

An Australian China FTA – Getting the Focus Right

Government officials warn that no decision to negotiate a Free Trade Agreement (FTA) with China will be taken until a joint Australian Chinese scoping study is completed in March, 2005. That's the official position. It is most likely an FTA will be negotiated. Such an Agreement will be irresistible to Canberra. The challenge for business is to ensure that an FTA produces tangible commercial and economic benefits.

China's importance

China is already playing a leading role in the world economy. Over the past decade, China's exports have tripled. China now accounts for 30 percent of world manufacturing output and is now the world's fourth largest exporter and third largest importer. China's export machine is dominated by outsourcing by Western multinationals. Around 65 percent of the increase in exports over the last decade can be traced to Chinese subsidiaries of multinationals and foreign joint-venture partners. China's imports are dominated by raw materials for energy and development of infrastructure.

China is now one of Australia's leading trading partners. In 2003 China was Australia's third largest trading partner, its third largest export market, and its third largest source of imports. In 2001 two-way merchandise trade between Australia and China reached almost \$18 billion, and two way services trade, \$1.6 billion. Overall, this represents a doubling of trade since 1997. This trend will continue.

Who wants what in an FTA?

China's leading economic interest in Australia is to secure supply in energy and other strategic minerals. Its power sector is still State owned and is likely to believe political agreements between governments are an effective way to guarantee supply. This is managed trade. Free Trade Agreements do the opposite. As operators in a market economy, Australian business considers security of supply is best achieved when laws protect the terms of commercial agreements. The job of an FTA is to strengthen that legal protection. China's legal system is still weak and its capacity to provide that protection is uncertain.

Some Chinese analysts recognize that Australia has skills and technology in services, such as finance, telecommunications and logistics which could benefit China if they were given better opportunities to work and invest in China. The problem for Australia's businesses in services is that they are much smaller than those in the US and the EU and the incentive for China to give tangible benefit to Australian businesses is diminished by the fact Australia is such a small trading partner. China has political interests in an agreement which are discussed below. That may not help to produce an agreement of value to Australian business.

Trade barriers are not particularly high in China, but for some agricultural products, their removal would be valuable. For most Australian business, and this includes the largest agricultural exporter – wool, and Australia's other traditional agricultural exporter – wheat, the interest is on other features of regulation in the Chinese economy, we can call these "post border" issues, which inhibit trade, investment and business.

“Post border” issues

Trade liberalization today is as much about improving conditions for foreign competitors in domestic markets as it is about reducing barriers at the border. For example, in industries where Chinese corporations or enterprises enjoyed dominant positions in markets, either because of state ownership or preferment, measures which create greater opportunities for Australian business should have high priority on Australia’s negotiating agenda.

Where Chinese technical standards constrain the capacity of Australian companies to supply Chinese markets, opportunities to strengthen and comment on such standards before they were implemented in China would directly benefit Australian business.

Most Australian companies would benefit from greater freedom to invest in China and, in manufacturing and processing, in the supply chain. Most Australian businesses would gain from greater freedom of movement of business personnel. Services industries would benefit from increased freedom to operate in the Chinese market. It would be realistic for Australia to seek national treatment for Australian services companies.

It is this suite of post border issues where Australian business is seeking gains from an FTA with China.

Impact on Australian manufacturing

Australia’s manufacturers are apprehensive about the impact of an FTA. Part of the concern is Canberra’s willingness to concede to China’s request that Australia waive the right to treat China as a “non market economy” when assessing complaints that Chinese producers have “dumped” products at less than home market price in Australia. China has made this a pre-condition for negotiating an FTA.

This is principally a political issue for China. The US and the EU secured a right for all WTO members to treat China as a non-market economy for anti-dumping purposes as part of the terms of China’s accession to the WTO. China went along, but considered it unfair. It is also irritated that the EU has agreed not to treat Russia as a non market economy and it is not even in the WTO. Canberra’s assessment is that surrendering the right costs Australia nothing. Australia is still able to take action against Chinese products if they breach WTO rules against dumping.

