393 Swanston St
Melbourne
Victoria 3000 Australia

TELEPHONE
ISD (613) 9663 5266
STD (03) 9663 5266

FACSIMILE
(03) 9663 4051
(03) 9663 8220

WEB
www.actu.asn.au

PRESIDENT
Sharan Burrow

SECRETARY
Greg Combet

18 April 2005

Committee Secretary
Senate Foreign Affairs, Defence and Trade Committee
Suite S1.57
Parliament House
CANBERRA ACT 2600

BY E-MAIL: fadt.sen@aph.gov.au

ATTENTION: KATHLEEN DERMODY

Dear Committee Secretary

Please find attached the ACTU's submission to the Senate inquiry regarding Australia's relationship with China.

We look forward to further updates on this matter. We are particularly keen to receive further information on trade related matters following the Prime Minister's meetings this week in Beijing and assessments relating to the Australia-China FTA Feasibility Study.

Yours sincerely

Sharan Burrow
ACTU PRESIDENT

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ACTU Submission to the Senate Foreign Affairs, Defence and Trade Committee Regarding Australia's Relationship with China.

The Australian Council of Trade Unions welcomes the opportunity to make a submission to the Committee's inquiry into the economic and political relationship between Australia and China. This submission will focus upon issues in connection with the proposed preferential trade liberalisation agreement (PTLA) with China and will also briefly comment on some other matters in pertaining to the relationship.

Trade liberalisation is about removing impediments to and exclusions from the operation of market forces that national government have established in respect of trade with other countries. Consequently there is room for debate about the desirability of allowing market forces to operate in respect of particular trade sectors or areas within sectors. There is also room for debate about the timing of, and preconditions for the removal of limitations on the operation of market forces in international trade, and the establishment of new frameworks for trade as existing barriers are removed. The ACTU's views on these matters are canvassed in this submission.

This submission describes the mooted bilateral agreement with China as a preferential trade liberalisation agreement because what is actually intended is to offer China preferential access to the Australian market, relative to that available to the vast majority of the 148 or so member countries of the World Trade Organisation. Apart from raising the issue of whether there should be criteria other than economic and geo-political considerations in the choice of partner, the following risks are inherent in preferential bilateral arrangements:

- some if not the greater part of any resulting increase in trade is actually due to the diversion of trade between one or both of the parties to the PTLA and other countries.
- increased complexity and other costs to exporting and importing businesses due to the proliferation of different rules of origin as a result of multiple bilateral agreements.
- diversion of resources and effort from multilateral liberalisation negotiations.

A study by the Productivity Commission of over a dozen bilateral PTLAs found that most of them led to significant trade diversion. The problem of rules of origin for tariff-free movement of industrial goods can be illustrated by reference to the existing PTLAs to which Australia is a party. The rules of origin approach in the Closer Economic Relations agreement with New Zealand and the Singapore Australia Free Trade Agreement is significantly different from that in the agreement with the US. Even where the approach is similar, as is the case with the agreements with the US and Thailand, there can be complexity costs due to variations in the detail.

The diversion of effort risk is evident in the number of PTLA negotiations, feasibility processes, and preliminary discussions the Commonwealth is pursuing at the same time as the Doha round of multilateral negotiations, e.g. ASEAN, Malaysia, United Arab Emirates, China, Mexico, Japan, Indonesia, and the South Pacific Island states.

Assessing the Prospects for Trade Benefits

There has been considerable media and other commentary about the potential significant economic advantages a bilateral agreement with China could deliver to Australia, chiefly since the conclusion of the Australia-China Economic Framework Agreement. Some commentators have hailed China as the prospective New Japan, in terms of its medium to long-term significance for Australia's economy, should the bilateral agreement be concluded.

It is a rather inapt comparison for two reasons. First, because the impact of the relationship with Japan on our economy over the last 40 years or so was so significant notwithstanding the absence, despite Australia's efforts, of a bilateral trade agreement. Second, Japan in the aftermath of the American occupation was a liberal democracy with an independent trade union movement and these characteristics contributed to the Australian community's acceptance of the development and strength of the relationship.

Nevertheless, the comparison suggests that a good starting point for evaluating a proposal for a bilateral PTLA is an assessment of the expansion in trade that is likely to continue regardless of whether the agreement eventuates. Another important consideration for evaluating a proposal for a PTLA is a realistic assessment of the degree of trade liberalisation likely to be achieved in the agreement for sectors of interest to Australia, such as resources, agriculture, and services. In the absence of such assessments, there is a risk that the claimed benefits of a bilateral agreement are exaggerated by increases in trade that were always likely to occur, and by improbable liberalisation scenarios.

