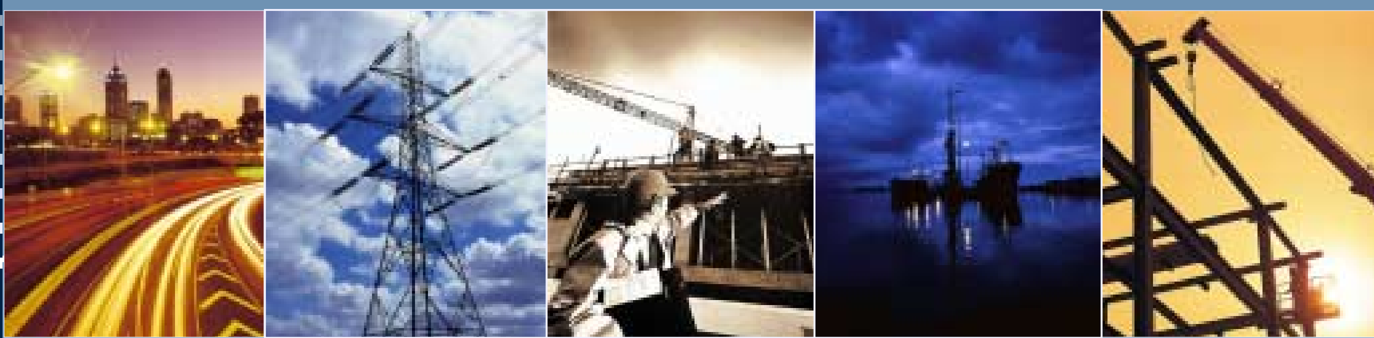
Australia-China Free Trade Agreement

A Submission to the Department of Foreign Affairs and Trade Joint Feasibility Study into a Proposed Free Trade Agreement between Australia and China

December 2004



CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

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Introduction and Overview

About CCI

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

Background and Introduction

In October 2003 Australian Trade Minister Mark Vaile signed the Trade and Economic Framework between Australia and China with Chinese Vice Minister for Commerce, Yu Guangzhou, in the presence of Prime Minister John Howard and Chinese President Hu Jintao.

The Trade and Economic Framework sets the direction for the future direction of the expanding trade and economic relationship between Australia and China.

A key element of this framework is the commitment to undertake a joint feasibility study into a possible free trade agreement (FTA) between Australia and China. The feasibility study is aimed at identifying the opportunities and challenges of such an agreement prior to any decision being taken to commence negotiations. The terms of reference of the joint feasibility study are detailed in the Appendix.

This submission is divided into three sections.

- The first section provides background information on the developments in the Chinese economy and its growing importance in the global economy.
- The second section provides an analysis of the bilateral trade relations that exist between China and Australia, and more specifically Western Australia.
- The third section discusses the likely benefits that can be achieved through a free trade agreement with China, as well as some specific issues of relevance to Western Australia that need to be addressed as part of the negotiations.

Executive Summary

China is playing an increasingly integrated role in the global economy as it continues its extensive program of economic and institutional reform. Paramount among China's reforms have been those linked to its accession to the World Trade Organisation (WTO) in 2001, which has opened China's doors to trade and extended its business links into the region and beyond.

Australia enjoys strong and wide-ranging economic complementarities with China which bolster economic and trade ties. China has become Australia's third-largest merchandise trading partner and over the 2003-04 financial year moved ahead of the United States to become Australia's second-largest merchandise export market.

China has recently become Western Australia's second largest trading partner, due to strong growth for Western Australia's key commodity exports such as iron ore, alumina and petroleum. Recent contracts, such as signing of a $25 billion contract to supply China with LNG over the next 25 years, will be expected to further boost Western Australia's exports to China from 2006.

While commodity exports to China have been significant, services exports to China are also growing. With China's growth pushing its population's living standards and disposable incomes to new highs, this should create further opportunities for increased trade in professional services, eucation and tourism, as well as increased trade in consumer goods.

These gains will be consolidated through implementation of the Trade and Economic Framework, which sets the agenda for strengthening and expanding Australia and China's trade relationship over coming years. It is also expected to provide a sound foundation for each side to take advantage of new commercial opportunities, focusing on identifying opportunities for closer cooperation and developing strategies to promote business opportunities in areas of high potential.

A key element of this framework is the commitment to undertake a joint feasibility study into a possible FTA between Australia and China. While trade barriers have been reduced as part of China's accession to the WTO, significant barriers still remain, particularly in the agricultural sector. However, Australia also has a range of barriers that impact on the free flow of goods and services with China – particularly in relation to business and student visas.

