

Australia-China Free Trade Agreement

Submission by the National Association of Forest Industries

1. INTRODUCTION

At the present time, the forest and timber industry is accelerating the trade of forest products and knowledge with China. The National Association of Forest Industries has a Memorandum of Understanding with the Fujian Forest Industry Association, which provides access to over 80% of China's forest and timber companies, as the basis for strengthening economic ties on forestry between the two countries.

Most interest at present lies in the Chinese imports of raw materials and access to information and seed sources for eucalypt species, where the information covers species selection, plantation management, timber harvesting and wood processing. From an Australian perspective, the China market represents an opportunity to expand the global demand for Australian timber products, particularly hardwood products derived from eucalypts.

NAFI Comment:

These industry initiatives should continue to be supported by government-to-government cooperative agreements, in association with the requirements of an Australia-China FTA. The cooperative agreements can be used to foster the exchange of information between industry associations as the basis for facilitating trade and investment opportunities between both countries.

2. TARIFF RATES ON AUSTRALIAN EXPORTS TO CHINA

At the present time, tariffs on Australian exports to China vary, depending on whether the goods are low value inputs or finished products. As part of China's accession to the WTO, their tariff rates on most forest products will fall considerably by 2010, to between 4 and 7.5%.

For logs, sawntimber, veneer, plywood and woodchips, Australia's tariffs are generally 5% or zero. In terms of paper products, there is no tariff on pulp imports and the current bound tariff rates (to comply with WTO obligations) within the five main product categories are either 0 or 12% for newsprint, paper products, facial tissues, kraft liner and fluting, and paper, depending on the tariff classification for each group of products. The maximum Australian tariff rates on those paper products with a tariff of 12% at present, will fall to 5, 7.5, 5, 2-7.5 and 5% by 2010, respectively. The Australian tariff on prefabricated buildings has a bound tariff rate of 15%.

The FTA Feasibility Statement identified the following Impact of Trade Liberalisation on Goods - Forest Products

Australia's forests produced an average of 25.2 million cubic metres of forest products and 2.9 million tonnes of paper products over the period 2000-01 to 2002-03. Australia is a net importer of forest products – exports averaged 11.8 million cubic metres of forest products and 0.8 million tonnes of paper. Imports averaged 9.9 million cubic metres and 1.4 million

tonnes of paper. China's production of forest products (unprocessed logs) was 47.59 million cubic metres and 43 million tonnes of paper and paper board in 2003.

On average Australia's annual main exports of forest and paper products to China over the last 3 years consisted of unprocessed logs (250,000 cubic metres, worth \$20m), sawn wood (15,000 cubic metres, \$9.6m), paper and paper products (243,000 tonnes, \$151m), and miscellaneous forest products (\$2.8m)¹.

Over the same period, average annual Chinese forest and paper exports to Australia consisted of sawn wood (1,500 cubic metres, \$2.4m), wood-based panels (6,900 cubic metres), paper and paper products (44,400 tonnes, \$103m) and miscellaneous forest products (\$84m)¹.

For logs and woodchips, China's tariffs are currently less than 5 per cent with most set at 1 per cent. Tariffs on processed wood products currently range between 4-17%, and between 0-11% for paper products. Further tariff reductions will be phased in until 2010 under China's WTO accession commitments.

In addition to tariff and non-tariff measures affecting agricultural trade identified elsewhere in Chapter 3, a possible FTA could consider specific market access issues including tariff escalation. That is, the tariff rates increase as the degree of value adding within the products increases.

Bilateral trade is expected to continue to grow in coming years. Australian forestry exports to China concentrate on specific niche markets where demand exceeds domestic supply. In particular, Australia expects expanding Chinese demand for sawn wood imports to meet growing housing construction needs and that there will be a continuing strong demand for higher valued and secondary processed wood products. The Australian and Chinese forestry industries have also entered into a number of joint cooperation projects to share their expertise and progress issues of mutual interest. Such industry activities could be supported by government-to-government cooperative initiatives. A possible FTA could take into account the potential impact on both countries' processed forestry products.

