THE MINERALS COUNCIL OF AUSTRALIA

SUBMISSION

TO

DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

ISSUES FOR CONSIDERATION

in a

AUSTRALIA / CHINA FTA FEASIBILITY STUDY

JULY 2004

Summary

China is a major market for the Australian minerals industry with strong and sustained growth predicted for the foreseeable future. China also offers potential investment opportunities for the minerals sector in exploration and development. Chinese equity in Australian resource developments is also increasing.

Despite this positive outlook, there are a number of rigidities and impediments to enhanced trade and investment with China and the MCA and its member companies would wish to see these addressed in the feasibility study of a Free Trade Agreement between Australia and China.

The key issues or themes identified by the MCA for feasibility study consideration are:

- Maintaining China's momentum for full transition to a market economy and its full participation in the WTO as a leading global economy;
- Reaffirmation of existing commitments enshrined in the WTO
- Extension of the scope or application of WTO rules;
- Reductions in tariff and non-tariff barriers;
- Capacity for Australian business interests to operate more freely in China's market, including domestic trading rights;
- Measures that are not provided for in the WTO, but which enhance opportunities to improve the business environment
    - Removal of import licence restrictions
    - Certainty with respect to intellectual property rights
- Transparency with respect to legislative and regulatory arrangements
    - Certainty of legal process
    - Rights of appeal;
    - Dispute resolution, and
    - Overlap and duplication between different levels of government.
- Issues specific to minerals exploration and mineral development in China:
    - Access to pre-competitive geological data
    - The complexity of the licence approval processes
    - The right to mine and export
    - The absence of a double taxation agreement
    - China's need to recognise that reforms of current laws and regulations are in its interests

Background

- China is not yet a full market economy;

- China is simultaneously moving to institutionalise a market economy and encourage national industries with policies of economic preferment;

- Bureaucratic interference in the internal business environment in China may create greater Impediments to business than controls on trade at the border;

- China's accession to the WTO provides a template of commitments to replicate or seek to extend in an FTA;

- Australia is one of a few reliable places where China can source raw materials critical to its future economic growth, which together with an open and stable investment climate enhances its leverage, to mount a case to Beijing that China should conclude an FTA with Australia;

- Australia's economic importance to China is as a major supplier of raw materials (iron core, steel, metals), wool and agricultural products.

China's trade

China is the world's fourth largest exporter and third largest importer.

China's increased exports over the last decade have in large part been attributed to Chinese subsidiaries of multinationals and foreign joint-venture partners.

China's imports are dominated by raw materials for energy and infrastructure development. China is now the world's second largest oil importer and accounts for half of the world's consumption of cement, 30 percent of coal, and 36 percent of steel. China's copper and nickel imports have risen substantially.

China's economy and policy directions

Over the last two and a half decades, China's economy has recorded an average annual growth rate of close to 9 percent. This rapid expansion has lifted China's economy to the position of the sixth largest in the world. China has also become increasingly integrated into the global economy

The main policy thrusts of the Chinese government include attracting foreign direct investment as a channel for technology and expertise, investment in higher education, investment in research and development and investment in infrastructure.

To achieve its policy goals, China needs to overcome some of the weaknesses in its domestic financial markets including a fragile banking system, ineffective prudential supervision, weak central bank regulation and supervision of commercial banks, a large build-up and lack of accountability for non-performing loans

Trade Liberalisation

China's accession to the WTO highlighted its desire to liberalise and increase economic integration by taking part in the rules-based international trading system. China has since liberalised most industrial and agricultural goods.

However, China is still a relatively new participant in the multilateral trading system and has not yet made the full transition to a market economy and its capacity to give legal force to commitments under WTO rules is in some important respects still to be demonstrated by practice.

While China's WTO accession documents make no mention of its status as a non market economy, she has accepted that investigating authorities in other WTO Members may apply non-market methodologies in antidumping and subsidy-countervailing investigations for fifteen years from accession. Nevertheless, China has since made it clear that she wishes to be viewed as a market economy.

Australia has agreed to recognise China as a non-market if, through the findings of its feasibility study, it decides to negotiate an FTA with China

Australia's Resource Exports to China

China's highest value imports from Australia are iron ores, aluminium, copper, wool, coal and flat rolled iron. Minerals exports to China are in the order of $3.5 billion or just less than 10% of total Australian minerals exports.

Rapid industrialization in China has created great demand for Australia's mineral and energy exports, which now make up the single largest export group. China is now Australia's third largest customer for resource products after Japan and Korea.