Removing these restrictions will be crucial in helping to deliver the likely benefits from a FTA with China.

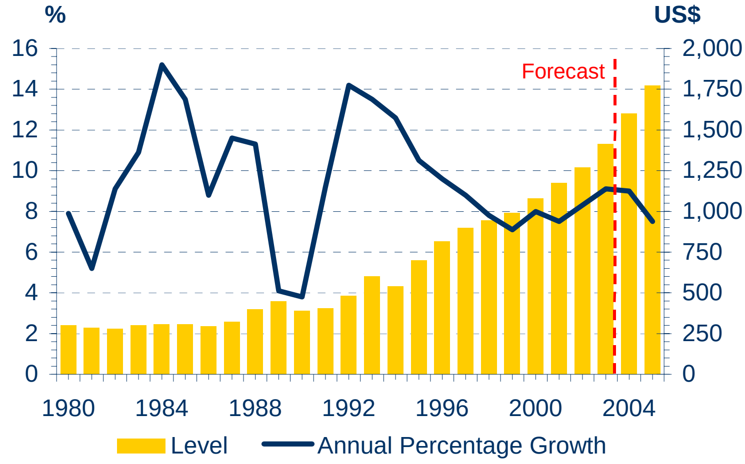
China Economic Overview

Background

Since the inception of economic reforms in the 1970s, China has had one of the fastest growing economies in the world. Between 1980 and 2004, China's real GDP expanded more than five-fold, with an average annual rate of growth of 9.5 per cent over this period. Australia's economy grew at 3.3 per cent a year over the same period.

This impressive growth record is reflective of the transition in the Chinese economy to an industrialised economy, with the level of investment increasing by an average of 20 per cent each year since 1986[1]. Investment activity in China in 2003 was 16 times larger than the level of activity in 1986.

Figure 1
China: Real Gross Domestic Product
Level and Annual Percentage Change



Source: International Monetary Fund

Gross fixed capital formation in China was 45 per cent of GDP in 2003, and has averaged around 38 per cent of GDP since 1986. By comparison, the rate of capital formation in Japan during the period of its industrialisation (from 1969 to 1990) was 31.5 per cent.

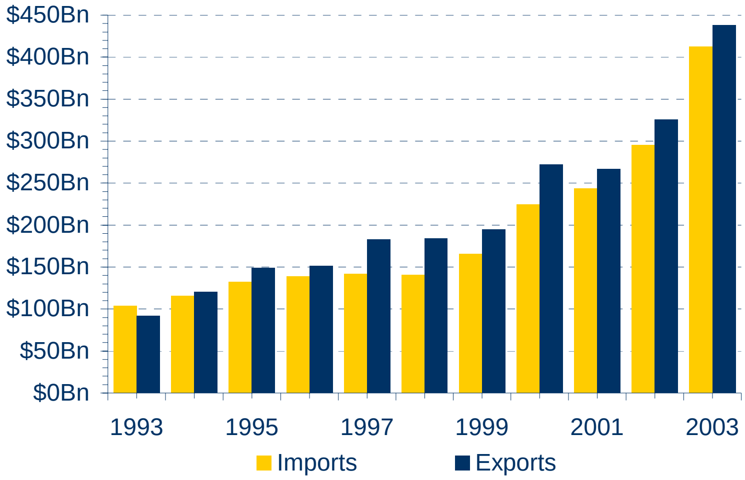
Growth in international trade has been the other key development in the Chinese economy. Since 1980, exports from China have increased by an average annual rate of 17 per cent (to US$438 billion), while imports have increased by 14 per cent (to US$413 billion). Growth in international trade was particularly strong in 2003, with exports increasing by 35 per cent, while imports grew by 40 per cent.

China's growth has been a key driver of global economic growth over the past few years. Its strong demand for energy and metal commodities has helped to drive up the price of these commodities, boosting profitability for businesses and generating export-driven growth for its trading partners.

Japan, which is China's largest trading partner, has been a significant beneficiary of the strong Chinese economy, helping to push it towards a sustained period of economic growth in recent years after experiencing a series of rolling recessions since the early 1990s.

The International Monetary Fund (IMF) estimates that in 2004 China's GDP at market exchange rates ranked sixth in the world, behind the USA, Japan, Germany, the UK and France. Adjusting for exchange rate effects, China's GDP at purchasing power parity is now estimated to be the second largest in the world, after the USA. It has overtaken Brazil, the UK, France, Italy, India, Russia and Germany in the past 20 years.

