

# The China-Australia Free-Trade Negotiations: Implications for South Africa

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## Executive Summary

The Tenth Round of the China-Australia FTA Negotiations was held in Canberra on 1<sup>st</sup> November 2007. The FTA process, which was initiated in October 2003, has effectively been in a stalemate for the past year. Since the Seventh Round in December 2006, China has not substantially improved its offer for reducing tariffs on Australian goods imports. Australia has refused to move onto detailed tariff discussions until China commits to opening up its agriculture markets through tariff reduction and addressing a range of NTBs. Other stumbling blocks include technical disagreements over Rules of Origin, IPR, China's government procurement policy and China's import licensing scheme.

In early 2006, the South African (on behalf of SACU countries) and PRC Governments were in an advanced stage of discussions about an FTA. These discussions have been sidelined by South Africa's imposition of import quotas on Chinese textile imports and South African President Thabo Mbeki's directive to expediently address the growing trade deficit with China.

This paper looks at the China-Australia FTA negotiations up to the Sixth Round on 14<sup>th</sup> September 2006. The research objective is to identify key learnings, which could assist South African and other SACU countries' trade negotiators in negotiating their current trade and investment initiatives with China, as well as a possible future FTA.

The South African and Australian economies share many similarities and comparable trade profiles *vis-à-vis* China. However, there are significant differences, including the structure of economies, competitive advantages, and vulnerability to Chinese imports, that will have an impact on the costs and benefits each economy will face under an FTA with China.

Australia is China's 11<sup>th</sup> largest trading partner, 14<sup>th</sup> largest source of imports and 9<sup>th</sup> largest export destination. South Africa is not a major trading partner for China. Australia is broadly in a stronger position than South Africa to benefit from a full FTA with China. Australia's deficit is much less significant in GDP terms and South Africa is arguably more sensitive to output and job losses in the manufacturing sector.

Priority sectors in an Australia-China FTA are: Australia's manufactured merchandise market (TCF sector, auto sector); China's agricultural produce market; China's services market; China's investment policy framework. The priority sectors in a possible South Africa-China FTA would be similar. Australian negotiators have targeted China's services sector and investment framework as a key source of benefits for the Australian economy under an FTA. Access is hampered by restrictions on business scope, a wide range of NTBs, and a restrictive investment policy framework for foreign investors. Chinese officials have said they would not be comfortable opening these areas for negotiation under an FTA.

Tariff reductions are largely meaningless to exporters without the effective reduction in NTBs. South African negotiators should be pro-active in tackling these issues in China before, during and after the formal negotiations phase. This may include specific provisions in the FTA on post-FTA review mechanisms, and provisions to deal with non-compliance in this area.

Non-commercial, strategic interests have been strong drivers for China's engagement of Australia in an FTA process. In this respect, Australia is negotiating from a position of strength; China is interested in Australian resources (LNG, uranium) from a long-term, strategic outlook. China is also motivated by wanting to conclude an FTA with a major developed country, and in doing so training its trade negotiators and technical experts in the trade negotiation process. South Africa does not offer China the same strategic value.

The Joint Feasibility Study (JFS), conducted jointly by both negotiating teams prior to the start of formal negotiations, has played an integral role in the China-Australia FTA engagement. The JFS serves as a research document that is the centrepiece of DFAT's mission to engage the Australian domestic stakeholders. The JFS forced both governments to show their hand on potentially sensitive issues that would arise later in the formal FTA negotiations. The document is also a vehicle for information exchange, used to 'educate' stakeholders from both sides. As a jointly negotiated document the JFS sets a very important tone of consensus and cooperation. South African policy-makers are encouraged to dedicate the time and resources necessary to engage their Chinese counterparts through this invaluable exercise.

Australia has asked China to commit to domestic reforms (especially in the areas of services and investment policy) as a prerequisite for an FTA. However, China is under enormous pressure to continue its rapid reforms and some Australian officials suggested that it may be unreasonable to expect a much faster pace of reform. Instead of focusing on the national level regulatory and policy frameworks, the South African negotiators should use the FTA process as a platform to leverage preferential access for specific South African companies. South African MNCs and SMEs will ultimately be the vehicles through which the South African economy and people derive benefits from an FTA. South African negotiators should work closely with these companies throughout the FTA process.

South African negotiators should not agree to anything less than a comprehensive FTA with China. China has made it clear that it prefers to 'delay' negotiations on services and investment liberalisation. One Australian negotiator commented that an initial FTA including only merchandise trade is unlikely to produce a positive outcome for the South African economy and society; it may even lead to a net loss in output and employment. He urged South African policy-makers to appreciate that the real benefits of going through the FTA process with China lie in the improved trade in services, investment facilitation, and increased broader bilateral cooperation.

Chinese negotiators and officials are often not allowed, or are unwilling, to openly discuss sensitive topics with their Australian counterparts. Australian officials have found that Chinese 'think tanks' or University professors are often able to shed more light on domestic issues in China. Engaging with these academics and various business stakeholders through seminars and workshops has been very useful in better understanding the dynamics of China's stance on the FTA.

Australia has been very pro-active in promoting dialogue between the various factions in China's government bureaucracy. The Australian Embassy in Beijing has organised an extensive program of conferences, seminars and meetings, in order to bring about greater communication between the different Chinese departments and agencies; and in doing so, facilitating more constructive negotiations for both sides. The Australian Embassy in China has been very useful in building support for the FTA amongst the various departments and provincial authorities in China. The China FTA Taskforce has a senior negotiator and a large team based permanently in Australia's Beijing Embassy, and the Ambassador devotes much of his time to FTA-related activities.

The Australians have taken a multi-pronged approach to engagement with China – the FTA is only one element. It is essential not to rely on the FTA initiative as the sole basis for bilateral cooperation with China, ensuring that there are alternative channels open through which separate issues may be resolved. Examples of other channels include the Australia-China LNG deal and the current cooperation on the export of Australian uranium. These projects have been handled concurrently with the ongoing FTA process. The Chinese negotiators have in the past used the FTA negotiation to apply pressure on separate bilateral issues.

A full FTA between South Africa and China would require both economies to undergo painful restructuring. An Australian negotiator emphasised that FTA negotiations should be backed by the political will on both sides to make the market system and broader trade liberalization the basis of the FTA. Australia has embarked on a gradual and often painful process of tariff liberalisation and restructuring since the 1980s. Without the same level of 'preparedness', an FTA between China and South Africa is unlikely to be successful.