



**Australia-China FTA Conference
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It gives me great pleasure to be here in China once again to speak on behalf of Australia's manufacturing sector as we examine the issues surrounding the proposed Free Trade Agreement between Australia and China.

These FTA negotiations are taking place in the context of profound changes in China's economy. China is now the World's fourth-largest economy. It is expected to be ranked third by 2010 and second by 2015-2020.

This rapid development presents both enormous opportunities and challenges, not just for other economies, but for China itself. Among the most pressing challenges facing China are the twin imperatives to grow the economy at a high rate in order to meet economic and social objectives while at the same time protecting China's physical environment.

Turning to Australia, we, like China, have seen a sustained period of strong economic growth. We are currently experiencing the longest economic expansion in the last half century, which has seen 15 years of continuous growth, founded upon rapid microeconomic reform and the opening of Australia's economy to the world in the 1980s and 1990s. As a result, the World Economic Forum in its 2005-06 Global Competitiveness Report, ranked Australia tenth out of 117 economies, up four places from our ranking in the previous year.

Nonetheless, it is a simple truism that the competitive global environment largely led by China dictates that Australia keep improving, or we will be quickly left behind.

Australian manufacturing has - and will continue to be - a significant driving force in the Australian economy. As a single sector it accounts for the largest share of business activity, employment, business research and development, and a substantial proportion of business investment in the overall economy. In percentage terms the manufacturing sector accounts for around 13 per cent of Australia's GDP, which is substantially larger than mining and agriculture combined, covering five per cent and 3.6 per cent respectively.

Manufactured goods make up over 45 per cent of all Australia's exports (on an industry of origin basis). In the last 15 years, Australian exports of simply transformed manufactures have doubled, while exports of elaborately transformed manufactures have trebled.

But Australian manufacturers are realists. Despite these impressive statistics, they know they are at the frontline in facing the challenges posed by global competition predominantly led by China.

There is also an increasing understanding by Australian manufacturers that they must integrate themselves into global supply chains. The percentage of Australian manufacturing derived offshore – either from offshore production or through the use of imported materials – is expected to increase from 15 to 25 per cent over the next three years. For example, around a third of inputs to Australian automotive production are imported, although this varies significantly from manufacturer to manufacturer.

Substantial offshore investment has also become an integral multi-domestic strategy for many Australian manufacturers, so that since 2000, inward investment in manufacturing is now in fact being outpaced by offshore investment in manufacturing.

Inevitably, with or without an FTA, economic ties between Australia and China will become even closer and stronger. Our futures are linked as never before and we will continue to work to maximise the mutual benefits of our growing relationship.

Given all of these circumstances, and especially in the context of today's conference, I want to put to you the firm expectations which Australian manufacturers have in regard to the proposed Australia-China FTA. In brief, these are:

1. While acknowledging that there are complementary features that exist between our two economies, intrasectoral trade in the manufacturing sector must be enhanced.
2. The Agreement must be comprehensive in scope, and genuinely liberalising across all sectors of the commercial relationship.
3. Elimination of the maximum number of tariffs on Australian exports into China, especially given the extensive unilateral tariff reductions Australia has already implemented.
4. Substantial improvement in China's enforcement of intellectual property rights.
5. Reforming other major non-tariff barriers faced by Australians doing business in China, including: lack of transparency in legal and financial systems; inconsistency in Customs requirements; unnecessarily onerous technical standards and investment restrictions.

Without doubt, a key threshold issue for Australian manufacturers goes to the fundamental question of the so-called "complementary" nature of the Australian and Chinese economies. I want to take a few moments to analyse this statement. Virtually all of China's \$21.4 billion worth of exports to Australia in 2005 were value added products such as clothing; computers; toys, games and sporting goods; and telecommunications equipment. Commodities such as iron ore, wool, copper and coal dominated the \$16.1 billion worth of Australian exports to China. At this level there are unquestionably strong complementary trade flows, which clearly benefit both countries. Despite this, Australia has a \$5.3 billion merchandise trade deficit with China, which is only partially offset by a \$1.3 billion services trade surplus in Australia's favour, still leaving an overall trade deficit for Australia of \$4 billion.

Within this framework, we must not lose sight of the fact that there are genuine intrasectoral complementarities that do exist now between the manufacturing sectors of our two countries but there is still much greater untapped potential. Australian industry is becoming increasingly aware of these complementarities which are seen as critical if Australian manufacturers are to view this engagement as a balanced partnership.