Figure 2
Merchandise Exports and Imports, China
US$ Billions



Source: International Monetary Fund

Despite its rapid advancement, China's per capita GDP remains well below the advanced economies, at about 14 per cent of the USA's even when exchange rates are taken into account. However, in 1981 China's per capita GDP was three per cent of the USA's.

China is the world's most populous country, with an estimated 1.3 billion people in 2003. China's strong and sustained economic growth in recent years has been a key factor in what is arguably the most rapid and marked improvement in human economic welfare in history. According to estimates from the World Bank, the percentage of China's population living in absolute poverty[2] has fallen from 634 million (or 64 per cent of its total population) in 1981 to 212 million (or 17 per cent of its total population) in 2001[3]. The marked reduction in China's absolute poverty rate is testimony to the effects of two decades of strong economic growth.

Structure of the Chinese Economy

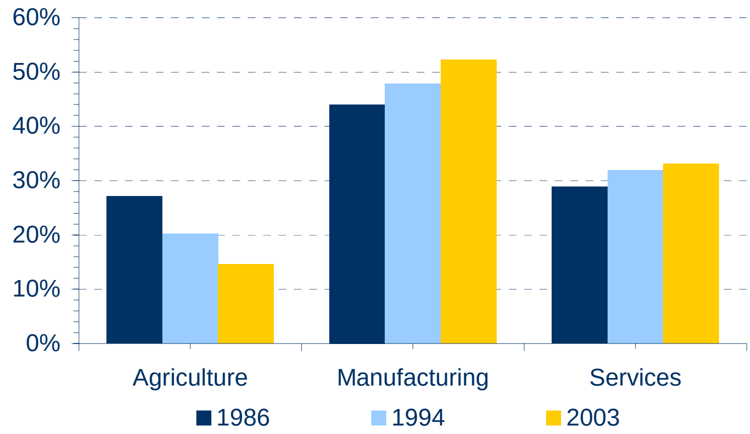
The process of China's rapid industrialisation has resulted in significant changes to the structure of its economy. While agriculture remains an important contributor to China's economy, its relative importance compared to manufacturing and services industries has declined over the past 20 years. Agricultural output as a percentage of total output fell from 27 per cent in 1986 to 15 per cent in 2003.

By contrast, the manufacturing and services industries have increased in importance over the same period, with manufacturing output increasing from 44 per cent in 1986 to 52 per cent in 2003, while the services sector has gone from 29 per cent to 33 per cent of total output over the same period.

These trends are consistent with the transition to an industrialised economy.

Much of the agricultural sector in China is small-scale (China's average farm size is one of the smallest in the world) and generally uncompetitive in international markets[4]. This sector has historically benefited from high tariffs, and therefore faces some significant competitive challenges over the coming years.

Figure 3
Structure of Chinese Economy
Sector Percentage of Total Output, 1986-2003



Source: International Monetary Fund

Along with the structural changes to the Chinese economy has been a significant transformation of the labour force over the past 20 years. According to statistics from the IMF, the share of the workforce employed in agriculture has declined from around 61 per cent in 1986 to just under 50 per cent in 2003. The number of people employed in agriculture peaked at 391 million in 1991, and has since declined in absolute terms, with around 365 million people employed in the agricultural sector in 2003. By contrast, 170 million more people were employed in the services sector in 2003 than in 1986.

International Trade

Since the beginning of its "Open Door Policy" in 1979, China's international trade has grown substantially. According to the WTO[5], China was the world's fourth-largest exporter of merchandise in 2003, accounting for 5.8 per cent of the total global export market. Only Germany, the USA and Japan exported more than China in 2003. By comparison, in 1993 China only accounted for 2.4 per cent of total global merchandise exports.

In addition, China was also the world's third-largest importer, and accounted for 5.3 per cent of total world imports in 2003, behind the USA and Germany. A decade previously China accounted for 2.7 per cent of global merchandise imports.

China ranked as the ninth largest exporter of commercial services (accounting for 2.6 per cent of total global exports in commercial services) and eighth largest importer (with 3.1 per cent). China accounted for just 1.2 per cent of total global exports and imports of commercial services in 1993.

China has a large and growing foreign trade surplus. In 2003, China's surplus reached US$46 billion, or 3.2 per cent of GDP, which compares against a surplus of just US$0.3 billion, or 0.1 per cent of GDP in 1980.

