

TRADE POLICY ISSUES

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Summary

This short paper detailing trade policy considerations argues Australia and China are at a juncture in their respective development paths which allows them to choose to enter a significantly closer economic relationship with free trade in goods without exception, opened access in services and freer and secure investment. This would be in both countries' interests.

The vehicle should be a WTO plus Free Trade Agreement (FTA) fully within the rules of GATT Article XXIV and the Understanding on the Interpretation of GATT Article XXIV. That is, there should be no exemptions to coverage and all phasing should be completed within 10 years from date of entry into force. In short, the objective should be a high quality agreement of the Australia New Zealand Closer Economic Trade Relations Agreement (CER) kind. The Leaders of the two countries should, after taking into account the Feasibility Study for a FTA, give directions publicly to their negotiators to achieve this outcome by a set near term date at the end of 2005.

Reasons are given why this objective is both highly desirable and achievable. A principal reason is that the dynamic to achieve this presently exists in both countries – China strongly wants and deserves to climb out of the discriminatory application of excessive trade remedy measures imposed by the largest economic powers in the WTO under the WTO rules set for non-market economies. Australia has the ability to grant this status to China for trade to Australia without foregoing a reasonable ability to apply trade remedies to unfair and injurious imports from China.

This grant to China would not be without cost to Australia and in return Australia would need a high quality agreement. The economy wide effects of such an outcome for both countries would be very positive. Current debate in Australia over Free Trade Agreements has underlined the value of high quality agreements.

Some proposals for inclusions in a closer economic relations WTO plus FTA also are included.

Trade Policy Issues

Background

Australia and China already have a vibrant, expanding and substantial trade in goods and services. The trade flows occur over thousands of tariff lines in both directions. Generally the trade flows in both goods and services are in products and sectors which arise from natural comparative advantage. The structure of the two economies is very complementary. There are also investment links in both directions and these will expand with economic growth and the opening up of the factors that govern investment.

Economic growth performance in both countries is proving to be both high and sustained. This is to be expected as both countries have pursued significant micro and macro economic reforms for more than 15 years. Both countries are at the head of the tables of developed and developing country economic growth performance. Strong economic growth helps economies to undergo economic and social change while at the same time underpinning future growth performance. A natural economic affinity exists between Australia and China. Other conference papers will discuss and detail these aspects.

This setting opens the door to both countries seeking policies to enhance their respective interests. These interests are not just economic interests but extend across the spectrum of interests, including security, close and productive bilateral and regional stability and good relations interests.

Trade Barriers - Goods

Significant trade barriers confront trade flows in both directions – with China having somewhat higher and more extensive protection than Australia. China has made enormous progress in dismantling the formidable trade barriers in place before China's accession to membership of the WTO on 11 December 2001. Suffice to say in this paper the main remaining protected sectors Australia faces in trade in goods to China are agricultural products and processed food, raw material fibres – wool, wool tops and cotton, some mineral products, petroleum products and a range of manufactured items, machinery, textiles and clothing, steel and motor vehicles and components.

Tariffs are not the only impediments in both countries. China still deploys a range of other protective mechanisms such as tariff-rate quotas

(regarded as a tariff under WTO rules), designated trading, state trading, restricted trading rights (to be fully liberalized in December 2004), import quotas on motor vehicles (WTO illegal but sanctioned until 2005), and less than satisfactory at times Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) administration to name the more obvious.

Australia has remaining tariffs with protective incidence on certain textiles, clothing and footwear, and motor vehicles and of course less than fully objective criteria in the trade remedy area for non-market economies. Other tariffs are of a nuisance kind. Reform of SPS measures remains a controversial and slow moving area in both countries and higher priority to WTO SPS Agreement consistent outcomes will be in both countries' interests.

Trade in Services

Trade in Services is presently governed by the General Agreement on Services (GATS) and commitments made under it. While China's WTO services commitments schedule compares very favourably with that of other developing country WTO members, both countries have scope and interest in expanding their commitments and services trade.