The second concern of Australian manufacturers is the increasing competitiveness of Chinese manufacturers. It is not just that Chinese producers have low labor costs; they are acquiring economy of scale and are rapidly increasing competitiveness. Australia’s average tariffs are only 3.8 percent. Even if Australia did not negotiate an FTA, like manufacturers everywhere, businesses in Australia would face more competition from China. Those businesses depending on China for parts of course benefit.

The politics of an FTA

It is reasonable to assume that China will seek to link terms of an FTA to a wider set of issues. These should be assumed to include geopolitical and diplomatic interests. China certainly appears to be using the offer to negotiate agreements for political

purposes. It has proposed a regional FTA with ASEAN but does not appear to be pushing strongly for commitments to liberalize. The principal commitment in the agreement is to set a timetable to negotiate an agreement rather than formal commitments to reduce barriers. Clearly China is using trade to create political associations to demonstrate leadership in East Asia.

There is nothing particularly new about this. All major trading powers behave in this way to a degree. China however is still a relatively new player in world trade. It has not yet made the full transition to a market economy and it has yet to demonstrate that its legal and administrative system can give full legal effect to commitments under WTO rules. We know the EU and the US play politics with trade, but we also know they are constrained by the legal commitments they have made.

The attraction of an FTA with China will be powerful to Australian officials. An FTA would be the first, important, high level agreement between Australia and China. In today's globalized world, FTAs have high political value. Australia can't have a political or military agreement with China because of its alliance with the US. An FTA would be seen as a good substitute.

What type of FTA?

An FTA between Australia and China could take three forms: first, a modern, comprehensive FTA; second, a bilateral economic and investment cooperation agreement, not a free trade agreement; and finally a hybrid – an agreement based on a classical FTA, but with non-classical elements.

The hybrid is a practical option. It is a classical FTA, but seeks inclusion of measures which improve opportunities for business. The benefits are that the FTA would make commitments legally binding; it would be a standard vehicle to press for greater access in goods and services; commitments China has made in the World Trade Organization (WTO) could be restated as commitments between Australia and China and bound by the provisions of the bilateral agreement; and Australian officials could press as far as they wanted to for measures to secure investment and improve the business environment, comfortable in the knowledge that these can be set out as side letters if China would not have them in an FTA.

The hybrid model also creates opportunities for Australia to offer to support China in non-trade areas, such as research and improving institutions and procedures. Most Australian industries would support arrangements in an FTA which facilitated their working with Chinese business partners (through research and training programs) to develop common business interests.

Getting the focus right

China's size makes it a sensation, whatever it does. It excites and threatens, even when it does nothing. It will become a more important trading partner for Australia (and everyone else for that matter). The risk for Australia is that the process of preparing for and negotiating an FTA with it will end up measured by political not economic criteria. This has happened already to a degree with the debate over China's status as a "non market economy".

It will be a constant risk during the negotiations of an FTA because of the allure of completing an agreement with the world's most sensational economy. It makes sense for a country to seek to secure its economic relationship with major trading partners through bilateral agreements. In the global free market system in today's world, this is achieved by agreements (we still anachronistically call them "Free Trade" Agreements) which secure legal rights for businesses to operate on open market terms in the economies of other parties to the Agreement.

There are two difficulties for Australia in negotiating such an agreement with China. The first is that Australia does not have that much to offer China by way of concessions. Our market is open. We are already a preferred supplier of strategic materials because we are low cost, stable and reliable. Nor can we expect China to acknowledge the enlightened reason for negotiating an FTA. That is the common interest in providing common frameworks of law to support economic activity in a free market. The problem here is that China is not yet a fully developed free market economy.

But a Free Trade Agreement which does not do that or does not add to legal rights already secured through the multilateral system created by the WTO (through it China and Australia extend considerable legal rights to each other) basically serves the political purpose of establishing a closer relationship with the other country.

Given how economically important China will be to Australia, that will not be enough. Australian will do itself no favours nor produce an agreement of any real value unless the FTA tangibly enhances the capacity of Australian business to work in China. The basic focus on the FTA must be on the economic questions and the measure of success must be improving the "post border" environment for business in China.

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