The USA was China's principal export destination in 2003 (accounting for 21.1 per cent of total exports), followed by Hong Kong (17.4 per cent), Japan (13.6 per cent), South Korea (4.6 per cent) and Germany (four per cent). Australia ranks as China's 12th largest export destination, accounting for 1.4 per cent of total exports in 2003.

China's principal import sources in 2003 were Japan (18 per cent), Taiwan (11.9 per cent), South Korea (10.4 per cent), the USA (8.2 per cent) and Germany (5.9 per cent). Australia ranked as China's 12th biggest import source, accounting for 1.8 per cent of total imports in 2003.

Table 1
China's Global Trade Relationships, 2003

	Major Export Destinations			Major Import Sources		
Rank	Country	$US million	% of Total	Country	$US million	% of Total
1	United States	92,633	21.1%	Japan	74,151	18.0%
2	Hong Kong	76,289	17.4%	Taiwan	49,127	11.9%
3	Japan	59,423	13.6%	South Korea	43,135	10.4%
4	South Korea	20,096	4.6%	United States	33,934	8.2%
5	Germany	17,536	4.0%	Germany	24,391	5.9%
12	*Australia*	*6,134*	*1.4%*	*Australia*	*7,301*	*1.8%*

Source: International Monetary Fund

Outlook

There has been a modest slowing in growth in the Chinese economy in recent months following the announcement in May 2004 of measures aimed at curbing over-investment in certain sectors and reducing credit and money growth. Chinese authorities also lifted interest rates in October, following concerns that investment growth had not slowed to the extent needed.

Despite these measures, real GDP rose by 9.6 per cent over the year to September 2004. However, there has been some slowing in those areas targeted by the Chinese authorities, with investment in capital coming down to 28 per cent over the year to September, compared to more than 50 per cent at the start of the year.

The IMF predicts that these measures will help to slow the Chinese economy, with growth expected to slow from a forecast 9.1 per cent in 2004 to 7.5 per cent in 2005.

There are, however, a number of risks that could temper this still rather positive economic outlook, ranging from the impact of higher oil prices to the future floating of the Yuan. The parlous state of China's banking system, which is burdened by a large number of non-performing loans, is also of concern, with some reports suggesting that these non-performing loans may account for up to 50 per cent of total loans[6]. The combination of a badly functioning banking system, excessively cheap money and a heavy handed government is bound to result in some bad investment decisions. However, even if some of these investments prove to be wasteful, it is unlikely that this will dramatically affect China's long term economic future.

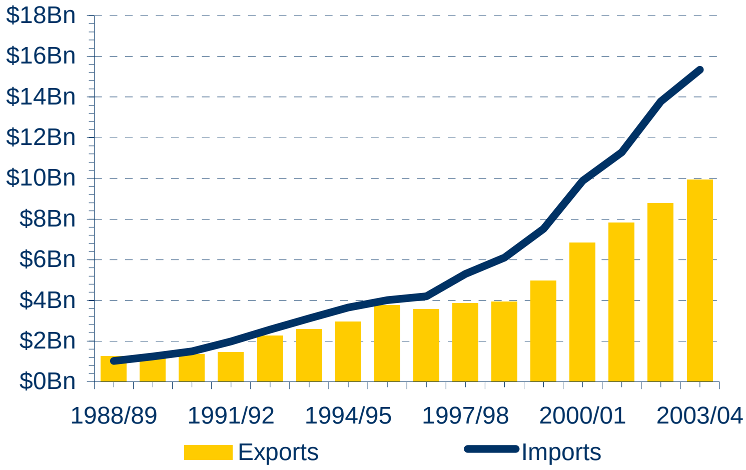
Australia-China Trade

Australia

Australia has benefited greatly from China's rapid economic development through an ever expanding trade relationship. For example, Australian exports to China have grown on average by over 16 per cent per annum for the past 15 years, and in the process China has become Australia's second largest merchandise export market after Japan, worth $9.9 billion in 2003-04. Over the past 15 years, China has overtaken the United States, New Zealand, South Korea, Hong Kong, Taiwan, the UK and Singapore in terms of importance as a destination source for Australia's exports.

Australia's traditional export products continue to make up the bulk of its exports to China. In 2003-04, Australia's largest exports to China were iron ore ($1.9 billion), wool ($1.1 billion), crude petroleum ($670 million), coal ($325 million) and aluminium ($276 million).

