Presentation by the Australian Wool industry to the Australia/China FTA Agriculture Conference

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Key messages

The key messages are:

- Australian wool overwhelmingly does not compete with China's wool
- Australia's wool complements China's wool in meeting needs of a competitive Chinese wool textile industry
- An Australia/China Free Trade Agreement which liberalises wool trade will be mutually beneficial.

Introduction

This paper is being provided on behalf of the free trade committee of Australian Wool Innovation Limited (AWI), the members of which include representatives of growers, processors, testing and exporting. AWI is a not-for-profit company owned by Australian woolgrowers. The paper covers a number of areas of considerable importance to the future of the Australian and Chinese wool industries.

Firstly it identifies the deep integration and complementarity of Australian and Chinese wool. Our industries complement each other rather than compete with each other. It then discusses the potential for a Free Trade Agreement (FTA) to generate mutual benefits for both countries. Finally it describes the important initiatives undertaken by the Australian wool industry to assist China, and finally end with some key conclusions.

Australian and China wool industries rely strongly on each other

Australia and China are two of the world's biggest wool industries. Annually, Australia grows around 350,000 tonnes of wool and China around 160,000 tonnes. The wool industries of Australia and China are strongly interdependent. Australia is the biggest wool growing nation and exporter in the world supplying 60% of China's needs. It is only a small manufacturer of textiles.

China is the world's largest grower and consumer of wool textiles, taking 60 percent of Australia's wool exports. By 2010 according to the Woolmark Company China's demand for wool is forecast to almost double to command 62 percent of all global demand for apparel wool.

Australia depends on China as a market for its wool exports, and China depends on Australia for its imports of wool used to make textiles both for its domestic and export markets.

Complementarity of Australian and Chinese wool

The type of wool the Australian and Chinese wool industries grow are highly complementary. China has a domestic wool industry that grows wool suitable for furnishings and carpets, while Australia grows the wool China requires for the manufacture of fine wool garments for domestic use and export.

Competition between the two is very small. Most Australian wool is Merino, and is narrower (or "finer") and longer wool which is suitable for use in producing high quality apparel. This type of wool makes up no more than 10 percent of Chinese wool grown.

Most Chinese wool is broader and shorter, greater than 25 microns and appropriate for use in a different and broader range of apparel and textile products.

Australia's wool types going to China have changed – they are becoming finer. Generally China has imported 23-25 micron wool in the past from Australia. In recent years the share of finer wool imported has increased. Currently nearly one third of the unprocessed wool Australia exports to China is 19 microns or finer, compared with under 3 percent 10 years ago. This reflects the move by the Chinese textile industry to produce higher quality apparel for its markets at home and abroad which in turn requires more finer Merino wool as a raw material.

Barriers to trade growth – trade restrictions

Trade barriers continue to hinder Australian exports to China. China reduced some barriers as a result of its WTO commitments, but important barriers remain. These include tariffs, tariff rate quotas and the cost of re-testing wool in China.

The most costly feature of Chinese barriers to imports of Australian wool is that they penalise Australian woolgrowers and Chinese textile manufacturers more as demand increases; and Chinese demand for wool is growing.

There is a global “tariff rate quota” (TRQ) system, operating on greasy and lightly processed wool, which means that wool imported below a certain volume attracts a low tariff (called the “in-quota” rate) while wool imported after the specified volume has been filled attracts a higher tariff (called the “out of quota” rate).

In the case of greasy wool, this represents a huge increase in duty from one percent to 38 percent.

The cost of the TRQ on greasy wool is not just the duty itself, but the way it stifles demand for imports once the “in-quota” volume is full. It is clear that if wool import demand continues growing, then the cost of the TRQ will continue to mount, unless the TRQ is abolished or the “in-quota” volumes grow in line with demand.

Barriers to Trade growth –Testing

A proportion of wool is re-tested in China to confirm whether the wool is of the quality claimed in export documents. A fee is charged for re-testing on all imports and collected at the provincial level. This re-testing of wool is unnecessary as all Australian wool is tested to international standards prior to sale.

Research also suggests that while all wool imports are being charged for re-testing, only 20 percent of the wool is actually tested. The charge is being levied on the importer who passes it back to the exporter. The charge is estimated to be around 0.15 percent on average. Better protocols in place on wool quality, standards, and cooperative testing procedures could eliminate the need for re-testing.

Some 85 per cent of wool sold in Australia goes to the auction system. Transport, handling, testing, warehousing, dumping and selling systems are commercial activities in competitive marketplaces. By contrast, it appears that only a tiny proportion of wool produced in China goes to auctions, and is measured and tested like in Australia.

Barriers to Trade growth – Risk

Currently wool imports by China are approaching the level at which the above quota rate will apply. In 2004 the quota for raw wool was 78 percent utilised, and for 2005 this had increased to 87%. For the first 6 months of 2006, the quota has been 47 percent utilised.

China’s demand for wool is expected to grow substantially in tandem with the growth for its wool textile products in domestic and export markets. As this happens, the risk of China applying the above quota rate will rise.

