

**AUSTRALIA, CHINA FREE TRADE AGREEMENT:  
THE PURSUIT OF A  
NET WELFARE GAIN**

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## *I INTRODUCTION*

The negotiation of a comprehensive Free Trade Agreement (FTA) with China places Australia in a unique and potentially lucrative position. An FTA between Australia and China has all the ingredients required to create a net welfare gain; both parties stand to benefit directly and indirectly from the successful completion of an all inclusive bargain. For the first time China has agreed to engage in talks where “everything is on the table”.

Australia and China each have two key objectives underlying the negotiation process. At the forefront of Australia’s agenda is the reduction of tariffs and protectionist measures at China’s end. The second key objective is to make the Chinese markets more accessible, which involves tackling the ‘behind the border issues’.<sup>2</sup> Comparatively, China hopes to gain international credibility and resource security from successfully completing an FTA with Australia.

Whereas previous FTA’s have been with politically and economically similar countries,<sup>3</sup> negotiators face huge challenges in bridging the vast cultural gulf. Further to this the

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<sup>2</sup> ‘Behind the border issues’ is a phrase coined by the media and Trade Minister Mark Vaile to refer to issues which have significant effect on the ability of companies to establish themselves in China or to operate in China. The two major behind the border issues are transparency and protection of intellectual property rights.

<sup>3</sup> US, NZ are two countries with similar political structures

The US has proclaimed its desire for democracy to a similar degree as Australia. As President Bush said in his State of Union Address, “Our aim is to build and preserve a community of free and independent nations, with governments that answer to their citizens, and reflect their own cultures. And because democracies respect their own people and their neighbors, the advance of freedom will lead to peace.” Our shared values and common traditions provide a crucial foundation for closer political and economic integration.

Roger Noriega, Assistant Secretary for Western Hemisphere Affairs. ‘China’s influence in the Western Hemisphere’ (Statement before the house subcommittee on the Western Hemisphere, Washington, 6 April 2005)

Full text available <[www.state.gov/p/wha/rls/rm/2005/q2/44375.htm](http://www.state.gov/p/wha/rls/rm/2005/q2/44375.htm)> at 16 September 2005.

differing stages of economic maturity creates another hurdle. Consequently, discussions will be at times tedious and compromise hard fought. This sentiment was echoed by Prime Minister John Howard where on the topic of Australia and China FTA he stated ‘it will be a very complex negotiation, but it will be approached by Australia in a positive frame of mind and with great energy and commitment’.<sup>4</sup>

In Part 1 this paper seeks to provide a general overview of the trade environment currently in existence between Australia and China. Part 2 outlines the benefits and drawbacks resulting from an FTA. We shall then seek to illuminate any potential problems in key industries in Part 3 and provide possible solutions. Overarching issues are discussed in Part 4. Finally, in Part 5 we suggest a dispute resolution process and a mechanism for disseminating information to enable small and medium business to also access the benefits of this FTA.

### *A Why is Free Trade Good? An Economic Analysis*

The basic notion behind trade is that we can consume goods and services that we would not otherwise be able to produce and hence consume on our own. Without trade one would not have the choice of the best quality at the cheapest possible price.<sup>5</sup> The benefits of free trade can be explained by the concept of comparative advantage. A country has a comparative advantage if they can produce a product at a lower *opportunity* cost than any

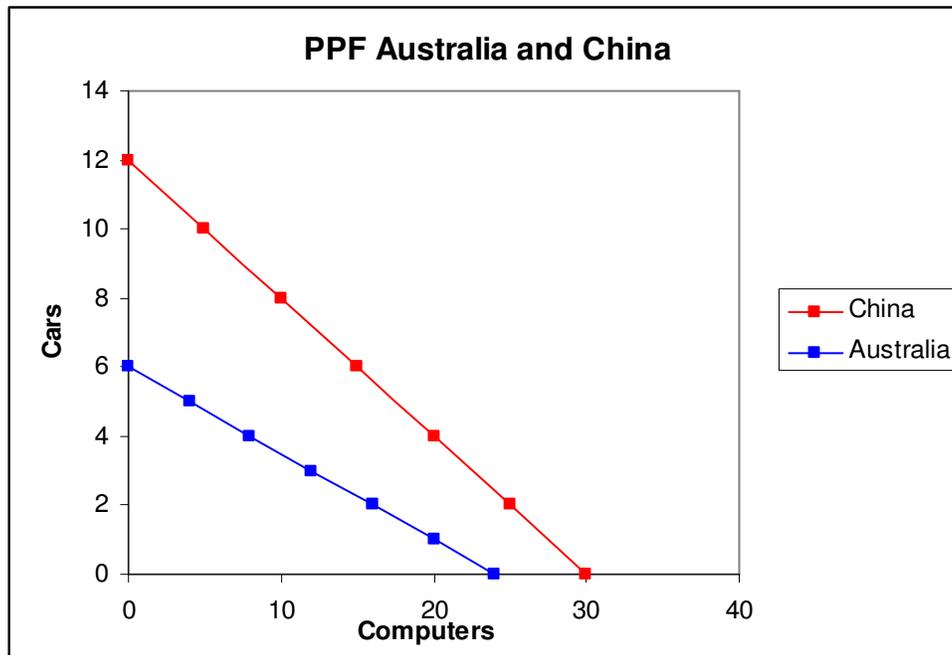
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<sup>4</sup> Prime Minister John Howard, ‘Speech delivered in Beijing’, China, 19 April 2005.

<sup>5</sup> Norberg, Johan, *In Defence of Global Capitalism* (2005) 71.

other country.<sup>6</sup> Here one must distinguish between absolute advantage and comparative or relative advantage. A country has an absolute advantage in the production of a good or service if its output per unit of inputs is greater than any other country's,<sup>7</sup> that is to say it is the best producer of that good or service. For a country to benefit from free trade an absolute advantage is not essential, even if a few countries are best at producing everything (absolute advantage), countries that are not at the pinnacle of production in any industry can still handsomely benefit from free trade by producing the goods and services in which they have a comparative or relative advantage. To illustrate; assume China and Australia only produced two goods, cars and computers, the relative outputs could be described by their respective Production Possibility Frontiers (PPF)<sup>8</sup> in diagram 1 below:

Diagram 1



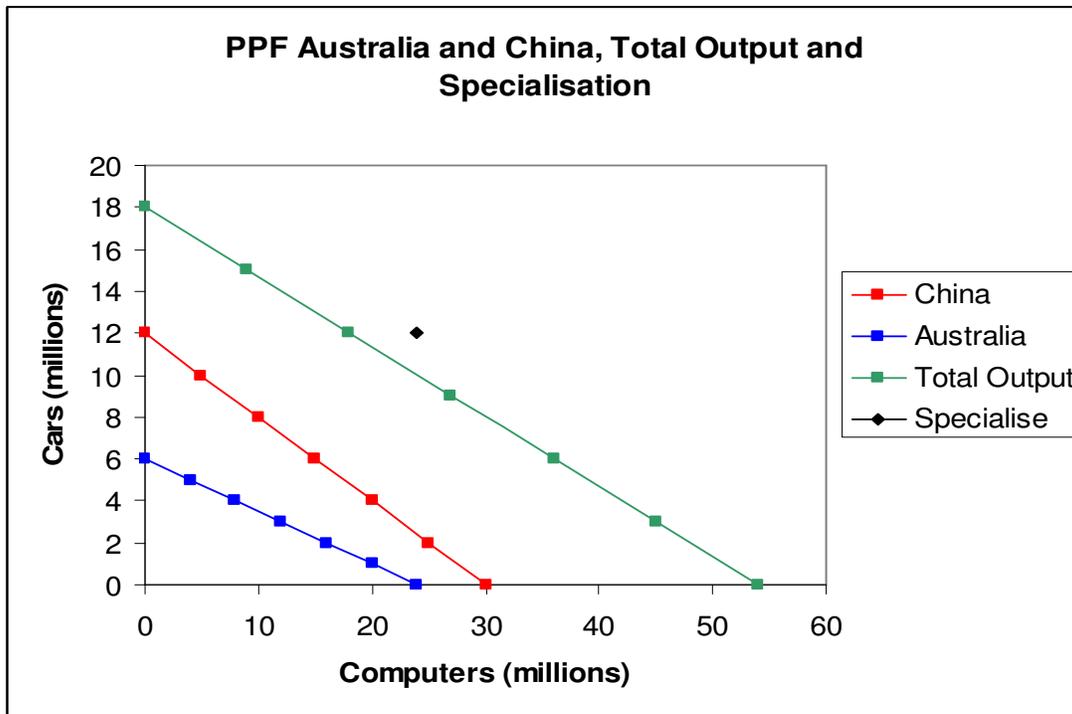
<sup>6</sup> D McTaggart, C Findlay and M Parkin, *Economics* (4<sup>th</sup> ed. 2003) 23-24.

<sup>7</sup> D McTaggart, C Findlay and M Parkin, *Economics* (4<sup>th</sup> ed. 2003) 23

<sup>8</sup> The PPF is the boundary between attainable and unattainable levels of production at any point in time. D McTaggart, C Findlay and M Parkin, *Economics* (4<sup>th</sup> ed. 2003) 21.

From the diagram we can ascertain that China has an absolute advantage in producing both cars and computers, at first glance it may appear that China would obtain no advantage in trade with Australia. However upon closer inspection one would discover that Australia has a lower *opportunity* cost of producing computers,<sup>9</sup> each computer produced in Australia requires a smaller sacrifice in car production than would be the case in China.<sup>10</sup> Thus a net gain will result from trade, if Australia specialises in computer production by producing their maximum output of computers and China specialises in car production by producing their maximum output of cars, Australia and China can produce beyond their combined Production Possibility Frontier. This is reflected in Diagram 2 below where at the point of specialisation lies beyond the combined total output of Australia and China;

Diagram 2



<sup>9</sup> See appendix 1 for calculations.

<sup>10</sup> Ibid.

Hence one can see that free trade should result in increased production that will allow both Australia and China to consume beyond their PPF and that a country need not have an absolute advantage to benefit from free trade.

Common anti global sentiment seems to argue that exporting is beneficial and importing is detrimental.<sup>11</sup> This premise is fundamentally flawed. If a country was to limit imports the sheltered local producers would sell their produce domestically at a price higher than that command by the free market. This would result in lower exports, as the produce would be sold locally. At the same time this would lower the welfare of consumers who have now paid a higher price for the local good,<sup>12</sup> as this purchase has devoured a greater portion of their disposable income. For a country to realise their economic potential they should export what they produce best so that they may import goods and services that they are not so efficient in producing. If a country was to only export they may indeed stock pile currency, however until you purchase imports that you can not produce yourself, or can not produce as efficiently as others your standard of living will not rise.<sup>13</sup>

Empirical evidence also supports the proposition that free trade is desirable. From 1970 – 1989 growth in free trade countries was between three to six times higher than in

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<sup>11</sup> A mercantilism argument based on the premise that a nations wealth and power were best served by increasing exports and collecting precious metals in return. A trade surplus is the only way to prosper. G.R. Steele, 'The Money Economy: Mercantilism, Classical Economics and Keynes' General Theory - Special Invited Issue: Money, Trust, Speculation and Social Justice - Part 2: Trust and Money' (1998) October *The American Journal of Economics and Sociology* <[http://www.findarticles.com/p/articles/mi\\_m0254/is\\_4\\_57/ai\\_53449309](http://www.findarticles.com/p/articles/mi_m0254/is_4_57/ai_53449309)> at 5 November 2005.

<sup>12</sup> Norberg, Johan, *In Defence of Global Capitalism* (2005) 75.

<sup>13</sup> *Ibid* 75-76.

protectionist countries.<sup>14</sup> On top of this annual growth within free trade countries did not fall below 1.2% in this time frame, with developing free trade countries experiencing growth levels no lower than 2.3% from 1970 – 1989.<sup>15</sup>

Free trade represents freedom to choose what one wants to buy, where they can choose from who to buy and when.<sup>16</sup> Such an environment leads to the efficient allocation of resources. Countries that specialise in industries where their comparative advantages lie will generate their greatest possible value as resources flow from less competitive industries to new and dynamic production centres. This should in turn increase the wealth and welfare of the nation as they may trade their surplus for imports. Further to this, whilst importing goods and services a country may be directly or indirectly importing technology and innovation – two key drivers of improvement in efficiency<sup>17</sup>. Hence we can conclude that free trade is the most desirable state of trade.

### *B Multilateral vs Bilateral Free Trade*

Most economists would agree that multilateral agreements are by far superior to bilateral free trade agreements.<sup>18</sup> Bilateral free trade agreements are agreements between two

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<sup>14</sup> Norberg, Johan, *In Defence of Global Capitalism* (2005) 82, citing Jeffrey Sachs and Andrew Warner, 'Economic Reform and the Process of Global Integration' *Brookings Papers on Economic Activity* (1995).

<sup>15</sup> *Ibid.*

<sup>16</sup> Norberg, Johan, *In Defence of Global Capitalism* (2005) 80.

<sup>17</sup> Michael Porter, 'The Competitive Advantage of Nations' (1990) March – April *Harvard Business Review* 73, 73-76.

<sup>18</sup> Bryan Mercurio, 'Should Australia Continue Negotiating Bilateral Free Trade Agreements? A Practical Analysis' (2004) 27(3) *University of New South Wales Law Journal* 667, 676.

parties (countries). Multilateral free trade is descriptive of multiple countries engaging in free trade. Multilateral free trade is often associated with the WTO.<sup>19</sup>

Perhaps the most compelling argument against bilateral trading agreements is the trade diversion argument.<sup>20</sup> Bilateral partners that produce less efficiently may increase their market share at the expense of non member parties, whose product costs have been artificially inflated by less favourable tariff treatment. This creates an environment where the more efficient producer's product has a higher cost to the end consumer, generating a diversionary effect whereby resources are allocated to the inefficient producer.<sup>21</sup>

Although this may be the case this principle is only holds within certain parameters.

Over the past decade concerns have been raised over the effect bilateral agreements, commentators suggest they may be adverse to multilateral trade liberalization.<sup>22</sup> Bilateral agreements may absorb valuable and scarce negotiating resources, subverting multilateral endeavors.<sup>23</sup> The WTO has established WTO Committee on Regional Trade Agreements, one of their objectives is to assess the whether regional or preferential free trade agreements are compatible with multilateral trade.<sup>24</sup> The Singapore Ministerial

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<sup>19</sup> OECD, 'Regionalism and the Multilateral Trading System' (2003) *Policy Brief* <[www.oecd.org/publications/Pol\\_brief](http://www.oecd.org/publications/Pol_brief)> at 20 October 2005.

<sup>20</sup> The World Bank, *Global Economic Prospects Trade, Regionalism and Development* (2005) 133.

<sup>21</sup> Bryan Mercurio, 'Should Australia Continue Negotiating Bilateral Free Trade Agreements? A Practical Analysis' (2004) 27(3) *University of New South Wales Law Journal* 667, 697.

<sup>22</sup> Kamal Saggi and Halis Murat Yildiz, 'Bilateral Trade Agreements and the Feasibility of Multilateral Free Trade' (Draft, July 2005) 2.

<sup>23</sup> The World Bank, *Global Economic Prospects Trade, Regionalism and Development* (2005) 133.

<sup>24</sup> Bryan Mercurio, 'Should Australia Continue Negotiating Bilateral Free Trade Agreements? A Practical Analysis' (2004) 27(3) *University of New South Wales Law Journal* 667, 675.

Declaration stated ‘We reaffirm the primacy of the multilateral trading...’<sup>25</sup> indicating that a multilateral agreement sits at the pinnacle of free trade, however they did acknowledge that FTA’s can be consistent with multilateral trade as they can be used to promote trade liberalisation.<sup>26</sup>

Whilst multilateral free trade is preferable reality seems to indicate that such an agreement is not on the table. The fourth Ministerial Conference of the WTO was held in Doha in 2001 initiating the ninth round of multilateral negotiations. The Doha round sought to introduce a far reaching single undertaking, encompassing industries ranging from services to agriculture in an attempt to prevent nations from withholding certain industries. In 2003 the Doha round broke down due to irreconcilable differences between developed and developing nations. The ambitious single undertaking’s stall in Cancun highlights the difference between nations and the difficulty in negotiating a meaningful multilateral free trade agreement.

There has been considerable debate as to whether bilateral agreements are ‘building blocks’ or ‘stumbling blocks’ within a multilateral context. The Department of Foreign Affairs and Trade succinctly summed up the value of bilateral free trade agreements by stating;

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<sup>25</sup> Ibid, citing: Singapore Ministerial Conference, *Singapore Ministerial Declaration*, (1996) [7], <[http://www.wto.org/english/thewto\\_e/minist\\_e/min96\\_e/wtodec\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm)> at 6 November 2004.