Figure 4
Australian Export Credits and Import Debits
China, $ Billion



Source: ABS Cat No.5432.0

China has also become an increasingly significant source of imports into Australia, accounting for 12 per cent of Australia's total imports in 2003-04 ($15.3 billion). Only the United States and Japan provide Australia with more imports than China.

In 2003-04, Australia's major imports from China were clothing ($2.4 billion), computers ($1.4 billion), toys, games and sporting goods ($974 million), telecommunications equipment ($722 million) and furniture ($562 million).

Australia has a growing merchandise trade deficit with China, with a deficit of $5.4 billion recorded in 2003-04 (compared to a deficit of $230 million in 1988-99).

Australian service exports to China are also rising, reaching $1 billion in 2003 and making China our seventh largest services market. Growth in services exports is likely to grow strongly in the future, particularly as China's middle class expands.

China's granting to Australia of Approved Destination Status (ADS)[7] in 1997 has helped facilitate considerable growth in Chinese tourism to Australia. Since Australia was granted

ADS, international visitor arrivals from China have tripled. China is now Australia's sixth largest tourist source, with a 4.3 per cent share of visitor arrivals.

The Tourism Forecasting Council has forecast inbound tourism from China to increase by a further 25 per cent in 2004 and 21 per cent in 2005.

The provision of education services to foreigners is becoming increasingly important both at a national and state level. Exports of education services to China were estimated at $379 million in 2002-03. Chinese students represented almost 19 per cent of all overseas students in Australia in 2003.

Western Australia

China has become one of Western Australia's most important export markets, and as a result developments in the Chinese economy can have pronounced effects on the Western Australian economy.

China is now Western Australia's second-largest export market, with exports valued at $4.4 billion in 2003-04. Over the past 15 years, exports to China have grown by an average annual rate of 18.4 per cent – double the average annual growth rate of total exports.

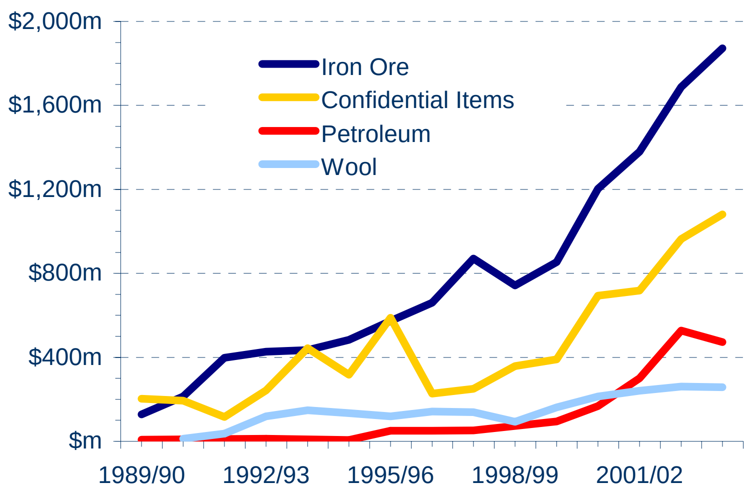
A key driver in the development of Western Australia-China trade has been the close complementarity of the two economies, and especially Chinese demand for Western Australian minerals. Demand for resources such as iron ore, petroleum and alumina has bee rising due to China's rapid industrial expansion.

Iron ore is Western Australia's single largest export product to China. Iron ore exports grew by an average annual rate of 23 per cent between 1988-89 and 2003-04, to reach $1.9 billion.

Confidential items, which include alumina, are Western Australia's second biggest export product to China, and have also grown strongly, by an average annual rate of 24 per cent since 1988-99. In 2003-04, exports of confidential items totalled $1.1 billion.

Strong Chinese demand for commodities such as iron ore have underpinned a number of major export deals for Western

Figure 5
WA Commodity Exports to China



Source: Department of Treasury and Finance

Australia, with the Minister for State Development earlier this year announcing that Western Australia had won a record 25 year $11.6 billion iron ore export deal with China.

Investment activity in Western Australia's resources industry has risen in order to meet this demand. Some of the recent announcements include a $1.4 billion multi-user railway and port facilities in the Pilbara, the $1.8 billion Ravensthorpe Nickel Project, a $600 million expansion of Alcoa's Pinjarra alumina refinery, as well as significant expansions to existing BHP Billiton and Hamersley iron ore mines.

