996 request for consultations.
1995	United States	Measures Affecting the Importation of Salmonids	Panel established and then suspended after amendments to the measures in dispute. Mutually agreed solution notified in 2000.
1995	Canada	Measures Affecting Importation of Salmon	Panel report and Appellate Body report in favour of Canada. Compliance notified in 2000.

^a Separate cases on the same issue brought by each country independently.

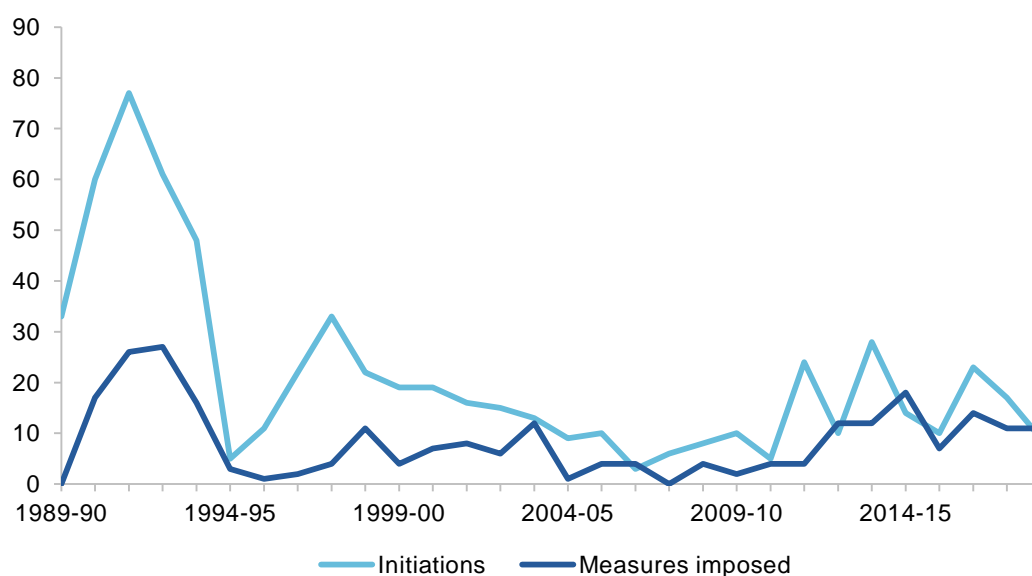
Source: WTO (2020a).

3.4 Australia's anti-dumping and countervailing activity

Although the WTO rules allow for the imposition of anti-dumping measures, there are no convincing justifications for these measures, and they reduce the wellbeing of the Australian community (PC 2016a). Nevertheless, their use has shown no signs of abating in the global trade environment, with the European Union joining the United States, Canada and Australia

in 2020 in implementing anti-dumping measures on Chinese aluminium and steel. Australia is one of the most prolific users of anti-dumping measures in the world (PC 2019), and continues to impose an array of anti-dumping measures (figure 3.2).

Figure 3.2 Australia continues to implement anti-dumping measures^a



^a Data are from the World Bank up until 2014-15 and the Anti-Dumping Commission thereafter.

Sources: World Bank (2018), DISER (2019).

The WTO finds Australia's anti-dumping measures are paper thin

Australia's Anti-Dumping Commission has been imposing anti-dumping measures on foreign importers of A4 copy paper since 2016, including Indonesia, which successfully challenged this at the WTO's dispute settlement body on 4 December 2019. The ruling claimed the Anti-Dumping Commission had not made the required calculations in line with the appropriate methodology used to determine whether dumping had occurred (WTO 2020c). Trade Minister Simon Birmingham responded to the ruling, stating that the Australian Government stood by its 'robust anti-dumping system' and that 'this ruling will not impact on the integrity of our anti-dumping regime which continues to protect Australian industry from unfair trading practices' (Grigg and Seo 2019).