<sup>26</sup> Ibid.

‘Bilateral and multilateral trade activities can be mutually reinforcing. Free trade agreements can accelerate trade liberalisation and set higher benchmarks for the multilateral system. The knowledge and skills gained through FTA negotiations can be transferred to multilateral trade negotiations within the WTO’.<sup>27</sup>

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<sup>27</sup> Department of Foreign Affairs and Trade, Free Trade Agreements  
<[http://www.dfat.gov.au/trade/negotiations/wto\\_agreements.html](http://www.dfat.gov.au/trade/negotiations/wto_agreements.html)> at 20 October 2005.

### *III PART ONE: OVERVIEW OF TRADE*

#### *A Goods*

A prima facie reflection on Australia's minimal 1.1% share of global merchandise trade in 2002<sup>28</sup> would suggest that Australian suppliers lack bargaining power in relation to the price received for exports. However, Australia in the most part is a free economy allowing market forces to direct investment patterns towards those industries which hold a comparative advantage. For example, Australia is a major world producer of iron ore (10%), bauxite (31%) and uranium (8.2%). Suppliers benefit from the reduced costs of production associated with the drop in inefficient use of resources. Furthermore, those specialist industries focusing on a comparative advantage are more likely to take advantage of a market shortage given the reduced time delays in the production process.<sup>29</sup> Consequently, Australian exporters currently hold relative bargaining power due to hyper demand - ensuring their products are highly sought after in a global environment rewarding specialization.<sup>30</sup>

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<sup>28</sup> Mark Thirlwell, *Shaking the world? China and the world economy* (2005) Lowy Institute for International Policy <[www.lowyinstitute.org/Publication.asp?pid=279](http://www.lowyinstitute.org/Publication.asp?pid=279)> at 14 August 2005.

<sup>29</sup> Jane Belcher, *BHP Billiton Settles Iron Ore Prices* (2005) BHP Billiton Investors & media <[www.bhpbilliton.com/bb/investorsAndMedia/newsReleaseDetail.jsp?id=News/2005/NR\\_BHPBilliton130405.html&title=BHP+Billiton+Settles+Iron+Ore+Prices](http://www.bhpbilliton.com/bb/investorsAndMedia/newsReleaseDetail.jsp?id=News/2005/NR_BHPBilliton130405.html&title=BHP+Billiton+Settles+Iron+Ore+Prices)> at 6 September 2005.

<sup>30</sup> Bharat Forge, *Journey Towards Competitiveness* (2005) The Financial Express <[fecolumnists.expressindia.com/full\\_column.php?content\\_id=87241](http://fecolumnists.expressindia.com/full_column.php?content_id=87241)> at 3 September 2005.

Given Australia's ability to capture bargaining power despite its moderate market share one would expect the Chinese, with a 15% share of global merchandise trade in 2003,<sup>31</sup> to easily command a strong bargaining position. This expectation has been realized but to varying degrees. Many have argued that China has only recently sought specialized industries<sup>32</sup> whilst others suggest that specialisation has been an embedded characteristic of Chinese production for centuries.<sup>33</sup> Whichever of these suggestions prove true China must in the future continue to strive towards specialisation if it hopes to unlock the benefits available from free trade arrangements. Foreign consumers are for the most part interested in cheap goods or those with a unique nature- both highly dependent on specialisation.

This FTA is particularly relevant given that China is now Australia's third largest trade partner, second largest export market and second largest origin of imports.<sup>34</sup> Due to the volume of trade and the current levels of Chinese tariffs any reduction in tariffs would improve competitiveness and profitability. Australia applies a low arithmetic average tariff of 3.5% as at 1 January 2005 for goods coming from China, with over 85% of Australian tariff rates varying between zero and 5%.<sup>35</sup> This is significantly less than that of China which employs an average tariff rate of 9.9% for goods coming from

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<sup>31</sup> Mark Thirlwell, *Shaking the world? China and the world economy* (2005) Lowy Institute for International Policy <[www.lowyinstitute.org/Publication.asp?pid=279](http://www.lowyinstitute.org/Publication.asp?pid=279)> at 14 August 2005.

<sup>32</sup> Bharat Forge, *Journey Towards Competitiveness* (2005) The Financial Express <[fecolumnists.expressindia.com/full\\_column.php?content\\_id=87241](http://fecolumnists.expressindia.com/full_column.php?content_id=87241)> at 3 September 2005.

Damian Wild, *China facing a skill shortage* (2005) Accountancy Age <[www.accountancyage.com/accountancyage/features/2139081/work-progress](http://www.accountancyage.com/accountancyage/features/2139081/work-progress)> at 20 October 2005.

<sup>33</sup> Need ref

<sup>34</sup> Ministry of Commerce of P.R of China, *China, Australia Agree to Start FTA Talks* (2004) The Economic and Commercial Councilors Office of the Embassy of the P.R of China in the State of Kuwait <<http://kw2mofcom.gov.cn/article/chinanews/200504/20050400073525.html>> at 20 October 2005.

<sup>35</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 15.

Australia.<sup>36</sup> Prior to entering the WTO China's average tariff rate was 15.3%; this 6% reduction over the past four years should install confidence and credibility as to Chinese compromise on key issues discussed throughout FTA negotiations.<sup>37</sup>

In 2002-03, eight of Australia's top ten export commodities were Primary products. The two exceptions were Aluminum and Passenger Motor Vehicles. Together, the ten commodities accounted for 43% of total exports in 2002-03. Exports to China in 2002-03 included Iron- ore (\$1.7b), Wool (\$1.3b), Crude petroleum (\$527m) and Coal (\$215m). Significant imports from China in 2002-03 included Computers (\$991m), Toys (\$893m), CTF (\$771m) and Women's clothing (\$625m).<sup>38</sup>

### *B Services*

Globally, the services sector accounts for nearly 20% of all trade. On top of this services comprise two thirds of global output and one third of employment; these statistics make services the fastest growing sector within the global economy.<sup>39</sup>

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<sup>36</sup> Ibid 16.

<sup>37</sup> The World Trade Organisation (WTO)'s next director- general Supachai Panitchpakdi has stated 'the TWO entry signaled China's willingness to play by international trade rules and bring its economy into harmony with the world'. Furthermore, the director- general has urged China to continue economic reform efforts and the signing of Bilateral Agreements will fully unlock the benefits China has to offer. *China to Become One of Largest Economies in 50 Years: Supachai* (2002) People's Daily online <[English.people.com.cn/200204/21/eng20020421\\_94436.shtml](http://English.people.com.cn/200204/21/eng20020421_94436.shtml)> at 12 September 2005.

<sup>38</sup> Market Information and Analysis Section, 'Composition of Trade Australia 2002-03' (Department of Foreign Affairs & Trade, 2003) 1.

<sup>39</sup> The WTO, 'Understanding the WTO: Agreements, Services: Rules for Growth and Investment' <[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm6_e.htm)> at 20 October 2005.

The services sector is fundamental to the Australian economy, accounting for a substantial proportion of bilateral trade between Australia and China. Services alone have spiked from \$US0.39 billion in 1993, to US\$1.23 billion in 2003.<sup>40</sup> In the same year, services accounted for 71% of GDP<sup>41</sup> and in the three years to 2004 service exports to China grew on average by around 26%. China is now Australia's seventh largest export market for services.<sup>42</sup>

Three key components of services traded between Australia and China include: Education, Travel and Transport. Education is Australia's largest service export to China, with trade valued at approximately US\$250 million in 2003; this is greater than exports of commodities such as coal and aluminum.<sup>43</sup> Travel related services were the next most significant export, where just under 5% of all travelers to Australia were Chinese visitors; 251 200 Chinese people visited Australia in 2004, the Australia Bureau of Tourism has forecast this figure could reach one million by 2010.<sup>44</sup> This growth is expected to be the result of increased disposable income within China; as the nation's economic growth rises, higher wages encourage travel - this is similar to the phenomena experienced in Japan.<sup>45</sup> Transport services were the next most significant item due to the positive correlation between goods exported and transport services. A major proportion of exports to China, as discussed above, include raw materials, this creates a constant demand for shipping and logistical services.

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<sup>40</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 43.

<sup>41</sup> Ibid 13.

<sup>42</sup> Ibid 11.

<sup>43</sup> Ibid 11 and table 2.2.

<sup>44</sup> Ibid 11.

<sup>45</sup> Masumi Suga, '4.2% more Japanese arrivals predicted', *Bloomberg News*, 6<sup>th</sup> July 2005. <<http://the.honoluluadvertiser.com/article/2005/Jul/06/bz/bz03a.html>> at 2 August 2005.

Conversely, services comprise only 31.8% of GDP in China, contrast to 71% in Australia.<sup>46</sup> Since their inclusion into the WTO China has taken many necessary steps to liberalise their services market,<sup>47</sup> such changes have contributed to the rapidly expanding export of services which stood at US\$102 billion in 2003.<sup>48</sup>

Economic reforms in both countries have acted as a catalyst to increased bilateral activity. The increasing sophistication of the Chinese economy presents considerable upside for growth in professional services such as legal, financial, accounting and communications to name but a few. For example, there is one major flaw in China's push to become an economic superpower- a massive lack of accountants. It is estimated that China will seek to recruit up to 300, 000 accountants to plug the current gap.<sup>49</sup> At this point one should note that trade in services is difficult to quantify and tends to be understated.<sup>50</sup>

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<sup>46</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 43.

<sup>47</sup> Tom Owen, 'The Handbook of World Stock, Derivative and Commodity Exchange', *Asia Pacific Review* <[http://www.exchange-handbook.co.uk/articles\\_story.cfm?id=5631](http://www.exchange-handbook.co.uk/articles_story.cfm?id=5631)> at 12 August 2005; Annual Report Department of Foreign Affairs and Trade 93/94, <[http://www.dfat.gov.au/dept/annual\\_reports/93\\_94/intcntxt.html](http://www.dfat.gov.au/dept/annual_reports/93_94/intcntxt.html)> at 2 August 2005.

<sup>48</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 44.

<sup>49</sup> Damian Wild, *China facing a skill shortage* (2005) Accountancy Age <[www.accountancyage.com/accountancyage/features/2139081/work-progress](http://www.accountancyage.com/accountancyage/features/2139081/work-progress)> at 20 October 2005.

<sup>50</sup> Ric Wells (Speech delivered at Exchange Plaza, Perth, 5<sup>th</sup> May 2005).

## *IV PART TWO: BENEFITS AND DRAWBACKS OF FTA*

### *A Benefits of FTA*

#### *1 Australia*

##### *(a) Low Tariffs*

The already low tariff base provides a stable foundation for any FTA negotiation as the potential for a profound shock is curtailed by Australia's liberal and open policies currently in place. The average tariff rate in Australia is 3.5%, with the highest rates occurring in the PMV and TCF industries of between 10% to 17.5%; however these rates are scheduled to be phased down to 5% by 2015.<sup>51</sup>

The average tariff rate in China is 9.9%.<sup>52</sup> An FTA would apply pressure on China to reduce tariffs at a more expedient pace; this would be advantageous to Australian exporters as their goods would be more competitive in the Chinese market. At this point we should note while the potential upside is great, inhibiting factors such as capacity, or lack there of, are likely to limit any substantial shift in resource allocation within Australia.<sup>53</sup>

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<sup>51</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 15-17.

<sup>52</sup> Ibid 16.

<sup>53</sup> While China's tariff rates are higher than Australia's, within a global context they are relatively low for a developing nation. Steven Suranovic, 'Measuring Protectionism: Average Tariff Rates Around the World'

### *(b) Complementary Economies*

Australia and China have complementary economies; Australia is rich in resources and minerals, whereas China's competitive advantage lies in manufactured goods.<sup>54</sup> Australia has the minerals, resources and raw materials that China requires as inputs, which they transform and either consume or export.

The problem associated with the diversionary<sup>55</sup> impact of bilateral agreements is discussed above, however, as stated this premises only holds if one (or both) of the following conditions are satisfied. Firstly, if contracting parties are not significant trading partners. Secondly, where the parties have considerable tariff barriers to trade.<sup>56</sup> In the case of an Australia – China FTA the contracting parties could properly be described as 'natural trading partners' (due to their complementary economies) when a reciprocal relationship such as this exists diversion of resources becomes less of an issue. By comparison, in the Australia – USA FTA there was considerable trade between the two countries and the criterion of low barriers to trade was satisfied. In an Australia – China FTA China's barriers to trade stand at an elevated level to those surrounding the USA economy. This may indicate diversion of resources may be a more prevalent issue in this

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(2003) *Ten International Economics Study Centre* <<http://internationalecon.com/v1.0/ch20/20c010.html>> at 5 October 2005.

<sup>54</sup> Tyler Marshall, 'China's Stature Growing in Asia' *China Daily (Courtesy of the LA Times)* 29<sup>th</sup> December 2003 <[http://www2.chinadaily.com.cn/en/doc/2003-12/29/content\\_294121.htm](http://www2.chinadaily.com.cn/en/doc/2003-12/29/content_294121.htm)> at 2 August 2005.

<sup>55</sup> Bryan Mercurio, 'Should Australia Continue Negotiating Bilateral Free Trade Agreements? A Practical Analysis' (2004) 27(3) *University of New South Wales Law Journal* 667, 697.

<sup>56</sup> *Ibid*, 698

FTA, however within a global context China's tariff rates are not disproportionate with other developing countries, in fact China's tariffs are low in comparison to other developing nations; this has been cited as a possible explanation for China's accelerated economic growth.<sup>57</sup> Given the nature of the goods traded, tempered by the first issue - that China is a significant trading partner - it appears safe to conclude that diversion of resources will not be a critical issue in the FTA. Thus, an FTA has the potential to benefit Australia and China without resulting in any substantial deviation of resources from other economies which may be burdensome to other international relationships.<sup>58</sup>

### *(c) Net Welfare Gain*

WTO membership has helped Australian exports rise from A\$93 billion to over A\$154 billion since the WTO's inception.<sup>59</sup> Furthermore, this has contributed to over 250 000 jobs created in Australia during that short timeframe.<sup>60</sup> The proposed FTA between Australia and China should provide a net welfare gain to both countries.<sup>61</sup> The economic model indicates that if fully implemented in 2006, an FTA should boost Australian GDP for the period 2006 – 2015 by US\$18 billion and China's GDP by US\$64 billion,<sup>62</sup> noting

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<sup>57</sup> Steven Suranovic, 'Measuring Protectionism: Average Tariff Rates Around the World' (2003) *Ten International Economics Study Centre* <<http://internationalecon.com/v1.0/ch20/20c010.html>> at 5 October 2005.

<sup>58</sup> This conclusion is supported by the Economic Model. Department of Foreign Affairs and Trade, 'Economic Modeling' (Factsheet, 2005).

<sup>59</sup> Department of Foreign Affairs and Trade, 'Push to Highlight Importance of the WTO to Australia' (Press Release, 8 November 2002), <[http://www.trademinister.gov.au/releases/2002/mvt145\\_02.html](http://www.trademinister.gov.au/releases/2002/mvt145_02.html)> at 2 August 2005.

<sup>60</sup> Department of Foreign Affairs and Trade, 'Push to Highlight Importance of the WTO to Australia' (Press Release, 8 November 2002), <[http://www.trademinister.gov.au/releases/2002/mvt145\\_02.html](http://www.trademinister.gov.au/releases/2002/mvt145_02.html)> at 2 August 2005.

<sup>61</sup> See Introduction – Why Free Trade is Good: An Economic Analysis.

<sup>62</sup> The Centre of Policy Studies conducted the modelling analysis using the Monash – Multi Country Model. This simulates three aspects of an FTA: removal of border protection on merchandise trade, investment

here that certain items such as lower transactional costs and improved bilateral co-operation are not captured by the model, reality is that the benefits are likely to be understated.<sup>63</sup>

In saying this we should have regard for the reliability of economic modeling. The report itself elucidates that the quality of a model reflects the quality of the underlying data on barriers and restrictions along with statistical inputs.<sup>64</sup> The accuracy of China's statistics and official data has been questioned by various commentators. Prof. Thomas Rawski in a study from 1997-2001 revealed GDP growth statistics were hugely inconsistent with a number of other statistics released by the government such as growth in energy consumption, and CPI inflation.<sup>65</sup> Economic modeling has also been criticised in past FTA scoping studies, for example the Free Trade Area of the Americas (FTAA), where critics argued the model relied too heavily on complex and controversial assumptions. Furthermore it did not take into account some of the most important impacts likely to result from the FTAA such as changes in investment rules.<sup>66</sup>

Economic modeling has proved controversial in the past for the Australian government.