NAFI Comment:

Australian tariff rates should remain at the current applied rates and only be reduced in accordance with the changes arising for tariffs under the WTO program, once the bound rates have been reduced to Australia's applied rates on forest, timber and paper products. For our offensive position, China should accelerate its bilateral tariff reforms, reducing their current tariffs to match Australian tariffs on a like-for-like basis.

3. NON-TARIFF BARRIERS TO MARKET ACCESS AND INVESTMENT IN CHINA

Given the reform process being undertaken by China at the present time, most tariff barriers will be reduced quite significantly through their WTO processes. Non-tariff barriers will therefore represent the key area of interest for the forest and timber industry during the negotiations of the proposed Australia-China FTA. These barriers largely arise from the processes for recognition of the quarantine protocols, certification and labelling standards, product standards and specifications, the Rules of Origin, and the legislative and legal system for regulating investment and trade with China. The processes of trade liberalisation also require that any domestic assistance to industry is consistent with WTO obligations and the nature of assistance provided by Governments should be considered as part of the FTA negotiations.

¹ ABARE 2005, *Australian Forest and Wood Products Statistics, September and December Quarters 2004*, Canberra, May.

3.1. Intellectual Property

Over the past decade, China has shown a strong interest in gaining a better understanding of Australia's timber species, particularly the potential for processing hardwood timber products grown from eucalypts. A number of research exchanges have been undertaken through the Joint Working Group on Forestry (which exists under the Australia China Agreement for Cooperation on Agriculture, ACACA) to improve the transfer of knowledge between Australia and China.

Since 1985, CSIRO Forestry and Forest Products have taken part in a number of ACIAR projects in China, some AusAID-supported projects and a range of other projects (including the training of Chinese scientists). These projects concentrated on the use of improved genetic material and growing Australian trees in China. More recently, ACIAR has moved to funding a mix of research activities focused on growing trees and processing timber.

All participants in ACIAR projects have unrestricted, royalty-free, non-exclusive licences to utilise intellectual property arising from the projects, anywhere in the world. If participants commercialise any intellectual property, there is a pre-agreed split of ownership and revenue. However, this approach is becoming more of an issue as the research organisations in China move to a stronger commercial focus, especially with CSIRO having a number of MOUs signed with some of these research organisations.

Good quality tree seeds are an extremely valuable resource. At the present time, there is growing interest in accessing improved seed sources from Australia, which grow in quite diverse climates and can be used for timber production and/or land rehabilitation. For example, Casuarina species (she-oak) species are of interest for China's land rehabilitation projects.

Similarly, China has conducted a significant number of trials on eucalypt hybrids and clonal material. Australian companies could manage trials with this improved genetic material, especially in Northern Australia, to identify superior performing resources to supply our domestic industry.

Australia's Forest and Wood Products R&D Corporation has invested a significant amount of industry and government funds in research projects directed at improving the recovery of high-value timber products from harvested logs. Additional research activities are being pursued to ensure that Australia's timber products continue to comply with domestic and international standards governing the use of timber products.

The FTA negotiators should consider the processes and capacity for protecting Australia's intellectual property in seed sources, forest management, timber harvesting, timber processing and the uses for these timber products.

The FTA Feasibility Statement identified the following opportunities for increased cooperation on Intellectual Property (p 103)

In the context of a possible FTA, Australia and China could consider the following areas for furthering IP cooperation:

- *reaffirm commitments and obligations under the various multilateral treaties and organisations to which they are both parties to i.e. World Intellectual Property Organization (WIPO), TRIPs and the APEC Intellectual Property Rights Experts Group (IPEG);*
- *both parties give positive consideration to signing other multilateral IP treaties;*
- *create opportunities through cooperative arrangements to foster dialogue on IP issues and consider arrangements to address any issues that may arise;*

- *introduce cooperative mechanisms to settle the problems identified in the IPR area;*
- *reaffirm and strengthen cooperative arrangements between respective government agencies, educational institutions and other organisations, including in relation to the protection, enforcement and development of IPR; and*
- *information exchanges to assist in developing a greater understanding of the operation of their respective IP systems, including enforcement and administration.*

NAFI Comment:

NAFI supports pursuing these proposals for increased cooperation under an FTA. An example of China's growing interest in IP for the forestry sector arises from their support for carbon accounting and carbon trading, and working with Australian companies and the Australian Government to access the detailed modelling that sits behind our national carbon accounting framework.

