

# Trade Sustainability Impact Assessment in support of FTA negotiations between the European Union and Australia

## **Draft Final Report**

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### **EXECUTIVE SUMMARY**

1. This draft final report for the Trade Sustainability Impact Assessment (SIA) in support of the free trade agreement (FTA) negotiations between the European Union (EU) and Australia presents findings of the potential economic, social, human rights and environmental impacts stemming from provisions in the FTA or being a consequence of removing or reducing barriers to bilateral trade and investment between the EU and Australia. The report also provides a number of recommendations, derived from the analysis, on issues to be incorporated into the FTA and mitigating measures.

2. The starting point for the SIA analysis was the simulation of the FTA's economic effects undertaken by the European Commission DG Trade in early 2019 using a Computable General Equilibrium (CGE) model, which simulates the effects of two alternative negotiation outcomes with different degrees of liberalisation: 1) a conservative scenario, which comprises elimination of tariffs on non-agricultural products (but not agricultural products), and some services trade liberalisation; and 2) an ambitious scenario, which comprises a full elimination of tariffs and quotas also on agricultural trade as well as a reduction of some non-tariff barriers on non-agricultural goods. It should be highlighted that this ambitious scenario is based on a theoretical assumption of a full elimination of tariffs and quotas in the agricultural sector. Such scenario has not been followed by the Commission in any trade negotiation.

3. It should also be noted for clarification, that the CGE model considers the FTAs with Australia and New Zealand jointly. The model simulates the long term effects of the FTA by comparing the situation in 2030 with the FTA (in the conservative or the ambitious scenario) with the "baseline" situation of having no FTA in place. The expected economic effects of the FTA then constituted the basis for additional quantitative and qualitative analysis of the FTA impact on other economic issues, social indicators and gender equity, human rights, and climate change and the environment. Consultations with stakeholders in the EU and Australia were also undertaken through online surveys, requests for position papers, interviews, and meetings.

#### **Overall sustainability analysis**

4. From an **economic** perspective, the FTA is likely to have a small but positive *overall impact* on both the EU and Australia, based on an analysis also incorporating an FTA between the EU and Australia (Table 1). In the EU, welfare in 2030 is expected to increase by €4.1 billion and real GDP by €3.9 billion, compared to a situation without the FTA, and

Australian welfare and real GDP are expected to increase by €1.4 billion and 4.7 billion, respectively (in the ambitious scenario). Bilateral exports are expected to increase by 32.5% and 10.4% respectively for the EU and Australia in the ambitious scenario. Gains of the FTA are balanced, with Australia benefiting more in terms of real GDP while the EU gains more in trade. The price and wage effects are minimal, with no relative change for the EU but a marginal positive effect on real wages for skilled and unskilled workers in Australia.

Table 1: Summary of macroeconomic effects

	EU27		Australia	
	Conservative	Ambitious	Conservative	Ambitious
<b>Major macroeconomic indicators</b>				
Welfare (€ million)	2,176	4,086	875	1,371
Real GDP (€ million)	1,755	3,917	2,822	4,741
<b>Trade effects</b>				
Bilateral exports (% change)	16.1	32.5	5.5	10.4
<b>Factor markets</b>				
Real wages unskilled labour (% change)	+0.0	+0.0	0.2	0.3
Real wages skilled labour (% change)	+0.0	+0.0	0.2	0.3

Source: Authors' calculations based on the CGE results provided by DG Trade

5. The *impact on sectors* in the EU in terms of output change is limited. The most positive effects (of up to 0.4% under the ambitious scenario) are predicted for the motor vehicles, machinery and gas sectors. Conversely, a number of sectors are expected to experience some contraction compared to a no-FTA situation, in particular beef and sheep meat (-1.4% in the ambitious scenario). Sectoral output effects in Australia are almost a mirror image but slightly larger in scope, with increases in beef and sheep meat (+4.6%) and other agricultural sectors as well as utilities, and decreases of up to -2.2% in machinery, motor vehicles, and gas.