The latest figures show that only 12.5 per cent of Australia's exports by value to China last year, were manufactured goods. Principal among these were electrical equipment and machinery; machinery and transport equipment; and chemicals. Looking forward, Australian

manufacturing has a number of areas which could benefit greatly from increased access to the Chinese market. These include mining and energy technologies, construction and building products, infrastructure, chemicals, food & beverages, environmental technology, biotechnology and health – all of these areas fit key requirements of China's rapidly expanding economy. China's 247 million strong middle class is also a massive potential market for Australian exports of dairy and other food products, organic products, wine and other beverages, and niche consumer goods, such as art, jewellery and cosmetics.

Australian industry sees great potential in attaching solutions to China's growing manufacturing activities and for Australian companies to move up the value chain by providing these specialised products. For example, one Ai Group member company BlueScope Steel uses the latest design technology to deliver high-quality construction solutions in China. Another of our member companies has signed a multi-million dollar contract to provide manufacturing robots to a major Chinese manufacturer. A third member company has provided enterprise software applications to a Chinese automotive accessories manufacturer to enable lean manufacturing operations and achieve dramatic reductions in material inventory, substantial reductions in stock space and enhanced data for logistical support and personnel savings.

So to define, let alone conclude, an FTA between Australia and China which does not go to the heart of addressing the opportunities and challenges surrounding this threshold issue of intrasectoral complementarity would simply mean that Australian manufacturers would see no purpose in the FTA, let alone receive their ultimate support.

Taking this threshold issue further, this means that the FTA should deliver immediate tariff elimination on the greatest number of products possible, while accommodating existing transitional arrangements for sensitive sub sectors which could exist on both sides. For those items for which a phased tariff reduction is necessary, zero or near zero tariffs should be achieved within a maximum of ten years.

Australia's average tariff level is 3.4 per cent. Our tariffs on manufactured products are now either five percent or zero, with the exception of automotive and TCF sectors, which are also in the process of substantial liberalisation. Tariffs for passenger motor vehicles and parts are now ten percent, and will fall to five per cent in 2010. TCF imports currently attract a tariff which ranges from five percent to 17.5 per cent. Of these, the tariffs on clothing and certain finished textile products will fall to 10 per cent in 2010 and then to five per cent in 2015, and the tariff on footwear will be reduced to five per cent in 2010. Ai Group has a firm view that the tariff phase-down arrangements on these two highly sensitive sectors must be embodied unchanged in any final FTA arrangements.

On the other hand, China's average tariff level is 9.9 per cent. This has fallen substantially from 15.3 per cent in 2000, and 56 per cent in 1982. We welcome the efforts that China has made to date, both prior to and since the milestone of its accession to the World Trade Organisation in 2001.

The average tariff level on industrial products entering China is 9 per cent, which has fallen from 14.8 per cent in 2001. Some tariffs on manufactured products are significantly above the average, for example, passenger motor vehicles at 25 per cent (as of 1 July 2006); audio and video equipment at around 30 per cent; car tyres at 10-25 per cent; motor vehicle parts at 10 per cent (as of 1 July 2006); clothing at 14-25 per cent and carpet at 10-16 per cent.

It is important to note that when we compare the duty free entry of merchandise goods into both countries we find that Australia only receives duty free entry on 8.4 per cent of tariff lines, whereas China receives duty free entry on 48 per cent of tariff lines.

Clearly, from Australia's perspective these statistics highlight that there is a critical need for genuine reform on the tariff front in the FTA. However, tariff reductions are, in some respects, the easy side of market liberalisation. The benefits of such reductions, while important, can be completely nullified by the operation of non-tariff barriers in the Chinese market. And therefore, matters relating to beyond the border market restrictions are companion issues to the tariffs and of critical importance.

In order to obtain detailed information on these non-tariff barriers as well as to define more effectively the issues impacting on the commercial relationship between Australia and China, the Australian Industry Group has just undertaken a major study of Australian manufacturers. The yet to be released study canvassed over 700 companies with a total turnover of \$24.5 billion.

Preliminary results of the study show that Australian manufacturers are encountering significant non-tariff barriers in the Chinese market, with 20 to 50 per cent of respondents listing one or more of the following seven key issues, in descending order of frequency -

- Lack of intellectual property protection;
- Lack of transparency in legal and financial systems;
- Inconsistent enforcement of import duties;
- Inconsistent interpretation of provincial laws;
- Different customs requirements;
- Unique technical standards; and
- Restrictions on foreign investment.