3.2. Quarantine Protocols – development and acceptance

The slow process for agreement on quarantine protocols has presented an unnecessary delay in the export of forest products to China. Although Australian companies have been able to use the same validated quarantine practices when exporting to other countries, or even for exporting similar goods from New Zealand to China, there have been significant delays in gaining recognition of the Australian protocol.

When value-added, kiln-dried timber products are traded between China and Australia, only some products need to be accompanied by a phytosanitary certificate. If Australian companies supply those same products to other countries, such as the USA, there is no requirement for a phytosanitary certificate to accompany the timber. Some analysis should be undertaken to determine if there is any additional benefit gained from having exporting companies go through the additional costs of obtaining a phytosanitary certificate for their products.

Progress on these matters could be accelerated through the Memorandum of Understanding on Customs Cooperation, particularly the commitment to 'maintaining customs procedures that are transparent and reflect international standards'.

The FTA Feasibility Statement identified the following opportunities for increased cooperation with Sanitary and Phytosanitary Measures (SPS) (p.93)

The 2003 Memorandum of Understanding on Cooperation on Sanitary and Phytosanitary Matters provides a sound basis for building on and enhancing the already strong quarantine cooperation between Australia and China.

In the context of a possible FTA, Australia and China will have an opportunity to:

- *deal with sanitary and phytosanitary issues in a framework of enhanced consultation and cooperation;*
- *improve the understanding of each other's measures and regulatory systems;*
- *work together to improve quarantine operations and associated regulatory practices and to address problems as they arise;*
- *review relevant inspection, testing and certification procedures to see whether they are reasonable and necessary;*
- *work together to ensure that, if isolated incidents of non-compliance with SPS measures or other standards occur, these do not result in unjustifiable restrictions on trade;*
- *explore arrangements to address issues of consistency and transparency;*

- *respond to each others' requests for consideration of equivalence of SPS measures and related processes; and*
- *continue close cooperation between Australia and China in enhancing China's sanitary and phytosanitary capacities.*

NAFI Comment:

NAFI supports the pursuit of these opportunities through an FTA, under the guidance of the MOU on Customs Cooperation. NAFI requests that some consideration be given in the FTA negotiations to having an improved, consistent process for the recognition and adoption of quarantine protocols and phytosanitary measures which are transparent and reflect the requirements of international standards. As part of that process, Australia should not lessen domestic quarantine barriers which protect our vegetative resources.

3.3 Mutual Recognition of Product Standards

3.3.1 Forest Certification and Labelling

There is a considerable degree of interest globally in using certification standards to control market access for timber products. In some countries, there have been efforts (not in China) to impede or restrict the sale of products if they do not carry the Forest Stewardship Council's label.

Australia has completed its forest certification scheme, the Australian Forestry Standard (AFS), which has gained international recognition through the Programme for Endorsement of Forest Certification schemes (PEFC)². The Australian Government has played an important role in supporting the development of the Australian Forestry Standard. China is in the final stages of completing its forest certification standard. Neither the Chinese or Australian standards are recognised under the Forest Stewardship Council label.

Australian companies have started to certify or accredit their forest management practices against the criteria and indicators of the AFS. However, not all Australian forests and plantations are currently certified. For those forests and plantations not covered by the AFS or any equivalent forestry standard, it is important to note that Australia's forests and plantations are all grown and managed in accordance with the legislated Codes of Practice which operate in each State and Territory.

While there have been attempts by environmental NGOs to prevent illegal logging by pressuring Governments only to support the purchase of timber from certified sources, the reality is that many places are similar to Australia. Not all sources of timber supply are currently certified and any legislated requirement to purchase timber from those companies covered by a certification standard would exclude a considerable amount of timber from market place.