China and Australia have a complementary trade relationship. Put simply China exports manufactured goods to Australia, and we export resources to China. This may not be a desirable state of affairs but it does point to the likelihood that the resources trade with China, which in 2003 represented 58% of Australia's total goods exports to that country, will continue to increase without a PTLA. China is not only importing Australian iron ore, copper, coal, etc; it also has concluded several and continues to negotiate further long-term supply arrangements buttressed by strategic equity positions in Australian companies and energy projects. Any gains in the resources area as a result of a PTLA symbolising and reinforcing the partnership are likely to be very modest.

For different reasons, the same can be said about agriculture. China has several hundred million peasants on small to minute holdings to protect and is therefore highly unlikely to make major concessions to Australia's export interests. According to the front page of The Australian, 12 March 2005, Mark Vaile described the level of Chinese government support for agriculture as 'at the moment quite extravagant' but indicated that this was a matter for multilateral rather than bilateral trade negotiations. This statement suggests that relatively modest gains in agricultural market access are expected from a PTLA with China.

In the ACTU's view, the likely gains in the services sector are also modest. China only joined the WTO in December 2001.WTO accession requires the consent of all existing members and this provides the latter, particularly those that nominate for the

committee to consider the application, with the opportunity to extract significant liberalisation concessions that are above the level of commitments of many if not most longer- term WTO members. Countries such as the US with ambitious services sector export objectives were centrally involved in the accession process. As a result China agreed to a degree of services liberalisation that in terms of both the inclusion of politically sensitive services, and the scope for majority or full foreign ownership, exceed the standard of liberalisation commitments from the developing world, and other East Asian WTO members.

For example, China's commitments include education services, which are not part of the 1994-5 commitments under the General Agreement on Trade in Services (GATS) given by countries such as Singapore, Indonesia, Malaysia, the Philippines, Thailand, India, and Pakistan. China's commitments also extend to health services.

To be fair, there are geographic restrictions in China's GATS schedule that designate cities or regions where foreign suppliers can be established for particular service sectors. However, these tend to be for a transitional period of a 3-5 years, rather than ongoing limitations. The same is true for many scheduled limits on foreign equity.

For example, full foreign ownership is, or in a few years will be, permitted for firms established in China to provide services in respect of taxation, accounting, architecture, engineering, urban planning, computer hardware installation, data processing, advertising, management consulting, technical testing and analysis, offshore oil fields, geological and geophysical matters, scientific prospecting, packaging, maintenance and repair, courier, non-life insurance, aviation and transport insurance, tourism and travel, luxury hotels, rail and road freight transport, franchising, storage and warehousing, and a range of banking services. Majority foreign ownership is or soon will be permitted for medical and dental, software implementation, contractual real estate, photographic, convention, translation and interpretation, construction, distribution, retailing other than tobacco, adult and higher education, and environmental services, and for services incidental to agriculture, forestry, hunting and fishing. Foreign ownership of 49-50% of equity is or will soon be allowed for telecommunications, securities, and maritime services.

This is a relatively extensive schedule of GATS commitments and one recently and probably reluctantly concluded. China's negotiators will also be aware of the scale of the reservations, limitations, and exclusions specified by Singapore and even more so Thailand for the services sector in the Singapore - Australia Free Trade Agreement and the Thailand - Australia Free Trade Agreement. The highly limited GATS commitments of Malaysia, Australia's other current East Asian negotiating partner for a bilateral PTLA, and the reluctance to liberalise services on the part of the ASEAN bloc with which we are negotiating a regional PTLA, will also be known. While clearly there is scope for some gains to be made, expectations of a services sector bonanza as a result of an agreement with China, already our seventh largest services export market, are not likely to be realised.

Expectations of greater protection of, and opportunities for, Australian investment in China as a result of a PTLA need to be similarly moderated. There is already a bilateral investment encouragement and protection agreement between Australia and China, which entered into force in 1988. It requires China to ensure fair and equitable

treatment to investments and activities associated with such investments, to accord protection and security to investments and activities associated with investments, and to treat Australian investments and associated activities no less favourably than those of a third country except where there is a free trade agreement or a double taxation agreement with the third country.