In the FTA between Australia and the USA a government sponsored model calculated net

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liberalisation, and removal of barriers to services trade. The analytical framework is a multi-country, multi-sector computable general equilibrium model. Assumptions include removal of all tariff and non tariff barriers by 2006. Dr Yinhua Mai et al 'Modelling the Potential Benefits of an Australia – China Free Trade Agreement' (2005) *The Centre of Policy Studies*, 8.

<sup>63</sup> Ric Wells (Speech delivered at Exchange Plaza, Perth, 5<sup>th</sup> May 2005).

<sup>64</sup> Dr Yinhua Mai et al 'Modelling the Potential Benefits of an Australia – China Free Trade Agreement' (2005) *The Centre of Policy Studies*, 9.

<sup>65</sup> The Economist Intelligence Unit, *Country Profile: China* (2005) 41-42.

<sup>66</sup> See generally Dr. Frank Ackerman, Kevin Gallagher, and Dr. Alejandro Nadal 'The Limits of Economic Modeling in the FTAA Environmental Review: Economists find flaws in proposed methodology' (2001) *Globalisation and Sustainable Development Program Background Paper*.

gains of \$6.1 billion per year, whereas a model commissioned by a Senate Select Committee revealed a net gain of only \$53 million per year. The government commissioned model gains were later revised down to around \$2 billion however many economists claimed the assumptions necessary to sustain such a valuation were 'heroic'.<sup>67</sup> Regardless of any exclusions or assumptions and varied criticisms of economic modeling it appears that both economies stand to gain from an FTA.

#### *(d) First Mover Advantage*

The Chinese economy is expanding at a frantic pace.<sup>68</sup> The past ten years have seen an emergence from once an economically unstructured economy to its heightened efficient state. It is imperative for Australia's medium to long term success that it forms an alliance with this awakening financial giant. The Economist recently wrote: 'If [Asian nations] are to have any hope of luring foreign businessmen these days, these countries need to trumpet their growing economic ties with Asia's next giant'.<sup>69</sup> This is a concession that even fellow Asian nations have resigned to the fact that the number one position in the Asian market will soon be held by China. Furthermore, China's rapidly developing economy<sup>70</sup> coupled with the fact that they have the largest population in the

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<sup>67</sup> Brian Toohey with Mark Skulley, 'New Modeling Cuts FTA Gains', *Australian Financial Review* 8 June 2004.

<sup>68</sup> 9.2% this year, and forecast to grow at 8% per year for the next decade. Durie, John, 'Testing Beijing for a 'Real' Deal', *Australian Financial Review* 29 September 2005, 64.

<sup>69</sup> 'Everybody's Doing It: Why Asian Countries are Racing to Sign Bilateral Trade Deals with Each Other', *The Economist* (London), 28 February 2004, 2.

<sup>70</sup> Over the past 26 years since China adopted economic reform, its average annual economic growth has hit 9.4%, four times that of developed countries in the same period, three times that of world economic growth and double that of developing countries. The International Monetary Fund (IMF) has indicated that China is the next world locomotive quickly catching the existing locomotive- the US.

world<sup>71</sup> presents itself as an attractive market. An FTA would provide Australia with a foothold into the Chinese economy which should assist Australian businesses in exploiting a first mover advantage. This would enable Australia to enter the Chinese market and establish an Australian reputation as a market leader, furthermore pioneering industries in China will allow Australia to move down the learning curve. The consequence of this is that Australian firms can carve out market share and attempt to raise barriers to entry and consolidate in the Chinese market, whilst at the same time exploit pioneer profits<sup>72</sup>. While this may be the case firms must be mindful that late movers will seek to imitate a successful strategy, without protecting this new market profits and market share may be eroded by lower cost late movers who will seek to take advantage of research and development that invariably slips into the public domain.<sup>73</sup> Michael Porter argues that in order to combat late movers pioneers must embrace innovation if they hope to stay ahead of the market, 'A nation's competitiveness depends upon the capacity of its industry to innovate and upgrade'.<sup>74</sup> Porter continues on to argue that the only way to sustain a competitive advantage is to upgrade it and that nations succeed in particular industries because the local environment is the 'most forward-looking, dynamic and challenging'.<sup>75</sup> This would be particularly lucrative in the banking and finance sectors, where China's population and Australia's expertise should enable Australian organisations to capture market share.

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*China's development brings opportunities to the world* China Hiking Adventures <[china-hiking.com/ChinaStatus/Economy/jingjizs.htm](http://china-hiking.com/ChinaStatus/Economy/jingjizs.htm)> at 16 September 2005.

<sup>71</sup> International Programs Center. <http://www.census.gov/cgi-bin/ipc/idbrank.pl>; Last Revised: 26 Apr 2005  
Source: U.S. Census Bureau, Population Division,  
International Programs Center.

<sup>72</sup> Thomas L. Wheelen, J. David Hunger, *Strategic Management and Business Policy* (9<sup>th</sup> ed, 2004) 124.

<sup>73</sup> *Ibid*, 124-125.

<sup>74</sup> Michael Porter, 'The Competitive Advantage of Nations' (1990) March – April *Harvard Business Review* 73, 73-76.

<sup>75</sup> *Ibid*.

Inevitably, the Chinese economy will open up to the world. WTO market access commitments will take effect and transitional provisions in China's Protocol of Accession<sup>76</sup> will eventually expire; China will then be exposed to the reality of global competition.<sup>77</sup> An FTA will provide Australia with a valuable opportunity to enter and establish themselves within China at the ground level.

### *(e) External Shock*

There has been considerable discussion in the media of the effects of reducing, or the abolition of tariffs. Most economists would agree that when protective barriers are discarded a net welfare gain should result.<sup>78</sup> This principal was stated quite eloquently in the passage, 'Reallocation is at the heart of welfare gains from openness as factor deployment becomes more efficient'.<sup>79</sup> Australia or China for that matter could at any time unilaterally abolish tariffs in the absence of an FTA or any bilateral or multilateral agreement. The problem that must be dealt with here is that of political pressure.

Australia could choose to drop tariffs; however this would be a difficult task to achieve politically due to the backlash from pressure groups, unions, opposing parties and certain industries.<sup>80</sup> While freer trade benefits consumers they are for the most part a disperse

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<sup>76</sup> *Protocol on the Accession of the People's Republic of China* 10 November 2001, art 16(9), made in accordance with the *Marrakesh Agreement Establishing the World Trade Organization*

<sup>77</sup> Fredrick M Abbott, 'China's Accession to the WTO' (1998) *The American Society of International Law* <<http://www.asil.org/insights/insigh13.htm>> at 20 October 2005.

<sup>78</sup> Mark Boehm, *20<sup>th</sup> Century Economic Development in Australia* (3<sup>rd</sup> ed, 1993) 218.

<sup>79</sup> John Haltimanger, 'Effects of Tariffs and Real Exchange Rates on Job Reallocation: Evidence from Latin America' (2004) 7(4) *Policy Reform* 191, 191-192.

<sup>80</sup> For instance the textile clothing and footwear industry. AFR 20 April 2005, Tracy Sutherland, '1900 jobs will be lost, *Australian Financial Review*, 20<sup>th</sup> April 2005.

and unorganised group who are unlikely to be vocal in favour of free trade.<sup>81</sup> An FTA provides an external shock that can be used to trigger a reduction in tariffs. If Australia includes tariffs in the FTA agreement then there would be an obligation to reduce tariffs, this should make the concept of removing (or reducing) tariffs more digestible to the wider public, reducing political fallout.

*(f) Increased employment*

A common theme in Australia media, particularly pro union material is that of widespread job loss. Such claims often vastly overstate the effect of an FTA by quoting figures out of context to rile support.<sup>82</sup> A similar phenomenon was experienced in relation to the North American Free Trade Agreement (NAFTA).<sup>83</sup> Job loss is likely to be limited to areas where Chinese producers/providers are substantially more efficient and cheaper. Barriers in these industries are already scheduled to be phased down,<sup>84</sup> and hence most effects cited within the media upon the labour market will be felt even in the absence of an FTA.

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<sup>81</sup> Norberg, Johan, *In Defence of Global Capitalism* (2005) 77.

<sup>82</sup> For instance the textile clothing and footwear industry. AFR 20 April 2005, Tracy Sutherland, '1900 jobs will be lost, *Australian Financial Review*, 20<sup>th</sup> April 2005.

<sup>83</sup> See Generally Sidney Weintraub 'Ten Years Hence, Is NAFTA Succeeding?' (2004) June *Texas Business Review* 1. Where other legitimate influences on employment are ignored. Issues such as the broader economic climate, government and macroeconomic policy are not afforded appropriate weight.

<sup>84</sup> Customs Tariff Amendment (Textile, Clothing and Footwear Post 2005 Arrangement) 2004 (Cth). The Customs Tariff Bill amends the *Customs Tariff Act 1995* ('the Act') to reduce the general rate of customs duty on textile, clothing and footwear ('TCF') items from 1 January 2010 and 1 January 2015.

The scheduled reductions will mean that the general rate of customs duty applicable to all TCF goods (with the exception of clothing and finished textiles) will be 5 per cent from 1 January 2010. The general rate of customs duty on these other items will be reduced to 5 per cent from 1 January 2015. Bills Digest No. 47 2004–05 (Cth) <<http://www.aph.gov.au/library/pubs/bd/2004-05/05bd047.htm>> at 10 September 2005.

Cheaper imports should not increase unemployment in the long run. Savings on cheaper imports may be channeled to more efficient industries or it may be spent on investing in and developing new and dynamic markets where a competitive advantage may develop and new occupations will be created.<sup>85</sup> The net effect of an FTA is positive, more jobs will be created than eliminated in the Australian economy, and this position is supported by the economic modeling.<sup>86</sup>

## 2 China

### *(a) Knowledge Processes and Expertise*

China is in an earlier stage of economic development, yet expanding at a rapid rate.<sup>87</sup> China stands to gain immensely from the benefits of knowledge, processes (such as best practice) and expertise. A unique opportunity exists for China to take advantage of Australian knowledge; this will minimise the strain that such growth levels place on a country – socially, culturally and environmentally. Such an importation is consistent with China's cautious nature and skepticism towards openness.<sup>88</sup> An FTA should aid in China's rapid expansion as Australian expertise can be shared to ease pressure and improve infrastructure so as to better handle China's expansion.

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<sup>85</sup> Norberg, Johan, *In Defence of Global Capitalism* (2005) 87.

<sup>86</sup> Department of Foreign Affairs and Trade, 'Economic Modeling' (Factsheet, 2005).

<sup>87</sup> *China's development brings opportunities to the world* China Hiking Adventures <[china-hiking.com/ChinaStatus/Economy/jingjizs.htm](http://china-hiking.com/ChinaStatus/Economy/jingjizs.htm)> at 16 September 2005.

<sup>88</sup> To illustrate in 1979 China established four Special Economic Zones to deal with teething problems associated with their 'open door policy'. Richard T. Phillips, *China Since 1911* (1996) 261-262.

### *(b) Resource Security*

One of the most important factors from China's point of view within the FTA negotiations will be resource security. An economic boom is dependent on key inputs to meet demand for final products. China does not have the capacity to internally produce all necessary resources; therefore they have to rely on imported inputs. The removal of artificial trade barriers – such as tariffs – should unshackle market forces allowing the redistribution of factors of production to their most efficient use. Over time inputs will gravitate to their most profitable means of consumption; presently the resource sector, fueled by Chinese demand is one such end. Consequently, net production would be expected to expand due to a redeployment of inputs towards mineral exploration.

As we have already discussed China's economy is expanding at a frantic pace, for this level of growth to be sustainable they must have access to resources. Australia is rich in resources, making Australia an attractive party to any FTA with China. Problems with resource security and price were exemplified when BHP demanded a 112.5% increase in the price of steel as opposed to the 71.5% increase by the rest of the market;<sup>89</sup> the backlash was considerable and strained relations. An FTA may alleviate some of this pressure and provide some security to China over the long run supply of natural resources.

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<sup>89</sup> David Lague and Wayne Arnold, 'China's diplomatic war over ore' *International Herald Tribune* 5<sup>th</sup> April 2005 <<http://www.iht.com/articles/2005/04/04/business/ore.php>> at 2 August 2005.

China's appetite for raw materials is evident in the words of BHP Billiton chief executive Chip Goodyear, who said China had become the company's largest customer, accounting for 12.8% of revenue, up from 9.8% in 2004.<sup>90</sup> Similarly, China accounts for 13% of Rio Tinto's sales revenue, up from 9% in 2004.<sup>91</sup> In light of this, multi – sourcing is another important facet of securing resources for a nation. Instability in the Middle East and the recent effects of cyclone Katrina exemplify how volatile resource prices and supply can be. Australia enjoys a stable political environment, with the physical land mass, in most part, enjoying similar environmental stability. An FTA and long term contracts with Australian firms would be attractive to Chinese manufacturers as the risk factors aforementioned would be substantially mitigated. Therefore Australia presents a stable climate that China can rely upon for resource security.

### *(c) International Credibility*

The Chinese economy has the labor and education to be an economic heavyweight but it does not have the experience of dealing in international bilateral trade agreements. An FTA with Australia will provide China with a learning curve in which to base future agreements, often on a much larger scale such as the United States or the European Union. China, as it develops, is seeking recognition from the wider international community.

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<sup>90</sup> Yvonne Ball, 'Rio Tinto Boards Steel Train for China' *Australian Financial Review*, 14 September 2005, 15.

<sup>91</sup> *Ibid.*

Prior to FTA negotiations Australia granted China Market Economy status (MES) in relation to the application of Australian Anti Dumping Laws,<sup>92</sup> on top of this China now has a position in the World Trade Organisation.<sup>93</sup> In the decade from 1994-95 to 2003-04, imports from China have been subject to eighteen anti- dumping actions<sup>94</sup> initiated by Australian industry; this represents 10% of the total number for the period with chemicals and petroleum making the majority of cases.<sup>95</sup> The granting of MES will reduce the number of anti- dumping actions against China as its normal value of exports will be regarded as its domestic price rather than the price in a surrogate third country.

Negotiating an FTA with Australia would bolster China's credibility in the international arena, as it would prove they are able to negotiate and broker a large deal with a developed nation. This intrinsic value is arguably greater than monetary benefits of an FTA as this would pave the way for similar deals for China, especially with the USA and the EU.

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<sup>92</sup> Under sections 15 and 16 of the Protocol of Accession of the People's Republic of China to the World Trade Organization (WTO)

China has agreed that WTO member states could treat it as a non- market economy until 2015. However, Australia's decision to grant MES to China would require that China no longer be treated as NME for all products originating in China.

Department of Foreign Affairs and Trade, 'Market Economy Status' (Factsheet, 2005).

Australian Industry Group chief Heather Ridout is worried that a China- Australia Free Trade deal could lead to a flood of cheap Chinese goods onto the Australian market

Catherine McGrath, *Warning issued over China free trade deal* (2005) Australian Broadcasting Commission <[www.abc.net.au/am/content/2005/s1322663.htm](http://www.abc.net.au/am/content/2005/s1322663.htm)> at 7 October 2005.

<sup>93</sup> China has been a member of the WTO since 11 December 2001; WTO Members and Observers from 16 Feb 2005 <[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm)> at 20 August 2005.

<sup>94</sup> Dumping occurs when the export price of a product exported from one country to another is less than the comparable price for the like product when destined for consumption in the exporting country. Anti dumping laws allow Australia to impose a duty to the value of the dumping margin- the difference between the export price and normal value.

Michael Priestley, *Anti- dumping rules and the Australia- China Free Trade Agreement* (2005) Economics, Commerce and Industrial Relations Section Research note no. 38 2004-05

<[www.aph.gov.au/library/pubs/rn/2004-05/05rn38.htm](http://www.aph.gov.au/library/pubs/rn/2004-05/05rn38.htm)> at 7 October 2005.

<sup>95</sup> Michael Priestley, *Anti- dumping rules and the Australia- China Free Trade Agreement* (2005)

Economics, Commerce and Industrial Relations Section Research note no. 38 2004-05

<[www.aph.gov.au/library/pubs/rn/2004-05/05rn38.htm](http://www.aph.gov.au/library/pubs/rn/2004-05/05rn38.htm)> at 7 October 2005.

Australia is an ideal candidate for an FTA from a Chinese perspective as it presents itself as a 'safe option'. Risks associated with an FTA are minimal due to the small and open nature of the Australian economy.<sup>96</sup> This gives China a chance to 'test the water' and decide if FTA's would be an effective and compatible mechanism to fuel her expansion whilst at the same time bolstering international credibility. This course of action is consistent with China's conservative bureaucracy and their approach to development.<sup>97</sup> A 'testing the water' approach was also taken when implementing their open door policy in 1979 through the creation of four Special Economic Zones.<sup>98</sup>

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<sup>96</sup> 1.1% share of global merchandise trade in 2002. Mark Thirlwell, *Shaking the world? China and the world economy* (2005) Lowy Institute for International Policy <[www.lowyinstitute.org/Publication.asp?pid=279](http://www.lowyinstitute.org/Publication.asp?pid=279)> at 14 August 2005.