Once this takes place, the textile industry will respond by substituting competing fibres (mainly synthetics) for wool. The Australian wool industry, as the major supplier to China, will suffer.

It should be mentioned here that Australian woolgrowers receive no subsidies. This is confirmed by the Organisation for Economic Cooperation and Development (OECD) which in its Producer Support Estimates for 2005 indicates that the Australian wool grower has received no support from Government programs for market prices for many years (the last year in which any such support was received being 1997).

Significant benefits to both countries from FTA for wool

Independent modelling carried out by The Centre of Policy Studies at Monash University shows that there would be significant benefits to the industries in both China and Australia, if the barriers to trade in wool between Australia and China were liberalised.

<u>In Australia</u>, the value of greasy wool exports would increase by US$600m over and above the expected increase in the trade without an FTA. The volume of greasy wool exports to China would increase by up to 20 percent over and above the expected increase in the trade without an FTA.

Significant benefits to both countries from FTA for wool

<u>In China,</u> the textile and clothing industry would increase the level of value added production by nearly US$400 million. China's total exports would rise by US$1.3 billion with its textile and apparel exports increasing by over US$800 million.

Most significantly, real gross domestic product in China would increase by US$457 million indicating the substantial benefits of an FTA in wool to the wider Chinese economy.

Wool output in China would continue to grow, as Chinese and Australian wools are overwhelmingly complementary. However China's wool output according to the modelling would be around 9 percent lower over the whole period to 2015 than without an FTA (i.e. it would grow by less than one percent a year slower than without the FTA).

The impact is relatively small because there is little overlap between wool grown in Australia and China. Research undertaken for AWI has additionally found that woolgrowers in China have shifted out of wool into sheep meat production in response to economic signals.

New Zealand wool is more threatening to China's woolgrowers

While Australia's wool exports to China complement China's wool production, this is not the case for New Zealand. The vast majority of wool grown in Australia and exported to China is different in type from the wool grown in China and New Zealand. However, the wool grown by China is similar to the wool New Zealand exports to China.

The wool Australia exports to China is of a lower micron width than the wool New Zealand exports to China and the wool produced in China. As a result, woolgrowers in New Zealand and China compete more with each other in the production of wool than with Australian growers.

China's wool production competes overwhelmingly with New Zealand's wool exports to China rather than with Australian wool exports

Only 13 percent of Australia's wool is 24 microns or wider, but 87 percent of the wool grown by China is 25 microns or wider, while 98 percent of the wool exported from New Zealand to China wool is 24 microns or wider.

The conclusion is that China's wool production competes overwhelmingly with New Zealand's wool exports to China rather than with Australian wool exports.

Assistance by Australia to the Chinese wool industry

The Australian wool industry is conscious of the sensitivities of free trade in wool for China. In order to assuage those concerns, the Australian wool industry has undertaken a number of initiatives.

Seminars and information exchanges have been held between the Australian wool industry and relevant industry and government agencies in China with the view to enhancing the understanding of the mutual benefits that would flow from an FTA.

A further initiative is the project being proposed by the Australian wool industry for a technical cooperation initiative that will be undertaken by AWI as part of the Australia/China agricultural cooperation program.

The project will provide a range of activities, predominantly training farmers and arranging for information sharing among industry players in Xinjiang and Inner Mongolia. The project is designed to improve the cash return and profitability for Chinese wool farmers/growers in remote regions of China.

Chinese woolgrowers will benefit from the adoption of superior techniques for grading, classing and storing the wool produced by independent wool producers in remote regions of China. Communication will be enhanced through establishing new contacts among Chinese local officials in wool growing regions, wool farmers, wool mills and wool marketing organisations.

The profitability of Chinese wool growers will be enhanced, helping to sustain the wool industry in the medium term. This latest proposed project continues a process whereby Australia has provided significant assistance to the Chinese wool industry for many years.

Over the past four years alone, over $12m has been budgeted for projects by AWI in China. More broadly, Australia has also provided technical assistance to China's wool industry, including growers, through many programs over the years, such as through the Australian Centre for International Agricultural Research.

Key Conclusions

For the Australian Wool Industry, China is vital. Australia exports 98 percent of its wool clip and almost 60 percent of this goes to China. China is the world's largest manufacturer of woolen textiles for export. It is also the world's largest domestic retail market.

For China, access to high quality Merino-style wool from Australia is vital so that the textile industry in China can meet the needs of its domestic and world market customers.

The wool industries of Australia and China are closely integrated – what benefits one benefits the other. They are also highly complementary rather than competitive.

An FTA should formalise the already close integration and complementarity between the two industries and ensure that the risks posed to trade from potential future application of the very high above quota tariff or other barriers are eliminated.

Enhanced mutual profitability and economic benefits for Australia and China will be the result. Indeed the benefits from free trade in wool for both countries make it clear that a good outcome on wool is integral to a successful FTA between Australia and China.