NAFI Comment:

It is important that market access is not impeded by a requirement for timber products to carry a specific label or requirement for forests and plantations in the exporting countries to be managed in accordance with any particular forest certification scheme.

From an Australian perspective forest and wood products should be acceptable to the Chinese market independent of whether they come from forests that are certified against the Australian Forest Standard, certified against any equivalent certification standard, or the timber is harvested from uncertified forests. In the latter case, the timber would still be harvested from areas that are managed in accordance with the legislated Codes of Practice.

² previously Pan-European Forest Certification

It will take some time for all of the forests and plantations in both countries to be certified. To avoid any potential conflicts through non-tariff barriers, a process should be considered to support the mutual recognition, between China and Australia, of national standards for certifying agricultural and forestry products.

3.3.2 Product standards and specifications

At the present time, there are variations in product standards and specifications that could restrict market access for value-added products in both countries. The design and use of Australian forest products are subject to the requirements of a wide range of national standards. Similar standards apply in China. However, there is a limited understanding of how the products from each country will meet the requirements of the other's standards.

An approach is required to support the on-going demonstration of equivalence between the products and standards of both countries. In some cases, the Chinese products may not be acceptable for the Australian market and buyers need to be adequately protected. For example, some forms of Chinese flooring are produced with formaldehyde-based glues that are not acceptable under Australian standards.

The FTA Feasibility Statement identified the following opportunities for increased cooperation with Technical Regulations and Standards (p. 96)

To facilitate trade and ensure that technical regulations and standards do not become unnecessary obstacles to trade both sides have agreed in the TEF³ to a number of specific work plans and mechanisms to promote further cooperative activities on technical barriers to trade.

A free trade agreement between Australia and China would seek to build on the initiatives already in place in the TEF in order to help reduce transaction costs resulting from different standards, conformity assessment requirements and surveillance systems.

In the context of a possible FTA Australia and China would have an opportunity to:

- improve information-exchange mechanisms between the related government authorities of the two countries and to enhance transparency in the regime of technical regulations and standards;*
- explore the role of contact points in facilitating TBT⁴ cooperation and the terms of reference for such a role;*
- encourage wider application of international standards through bilateral cooperation;*
- identify and eliminate existing technical barriers to promote bilateral trade through the FTA mechanism;*
- strengthen cooperation and exchange information on mutual recognition of conformity assessment; and*
- carry out bilateral cooperation on human capacity building in the field of technical regulations and standards, such as training programs for officials of related government institutions and professional personnel.*

NAFI Comment:

NAFI supports the pursuit of these opportunities through an FTA. As part of the FTA negotiations, consideration should be given to the establishment of a joint technical

³ Australia-China Trade and Economic Framework (TEF)

⁴ WTO Agreement on Technical Barriers to Trade (TBT)

committee on agricultural and forestry matters under ACACA, as the basis for more rapidly resolving many of the potential technical barriers to trade between the two countries.

3.4 Rules of Origin

A process needs to be outlined to indicate how the Rules of Origin will apply to imported products. For example, plywood logs from Indonesia are exported to China, manufactured into plywood and exported to Australia. Similarly, a considerable amount of semi-processed timber is exported to China, made into furniture and exported.

The FTA Feasibility Statement identified the following Future Direction with Rules of Origin (p39 - 40)

Australia has a number of different ROOs regimes under various trade agreements and other preferential arrangements. These ROOs regimes can be broadly classified into two main groups: across-the-board based on factory cost and product-specific based on the "Change in Tariff Classification" method.

Factory cost

Australia's factory cost ROOs are a variant on the value-added approach and have a two-fold requirement:

- *the last process in the manufacture of the goods must be undertaken in the territory of the Party; and*
- *50 per cent of the factory cost of producing the finished goods must be allowable costs, representing local content, incurred by the manufacturer of the goods.*

The factory cost is calculated using a specified set of costs covering the materials used in production and certain overhead and labour costs.