The 1988 agreement also requires China not to take any measures of expropriation or nationalisation or other measures having a similar effect unless the measures are in the public interest, non discriminatory, and involve reasonable compensation. The basis of calculation of compensation is outlined, and the agreement empowers an aggrieved investor to refer a dispute over compensation to an international arbitral tribunal. Moreover, the Australian government can refer a dispute over the operation of the agreement to an international tribunal.

In addition, according to the article headed 'China greater for cool-headed' in the 1 April 2005 edition of the Australian Financial Review, Mr Kym Hewitt, Austrade's senior trade commissioner in Beijing, states that most foreign businesses now open in China as wholly foreign-owned enterprises. This observation reinforces the point made above about the extent of foreign ownership permitted for the services sector. The DFAT brochure on the joint feasibility study notes that 55% of China's exports in 2003 were funded by foreign enterprises.

Caution should also be exercised in assessing net benefits from a China Australia FTA based on flowing on to China the changes made to foreign investment in the U.S. Australia FTA. Raising the takeover threshold to $800 million is likely to have two effects over time. Firstly, China is likely to takeover smaller Australian mining companies to secure resource access and establish more beneficial prices to China. Secondly China may begin to takeover smaller Australian based firms with strategic intellectual property for commercialisation in China. It is not at all clear that these developments would constitute a net benefit for Australia.

A further note of caution on the anticipated benefits of a PTLA with China was sounded in a 13 August 2004 paper on its legal system and business environment written by Ian McCubbin, a Partner in the firm Deacons. McCubbin argues that assessments of problems with China's compliance with its WTO obligations as due to conscious decisions by the Government, an industry sector or a company are often misplaced. He states that the problems tend to be due more to China's regulatory framework failing to keep up with the pace of the transition of its economy from a command to a free market economy. Moreover, " the purpose of this paper is to demonstrate that China's capacity to deliver on any FTA commitments, like its WTO commitments, or indeed even to make commitments, is severely limited by its relatively embryonic legal and regulatory system, which is likely to have the effect of restricting free market access, regardless of the terms of an FTA."

McCubbin does not argue against an FTA but instead believes that " A Free Trade Agreement will not solve the legal and regulatory challenges facing Australian companies trading with China or investing in China. Those issues are far deeper than any bi-lateral agreements."

At the time of writing this submission, the ACTU's perspective was regrettably uninformed by the findings of the completed joint feasibility study into the proposed PTLA, the release of which apparently is waiting upon China's agreement. It is to be hoped that the feasibility report will meet the onus which in our view rests on the proponents of a PTLA, namely to realistically assess both the prospects for liberalisation and the projected trade and economic benefits that are likely to result from a PTLA, discounting future trade expansion due to existing trends.

In the interests of transparency, estimates of the benefits of an agreement with China should also discount trade that is projected to occur due to diversion of trade with third parties, and identify separately those economic benefits due to increased Australian exports to and investment in China, and those due to the impact of liberalisation of the Australian economy. The claimed benefits of domestic liberalisation are achievable without a PTLA, as a result of domestic policy decisions that have a multilateral effect. Judging by previous bilateral negotiations, in the absence of separate calculations in feasibility studies, consultant's reports, and Minister's statements much of the media and the general public will perceive aggregate figures of economic benefits as indicative of export and offshore investment gains.

Manufacturing and a China Agreement

As will be outlined later in this submission, there are risks even for those sectors where Australia may expect to be the main beneficiary of gains in trade as a result of a PTLA with China. In the case of manufacturing, however, the starting point for any assessment is that this sector is where China is the prime beneficiary of the trading relationship.

Major Australian imports from China include clothing, computers, toys, games, sporting goods, furniture and telecommunications goods. In terms of elaborately transformed manufactures (ETMs) Australia's trade deficit with China rose from $3 billion to over $13.3 billion between 1995 and 2003-2004 , notwithstanding growth in China's total imports of ETMs from US$51.4 billion to more then US$300 billion over the same period. Despite strong growth of Australian ETM's to China from a low base, we continued to lose market share as we have in many East Asian economies since the mid 1990's.

This trend raises two questions: are there illegitimate cost advantages that contribute to growth in China's manufacturing exports to Australia and are there are problems with domestic policy settings that limit the export and import-competing potential of Australian industry?

Public debate on illegitimate cost advantages has to date been focused on the problem of dumping. The Australian Industry Group has highlighted the importance of maintaining Australia's ability to use particular anti-dumping options currently available under the terms of China's accession to the WTO. The ACTU shares this concern and believes that no agreement should be concluded with China that disadvantages local firms in their recourse to anti-dumping relief or diminishes the capacity to assess government subsidies including to state owned enterprises, as well

as the manipulation of business input prices, and to use surrogate costs and prices to determine normal value in dumping cases where this is appropriate.

