

CONFIDENTIAL



Australia – China Free Trade Agreement Feasibility Study

Australian Industry Group
Submission to the
Department of Foreign Affairs and Trade

July 2004

CONTENTS

Summary and Recommendations	
Executive Summary	1
Recommendations	3
Background	
The Trade Relationship	5
The Investment Relationship	7
China's WTO Accession Commitments	7
Australia-China Trade & Economic Framework	8
Industry Consultation	
Ai Group Research & Analysis	10
The impact of China on Australian industry	10
China's influence by sector	12
China's influence by firm size	13
Attitudes to an Australia-China FTA	14
The objectives of an FTA	17
Ai Group Position and Key Recommendations	
Ai Group Position	19
Recommendation 1: strategic importance of Australian manufacturing	20
Recommendation 2: market economy status	22
Recommendation 3: introduce an Advanced Manufacturing Program	25
Recommendation 4: tariff concession scheme	27
Recommendation 5: a comprehensive agreement	27
Recommendation 6: intellectual property protection	28
Recommendation 7: reciprocal tariff elimination	29
Recommendation 8: transitional safeguards	31
Recommendation 9: rules of origin	31
Recommendation 10: non tariff barriers	32
Recommendation 11: bilateral investment flows	33
Recommendation 12: global trade strategy	34
Recommendation 13: China Help Desk	34
Appendix 1: China Special Issue Survey – Questionnaire Form	36
Appendix 2: Company Interview Form	38
Appendix 3: Australian Manufacturing & China: Opportunities and Challenges	51
Appendix 4: Letter to the PM from Ai Group on Anti-Dumping matters	88
Appendix 5: Letter to Ai Group from ACS on Anti-Dumping matters	92
Appendix 6: Letter to Ai Group from DFAT on Anti-Dumping matters	97

SUMMARY AND RECOMMENDATIONS

Executive Summary

Ai Group acknowledges the growing importance of Australia's bilateral engagement with China and welcomes developments in our relationship that are in the best interests of all sectors of the Australian economy.

China is now the world's sixth largest economy and the fourth largest trader. China is Australia's third largest export market. Australia mainly exports primary commodities to China, while China mainly exports labour intensive, value-added manufactured products to Australia. Better relativities in the trade relationship between Australia and China must be achieved if Australia is to continue to develop as a balanced and knowledge-based economy.

While China poses significant competitive challenges to Australian industry, it also represents some very important opportunities. It is critical that Australia adopts a strategic policy position in support of manufacturing – a major contributor to Australia's GDP and exports – so that it can be better positioned to meet bilateral and global change.

Australian manufacturers have worked extremely hard to achieve their current levels of competitiveness, both on domestic and global markets. This progress needs to continue and it will be critically undermined if the Australian Government does not ensure that we have fair trading arrangements at home and substantially enhanced access conditions in offshore markets including China.

Australia is now examining what the implications are for our economy if we enter into a Free Trade Agreement with China. However some issues are clear even at this stage. Most significantly, China's phenomenal growth as a world economic power and a key trading partner with Australia is on-going though hampered by many tariff and non-tariff barriers within China.

Further, China both represents and is at the very forefront of the competitive challenges which Australia's manufacturing industry faces, both in our own domestic market and in global markets. This challenge is massively exacerbated by China's managed exchange rate policy and hidden industry price support mechanisms.

While some of these factors will largely remain whether or not Australia enters into an FTA with China, nonetheless they all must be addressed comprehensively if the bilateral relationship is to be consolidated and developed on an equitable basis.

In order to clearly understand the views of Australia's manufacturing industry in relation to these matters, Ai Group has undertaken an extensive study which shows that at the present time, a large proportion of this sector is not convinced that an FTA with China would be advantageous. Further, manufacturers are deeply concerned about the level of transparency and compliance that China could deliver under any proposed FTA.

For instance, responses to the Ai Group survey of 848 manufacturers found:

- 13.2 per cent of manufacturers reported that an Australia – China FTA would be beneficial at this stage of China’s development, while 41.7 per cent were uncertain about the impact of an FTA on their business. In contrast, 45.2 per cent of manufacturers saw no benefit.
- Among the 12 key manufacturing sectors, none came out as viewing an Australia – China FTA as being unquestionably favourable.
- In comparison to the industry average, a slightly higher proportion of exporting firms (16.8%) viewed an Australia – China FTA as being beneficial to their business. The proportion of exporters who perceived an FTA as being beneficial increased with employment size. Of exporters employing more than 200 persons, the proportion of firms viewing an FTA as beneficial was 28.6 per cent (with 40.3% uncertain and 31.2% reporting no benefit).

These results need to be seen in light of information currently available to manufacturers. Specifically, the breadth of application and content of any FTA with China is unknown, and this is reflected in the large proportion of firms citing a degree of uncertainty.

Clearly, the Australian Government has a significant task ahead of it if it is to convince a larger cross-section of Australia’s manufacturing sector of the benefits of an FTA with China. One essential step in this process must be for the Government to commission immediately quantitative economic research into the relative impacts on the manufacturing sectors in both Australia and China under a proposed FTA.

Given these circumstances, Ai Group’s position can be stated as:

- (a) Recognising that much of the opportunities and challenges facing Australian industry in relation to China will continue with or without an FTA between our two countries.
- (b) Finding an equitable basis on which Australia can continue to engage with China is the threshold issue.
- (c) Before Australia enters into any FTA negotiations with China, manufacturers must be assured that:
 - i. An Advanced Manufacturing Program is implemented as an inextricable component of the FTA process. This Program to address the competitive impediments faced by Australian manufacturers on our domestic market as well as to recognise and to position manufacturers as a critical contributor to Australia’s growth, exports and knowledge base.
 - ii. Australia’s anti-dumping rights will not be diminished.
 - iii. Effective commercial safeguards in relation to intellectual property infringements will be central to our on-going relationship with China.

The complete list of recommendations contained in this Submission can be categorised either as being essentially embedded in, or inextricably linked to, the formal FTA process.

Recommendations

Recommendation 1

Acknowledge the strategic importance of Australia's manufacturing sector within any proposed FTA framework and ensure mutual gains for the manufacturing sectors of both Australia and China. As part of this process, the Australian Government to commission immediately quantitative economic research into the relative impacts on the manufacturing sectors in both Australia and China.

Recommendation 2

Ensure a fair trading environment for Australian manufacturing. Ai Group strongly opposes granting China market economy status unless the Government can clearly demonstrate that Australia's anti-dumping rights will not be diminished. Within this context it is essential that industry get ready access to reliable normal value information.

Recommendation 3

Introduce a forward-looking Advanced Manufacturing Program to enhance Australian industry's competitiveness in the face of the increasing importance of trade and investment flows between China and Australia.

Recommendation 4

Abolish the 3% tariff applying under the Tariff Concession Scheme for imports from all countries, to assist Australian manufacturing competitiveness.

Recommendation 5

The Australian Government to clearly demonstrate that it has satisfactorily addressed the concerns articulated by Ai Group in this Submission. Should this occur and industry has given its support to commence FTA negotiations with China, the Australian Government must ensure at the outset that the Agreement will be comprehensive, covering all sectors of trade, services and investment.

Recommendation 6

Enhanced intellectual property protection is essential. This requires China to implement and enforce effective and commercially realistic penalties that have a clear deterrent effect.

Recommendation 7

If an Agreement goes forward, it should deliver immediate tariff elimination on the largest number of products possible, while accommodating transitional arrangements for sensitive sub-sectors. For those items for which phased tariff reduction is necessary, zero tariffs should be achieved within a maximum of 10 years.

Recommendation 8

Transitional safeguards must be in place and readily accessible to support industry from import surges that cause or threaten to cause serious injury.

Recommendation 9

Rules of Origin to follow the product-specific methodology employed in the Thailand-Australia FTA.

Recommendation 10

Non-tariff barriers to be addressed with close attention to standards and conformity issues, to ensure equitable treatment.

Recommendation 11

Barriers hindering bilateral investment flows to be removed and supported by provisions facilitating the temporary entry of business people.

Recommendation 12

Any FTA negotiations to be part of a global trade strategy encompassing simultaneous multilateral, regional and bilateral activities.

Recommendation 13

The Australian Government to establish immediately a China Help Desk.

BACKGROUND

The Trade Relationship

The importance of China as a trade and investment partner cannot be overstated. Further, given the rapid growth of China's economy and its increasing engagement in world trade, it has an assured place as a major driver of world markets.

China is now the sixth largest economy and fourth largest trader in the world, and is taking its place alongside Japan as a major driver of Asian growth and the world economy. China's share of world trade has rocketed from less than one per cent 20 years ago to nearly six per cent currently. Since the mid 1990s economic growth in China has averaged over eight per cent.

China is Australia's third largest export market. Australian exports to China have grown strongly since 1999. In 2003, Australia's merchandise exports to China rose by 8.4% to over \$9 billion. Two-way trade was worth more than \$23 billion, leaving a trade deficit for Australia of over \$5 billion.

In 2003 exports of iron ore (our biggest export item) and alumina were more than triple what they were in 1996. Strong export growth was also achieved in LNG, nickel and crude petroleum. Meanwhile, sales of wool, barley and oil seeds declined sharply. It is no surprise that Australia mainly exports primary commodities to China, while China mainly exports labor intensive manufactured products to Australia.

