

# VICTORIAN GOVERNMENT SUBMISSION TO THE AUSTRALIA CHINA FREE TRADE AGREEMENT FEASIBILITY STUDY

## Introduction

The Victorian Government welcomes the opportunity to make a submission to the joint Feasibility Study into a possible Australia China Free Trade Agreement (FTA).

Given China's strong economic growth, its increasing global integration and the relative complementarity of the Australian and Chinese economies, it is important to investigate the feasibility of an FTA.

An Australia China FTA is likely to have a significant impact on the Victorian economy. China is currently Victoria's fourth largest export market, third largest import market and a growing source of foreign direct investment.

The Victorian Government notes that the joint Feasibility Study does not commit China and Australia to an FTA. Prior to any commitment by the Commonwealth Government, it is important that the feasibility and implications of an Australia China FTA are fully assessed, understood and communicated, in consultation with industry, governments, non-government organisations and wider society. Over the course of the Feasibility Study, the Commonwealth Government should establish a full and effective process of consultation with States and Territories.

This Submission provides an outline of the current Victorian and Chinese economic relationship (Section 1), a summary of current Victorian Government activities in China (Section 2) and an outline of key issues that should be addressed by the Feasibility Study (Section 3). In preparing this submission, the Victorian Government has consulted with a range of industry associations and stakeholders.

The Victorian Government looks forward to a continuing dialogue with the Commonwealth Government as work on the Feasibility Study moves forward.

## Section 1: Victorian and Chinese Economic Relationship

Victoria has a strong and developing trading relationship with China. Currently, China is Victoria's fourth largest export market and third largest source of imports. In 2002/03, Victoria had a trade-deficit with China, importing \$5.08 billion and exporting \$1.6 billion worth of goods (see **Attachment 1**).

Victoria's exports to China have grown significantly in recent years. Today, Victoria's main exports to China are wool, aluminum, hides and skins, dairy products, photographic and cinematographic supplies, various metals, leather and live animals.

China is also a key export market for Victoria's tourism and education sectors. It is Victoria's fourth largest, and the fastest growing, source of international visitors. More than 74,500 Chinese visited Victoria in 2003, 44% for a holiday, 36% for business, 11% for education and 6% visiting friends and relatives (3% for other reasons). China is also currently the fastest growing of the major markets for international students in Victoria. In 2002/03, Chinese students accounted for over

48% of international school students and 15% of higher education students in Victoria.

Victoria's main imports from China are manufactures such as: textile based materials including clothing; toys, sporting goods and games; footwear; furniture and furniture parts; and electrical machinery and apparatus.

Victoria is currently facing both opportunities and challenges as a result of China's strong economic growth and global integration, and these will continue into the medium to long-term. Given the strength of China's manufacturing industry, Victoria's manufacturing sector faces considerable competition from China, both domestically and in export markets. At the same time, key export opportunities in China include:

- elaborately transformed manufactures (ETMs);
- research, design, science and technology based industries;
- environmental management and technology;
- biotechnology, medical and other health industries;
- managed funds and professional services (legal/accounting);
- housing market (construction and housing appliances);
- financial services (as China develops its capital markets);
- education;
- tourism; and
- various advanced services (including architecture, economic consulting, design and urban planning).

The Victorian Government recognises that an Australia China FTA has the potential to bring benefits beyond trade, such as an increase in bilateral investment flows and in the movement of people for business, education and tourism purposes.

## **Section 2: Victorian Government activities in China**

*Victoria: Leading the Way*, the Victorian Government's recent economic statement, outlines a range of actions to ensure the State's strong economic performance continues and that Victoria continues to attract people, businesses, ideas and investment. In particular, *Victoria: Leading the Way* focuses on increasing the competitiveness and export performance of Victorian businesses.

In recognition of China's strong growth, ongoing economic liberalisation and global integration, the Victorian Government has a strong focus on the Chinese market – promoting Victorian industry capabilities, assisting businesses to capitalise on emerging trade and investment opportunities and promoting Victoria as a globally competitive business location.

The Victorian Government's recently released *Opening Doors to Export Plan* targets China as one of three emerging markets for Victorian exporters. Under the Plan, a *Victorian Trade Envoy* to North Asia will be appointed to assist Victorian companies to overcome language, cultural and other barriers to trade.

The Victorian Government has an increasing presence in China. Since 1990, the Victorian Government has had a Business Office in Hong Kong, assisting prospective investors with advice and information about Victoria and supporting Victorian companies seeking to export. In December 2003, the Victorian Government established a Business Office in Nanjing, servicing the Jiangsu, Shanghai and Zhejiang Provinces. The Government also has Tourism Victoria offices in Shanghai and Hong Kong, which market Victoria as a tourism destination.