However this does not exhaust the issue of illegitimate cost advantages. A developing country may have cost-advantages in manufacturing due to transnational corporations investing with the most up-to-date work organisation, technology, plant and equipment in order to generate economies of scale and scope. The same developing economy may also enjoy an advantage in labour costs because of the operation of market forces, a lower overall share of wages as a proportion of GDP, fewer on-costs, higher unemployment, and labour oversupply due to population shifts from rural to urban areas. These factors provide a legitimate cost-advantage in export prices and in import-competition.

However, in the case of China, there is an additional cost advantage that is not legitimate, namely the reduction in wages and conditions as a result of the denial of the right to organise and bargain collectively in independent trade unions, and the right to legally strike to achieve higher wages and conditions. The effect of this denial of rights is reinforced by the failure to enforce what labour laws currently exist, massive unpaid and unrecovered wages particularly in the construction sector, deficient and poorly enforced occupational health and safety regulations, and special export economic zones that combine cut-throat competition, excessively strict labour discipline, and grossly excessive working hours.

While some of these features can be found in other developing countries, China is an extreme case and it is with China that the Commonwealth proposes to negotiate a preferential trade liberalisation agreement. The ACTU also advocated the inclusion of a strong labour clause in the bilateral PTLA's that the Commonwealth negotiated with Singapore, Thailand, and the US. The ACTU submits that no such agreement should be negotiated with China without an enforceable labour clause that commits both parties to sign and implement the core conventions of the International Labour Organisation (ILO), includes effective monitoring and dispute resolution procedures, and establishes a permanent forum for social dialogue on workers' rights.

The ACTU accepts that it would be necessary for a phased implementation of such commitments in the case of China given the extent of the political, legal and institutional changes required, the likely adjustment costs, and the resource implications in terms of education and compliance. This would be to the advantage of both parties provided there was a corresponding contingent phase-in of Australian and Chinese tariff reductions negotiated in the agreement. Such an arrangement would allow the existing tariff phase-down provisions in respect of the automotive and textile, clothing and footwear (TCF) sectors to continue, which in our view is crucial. It would also provide the time for the development and implementation of an industry strategy to maintain and strengthen an export-oriented, high value added manufacturing sector.

There would be no need, however, to delay the establishment of the permanent forum for social dialogue. The forum would allow for informed consideration and monitoring of labour rights issues in both countries and the pace of progressive implementation of the labour rights commitments in the agreement, and also provide an opportunity for initial discussion of alleged non-compliance prior to the activation of formal dispute resolution. The ACTU submits it should be represented at such a forum, along with the ILO.

Services Sector Risks.

The other side of any balance sheet in respect of the services sector are the risks to Australia, and indeed to both countries. It should be noted that the Australian dollar value of current services exports to China, relative to the value of service sector imports from China, isn't as great as many people assume. In 2004 the value of exports was $1269 million, and of imports $995 million.

Liberalisation is a two way street and China is bound to seek the removal of barriers to services trade and investment in Australia. Securing greater foreign ownership in China's telecommunications sector while maintaining foreign equity limits in respect of a privatised Telstra might prove to be an interesting negotiating exercise.

China might also seek commitments beyond those in Australia's current schedule of GATS commitments in respect of energy services, services incidental to agriculture, mining and forestry, and associated transportation services, given that country's strategic interest in the energy and mining sectors and existing equity investments in agriculture as well as those two sectors. China is also a rising power in respect of maritime services, unfortunately also in the supply of cheap labour for flag of convenience ships, and may seek commitments in this area. Australia justifiably maintains trade restrictions for maritime services as a matter of domestic policy, and also in its GATS commitments, and should continue to do so. No agreement with China should be concluded that expands the access of flag of convenience ships to Australia's maritime services sector.

In the interests of the people of both countries the ACTU is concerned over the approach that Australia's negotiators will take in the negotiations. The Department of Foreign Affairs and Trade (DFAT) is likely to adopt the same approach taken in other bilateral negotiations and seek Services and Investment Chapters that are negative list in structure, and that fail to protect by way of exclusion public, social, and essential services.

Trade liberalisation agreements can be either negative or positive list in structure in respect of services and investment. The ACTU opposes the promotion and adoption of a negative list structure.

