

Overview and analysis

Trade agreements

- 2.1 The *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China* (the China Australia Free Trade Agreement or ChAFTA), is the third free trade agreement to come before the Joint Standing Committee on Treaties (JSCOT) in the 44th Parliament. The previous agreements were with Korea and Japan.
- 2.2 As noted in the Committee's previous reports; bilateral, plurilateral and regional trade agreements increased as negotiations on the World Trade Organization's (WTO) multilateral trade agreements slowed during the 1990s.¹ These agreements, often referred to as 'free trade agreements' but more correctly 'preferential trade agreements', are signed between two or more countries and provide them with favourable market access conditions by reducing tariff and non-tariff barriers.
- 2.3 As of September 2015, Australia has nine free trade agreements (FTAs) in place, seven under negotiation and one signed but not yet in force.

Observations on free trade agreements

- 2.4 Advocates for free trade agreements suggest that FTAs have provided a way forward since the WTO process stalled during the 1990s, encouraging trade liberalisation, opening up market access and strengthening bilateral relationships. The WTO gives conditional support for free trade agreements, allowing for them under the General Agreement on Tariffs and Trade's (GATT) Article 24, providing they meet WTO rules. The WTO

1 See the Joint Standing Committee on Treaties (JSCOT), *Report 142: Treaty tabled on 13 May 2014*, September 2014, and JSCOT, *Report 144: Treaty tabled on 14 July 2014*, October 2014.

indicates that such agreements can go beyond what may be available in a multilateral agreement at a given time.² It is often quicker and easier to achieve an outcome for an FTA where negotiations are taking place between a limited number of parties.³

- 2.5 As well as tariff reduction or elimination, free trade agreements often cover a range of non-tariff barriers and increasingly cover such matters as investment protection, intellectual property rights, trade facilitation, government procurement, and labour and environment standards. Many of these impediments to free trade are 'not within scope in the WTO setting' and FTAs open up an avenue to pursue such matters.⁴ The outcome in these non-tariff areas frequently lays the foundation for rules and issues that are subsequently incorporated into multilateral agreements.⁵
- 2.6 On the other hand, the contribution of free trade agreements to world trade liberalisation and economic growth has been questioned. The WTO cautions that, although such agreements can complement the multilateral trading system, there are a number of concerns:
- net economic impact will depend on the architecture of the individual agreement and its internal parameters;
 - they are discriminatory and advantage the signatory countries;
 - distortions in resource allocation, and trade and investment diversion may minimise benefits; and
 - the proliferation of agreements and consequent overlapping trade rules can hamper trade by imposing extra costs on potential participants.⁶
- 2.7 The Productivity Commission found that commercial benefits for Australian businesses from bilateral and regional trade agreements

2 World Trade Organization (WTO), 'Understanding the WTO', p. 64, <https://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf> viewed 4 September 2015.

3 The Australian APEC Study Centre, Monash University, *An Australian-USA Free Trade Agreement: Issues and Implications*, Department of Foreign Affairs and Trade, August 2001, p. 19, <http://www.sice.oas.org/TPD/USA_AUS/Studies/MonashU_e.pdf> viewed 4 September 2015.

4 Productivity Commission, *Bilateral and Regional Trade Agreements*, November 2010, p. xxi.

5 WTO, 'Understanding the WTO', p. 64, <https://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf> viewed 4 September 2015.

6 WTO, 'Regional Trade Agreements: Scope of RTAs', <https://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm> viewed 4 September 2015.

(BRTAs) were limited as the agreements did not address the non-tariff barriers that prevented market access.⁷

- 2.8 The Productivity Commission called for a more realistic, transparent process, including a post-negotiation analysis, to identify possible adverse impacts.⁸

China Australia Free Trade Agreement

- 2.9 The following summary of the *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China (ChAFTA)* and its claimed benefits is taken from the National Interest Analysis (NIA) and the Regulation Impact Statement (RIS).