Since 1979, the Victorian Government has had a Sister-State relationship with Jiangsu Province in China. A Victoria-Jiangsu Joint Economic Committee is responsible for economic development under the relationship. Successful projects in recent years include a Memorandum of Understanding (MOU) for new biotechnology strategic alliances and joint ventures (signed 19 November 2003), an agreement on education exchanges and cooperation between the Victorian Department of Education and Training and the Jiangsu Provincial Department of Education (signed June 2004) and an MOU on agribusiness cooperation with the Jiangsu Ministry of Agriculture.

China is the fastest growing source of international students in Victoria. To capitalise on this, all Victorian universities have agreements with Chinese universities and 18 Victorian Government schools have sister school relationships with Chinese schools. A number of Victorian educational institutions have campuses, or are in the process of establishing campuses, in China.

It should be noted that currently, China does not recognise State Governments as a legal entity. This has implications for the establishment of State Government offices, as they are required to register as a private company.

### **Section 3: Key issues to be addressed by the Feasibility Study**

The Victorian Government considers that the Feasibility Study should cover all issues related to trade with China, including tariff and non-tariff barriers. The Feasibility Study should:

- identify all restrictions on trade between Australia and China;
- document the extent of these restrictions;
- determine how an FTA could address these restrictions; and
- analyse the impact of removing these restrictions.

The Victorian Government has identified a range of issues that it considers should be included in the scope of the Feasibility Study.

### **a) Broad implications of an Australia-China FTA**

As well as the implications for Australia's economic growth, the Feasibility Study should consider and report on the broader implications of an FTA with China. It is not clear from the Terms of Reference whether the Feasibility Study will include a broad analysis. In particular:

- The Feasibility Study should consider the employment implications of an Australia China FTA and the adjustment pressures that could result on industry sectors. For example, given the strength of China's manufacturing industry, there is concern regarding the impact of an FTA on Australia's manufacturing industry - a significant component of which is based in Victoria. The inclusion of case studies and qualitative analysis in the Feasibility Study could provide a further insight on the potential implications for such industries.
- The Feasibility Study should include an economic analysis of the impact of an Australia China FTA at the Australian State and Territory level.
- The economic analysis should also assess whether an Australia China FTA could lead to trade diversion, and, if so, the extent of such diversion.
- The Feasibility Study should consider the environmental implications of an FTA.

### **b) Impact of recognising China as a market economy**

China has stipulated that Australia must recognise it as a 'market economy' before FTA negotiations can commence. Given that there is no internationally agreed definition, it is important for the Commonwealth Government to clearly define the grounds on which it will assess China's market economy status.

The Feasibility Study should examine whether China is a market economy. For example, given the pervasive influence of State Owned Enterprises (SOEs) across the Chinese economy, it is important to assess whether any subsidisation occurs. The Study should also assess the effect of recognising China as a market economy. Issues of particular concern to the Victorian Government are:

- Recognition of China as a market economy would have a practical impact on the application of Australia's anti-dumping legislation. Ensuring effective anti-dumping measures is an important issue for Victoria, given our large manufacturing base. Currently, Australia's 'anti-dumping rules' are more rigorous for countries like China, in recognition that they are economies in transition. The Victorian Government is concerned that recognising China as a market economy prematurely, may negatively impact on Australian companies (some of which believe that dumping is effectively occurring).
- Australian industry needs to be satisfied that any Chinese or Australian 'anti-dumping judicial body' implements its findings swiftly and robustly.

### **c) Inclusion of State/ Provincial Government Regulations**

Chinese Provincial Governments have a high degree of autonomy in law making, and the power to control and limit trade within their borders. As an example, to export a motor vehicle to China, an Australian firm usually needs to gain approval from both the Central and the specific Provincial Government.

The Feasibility Study should identify all the barriers to trade that exist at the State/Provincial level and consider the potential for an FTA to address these. The Feasibility Study should also consider the extent to which an FTA signed by federal governments would be able to direct State/Provincial governments (i.e. would it be necessary for the Provinces to be parties to an FTA?)

### **d) Chinese Government industry development policies**

There are a number of local content requirements (which reportedly, can be as high as 70%), and industry development policies in China, such as the provision of tax breaks for exporters. Currently, there is a lack of detailed information about the operation and enforcement of these policies. The Feasibility Study should document China's local content and industry development policies and examine the impact of these being removed under an FTA.