Top 5 Australian Exports 2003		Top 5 Australian Imports 2003	
Iron Ore	\$1.73 bn	Clothing	\$2.40 bn
Wool	\$938 m	Computers	\$1.12 bn
Crude Petroleum	\$770 m	Toys, games & Sporting goods	\$955 m
Aluminium	\$244 m	Telecommunications equipment	\$579 m
Coal	\$242 m	Footwear	\$567 m

Source: Market Information and Analysis Section, DFAT

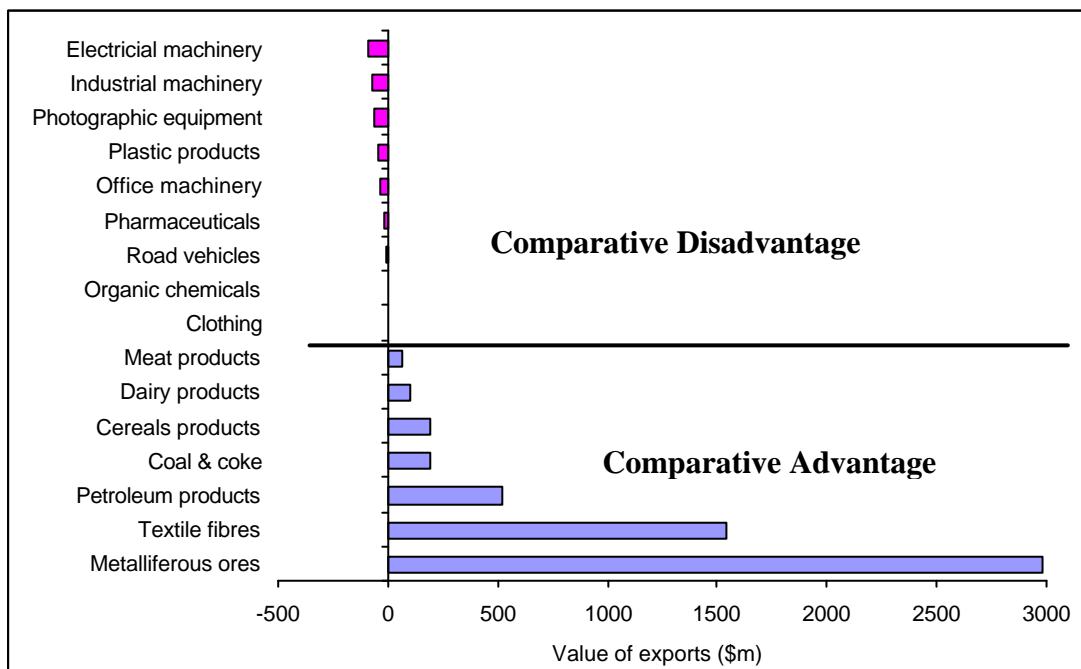
Top 5 Australian Manufactured Exports 2002/03	
Pigments, paints, varnishes	\$137 m
Chemicals & related products	\$135 m
Electrical machinery & appliances	\$95 m
Machinery & transport equipment	\$94 m
Paper & paperboard	\$94 m

Source: ANZ Industry Brief April 2004

In fact, around two-thirds of Australian merchandise exports to China are primary products - principally iron ore, alumina, wool, barley, coal, copper ores and oil and gas products. While there has been an increase in recent years in Australian manufactured exports such as electrical machinery and appliances and telecommunications equipment, elaborately transformed manufactures (ETMs) remain a very small part of our merchandise exports.

Nonetheless, for the period 1999-2003, Australia's manufactured exports to China increased from a relatively low base of \$658 million to \$1.8 billion, representing an increase of 165% over this 5 year period. This compares with an increase of 14% for Australia's total manufactured exports to all world markets over the same period.

The following table shows the relative positioning of Australia's comparative advantages and disadvantages with China. (Source: Australian Bureau of Statistics trade data for 2003 and the Economic Analytical Unit of DFAT.)



China is Australia's third largest source of imports, our principal source of clothing and footwear, and a significant source of Australia's textile, toy and sporting goods imports. Imports continue to rise more sharply than our growing exports, maintaining a slowly increasing merchandise trade deficit (\$5.2 billion in 2003). Despite the predominance of TCF imports, the import mix is showing strong growth in imports of higher value-added products, such as computers, household electrical goods and telecommunications equipment. This trend reflects the growing sophistication of Chinese production and further integration of Chinese manufacture in Asian supply-chains.

The pervasiveness of Chinese goods in the Australian market can be demonstrated in the list of imports for which China was the number one source in 2002-03: paper manufactures; textile yarn; clothing and footwear; other textile

manufactures; aluminium; other manufactures of base metal; other metal household equipment; office machines; computers; radio broadcast receivers; electricity distribution equipment; household type equipment; furniture; travel goods and handbags; other articles of plastic; and toys, games and sporting goods.

The nature of our trade relationship (Australia predominantly exports primary products, and imports labour intensive manufactured products) is noted in numerous DFAT publications as a sign that the Australian and Chinese economies are strongly matched, or have a high level of 'complementarity'. This positive interpretation of the trade relationship overlooks the competitive pressures that an increasingly sophisticated Chinese manufacturing sector is placing on Australian manufacturing. This situation is significantly exacerbated by China's managed exchange rate policy, which pegs the RMB to the US dollar.

The Investment Relationship

Total Chinese investment in Australia as at June 2003 was \$2.2 billion. Major Chinese investments have been made in the manufacturing, mining, mineral processing, leather processing, wool processing and agriculture sectors. These include the Channar iron ore mine in the Pilbara region of Western Australia and the Portland Aluminium smelter in Victoria. Investments are also diversifying into other sectors such as manufacturing, real estate, mineral exploration and wool processing.

Australian investment in China has plateaued in recent years. It totalled \$1.2 billion at June 2003. Australian companies are involved in building and construction, transport and distribution, high-value manufacturing, environmental management, food processing, information technology, telecommunications, advertising and design.

The Chinese Government places a range of restrictions on foreign investment including requiring government approval on all foreign investment in China and restricting establishment of wholly foreign-owned enterprises in a range of industry sectors, including mining and minerals processing, transport and some transport infrastructure, telecommunications, wood processing, printing, tourism, and a range of services industries.

China's WTO Accession Commitments

China's WTO accession commitment implementation record has been found wanting and raises concerns as to China's practical ability to take on additional implementation commitments – which would be so-called WTO Plus commitments – under an Australia-China FTA.

China acceded to the WTO on 11 December 2001, after 15 years of negotiations. It undertook to implement a wide range of reforms under its

accession commitments, designed to improve market access for WTO member countries, institute national treatment and transparency standards, protect intellectual property rights, limit the use of trade-distorting domestic subsidies, and bring its legal and regulatory system more in line with other WTO members.

By the end of China's second year of membership in the WTO (late 2003), it became clear that it was falling far short of implementing its WTO commitments. According to the US Trade Representative's "2003 Report To Congress On China's WTO Compliance":

"China's WTO implementation progress must be measured by the degree to which China has begun to institutionalize market mechanisms and to make its trade regime more predictable and transparent. By that score, the shortcomings in China's WTO implementation are noteworthy."

While the USTR report recognises important gains made in China's development over the first two years of WTO membership, its disappointment in China's implementation record is clear:

"...institutionalization of market mechanisms still remains incomplete, and intervention by Chinese government officials in the market is common. In many instances, China has sought to deflect attention from its inadequate implementation of required systemic changes by managing trade in such a way as to temporarily increase affected imports from vocal trading partners, such as the United States."

Evidently, China's efforts have been found wanting in the areas of agriculture, services (and particularly the distribution services sector), enforcement of intellectual property rights and transparency. China's questionable use of VAT tax policies to favour domestic production, and the use of industrial policies to encourage domestic production at the expense of imports were also highlighted.

The Australia-China Trade & Economic Framework

In recognition of the importance of the Australia-China relationship and in order to foster the growth and development of bilateral trade and investment, Australia and China entered into a Trade & Economic Framework agreement. Central to the agreement is a commitment to undertake a joint feasibility study into a possible Free Trade Agreement.

On 24 October 2003, Australia's Trade Minister, Mark Vaile and China's Vice Minister for Commerce, Yu Guangzhou, signed the Australia-China Trade and Economic Framework (TEF) agreement, following more than 12 months of formal negotiations. The intention of the TEF is to enable Australian exporters and investors to maximize the benefits from China's continuing economic reform and recent WTO accession.

According to Australian Government documentation the TEF will boost the economic relationship in three ways:

- By promoting business cooperation in sectors with the best potential.
Targeted measures in key sectors such as energy and minerals, agriculture, services and investment are planned. Other bilateral issues including education, health, food safety, customs cooperation and intellectual property rights are also included.
- By enhancing economic dialogue.
Increasing high-level visits with an economic focus as well as strengthened dialogue among senior officials.
- By undertaking a joint feasibility study into a possible free trade agreement (FTA) between Australia and China.
The study will examine the costs and benefits of an FTA and will allow both Governments to consider whether to proceed with FTA negotiations. The study was to be completed by October 2005, but has been brought forward to about March 2005.

This submission by Ai Group is aimed at assisting the feasibility study.

INDUSTRY CONSULTATION

Ai Group Research & Analysis

Ai Group undertook two primary forms of industry consultation on the issue of whether Australia should have an FTA with China:

1. China Special Issue survey of 848 companies. (See Questionnaire Form at Appendix 1)
2. Interviews with 50 companies. (See Interview Form at Appendix 2)

The survey and company interview data were used to produce the report: “Australian Manufacturing and China: Opportunities and Challenges” (Appendix 3).

The Ai Group survey in particular, sought feedback on the impacts of China in terms of customer and product markets, company performance, strategic responses to China, and views surrounding closer economic ties between Australia and China, including the impact of an FTA.

Company interviews were undertaken with chief executive/senior executives with the objective of adding qualitative information to the survey results. All the major sectors represented by Ai Group were covered, as well as a range of company sizes within each sector. These sectors are:

- Food and Beverages
- Textiles
- Clothing & Footwear
- Basic metals
- Fabricated metal products
- Machinery & equipment
- Transport equipment
- Chemicals, petroleum and coal
- Wood and furniture
- Paper, printing and publishing
- Construction materials
- Miscellaneous manufacturing

The impact of China on Australian industry

In gauging the views of industry on a potential FTA, it is necessary to assess the impact of China on Australian manufacturing. It is important to summarise these findings, as this sets the scene of threats and opportunities within which companies view the China relationship.

Our research indicates that some 68% of Australian manufacturers believe China is a critical issue for the future of their businesses. Manufacturers have to again rethink their business. The challenge is clearly on companies to lift competitiveness – a shift that involves game-changing strategies – continuous improvement models alone are not sufficient.

Excerpt: Key Findings, “Australian Manufacturing and China: Opportunities and Challenges”

China’s impact on the domestic manufacturing industry

Survey findings confirm that China is a critical issue for Australian manufacturers:

- More than two-thirds (68.4%) of all firms are affected by China in either customer or supplier markets.
- While some are benefiting from China’s emergence as an export market and as a source of low cost inputs, the survey shows China is having an overall negative net impact on activity and profits through its competitiveness in the domestic and export markets of Australian firms.
- Based on survey responses, Ai Group estimates the impact of China translates into a financial loss for the domestic manufacturing sector of \$560 million over the past year (or 0.21% of total turnover).¹
- The table below provides a summary of China’s estimated impact on Australian manufacturing.