6. The FTA is expected to have a positive *impact on SMEs* in both the EU and Australia, as it would improve market access for SMEs through trade and investment liberalisation, global supply chains, and the overall reduction of administrative costs via lower entry and operating expenses. *Investment liberalisation* under the FTA could lead to an 87.2% increase in EU FDI flows to Australia and a 20.8% rise in inward FDI stock. Preferential *procurement* liberalisation is associated with a 50.4% increase in public imports, which would translate into average Australia public imports from the EU in 2014 increasing from €37.6 million to €56.4 million.

7. The FTA's anticipated *effects on Turkey and the Least Developed Countries* are negligible, and on the *EU's Outermost Regions and Overseas Countries and Territories* expected to be small.

8. The **social impact** analysis shows that *employment* effects will be limited in most sectors. Keeping in mind that the economic model holds overall employment constant and is thus able only to show relative shifts across sectors, the simulations predict that employment in the EU will shift, again comparing the situation in 2030 with the FTAs in place against a situation without the FTAs, from some agricultural sectors (ruminant meat, rice, sugar, vegetables, fruits and nuts) and the coal sector to motor vehicles and transport equipment, and gas. In Australia, sectoral employment shifts are expected to be somewhat larger, with the highest job reductions (of up to 2.4%) in the machinery and motor vehicles and transport equipment sectors, and the largest job creation effects in the ruminant meat sector (up to 5.0%). The FTA could also contribute to increased employment opportunities for migrant workers in Australia, if recently identified staff shortages in the ruminant meat sector are not met by local workers and if immigration and visa policies facilitate recruitment overseas.

9. The FTA is expected to have a positive but limited impact on *real wages* in Australia (increase of up to 0.3% for both unskilled and skilled workers), and a marginally positive effect on wages in the EU. If agreed in negotiations, new FTA provisions on *health and safety at work* under the TSD chapter may encourage the Parties to take further unilateral actions and pursue bilateral cooperation and dialogue in this area improving working conditions and supporting increased protection of workers. Negotiation and implementation of the FTA may also facilitate the process leading to ratification of the fundamental ILO Minimum Age Convention No. 138 by Australia and contribute to a better protection of *children's rights*.

10. The FTA impact on women in their roles as workers, entrepreneurs, traders and consumers, overall, is expected to be limited. In the EU, women tend to work more frequently than men in services sectors, which are not expected to see any changes in employment levels as a result of the FTA. In Australia, the picture is more diversified, but sectors having a higher share in employment of men than of women are likely to be more affected by the new FTA, both positively and negatively, and hence the effect on women is likely to be limited. Regarding women as consumers, the FTA impact is anticipated to be negligible.

11. The **human rights effects** of the FTA are expected to be very small. Following screening and scoping, the in-depth analysis focussed on the right to work, and the right to health and access to essential medicines.

12. With regard to the *right to work*, increased trade flows between the EU and Australia triggered by the FTA are expected to promote economic growth as well as an increase in employment overall – this finding is a result of the predicted increases in wage levels at the overall level in the model which holds total employment constant. At the sectoral level, however, effects vary: While some sectors in both the EU and Australia are expected to see increased employment, others are expected to decrease activity, which negatively affects employment. The right to work is expected to be positively affected in the sectors that benefit. Moreover, in some sectors gains and losses may also lead to a broader impact on human rights: e.g. the rights of migrants could be affected in those sectors that actively employ migrants in Australia, or the right to water may be under pressure as a result of growth in water-intensive sectors, especially if there exists a particular vulnerability with respect to this right from the start. The TSD Chapter that is expected to be included in the FTA aims to promote and ensure effective implementation of the highest standards of labour, safety, environmental and consumer protection as well as enhance civil society inclusion in all areas of the FTA.

13. Since impacts on the *right to health* are related to other rights that are more directly linked to the potential economic impact of the FTA, like the right to a clean environment and the right to water, most of the effects are expected to be minor. For example, while bilateral trade in the beverages and tobacco sector (esp. wine) is expected to benefit from the FTA, which could be an indication that there could be impacts on consumer health, production in the EU does not change, while in Australia it increases by a mere 0.5%. Concerning access to medicines, because FTA provisions on time periods for regulatory data protection or details on supplementary protection certificates (patent term extension) are not clear at the moment, the impact cannot be determined at present.