As I have already mentioned, innovation is a critical attribute needed for Australian companies to compete in the global marketplace. Intellectual property rights are essential for safeguarding this innovation. IP rights infringement by Chinese companies remains the greatest concern of not only Australians exporting to and investing in China, but for companies supplying the Australian and third country markets. Almost half the responses to our recent study identified shortcomings in China's IP protection as the number one issue of concern among all China's non-tariff barriers.

Despite the commendable efforts to date of China's authorities, piracy and counterfeiting remain a critical problem. The International Intellectual Property Alliance reports that piracy rates in China remain at over 90 per cent across all copyright industries. IP infringement in the Chinese market is enormously exacerbated by the ineffective pricing formula used by authorities on which to base penalty payments imposed on those parties found guilty of counterfeiting and piracy.

Australian consumer goods companies report that on average 15-20 per cent of their products on the Chinese market are counterfeit. Ai Group members in the auto and electrical products sectors have identified numerous factories illegally copying their products. When they have taken action with local authorities to shut these plants down, they find that other infringers rapidly spring up in other locations. Many of our members see enforcement of their IP rights in China as a futile endeavour and intentionally withhold innovative designs or products from the Chinese market.

China's IP enforcement problems are also being exported to the world. More than one in five companies in the Ai Group study said they had experienced IP infringement from Chinese goods in the Australian market, nearly double the number of surveyed companies experiencing IP infringement in the Chinese market.

IP rights infringement also affects China's prosperity. Widespread breaches of IP rights stifle innovation in the Chinese economy, as well as lowering Government revenue. China estimated that its own tax losses due to counterfeiting in 2002 were around US\$3.2 billion. Can I suggest that if China is to be truly seen and treated as a modern market economy, then effective protection of IP rights is critical.

So it is central to the FTA that it delivers substantial improvements in the protection of IP rights for Australian companies doing business with and in China. Of course the Australian Industry Group is not underestimating the magnitude of the IP enforcement task, but we do believe that more can be done to strengthen the enforcement of China's existing IP laws. As I said, this is a fundamental issue that concerns our members more than any other non-tariff barrier in the Chinese market.

In looking at ways to address this issue specifically, Ai Group would want the FTA to address the following IP enforcement issues in China:

- Improved coordination between central and local government agencies;
- Lowering the high thresholds for initiating investigations and prosecuting criminal cases;
- Addressing the situation whereby IP infringement cases brought by administrative authorities often do not treat the infringing goods as having the value of the genuine articles, but rather establish value based on the price of the counterfeit or pirated goods;
- Improved and more transparent enforcement processes;
- Prevent exports of counterfeit and pirated goods, and prosecute exporters of infringing products; and
- The establishment of an ongoing bilateral consultative and referral mechanism to address the particular IP concerns of Australian business people regarding IP rights infringement in or from China. In this regard, the Australian Industry Group has for some time advocated that as an early investment in the FTA process, Australia and China agree to set up now a dedicated IP panel that could focus on implementation issues hindering Australian companies.

In furthering our work in this IP area, the Australian Industry Group, together with IP Australia – an Australian Government agency - and the Intellectual Property Research Institute of Australia, is currently undertaking a follow-up survey of Australian businesses concerning their experience with doing business in China, with a particular focus on IP issues. The results of this survey will provide additional input to this important part of our FTA negotiations.

Looking at other Non-Tariff Barriers affecting Australia's access to the China market, a lack of transparency in legal and financial systems was identified by almost half of the manufacturers surveyed in the Ai Group study as another key issue. The latest Transparency International Corruption Perceptions Index - which assesses more than 150 countries in terms of perceived levels of corruption – has ranked Australia ninth and China 78th. Given this disparity, it is not surprising that Australian business people frequently encounter difficulty operating in the Chinese market.

On another issue, despite China's accession to the WTO and the publication of guidelines relating to the customs valuation of imported goods, more than 40 percent of manufacturers surveyed in Ai Group's study cited the enforcement of import duties as a further non-tariff barrier.

The inconsistent interpretation of provincial laws was raised as a problem by more than a third of Ai Group survey respondents. Legislation in China tends to be general in drafting style, lending itself to different outcomes in interpretation between and within provinces. Regional protectionism by provincial and local authorities is sometimes the motive for the inconsistent application of provincial legislation.

Over one third of manufacturers surveyed perceived difficulties with China's enforcement of technical standards. For example, our wine industry now faces onerous labelling and packaging restrictions on exports to China. Member companies have also experienced unwarranted difficulties and expense with the administration of the new China Compulsory Certification (CCC) mark system. This system has been applied inconsistently, and requires the expensive and onerous on-site inspection of manufacturing facilities outside China, for which Australian manufacturers have to bear the cost.