A positive list agreement applies the agreed liberalisation obligations only to those service sectors and sub-sectors that the parties specifically list as bound, with or without qualifying reservations or limitations. It also has the advantage that where, for a service included as bound with qualifications in the trade agreement, a national, regional or local government subsequently alters a domestic law, regulation or policy to provide greater liberalisation in practice than that envisaged under the qualified

commitment, a successor government is free to reverse the shift by repealing or amending the new law or policy.

In contrast a negative list structure has two problems. First, the liberalisation obligations apply automatically to services that did not even exist at the time the agreement was negotiated, thereby limiting the regulatory options of future governments in office when the new services emerge. Second, negative list agreements tend to have two annexes for limitations on liberalisation. One annex exempts measures affecting a service in a way that allows government full policy discretion, i.e. a government can change the arrangements to be further away from the state posited as desirable by the trade liberalisation obligations of the agreement. The other annex protects the existing arrangements only to the extent of allowing the maintenance of the degree of variance from liberalisation in effect at the time the agreement is concluded.

The latter annex has the additional disadvantage that if a future government varies the existing arrangements in the direction of further liberalisation, no successor government can act to revert in whole or in part back to the status quo when the annex was written. Policy movement is therefore unidirectional – towards comprehensive liberalisation. In practice, with negative list agreements the reservations that are listed under this annex tend to be greater in number than those in the annex allowing full policy discretion.

No matter the structure of the Services and Investment Chapters in a PTLA with China, the ACTU believes exclusions are required to maintain full domestic government policy discretion in respect of public, social, and essential services. This broad reference reflects the realty that increasingly in Australia and elsewhere what were once public services, such as water, rail transport, power generation etc, are privatised. The fact that such services are privately delivered does not alter the importance of governments retaining the power to regulate such services in the public interest, a power that can be circumscribed by liberalisation commitments in a PTLA.

There is an exclusion in the text of GATS for ‘services in the exercise of governmental authority’ and this is often replicated in PTLAs. However an agreement with China that contained this exclusion would not provide adequate protection of regulatory rights. Such services are defined restrictively as ones neither provided on a commercial basis nor in competition with other service providers. Moreover, there is no common understanding about whether privately delivered services under a licence from government can be classified as services in the exercise of governmental authority. For this reason, the Government of Singapore listed a specific reservation for services devolved by government to the private sector in the Singapore-Australia Free trade Agreement.

Civil Rights and the Relationship

The Country Information section of the DFAT website contains a paper headed People's Republic of China Country Brief – November 2004, Australia – China Relations. According to this paper " Our approach to human rights in China is constructive and based on dialogue rather than public confrontation". The ACTU's concern is that this approach appears to be interpreted by the Government as not merely involving avoidance of public confrontation, but also avoidance of occasional public criticism.

Over the last several months, according to media reports, the Government's political signals to China have included:

- In response to a parliamentary question by the Member for Melbourne Ports about civil rights in China, the Minister for Foreign Affairs simply read sections of the Chinese Constitution on civil rights, as if reality corresponds to the constitutional text. The Minister also declined to criticise the extensive use of detention in China on the grounds that Australia has a mandatory detention policy for unauthorised arrival by asylum-seekers.
- The Minister interpreted the ANZUS Alliance as not requiring Australia's engagement in the event of military conflict in the Taiwan straits, notwithstanding US involvement in such a conflict.
- The Prime Minister indicated that Australia does not oppose to the mooted EU military hardware sales to China.
- The joint feasibility study for a PTLA with China has been undertaken notwithstanding the fact that all other PTLA's concluded by Australia to date have been with countries that have systems of government with multi-party electoral contests.

The ACTU's objective is highlighting the above is not to indicate opposition to each and every cited diplomatic signal, or to question Australia's One China policy. However, when the apparent absence of public criticisms by senior Ministers of China's record on human rights is added, the pattern of signals can be interpreted as indicating that such matters are of minor concern in the evolving Australia-China relationship. This interpretation will be reinforced if the Commonwealth declines to make enforceable labour rights a requirement for a PTLA with China.

Given Australia's strategic interest in avoiding a conflict between China and the US over Taiwan, any downplaying of the significance of civil rights is counterproductive. It is difficult to foresee the peaceful unification of China and Taiwan occurring without a version of the "one country, two systems" model that maintains democracy in Taiwan well above the standard of the Basic Law for Hong Kong, and that is underpinned by significant democratic progress in the rest of China.