As noted by Russel Wiese, a trade lawyer at Hunt & Hunt:

Australia now faces WTO proceedings from China that will almost certainly be successful ... It is unthinkable that China won't use the [Indonesian] decision to get an outcome from Australia on steel and aluminium. (Grigg and Seo 2019)

The ruling has wider implications for Australia's anti-dumping regime because it opens the door for further successful challenges in analogous circumstances.

A How the assistance estimates are calculated

Industry is assisted through a wide array of government programs, regulatory instruments and policies. Each year, the Commission updates and publishes estimates of the assistance provided by:

- import tariffs, which raise the price of imported products (mainly manufactured goods) allowing competing domestic firms to charge higher prices. The tariff assistance estimate is the equivalent budget outlay to the industry that would be expected to have the same effect on Australian producers' prices and volumes of production. The measure is not the amount of duty collected
- Australian Government budgetary measures — comprising subsidies (predominantly grants and concessional loans) and tax concessions. Budgetary support advantages recipient firms and industries over those that do not receive support.⁹

The estimates cover a broad range of measures that afford substantive support to industry and that can be readily quantified on a consistent annual basis. However, they do not capture all Australian Government support for industry (box A.1). For example, the assistance provided through government regulation is not included in the estimates, nor is assistance arising from government purchasing preferences. In large part this is because the extent of these forms of assistance is difficult to estimate.

The estimates also do not include assistance from other government jurisdictions. In the past at least, this has been considerable. For example, State and Territory governments' assistance to industry amounted to around \$4 billion in identifiable assistance in 2008-09 (equating to around \$184 per person), of which around 60 per cent went to the primary production and resources industry (PC 2011). The estimates in this *Review*, therefore, do not cover the full extent of assistance to industry and the gap between reported values and actual assistance is potentially large.

There are also government policies that can advantage businesses, but that are not considered industry assistance. This arises where activities to support social or other objectives increase demand for an industry's products, or where they lower the costs of production for some businesses (box A.1). This *Review* reports on government activities that constitute industry assistance and that can be readily measured.

⁹ The assistance estimates reported in this year's *Review* cover the period 2013-14 to 2018-19. Further information on the assistance estimation methodology, program coverage and industry allocation is to be provided in a (forthcoming) Methodological Annex to this *Review*.

Box A.1 **What is not included in the Commission's assistance estimates**

The Commission's assistance estimates cover only those measures that selectively benefit particular firms, industries or activities, and that can be quantified given practical constraints in measurement and data availability. Consequently, there are some significant government programs that selectively confer industry assistance, but cannot be appropriately estimated. Conversely, certain businesses benefit significantly from some government arrangements, but the benefit is not classified as (preferential) industry assistance, generally because the purpose of the arrangement is a broader public objective.

Examples of industry assistance not included in the core estimates

- Regulatory restrictions on competition such as those relating to pharmacies, air services, the importation of books, media and broadcasting, and the importation of second hand cars
- Government purchasing preferences and local content arrangements, such as defence procurement
- Concessional debt and equity finance
- State and territory government support to industry
- Anti-dumping and countervailing duties
- Access and pricing of resources (mining, forestry, fisheries and water), if on favourable economic terms
- Support for professional sport (such as tax concessions for international tournaments in Australia and support for sporting venue redevelopment).

Some of these arrangements have been examined in detail in the Commission's inquiries, research reports, and previous *Reviews*.

Examples of policies that provide a benefit to certain businesses that are not classified as industry assistance

- Superannuation concessions
- The private health insurance rebate
- Government funding of private community service providers
- Indigenous business support
- Employment incentives to business
- Remote housing concessions in mining regions
- Differential tax rates in relation to excises, GST and Fringe Benefit Tax (and state payroll tax)
- Improved transport infrastructure, for example, an upgraded road in a concentrated beef producing area would be expected to lower logistics costs for beef producers, but the road is not for the sole use of beef producers.

Although not classified as assistance, evaluations of these programs should include analysis of the differential effects on businesses in an industry and across industries.