This ROO, with some variation, forms the basis for Australia's trade agreements with New Zealand, Singapore, Papua New Guinea and the Forum Island Countries, the Australian Generalised Tariff Preference (AGTP) system for developing countries and duty-free preference for Least Developed Countries, with some variations.

Change of Tariff Classification

Product-specific ROOs based on change of tariff classification are used in Australia's FTAs with the United States and Thailand. These ROOs require imports to undergo a specified change in tariff classification, supplemented in some cases (largely the machinery and electronic equipment tariff chapters) by a regional value content (local content) requirement.

Future Direction (p 42)

Robust, coherent and predictable rules of origin are essential for goods traded under preference. In a possible bilateral FTA, Australia and China would wish to consider rules of origin that facilitate trade and are readily enforceable at the border.

NAFI Comment:

NAFI is seeking clarification of the ROO approach that might be adopted by the Australian Government during the FTA negotiations.

3.5 Investment in China

A major concern for companies with the potential to invest in China is the uncertainty over the capacity of the legal system to protect their rights, particularly with wholly owned enterprises. Those rights cover the employment of staff, development approvals for projects,

environmental regulations, protection of intellectual property, product distribution and the repatriation of profits. While entering into joint ventures may diminish these risks, the lack of an effective legal system means that these issues all add a considerable degree of uncertainty and risk to the projects.

It has also been recognised that there are differences in the policies applied by the national, provincial and local or municipal governments, especially with respect to attracting new investment projects or companies. Australian companies are uncertain of their legal rights where there are particular national laws or policies, and the provincial or local governments make a decision to support a project or investment, where that decision may be contrary to the national laws.

For example, the relationships between the economic development zones, free trade zones and municipal (city) governments are quite difficult to understand, especially where these relationships extend into the management of infrastructure, such as the railways and ports. The three jurisdictions may be located in one city and will be governed by different laws. The economic and development and free trade zones come under national laws, while the municipal government areas are controlled by State regulations and policies. New investors may therefore find it difficult to identify which rules will have precedence in relation to their particular investment activities.

Two areas could be pursued to deliver a greater level of transparency and understanding in regards to the trade and investment opportunities between Australia and China. The China-Australia Governance Program, which will be implemented between 2004 and 2010, will consider trade-related reforms and should be encapsulated within the FTA. It should also be possible to build on the existing agreements and mechanisms for promoting trade and investment between the two countries through the establishment of a closer working relationship between the investment and trade agencies of both Australia and China.

The FTA Feasibility Statement stated as follows in regard to Impact of Trade Liberalisation (p.76)

A key objective of investment liberalisation in a possible bilateral FTA should be to address, where possible, barriers to investment flows between both countries. Central to meeting this objective is three outcomes:

- *negotiated concessions which remove existing restrictions in each country's foreign investment regimes;*
- *enhanced transparency of each country's foreign investment regimes, including procedural transparency in the processing of applications and implementation of decisions, and streamlined investment regulations and application processes; and*
- *stronger protection afforded to Australian and Chinese foreign investors including, but not limited to, the right to repatriate profits and capital, compensation for expropriation and improved mechanisms for handling post-establishment disputes.*

Overall Impact of Liberalisation on Bilateral Investment (p.82)

Australian and Chinese investors in the goods and services sectors have raised a number of concerns regarding bilateral investment in the course of consultations for this study. These include takeover restrictions, enforcement of intellectual and other property rights, shareholding and other joint venture requirements, profit repatriation and associated tax and foreign exchange rules, the transparency of approvals processes, certainty of rules and criteria, agency responsibilities in investment authorisation, consistency between state/provincial laws and regulations and overlapping responsibilities with central governments, mobility of business people and availability of domestic procedures for prompt review and correction of government administrative actions. The scope for addressing these investment issues in an FTA is dependant on: the actual negotiations, should they proceed;

domestic economic and social reform; and interactions between other bilateral, regional and multilateral trade negotiations. In addition, the impact of a possible FTA on the incentives to invest will vary with each sector.