Another significant development in Western Australia's resource trade relationship is China's increasing demand for energy. At present, coal is the main domestic energy source in China, providing approximately 70 per cent of the country's energy needs[8]. However, with many coastal cities having been banned from burning coal for environmental reasons, there is strong demand for cleaner energy such as natural gas.

This has provided significant opportunities for Western Australia due it its large reserves of natural gas. In October 2002, the North West Shelf venture was chosen to be the sole supplier of LNG to its first LNG project in the Guangdong Province, with three million tonnes of LNG to be supplied each year for 25 years. The contract is estimated to be worth $25 billion in export income for Western Australia.

This deal should see between $700 million and $1 billion worth of LNG exported to the Guangdong Province annually from 2006.

This agreement was followed by the announcement in October 2003 that the China National Offshore Oil Corporation had committed to purchasing $30 billion of Gorgon LNG in return for a 12.5 per cent stake of the Gorgon gas field, once the project commences.

Exports of petroleum have increased considerably in recent years. In 1988-89, Western Australia exported just $7.8 million worth of petroleum to China, but by 2003-04 this had increased to $473 million.

China also has strong linkages with other sectors of Western Australia's economy. Wool is Western Australia's third largest export commodity, totalling $256 million in 2003-04. While demand for wool was relatively subdued in the past, it has picked up in the past five years as a result of decreased protection under China's WTO commitments, growing by an average annual rate of 25.3 per cent.

Refined products such as pig iron and pigments and paints are also important export earners for Western Australia. In 2003-04, exports pig iron totalled $207 million, while exports of pigments and paints totalled $127 million. Both products have also grown strongly in recent years.

China is also an important export market for services such as tourism and education. While data specific to Western Australia on the importance of these service exports is not available, the trends in services exports nationally highlight their likely importance to Western Australia.

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Implications of Proposed Free Trade Agreement

WTO Reforms

As part of its accession to the WTO on 11 December 2001, China agreed to undertake a series of commitments to open and liberalise its regime to better integrate with the global economy. Within three years of the WTO accession, all enterprises in China would be granted the full right to trade internationally. China's WTO agreement also commits it to progressively reducing a wide range of other trade and investment barriers, with the average tariff level reduced from 17 per cent to 10 per cent by 2005.

Already we are seeing the benefits from the liberalisation of the Chinese economy, through increased global trade and investment.

However, high tariff rates still apply to a range of goods, in particular agricultural goods, with an average rate of 17.4 per cent. In addition, import quotas exist on a range of agricultural goods such as wool, cotton, grains and sugar.

The opportunity for some or all of these barriers to be removed as part of a potential FTA with Australia presents significant opportunities for Australian and Western Australian exporters.

Free Trade Theory

The benefits of free trade are based on an idea dating back almost 200 years, that of comparative advantage. This argues that trade between two countries will usually raise living standards in both. It applies even if one country is very poor and another very rich, or one is better at producing everything than the other, or if both countries have the same natural resources and produce the same goods and services. All that is needed for both parties to gain from trade is that their relative costs are not identical.

Tariffs are the most widely understood barrier to free trade. By raising the price of imported goods, tariffs allow protected domestic industries to charge higher prices in the domestic market for their produce without being uncompetitive relative to imports. The immediate effects of tariffs are threefold: higher domestic prices for imports and their substitutes, additional government revenues, and a disincentive for protected domestic industries to export, as the domestic price is artificially higher than the world price.

But their impact does not stop there. Consumers have to pay more for imports and their domestically produced substitutes, so real incomes fall. Exporters have to export more to purchase the same volume of imports, so real GDP adjusted for the terms of trade falls further still. As employees seek to maintain the real value of their wages in the face of higher prices, nominal wages rise. This adds to wage costs for all employers. Industry must also pay more for imported inputs and those from protected domestic producers, so material input costs rise.

Firms servicing domestic markets may pass on some of those costs in the form of higher prices, especially as domestic costs and prices are higher. But exporters are usually ‘price takers’, unable to sell in international markets above the international price. So they are usually the biggest losers.

Indeed, one of the most important results of models of the impact of tariffs is that they decrease exports by precisely the same amount as an equivalent tax on exports.

This loss of exports is itself not evenly spread. Investment and employment shift into protected industries and out of unprotected ones. Non-traditional export activities fail to emerge or quickly whither, and exports are skewed towards industries in which some factors of production are fixed, notably agriculture and mining.

The most commonly cited argument for maintaining high levels of protection is the pain of adjustment. Although removing tariffs may eventually lead to an improvement in economic performance, it is argued that the cost of transition from here to there is greater than the benefit of being there.