<sup>97</sup> Durie, John, 'Testing Beijing for a 'Real' Deal', *Australian Financial Review* 29 September 2005, 64.

<sup>98</sup> Richard T. Phillips, *China Since 1911* (1996) 261-262.

## *B Drawbacks of FTA*

### *1 Australia*

#### *(a) Job loss for highly labor intensive sectors*

There are two key driving forces behind the growth of any economy; efficiency and specialisation. China achieves efficiency through the combination of economies of scale and low wages. A look at trade structures reveals that relative to the rest of the world China has a comparative advantage in labor- intensive industries such as apparel.<sup>99</sup> Given the size of the Australian economy it does not achieve sufficient cost leadership and therefore focuses on specialisation. High labor intensive jobs, such as TCF and PMV,<sup>100</sup> must be retrained to achieve such a goal. For example, Britain's textile industry is experiencing significant detriment from Chinese imports because they have not adequately investigated additional lines of business. Australia will face the same scenario if the textile industry continues to rely on short term high protection levels rather than finding solutions to the long term introduction of Chinese goods.<sup>101</sup> Car production must compete in the family sector rather than for fuel efficiency purposes which the Chinese

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<sup>99</sup> New Economic Prospects in Asia (2002) Research Committee Report Asia in Pursuit, Japan Transfixed <[www.mof.go.jp/jouhou/sokei/kenkyu/ron049.pdf](http://www.mof.go.jp/jouhou/sokei/kenkyu/ron049.pdf)> at 8 September 2005

<sup>100</sup> There are four major vehicle manufacturers in Australia- Ford, Toyota, Holden and Mitsubishi- which account for 7% of Australia's manufacturing value added. Productivity increases over the past decade coupled with a record 94,058 units exported in 2002 indicate strong potential for successful integration into the Chinese market, particularly with regard to a specialisation strategy.

Andrew Ford, First Secretary, *Australia* (Economics section, Australian Embassy, 2003)  
Found at <[www.unescap.org/tid/publication/part\\_two2223\\_aus.pdf](http://www.unescap.org/tid/publication/part_two2223_aus.pdf)> at 28 August 2005.

<sup>101</sup> *UK Clothing Firms Need to pull their socks up* (2005) Business Credit Management  
<[www.creditman.biz/uk/members/news-view.asp?newsviewid=5235&id=1&mylocation=News](http://www.creditman.biz/uk/members/news-view.asp?newsviewid=5235&id=1&mylocation=News)> at 20 October 2005.

can produce much cheaper. TCF must compete to suit specific demand sectors, such as business wear, rather than casual clothing which can be produced quicker and cheaper in China. Thus, the effect of a free trade agreement in the short term may cause job loss,<sup>102</sup> however, in the long term the workforce will retrain<sup>103</sup> and adapt, allowing Australia to flourish through creativity and specialisation. The result; Australia long term will benefit from an FTA.

The reduction of Australian tariffs in industries directly affected by the inflow of Chinese goods provides a clear intention on behalf of Australia to abide by the characteristics of this FTA. Consequently, China is left with no excuse for continuing to uphold protectionist measures at its end. Failure to actively pursue and implement an open trade environment may disturb the sentiment towards China held by Australia. Such mistrust will seriously affect China's intended objective of international credibility. Therefore, one may say that the reduction in tariffs throughout our inefficient production sectors will aid the fortunes of suppliers in our efficient export sectors.

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<sup>102</sup> Employment in the PMV sector in 2000 was 51,000

Andrew Ford, First Secretary, *Australia* (Economics section, Australian Embassy, 2003)

Found at <[www.unescap.org/tid/publication/part\\_two2223\\_aus.pdf](http://www.unescap.org/tid/publication/part_two2223_aus.pdf)> at 28 August 2005

<sup>103</sup> Training has been recognised as the best means for long term employment rates. In regard to Chinese exports and their effect on domestic industries it has been noted by Alan Greenspan, chairman of the Federal Reserve Board of the United States that 'the assertion of these people was based on the assumption that other countries wouldn't replace China in exporting goods to the United States'. What he is indicating is that a reduction in Chinese imports will lead to an increase in a third countries exports and therefore the overall effect on the domestic industry is unchanged.

*Restriction on Chinese export no solution for US employment problem* People daily online  
<[English.peopledaily.com.cn/200402/16/eng20040216\\_134901.shtml](http://English.peopledaily.com.cn/200402/16/eng20040216_134901.shtml)> at 16 September 2005.

*(b) Multilateral outlook*

Whilst many trade theories establish potential benefits they tend to focus on the cost side of international trade and the belief that each country should focus on that product which it has a comparative advantage of production.<sup>104</sup> Neoclassical economics supports Ricardo's theory that every country has a comparative advantage in the production of some good, even if the other country has an absolute advantage. The theory is expanded to suggest that when a country trades according to its comparative advantage, it is making the best advantage of its own resources in production for export and for domestic production. However, not all international trade is determined on cost structures and in fact demand plays just as significant role. When a country enters into a bilateral agreement it must be sure that such an agreement will not create negative sentiment amongst its other trading partners. Australia has been a major player in the WTO's multilateral outlook having undertaken 50 years of rigorous trade liberalisation. Australia must ensure there is no damage to Coal contracts with France,<sup>105</sup> copper agreements with Europe<sup>106</sup> or uranium oxide agreements with United Kingdom,<sup>107</sup> otherwise the damage to international reputation will far exceed the economic gains with China. For each major

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<sup>104</sup> Gen Yamamoto, *Theoretical Considerations of Multilateralism and Regionalism* (2002) Apec Study Center institute of Developing Economics <[www.ide.go.jp/English/Publish/Apec/pdf/apec13\\_wp2.pdf](http://www.ide.go.jp/English/Publish/Apec/pdf/apec13_wp2.pdf)> at 16 September 2005.

Also

Dr. Roger McCain, *Trade according to Comparative Advantage* Department of Economics Drexel University (2002)

<[www.drexel.edu/top/prin/txt/trade/toh1.html](http://www.drexel.edu/top/prin/txt/trade/toh1.html)> at 6 September 2005.

<sup>105</sup> France profile (2005) Australian Government Austrade <[www.austrade.gov.au/australia/layout/0,,0\\_S2-1\\_CLNTXID0019-2\\_-3\\_PWB125330-4\\_cultureconomics-5\\_-6\\_-7\\_,00.html](http://www.austrade.gov.au/australia/layout/0,,0_S2-1_CLNTXID0019-2_-3_PWB125330-4_cultureconomics-5_-6_-7_,00.html)> at 20 October 2005.

<sup>106</sup> *Olympic Dam* (2005) BHP Billiton

<[www.bhpbilliton.com/bb/ourBusiness/baseMetals/baseMetalsOperations.jsp?id=CustomerCentre/ProductGroups?BaseMetals/OlympicDam.html](http://www.bhpbilliton.com/bb/ourBusiness/baseMetals/baseMetalsOperations.jsp?id=CustomerCentre/ProductGroups?BaseMetals/OlympicDam.html)> at 14 September 2005.

<sup>107</sup> *Olympic Dam* (2005) BHP Billiton

<[www.bhpbilliton.com/bb/ourBusiness/baseMetals/baseMetalsOperations.jsp?id=CustomerCentre/ProductGroups?BaseMetals/OlympicDam.html](http://www.bhpbilliton.com/bb/ourBusiness/baseMetals/baseMetalsOperations.jsp?id=CustomerCentre/ProductGroups?BaseMetals/OlympicDam.html)> at 14 September 2005.

trading partner it is advised that Australia construct an accurate account of resource stocks likely to be available before and after any China FTA. Openness from Australia at an early stage will ensure faithfulness by our trading partners at a later stage.<sup>108</sup>

### *(c) Enforceability*

Australia and China face the difficult task of agreeing on an appropriate dispute resolution process. The current dispute settlement understanding (DSU) system used by the WTO is only applicable for WTO obligations- the negotiation and performance of obligations under an FTA are not covered.<sup>109</sup> However, participation in these systems is indicative of a countries ability to successfully resolve international disputes.

Australia has played an active role in the development of the DSU so is familiar with its benefits, problems, processes and implementation. The DSU system, has been under constant review over the past decade<sup>110</sup> since its prosperous inception the decade before. Australia has used such a system on more than 30 occasions through being a claimant,

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<sup>108</sup> Richard Mills and Ricardo Reyes, USTR Releases 2003 Inventory of Trade Barriers (2003) Office of the United States Trade Representative  
<[www.ustr.gov/Document\\_Library/Press\\_Releases/2003/April/USTR\\_Releases\\_2003\\_Inventory\\_of\\_Trade\\_Barriers.html](http://www.ustr.gov/Document_Library/Press_Releases/2003/April/USTR_Releases_2003_Inventory_of_Trade_Barriers.html)> at 20 October 2005.

<sup>109</sup> Dispute settlement system training module: Chapter 1 Introduction to the WTO dispute settlement system (2005) World Trade Organisation  
<[www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_settlement\\_cbt\\_e?c1s3p3\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_settlement_cbt_e?c1s3p3_e.htm)> at 20 October 2005.

<sup>110</sup> Bryan Mercurio, *Should Australia continue negotiating bilateral free trade agreements? A practical analysis* (2002) World trade law dispute settlement commentary  
<<http://www.worldtradelaw.net/articles/mercuriobilateral.pdf>> at 10 July 2005.

respondent or third party<sup>111</sup> and has successfully litigated five WTO complaints to date, with two of those disputes being resolved without having to resort to the full process of the DSU.<sup>112</sup>

China (as well as Australia) have adopted the United Nations Contract for the International Sale of Goods (CISG) and has issued the third most arbitral awards<sup>113</sup> indicating a clear intention of having a consistent method of dispute resolution.<sup>114</sup>

From this we can see that both parties are committed to their international obligations and some mechanism of enforceability is not an unreasonable goal. If an FTA is able to successfully implement an appropriate enforcement mechanism market access to China would be expanded exponentially.

#### *(d) Political pressures*

Many have suggested that acceptance of any FTA agreement should first receive the approval of the Australian people through referendum.<sup>115</sup> We do not feel this is a

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<sup>111</sup> *Australia and WTO Dispute Settlement* (2004) Department of Foreign Affairs and Trade <[http://www.dfat.gov.au/trade/negotiations/wto\\_disputes.html](http://www.dfat.gov.au/trade/negotiations/wto_disputes.html)> at 14 July 2005.

<sup>112</sup> The two disputes not requiring full recourse to the DSU are: *India – Quantitative Restrictions on Agricultural, Textiles and Industrial Products*, WTO Doc WT/DS91 (1997) (during consultations dated March 1998, India committed to removing quantitative restrictions on a range of products according to an agreed timetable); *Hungary – Export Subsidies in respect of Agricultural Products*, WTO Doc WT/DS35 (1996) (in March 1996, Australia and five other complainants sought consultations with Hungary where a mutually agreed solution involving a time-limited waiver was reached after some of the complainants requested the establishment of a panel).

*Australia and WTO Dispute Settlement* (2004) Department of Foreign Affairs and Trade <[http://www.dfat.gov.au/trade/negotiations/wto\\_disputes.html](http://www.dfat.gov.au/trade/negotiations/wto_disputes.html)> at 14 July 2005.

<sup>113</sup> China has made 9 arbitral awards over the period 1988- 1998 compared to Australia's 2 J Ziegel, *Review of the Convention on Contracts for the International Sale of Goods* (1998) <<http://www.yorku.ca/osgoode/cisg/writings/ziegelsix.htm#25>> at 3 June 2005.

<sup>114</sup> For a more detailed discussion see the heading below on contracting arrangements

necessary step given the nature of Australian democracy, which is a representative democracy rather than a direct democracy. Pressure groups have been given ample opportunity to express their opinions and the government will continue negotiations if felt that it is in the best interests of the majority of the population.

*(e) Uncertainty for lawyers & business people*

In Australia we are blessed with access to; information,<sup>116</sup> decisions,<sup>117</sup> and reasons.<sup>118</sup> These three ingredients provide the recipe for successful business agreements and courtroom appeals. China functions primarily on a relationship basis, whether we are talking about customers, suppliers, joint venture partners or even local government officials.<sup>119</sup> Consequently, consistency of the law is often thwarted and the research task of the lawyer is compounded exponentially. Unfortunately, many Australian lawyers and businessmen lack the necessary partnership arrangement which significantly limits their prospects of legal or economic success.

In Australia, we take transparency in operations for granted and must realize that under the current leadership of China the same level of separation between politics and law does not exist. For those entering China for the first time it is suggested that you use go-

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<sup>115</sup> 'This issue is big and involves the sovereignty of the country. Any FTA agreement should go to Parliament and should also seek support from the public. This process will take one or two years so that the information can be spread out and digested'

Watcharaporn Thongrun, *Calls for rethink on privatization, FTA's* (2003) Bilaterals. Org everything that's not happening at the WTO <[http://www.bilaterals.org/article.php?id\\_article=64](http://www.bilaterals.org/article.php?id_article=64)> at 6 August 2005.

<sup>116</sup> Freedom of Information Act 1982 (Cth)

<sup>117</sup> Administrative Appeals Tribunal Act 1975 (Cth)

<sup>118</sup> Administrative Appeals Tribunal Act 1975 (Cth)

<sup>119</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 31.

betweens wherever possible, such as the China- Britain Business Council.<sup>120</sup> They have the local knowledge, reputation and guanxi (relationships) to be taken seriously, whereas the visitor is just a ghost.<sup>121</sup> The next step is to use existing contacts to build new ones. In this sense homework on business partners is much more important than homework on the market.<sup>122</sup> Ideally, your business partner should be in a position to provide inputs relating to physical site, comprehensive local market knowledge, distribution networks, access to raw materials and both commercial and political connection.<sup>123</sup> Solo visits to China require a visa and permit contact with consultants whose local offices will, for a fee, organize a translator and a schedule of meetings with their contacts.<sup>124</sup> Business visits require both a visa and the difficult task of obtaining an invitation from an official 'host'.<sup>125</sup> The building of relationships can be an expensive and time consuming exercise- those not in a position to undertake this commitment should think otherwise about doing business in China.

Whilst the Chinese's use of lawyers is now highly prolific for negotiating business ventures in the West there remains a deep- seated reluctance to use the law, or even to employ lawyers when doing business inside China.<sup>126</sup> China had little commercial law from 1949 until 1979 and no legal provisions for foreign people to do business in

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<sup>120</sup> The China- Britain Business Council has offices in Shanghai, Beijing, Chengdu, Wuhan, Shenzhen, Qingdao, Hangzhou, Shenyang. The organisation offers business advice and consultancy, market research, business meeting packages, trade missions, financial and legal services.

Helping you do business in China (2005) <[www.cbbc.org/](http://www.cbbc.org/)> at 3 October 2005.

<sup>121</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 31.

<sup>122</sup> *Ibid*, 29.

<sup>123</sup> China Profile (2005) Australian Government Austrade <[www.austrade.gov.au/australia/layout/0,,0\\_S2-1\\_CLNTXID0019-2\\_-3\\_PWB156799-4\\_doingbusiness-5\\_-6\\_-7\\_,00.html#businesspartners](http://www.austrade.gov.au/australia/layout/0,,0_S2-1_CLNTXID0019-2_-3_PWB156799-4_doingbusiness-5_-6_-7_,00.html#businesspartners)> at 20 October 2005.

<sup>124</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 30.

<sup>125</sup> *Ibid*.

<sup>126</sup> *Ibid*, 110.

China.<sup>127</sup> Increased interaction with the West is bringing in a greater degree of legal instruments but given the hasty assembling of Chinese commercial law over the past 25 years many parts contradict each other.<sup>128</sup> Chinese law once distinguished between international and domestic transactions- such as contract, technology transfer and tax laws- the removal of this distinction was a key reason for its WTO entrance.<sup>129</sup> But whatever the legislation may say today, law and practice are likely to diverge for some time.<sup>130</sup> Perhaps the above may be encapsulated in the following quotation “don’t rely exclusively on the law... you will lose.”<sup>131</sup>

## 2 China

### (a) Political pressures

Continued economic growth in China is highly dependent on a global improvement in political trust. The government is under increasing pressure to enter into bilateral agreements to strengthen the trust in China held by the rest of the world.<sup>132</sup> However, the Chinese government is a hierarchy which thrives on control. Through entering an FTA, such control is diminished as the decision making power is permanently lost in regard to import and export restrictions. To regain such control would see it dishonor an FTA the

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<sup>127</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 109.