Estimated financial impact of China on operating performance

Business performance indicator	Estimated impact (\$m)	Estimated impact as % of turnover
Impact of China as an export market	280	0.10
Impact of China on input costs	240	0.09
Additional revenue from China based investments	30	0.01
Impact of China on domestic sales	-920	-0.34
Impact of China on export sales (ex-China)	-190	-0.07
Net impact of China on domestic manufacturing	-560	-0.21

The responses of Australian manufacturers to China

Firms are aggressively responding to the opportunities and confronting the challenges presented by China. Of those firms affected by China in either customer or supplier markets, 87.9 per cent have formally implemented some change to company strategy.

¹ Important to emphasize however, these results may also have been influenced by exchange rate movements. The appreciation of the Australian dollar against the Chinese renminbi since late 2001 would have amplified China’s competitive advantages and dampened Australia’s competitiveness.

Across all manufacturing, the most frequently nominated strategic responses to China were:

- Accelerating the pursuit of production efficiencies (38.9% of surveyed manufacturers);
- Sourcing more imports from China for use in domestic production (31.5%);
- Accelerating the adoption of new technologies (30%); and
- Moving up or down the company's supply chain.

Taking into account survey responses and adjusting for an overweighting of exporters and large firms in the survey, it has been calculated that five per cent of all Australian manufacturing firms are in the process of responding to China by shifting at least some productive capacity to China. As well, it is estimated that 4.2 per cent of Australian manufacturing firms are in the process of shifting capacity to a third country. Firms citing productive capacity has been relocated to China or a third country accounted for a disproportionately large share of turnover (almost 40%) of responding firms.

China's influence by sector

As expected, there are key differences between sectors in relation to the impact of China on Australian manufacturing.

Excerpt: Key Findings, "Australian Manufacturing and China: Opportunities and Challenges"

China's influence varies among sectors

Survey results also show China's influence on activity across the 12 major manufacturing sectors is uneven, largely reflecting varying trade exposures:

- In terms of China's potential as an export market, the textiles (particularly unprocessed products such as yarns and fabrics), chemicals, petroleum & coal products, food & beverages, and basic metals sectors were those benefiting most relative to all industry. Clearly, these sectors are benefiting from strong Chinese demand for products linked to Australia's natural resources and agricultural base.
- As reflected in financial estimates above, China's influence is greatest in terms of its impact on domestic competition through imports. Sectors such as textiles (particularly carpets and other finished products), clothing & footwear, basic metals

and wood, wood products & furniture report relatively strong competition from China in domestic markets.

- China's (negative) impact in Australia's export markets was strongest in the textiles, basic metals and miscellaneous manufacturing sectors.
- A positive for industry is the ability for local firms to source low cost inputs from China for use in domestic production. Textiles (mainly in the form of finished textile products), clothing & footwear, basic metals and transport equipment producers were among those benefiting most.

Across all sectors, the net effect of China is to reduce earnings (profits), largely reflecting the overarching impact of China's competitiveness in markets, driving down prices and eating into market share. Within this however, were some key differences:

- While a relatively large number of firms in the textiles, clothing & footwear, basic metals and chemicals, petroleum & coal products sectors reported higher profits due to China, these were easily outnumbered by those reporting a negative outcome.
- In comparison to other sectors of manufacturing, China's overall impact on profits in the food and beverages sector is relatively low (nevertheless, more firms report a negative impact on profits from China than a positive impact, reflecting general competitive pressures).
- Producers in the wood, wood products & furniture, paper, printing & publishing, construction materials, fabricated metals and miscellaneous manufacturing sectors overwhelmingly viewed China as a negative influence on profits over the past year.

China's influence by firm size

Larger firms had a greater propensity to cite China as an export destination, and noted the opportunities presented by China as a result of its enormous market size and growing affluence. As is to be expected, larger firms were also more prominent in viewing China as an investment destination. For smaller companies, without sufficient capital to invest in China, there was a greater focus on domestic markets, where Chinese competition is creating substantial pressures.

Excerpt: Key Findings, “Australian Manufacturing and China: Opportunities and Challenges”

Based on survey responses, China is impacting on large (over 100 employees) and medium sized firms more so than small manufacturers (up to and including 25 employees):

- The Ai Group survey shows large employers had a greater propensity to cite China as having an impact as an export market.
- Large as well as medium sized manufacturers were more likely than smaller counterparts to nominate China as impacting on competition in both domestic and export markets.
- In terms of taking advantage of sourcing low cost inputs from China for use in domestic production, results were related to employment size – large firms were most likely to nominate China’s as having an impact, followed by medium and small sized manufacturers.
- Large firms were significantly more likely to nominate China as impacting in terms of a destination for foreign investment.
- Profit outcomes across small, medium and large firms were relatively consistent, with similar proportions of firms reporting higher or lower profits due to China.

Attitudes to an Australia – China FTA

Clearly, Australian manufacturing companies are yet to be convinced that an FTA with China would be advantageous, with only just over 13% seeing any benefit to their firm.

Excerpt: Key Findings, “Australian Manufacturing and China: Opportunities and Challenges”

- In total, 13.2 per cent of manufacturers reported that an Australia – China FTA would be beneficial at this stage of China’s development, while 41.7 per cent were uncertain about the impact of an FTA on their business. In contrast, 45.2 per cent of manufacturers saw no benefit.
- In comparison to the industry average, a slightly higher proportion of exporting firms (16.8%) viewed an Australia – China FTA as being beneficial to their business. As well, the proportion of exporters who perceived an FTA as being beneficial increased with employment size. Of exporters employing more than 200

persons, the proportion of firms viewing an FTA as beneficial was 28.6 per cent (with 40.3% uncertain and 31.2% reporting no benefit).

- There was some variation in perceived benefits from an Australia – China FTA by firm size. Just under one-in-five large manufacturers (19.8%) viewed such an agreement as potentially beneficial to their firm, compared to 14.6 per cent of medium sized firms, and 10.1% of small firms.
- These results need to be seen in light of information currently available to manufacturers. Specifically, the breadth of application and content of any FTA with China is unknown, and this is reflected in the large proportion of firms citing a degree of uncertainty.

A common theme throughout the company interview process was the disparity in cost bases between the two countries (lack of level playing field), making competition unfair. Companies pointed out that they believed China was not a market economy and as a result able to keep costs artificially low. Low labor costs, low environmental protection costs, subsidized energy inputs, subsidized infrastructure costs, subsidized freight, lower overheads (no superannuation payments, occupational health and safety costs etc) were also cited as key cost advantages for China. Coupled with China's enormous scale of manufacture and exponential growth in production plant infrastructure and increasing sophistication of production technology, the scene is only set to get more challenging.

The question is how will an FTA with China alter this competitive situation?

It is quite possible that for many in industry, concerns about Chinese competition may override a consideration of how an FTA would indeed affect the “Chinese Juggernaut” (either negatively or positively). Many in industry take a position that providing China with improved trade access to Australia can only heighten competitive pressures.

The following quotations are representative of negative responses to an FTA:

“I am opposed to an FTA because there has been no consideration by the Australian government for a strategy for long term manufacturing in Australia. Bilateral negotiations without this consideration lead inexorably to the decline of this sector in the Australian economy and fundamentally, I believe that a thriving, innovative knowledge based economy still requires some fundamental manufacturing industry.” (Multinational chemical firm)

“Any technological edge we have will be matched by China in a handful of years. An FTA will be a poor result for manufacturing innovation and high technology. China will devastate us.” (Large timber firm.)

“It is questionable how much extra business Australia would get under an FTA: China is already a huge importer of agricultural products and will

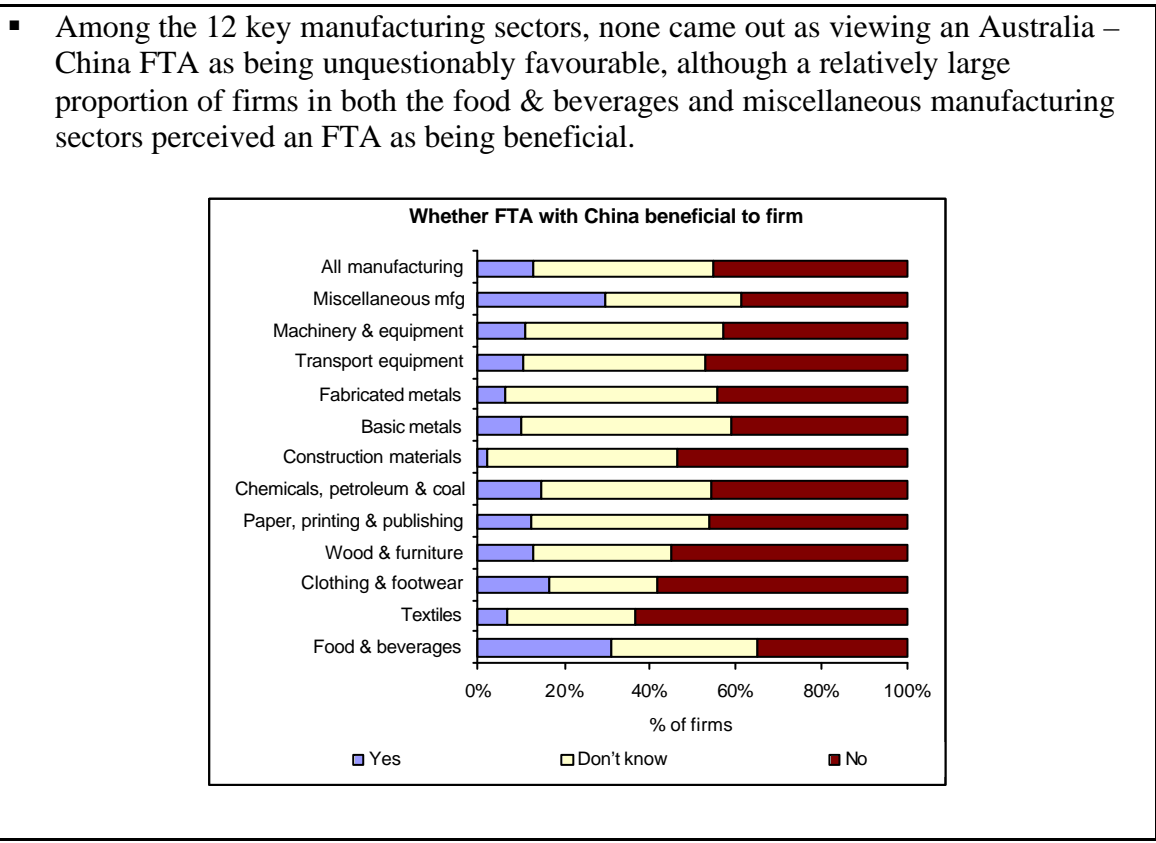
continue to import from us anyway. In Australia’s globally competitive sectors – agriculture and resources – an FTA is not needed to safeguard trade. In other sectors that are not globally effective, there will be no benefit. Only retailers will benefit.” (Large TCF firm.)