Iron ore is Australia's biggest single resource export to China and alone was worth over $1.6 billion in 2003. Aluminium is the other major mineral export, surging to just over $1.2 billion in 2003.

China buys around a third of Australia's copper ore and related concentrates, making Australia the second largest supplier after Chile.

The sale of intermediate and finished metal products to China has been positive.

Investment

Two-way Foreign Direct Investment (FDI) between Australia and China is modest, with large investors accounting for the bulk of Australian investment in China.

At June 2003, China was Australia's 18th largest investment destination ($1.2 billion) with a fairly even division between manufacturing, mineral exploration, legal, banking and education services. At June 2003 China was 14th largest investor in Australia with investments of $2.2 billion in resource and property sectors.

The absence of capital account convertibility in China means that the ability of capital to flow instantaneously in and out of the country is limited.

Limitations on service sectors where Australia has competitive advantage in skills (mining, financial services and broad acre agribusiness), have lessened the demand for investment.

Minerals industry interests in an FTA

China is emerging as a leading economy in the world economy and the MCA would expect that an FTA would optimize opportunities to participate in that growth.

While tariff barriers at the border are quite low in a number of cases for minerals products, the MCA considers an FTA provides the opportunity to eliminate all tariffs on minerals and energy and potentially increase Australia's market share for mineral resources.

The MCA also considers an FTA should focus on other features of regulation in the Chinese economy, which inhibit trade, investment and business. In particular, the minerals industry would wish to see greater freedom to invest in China, liberalisation of domestic trading rights including import licence restrictions and an enhanced capacity for the movement of business personnel.

Implementation of domestic trading rights has lagged China's commitments in the WTO accession protocol. Non-tariff barriers remain in the form of import licence restrictions with priority given to State Owned Enterprises or favoured companies, resulting in uncertainty for exporters and an impediment for some Chinese importers.

The MCA would support arrangements in an FTA which facilitated Australian companies working with Chinese business partners (through research and training programs) to develop common business interests.

Impediments to Trade and Investment

At a fundamental level, Australian business benefits increasingly the more Chinese law protects property rights, provides freedom of business to operate and gives legal protection for foreign companies against discrimination. This is the protection which the WTO seeks to strengthen through international law. The legal foundation for a free market in China is still weak. WTO law and practice is an important buttress. The more Chinese law and practice accords with WTO rules and procedures, the more Australian business benefits.

To the extent it is practicable, it is desirable that an FTA strengthens the legal foundation for a free market in China and enhances implementation by China of its WTO obligations.

With respect to minerals exploration in China, not all areas are open to foreign investment. The Chinese government has produced a list of guidelines for foreign mineral and energy investment that provides for some liberalisation, not subject to WTO discipline, while retaining some limitations. These guidelines categorise resources into three categories “encouraged”, “restricted” and “prohibited”. Essentially, the better the resource potential, the more difficult for foreign investors to access.

The protection of intellectual property is a key consideration for potential investors in the minerals sector. A fragmented bureaucratic apparatus means that in the enforcement of intellectual property rights including the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS), China consistently fails to meet its WTO obligations. The key Chinese bureaucracies are the Intellectual Property Office (formerly the Patent Office), the Copyright Bureau, and the Trademark Office within the Administration of Industry and Commerce. All are discrete bodies and belong to distinct bureaucratic clusters.

Issues for Inclusion in the Feasibility Study of a FTA with China

General Issues

Australia should seek to:

- support and not detract from China’s full transition to a market economy and its full participation in the WTO as a leading global economy;
- secure commitments from China, bound in international law, which enable business to operate more freely in China’s market;
- re-state the commitments already enshrined in the WTO, in particular:
    - not to use non-tariff measures;
    - not to allow technical standards to restrict trade unreasonably;
    - to provide right of consultation on implementation of technical standards that may impede trade;
    - to ensure state trading enterprises do not distort markets or trade; or
    - to set the basis for quarantine barriers and not allow them to unreasonably distort trade.
- make commitments that extend the scope or application of WTO rules, limited by WTO obligations not to discriminate among WTO members
    - not to subsidise trade between countries (preferential cross-border import tariffs are enjoyed by some countries);
    - to harmonize technical standards;
    - to agree on terms of administration of contingent protection (particularly anti-dumping)
    - to strengthen protection of intellectual property
- agree on measures that are not provided for in the WTO, but which improve opportunities to improve the business environment:
    - to remove or reduce restrictions on foreign investors;
    - to liberalise domestic trading rights for foreign companies, including the removal of restrictions on import licences;
    - to cross recognize technical standards;
    - to facilitate trade through improved administration of customs and border controls (Chinese documentation requirements for Australian exports are more onerous and time consuming than for other Asian countries);
    - to facilitate the movement of business personnel;
    - to develop understandings governing supply of products of strategic significance to China’s economy;

- to agree on collaboration to improve the functioning of institutions and procedures central to the success of business, for example:

  - joint research;

  - provision of training and capacity building; and

  - education and exchanges.