<sup>128</sup> *Ibid*, 110.

<sup>129</sup> *Tim Ibid* , 111.

<sup>130</sup> *Ibid*.

<sup>131</sup> James McGregor, *One billion customers; lessons from the front lines of doing business in China* (2005).

<sup>132</sup> Ministry of Commerce of P.R. China, *China, Australia agree to start FTA talks* (2004) The Economic and Commercial Counsellor’s Office of the Embassy of the People’s Republic of China in the State of Kuwait <<http://kw2.mofcom.gov.cn/aarticle/chinanews/200504/20050400073525.html>> at 20 October 2005.

effect of which would be significantly detrimental to its economic stranglehold as distrust would be formed worldwide. Whilst Chinese businessmen view this FTA as an opportunity to gain highly sought after political trust<sup>133</sup> it will require an unprecedented control concession from their government.

Political liberalization is closely tied with transparency, openness, and an independent and fair judiciary; all of which are characteristics associated with effective markets. A 'black box' approach to decision making, whether it be judicial or administrative can only undermine confidence in the system - creating skepticism - resulting in sub optimal performance within the market. Political liberalization must be the front runner; without a shift in the Chinese bureaucracy it would be unrealistic to expect improved confidence in China. Whilst this may be obvious to potential investors, it is by no means inevitable. Historically, China has been reluctant to embrace the requisite degree of democratic processes within the cogs of government.

During talks in Beijing on April 18 Premier Wen Jiabao expressly stated China's intention from this FTA with Australia. He declared 'China will enhance political relations with Australia on the basis of mutual respect, equality and reciprocity, and strengthen communication on major issues of common concern so as to promote and consolidate the political basis for bilateral relations'.<sup>134</sup>

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<sup>133</sup> Ministry of Commerce of P.R. China, *China, Australia agree to start FTA talks* (2004) The Economic and Commercial Counsellor's Office of the Embassy of the People's Republic of China in the State of Kuwait <<http://kw2.mofcom.gov.cn/aarticle/chinaneews/200504/20050400073525.html>> at 20 October 2005.

<sup>134</sup> Ministry of Commerce of P.R. China, *China, Australia agree to start FTA talks* (2004) The Economic and Commercial Counsellor's Office of the Embassy of the People's Republic of China in the State of

Despite these assertions from the Chinese premier one must remain skeptical with prominent calls for political liberalization extending to the internal environment such as the Beijing Spring occurring after the Cultural Revolution.<sup>135</sup> Similarly to their international counterparts this internal group suffered in attempts to reform the Communist party. One influential member, Wei Jingsheng,<sup>136</sup> was sentenced to fifteen years imprisonment for the publication of a founding document<sup>137</sup> which argued that the holding of power by the laboring masses was essential for modernization.<sup>138</sup> In the 1980s, these ideas increased in popularity given the growing corruption, economic dislocation and the sense that reforms in the Soviet Union and Eastern Europe were leaving China behind.<sup>139</sup> This movement climaxed in 1989 leading to the Tiananmen Square protests.<sup>140</sup>

Despite obvious Western sympathy<sup>141</sup> the Chinese Government was able to quash this democracy movement by convincing people that a gradual reform process was best practice given the difficulties that the Soviet Union faced in converting to democracy and

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Kuwait <<http://kw2.mofcom.gov.cn/aarticle/chinanews/200504/20050400073525.html>> at 20 October 2005.

<sup>135</sup> The Beijing Spring is a significant movement which began in 1978 and was important to the Tiananmen Square Protests of 1989.

Ron Gluckman, *Beijing Spring* (2003) Asian Wall Street Journal <[www.gluckman.com/ChinaProtest.html](http://www.gluckman.com/ChinaProtest.html)> at 7 October 2005.

<sup>136</sup> Wei Jingsheng fought for human rights and democracy for China. He was quoted as saying 'The repression of the 1989 movement, taught the Chinese people a very bitter lesson:... that relying on the dictators to gradually move towards democracy was a vain hope'.

Wei Jingsheng AKA 'The father of Chinese democracy' (2003) heroes and killers of the 20<sup>th</sup> century <[www.moreorless.au.com/heroes/wei.html](http://www.moreorless.au.com/heroes/wei.html)> at 7 October 2005.

<sup>137</sup> This founding document was considered to be the manifesto, the Fifth Modernization.

<sup>138</sup> *Chinese democracy movement* (2005) Wikipedia, the free encyclopdedia <[http://en.wikipedia.org/wiki/Chinese\\_democracy\\_movement](http://en.wikipedia.org/wiki/Chinese_democracy_movement)> at 16 September 2005.

<sup>139</sup> Ibid.

<sup>140</sup> At such protests attempts to reform the Communist Party were starved of by Government troops Tiananmen Square Protest (2005) Encarta Online Encyclopedia 2005

<[Encarta.msn.com/encyclopedia\\_761573064?Tiananmen\\_Square\\_Protest.html](http://Encarta.msn.com/encyclopedia_761573064?Tiananmen_Square_Protest.html)> at 7 October 2005.

<sup>141</sup> *Chinese democracy movement* (2005) Wikipedia, the free encyclopdedia <[http://en.wikipedia.org/wiki/Chinese\\_democracy\\_movement](http://en.wikipedia.org/wiki/Chinese_democracy_movement)> at 16 September 2005.

capitalism.<sup>142</sup> Furthermore, support for the PRC grew with the granting of most- favored nation status (US trade law)<sup>143</sup> for China and the general feeling that democratic leaders were out of touch with the growing economic prosperity and need for political constancy.<sup>144</sup> Consequently, the democracy movement is deemed to be flawed because it promotes radicalism and revolution.<sup>145</sup> Australia must realise that political liberalization is not inevitable and is at best evolutionary<sup>146</sup> rather than revolutionary as has optimistically been suggested.<sup>147</sup>

If calls for political liberalization continue to be banished today it will seriously impair market forces affecting levels of protection and allocation of resources. The result of this will be seriously detrimental to the Chinese's prospects of political trust which in turn will impact the economic prosperity of China. The Chinese businessmen of today must relate to a figure of the ilk of Wei Jingsheng to ensure that political liberalization is more than just a pre FTA statement.

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<sup>142</sup> This is heavily disputed since China has shown no signs of increased political liberalization, even though it had already successfully converted to capitalism.

*Chinese democracy movement* (2005) Wikipedia, the free encyclopdedia  
<[http://en.wikipedia.org/wiki/Chinese\\_democracy\\_movement](http://en.wikipedia.org/wiki/Chinese_democracy_movement)> at 16 September 2005.

Capitalism refers to an economic system where all the factors of production are privately owned and the forces of supply and demand determine the prices of goods and services and the distribution of resources.

*Chinese democracy movement* (2005) Wikipedia, the free encyclopdedia  
<<http://en.wikipedia.org/wiki/Capitalism>> at 16 September 2005.

<sup>143</sup> Ibid. The most- favored nations principle (called normal trade relations in the USA) is a status accorded by one nation to another in international trade which means that the receiving nation will receive the same benefits available to any third nation.

<sup>144</sup> Ibid.

<sup>145</sup> Ibid.

<sup>146</sup> Ibid. Many pro- democracy supporters have raised arguments indicating the ability of China to successfully overcome the challenges faced during the transition from a communist to a capitalist economy.

<sup>147</sup> Ibid. Whilst there has been considerable western sympathy for the democracy movement, most Chinese do not think consider it a viable alternative to the current government, and most protest activity now is expressed in single issue demonstrations which are to an extent tolerated by the government.

The uncertainty surrounding political liberalization in China is undoubtedly Australia's biggest concern. On face value the Chinese government has expressed a clear intention to vigorously fulfill the obligations imposed by this bilateral agreement. On a negative note, China has a history of failed political liberalization. On a positive note for Australia, China is aware of the implications of failing to abide by key characteristics of this FTA. Firstly, Australian exporters will shift their orientation away from China seriously affecting the Chinese's highly sought after resource security purpose. Secondly, negative sentiment held by Australia will flow throughout the world economy thus affecting China's international credibility.

## *V PART THREE: INDUSTRY SPECIFIC ANALYSIS*

### *A Goods*

#### *1 Agriculture*

Tariffs are a common barrier faced by Australian exporters in their pursuit for competitiveness in the Chinese market. Furthermore, many of Australia's major exports- wool, wheat, sugar and cotton- are subject to tariff rate quotas restricting the quantity of trade in these important sectors.<sup>148</sup>

China's dairy consumption has more than trebled over the last decade, yet our dairy farmers are still restricted in reaching this market due to tariffs of around 15 per cent.<sup>149</sup> China's meat consumption is expanding rapidly yet our meat exporters face tariffs up to 25 per cent.<sup>150</sup> Australia is the world's largest supplier of fine wool and China is the world's dominant producer of wool textiles yet this fine fit is still hindered by existence of tariff rate quotas. Similarly sugar is affected by tariffs; Chinese consumption of sugar has risen given the increased consumption of processed foods and beverages and Australian exporters still face a tariff of 15% which rises to 50% once the allocated quota has been reached.<sup>151</sup> The demand for fruit and vegetables all year round can be satisfied given the different hemispheres yet tariffs still exist despite the inability of the Chinese

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<sup>148</sup> Department of Foreign Affairs and Trade, 'Potential Benefits- Agriculture' (Factsheet, 2005) 2.

<sup>149</sup> Ibid.

<sup>150</sup> Ibid.

<sup>151</sup> Ibid.

market to develop such products during particular times in the year. Other industries set to benefit include: seafood, forest products, live animals, wine and beverages and processed foods. Given the potential quantity of market accessible to such sectors, a free trade agreement and the associated tariff reductions would be hugely beneficial for Australia's export revenue.

The Chinese economy has a large agricultural sector which is spread amongst wide geographical regions. Many producers are reliant on the tariff rates imposed by the Chinese government to ensure that their less efficient means of production do not prevent competitiveness in the market. Due to the social and cultural circumstances within China, agriculture will be a highly sensitive topic with the Chinese unlikely to concede any ground.

Market forces, with the assistance of the Chinese government should encourage the local producers to focus their resources on those products which they can achieve competitive advantage. A Chinese effort to link farmers to desired markets should follow a similar procedure to its horticulture industry. Horticulture Australia Limited (HAL) signed a framework agreement on cooperation in horticulture with the China Association for the Promotion of International Cooperation in Agriculture (CAPICA), which recognises the complementary nature of the two countries horticulture industries. Such a framework is conducive to speeding up negotiations on formal market access for Australian

horticulture products into China.<sup>152</sup> This agreement acknowledges China's competitive advantage through the availability of abundant labour and Australia's competitive advantage in world class production. The Chinese will pay particular interest to the Australian structure whereby growers are involved in Industry Bodies and undertake research and marketing through HAL.<sup>153</sup>

Intrinsically related to agriculture are Australia's Sanitary and Phytosanitary measures. Australia maintains strict quarantine regulations which it is not willing to negotiate on with the aim of minimizing the risk to Australia's domestic and export industries of serious pests and diseases.<sup>154</sup> China too has made attempts to improve its quarantine regulations with the introduction of the Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ). This provides a series of rules to streamline inspection and quarantine activities of imported products. Furthermore, periodic testing is done on a random sample of products to ensure maximum adherence to standards is maintained. Given each countries commitment to a safety first approach with imports it is expected that both countries will be reasonable with their expectations concerning exports.

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<sup>152</sup> HAL's managing director, John Webster, commented, "I am delighted that Australian industry and Government representatives at the forum see the conclusion of this Agreement as an important step for the progress of the relationship between the horticulture industries of our countries."

P1 of the website= [www.linkingfarmerswithmarkets.net/index.php?p=4&id=19](http://www.linkingfarmerswithmarkets.net/index.php?p=4&id=19)

<sup>153</sup> Karen Hellwig, 'Australian horticulture industry signs a framework agreement on cooperation in horticulture with China' <website= [www.linkingfarmerswithmarkets.net/index.php?p=4&id=19](http://www.linkingfarmerswithmarkets.net/index.php?p=4&id=19)> at 2 August 2005.

<sup>154</sup> Department of Foreign Affairs and Trade, 'Potential Benefits- Agriculture' (Factsheet, 2005) 2.

## 2 Mining

Minerals, metals and energy resources are key inputs required to fuel China's ongoing industrialization and urbanization. Fortunately for Australia, it is plentiful in such export items. A FTA will aid repetition of like arrangements to the Guangdong LNG project. Such a venture sees A\$1 billion of liquefied natural gas annually exported to China over 25 years.<sup>155</sup>

Due to the quantity of exports in this sector the tariff revenue achieved by the Chinese is significant. China may be reluctant to reduce such tariffs for this financial reason. More importantly however, domestic Chinese suppliers argue that there is a need for a domestic supply chain in the event of international complexities; this is often called the 'national security' argument. If followed, this argument encourages ongoing tariff protection for the industry to enable less efficient Chinese suppliers to remain competitive.

In regard to the inefficient Chinese suppliers, there are two courses of action to ensure their survival in the mining industry. Firstly, they must be encouraged to only mine those resources which they have a comparative advantage, or industry where they may develop a competitive advantage such as coal.<sup>156</sup> Secondly, they should be encouraged to form joint ventures or subsidies with Australian miners and thus reap the rewards of their

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<sup>155</sup> Mark Twain, 'Access China Gas and Heating Business Market Efficiently' *Access China Market* <Efficiently <http://anser.bc.ca/>> at 1 November 2005.

<sup>156</sup> The revision of Chinese coal mining laws will help ensure mining becomes more efficient and that safety is improved. The new laws are expected to create more investment channels and possibly a competitive advantage.

Fu Jin, *Revision of law to upgrade mine safety* (2005) China daily <[www.chinadaily.com.cn/english/doc/2005-01/24/content\\_411818.htm](http://www.chinadaily.com.cn/english/doc/2005-01/24/content_411818.htm)> at 5 October 2005.

efficient means of extraction. Whilst Chinese producers are reliant on resources it does not make sense for such inputs to be domestic in entirety. An FTA will provide a safety net for Chinese producers ensuring long term provisions of such resources from a reliable provider, namely Australia.

### *3 Manufacturing*

A criticism of industry protection is that it tends to stifle innovation and training.<sup>157</sup> There is less pressure on entrepreneurs, managers and workers to seek the attainment of world best practice.<sup>158</sup> Consequently, a reduction in protection would be expected to stimulate a flow of resources into innovation and training. This result has been achieved in Australia's PMV industry with an increase in research and development costs<sup>159</sup> closely associated with a reduction in protection levels.<sup>160</sup> Consequently, tariff reform has contributed towards lower prices and a higher quality product.

Australia's exportation of manufactured goods has become very China orientated with a 160% increase over the past 5 years compared with only 13% to the rest of the world.<sup>161</sup>

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<sup>157</sup> Michael Emmerly, 'The Performance Record of Australian Manufacturing' (Research Paper 22, Parliament of Australia Economics, Commerce and Industrial Relations Group, 2000) Also found at <[www.aph.gov.au/library/pubs/rp/1999-2000/2000rp22.htm#efficient](http://www.aph.gov.au/library/pubs/rp/1999-2000/2000rp22.htm#efficient)>

<sup>158</sup> Ibid.

<sup>159</sup> The PMV industry increased its research and development costs by \$40 million (11% increase) in the period 1999-00 from the levels invested in the previous year. Manufacturing Research and experimental development (2002) Australian Bureau of Statistics <[www.abs.gov.au/Ausstats/abs@.nsf/Lookup/288A3CAFFDE706B5CA256B35007F93AB](http://www.abs.gov.au/Ausstats/abs@.nsf/Lookup/288A3CAFFDE706B5CA256B35007F93AB)> at 4 September 2005.

<sup>160</sup> Andrew Ford, First Secretary, *Australia* (Economics section, Australian Embassy, 2003) Found at <[www.unescap.org/tid/publication/part\\_two2223\\_au.pdf](http://www.unescap.org/tid/publication/part_two2223_au.pdf)> at 28 August 2005

<sup>161</sup> Department of Foreign Affairs and Trade, 'Potential Benefits- Manufacturing' (Factsheet, 2005) 1.

China's current tariff rates cost our exporters between A\$50 million and A\$195 million a year. As Australian products rise up the value chain the tariff rate increases,<sup>162</sup> a fact which must be readdressed as Australia pursues an increase in finished products.