Companies reporting in the positive for an FTA at this stage were heavily in the minority. Of these however, some identified key areas of opportunity:

“We expect China to be a major market for us over the next 50 years. Any reduction of barriers to the Chinese market is good. For us, an FTA involving the removal of tariffs and regulatory barriers would lower the costs of components, and provide a boost to exports to China and third countries.” (Transport equipment manufacturer)

“China is a big market for our products, with Chinese industry not capable of supporting local demand. We do see barriers in terms of customs duties being too high, a lack of transparency and other non-tariff barriers. An objective of an FTA should be for a phased in reduction of Chinese tariffs and customs duties. Overall, an FTA would be a positive from a sales point of view.” (Food & beverage manufacturer)

At this stage of China’s development Ai Group analysis shows that on a sector-by-sector basis, no individual sector views an FTA with China as being unquestionably favourable.



The objectives of an FTA

Excerpt: Key Findings, “Australian Manufacturing and China: Opportunities and Challenges”

Importantly, and within the context of investigations into a potential Australia – China free trade agreement (FTA), manufacturers nominated a wide range of trade barriers preventing greater exports to, or investment within China - most comprising non-tariff and/or other non-formal barriers:

- 9.6 per cent of respondents cited finding suitable partners for Chinese based investments or exports, with the same proportion reporting high start up costs (and the impact on the return on capital) as a barrier.
- More than one-in-five manufacturers (28.4%) responding to the survey are confronting competition from Chinese products that they perceive to be priced below cost.

According to the company interviews, further areas, which must be included in an FTA with China, are:

- Enhanced protection of intellectual property
- Lead to legitimate pegging of the currency to true market value
- Strong anti-dumping provisions
- Transparency in legal and financial systems
 - Consistent interpretation of laws and uniform laws across Provincial jurisdictions
 - Transparency in application of taxes, particularly across Provincial jurisdictions
- Uniform and clear standards across Provincial jurisdictions
- Safeguards to protect industry from import surges which damage local industry
- Eliminate non-tariff barriers (NTBs)
- Establish value added products in China ahead of US, Europe etc
- Build the bilateral relationship/ ensure Australia benefits from China’s growth
- Must include effective punitive measures to ensure Chinese compliance
- Remove foreign investment restrictions
- Assist China to become a market economy
- Cut bureaucratic barriers
- Consistent enforcement of import duties and transparent quarantine control
- Provide access to internal markets/distribution
- Secure Australian trade in raw materials, technology transfer, education and cultural products.

The objectives noted above regarding the strengthening of Australia's anti-dumping legislation are reinforced by Ai Group's survey finding that 28.4% of firms had the perception that Chinese goods were being dumped in Australia

A representative comment on this issue from the interview process is as follows:

*"We should not sign an FTA that recognizes China as a free market economy. China is patently not a market economy and ensuring competition with China is on a level playing field is vital. Currently it is not. Verification of pricing in an anti-dumping case is a key issue."
(Large steel firm.)*

Unquestionably, industry totally opposes any diminution in anti-dumping support mechanisms.

AI GROUP POSITION AND KEY RECOMMENDATIONS

Ai Group Position

Ai Group acknowledges the growing importance of Australia's bilateral engagement with China and welcomes developments in our relationship that are in the best interests of all sectors of the Australian economy.

A large proportion of Australia's manufacturing sector is not convinced however, that an FTA with China would be advantageous. Further, manufacturers are deeply concerned about the level of transparency and compliance that China could deliver under any proposed FTA.

The results of Ai Group's survey indicate that manufacturers need convincing about the advantages of an FTA with China. Some 13.2 per cent of firms (16.8% of exporters) viewed an FTA as beneficial to their firm, 41.7 per cent were uncertain about the impact of an FTA on their business, and 45.2 per cent saw no benefit.

The large number of firms citing a degree of uncertainty is to be expected given that the nature of the potential FTA is unknown. As noted earlier, it is also important to bear in mind that it is likely that firms are considering the broader (and often negative) competitiveness impacts of China when forming an opinion on an FTA.

The Australian Government has a major task ahead of it to explain how the manufacturing sector will benefit if the support of this sector is to be garnered.

A general level of scepticism about the transparency of the Chinese system of government and business practice compounds the difficulty in successfully completing this task. Ai Group's study uncovered widespread fears that China would not want or be able to comply with its bilateral commitments with Australia. This included general Chinese attitudes to laws and protection of IP, pegging of the Chinese currency, subsidised inputs to industry, and low overheads and wage costs. This is further compounded by relatively less developed institutional infrastructures to ensure compliance and transparency in all areas affected by an FTA.

Within this context and before Ai Group would agree that Australia proceed to any FTA negotiations with China, manufacturing industry needs assurance that:

- i. An Advanced Manufacturing Program is implemented as an inextricable component of the FTA process. This Program to address the competitive impediments faced by Australian manufacturers on our domestic market as well as to recognise and to position manufacturers as a critical contributor to Australia's growth, exports and knowledge base.

- ii. Australia's anti-dumping rights will not be diminished.
- iii. Effective commercial safeguards in relation to intellectual property abuses will be central to our on-going relationship with China.

Key Recommendations

- 1. Acknowledge the strategic importance of Australia's manufacturing sector within any proposed FTA framework and ensure mutual gains for the manufacturing sectors of both Australia and China. As part of this process, the Australian Government to commission immediately quantitative economic research into the relative impacts on the manufacturing sectors in both Australia and China.**

It is critical that the Australian Government acknowledges the importance of the manufacturing sector to the Australian economy in both the spirit and detail of any proposed FTA with China. As a sector that is concerned that it could be disadvantaged in a China FTA, the Government must therefore assure manufacturers that conditions embedded in and parallel to an FTA will foster the long-term future of Australian manufacturing. One essential step in properly addressing this issue is for the Government to commission quantitative economic research into the relative impacts on the manufacturing sectors in both Australia and China.

China both typifies and leads the enormous pressures on Australian manufacturing now. As a result, if this sector is to continue to meaningfully contribute to the Australian economy, these issues need to be addressed. The proposed FTA with China merely emphasises this imperative.

Manufacturing is a major sector of the Australian economy, with output and employment levels that are much greater than mining and agriculture combined.

Australia's manufacturing sector constitutes about 13% of GDP, employs 12% of the workforce, generates 40% of Australia's exports, undertakes about 50% of Australia's private sector R&D and is of critical importance to the ongoing wealth creation of the entire Australian economy. Manufacturing is the source of full-time work for over 1 million Australians. Accordingly, any FTA negotiations with China must acknowledge the strategic importance of Australia's manufacturing sector within the framework itself. An FTA must also draw on the strengths of both countries' manufacturing sectors to ensure mutual gains.

It is important to note some salient points made in the Productivity Commission report, "Trends in Australian Manufacturing", August 2003, which highlights the openness and competitiveness of the Australian manufacturing sector:

Key points

- Over four decades, growth in manufacturing trade has helped to transform Australian merchandise exports from a largely agricultural base into a mix of mining, manufacturing and agriculture, with agriculture becoming the least important among the three.
- Australian manufacturing is becoming increasingly open. In 1999-2000, over one-third of domestically sold manufactured goods were produced overseas and about one-quarter of domestically produced goods were sold overseas. This is up from, respectively, less than one-quarter and one-sixth a decade earlier.
- Intra industry trade — the extent to which similar products are concurrently exported and imported — has increased substantially over the past 30 years, particularly since the late 1980s. This is suggestive of the capacity for Australian manufacturing to develop capabilities within almost all areas of manufacturing, even those where competitiveness has been declining.
- Greater global trade integration by Australian manufacturing has been partly facilitated by reductions in border protection. The average effective rate of assistance for manufacturing fell from 35 per cent in 1968-69 to five per cent in 2000-01.

Ai Group argues in the strongest terms that any policy decisions undertaken by the Australian Government within the context of an FTA with China must not focus on resource/primary exports at the expense of Australia's manufacturing sector. While it may have been appropriate post World War 2 for Australia to focus on primary exports to Japan and essentially wait decades until we could benefit from value-added exports, the Australian manufacturing mix has changed considerably and does not warrant a similar policy with China. Four decades of growth in manufacturing have seen this sector become a key contributor to the Australian economy, globally competitive and open, and a significant source of employment, innovation and R&D.

Australian manufacturing is currently grappling with the challenges posed by China: increasing sophistication in manufactures beyond the traditional labour-intensive industries, Chinese Government subsidisation coupled with low cost structures, leading edge global investment and massive production volumes has resulted in highly competitive pricing structures which are often impossible for Australian industry to match. Given the importance of manufacturing to the Australian economy, it is essential that this sector is not undermined in any FTA.