14. From an **environmental perspective**, the most substantial expected impacts of the FTA are related to climate change, land use and biodiversity.

15. With regard to *climate change*, non-CO<sub>2</sub> greenhouse gasses (GHG) emissions are expected to increase in case of an ambitious scenario, resulting from increased production in Australia (e.g. in the beef and sheep meat sector) and in the EU. This increase is *partially* offset by decreasing emissions in other countries. Global non-CO<sub>2</sub> GHG emissions are expected to marginally increase as result of trade creation. It is expected that Australia

and the EU will reaffirm their commitments to (implement) the Paris Agreement, their Nationally Determined Contributions (NDC) and other multilateral environmental agreements. We note that Australia's NDC appear insufficient to meet the Paris Agreement goal of keeping global warming below 2°C.

16. Both parties are also expected to commit to promoting mutual supportiveness of trade in environmental goods, and climate policies and measures, which are on itself positive provisions.

17. The FTA is expected to have a significant negative impact on *land use* in Australia. This is driven by the expected increase in production in the beef and sheep meat sector under an ambitious FTA, compared to the business as usual situation. The expected 4.6% increase in production could lead to land clearing, which is currently one of the most pressing environmental threats in Australia resulting in biodiversity loss and negative impacts on climate change.

### **Sector analyses**

18. The SIA also provides more detailed assessments of the **FTA impact on five economic sectors** – ruminant meat, motor vehicles and transport equipment, dairy, machinery, and communication and business services – as well as five case studies – wine, the lithium value chain, textiles labelling and rules of origin, ecosystems and biodiversity, and iron ore mining. The sector analysis findings can be summarised as follows.

19. *Ruminant meat*: Liberalising measures on trade in agricultural goods as part of the FTA (in the ambitious scenario) have the effect of further enhancing the competitiveness of the ruminant meat sector in Australia and challenge the ruminant meat sector in the EU that is relatively less competitive: In the EU, output of ruminant meat is estimated to decrease by 1.4% under the ambitious scenario (compared to a situation without the FTA), and increase by 4.6% in Australia. This economic impact drives potential social and human rights effects: sector employment in the EU is expected to be lower than without the FTA but be higher in Australia. Therefore, the FTA could in this scenario negatively affect the right to work and the right to an adequate standard of living for beef and sheep meat producers in the EU and affect these rights positively for Australia. The right to health could also be impacted in two ways: via the right to food (different food standards in the EU and Australia) and via the right to a clean environment (land use from beef and sheep meat, GHG emissions). Methane and nitrous dioxide emissions in Australia are predicted to increase in the ambitious scenario, but fall in the EU. Biodiversity can be negatively affected by intensified land clearing, which according to studies is considered more prevailing in Australia than in other countries. Lastly, the predicted increase in beef and sheep meat production in Australia will also lead to increased pressure on water quality since the amount of nitrogen from urine and manure is expected to increase proportionally to the growth in the number of cattle.

20. *Motor vehicles and transport equipment*: In the EU, output of motor vehicle & transport equipment is estimated to increase by 0.2% under the conservative scenario and by 0.3% under the ambitious liberalisation scenario, compared to a situation without the FTAs. For Australia, sectoral output is expected to decline by -1.4% in the conservative scenario and -1.8% in the ambitious one (albeit from a much lower baseline value). In terms of investments, raising the investment screening ceiling would facilitate EU investments into Australia. Employment effects are in line with the economic effects. For Australia, the real employment effects are however likely to be lower because Australian production of passenger cars, which account for 90% of vehicles imports from the EU, already stopped in 2017. Given the limited actual employment effects, the FTA is not very likely to bring about changes in job quality in the sector. Effects on the right to work, the right to an adequate standard of living, and the right to a clean environment are expected to be marginal. From an environmental perspective, due to the higher level of fuel efficiency

(measured in CO<sub>2</sub>/km) of EU cars compared to Australian ones, there is potential for the FTA to lower the climate change impact in the road transportation sector in Australia in case car manufacturers in the EU sell the same cars in Australia as in the EU. If this is the case, it can be expected that an increase in EU motor vehicle trade will lead to a minor decrease in Australia's CO<sub>2</sub> emissions (in regard to the products' use phase) from car production. This is similar for the motor vehicle sector's toxic air pollution.