Estimates of the 'effective rate of assistance' (ERA) in this *Review* (chapter 1) are also limited. The ERAs are measured as the value of combined assistance to a particular industry as a share of that industry's unassisted net output (industry value added). But ERAs are only

published for the manufacturing, primary production (mostly agriculture) and mining sectors, not the services sector, despite services constituting over 80 per cent of the Australian economy. Among other things, this reflects technical matters associated with the treatment of services in transportable goods sectors, which would mean that ERAs for services involve double-counting of service industry value added in the formation of economy-wide ERA measures.

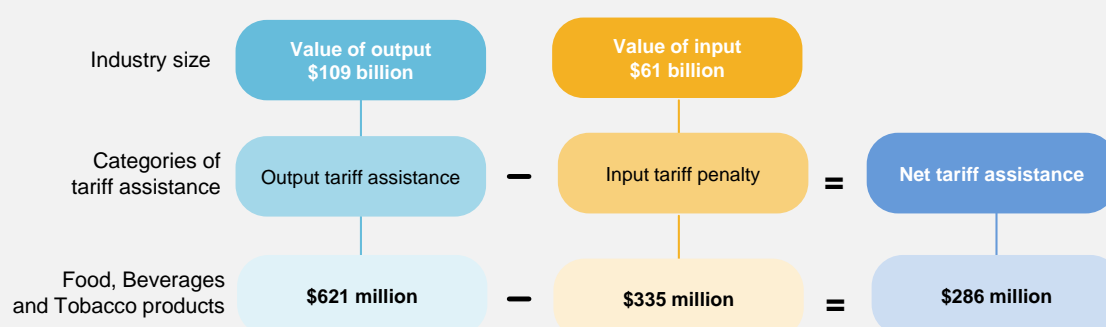
A.1 Tariff assistance

The Commission's estimates of tariff assistance are divided into three categories — 'output' assistance, 'input' penalties and 'net' assistance.

- Tariffs on imported goods increase the price at which those goods are sold on the Australian market and, thus, allow scope for domestic producers of competing products to increase their prices. These effects are captured by the Commission's estimates of output assistance.
- Tariffs also increase the price of local and imported goods that are used as inputs and thus penalise local user industries. This 'penalty' is reduced if tariff concessions are available to Australian producers. The penalties are reflected in the Commission's estimates of input penalties.
- Net tariff assistance represents the total net assistance provided through tariffs to industry, and is calculated as output tariff assistance less the input penalties (box A.2).

Box A.2 Tariff assistance concepts applied to the food, beverage and tobacco products industry

To illustrate the concepts of output tariff assistance, input tariff penalty and net tariff assistance, this box outlines the Commission's estimates for the food, beverage and tobacco products industry in 2018-19. The \$621 million output tariff assistance for the industry is largely derived from 5 per cent tariffs on imports of chocolate products, selected wines, and bread and pastry products. While for inputs, 5 per cent tariffs on imports of chocolate and sugar confectionary products accounted for most of the \$335 million input tariff penalty imposed on the food, beverages and tobacco products industry.



Source: Commission estimates.