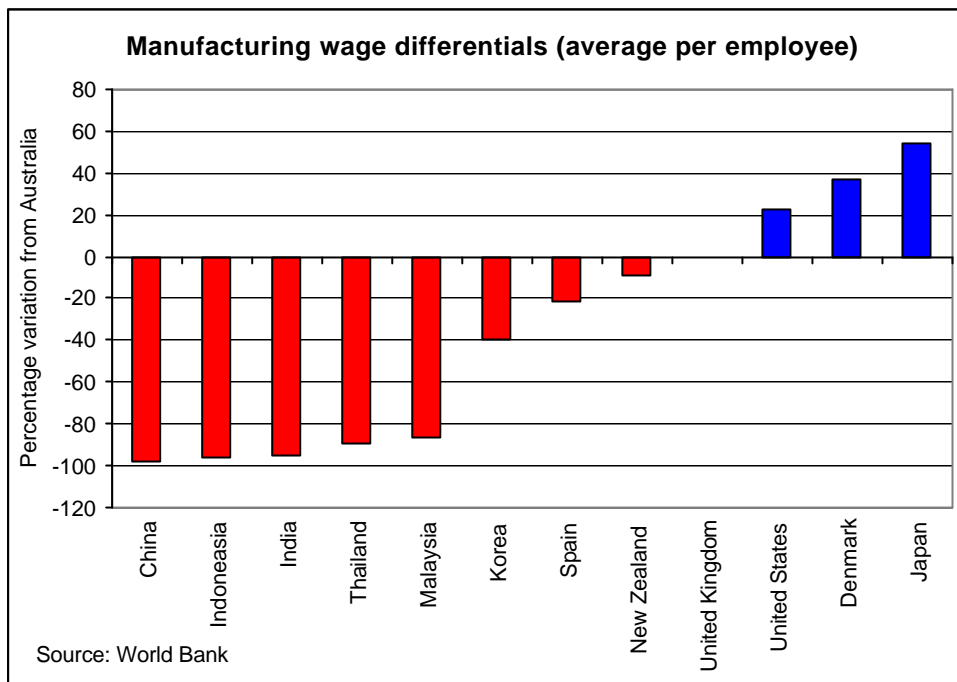
2. Ensure a fair trading environment for Australian manufacturing. Ai Group strongly opposes granting China market economy status unless the Government can clearly demonstrate that Australia's anti-dumping rights will not be diminished. Within this context it is essential that industry get ready access to reliable normal value information.

Through the last two decades of unilateral trade liberalisation, Australia's manufacturing industry has become globally competitive, efficient and innovative across many of its sectors. Australian manufacturing can continue to develop provided it can operate within an environment that not only prescribes, but also delivers in practical terms, equitable rules of trade.

The key impediments to equitable trade, as cited by industry are as follows:

- Pegging of the Chinese RMB to the US Dollar.
According to the Economist magazine, China's currency is undervalued against the Australian dollar by 44%. An FTA negotiation with China must add weight to the world argument that China should realign its currency more towards true market value.
- Significantly lower labour and overhead costs.
Ai Group member companies with joint-venture operations in China cite the cost of labour in China to be 800RMB (or \$US100 per month) whereas an equivalent worker in Australia is \$3,750 per month. One company in Ai Group's study explained it could employ in China eight workers for the price of one in Australia. This dramatic imbalance in labour costs, coupled with minimum expenditure by Chinese industry on compliance costs such as environmental protection, occupational health and safety, superannuation and related overheads carried by Australian manufacturers highlights the disparity in comparative cost structures.
- Subsidisation of industry and in particular energy inputs, plant infrastructure and certain raw material inputs.

Indeed, World Bank data published in 1999 shows that China has the greatest negative percentage variation from Australia, on average manufacturing wages:



The following comments made by companies that took part in our interviews highlight this situation.

“Everything we supply has been affected by Chinese competition. The Chinese currency is pegged to the US\$ and as the dollar depreciates China’s export prices fall. Imports to Australia are 20% cheaper than a year ago. Chinese companies benefit from subsidised freight, subsidized cotton, lower wages and reduced overheads (no superannuation payments, or outlay on trade waste for example). We have lost one third of our business to Chinese imports.”
(Large TCF firm.)

“The main factor influencing pricing of Chinese products below cost is the cost of the main raw materials to downstream manufacturers in China. The government controlled oil/petrochemical industry supplies raw petroleum products (Naptha, propylene polymer, etc.) to local polymer users at prices below import parity and below import parity prices (based on Asian market prices) supplied to multinational/transplants. The extent to which this subsidized polymer is used to manufacture finished goods and is then shipped to Australia represents the potential dumping of products in Australia.”
(Multinational chemicals firm.)

Access to appropriate anti-dumping and countervailing mechanisms is essential to ensure industry is not disadvantaged as a result of unfair trading practices.

"Dumping" occurs when:

- a company exports its goods at a price below that of the sales price in the country of origin
- a company exports its goods at a price that is lower than the cost of production

A "countervailing subsidy" is when:

- a government provides financial assistance to benefit the production, manufacture, or exportation of goods

If dumping or a countervailing subsidy is alleged, an investigation may be initiated, and ultimately, if the allegations are proven, duties will be assessed against imports of the product entering the country that initiated the investigation.

China has stipulated that its proviso for negotiating an FTA with Australia, is that Australia recognise China as a Market Economy. This is a key issue for industry, which opposes any diminution in Australia's anti-dumping powers with respect to countries such as China.

Our current anti-dumping provisions acknowledging China as an "Economy in Transition" (EiT) commenced in July 1999. This classification changed the status of China as a once state-controlled economy towards a market economy. Certain amendments were made to the legislation for EiT in December 2003.

Since these amendments were made, only one dumping investigation has been initiated against China, in May 2004. Industry is concerned that inaccurate conclusions could be drawn, as there has only been one action since the amendments came into force. Industry's experience is that it has become much more difficult now to initiate an anti-dumping case particularly if surrogate country pricing is involved. Granting China market economy status will only exacerbate this problem in regard to obtaining ready access to normal values from a third country.

Indeed, under the original EiT provisions, only 9 investigations against China were undertaken, and price control was not found in any of the cases – much to the amazement of industry. Surrogate country pricing was only employed by default (because exporters failed to cooperate) in three cases. (See Appendix 5: Letter from ACS to Ai Group on Anti-Dumping matters.) A letter from DFAT to Ai Group highlights the approach that Australia has taken whereby there is greater reluctance to use surrogate country pricing. (See Appendix 6: Letter to Ai Group from DFAT on Anti-Dumping matters). Industry is disadvantaged by and strongly opposed to these developments.

The chief issue reiterated by industry is that ascertaining a true "normal price" in China for the purposes of establishing whether dumping has occurred, is extremely difficult and often impossible. Given this situation, in order to gain fair recourse in dumping matters, industry expects Australia's anti-dumping legislation to:

- Provide a clear definition of when local market pricing is inadequate (i.e. when price influence/control exists) and
- In such cases, allow for ready access to surrogate industry/country pricing to be taken into account. In some cases it may be adequate that this consideration be made only on inputs, rather than the complete product. For example, fair pricing on electricity inputs would be established by investigating surrogate industry or country pricing.

Ai Group's deep concerns about the treatment of China in our anti-dumping legislation were noted in our letter to the Prime Minister of 28 May 2004. (See Appendix 4: Letter to the PM on Anti-Dumping matters.)

Ai Group also recommends that an examination of Australia's countervailing legislation be conducted, as this may uncover alternative means of defining government control/influence on inputs. Ai Group believes that the legislation could be strengthened to clarify definitions and ease industry's access to countervailing measures.

Ai Group notes the US "Byrd Amendments" which allow reparation to be made direct to injured parties in a dumping action as opposed to the Australian legislation whereby penalty duties are paid to the Government. While the US legislation has been found not to be fully WTO compliant, Ai Group recommends a review of this arrangement to determine if some reparation can be made to injured parties after the collection of anti-dumping or countervailing duties.

Further, in order to deal expeditiously with anti-dumping claims, particularly in light of the frustrations industry experiences with the anti-dumping system and processes, Ai Group recommends to Government an increase in the specialist resources employed on anti-dumping measures within the Australian Customs Service. In addition, staff with experience/in depth understanding of the China market, including language skills should be trained and/or employed.

3. Introduce a forward-looking Advanced Manufacturing Program to enhance Australian industry's competitiveness in the face of the increasing importance of trade and investment flows between China and Australia.

The process of enhancing competitiveness alongside the emergence of China as a global industrial nation presents significant challenges to Australian industry.

Australian manufacturing went through one phase of transformation in the 1970s and 1980s, when the unilateral reduction of tariffs required companies to become more globally competitive and build exports. In the 1990s this process of change intensified as companies sought to lift productivity, adopt modern production techniques (such as lean management), and build their research and innovation capabilities.

Industry's success in rising to these challenges is reflected in the strong growth of manufactured exports over the past two decades. Manufactured exports have grown significantly faster than exports from other sectors over this period. The importance of this vibrant contribution to Australia's overall trade balance, the current account and to the diversification of our exports has been an outstanding feature of Australia's economic performance over the past two decades.

The next decade will see a new phase in industry transformation, which will require companies to be even more innovative, squeeze even greater efficiencies, become even more export focused, build international supply chains and outsource production processes, in order to succeed both in domestic and export markets.

These requirements are clearly evident in a number of indicators including the slowdown over the past few years in export growth generally and in manufactured exports in particular. This, in turn, is reflected in the surge in the trade imbalance (despite the generally favourable movements in the terms of trade) and the persistence of historically large current account deficits.

Responding to these challenges is not a matter for industry alone.

Australia's ability to compete globally rests to a significant extent on the continuation of the rates of productivity improvement generated over the past decade and a half. Stable and prudent macroeconomic policy and microeconomic reforms across a range of economic activity are central to further productivity gains. Continued reform of industrial relations; greater progress in reform of energy markets; extracting greater value from our publicly funded education and research institutions; and greater levels of investment in transport infrastructure, for example, have important roles to play in the ability of industry to compete and thrive in the ever-more competitive global environment.

As in previous decades, to supplement general strategies to improve productivity, Federal and State Governments will need to be active in facilitating improved competitiveness both at the sector and industry levels. Ai Group believes a forward-looking Advanced Manufacturing Program needs to be developed to encourage and facilitate the next phase of industry transformation. This should entail encouragement of research and innovation in general; the diffusion of lean manufacturing strategies and new technologies and processes; export development and skills enhancement.

The breadth of the manufacturing sector requires that measures such as these should combine a general approach of encouragement and facilitation with particular strategies based around specific industries and regions.

Efforts to improve competitiveness should also take the form of encouraging and facilitating Australian companies looking to develop facilities in China or build partnership arrangements with Chinese and China-based companies. Assisting businesses overcome information deficiencies and financial barriers to the development of projects and other business opportunities in China should also be part of the Advanced Manufacturing Program.

Well-designed measures in the Advanced Manufacturing Program would strengthen Australian operations and facilitate their integration into the increasingly globalised marketplace. These measures would help to ease the burden of transition and assist in the orderly and forward-looking relocation of operations and employment opportunities.

At a national level, these outcomes would yield strong benefits through their impact on employment, domestic and offshore investment and the current account position (both in terms of trade and, over time, in terms of investment income earned offshore). Such a program would also mitigate the social costs associated with the significant challenges ahead.