Background

- 2.10 According to the RIS Australia has an extensive, growing and highly complementary economic relationship with China. In 2013–14 two-way trade in goods and services reached \$159.7 billion, making China Australia's largest trading partner. China is both Australia's largest export market (\$107.6 billion or 32 per cent of total exports) and largest source of imports (\$52.1 billion or 15 per cent of total imports). The bilateral trade relationship is also among the fastest growing: exports grew 27 per cent from 2012–13 to 2013–14, while five-year trend growth to 2013–14 reached 19 per cent.⁹
- 2.11 The RIS states that, at the end of 2013, Chinese investment in Australia was valued at \$31.9 billion and Australian investment in China was \$29.6 billion. The RIS points out that, while bilateral investment figures are modest compared to other trade and investment relationships, investment in both directions is growing rapidly. At the end of 2013, Australian investment in China was 39 per cent higher and Chinese investment in Australia was 41 per cent higher than the previous year.¹⁰
- 2.12 However, the RIS argues that the bilateral trade and investment relationship will suffer in the absence of a bilateral trade agreement due to:

7 Productivity Commission, *Bilateral and Regional Trade Agreements*, p. xxiv.

8 Productivity Commission, *Bilateral and Regional Trade Agreements*, p. xxxiii.

9 Regulation Impact Statement, *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China*, done at Canberra, 15 June 2015, [2015] ATNIF 15 (hereafter referred to as 'RIS'), para 2.

10 RIS, para 3.

- limited trade opportunities due to persistent high import tariffs, particularly in agriculture;
- erosion of competitiveness for Australian goods and services exporters due to China's existing and future preferential agreements with other countries;
- constraints on Australian businesses' ability to fully capitalise on the increasing orientation of the Chinese economy towards consumption and services;
- denial of the benefit of increased certainty for Australian exporters as to treatment of their goods and services and investments in the Chinese market;
- risks of Australia becoming less attractive to Chinese investment; and
- lack of a framework for Australia and China to deepen liberalisation and expand market access over the longer term.¹¹

2.13 The RIS indicates that Australian exporters currently face significant tariff barriers into China, including tariff peaks for key products, limiting Australian businesses' ability to take full advantage of the growing Chinese market. China's imposition of high tariffs does not only constrain trade, it also adds additional costs to traded items, reducing efficiency and profitability.¹²

2.14 The RIS suggests that China's trade agreements with other countries, including ASEAN and New Zealand, put Australian exporters at a competitive disadvantage. The RIS argues that, as a result of the high tariffs and market access barriers faced by Australia and the preferential access given to Australia's competitors, without a bilateral FTA, Australian exporters will lose competitiveness and market share.¹³ Likewise Australian service industries may receive less favourable treatment than suppliers from countries with an existing FTA with China.¹⁴

2.15 The RIS also notes that on some products China applies a tariff lower than the maximum permitted under its WTO commitments, which means China has scope to raise tariffs for such products at any time. China has done this on a number of occasions, putting Australian exporters at a competitive disadvantage. By eliminating most of China's import tariffs

11 RIS, para 4.

12 RIS, para 8.

13 RIS, para 11.

14 RIS, paragraphs 18 and 19.

and locking in the reductions, the RIS argues that ChAFTA will provide greater certainty for Australian businesses.¹⁵

- 2.16 With regard to investment, the RIS points out that the 1988 bilateral treaty between Australia and China¹⁶ does not include market access obligations. ChAFTA is expected to provide increased certainty for investors in both countries.¹⁷

Overview and national interest summary

- 2.17 According to the NIA, ChAFTA is expected to significantly boost Australia's economic relationship with China, Australia's largest trading partner, and elevate the standing of the bilateral relationship overall. The Agreement is expected to give Australian exporters significantly improved market access in goods and services. It will eliminate or significantly reduce tariffs on a wide range of Australian goods exports including beef, dairy, sheepmeat, wine, horticulture, and energy and resource products. The NIA claims that the Agreement delivers China's best ever services commitments, including the provision of new or significantly improved market access not included in any of China's previous FTAs (with the exception of its Agreements with Hong Kong and Macau).¹⁸
- 2.18 The NIA states that beneficiaries of the Agreement are expected to include Australian service suppliers across a range of sectors including banking and financial, insurance, legal, education, health and aged care, construction, manufacturing and telecommunications. It is also expected that Australian businesses and consumers will have access to cheaper Chinese imports, particularly household and electronic goods. The NIA suggests that expanded trade liberalisation is likely to stimulate economic activity in Australia and could lead to job creation.¹⁹
- 2.19 The NIA maintains that the Agreement will protect Australia's competitive position in the Chinese market against other countries with which China has FTAs. The NIA indicates that the Agreement has the potential to facilitate the expansion of the economic relationship with

15 RIS, paragraphs 15 and 16.

16 *Agreement between the Government of Australia and the Government of the People's Republic of China on the Reciprocal Encouragement and Protection of Investments* (Beijing, 11 July 1988).