Trade in services is substantially in Australia's favour in terms of flows but the nature of the services provided is of great value to China (e.g. basic and higher education, technical know-how for agriculture, food processing, raw material exploration, mining, manufacturing, knowledge intensive professional and business services, telecoms, distribution, financial and legal, government services, etc.). China still retains much regulation and preferment of local service providers. This is diminishing under WTO accession – with the most valuable liberalization agreed to extend over the two years commencing December 2004. Nevertheless, China will retain significant restrictions on pricing, ownership, business scope or region and further liberalization would boost efficiency and more meaningful and better paid employment for Chinese workers. Australia too could benefit from a freer flow of services from Chinese service providers.

Benefits and Scope from Trade Liberalization in Goods and Services

Economists are quick to point out correctly that selective discriminatory trade liberalization is not “first best” policy. This said, unfortunately the real alternative is frequently little or no liberalization. The WTO world is already divided by a massive and expanding European Common Market and the world's largest economy – the USA - also has an expanding

network of WTO plus FTAs. Others, including China, have or are seeking FTAs or regional preferential arrangements. Notwithstanding recent steps by China and Australia to pursue various preferential arrangements with some of their trading partners, a step now to consider an FTA between them has compelling economic and political logic. For countries with the economic capabilities and natural comparative advantage that Australia and China possess it would be folly not pursue this because of the value it could deliver to them and because of what is happening with such arrangements globally.

Indeed, it represents for Australia a better long term outcome than the historic and valuable Australia Japan Treaty on Commerce of 1957 because it could free trade in all items quite quickly and so capture substantially the benefits of significant trade liberalization for the two countries. Perhaps more importantly it would move both economies to the point where the outcomes could be extended to all countries in a reasonable time frame so strengthening the multilateral framework. And there is a parallel worth recalling in that Australia had to undertake something politically unpopular in the Treaty on Commerce of 1957 – agree not to discriminate against Japanese products in the Australian market – which Australia had been doing by applying higher tariffs to Japanese goods and discriminating against Japan in the issuance of import licenses.

Unlike the setting for the Australia Japan Treaty on Commerce of 1957 the extent and height of protection between Australia and China today is quite different. The challenge of agreeing full liberalization across all sectors within a reasonable timeframe is quite achievable, even in the highly protected areas. Data demonstrating this is contained in the separate conference presentation by this speaker and much additional corroborating data is available. This is a fundamental point. The Feasibility Study should focus substantially on this material. It differentiates the difficulty of negotiating a high quality initial FTA (and the associated political issues) from the starting points that existed with the Australia United States FTA and the Australia Thailand FTA.

For the achievement of reducing protection over the past twenty years, successive Chinese leaderships at the national and provincial level deserve enormous credit. (Of enormous discredit to the leaderships of the major developed nations and many developing countries is the extent and height of remaining protection in their highly protected sectors and across their economies which has persisted or even grown over the decades). In terms of the protection reform steps taken over the past decade and a half, Australia and China stand very tall among most developed and developing countries. They share a common interest in

pressing their achievements and the benefits of strong economic performance on their trading partners. More important than pointing out this hard won outcome is grasping new reform opportunities to continue the reform effort.

Dynamic for Success

Each negotiating partner in this possible negotiation has a major but different important objective. The achievement of the objective entails real political difficulty for both. For China, it is to match the ambition of Australia for complete coverage and reasonable timeframes for achievement – not just perhaps an objective of the general body politic (some of which will have unrealistic non-trade demands) but also wide sections of efficient Australian producers of goods and services. For Australia, it is to match this liberalization and grant to China, status as a “market economy” and apply this under trade remedies (principally anti-dumping action) to Chinese imports into Australia. It would also require Australia to argue for this treatment for China in the WTO and bilaterally.

This is a good bargain with great gains for both countries and is achievable with appropriate will and skill on both sides. The Leaders of Australia and China should go further than their Governments good statements of general interest and position made on 24 October 2003 by their Trade and Commerce Ministers in their presence. The Leaders should, at the appropriate time next year, set clear objectives of the above nature for their negotiators. This is essential if special interests in the communities and in the Governments of both countries are not to oppose, diminish and delay the negotiating process and outcomes. In other words a whole of government approach is necessary from the outset.