This ignores the crucial fact that, even on the most conservative assumptions, failing to cut tariffs can be equally or more painful. The adjustment argument implies that a job or dollar of production foregone in one region or industry should be given less weight than a job or income lost in another region or industry. CCI is not convinced that this is sound social or economic policy.

A related argument concerns geographic concentration – industry restructuring concentrates the pain of economic adjustment in certain locations, while the pain of failure to adjust is disbursed. Again it is questionable whether concentrated losses of economic welfare are necessarily more undesirable than dispersed ones, but it is reasonable to assume that there can be associated social and economic disadvantages flowing from concentration. In such events, the most appropriate response would be to institute measures to alleviate or reverse the related effects, such as retraining programs or other adjustment programs.

One major difference between jobs lost and jobs foregone appears to be that the transmission mechanism for the former is much more readily apparent and understandable than for the latter. South Australian car workers made redundant during a period of tariff cuts will probably attribute their jobs losses to those tariff cuts. However, Western Australian miners who take up new jobs will probably not identify cause and effect so readily.

Overall Economic Benefits

The complementarity of Australia’s trade pattern with that of China suggests that there would be substantial benefits from measures to remove trade barriers between the two markets. In a paper presented to the Conference on Free Trade Agreements in the Asia Pacific Region in July 2004, ACIL Tasman estimated that the net economic benefits could be around $10.3

billion in net present value terms[9]. This analysis was based upon a number of assumptions, the most crucial being that between 2005 and 2015, all barriers to trade are removed.

The ACIL Tasman analysis found that significant benefits would likely be achieved by Australia's agricultural sector – particularly the production and export of wheat and other grains. By contrast, the analysis found that Australia's output of textiles, clothing and footwear and motor vehicles and parts industries would decline significantly in the face of more intense import competition from Chinese producers.

One shortcoming of the ACIL Tasman analysis is it does not appropriately determine the impact of the removal of tariff and non-tariff barriers in the services sector, which would be expected to be large.

A FTA would also likely improve foreign direct investment linkages, conferring benefits to both Australia and China.

While the removal of obstacles to freer trade will benefit exporting producers, it will also benefit the wider Australian community – from increased competition and the necessity it imposes on other producers to innovate and improve efficiency.

The extent to which these benefits can be realised will, however, be determined by the extent to which trade restrictions are liberalised in each country. In reality, the removal of all barriers to trade as part of a bilateral trade agreement is difficult to achieve, as demonstrated in the negotiations on the recently signed Australia-United States FTA. The balance of losers and winners in each country will therefore be determined by the specifics of the agreement.

One concern raised in relation to the increased emphasis on bilateral trade agreements, is that it will come at the expense of the global free trade agenda of the WTO. Ultimately, global trade liberalisation has far more to offer Australia than bilateral deals.

Despite these issues, the establishment of a FTA with China is seen as an once-in-a-lifetime opportunity, and will help integrate Australia more closely with one of the world's largest and fastest growing economies. In doing so, that should lead to more investment, jobs and economic growth.

Regional Implications

While the proposed FTA with China would be likely to significantly benefit Australia, the distribution of these benefits around Australia is likely to be highly uneven.

Western Australia has more to gain from the trade deal that the rest of Australia, as China already features more prominently as an export destination for WA, and because of the high degree of complementarity between the State's export profile and the current and likely future import needs of the Chinese economy. Indeed, for WA, a trade agreement with China is likely to be more significant and more beneficial than the recent agreement with the USA. Other resource-rich regions such as Queensland and Northern Territory would also benefit from improved access for their agricultural and resources industries.

However, Victoria and South Australia would be expected to benefit less as they are more economically reliant on basic manufactures, with relatively high tariff protection in the textiles, clothing and footwear and motor vehicle industries. These states could face competitive challenges from Chinese imports, although it is debatable whether these pressures would be significantly greater than those arising from China's accession to the WTO.

Significant opportunities are also likely to be presented to Australia's growing services industries. While the tourism industry has been growing strongly across most states, Queensland is still the dominant tourist destination. As a result, Queensland would be likely to benefit most from increased tourism from the proposed FTA.

New South Wales accounted for around 45 per cent of the Australian finance industry total factor income in 2003-04. Increased finance opportunities in the rapidly industrialising Chinese economy would therefore be expected to benefit New South Wales more than the other states, while the need for China to improve the viability, governance and openness of its financial sector could present growing opportunities for foreign financial institutions.