### **e) China's labour and environment standards**

The Victorian Government considers that the nature and enforcement of labour and environment standards in China are important issues. An FTA will only be desirable if it is soundly founded on environment and labour standards that are appropriate, rigorous and enforced.

The adequacy of labour standards and their enforcement can have a direct impact on the competitiveness of Australian businesses, and strong standards relating to worker protection and other health and safety objectives are desirable in their own right. The Feasibility Study should document relevant Chinese labour standards and associated processes, and include a comparative analysis of Chinese and Australian labour standards, and of Chinese standards in comparison with relevant international norms. The Feasibility Study should also analyse China's enforcement of its current labour standards.

Like labour standards, the adequacy of China's environmental standards and their enforcement can impact on the competitiveness of Australian businesses, and are important ends in themselves. The Feasibility Study should include an analysis of China's environmental standards and enforcement regime, and compare these with Australian and international norms.

#### **f) Standards and technical regulations**

The Victorian Government is concerned that there are not always clear guidelines on China's standards and technical regulations, and the timeliness of granting approvals. The Feasibility Study should assess the transparency of information on China's standards and technical regulations, at both a central and provincial level, and how this issue could be addressed by an FTA.

The Feasibility Study could also examine the progress that China has made towards aligning its standards and technical regulations with international standards since its World Trade Organisation (WTO) accession, and whether an FTA would provide an opportunity to progress this process.

#### **g) Protection of intellectual property**

An FTA with China could provide significant export opportunities for Australia's knowledge-based industries. However, the Victorian Government has concerns regarding the protection of intellectual property (IP) in China. It is important that the Feasibility Study assesses China's current level of IP protection and enforcement and the scope for these moving towards internationally accepted practice.

IP protection is an issue for Australian businesses engaging in joint ventures in China. Any IP brought into the joint venture becomes owned by the joint venture. The Feasibility Study should examine the protection of IP in joint ventures and consider how this could be improved in an FTA.

#### **h) Quarantine regulations and customs procedures**

If an FTA is negotiated with China, quarantine is likely to be an issue for both countries and Australia will be keen to maintain its standards. Consultation has highlighted that China's quarantine regulations have prevented the export of certain Victorian products, such as seafood, citrus fruits and cherries. While some protocols are currently being developed to enable the export of some fruits to China, it is important that the Feasibility Study assess the ability of an FTA to increase the transparency of China's quarantine restrictions at a broader level.

Statutory inspections apply to certain exports to China (e.g. wool). Feedback from industry has highlighted that China's inspection standards are often inconsistent with international standards, leading to difficulties in gaining customs clearance. The Feasibility Study should examine this, and consider the feasibility of a closer alignment with international standards being covered in an FTA.

#### **i) Rules of origin**

The Feasibility Study should analyse and provide an assessment of a range of rules of origin systems that could be adopted under an FTA, such as the 'Australia-United States FTA Approach', the 'Australia-New Zealand FTA Approach' and the system adopted under China's agreement with the Association of South East Asian Nations (ASEAN). The assessment should take into account issues such as ease of

administration, enforcement and review procedures. In particular, the Feasibility Study should take into account:

- transshipment - industry has raised concerns that an FTA could encourage third countries to tranship goods through China and thereby gain preferential access to Australian markets; and
- the need for consistency in adopting rules of origin systems under FTAs, so as to ease the administrative process for exporters.

#### **j) Repatriation of funds to Australia**

Australian companies often face difficulties in receiving authorisation to transfer funds externally, or to release funds for activities undertaken in China, which require payments to Australia institutions/agents. The Feasibility Study should investigate the extent of these restrictions on the transfer of funds between China and Australia and how these could be addressed in an FTA.

#### **k) Mutual recognition of qualifications**

In China, a number of professions face difficulties in obtaining recognition of their Australian or other international qualifications. For example, foreign lawyers find it difficult to obtain a licence or practise in China. The Feasibility Study should consider the extent to which an FTA could address the mutual recognition of qualifications, and the appropriate occupational registration and accreditation arrangements.

#### **l) Liberalisation of China's Financial Services Industry**

Since 1999, Victoria's financial services industry has grown by over 40%, making it the third largest sector in the Victorian economy today. The Victorian Government's *Financial Services Industry Plan* contains a range of initiatives to further grow the industry, including through export opportunities arising from new trade agreements.