17 RIS, paragraphs 20 and 21.

18 National Interest Analysis [2015] ATNIA 7 with attachments *Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China*, done at Canberra, 15 June 2015, [2015] ATNIF 15 (hereafter referred to as 'NIA'), para 4.

19 NIA, para 5.

China, including through a built-in review agenda for further liberalisation of bilateral trade and investment.²⁰

- 2.20 The NIA and RIS argue that the Agreement will deliver market access gains and cuts to tariffs in priority areas for Australia more quickly than any current multilateral and plurilateral negotiations underway, such as the WTO Doha Round and the Regional Comprehensive Economic Partnership (RCEP).²¹

Reasons for Australia to take the proposed treaty action

- 2.21 The NIA describes ChAFTA as a broad economic partnership agreement with China that is expected to further enhance the bilateral relationship, promote closer economic integration and highlight the relationship's strategic importance. According to the NIA the Agreement is expected to enhance an already significant and complementary bilateral economic relationship.²²
- 2.22 The NIA states that on entry into force of ChAFTA, more than 85 per cent of Australia's trade to China will have tariffs set at zero and on the full implementation of the Agreement, 95 per cent of trade will enter duty-free.²³ It also states that the Agreement will raise the Foreign Investment Review Board (FIRB) screening threshold for Chinese investors and commit China to providing Australian investors with the most favourable treatment it gives to any other investment partner in the future.²⁴
- 2.23 The following summary of the benefits for individual industries is taken from the NIA and RIS.

Agriculture and processed food

- 2.24 China is Australia's largest agriculture and fisheries market, with an estimated total value of \$9 billion in 2013-14. Its demand for high-quality agriculture and food products is growing rapidly. Nevertheless, China's current tariff barriers are high on certain agricultural products. Under the Agreement, agricultural tariffs of up to 30 per cent will be eliminated or significantly reduced on many Australian agricultural exports.²⁵

20 NIA, para 6.

21 NIA, para 7; RIS paragraphs 29-33.

22 NIA, para 8.

23 NIA, para 9.

24 NIA, para 10.

25 NIA, para 10.1. For further details see the RIS paragraphs 42-82.

Exclusions

2.25 China excluded several agricultural products from further liberalisation under the Agreement. China provides access to WTO members to its most sensitive agricultural markets (rice, wheat, cotton, maize and sugar) via large tariff rate quotas (TRQs) with low in-quota tariffs (one per cent for rice, wheat, cotton and maize, 15 per cent for sugar). Australian exporters have full access to these TRQs but Australia does not yet have technical quarantine market access for rice.²⁶

Resources, energy and manufacturing

2.26 Australia's exports of resources, energy and manufacturing products to China were worth over \$90 billion in 2013 (approximately 40 per cent of Australia's total exports), making China Australia's biggest export market in these sectors. On entry into force, 92.9 per cent of China's imports of these products from Australia (by value in 2013) will enter duty free. On full implementation of the Agreement, 99.9 per cent of Australia's current exports of these products will enter duty free. China will also provide greater certainty to traders by binding tariffs at zero for major resources and energy products, including iron ore, gold, crude petroleum oils and liquefied natural gas.²⁷

Impact on domestic manufacture

2.27 The RIS states that the implications of the Agreement for domestic manufacturing are expected to be mixed. Australian manufacturing businesses that use goods and materials produced in China are expected to have access to lower input costs as tariffs are eliminated or phased down, while industries that compete with products produced in China are expected to face additional competitive pressure. However, the RIS argues that greater competition provides incentives for domestic producers to innovate and lift their productivity, and is consistent with the Government's Industry Innovation and Competitiveness Agenda.²⁸

Services

2.28 China is Australia's largest services market, with exports worth \$7.5 billion in 2013–14 (13 per cent of Australia's services exports). Under the Agreement, China will bind its regulatory regime in a wider range of service sectors, providing greater certainty of treatment for Australian service providers. In some areas, the Agreement is expected to provide