Specific Issues for the minerals sector

Tariffs

- Elimination of all tariffs on imports of mineral products by China

Corporate Structures

- Flexible structures are needed to respond to the uncertainty associated with investment in exploration;
- The requirement to lodge registered capital does not encourage exploration investment;
- Processes to accomplish recovery of capital eg termination of a Joint Venture are slow and subject to approvals.

Approval Processes

- Current project approval process for Sino-Foreign Joint Ventures is complex;
    - Different levels of government can issue exploration and mining licences
    - A clear and simplified process is needed
- Investment projects over $US30 million must be approved by State Ministries;
- Investments below $US30 million need only be approved by the relevant provincial Development and Planning Commission;
- Investment in mining projects is typically staged, with early stages often less than the threshold and the overall cost greater than the threshold
- Initial approval at provincial level does not guarantee project approval – the State can impose different conditions and project terms after a bankable feasibility study is completed and significant investment incurred.
    - Criteria for State level approval difficult to establish in advance;
    - SDPC approval after a successful bankable feasibility study completed;
    - Investor needs to deal with three agencies (MOLAR, MOFTEC and SDPC);
    - No clear timeframes or time limits for approval
- Exploration licences can only be granted to qualified “geological exploration units registered in China”
    - No foreign company has been granted such a qualification;
    - Foreign companies have to Joint Venture with qualified provincial –based groups
    - Strict rules apply to qualification including
        - Knowledge and experience of China’s geology and mineral deposits
        - Experience in exploring for nominated commodities;
        - Staffing and equipment in China

Mining Rights

- No certainty regarding the right to mine if exploration is successful
    - Current regulations give the holder of an exploration licence a "privileged priority to obtain the mining rights to the mineral resources in the exploration area (Regulations for Transferring Exploration Rights and Mining Rights Art 3.1);
    - No guarantee that a party who holds the exploration licence will obtain the mining licence (even if they comply with all necessary environmental and other regulations);
    - The right to mine for investors in exploration should be protected, subject to compliance with transparent applicable regulations;
    - Many projects contain a mix of metals – base metals are "encouraged", while gold is "restricted";
    - No harmonisation of exploration and mining rights by different levels of government;
    - When local authorities are investor and regulator, can lead to confusion when rights conflict.

Legislative Clarification and Transparency

- Certainty of legal process, including rights of appeal and dispute resolution
- Restrictions on the availability and use of geological data are counterproductive to the promotion of investment in the mining sector in China
    - Rules are not consistently applied and depend on interpretation by local authorities;
    - Assessment of the value of assets (eg rights, data) is limited to agencies accredited by MOLAR who don't necessarily have arms length relationship
    - Regulations do not permit the transfer of data offshore for due diligence;
    - Regulations needed as to what data is available publicy
    - Physical presence of the "legal person" required to sign documents leads to cost and delay
- Obsolete laws and regulations adopted in the early 1990s limiting foreign direct investment in the mining sector should be repealed;
- Clarification is needed on the treatment of investment in mines producing a combination of minerals falling into different investment categories (eg gold – "restricted" and copper, zinc and lead – "encouraged");
- Conflicting regulations and modes of implementation between governments at the national and provincial level.

Tax Treatment

- Harmonisation of tax incentives is needed for domestic and foreign direct investment
    - Some provinces / regions have adopted preferential tax treatment for foreign mining investment;
    - Clarification needed as to which government department can authorise tax terms and pre-conditions to be filled
    - Tax treatment for mining not aligned with other resource sectors (eg oil and gas)
- No provision for grouping tax losses – costs of unsuccessful exploration cannot be recovered

- No provision for Australian companies to keep Australian dollars accounts or accounts in the currency of choice
- Absence of a tax treaty between Australia and China can result in double taxation
    - Senior Australian based representatives pay Chinese tax for the days they spend in China;
    - Australian staff who spend more than 183 days in China pay Chinese tax.

Trading / Export Rights

- Current export rights are limited
- A timetable to relax export controls consistent with WTO obligations will help investors assess project risk.

The MCA would welcome the opportunity to be fully consulted as work progresses in the scoping study and before the results are finally concluded with the Chinese.

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7 July 2004

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