China is becoming competitive with regard to knowledge and capital-intensive goods and the export structure is gradually advancing toward high value added goods.<sup>163</sup>

However, low skilled labor intensive industries in China remain much more efficient than their Australian counterparts. Consequently, mass production and routine based industries in Australia will struggle to compete against Chinese alternatives.<sup>164</sup> TCF and PMV are prime examples as the workforce consists largely of this type of employment.<sup>165</sup> If Australia is to persist in the production of such industries exporters must redress the problems faced by their counterparts throughout the world. For example, the British textile sector has been flooded by cheap Chinese garments threatening UK factories and job loss.<sup>166</sup> Many Australian sectors must reassess their long term viability and take precautions such as insuring themselves against bad debts, investigate additional lines of business and spread risk across more customers. After the above options are considered thoroughly then Australian business can still benefit from this strong Chinese manufacturing base by considering a partnership, but they should take a slow and

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<sup>162</sup> eg paper pulp= 0%, paper products= 9%, paper= 11%

<sup>163</sup> New Economic Prospects in Asia (2002) Research Committee Report Asia in Pursuit, Japan Transfixed <[www.mof.go.jp/jouhou/soken/kenkyu/ron049.pdf](http://www.mof.go.jp/jouhou/soken/kenkyu/ron049.pdf)> at 8 September 2005

<sup>164</sup> Ibid.

<sup>165</sup> By lowering tariffs gradually the PMV industry will be given a chance to adjust to the internationalization of the industry whilst maintaining stability and employment.

<sup>166</sup> This spells danger for British textile and clothing firms, particularly those companies that have spent millions of pounds setting up factories in places like Turkey, Sri Lanka, Pakistan and most recently Eastern Europe, in an effort to cut costs by taking advantage of low overhead and cheap labour.

*UK Clothing Firms Need to pull their socks up* (2005) Business Credit Management <[www.creditman.biz/uk/members/news-view.asp?newsviewid=5235&id=1&mylocation=News](http://www.creditman.biz/uk/members/news-view.asp?newsviewid=5235&id=1&mylocation=News)> at 20 October 2005.

measured approach to such a venture, given the abuse of intellectual property rights and the production of fake clothing in China is widespread.<sup>167</sup>

Australia's strength lies in industries that require highly skilled workers. If artificial costs are reduced through an FTA, such as customs tax, then existing exports become cheaper in the Chinese economy. Consequently, the development phase of Chinese labor towards highly skilled levels will be detrimentally effected given the associated drop in demand for such domestic labor. This is a potential sticking point in negotiations as trade unions in China seek to limit the effects of this within the Chinese economy.

Australian producers have two options if they wish to remain competitive amongst more efficient Chinese producers. Firstly, enter into partnerships with Chinese firms from which they learn from the procedures used by their partners. Secondly, capitalizations on Chinese niche areas through focus on those areas with a comparative advantage. An export orientation strategy has been particularly successful in Australia since 1999 with a shift towards capital intensive manufactured goods. Such manufactured items are a relative niche market in comparison to China's labor intensive industries due to the problems experienced with imitation of product processes. With such a large potential market available, Australian exporters may appeal to any type of taste.

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<sup>167</sup> *UK Clothing Firms Need to pull their socks up* (2005) Business Credit Management <[www.creditman.biz/uk/members/news-view.asp?newsviewid=5235&id=1&mylocation=News](http://www.creditman.biz/uk/members/news-view.asp?newsviewid=5235&id=1&mylocation=News)> at 20 October 2005.

Partnerships or joint agreements with Australian firms should also be encouraged to the Chinese unions in order of facilitating the education of the Chinese labor force. Skill levels will rise as Australian practices are performed throughout China.

## *B Services*

### *1 Professional Services*

This includes legal services, Accounting, Auditing, Architectural, Engineering and Medical services to name a few. Currently most professional services are in part regulated by government legislation and by one or more professional bodies (The Law Council of Australia, CPA, Institute of Chartered Accountants, Royal Australian Institute of Architects, Engineers Australia, and Australian Medical Council). China has similar regulations concerning professional services, however they are in most part regulated by the relevant governmental department (for instances the Ministry of Justice). In saying this professional bodies do play a role in regulating professions in China, one example would be the Chinese Institute of Certified Public Accounts, who supervise CPA's in China.

The legal profession is illustrative of barriers impeding the flow of professional services. Both Australia and China have obligations to the WTO to liberalise their respective legal services. Currently there are only 13 foreign law firms registered in NSW, however a number of Chinese people have studied law in Australia and have been licensed to

practice in Australia. China is in the process of liberalizing their legal profession, as at September 2004 there were 114 foreign law offices in China (approved by the Ministry of Justice); this included seven Australian law firms.<sup>168</sup>

Barriers that are currently restrict the provision of legal services include restrictions on joint partnerships and other forms of association between domestic and foreign firms, admission to practice requirements, residential requirements and scope of work to name but a few. An FTA should aim to address these issues with a view to creating a more liberal environment where professional services may flow more freely between Australia and China.

One of the major obstacles stemming the flow of legal services between Australia and China is the overlap of politics and law within China. This creates fundamental differences that may spawn distrust between Australian legal advocates and the Chinese judiciary. This problem is one of the behind the border issues that Australia must address in an Australia – China FTA. Such an issue can not be solved solely by bilateral negotiation; the separation of politics from law can only be effectively dealt with via a long term strategic planning and a willingness to embrace change.<sup>169</sup>

Touched upon above are the problems associated with the flow of professional services across national borders. While certain restrictions are essential to maintain quality of

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<sup>168</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 75.

<sup>169</sup> For a full discussion on the issues pertaining to the lack of independence of the Judiciary in China see Part IV Behind the Border Issues: Legal Reform.

service, the current regime is over restrictive and could be much more consumer friendly. A related issue is that of the movement of professionals into and out of Australia and China. Business between Australia and China is already in a state of acceleration, as the FTA progresses more business people will be traveling into and out of both countries. In order to efficiently conduct business and create a more receptive and accommodating business environment Australia and China must make the process of entry and movement of business people simpler. China's application for visas has been described as opaque, along with much of the countries other government decision making processes.<sup>170</sup> In contrast Australia utilises a highly sophisticated electronic entry system that enables China's business people to promptly enter the country.<sup>171</sup> Whist acknowledging the facilitation of trans-national mobility of business people is desirable we must also recognise the threat of terrorist attacks, a balance must be struck between mobility of business people and the integrity of borders.

A viable solution to this problem is for Australia and China to work together and develop a system of entry that is complimentary and easy to use. Such a system will promote trans border business ventures, as the perceived risk to participants will be lowered if they can be confident they can easily move between Australia and China. Both nations should support the APEC Business Travel Card Scheme,<sup>172</sup> not only will this assist business people in Australia and China, but should be beneficial to all APEC members.

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<sup>170</sup> Department of Foreign Affairs and Trade 'Australia-China FTA Negotiations - Interests and concerns of Australian services industries', <[http://www.dfat.gov.au/geo/china/fta/facts/services\\_2.html](http://www.dfat.gov.au/geo/china/fta/facts/services_2.html)> at 20 August 2005.

<sup>171</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 97.

<sup>172</sup> The APEC Business Travel Card was developed in response to the need of business people to gain streamlined entry to the economies of the Asia-Pacific region. The APEC Business Travel Card cuts through

While the system of entry is important, application for a visa and the timely approval and issuing of a visa is equally as important. Both countries must make the application process as simple as possible and clearly communicate to the business world how this is to be done. For frequent travelers a fast track system may be appropriate where it is possible to apply online and have a visa approved expediently. Both countries should seek to have visa's approved as quickly as possible so that people conducting business can confidently rely on their ability to enter business ventures and transactions that may have previously been avoided. Whilst this would be an ideal situation, we have mentioned above a fine balancing act must be weighed, where the security of both countries borders must take priority.

Another possible consideration may be the formation of a bi-national professional service provider. The establishment of a professional body spanning both Australia and China should facilitate trade in professional services. With a peak body drawing membership from professionals in both Australia and China under a common banner customers and governments alike should become more comfortable with the quality and competency of services being offered in both countries as the bi-national body could assist in regulating the industry. If a provider wished to render services in both Australia and China membership to such a body may act as assurance or a mechanism of approval that reflects competency in the professional service to be offered in both Australia and China. By way

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the red tape of business travel, and gives accredited business people pre-cleared entry to participating APEC economies. The card allows holders fast track entry and exit through special APEC lanes at major airports, furthermore the cardholder does not have to apply for VISA's or special entry permits to participating nations. As at 2004 there were 16 participating countries, including Australia and China. Business Mobility Group <<http://www.businessmobility.org/key/abtc.html>> at 20 August 2005.

of reference such a body could operate in similar fashion to the Instituted of Chartered Accounts and the CPA in Australia. A development such as this should boost bilateral trade in professional services between Australia and China as customers could be more confident in the services they were receiving and governments should be more comfortable with cross border supply and consumption abroad.<sup>173</sup>

## *2 Banking*

The main areas of bilateral cooperation are in the banking and insurance industries. ANZ Banking Group has a limited presence in Shanghai and Beijing. The Commonwealth Bank of Australia has offices in China and a strategic stake in Jinan City Commercial Bank. National Australia Bank, Westpac Banking Corporation and Macquarie Bank also have a presence in China.<sup>174</sup> The Bank of China and the Industrial and Commercial Bank of China both have a presence in the Australian banking sector.<sup>175</sup> There are considerable benefits to be obtained by both Australia and China by liberalizing the Banking Sector; China is still in the process of implementing WTO commitments in regard to Banking. Australia has a highly sophisticated and developed banking sector; Australia has much to gain by way of access to the Chinese market. Likewise, China can unlock considerable benefits by accessing Australian technology, processes and infrastructure to help

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<sup>173</sup> Mode 1 and Mode 2 services as classified by the WTO. 'Understanding the WTO: The Agreements, Services: Rules for Growth and Investment <[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm6_e.htm)> at 20 October 2005.

<sup>174</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 72.

<sup>175</sup> Ibid.

accelerate the maturity of the Chinese banking industry, as a sound financial system is integral to any developed country.

A significant impediment to the negotiation of an FTA between Australia and China presents itself in the form of both countries different stages of development (economic and socially).<sup>176</sup> Consequential to this is that Australia's level of sophistication is more advanced than China's in areas such as financial services, delivering Australian firms a substantial competitive advantage. China has historically been a "closed" economy,<sup>177</sup> sheltered from international trade. Strict regulation and government presence in most industries provided a legal barrier to international competition whilst at the same time acted as a deterrent to foreign market entrants.<sup>178</sup> Over the past decade China has sought to become a more open market place, such steps taken have included accession into the WTO<sup>179</sup> and the more recent relaxation of the controversial pegged Yuan.<sup>180</sup>

Australia's banking industry has developed a sophisticated market place that is highly efficient, liquid and responsive. Such a system has evolved in an international context since the deregulation of financial markets in Australia in the 1980's.<sup>181</sup> Consequently

Australian banks have had close to a twenty year head start in responding to global

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<sup>176</sup> It is estimated that over 160 million Chinese people still have consumption levels below one dollar a day. The World Bank, 'Economic Achievements and Current Challenges' March 2005 <[http://www.worldbank.org.cn/English/Overview/overview\\_brief.htm#L1\\_0](http://www.worldbank.org.cn/English/Overview/overview_brief.htm#L1_0)> at 16 August 2005.

<sup>177</sup> Cole Sternberg, 'Chinese Courts: More of a Gamble Than Arbitration?' (2004) 4 *International Business Law Review* 31, 48-49.

<sup>178</sup> Abraham Katz U.S. (Council for International Business) to Frederick L. Montgomery Chairman (Trade Policy Staff Committee), 17<sup>th</sup> March 1997, China Working Group Recommendations to USTR on China's Accession to WTO.

<sup>179</sup> China has been a member of the WTO since 11 December 2001; WTO Members and Observers from 16 Feb 2005 <[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm)> at 20 August 2005.

<sup>180</sup> Jim Parker, 'Yuan Inches Closer to Freedom' *Australian Financial Review*, 11<sup>th</sup> August 2005, 23.

<sup>181</sup> Mr. Ian Macfarlane (Deputy Governor of the RBA), 'Financial Deregulation and Financial Markets: Past Promise – Future Realities' (CEDA Conference, Sydney, 27 April 1995).

variables which has allowed the banks to build a wealth of knowledge and best practice procedures that may only come from experience.

Situations such as this create problems for an FTA as Australian Banks will command a competitive advantage over domestic Chinese banks. Any liberalisation of the Chinese Financial markets will be hard fought, at China's end political pressure will be intense in an attempt to preserve the local banks. Foreign presence within the industry will be met with skepticism as the old culture still lingers with a distrust of foreign players.<sup>182</sup>

Whilst it would be naïve and impractical to request China to allow Australian firms unrestricted access to the Chinese markets, a less confrontational approach is already underway. Many Australian banks have already taken a strategic interest in domestic Chinese banks.<sup>183</sup> Current regulations in China prevent a more active role being taken by foreign players in the local market; however this process is under review. The current strategy of the big Australian banks seems to be the most effective point of entry into the Chinese banking industry and inline with Chinese business culture (an indirect approach). China is looking to further liberalise their banking sector with the privatization of State owned Banks.<sup>184</sup> This solution appears as if it will be effective in achieving returns for both countries. With Australian banks taking a stake in Chinese banks, infrastructure and

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<sup>182</sup> Rebecca Fannin, 'Where's China?' *Asia Week*  
<<http://www.asiaweek.com/asiaweek/technology/article/0,8707,168240,00.html>> at 19 August 2005; Uday Lal Pai, 'New Media, Old School Team Up to Re' February 2, 2001  
<<http://asia.internet.com/news/article.php/674571>> at 19 August 2005.

<sup>183</sup> Eric Johnson, 'China's Mid - Sized Banks a Worthy Target' *Australian Financial Review*, 11 August 05.

<sup>184</sup> Francesco Guerrera, 'Beijing Plans to Privatise Bank' August 16 2005,  
<<http://news.ft.com/cms/s/c4516456-0e0e-11da-aa67-00000e2511c8.html>> at 19 August 2005.

knowledge will be shared, while at the same time the Australian banks will be compensated by higher returns from the Chinese banks they have invested in.

### *3 Education*

Education is one of Australia's largest service exports; currently a co-operative relationship exists between Australia and China for the provision of educational services. In 2003 57, 579 Chinese students were enrolled in courses within Australia, this makes China Australia's largest source of international students.<sup>185</sup> One area an FTA could improve Educational services could be in allowing Foreign institutions a commercial presence within the domestic market, currently this is not possible. Another issue that may be addressed is the movement of educational professionals and the mutual recognition of professional and academic qualifications.

Problems in education are similar to those discussed in relation to the movement of business people. Likewise the lack of recognition of foreign qualifications deters and prevents the flow of services. A system that acknowledged skills obtained abroad would be more conducive to the flow of education services between Australia and China. The problem here lies in the differing regulations and requirements for alike fields.

A possible solution here is not the automatic recognition of foreign qualifications, but in collaboration between Australia and China. The requirements for educational

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<sup>185</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 71.

qualifications should be discussed between Australian and Chinese peak bodies so that the requisite skills are covered in the curriculum to be studied before a person can obtain qualifications in education. The complete implementation of such a strategy is not practical, not every person who undertook educational training would necessarily be concerned with recognition beyond their native border of their credentials, however it would be feasible to compromise, creating a syllabus that is more receptive to multinational recognition so that a condensed bridging course is all that is required before a Chinese national can have their qualifications acknowledged in Australia and vice versa. A similar system may also be attractive with professional services; however this would be more difficult due to the differing regulations and discrete requirements of each country.<sup>186</sup>

An FTA may provide the environment where a bi-national peak body in educational training may be established. Here the peak body, with input from both Australia and China could devise a curriculum that would allow a member to have their qualifications acknowledged in both countries. In this light an educator who wished to render services in both Australia and China could seek membership from this body<sup>187</sup>. Thus a possible solution exists in collaboration with the view to creating a more akin service so that skills are more readily transferable and applicable beyond ones domestic country.

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<sup>186</sup> To illustrate, it would be naïve to suggest a legal practitioner in Australia could seamlessly adapt to legal practice in China without some form of training. Furthermore, the quality of service would be compromised as clients would lose faith in the system if competency was to deteriorate.

<sup>187</sup> This argument is similar to that articulated in 'Professional Services' above.

## *C Investment*

The FTA will seek to address barriers that may impede investment flows between Australia and China. The FTA will focus on removing restrictions on foreign investment and promote transparency in foreign investment regimes. Australia currently has a transparent and relatively liberal policy on foreign investment; systems are in place to screen foreign investment to ensure it is not contrary to national interest. The presumption in Australia is that any foreign investment is in the nation's interest and should go ahead, however the Treasurer may reject an application if he considers the matter to be contrary to the national interest. It is rare for the Treasurer to reject a proposal however this did occur in 2001 when Treasurer Peter Costello Rejected Shell's takeover of Woodside.<sup>188</sup> Over the past 5 years there have only been four non-real estate rejections.<sup>189</sup>

China encourages foreign investment and since their accession into the WTO they have created a more foreign investor friendly environment. China has a registration system where approval for investment is granted on a case by case basis. Proposals are lodged with the Ministry of Commerce and when approved a certificate is issued. Any proposal must be approved or disapproved within three months.<sup>190</sup> China offers taxation incentives

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<sup>188</sup> Neil Mitchell, Interview with the Honourable Peter Costello (MP, Treasurer) (3AW, 24 April 2001) Transcript No. 2001/041.