4. *Abolish the 3% tariff applying under the Tariff Concession Scheme for imports from all countries, to assist Australian manufacturing competitiveness.*

As discussed earlier in this Submission, Australia's manufacturing sector has worked hard to improve its productivity and increase its overall international competitiveness. It needs to do this. The pressures bearing down on Australian manufacturing from global competition, including China, in our domestic and export markets are intense. Proceeding to negotiate an FTA with China will exacerbate these pressures for many companies and sectors. We need to do everything possible to assist Australian manufacturers in this challenge.

It is imperative that the Government abolish immediately the 3% tariff applying under the Tariff Concession Scheme for imports from all countries. This tariff, which adds to the costs of imported business inputs for which there is no domestic producer, was introduced by the Government some years ago as a "temporary" response to a then-difficult budget situation. The Government has repeatedly lauded its record in achieving successive budget surpluses in later years. There are no grounds now for retaining this tax on industry's competitiveness.

It is not sufficient to effectively abolish the 3% duty levied under the TCS just with our FTA partners. In order to take full advantage of any opportunities that an FTA with China may bring to Australian manufacturers, and to be able to compete effectively with China in our domestic market, and third country markets, we must have access to the lowest cost inputs possible from global sources. This demands the immediate abolition of duties on all goods listed in the TCS, sourced from any country.

5. *The Australian Government to clearly demonstrate that it has satisfactorily addressed the concerns articulated by Ai Group in this Submission. Should this occur and industry has given its support to commence FTA negotiations with China, the Australian Government must ensure at the outset that the Agreement will be comprehensive, covering all sectors of trade, services and investment.*

In order for any proposed Agreement to have real merit, it should cover all sectors of trade, services and investment. An effective agreement should weigh "whole of country" issues simultaneously.

Ai Group takes a rigorous position with regard to the definition of a WTO-compliant FTA, which stipulates, “substantially all trade” should move to free trade. Exceptions to free trade should only be under highly limited and extenuating circumstances, in which the overall economic benefit to Australia remains clear.

Liberalisation of trade between Australia and China, if done on an equitable basis, would also have a positive impact on the current round of negotiations in the WTO, which is foundering to some degree, and in need of strong leadership. Australia is a strong advocate of the WTO Doha Round negotiating mandate, and must therefore be seen to apply these principles rigorously if we do not wish to undermine our negotiating position within the WTO.

Further, the opportunity for greatest leverage would be lost if individual products or sectors should be re-visited outside initial bilateral FTA negotiations.

6. Enhanced intellectual property protection is essential. This requires China to implement and enforce effective and commercially realistic penalties that have a clear deterrent effect.

One of the most commonly cited problems in competing with China (whether in China, Australia or in third markets) is the protection of Intellectual Property (IP).

Certainly China is moving to improve intellectual property rights as a result of its WTO accession and its acceptance of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). TRIPS obliges China to adhere to internationally accepted standards of protection for copyrights and neighbouring rights, trademarks, geographical indications, industrial designs, patents, integrated-circuit layout designs and undisclosed information. The TRIPS Agreement also establishes standards for the enforcement of IP rights in administrative and civil actions, and in regard to copyright piracy and trademark counterfeiting, in criminal actions and action at the border. As noted in the US Trade Representative’s “2003 Report to Congress on China’s WTO Compliance”:

“IPR enforcement, however, remains ineffective, and in 2003 the United States repeatedly urged China to take immediate and substantial steps to put it on the path toward compliance with its critical TRIPS Agreement obligation to maintain effective enforcement mechanisms.”

The TRIPS Agreement requires China to implement effective enforcement procedures and to provide civil and criminal remedies that have a deterrent effect. The US Trade Representative’s assessment that this has not yet occurred is reflected in the experiences of Australian industry. Ai Group members state that it is common Chinese practice to simply copy products without any fear of reprisal. Examples are cited such as the case of Xerox who took a Chinese company to court in China for breach of copyright, and although they were successful, were only awarded damages of US\$2000. Once again as noted in the US Trade Representative’s report:

“IPR enforcement is hampered by lack of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for criminal prosecution, lack of training and weak punishments.” And:

“Effective enforcement against IPR infringement in China is universally recognized as the chief concern of IPR rights-holders, as piracy rates in China in all areas, including copyright, trademark and patents, continue to be excessively high.”

If Australia is to enter into an FTA with China, we need to see commitments that ensure China does honour the TRIPS Agreement. As a result, China needs to agree to greater administrative penalties for IPR infringements. Strong leadership and financial support from the Chinese central Government will also be critical in addressing this problem.

Given China’s WTO accession record in the area of IPR, Ai Group has to be realistic as to the likely prospect of such a provision becoming effective. However Australia should not fail to place considerable pressure on China in this regard, as a sustained effort from all WTO countries will be required to achieve significant improvements.

7. If an Agreement goes forward, it should deliver immediate tariff elimination on the largest number of products possible, while accommodating transitional arrangements for sensitive sub-sectors. For those items for which phased tariff reduction is necessary, zero tariffs should be achieved within a maximum of 10 years.

Ongoing and extensive consultation with industry is necessary before any definite position could be put forward in regard to tariff elimination under a proposed FTA with China. Nonetheless, Ai Group research to date clearly shows that certain sub-sectors within manufacturing will require transitional arrangements to accommodate restructuring in preparation for any elimination of tariffs. So far, sectors for which transitional arrangements are felt necessary are TCF, automotive, chemicals and some specialised areas of general manufacturing.

While the overriding goal would be to eliminate tariffs on the largest possible number of tariff lines immediately, nonetheless certain items within manufacturing will require a phased tariff reduction period.

Certainly import sensitive industry sectors such as the automotive and TCF (textile, clothing and footwear) sectors are currently dealing with restructuring in the face of unilateral tariff reduction (in line with Australian government policy) and will require phased tariff reduction. This does not preclude the possibility of zero-for-zero tariff arrangements being suitable on certain items within these manufacturing sub-sectors. Further, a margin of preference allocated to China

on items with retained tariffs, should be matched by a steep reduction in Chinese tariffs on like products, to close the gap in disparity.

Australian tariff rates on passenger motor vehicles, their derivatives, original equipment components and replacement components will be reduced to 10% (from current 15%) in 2005, the year that could conceivably see the commencement of negotiations for an FTA with China. They are set to be reduced to 5% in 2010, and remain at that level until (at least) 2015.

Current tariff rates for the TCF sector are at a maximum of 25% for apparel and certain finished textiles and 15% for footwear and woven fabrics. There are also a number of lines at 0, 5 and 10%. TCF tariffs are to remain at these levels until January 2005, when tariffs on apparel and certain finished textiles, footwear and fabrics have been legislated to decline to 17.5, 10 and 7.5% respectively. In 2010 the 17.5% tariff lines will reduce to 10% and all other items to 5%, and in 2014 all items will be at 5%.

As mentioned above other sensitive sectors will also require transitional arrangements.

An FTA involving a reduction in Chinese tariffs on Australian made goods would provide an additional stimulus to our exports.

China's average tariff rate is currently just over 11% (2003). These have fallen from a simple average of 16.4% in 2000. At that time, among the 7,062 tariff headings, 3,027 were above 15%.

There are still a substantial number of items with significant tariff peaks. For example: certain fruit juices 30%, ice cream 19%, pasta 15%, biscuits 20%, mineral water 27.5%, wine 14%, paints and varnishes 10%, cosmetics 16%, cinematographic items up to 47%, articles of leather 20%, woven fabrics up to 18%, carpets 14%, apparel up to 25%, footwear 24%, stainless steel products 20%, glass 22%, air conditioners 20%, passenger motor vehicles 30%, motor vehicle parts 25%, fishing rods 21%.

Under China's WTO accession commitments it is planned to cut tariffs to an average of 10% by 2010, including an average rate of 9% for industrial products.

By 2010 significant peaks will remain however, on a range of industrial goods. Motor vehicles, for example, will still attract a 25% tariff.

One key consideration in relation to the elimination of Chinese tariffs under an Australia-China FTA is that any preferential tariff arrangements Australia gains ahead of third country competitors would naturally give Australia a competitive advantage. This could well prove critical in the China market.

8. *Transitional safeguards must be in place and readily accessible to support industry from import surges that cause or threaten to cause serious injury.*

WTO members may take a safeguard action (i.e., temporarily restrict imports of a product) to support a specific domestic industry from an increase in imports of any product which is causing, or which is threatening to cause, serious injury to domestic industry.

An import “surge” justifying safeguard action can (and should in this case) be a real increase in imports (an absolute increase); or an increase in the imports’ share of a shrinking market, even if the import quantity has not increased (relative increase).

If the Australian Government were to proceed to FTA negotiations with China, Australian industry is looking to have in place strong safeguard provisions to provide manufacturing ready recourse against import surges from China. This tool of international trade is extremely important as it can be invoked far more rapidly than other tools such as anti-dumping and countervailing duties. This is especially important given the high level of frustration industry has cited in having anti-dumping applications accepted for action, which, when triggered, take a minimum of 60 days and often double this time period for outcomes to flow.

9. *Rules of Origin to follow the product-specific methodology employed in the Thailand-Australia FTA.*

Extensive research undertaken by Ai Group has found that industry considers a Change in Tariff Classification (CTC) based methodology such as the one employed in the Thailand-Australia FTA (TAFTA) to be acceptable.

As Australia will employ the CTC based methodology in our FTAs with Thailand and the USA (and potentially with New Zealand in the future), we believe that a similar principle should be used in all future FTAs. It is desirable that we achieve the highest level of harmonization between the various trade agreements that Australia has or will be party to, so as to reduce the complexity of world trade rules in which Australian companies must operate.

The Rules of Origin (ROO) under TAFTA largely employ CTC tests to confer origin. In other words, CTC tests, which differ slightly for each tariff code, state that, if the imported inputs come from “different parts” of the Customs tariff schedule, then the finished product has undergone sufficient transformation to be deemed as originating. The classifications of the “different parts” of the tariff schedule from which imported inputs may be derived impacts the degree of tariff classification change required.

Some 15% of tariff lines have a local content percentage test applied in addition to the CTC test. The local content test utilises a so-called “Build-Down” formula, which starts at the customs value of the goods (excluding international

transportation costs), and subtracts the value of the non-originating materials. The total is divided by the customs value to get the qualifying percentage.