26 RIS, paragraphs 83–84.

27 NIA, para 10.2. For further details see the RIS paragraphs 88–113.

28 RIS, para 114. For further details see the RIS paragraphs 115–119.

new access for Australian service providers. Australian banks, insurers, securities and futures companies, education providers, law firms, health and aged care services, mining and extractive industries, telecommunications providers, tourism and travel services are expected to be able to do business more easily in China.²⁹

- 2.29 Australia and China have agreed to a review two years after the Agreement's entry into force to consider the progressive liberalisation of measures affecting trade in services.³⁰

Investment

- 2.30 The Agreement is expected to provide further opportunities for investors in both countries. China has undertaken to extend the most favourable treatment it gives to any other investment party in a subsequent agreement with Australian investors. The FIRB screening threshold for Chinese private investors in non-sensitive sectors will increase from \$252 million to \$1 094 million.³¹
- 2.31 Australia has retained the ability to screen investments in sensitive sectors, including media, telecommunications and defence-related industries at lower levels and reserved policy space to screen proposals for foreign investment in urban land, agricultural land (at \$15 million or above) and in agribusinesses (at \$53 million or above).³²
- 2.32 ChAFTA includes an investor-state dispute settlement mechanism which the NIA maintains contains appropriate protections for government regulation in areas such as public welfare, health, culture, environment and foreign investment screening.³³
- 2.33 Australia and China have agreed to a review within three years after the Agreement's entry into force to consider further investment protections and increased market access.³⁴

Other

- 2.34 The Agreement also includes commitments on:
- *movement of natural persons*: China and Australia will provide guaranteed access to individuals of the other Party for certain categories of business visitors and skilled service providers,³⁵

29 NIA, para 10.3.

30 NIA, para 10.3. For further details see the RIS paragraphs 126–146.

31 NIA, paragraphs 10.4 and 13.

32 NIA, para 13.

33 NIA, para 10.4.

34 NIA, para 10.4. For further details see the RIS paragraphs 147–152.

35 For further details see the RIS paragraphs 153–161.

- *intellectual property*: the chapter on intellectual property reaffirms the Parties' existing international obligations and includes provisions on various issues including national treatment, enforcement, border measures, geographical indications and cooperation;
- *competition policy*: promotes cooperation between Australian and Chinese competition authorities through the exchange of information and consultation;³⁶
- *government procurement*: negotiation of a reciprocal agreement on government procurement after the completion of China's negotiations to join the WTO Government Procurement Agreement; and
- *electronic commerce*: provisions to prevent the imposition of customs duties on electronic transmissions, safeguard electronic commerce and facilitate cooperation in respect of consumer protection.³⁷

Memoranda of Understanding

- 2.35 Alongside ChAFTA, Australia and China have negotiated two Memoranda of Understanding (MOUs). The first of these is a Work and Holiday Arrangement, under which Australia will grant visas for up to 5 000 Chinese work and holiday makers annually.³⁸
- 2.36 The second MOU will allow for Investor Facilitation Arrangements (IFAs). Chinese-owned companies registered in Australia undertaking large infrastructure development projects will be able to negotiate, similarly to Australian businesses, increased flexibilities for workers engaged on specific projects. IFAs will operate within the framework of Australia's existing 457 visa system and will not allow Australian employment laws or wages and conditions to be undermined.³⁹

Obligations

- 2.37 The text of ChAFTA comprises 17 Chapters, four Annexes (including Schedules of Commitments for Australia and China) and five side letters. There are two Memoranda of Understanding and an additional side letter which do not form part of the Agreement.⁴⁰
- 2.38 Upon entry into force, or over time, each Party will eliminate or reduce specified tariffs on imports of goods from the other Party (**Chapter 2**) that

36 For further details see the RIS para 64.

37 NIA, para 10.5. For further details see the RIS para 165.

38 NIA, para 14.

39 NIA, para 14.

40 NIA, para 15.

meet the agreed Rule of Origin criteria (**Chapter 3**). The Parties' Schedules of tariff commitments are set out at **Annex I** to the Agreement, with a country specific tariff rate quota for Australian wool exports to China (**Chapter 2**). A review clause of the Agreement (**Chapter 16**) stipulates a requirement for the Parties to consider the deepening liberalisation and further expansion of market access three years after ChAFTA's entry into force.⁴¹