Education services are relatively evenly spread across the major states on a per capita basis, with Victoria's per capita market share slightly ahead of the other states. However, given Western Australia's close proximity to China relative to the other states, it might be expected to benefit to a greater extent than the rest of Australia from growth in the education services market.

Specific Issues

There are a number of specific issues of particular importance for Western Australia that need to be addressed in the negotiations for a FTA with China. These are discussed below.

As a result of the WTO reforms which reduced the levels of protection on major resource commodities, exports have grown strongly in recent years. It is expected that if further improvements in market access can be achieved as a result of a FTA, this would deliver considerable benefits for a resource-rich state like Western Australia.

More significant levels of protection apply to agricultural products. A key priority in the negotiations will be to deliver reductions in the levels of protection on agricultural products, which have tariff rates as high as 121.6 per cent.

The emergence of a wealthy middle class in China also creates opportunities for Western Australia to increase its sales of premium wines if there is a reduction in the levels of protection in the industry. China's taxes on wine based on value and not volume, which disadvantages Western Australia's premium producers.

China has become an increasingly important source market for Australia's tourism industry. However, there are still a number of obstacles for the tourism industry, as the China National Tourism Administration regulates the outbound leisure travel market. An increase in the number of approved tour operators in Western Australia would be one measure which could help to facilitate further growth in State's tourism industry.

The application process for business people and students to obtain visas represents a key restriction on movement of people between Australia and China. A number of these restrictions are directly under the control of Australian authorities.

Businesses are reportedly finding it very difficult to obtain visas or extensions for travellers to or from China, with some suggesting that Chinese businessmen will not apply for visas to visit or work in Australia because of these difficulties.

Since April 2004, international students from China under the age of 18 have been forced to pass an English test (International English Language Testing System) and achieve "band 4" competency. Few students can achieve this level. Students over 18 have been forced to achieve "band 5" for the past three years. A further restriction limits students to a maximum of 30 weeks English study in Australia. These restrictions have forced education services offshore to the detriment of reputable Australian educators. Chinese students are now studying English in other countries (such as Singapore) with less restrictive visa practises. These students invariably choose a country other than Australia for their tertiary studies.

The recognition of China as a market economy for anti-dumping purposes is another issue that will need to be carefully explored, as once China is recognised by Australia as a market economy, this will make it much harder to argue that Chinese firms are dumping goods in Australia.

Increased investment opportunities for Australian firms could be achieved if the restrictions on foreign investors operating in China are eased. Currently, foreign investors are only allowed joint partnership with Chinese firms in most service sectors. While China is required under its WTO commitments to eventually open up most of its core service sector markets to international competition, the inclusion of service access in a proposed FTA could potentially provide Australian businesses with a head start and foothold in the market prior to being opened up to businesses from other countries.

Appendix: Terms of Reference

Annex II of the Trade and Economic Framework between Australia and the People's Republic of China details the following terms of reference of the joint feasibility study into a bilateral free trade agreement negotiation:

- to provide an overview of recent trends in bilateral trade and economic relations;
- to assess recent international trade policy developments and the possible implications for Australia-China trade and investment;
- to identify and describe existing barriers to trade and investment flows, covering goods, services and investment and other issues that might be addressed in a free trade agreement;
- to identify possible cooperation measures to promote trade and investment liberalisation and facilitation between Australia and China;
- to assess the impact of the removal and/or reduction of existing barriers to goods and services trade and investment; and
- make conclusions and recommendations as regards options for future action.

Notes and References

[1] According to figures published by the Asian Development Bank.
[2] Absolute poverty is defined as those earning less than the benchmark of $US1.08 per day in 1993 purchasing power parity terms.
[3] Shaohua Chen and Martin Ravallion, *How have the world's poorest fared since the early 1980s?* World Bank Working Paper No.3341, June 2004.
[4] *China: Economic Reform and Implications for Western Australia*, Department of Treasury and Finance Economic Research Paper, January 2003, page 5.
[5] World Trade Organisation, *International Trade Statistics 2004*, November 2004.
[6] The Economist, *Time to Hit the Brakes*, 13 May 2004.
[7] Without Approved Destination Status, Chinese citizens require an official or business reason to travel to the country concerned.
[8] Asia Research Centre, *China: Energy Policy and Natural Gas Use*, Murdoch University, 2001, p.10.
[9] ACIL Tasman, *The Proposed Free Trade Agreement with China – A Commentary and Some Preliminary Analysis*, July 2004.