10. Non-tariff barriers to be addressed with close attention to standards and conformity issues, to ensure equitable treatment.

While high tariffs are an easily identifiable barrier, non-tariff barriers (NTBs) are for the most part, more difficult to quantify and prove, and are more effective at preventing free trade. Within the China market, industry has identified NTBs as being a highly significant issue to be addressed under any proposed FTA. Progress on this issue must occur in order for real gains to be delivered to Australian manufacturing.

Some of the more common non-tariff barriers are: different and conflicting requirements between various spheres of government, market access quotas, onerous customs procedures, restrictive and non-transparent import licensing agreements, non-transparent or unduly restrictive regulations and standards, non-transparent or unduly restrictive sanitary or phytosanitary requirements, local content quotas, government financial support for domestic industries, ownership restrictions, investment restrictions, and ineffective enforcement of intellectual property rights.

Australian industry regularly faces barriers in all these forms and they are having a significantly negative and restraining impact on both trade and investment decisions. These barriers must be addressed as a priority under any proposed FTA arrangements.

Another area that is particularly of concern relates to Technical Barriers to Trade – barriers that occur as a result of technical regulations and standards.

Technical Barriers are a severe threat to free trade and investment, and as such a commitment to reciprocity and transparency would be critical. As with the yet to be ratified AUSFTA (Australia-US FTA) it will no doubt be necessary to establish an ongoing mechanism to facilitate communication and the exchange of information on technical standards and regulations. It is particularly important that the mechanism provides a framework for exporters to work with government on tackling barriers. It is also vital that the mechanism include clear time frames and targets for progress, and sufficient impetus to achieve harmonisation with international norms, and mutual recognition of standards and conformance testing.

With its Accession to the WTO, China also became obliged to honour the Agreement on Technical Barriers to Trade (TBT). This establishes rules and procedures on the development, adoption and application of voluntary product standards, mandatory technical regulations and the testing or certification procedures used to determine whether a product meets such standards or regulations. In particular, the TBT Agreement states that standards, technical regulations and conformity assessment procedures are to be developed and

applied transparently and on a non-discriminatory basis, and should be based on relevant international standards where appropriate.

As in many of the accession areas, China's record on TBT has been patchy. Despite a raft of improvements toward unifying the country's conformity assessment regime, some important commitments have not been achieved. Foreign companies do not have any choice regarding which laboratories they can use to test their products, for example. Further, in a number of sectors (including telecommunications equipment, electrical products, building materials, heating and air conditioning equipment and autos) China has been actively pursuing the development of unique requirements, despite the existence of well-established international standards. A number of other complaints about Chinese standards application persist.

If Australia enters into FTA negotiations with China, it must serve to strengthen ties with Chinese government regulatory authorities, Chinese industry associations and Chinese standards developers, and at the same time ensure close communication exists to achieve transparency. It may also be the case that Australia can offer some technical expertise and assistance to China's standards developments.

11. Barriers hindering bilateral investment flows to be removed and supported by provisions facilitating the temporary entry of business people.

As in Australia's other FTAs, an obligation to provide **national treatment** to the investors and investments of each Party (except where specific reservations are listed) should be followed. Performance requirements (such as export requirements, purchasing requirements, sales restrictions and technology transfer requirements) should be prohibited and protections against expropriation should be included.

In the case of our bilateral relationship with China, Ai Group believes provisions for **investor-state dispute settlement (ISDS)**, along with the government-to-government dispute resolution applying to the FTA as a whole, should be included. ISDS is seen as necessary with China, (as opposed to developed economies), as there are concerns about the transparency and adequacy of its domestic legal processes.

As an FTA is a Government-to-Government treaty, only the Governments of the countries that are a Party to the treaty can usually take action through international dispute settlement procedures in the event of a breach of the treaty. However, FTAs may also provide ISDS mechanisms in relation to its investment provisions, which would allow investors of one Party to take dispute settlement action against the Government of the other Party for a breach of the investment obligations.

In other words, ISDS provisions would give an investor from Australia the right to resort to international dispute settlement procedures in the event that it

believed that the Chinese Government had breached an obligation under the Investment Chapter of the agreement. In such cases, treaties usually provide for the investor to submit claims to an independent body such as: the International Centre for Settlement of Investment Disputes (ICSID) for conciliation or arbitration; or the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL).

Provisions facilitating the temporary entry of business people (and their families) are also important in achieving the benefits of the investment provisions. Issues such as work rights of spouses of people on working visas, visa arrangements for intra-corporate transfers and visa processing times must be addressed.

12. Any FTA negotiations to be part of a global trade strategy encompassing simultaneously multilateral, regional and bilateral activities.

Ai Group believes any FTA with China must not only stand on its own merits, but also be complementary to Australia's position in negotiations in simultaneous multilateral, sub-regional and bilateral activities.

The Australian Government is clearly committed to progressing WTO negotiations to achieve liberalisation and expansion of international trade under agreed and enforceable rules for reciprocal benefit. Simultaneously, Australian Government policy holds that pursuing FTAs is favoured if there are clear commercial and trade policy benefits and if better results can be secured more quickly than is possible in the WTO negotiations. FTAs clearly should be consistent with WTO guidelines.

The WTO and the multilateral trading system have generated significant benefits for Australia and the world economy. Since World War II average tariffs on manufactured goods in industrialised countries have fallen from 40% to 4%. In the same period, whilst there has been some growth in non-tariff barriers, world trade has increased 18-fold.

The role of the WTO is an evolving one to some extent, and with membership of over 140 countries, over two-thirds of which are made up of developing countries, reaching final agreements can be a time consuming process.

While Australia has seen advantage to date in complementing its multilateral and subregional trade action with bilateral FTAs, nonetheless Ai Group reiterates to Government the critical importance in simultaneously progressing all these avenues in order to improve market access for Australian industry.

13. The Australian Government to establish immediately a China Help Desk.

Government assistance, which goes well beyond the export assistance services provided by Austrade, is required by industry in our dealings with China.

Issues and problems relating to competition law, trade remedies, intellectual property, standards and labelling, quarantine, tariff classification and duty assessment for example, need to be covered. These services will not only be extremely helpful if negotiations with China for an FTA proceed, but are already being called for by industry.

A central “China Help Desk” located with the Federal Government will allow easy access by industry as a first stop measure in addressing any issues relating to companies’ involvement with China. “The China Help Desk” to incorporate outreach services provided by industry organisations such as Ai Group.

Appendix 1

China Special Issue Survey – Questionnaire Form

SPECIAL ISSUE – RESPONDING TO CHINA

Q9	What impact is China having on your business in the following areas? (Circle)					
		SIGNIFICANT IMPACT	MODERATE IMPACT	MINOR IMPACT	NO IMPACT	
	As an export market for your domestically produced goods	1	2	3	4	
	As a competitive threat (from imports) in your domestic market	1	2	3	4	
	As a competitive threat to your exports in markets other than China	1	2	3	4	
	As a source of low-cost inputs for your domestic production	1	2	3	4	
	As a destination for foreign investment	1	2	3	4	
Q10	If China is impacting on any of the following, please describe the product line most affected:				OFFICE USE	
	In the domestic market for your goods and services				[]	
	In the Chinese market for your exports				[]	
	In the Chinese market for your foreign investments				[]	
	In other export markets for your goods and services				[]	
	In your purchases of components and other inputs				[]	
Q11	What has been the impact of China on the following areas of your business over the past year: (Circle)					
		Up Significantly	Up Moderately	No Change	Down Moderately	Down Significantly
	Local selling prices	1	2	3	4	5
	Local input costs	1	2	3	4	5
	Local production	1	2	3	4	5
	Selling prices for exports to China.....	1	2	3	4	5
	Selling prices for other exports.....	1	2	3	4	5
	Company profits	1	2	3	4	5
Q12	Are any of your locally sold products facing competition from “below cost” priced Chinese imports?				OFFICE USE	
	Yes 1 -> specify main product line	No..... 2	Don't know	3	[]	
Q13	Please indicate whether EACH of the following describes your company’s response to China: (Circle)					
		Yes	No			
	No need to respond – China is not important to our market.....	1	2			
	Increase domestic productive capacity	1	2			
	Decrease productive capacity	1	2			
	Relocate productive capacity to China (outsourcing), including joint ventures	1	2			
	Relocate productive capacity to a third country (outsourcing), including joint ventures	1	2			
	Import from Chinese suppliers in which your company has no direct investment	1	2			
	Move up the supply chain – increased investment in R&D, product development, etc	1	2			
	Move down the supply chain - investing more in branding or distribution, etc	1	2			
	Accelerate adoption of new technologies	1	2			
	Accelerate pursuit of production efficiencies	1	2			
Q14	What do you estimate to be the financial impact on your firm over the last year in respect of:					
	Lower domestic sales as a result of Chinese import competition	\$ _____				
	Lower sales as a result of Chinese competition in export markets	\$ _____				
	Increased Australian exports to the Chinese market	\$ _____				
	Increased revenue from China-based investments	\$ _____				
	Lower input costs after switching to Chinese suppliers	\$ _____				
Q15	Please specify the most important hurdle to increasing your exports or direct investment in China:				OFFICE USE	
	_____				[]	
Q16	Would an Australia/China Free Trade Agreement be beneficial to your firm? (Circle)					
	Yes 1	No 2	Don't know	3		
Q17	In terms of the Chinese market, are you looking for assistance with: (Circle each that applies)					
	Market intelligence 1	Customs and quarantine issues2	Financing.....3			
	Legal and political issues.....4	Internal regulation issues.....5	Strategic partnering and investment...6			
	Other (Please specify) _____				[]	
	If Yes, where would you look for help? _____				[]	
Q18	What was your total turnover in 2003 (or last financial year)?					
	\$ _____					

Appendix 2

China Company Interview Form



CHINA STUDY REPORT OF COMPANY INTERVIEW

PART 1: COMPANY DETAILS

NAME OF COMPANY: _____

ADDRESS: _____

PHONE: _____

CONTACT PERSON: _____

POSITION: _____

EMAIL: _____

PART 2: GENERAL PERCEPTIONS OF CHINA

Q1 Do you think the continued emergence of China is good for the Australian economy?

(check box)

- Yes
- No
- Don't know

Q2 Could you elaborate on your views as to why China is good/not good for the Australian economy?