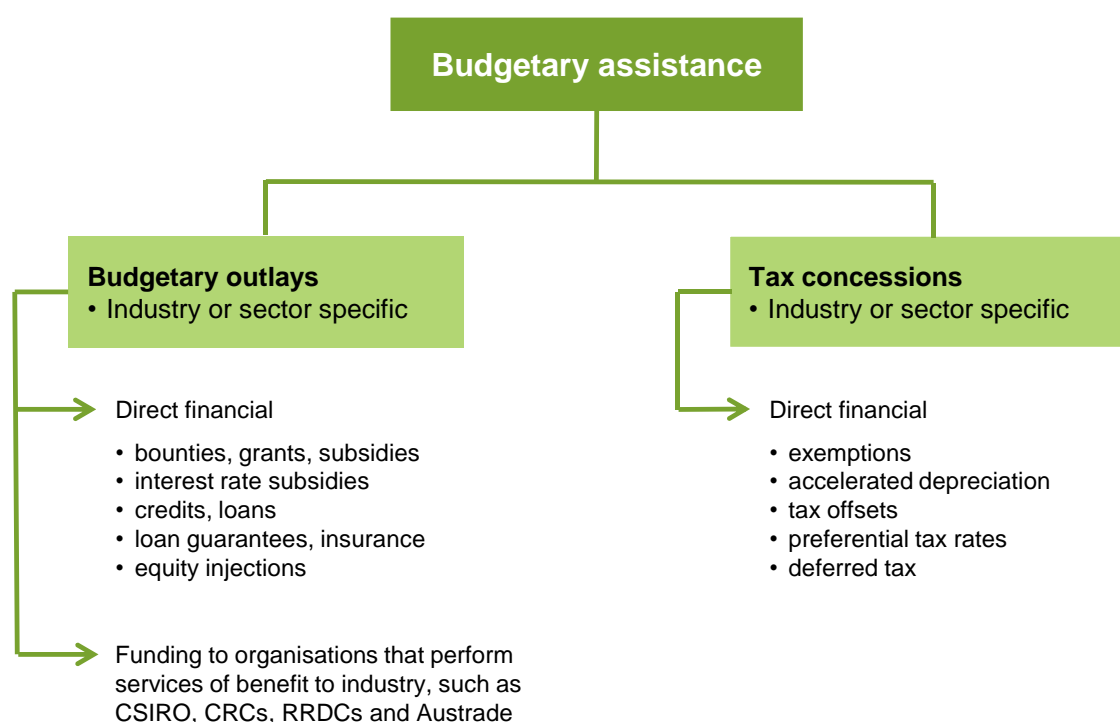
A.2 Budgetary assistance

The budgetary assistance estimates are derived primarily from actual expenditures shown in departmental and agency annual reports, and the Tax Benchmarks and Variations Statement (formerly known as the Tax Expenditures Statement) compiled by the Australian Treasury. Industry and sectoral disaggregation is based primarily on supplementary information provided by relevant departments or agencies.

The Commission records the incidence of budgetary assistance by applying the concept of ‘initial benefiting industry’. Assistance is allocated to the industry hosting the firm that initially benefits from a program or measure. Where a number of firms, in different industries, initially benefit from a particular program or measure, the Commission seeks to apportion the assistance between those industries. Further details will be included in the (forthcoming) Methodological Annex to this *Review*.

Estimates are presented for 34 industry groupings, while four ‘unallocated’ categories are used for programs where it has not been possible to confidently identify the initial benefiting industry or sector from available information.

Figure A.1 **Forms of budgetary assistance**



To facilitate more detailed assessments of changes in the composition and nature of assistance, the Commission also categorises its estimates of Australian Government budgetary assistance into:

- R&D measures, including those undertaken by CSIRO, Cooperative Research Centres and rural R&D corporations, as well as R&D taxation concessions¹⁰
- export measures, including through Export Market Development Grants, import duty drawback, TRADEX and Austrade
- investment measures, including development allowances and the Regional Headquarters Program
- industry specific measures, including the Automotive Transformation Scheme, Film Industry Offsets Scheme and the Offshore Banking Unit tax concession
- sector wide measures, such as drought relief assistance and the tax concessions under the Farm Management Deposits Scheme, in the case of the primary production sector
- small business programs, such as the small business capital gains tax concessions, the Small Business Simplified Depreciation Rules and concessional company taxation for small business
- regional assistance, including the Tasmanian Freight Equalisation Scheme, Tasmanian Jobs and Investment Fund and various structural adjustment programs with a regional focus
- a residual ‘other’ category, including the TCF Corporate Wear Program, the Asia Marketing Fund Initiative, and the Entrepreneurs’ Infrastructure Programme.

¹⁰ The Commission’s assistance estimates do not include the full government appropriation for CSIRO. Excluded are certain public research such as environmental R&D, some renewable energy R&D and general research towards expanding knowledge in various fields.

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