The FTA Feasibility Statement identified the following opportunities for increased cooperation with Transparency Provisions (p.110)

With the establishment of an FTA, Australia and China could carry out an all-directional information exchange on trade and investment laws, regulations and policies. The enhancement of cooperation between Australia and China in the area of transparency would play a positive role in promoting bilateral economic intercourse.

With this in mind, Australia and China could, in the context of a possible FTA, consider the following areas for cooperation:

- *both sides should ensure publication of relevant laws, regulations, administrative decisions, or other appropriate publications in a timely manner;*
- *a contact point should be established to facilitate communications between the two countries on any matter covered by an FTA;*
- *efforts should be made to ensure the consistent application of laws, regulations and administrative decisions across all jurisdictions; and*
- *both sides should ensure the availability of domestic procedures for prompt review and correction where necessary for administrative actions.*

NAFI Response:

Trade with China and investment in that country, are affected by the limitations of an internationally-effective legal system and a complex regulatory and policy approach from the national and provincial governments.

A number of companies have found it extremely difficult to obtain payments for wood products once they have landed in China. This has also had a significant impact on the willingness of some companies to invest in China.

Accordingly NAFI supports the suggested approach to address these concerns, as outlined above, and other relevant initiatives contained elsewhere in the FTA Feasibility Statement. The FTA could support Australian trade and investment interests most effectively through three key areas:

- requesting a greater level of certainty and transparency from the legal system;
- obtaining clearer information on whether national or provincial policies and regulations would have precedence over business activities in certain locations; and
- seeking to progress a program and timetable of trade-related reforms through the China-Australia Governance Program.

4 CONCLUSIONS

The FTA outlines the following recommended objectives and principles:

The study recommends that the objective of a possible Australia-China FTA should be to accelerate sustainable economic growth, create jobs and raise living standards by:

- *encouraging greater trade and investment flows as well as economic cooperation bilaterally;*
- *creating a larger market, thereby promoting productivity through greater competition and economies of scale;*

- *realising more fully the complementarities in the economic relationship by removing tariff and non-tariff barriers;*
- *adding momentum to regional and multilateral trade liberalisation efforts; and*
- *providing a framework for closer economic cooperation and addressing trade problems and barriers, including through commitments on transparency.*

While recognising that nothing in the study pre-judges how particular issues might be addressed in the scope of a possible FTA, seven principles are considered of importance to achieve the objectives of accelerating sustainable economic growth, creating jobs and raising living standards in both countries.

1. *The two sides should negotiate as equal trading partners.*
2. *An FTA must be consistent with WTO rules, and take into account APEC's goals for trade and investment liberalisation and facilitation.*
3. *Under a possible FTA negotiation, products across all sectors would be negotiable, involving liberalisation and facilitation of goods and services, and the issue of investment flows would also be addressed, with a view to achieving a balanced outcome through a single undertaking.*
4. *An FTA should be capable of delivering significant outcomes as soon as it enters into force.*
5. *The negotiation of a possible FTA should take into account that the two sides are at different stages of economic development and have different comparative advantages and adjustment costs.*
6. *An FTA needs to include arrangements to facilitate dispute settlement and consider including bilateral trade remedy measures.*
7. *Recognising that an FTA would be developed over time to achieve full liberalisation between its parties, it should include a timetable for periodic review.*

The study demonstrates that there are significant impediments to trade and investment between Australia and China. An ambitious FTA that removed or reduced them would deliver significant trade and economic benefits to both countries, promote closer integration of the Australian and Chinese economies over the long term, and support and reinforce multilateral and regional trade reform.

Accordingly, the study concludes that an Australia-China FTA is feasible and, on balance, would substantially benefit both countries.

This study concludes that an Australia-China FTA is feasible and, on balance, would substantially benefit both countries. Should both governments decide to enter into FTA negotiations covering goods, services, investment and bilateral cooperation as outlined in the study, it is recommended that the negotiations should begin as soon as possible.

NAFI Comment

NAFI supports the above principles, objectives and recommendations. NAFI is interested in knowing how progress with the FTA will be monitored, after it is agreed, and the nature of any sanctions that might be implemented where the commitments to the agreement are not upheld.