2.39 Under the Trade in Services and Investment Chapters of the Agreement (**Chapters 8 and 9** respectively), each Party will grant market access and non-discriminatory treatment (known as national treatment and most favoured nation (MFN) treatment) to services and investments from the other Party. In China's case, national and MFN treatment will apply to specific sectors listed in its Schedule of Specific Commitments (**Annex III**). In Australia's case, national and MFN treatment will apply except where specific measures or individual sectors are specifically reserved in the non-conforming measures annexures to the Agreement (**Annex III**). The Parties also commit to additional sector-specific disciplines affecting financial service providers and investors from each Party (**Annex 8-B**), in addition to those above in the Trade in Services and Investment Chapters of the Agreement.⁴²

2.40 ChAFTA also contains commitments and disciplines on:

- customs procedures (**Chapter 4**);
- sanitary and phytosanitary (SPS) measures⁴³ (**Chapter 5**);
- technical barriers to trade (**Chapter 6**);
- the movement of natural persons (**Chapter 10**);
- electronic commerce (**Chapter 12**); and
- Intellectual Property rights (**Chapter 11**).⁴⁴

2.41 **Chapter 15** (Dispute Settlement) contains a binding State-to-State dispute settlement mechanism modelled on previous free trade agreements and the WTO system. Most substantive obligations in the Agreement will be subject to this mechanism, except those found in the Chapters on Technical Barriers to Trade, Sanitary and Phytosanitary Measures, Electronic Commerce and the Movement of Natural Persons (aside from disputes meeting certain criteria).⁴⁵

41 NIA, para 16.

42 NIA, para 17.

43 'Sanitary and phytosanitary' (SPS) measures are measures, such as quarantine, to protect human, animal or plant life or health from pests and diseases.

44 NIA, para 13.

45 NIA, para 19.

- 2.42 **Chapter 9** contains an Investor-State Dispute Settlement mechanism.⁴⁶
- 2.43 **Chapter 13** (Transparency) requires the Parties to publish and administer their laws, regulations, procedures and administrative rulings of general application in respect of matters covered by ChAFTA consistently and fairly. **Chapter 14** (Institutional Provisions) establishes a Joint Commission to oversee the Agreement's implementation.⁴⁷
- 2.44 **Chapter 16** (General Provisions and Exceptions) sets out several WTO-style general and security exceptions which apply to a number of chapters of the Agreement. Such exceptions ensure FTA obligations do not unreasonably restrict government action in key policy areas, including action to protect essential security interests, the environment and health. **Chapter 16** also carves out application of a Party's taxation measures from the scope of the Agreement, and provides for the protection of confidential information.⁴⁸

Implementation

- 2.45 In order to implement the obligations in ChAFTA, a *Migration Act 1958* (Cth) Determination is required in relation to labour market testing. Amendments will also need to be made to the *Customs Act 1901* (Cth), the *Customs Tariff Act 1995* (Cth) and relevant customs regulations as follows:
- the Customs Regulations 2015;
 - the Life Insurance Regulations 1995 – in order to implement the agreement reached by the Parties to ChAFTA in respect of life insurance;
 - the Foreign Acquisitions and Takeovers Regulations 1989 requires amendment to incorporate the new threshold for screening investment proposals by Chinese private investors at 1 094 million.⁴⁹
- 2.46 In addition, new customs regulations will need to be enacted for the product specific rules of origin set out in **Annex II** of the Agreement.⁵⁰

Costs

- 2.47 The estimated loss of tariff revenue for Australia resulting from the Agreement is approximately \$160 million in 2015–16 and \$4 150 million

46 NIA, para 19.

47 NIA, para 20.

48 NIA, para 21.

49 NIA, para 23.

50 NIA, para 24.

over the forward estimates period. This estimate assumes that ChAFTA will enter into force in late 2015.⁵¹

- 2.48 This estimated costing does not include any flow-on impacts arising from increased bilateral trade with China once the Agreement enters into force or take into account additional lost tariff revenue if imports from China displace imports from other countries. The NIA states that the Government considers that entry into ChAFTA represents a net gain for the Australian economy.⁵²

Review

- 2.49 The review provision of the Agreement (**Article 16.5** (review of Agreement)), stipulates a requirement for the Parties to undertake a general review of the Agreement with a view to furthering its objectives (ie to consider the deepening liberalisation and further expansion of market access) within three years after the Agreement enters into force. Such negotiations may give rise to further treaty action under ChAFTA.⁵³

51 NIA, para 22.

52 NIA, para 22.

53 NIA, para 25.