PART 3: IMPACT OF CHINA ON FIRM

Q3 Has China impacted on your firm through its emergence as:

(tick all appropriate)

	TICK	(Interviewer) Seek response for
An export market for domestically produced goods	_____	Q4
A competitive threat in your other export markets	_____	Q5
A competitive threat in your domestic market	_____	Q6
A new source of low cost imports for your domestic production	_____	Q7
A destination for foreign investment	_____	Covered from Q14
China has had no impact	_____	

(Interviewer note: should ask firm questions six through nine having regard for boxes ticked in Q3)

Q4 Can you describe a product line for which export sales to China have improved over the past two years? (specifically seeks to provide a real world example to back quantitative data)

Q5 Could you provide an overview of a product line for which sales (or margins) to other export markets have been affected by China over the past two years? (specifically seeks to provide a real world example to back quantitative data)

Q6 Do you have any examples of a product line for which domestic sales (or margins) have been affected (or is under threat) over the past two years by China? (specifically seeks to provide a real world example to back quantitative data)

Q7 Can you describe a product line which has benefited from China as a source of low-cost inputs to production over the past two years? (specifically seeks to provide a real world example to back quantitative data)

Q8 Can you describe any product lines which have been affected by dumping of products from China priced below cost?

Q9 Overall, how has China's impacted on your firms performance over the past two years?(seeking broad ranging response without prompting)

Q10 More specifically, over the past two years, what impact has China had on your firm in terms of? (seeking impact across a range of measurable financial performance indicators)

(check box for each item)

	Up significantly	Up moderately	No change	Down moderately	Down significantly
Domestic sales (market share)					
Export sales (market share)					
Overall market share					
Domestic selling prices					
USD export prices					
Input costs					
Domestic investment					
Foreign investment					
Domestic employment levels					
Domestic production levels					
Foreign production levels					
Local profits					
Global profits					

PART 4: FIRM RESPONSES TO CHINA

Q11 How has your firms strategies for growth and survival changed over the past two years as a result of China? (prompt on changes to strategies – products, production, investment, staff)

Q12 (if not covered above, prompt on following) To summarise, which of the following best describes your firms response to the emergence of China?

(tick all appropriate)

	TICK
No need to respond – China is not important to our market	_____
Increased domestic productive capacity	_____
Decreased domestic productive capacity	_____
Relocating some/all productive capacity to China (outsourcing), including by means of joint ventures, etc	_____
Relocating some/all productive capacity to a third country (outsourcing), including by means of joint ventures, etc	_____
Importing from Chinese suppliers in which your company has no direct investment	_____
Moving up the supply chain – increased investment in research, innovation, product development, etc	_____
Moving down the supply chain - investing more in branding or distribution activities, etc ...	_____
Accelerated adoption of new technologies	_____
Accelerated pursuit of production efficiencies	_____

Q13 More specifically, how has China changed the way your firm views its commitment to producing locally versus offshore? (prompt on any outsourcing, changes to productive capacity)

Q14 Does your firm have a direct investment in a Chinese-based entity or venture?

(check box)

- Yes, have made direct investment -> Go to Q15
- No -> Go to Q17

Q15 What was the rationale or business motives behind the Chinese investment?

If not covered above, interviewer to prompt on:

(i) when investment occurred -> _____

(ii) control and ownership arrangements -> _____

(iii) types of products produced by Chinese entity -> _____

(iv) where products produced are distributed/sold (tick below)

- For re-export back to Australia for use as inputs to production process
- For direct sale in Chinese market
- For sale in other export markets

Q16 Could you describe any barriers or difficulties your firm encountered in directing investment towards China? (prompt on Chinese bureaucracy, difficulty in finding suitable partners)

Q17 Could you outline an example of an input to the production process for which you have increased imports from China at the expense of domestic suppliers? (prompt on size of lost domestic purchases)

Q18 What implications has or will China have for your firms commitment to environmental goals or strategies?

PART 5: LONGER TERM COMPETITIVENESS ISSUES

Q19 On what basis then do you see your firm as being able to compete with China, if at all, over the next two years? (seeking source of competitive advantage, lifting investment in China, even a response that firms don't know how they will survive would be interesting)?

Q20 (If not covered above) How would you describe China's impact on where you see your firm operating on the supply chain over the next two years? (prompt on issues such as moving up the supply chain through R&D, investment etc, or moving down the supply chain into distribution, logistics, service etc or staying put)

Q21 Considering the current capabilities of your firm, do you feel you are now in a position to successfully compete with China, or exploit opportunities presented by China?

(check box)

- Yes, fully able -> Go to Q25
- Yes, somewhat able
- Not able
- Don't know

Q22 If less than fully able, what other measures do you see as critical for your firm to implement in order to successfully compete with China?

Q23 Are these measures in the process of being implemented?

(check box)

- Yes
- No
- Don't know

Q24 If No, why not?

Q25 What assistance would benefit your firm in dealing with issues surrounding China?
(prompt on market research, finding business partners, legal issues, customs and quarantine,
financing)

Q26 Who would you go too to get such assistance?

PART 6: AUSTRALIA-CHINA FREE TRADE AGREEMENT

Q27 Does your firm face any barriers to doing business in China?

(check box)

- Yes -> Go to Q28
- No -> Go to Q29
- Don't know -> Go to Q29

Q28 What do you see as the key impediments to doing business in China?

Q29 Do you regard China as: (tick one)

- A free market economy
- A state-controlled (or command) economy
- An economy in transition between these two states (above)
- Don't know

Q30 Do you consider China's industrial labour costs to be in accord with free market practice?
(tick one)

- Yes
- No
- Don't know

Q31 Do you believe Australia should be actively pursuing a free trade agreement with China?

(check box)

- Yes -> Go to Q33
- No -> Go to Q32
- Don't know -> Go to Q33

Q32 Why don't you feel Australia should be pursuing an FTA with China?

Q33 From an Australian perspective, what do you think should be the objectives of any FTA? (for instance, cutting China's bureaucratic barriers, cutting investment barriers, protecting parts of local industry, reducing all tariffs to zero asap etc)

Q34 Are there any sectors of the Australian economy that should retain some degree of protection in any FTA with China? Which sectors?

Q35 Why do you feel these sectors need differential treatment?

Q36 What impact would an FTA imposing zero tariffs on all manufactured products have on your firm? (prompt on a range of issues such as ability to survive, production methods, outsourcing, export strategies etc)

Q37 Do you consider China's development to be: (tick one)

- An opportunity for your business
- A threat to your business
- Both a threat and opportunity
- Too early to say

Appendix 3

Australian Manufacturing and China: Opportunities and Challenges

Appendix 4

Letter to the PM from Ai Group on Anti-Dumping matters



28 May 2004

The Hon J W Howard MP
Prime Minister of Australia
Parliament House
CANBERRA ACT 2600

Dear Prime Minister

CHINA & AUSTRALIA'S MANUFACTURING INDUSTRY

China's economic development is having a profound impact on economies around the world including Australia's.

As Ai Group stated at the time, the Australian Government's decision to engage in a Trade & Economic Framework (TEF) arrangement with China is enormously significant.

As you well know, a principal focus of the TEF is to undertake a feasibility study into the potential for a Free Trade Agreement (FTA) between our two countries. The decisions we make as a result of this study, particularly if Australia agrees to proceed with FTA negotiations with China, will be truly historic.

Ai Group is currently undertaking a major survey of our industry, supplemented by interviews with a wide range of company CEO's, as part of our input to the feasibility study process. We are working very closely with a range of department officers on this study, spearheaded by the Department of Foreign Affairs and Trade. In addition, I will be leading an Ai Group senior delegation to China in August/September as part of our strategic assessment of the China market.

In all of these activities, the co-operation Ai Group has received from the various Government agencies has been exemplary.

This week, Ai Group's National Executive met in Canberra and discussed at length the TEF between Australia and China and the prospects for the possible progression to commence discussions on an FTA.

While Ai Group fully appreciates the enormous opportunities which China is offering to markets all around the world, including Australia, there are nonetheless some issues which Australia needs to watch very carefully. It is too early yet to be able to convey to you the results of our industry survey work on China, however there is one issue regarding our anti-dumping regime which is already causing deep concern in industry which I wanted to bring to your attention.

In a general sense, our National Executive expressed its concern about the chronic difficulties Australian industry has in trying to produce evidence establishing "normal value" for products originating from a range of countries and claimed to be dumped on the Australian market.

When this general concern is focused specifically on anti-dumping cases relating to China, the difficulties are compounded dramatically. The principal reason for this added concern in relation to China is due to the technical issues relating to the definition of China as an "Economy in Transition (EIT)".

Ai Group understands from Government officials that if Australia proceeds to an FTA with China, it will be on the basis that Australia agrees to change the official status of China from an EIT to a "market economy". This change in market status for China compounds the concerns industry has in relation to Australia's anti-dumping regime.

Accordingly, Ai Group's National Executive passed a formal resolution which I have been asked to convey to you personally and to some of your relevant Ministers. The National Executive resolution is attached for your consideration.

Ai Group is fully aware that this matter will be the subject of intense analysis during the feasibility study period. Ai Group will be doing everything possible to safeguard the interests of our industry according to the attached policy position.

I would be very happy to discuss this issue with you and your other responsible Ministers at any time.

Yours sincerely,



Heather Ridout
CHIEF EXECUTIVE

c.c. The Hon Mark Vaile MP, Minister for Trade
The Hon Alexander Downer MP, Minister for Foreign Affairs
The Hon Ian Macfarlane MP, Minister for Industry, Tourism and
Resources
Senator the Hon Chris Ellison, Minister for Justice and Customs

Ai GROUP NATIONAL EXECUTIVE

RESOLUTION

CHINA AND ANTI-DUMPING

1. Ai Group expresses its deep concern regarding Australia's anti-dumping regime in relation to China.
2. Ai Group is currently co-operating with the Government in the study on China under the Trade and Economic Framework arrangement to determine whether Australia should commence negotiations with China for a Free Trade Agreement.
3. As part of this study, Ai Group is strongly opposed to the granting of market economy status to China unless the Government can clearly demonstrate Australia's manufacturing interests are not disadvantaged in relation to anti-dumping procedures. Within this context, it is essential that industry get access to reliable normal value information.

26 May 2004

Appendix 5

Letter to Ai Group from ACS on Anti-Dumping matters

Appendix 6

Letter to Ai Group from DFAT on Anti-Dumping matters