21. *Machinery*: Output of the EU machinery sector is expected to benefit marginally in the conservative scenario and increase by 0.1% in the ambitious scenario. For Australia, in contrast, the estimated change in machinery sector output is -0.3% and -2.2%, respectively, under the two scenarios. Bilateral sector exports are predicted to increase both-ways. As for the automotive sector, employment effects in the EU and Australia are in line with output effects. The FTA is thus expected to add to the decline in manufacturing jobs in Australia observed in the last few years which are due to technological changes (e.g. automation) and a shift in the Australian economy towards services sectors. The negative sectoral employment effects in Australia could challenge the right to work and right to a decent standard of living for some Australian workers. The share of SMEs is significant in this sector, so the negative employment effects could disproportionately impact SMEs. For the EU the effects would be positive; small in relative terms, but significant in absolute terms because the sector is very large. Environmental effects derived from the economic effects are expected to be negligible. An impact from the FTA could still be expected if regulatory cooperation between the EU and Australia foreseen in the FTA would lead to a further heightening of any environmental standards in either region, such as for example on the energy efficiency standards of those products, eco-design or waste legislation. However, given the FTA's principles of countries maintaining their full autonomy and right to regulate on domestic policies, no material impact is expected on this front.

22. *Dairy*: In the EU, output of the dairy sector is estimated to rise by 0.1% in the conservative scenario and decline by 0.1% in the ambitious liberalisation scenario. For Australia, the estimated change in the sector's output is -0.3% in the conservative scenario, and a marginal decline in the ambitious one. The increase in bilateral dairy exports is considerable in both directions, but the total export increase remains very limited. Employment effects in the sector are expected to be very limited, both in the EU and Australia, and in line with the estimated changes in output. Impacts on changes in wages and prices are negligible. Given the limited employment effects in the dairy sector, it is rather unlikely that the FTA will bring about noticeable changes in job quality indicators or respect for rights at work. The FTA is also not expected to have any major impact on the situation of migrant workers in the dairy sector. The limited economic impact of the FTA on the sector is why also environmental and human rights effects are expected to be small, given the characteristics of the dairy industry. The effect on the right to work and right to health are negligible. The right to a clean environment is negatively affected by the FTA in the dairy sector but only marginally so.

23. *Communication and business services*: The analysis focuses on communication services, in particular telecommunication, and other business services, mainly professional services. A limitation in the analysis is that the economic model uses more aggregated sectors. In the EU, the FTA is expected to have only negligible impacts on output of "communication services" and "other services". In Australia, output of communication services is expected to be 0.1% and 0.2% higher, respectively, under the conservative and ambitious scenarios than without the FTA. For "other services" Australian output is estimated to be 0.1% under the ambitious scenario (and no change under the conservative scenario). Based on the results of the economic modelling, no changes in employment levels in the EU in the sector are expected, and changes in Australia are roughly in line with the predicted output changes. Based on textual proposal tabled by the EU, the FTA has also potential to open the way to further mutual recognition of professional qualifications between the Parties and to facilitate in this way mobility of professionals and supply of services between the EU and Australia. Human rights impacts for the sector are

not likely. Finally, since sectoral output is expected to increase in Australia, indirect environmental effects are also likely: a minor increase in GHG emissions (through higher demand for flights and road transport), air pollutant emissions (through road transport), energy use (e.g. in offices) and material use (e.g. in offices).

## **Recommendations**

24. For a concise overview of all **policy recommendations** as well as **recommended flanking measures**, we refer to the Chapter 6 in the main report, which provides a concise summary of the recommendations made throughout the study.