<<http://www.treasurer.gov.au/tsr/content/transcripts/2001/041.asp?pf=1>> at 1 August 2005.

<sup>189</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 77.

<sup>190</sup> At present, the basic laws and regulations of China concerning foreign investment are the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises and their implementing regulations. China FTA Study Taskforce,

as well to foreign companies, the normal corporate tax rate is 33%, however in some instances this may be reduced to 24% or 15% depending on the type of operation.<sup>191</sup>

Two way investment between Australia and China has been relatively modest. Most investment has been concentrated in the resources, energy and processing commodities industries due to the coincidence of interest in such sectors. Bilateral investment has not kept pace with the general increase in trade between Australia and China due to the restrictive regulatory regime in Australia and the non conducive business environment in China pre 1980's. It appears that bilateral trade will significantly increase as Australian investors gain confidence in the Chinese economy and markets as they develop and become more transparent, this process is already underway, recently Sakthi Siva, of UBS's Singapore brokerage recommended money managers increase their holdings in 'H shares'.<sup>192</sup>

The main problems impeding the flow of investment are exceedingly burdensome regulatory regimes and downbeat perception (albeit improving) of the Chinese business environment. China has traditionally been a closed economy, only recently have they begun the process of opening their economy to the world. At this point in time the Chinese economy is no where near the maturity levels of other major world economies

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'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 80.

<sup>191</sup> China FTA Study Taskforce, 'Australia- China Free Trade Agreement Joint Feasibility Study' (Department of Foreign Affairs and Trade, March 2005) 81.

<sup>192</sup> H shares are mainland Chinese companies traded in Hong Kong. Bloomberg, 'Analysts Bullish on Cheap Chinese Stocks' *Australian Financial Review* 27 October 2005, 31.

(USA and EU); however their rate of progress has been quite remarkable considering the cultural and economic hurdles they have negotiated.

Aside from the structural aspects of investment Australia should also be wary of China's level of debt which has been forecast at 110% of GDP by 2008.<sup>193</sup> Bonds are unattractive as there is the fear that the government will have to print money to service interest repayments.<sup>194</sup> Thus the infrastructure underpinning investment within China is problematic and must be addressed.

The problems relating to investments are predominantly those that relate to the immaturity of Chinese markets, appropriate infrastructure must be in place before any maturity can be reached. Similar to trade in services, any FTA should again recognise the growth potential for both economies and seek to create an environment that is advantageous and encouraging to bilateral investment. This will include regulatory change and a shift in market sentiment whereby China would be held in the same regard as other developed economies, such a shift must be long term orientated and not FTA rhetoric.

Time is the ultimate ingredient and most would agree it is only a matter of time before China becomes another legitimate powerhouse in the global economy. At present China seems to be on a highly efficient course to establishing an acceptable investment regime.

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<sup>193</sup> Joe Studwell, *The China Dream* (2003) 209.

<sup>194</sup> Ibid.

An FTA may be the catalyst necessary to accelerate this time line as Australia has the knowledge, processes and infrastructural framework to assist in China's growth.

Perhaps stepping outside the direct realms of an FTA consideration should be had for an indirect approach to resource security. Compatible with China's non confrontational business style and conservatism resource security may be facilitated via direct foreign investment in addition to a formal FTA. Some of China's first large scale foreign investment in Australia were in the Ore and Mining Sector,<sup>195</sup> such investments would create a more receptive environment to China's plight within the Australian market as ownership interests would be more closely aligned with China's national interest. An FTA may be helpful in accomplishing increased investment. To illustrate, China National Offshore Oil Corporation's (CNOOC) recent attempt to acquire California's Unocal was thwarted by 'unprecedented political opposition' on Capitol Hill.<sup>196</sup> Here CNOOC's bid was \$18.5 billion; on 10<sup>th</sup> August 2005 Chevron's lower bid of \$17.6 billion was accepted by Unocal. This highlights the fact that direct investment in the resource sector is a preferred approach to resource security; however political tension between USA and China prevented this from taking place.<sup>197</sup> An FTA should seek to bridge the political gulf, making future acquisitions more likely to succeed with a nation to whom China has an FTA. For instance rumours indicate CNOOC is interested in Woodside (as another attempt on a USA Firm is unlikely), the previous target in a takeover bid by Shell that

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<sup>195</sup> *Foreign Investments* (1997) China Economic Review  
<<http://www.chinaeconomicreview.com/subscriber/articledetail.php?id=637>> at 5 October 2005.

<sup>196</sup> 'Giving China a Bloody Nose' (2005) *The Economist* 4 August 2005.

<sup>197</sup> Ibid

failed on grounds of national interest.<sup>198</sup> An FTA could enhance the prospects of any such bid as the government intervention would be far more difficult in an FTA environment.<sup>199</sup>

While China may be licking her wounds after the Unocal bid Australia must also ask itself how far will China go in opening up investment channels? For success in China you need to demonstrate a gesture good faith and respect,<sup>200</sup> but give China too much and you may well end up with a poor deal.<sup>201</sup> This is illustrated by Rupert Murdoch's recent frustrated attempts to crack the Chinese media market culminated in News Corps Chairman and Chief Executive labeling the Chinese as 'Paranoid'.<sup>202</sup> Hence it would be in Australia's interests to be vocal at all stages in negotiating the FTA, if China drags her feet, make it known to the world and this should soon bring negotiations back on track as credibility is too valuable for the Chinese to risk on an Australian FTA.

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<sup>198</sup> Martin Hastings, 'The politics of Australian LNG supply to California – It's all about the game (part 3)' (2005) *Energy Bulletin* <<http://www.energybulletin.net/8706.html>> at 5 August 2005.

<sup>199</sup> Perhaps the most disturbing aspect of the rejected CNOOC takeover bid was the Anti – China sentiment in Washington and the absence of comment from pro China business groups. USA often takes the moral high ground when dealing with China, this frustrated takeover bid has damaged the USA's credibility and reveals a disregard for 'fair play' and open markets which it so proudly proclaims in the international arena. See 'Giving China a Bloody Nose' (2005) *The Economist* 4 August 2005.

<sup>200</sup> Durie, John, 'Testing Beijing for a 'Real' Deal', *Australian Financial Review* 29 September 2005, 64.

<sup>201</sup> Ibid.

<sup>202</sup> *Murdoch Hits Brick Wall* (2005) BBC News World Edition <<http://news.bbc.co.uk/2/hi/business/4259310.stm>> at 5 October 2005.

## *VI PART FOUR: BEHIND THE BORDER ISSUES*

One of the most significant hurdles upon the road to an FTA between Australia and China has been labeled by Vail (Minister for foreign affairs and Trade) as the “Behind the border issues”. This includes issues of transparency in decision making and approval processes and acceptable business practices. From an external viewpoint China is still in a transitional phase, whereby the clarity of the administrative decision making process and government interference or intrusion into business activity still registers above an acceptable level for many possible entrants into China’s markets. From an internal viewpoint, the above mentioned situation has been likened to a natural progression; the increase in market entrants has been the result of a growth in economic prosperity rather than a political upheaval.<sup>203</sup>

Behind the border issues also encapsulates cultural diversity. By comparison an FTA between Australia and China will be more difficult to arrive at contrast to the FTA struck between Australia and the USA, based on the different cultural backgrounds of each country. Australia is quite similar to the USA in terms of language, customs and western ideological principles.<sup>204</sup> China and Australia are starting from two starkly different

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<sup>203</sup> East Asia Analytical Unit Department of Foreign Affairs and Trade, *China embraces the market* (1997) 20-29

<sup>204</sup> Unlike the Chinese government which has consistently relegated democratic movements, the US has proclaimed its desire for democracy to a similar degree as Australia. As President Bush said in his State of Union Address, “Our aim is to build and preserve a community of free and independent nations, with governments that answer to their citizens, and reflect their own cultures. And because democracies respect their own people and their neighbors, the advance of freedom will lead to peace.” Our shared values and common traditions provide a crucial foundation for closer political and economic integration. Roger Noriega, Assistant Secretary for Western Hemisphere Affairs. ‘China’s influence in the Western Hemisphere’ (Statement before the house subcommittee on the Western Hemisphere, Washington, 6 April 2005)

cultural positions. This in itself will cause the negotiations to be more difficult as the two parties will have to agree upon common ground to begin with before any negotiation of substance can occur. Such concessions of fundamental principles are difficult to make and may prove to be problematic.

### *A Legal Reform*

Intellectual property rights, along with the protection and enforcement of contractual obligations have been a long standing problem for organisations carrying out business in China.<sup>205</sup> Much publicity has been given to the US concerns over the lack of protection afforded by China's legal system; such concerns have also been expressed by Mark Vaile, where he described intellectual property issues as 'top order'.<sup>206</sup> The Minister also stated intellectual property was a serious issue with every major trading partner.<sup>207</sup> The fear of most business is that the sanctity of trademarks, patents and copyright will be tainted if they venture into China. On top of this confidential information may enter the public domain. In relation to contracting, it would be exceedingly difficult to carry out business if a firm could not rely upon the contracts through which it conducts business. Without the comfort of a legally and practically enforceable agreement Australian businesses will be reluctant to commerce in China. This perhaps maybe encapsulated in two comments

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Full text available <[www.state.gov/p/wha/rls/rm/2005/q2/44375.htm](http://www.state.gov/p/wha/rls/rm/2005/q2/44375.htm)> at 16 September 2005.

<sup>205</sup> In the mid 1990's it was claimed that software piracy was costing the USA \$500 million a year. Fifteen pirate CD plants were producing 50 million CD's per annum whilst legitimate plants produced only 3 million. Pirate CD's accounted for 83% of the market during this time.

Tim Ambler and Morgen Witzel, *Doing Business in China* (2<sup>nd</sup> ed 2004) 114.

<sup>206</sup> Tracy Sutherland 'Piracy Talks Vital as Seas Grow Rough' *Australian Financial Review*, 19 August 2005, 4.

<sup>207</sup> *Ibid.*

made by James McGregor; ‘don’t rely exclusively on the law... you will lose’<sup>208</sup> and ‘... technology firms will always be ripped off’.<sup>209</sup>

The above situation is an issue that can not be satisfactorily remedied within negotiating an FTA, the solution must be long term focused. Problems such as the lack of the rule of law can not practically be stamped out overnight; it must follow cultural and social change in the fabric of Chinese business and government.

Another impediment to the flow of legal services is the intrinsic link between politics and law in China. The judiciary is far from independent in the Chinese system.<sup>210</sup> Interference by the CCP is a major concern within the Chinese legal system, some government officials (especially lower ranking officials) pressure Judge’s to reject administrative actions filed.<sup>211</sup> The problem with the Judiciary is commonly referred to as the ‘three nots’ (san bu),<sup>212</sup> this describes three situations; Firstly where the aggrieved party dare not sue for fear of retribution by the government. This is a major concern for private business as industry is often subject to tight controls; these controls are monitored by government departments (such as the industry and commerce bureaus) who wield an enormous degree of discretionary power. If a private business lodged an action it is possible such an agency may respond by denying further applications for approval.<sup>213</sup> Secondly, where the aggrieved party is unwilling to sue, this may be for a variety of

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<sup>208</sup> James McGregor, *One billion customers; lessons from the front lines of doing business in China* (2005).

<sup>209</sup> *Ibid.*

<sup>210</sup> See discussion below under Legal Reform.

<sup>211</sup> Veron Mei-Ying Hung, ‘Judicial Reform in China: Lessons from Shanghai’ (2005) *Carnegie Papers* No 58 April 2005, 4. <<http://www.carnegieendowment.org/files/CP58.Hung.FINAL.pdf>> at 20 October 2005.

<sup>212</sup> *Ibid.*, 5.

<sup>213</sup> *Ibid.*

reasons such as legal costs.<sup>214</sup> The final situation is where the aggrieved party did not know they could sue.<sup>215</sup>

Another problem with the Judiciary in China is *guanxi* or *renqing* cases. This refers to a situation where officials or party members interfere with a judge on behalf of a 'friend'. Such occurrences have been dubbed 'not uncommon'.<sup>216</sup> The most common forms of interference involve pressuring aggrieved parties to withdraw an action, rejecting cases filed or pressuring the judge to interpret legislation – which is often ambiguous – in a manner that favours the defendant.<sup>217</sup> This type of behaviour exists as the judiciary are to consider social and legal effects in reaching a decision. While both these aims are desirable reality dictates that the two may be incompatible in certain cases, such an environment is conducive to political interference.

A similar problem presents in the form of judicial corruption. From 1998 – 2004 2.7% of China's Judicial staff were punished for violating the law or discipline.<sup>218</sup> This is perhaps a function of the basic salary of a judge which in some instances is below US\$2500 per year.<sup>219</sup> Here we may conclude remuneration may entice some members of the judiciary to part take in corruption.

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<sup>214</sup> Ibid.

<sup>215</sup> Ibid, 6.

<sup>216</sup> Veron Mei-Ying Hung, 'Judicial Reform in China: Lessons from Shanghai' (2005) *Carnegie Papers* No 58 April 2005, 9. <<http://www.carnegieendowment.org/files/CP58.Hung.FINAL.pdf>> at 20 October 2005.

<sup>217</sup> Ibid 12.

<sup>218</sup> Ibid, 17.

<sup>219</sup> Ibid, 18. Noting all judges have the same base salary however this is adjusted based on the living standard of the locality. Shanghai has the highest average annual income judges here will receive greater compensation.

Hence in light of the above, before any meaningful reciprocal relationship can flourish the Chinese legal system must become detached from the political arm of government and embrace the rule of law.

While the protection of legal rights has been viewed in negative light above, it should also be stated that much has been done to improve the situation in China. The Chinese legal system is evolving and maturing, this may be a kin to the rapidly expanding economy. To fuel China's rapid expansion foreign investment is essentially, such investment will not be forthcoming if the investor is not confident their investment will be protected by law. The result of a maturing legal system and necessity has created a situation where China has dramatically improved the integrity of their judiciary. This sentiment was echoed by Xiao Yang, Chief Justice and president of the People's Supreme Court of the People's Republic of China in a speech delivered at the 11<sup>th</sup> Conference of Chief Justices of Asia and the Pacific, where he said;<sup>220</sup>

'Procedural justice is one of the legal terms that has caught most attention from China's legal community in recent years and has also become the basic objective of China's judicial reform'

Since 1 July 1995 when the Law of the People's Republic of China on Judges took effect Judges have been separated from civil servants. This basic, yet profound change is considered to be a fundamental principle of an independent judiciary<sup>221</sup> and exemplifies

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<sup>220</sup> Xiao Yang 'China Intensifies Reform of its Judicial System' (Speech delivered at the 11<sup>th</sup> Conference of Chief Justices of Asia and Pacific) *Australian Financial Review* 13 May 2005, 63.

<sup>221</sup> Montesquieu's theory on the separation of powers  
Gabrielle Moens, *The Constitution of the Commonwealth of Australia Annotated* (6<sup>th</sup> ed, 2001) 22.

China's commitment to create a more accountable and internationally acceptable legal system.

China is in the process of modernizing their legal system; this should encourage and support foreign market entrants. China's commitment to improving the protection afforded to intellectual property rights can be seen through the Supreme People's Court website on intellectual property, this site provides information on current cases, Chinese law and access to judgments.<sup>222</sup> Confidence in China's ability to protect intellectual property is growing, Microsoft have sought recourse to China's legal system to protect against copyright infringements with favourable results. Counsel for Microsoft, Tom Robertson, commented after the 1999 case;<sup>223</sup>

"The court verdict has greatly enhanced our confidence for China to wall off the pirate software in the industry,"

Thus we can foresee potential problems in regard to intellectual property. Some comfort from these fears may be sought in China's recent accession into the WTO, where they have been striving to improve this deficiency. Judicial reform has taken off, as with the Chinese economy it is only a matter of time before this process is completed to the satisfaction of business people around the world. Judicial reform and Economic development can not be solved within a document at some discrete point in time, the

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<sup>222</sup> The Supreme People's Court of The People's Republic of China, *Intellectual Property Website* < [www.chinaiprlaw.com](http://www.chinaiprlaw.com) > at 12 August 2005.