“Market Economy” Status

Other papers and presenters will deal in detail and discuss the technicalities involved in the “market economy” status issue. Despite what might be said in the future debate on this issue do not accept any assertions that Australia would be giving up its right to apply dumping duties or WTO countervailing rights against injurious imports from China. Australian Customs authorities would have to follow the more onerous general WTO based provisions already enshrined in Australian Customs law and practice which apply to nearly all WTO members. And remember Australia made a concession to China in this general area of Customs administration (“economies in transition”) in 2000 which China appreciated and which has paid good dividends for Australia and has

been accepted by the small section of Australian industry initially opposing it.

Reversing this approach and effectively joining with the US and the EU, as the Australian Government proposed in 2003, was threatening to damage the bilateral relationship with China. This approach must now be permanently abandoned. Australia can and must go further. New Zealand has announced its willingness to recognise “market economy” status for China. Granting market economy status would also buttress Australia’s right to expect and receive full reciprocal treatment of Australian goods in China –in practical terms not a foregone conclusion at present with Chinese investigators and processes at an elementary stage of development.

Is China a “market economy”?

At this point, not quite. Difficulties still exist in the remission of funds out of China despite the steps taken to achieve the full convertibility of the RMB. State trading enterprises are not fully corporatized and separate from the State. The Chinese financial sector is still carrying large non-performing loans and is still extending credit on non-commercial terms. The process of reform however continues and the final phase of the WTO Accession will secure further improvements.

The real question to be asked is – “Is any WTO member a complete market economy?” The answer is a qualified no. The US, EU and Japanese agriculture sectors have massive support and assistance to avoid the normal operation of markets and these distortions affect the terms of competition between domestically produced goods and services and imports in ways very similar to past or present Chinese Government intervention. Yet these WTO members enjoy “market economy” status in the WTO for trade remedy actions concerning their agriculture sectors. Many other country and sector examples could be given. China’s transformation from a command economy has come an enormous distance and it is now possible to grant “market economy” status if a relatively few remaining, if difficult, liberalization and deregulatory decisions can be agreed as part of an FTA package.

WTO requirements for FTAs

GATT Article XXIV applicable to goods requires essentially that “substantially all trade” be covered by a proposed FTA, duties and other regulations of commerce not be raised against other parties and that

agreements be achieved “within a reasonable length of time” - paragraph 5(c).

Article V of GATS requires for services “substantial sectoral coverage”, “absence or elimination of substantially all discrimination, in the sense of Article XVII” between the parties in areas subject to the Agreement (National Treatment), prohibition of new or more discriminatory measures, and these to be achieved in a reasonable timeframe except for some defined exceptions.

The Understanding on the Interpretation of Article XXIV argued for by Australia among others in the Uruguay Round negotiations provides inter alia, that the “reasonable length of time” referred to in paragraph 5(c) should exceed 10 years “only in exceptional cases”.

WTO plus considerations

It is common with modern FTA agreements to be of a WTO plus kind. An Australia China Free Trade agreement embracing closer economic relations might include Agreements covering –

- Investment promotion and protection
- Customs Administration and Cooperation
- SPS and TBT Administration and Cooperation
- Intellectual property protection Administration and Cooperation
- Competition policy Cooperation
- Paperless trading
- E-Commerce
- Government Services
- Education
- Tourism and Hospitality
- Food Standards and
- other worthy areas for fruitful cooperation and improvement

Conclusion

The ideas set out above are all the subjects of modern trade policy and provide a rich agenda for discussion and development. The arguments in this paper highlight the benefits of firmly grasping the opportunity to negotiate a high quality Free Trade Agreement between Australia and China. Such an Agreement would advance the economic and wider strategic interests of both parties and would also be consistent with the

opening-up policies both countries have pursued so successfully for the past two decades.