On the investment front, China has approved around 5,000 Australian investments, amounting to about \$1.2 billion. Nonetheless, almost a quarter of our survey respondents regarded foreign investment restrictions as further impeding access to the China market, compounding the other non-tariff barriers already identified. In some sectors regarded as not consistent with China's current development needs, foreign companies are still restricted to a minority share in a joint venture with a Chinese company. There are many examples where investment restrictions still remain. In the banking sector, a single foreign investor in a Chinese bank is restricted to 20 per cent, with a total of 24.9 per cent allowed for all foreign investors in that bank. Foreign investment is banned in a range of electronic and film media sectors. Foreign investors are not allowed to have a controlling share in iron and steel enterprises in China, and China's 2005 Steel Policy closely prescribes the number and size of steel producers, their location, products and the technology to be used.

As I mentioned earlier, offshoring has become an integral part of the business strategies of many companies and manufacturing is dependent upon a range of business services: finance, legal, insurance, engineering, transport to name a few. For this reason, investment and services liberalisation are inextricably entwined with the future of Australian manufacturing and removing barriers in these areas are a critical part of Australian manufacturing's FTA agenda.

Finally, on the issue of anti-dumping, latest figures show that from 1995 to 2005 China was the subject of 469 anti-dumping initiations globally, while Australia only faced 17 over the same period. Australian manufacturers are increasingly concerned that the incidence of Chinese products entering the Australian market at dumped prices is accelerating. Ai Group is doing and will continue to do everything possible - consistent with WTO rules - to attack cases of dumping on the Australian market whether this be from China or any other markets.

Within the broad Australia-China engagement, the Australian Industry Group's study shows that China is looming larger and larger in the worldview of Australia's manufacturers. The study found that around 85 per cent of companies were affected by China, up from 70 per cent on Ai Group's 2004 study.

Our study found that for Australian industry, China is now a competitor of near equal importance as domestic competitors, with over 40 per cent of respondents citing competition from China as an issue of concern. 40 per cent of companies surveyed said that China had caused a negative impact on profits, largely as a result of the effect of Chinese demand on global input prices and the import squeeze on domestic selling prices resulting from Chinese competition, which has been compounded enormously by the low value of China's currency.

While the currency issue is not strictly within the ambit of the FTA negotiations, I would like to leave you in no doubt that Australian manufacturers see the relative low value of the Yuan as a major obstacle to their competitiveness.

However, while the study clearly highlights that the “threats” from Chinese competition still substantially outweigh “opportunities”, significant benefits are increasingly being gained, notably through cost savings achieved by either producing in China or using Chinese production inputs. Nonetheless, at this point in time only some 12 per cent of companies indicated that they had a presence in China.

China is seen by companies as providing the best growth opportunities outside the Australian domestic market, with more than one in five companies expecting high or very high growth from engagement with China in the next year. A substantial proportion of companies are already gaining important benefits from tapping into Chinese supply chains, off-shoring, and export potential.

When we questioned Australia’s manufacturers whether or not they supported an FTA with China, only 24 per cent said they saw a benefit. While this is up from 13 per cent in 2004 the result underlines a substantial degree of ambivalence caused by the need to address the issues which I have emphasised here today. As shown from our study, Australian manufacturers will only support an FTA with China if it provides tangible benefits to their businesses and their future prospects.

It is clear from my remarks today that Australian companies are already deeply engaged with China both from a commercial and a trade policy perspective. However, the case for Australian manufacturing supporting an FTA is still to be demonstrated.

If China shows real commitment in effectively addressing the issues I have mentioned today, then Australian manufacturers could be persuaded that China is fully behind achieving a genuinely liberalising FTA with Australia.

So the Australian Industry Group believes that any FTA between the two countries must be comprehensive in scope, covering both tariff and non-tariff issues. It should be genuinely liberalising across all sectors of our economies. It is critical that both sides continue to work hard to ensure comprehensive sectoral coverage and that the FTA addresses the need for Australian manufacturers to find genuine opportunities within the China market while addressing those areas which blatantly offend against a level playing field

In closing my remarks today, I would like to thank the hosts of this Conference - the Chinese Ministry of Commerce, the Australian Department of Foreign Affairs & Trade, the Chinese Development Institute and Melbourne University’s Asian Economic Centre. This gathering provides an excellent opportunity for government and business representatives from both countries to come together and discuss these important issues. The high level of representation from both sides demonstrates the strength and maturity of the ties between our two countries. I look forward to continuing our dialogue on these important issues and deepening the personal and business relationships flowing from this critical engagement.

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