<sup>223</sup> This article discusses damages issued in two rules in favour of Microsoft. 'China Gets Tough on Piracy' *Wired News*, 8 March 1999 < <http://wired-vig.wired.com/news/politics/0,1283,18318,00.html> > at 12 August 2005.

fabric of the judiciary, attitudes and accepted norms must change, this evolution must be allowed an extended timeframe to ensure a successful and complete overhaul is achieved.

### *B Transparency in Administration*

The procedure for importation of Australian exports is another problem often faced by Australian exporters. China's structure of governance is quite different to our other major trading partners.<sup>224</sup> Through the introduction of a FTA one may expect publication of relevant laws, regulations, administrative decisions and any other appropriate publication in a timely manner.<sup>225</sup> Furthermore, this common procedure must be applied consistently across all jurisdictions. Domestic procedures must also exist for prompt review and correction where necessary of administrative actions.<sup>226</sup> In the event of a glitch in the system, such exporters will turn their attention elsewhere and this is known by the Chinese. Such transparency will be achieved with Australia as it is aware its operations will be closely monitored by future potential trade partners.<sup>227</sup> Evidence of this commitment towards transparency in administration is illustrated throughout horticulture negotiations between China and Australia.<sup>228</sup>

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<sup>224</sup> Department of Foreign Affairs and Trade, 'Potential Benefits' (Factsheet, 2005) 4.

<sup>225</sup> Department of Foreign Affairs and Trade, 'Non- Tariff Measures' (Factsheet, 2005).

<sup>226</sup> Ibid.

<sup>227</sup> China has agreed to begin talks with Japan and South Korea to determine the feasibility of a trilateral FTA. One of the biggest focuses throughout such negotiations is the pursuit of 'comprehensive security' that closely ties together aspects of economic exchange, diplomacy and national security. These two countries will closely monitor the China- Australia FTA to determine the likelihood of China's ability to meet this 'comprehensive security' objective.

Wang Shan *China eyes comprehensive security* Asia Network

<[www.asahi.com/english/asianet/hatsu/eng\\_hatsu031101c.html](http://www.asahi.com/english/asianet/hatsu/eng_hatsu031101c.html)> at 17 September 2005.

<sup>228</sup> "China offered considerable transparency to their industry at the forum, which will assist our understanding and give confidence in closer interaction," Mr John said, export chair, AUSVEG.

## *VII PART FIVE: RECOMMENDATIONS*

### *A Website*

The Department of Foreign Affairs and Trade (DFAT) hosts a China- Australia FTA specific website.<sup>229</sup> The website provides progressive updates of the negotiation process and allows submissions from interested parties, providing an effective medium of communication with the Government (FTA negotiators). Austrade is another useful site for Australian traders seeking to do business with China; the website is aimed at reducing the time, cost and risk involved in selecting, entering and developing international markets.<sup>230</sup>

The limitations of these two websites are twofold. Firstly, the FTA website has been tailored around the needs of users throughout the negotiation phase; it ceases being useful upon the completion of an FTA as it is essentially a pre- completion forum. Secondly, Austrade's deficiency lies in its lack of specificity; the website deals in general and broad terms. In effect, Austrade serves as a starting point for exporters to gather information, however given the breadth of Austrade's coverage and volume of content it is incapable of catering for all circumstances.<sup>231</sup>

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Karen Hellwig, Corporate Communications Manager, Australian horticulture industry signs a framework agreement on cooperation in horticulture with China  
<[www.linkingfarmerswithmarkets.net/index.php?p=4&id=19](http://www.linkingfarmerswithmarkets.net/index.php?p=4&id=19)> 2 August 2005.

<sup>229</sup> Department of Foreign Affairs and Trade <[www.dfat.gov.au/geo/china/fta/](http://www.dfat.gov.au/geo/china/fta/)> at 16 September 2005.

<sup>230</sup> Australian Trade Commission <[www.austrade.gov.au](http://www.austrade.gov.au)> at 16 September 2005.

<sup>231</sup> Austrade relates to exporters in general across all of Australia's trading partners, it is not China specific.

Large enterprises are financially equipped to fully unlock the benefits of an FTA, however it should be noted that the gains for small to medium businesses are less transparent due to complexities associated with international trade (such as dealing with customs).<sup>232</sup> A possible solution to assist small to medium business in fully unlocking the potential of the proposed FTA could be available through the creation of an interactive database. Here we are suggesting a similar service to that offered by the Western Australian State Administrative Tribunal.<sup>233</sup> This proposed interactive database would allow users to input the details applicable to their transnational contract with a Chinese national. The database would then generate all applicable forms necessary for the successful completion of their transaction. Along with such forms, the database should also generate a checklist document to assist the user in carrying out their business deal. As stated in Part II Benefits and Drawbacks, business relationships are essential for economic success in China, the proposed database is designed to supplement this. The database seeks to assist small to medium business in discharging legal obligations imposed on trans-border transactions

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<sup>232</sup> The law in relation to customs is governed by a multitude of legislation, making the application of this an expensive process. Whilst large businesses have a substantial resource base in order to spread the costs, small to medium sized business do not have the capacity to incur these expenses. For instance, the Customs Act alone has over 270 provisions

*Customs Act 1901* (Cth)

<sup>233</sup> SAT wizard available on the State Administrative Tribunal website <[www.sat.justice.wa.gov.au](http://www.sat.justice.wa.gov.au)> This service will generate the forms required to make an individualized application to the State Administrative Tribunal. On top of this, it will produce a summary of the steps an applicant is required to undertake in order to have his matter heard before the Tribunal. Once the appropriate forms have been generated there is also the option of lodging the forms online. State Administrative Tribunal <[www.sat.wa.gov.au](http://www.sat.wa.gov.au)> at 10 August 2005.

An extension of this proposed database may be the electronic lodgment of forms, where not only does the database generate the forms but allows the user to complete and lodge their documentation online. In this manner Australia may work towards streamlining this database with certain aspects of customs procedures. This may lead to increased efficiency, thus reducing the time between striking the deal and completion of contractual obligations.

This website should assist in making Chinese market places more accessible to Australian suppliers, thus assisting Australian firms in exploiting a first mover advantage. On top of this the forms generated should assist in clarity of contracting – as standard clauses should have uniformed meaning – small to medium business could be more confident in the contractual process and ‘surprises’ should become less prevalent as the system matures. The operation of the database is intrinsically linked to China’s international business reputation; consequently there should be a coincidence of interests.

### *B Contracting arrangements*

In relation to contractual arrangements between Australia and China, the concerns of businessmen are three pronged. Firstly, how will contracts be struck and what laws will apply in relation to such contracts? Secondly, sanctity of contract; will both parties honor their obligations? Thirdly, what are the avenues of redress for breach of contract or non-fulfillment and how effective are they?

For parties with their relevant places of business in different Contracting States, where their contract falls within the scope of the United Nations Contract for the International Sale of Goods (CISG), the contract is automatically governed by the CISG, unless the parties indicate otherwise.<sup>234</sup> In relation to the first concern, both China and Australia have been Contracting States since 1 January 1988 and 1 April 1989 respectively. Hong Kong became a “Special Administrative Region” of the People’s Republic of China on 1 July 1997, allowing it to also fall within this Contracting State construction. In Australia, section 66A of the Trade Practices Act 1974 (Cth) provides that the CISG takes precedence over the provisions of the Trade Practices Act.<sup>235</sup> For parties to such international sales transactions who do not wish to have them governed by the CISG, the recommended procedure is to so state in their contracts. This convention does not eliminate risks but does substantially reduce them.

Article 6 does allow parties to derogate from any provision contained within this convention. The Vienna convention will form the base agreement with parties merely required to state where and when certain articles do not apply or alternatively which articles will be replaced. A fundamental reason for China’s ratification of this convention was its application to sale of goods and exclusion of sensitive issues such as intellectual property.

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<sup>234</sup> This is outlined in article 1(1)(b) of the Vienna Convention and has been upheld in case law *Golden Acres Limited v Queensland Estates Pty Ltd* [1969] Qd. R 378

<sup>235</sup> Gabriël Moens, Lisa Cohn and Darren Peacock, “Australia’ in Mark Bonell (ed), *A New Approach to International Contracts* (1999) 24, 25.

In relation to the second concern, the Vienna convention applies much the same obligations upon each party as domestic contract laws with only minor variations in interpretation techniques. The strength of the CISG lies in its clarity with specific obligations of each party easily articulated. The contract sets out a step by step expectation upon each party which limits the overall extent of non- conformity and availability of particular remedies. Consequently, parties are discouraged from dishonoring their obligations. For instance, the courts have been very strict in their interpretation of ‘within reasonable time’ requirement for examining the goods.<sup>236</sup> If the buyer delays this obligation he is unlikely to have a valid claim for fundamental breach and thus avoidance of the contract.<sup>237</sup> Instead he will merely have to accept damages for the difference between the contract price and the market value of the goods. Without automatic application of the Vienna convention, contracting parties in Australia and China would be burdened with the task of imposing each party’s specific rights and obligations. Inadequate or incomplete contracts would be inevitable creating legal confusion which could otherwise have been avoided through use of the CISG as the law governing the contract.

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<sup>236</sup> Article 7: Interpretation of Convention

1. In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade
2. Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law

<sup>237</sup> Article 49(2)(b)(i) of the CISG states that the buyer loses the right to declare the contract avoided if he does not inform the seller of non- conformity of the goods within reasonable time after he knew or ought to have known of the non- conformity.

Leonardo Graffi, ‘Case Law on the Concept of “Fundamental Breach” in the Vienna Sales Convention’ (2003) *International Business Law Journal* 338.

In regard to the sale of goods the Vienna Convention is a well recognised and consistent body of laws capable of efficient application for contractual relations between Australia and China.<sup>238</sup> The appropriate interactive database and website discussed throughout the preceding paragraphs should have regard to the relevant articles establishing the rights and obligations of each party to the contract. Any database constructed as recommended above would operate under the assumption that the articles of the Vienna Convention applies in full. If any party chose to derogate from any provision they would have to make an article 6 declaration upon their own devices.

The third and final concern primarily deals with the issue of enforceability. Contractual disputes are a common occurrence in commercial relationships. China's legal structure lacks both consistency of decision making and appropriate avenues of appeal.<sup>239</sup> The necessary fundamental reform of such a system is not feasible in the short to medium term and will continue to hamper China's development into the global market. To cater for some unique issues that may arise between disputing parties involving Australia and China we would recommend a cross jurisdictional tribunal.<sup>240</sup> In this manner a body of common law may develop; this would enhance confidence in business transactions between Australia and China as consistency of application and interpretation would promote clarity via a neutral medium. As arbitration is so ingrained in Western business thinking, China is learning to accommodate it in conjunction with mediation- its

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<sup>238</sup> While the Vienna Convention forms a solid foundation there are gaps in its application- eg sale of aircraft, sale by auction, sale of securities, electricity, goods for persona use etc- and although the Hague Rules attempt to cover such gaps it is unclear when this body of rules will be in operation.

<sup>239</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 110.

<sup>240</sup> Such a tribunal may operate in a similar manner to that of the London Court of International Arbitration. The processes of this Tribunal can be seen on the website [www.lcia-arbitration.com](http://www.lcia-arbitration.com)

traditionally favored form of dispute settlement.<sup>241</sup> Furthermore, arbitration doesn't require fundamental reform to court and legal structures and is therefore regarded as the most feasible option towards ensuring enforceability of contractual obligations.

For the successful establishment of this tribunal there is a need for enacting laws from both countries to confer jurisdiction upon the tribunal.<sup>242</sup> Within this conferral of power both countries must ensure that there is an appropriate mechanism for the enforcement of awards by this tribunal. As a tribunal would not be a court within either country's legal system the enforcement of an order would be questionable. A remedy would be the insertion of a provision in the legislation which establishes the tribunal that allows any order to be filed with the appropriate court in the appropriate country along with an affidavit attesting the order has not been honored by the party in breach. On filing, the order is taken to be an order of the court in which it was lodged and enforceable in the same way as an order of that court would usually be.<sup>243</sup> Whilst China has traditionally been concerned with anything that smacks extra jurisdictional<sup>244</sup> it has begun liberalizing its dispute settlement regime. Disputes involving foreign entities may now be heard outside China and two recent examples highlight the growing tendency towards arbitration as a preferred solution. In 1999 the China National Petroleum Corporation and

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<sup>241</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 113.

<sup>242</sup> Such enacting legislation would be similar to that of ADR which had jurisdiction conferred upon it via the *Courts (Mediation and Arbitration) Act 1991*

<sup>243</sup> A similar provision is provided for in the enforcement of SAT orders State Administrative Tribunal Act 2004 s 85.

<sup>244</sup> For instance, the humiliating defeats in the opium war which culminated in the treaty of Nanking which was weighted entirely to Britain's favour. Fundamentally, it demanded British extraterritoriality where all British citizens would be subject to British not Chinese law in they committed any crime on Chinese soil. Richard Hooker, *The Opium Wars* (1996) Washington State University World Civilizations <[www.wsu.edu/~dee/CHING/OPIUM.HTM](http://www.wsu.edu/~dee/CHING/OPIUM.HTM)> at 4 October 2005.

China Petroleum Technology Development Corporation registered claims of about \$50 million lodged by their US opposite numbers. Costs went to the Chinese.<sup>245</sup>

Impartiality in decision making will be a major concern within any adjudication process. In an attempt to alleviate some of these concerns the bench should be evenly comprised of Australian and Chinese members with the casting vote held by a nonpartisan member. Whilst all members should be impartial the composition described above will contribute to the image of objectivity and thus enhance the integrity of the tribunal.

Unlike the Vienna convention this tribunal would not automatically apply to the commercial transaction between the parties. Instead, an article 6 derogation from the Vienna Convention must expressly provide for dispute settlement to be through the tribunal rather than the courts. The proposed website and database should make this derogation requirement very clear to any user and should provide a standard clause that may be used to ensure that any dispute between contracting parties will be heard by the specialist tribunal. By agreeing to submit to the tribunal's rules, the parties undertake to carry out any award expediently; and the parties also waive their right to any form of appeal, review or recourse to any state court or other judicial authority, insofar as such waiver may be validly made.<sup>246</sup>

At the expiration of a 30 day period any unpaid awards will be displayed on a database within the website. This will act as a deterrent to non- payment from businesses due to

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<sup>245</sup> Tim Ambler and Morgan Witzel, *Doing Business in China* (2<sup>nd</sup> ed, 2004) 114.

<sup>246</sup> LCIA Arbitration Rules, effective 1 January 1998, from rule 26.9 <[www.lcia-arbitration.com](http://www.lcia-arbitration.com)> at 12 August 2005.

the negative implications of being listed.<sup>247</sup> This will also help other businesses by alerting them to firms who engage in questionable business practices. Once a listed firm has settled their award, and associated interest, they shall be removed from the listing. As noted, enhanced credibility is one of China's objectives in the FTA with Australia. This listing should be highly effective as excessive listings will be harmful to China's international business reputation.

The website should also be a useful tool in providing relevant information concerning the special tribunal. Access to jurisdictional information, composition of the tribunal, aims of the tribunal and costs should all be regularly updated and available for public use.

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<sup>247</sup> This strategy has proved to be effective in the past, an example being the ACCC's name and shame campaign.

## *VIII CONCLUSION*

In conclusion, Australia's two key objectives, namely the pursuit of reduced tariffs and protectionist measures at China's end as well as increased accessibility to Chinese markets is consistent with China's need for resource security and improvement in international credibility. China's reputation is highly dependant upon satisfying Australia's two main goals. In turn resource security will be bolstered as the transnational relationship flourishes. In light of this and the arguments advanced throughout the paper a successful FTA between Australia and China should invariably result in a net welfare gain.

Despite the obvious gains one must acknowledge that the greatest gains that stand to be achieved lie in those industries where compromise is controversial. China will be reluctant to concede ground regarding its agriculture and banking sectors. Similarly, Australia will be tentative to commit to any acceleration in the reduction of protectionist measures surrounding the TCF and PMV industries. Furthermore, we must acknowledge that this FTA is of a different ilk to that of the US FTA as it is as much associated with resolving behind the border issues as it is about the removal of tariffs and quotas. At the forefront of the behind the border issues is transparency, or the black box nature, of the decision making processes within China. Intellectual property has often been viewed as the Achilles Heel to doing business in China; this topic should appear prominently within the negotiation process.

Whilst the general sentiment regarding the Australia and China FTA has been upbeat, reality dictates a number of things. Some may suggest it would be foolish to overlook the size differential between Australia and China as it is highly unlikely a bilateral agreement with Australia will fundamentally alter the fabric underpinning China; economically, socially or politically. A successful FTA's worth lies in its ability to act as a triggering event sparking reform that may entice other large economies of a sufficient scale, impressed by China's attitude and commitment, to enter similar agreements where change may transpire. One must understand that the process is more likely to be evolutionary rather than revolutionary.

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