Foreign financial firms wanting to enter the Chinese market, currently face a range of regulatory barriers. For example, foreign firms wishing to import financial services to China are required to establish a joint venture with a Chinese company. Capital adequacy requirements for foreign financial firms seeking to operate in China also appear to be restrictive. The Feasibility Study should investigate the extent of restrictive practices in China's financial services industry and how these could be addressed in an FTA.

#### **m) Investment**

China is now a significant player in global foreign direct investment (FDI) flows. From 1990 to 2002, the ratio of FDI to GDP in China has almost quadrupled, increasing from 1.0% to 3.9%, and outstripped increases in many other parts of the world. Nevertheless, foreign investors continue to face a range of barriers in China, relating to taxation and regulations at both the Central and Provincial Government level. The Feasibility Study should consider the potential for reducing such barriers, to liberalise China's foreign investment regime, such as permitting full ownership of

business ventures. It should also give consideration to the flow-on effects of allowing greater foreign investment in China, such as the possibility of Australian businesses shifting their operations to China.

Chinese companies seeking to invest outside China also face difficulties. The Feasibility Study should examine these difficulties and consider whether an FTA could include a less restrictive regime for Chinese companies seeking to invest in Australia.

Australian investors need to have confidence in the security of their long-term investments in China. The Feasibility Study should include an analysis of the robustness of China's legal system, and give consideration to whether there would be a need for specific dispute settlement mechanisms between investors, and between investors and governments, under an FTA.

#### **n) Opportunities for education exports**

China is one of Victoria's key sources for international students. A number of Victorian educational institutions have campuses, or are in the process of establishing campuses, in China. The FTA provides an opportunity to increase the presence of Australian education providers in China, and the number of Chinese students studying in Australia. The Feasibility Study should give consideration to whether an FTA would be able to address the following issues, which could help to increase trade in education:

- both Australia's and China's systems for processing student visa applications, including timeliness;
- China's recognition of University/Australian Qualifications Framework (AQF) qualifications;
- the Chinese Government's willingness to provide information on Chinese education institutions and courses of study;
- current restrictions on Australian education institutions advertising in China and the Chinese Government's willingness to reduce such restrictions; and
- better enabling the recognition of educational providers, both in Australia and in China, with particular reference to arrangements for registration of 'foreign' institutions.

#### **o) Temporary entry of people**

The Victorian Government considers that it is important to increase the movement of people between Australia and China for business, education and tourism purposes. The movement of people can lead to greater trade and investment between China and Australia.

The Feasibility Study should examine the current impediments to the movement of people between Australia and China (particularly the short-term entry of people for business purposes), and how these could be reduced under an FTA.



**p) Government procurement**

The inclusion of government procurement in an FTA could present significant opportunities for Australian businesses to tender for government work in China. The Feasibility Study should consider whether government procurement could be included in an FTA, and analyse how various government procurement regimes operate in China. Given the prevalence of SOEs in the Chinese economy, it is important that the size and nature of SOE procurement is also examined. This will enable a more comprehensive analysis of the impact of including government procurement in an FTA.

## VICTORIA'S TRADE WITH CHINA

\$m	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03
Exports	624	669	1124	1430	1561	1600
Imports	2154	2537	3029	3874	4378	5083

<b>TOP 10 EXPORTS</b>	<b>\$m</b>
Wool and other animal hair (incl. wool tops).	545.8
Combined confidential items excl some of SITC 280 (exports only) and some of SITCs 510 and 520 (imports only).	258.5
Aluminium.	82.0
Hides and skins (except furskins), raw.	66.7
Milk and cream and milk products (excl. butter and cheese).	66.6
Photographic and cinematographic supplies.	57.0
Non-ferrous base metal waste and scrap, nes.	40.3
Leather.	39.5
Live animals (excl. fish, crustaceans, molluscs and aquatic).	38.3
Plates, sheets, film, foil and strip, of plastics.	32.6

<b>TOP 10 IMPORTS</b>	<b>\$m</b>
Clothing of textile fabrics (incl. of fabrics of 657.33, 657.24).	393.3
Baby carriages, toys, games and sporting goods.	369.4
Footwear.	345.7
Women's or girls' clothing, of text fabrics not knitted or crocheted.	255.3
Men's or boy's clothing, of text fabrics, not knitted or crocheted.	234.2
Furniture and parts therefore, bedding, mattresses, mattress.	155.6
Made-up articles, wholly or chiefly of textile materials, nes.	142.2
Combined confidential items excl some of SITC 280.	130.0
Electrical machinery and apparatus, nes.	126.1
Automatic data processing machines & units thereof, magnetic, optical readers; data transcribers & processors.	120.1