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7 July 2004

Mr David Holly
Head
China Free Trade Agreement Study Taskforce
Department of Foreign Affairs and Trade

To email: chinafta@dfat.gov.au

Dear Mr Holly

Please find attached the ACTU's submission to the Joint Feasibility Study on the Australia China Free Trade Agreement.

Yours sincerely

A handwritten signature in black ink, appearing to read "A. Burrow", is written over a faint, circular official stamp.

Sharan Burrow
PRESIDENT

AUSTRALIA – CHINA FREE TRADE AGREEMENT JOINT FEASIBILITY STUDY

ACTU Submission

**To DFAT Study Taskforce
30 June 2004**

Australia – China Free Trade Agreement Joint Feasibility Study

ACTU Submission

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Introduction

The Australian Council of Trade Unions [ACTU] is Australia's peak union organisation. All major unions in Australia representing almost 2 million working women and men are affiliated to the ACTU.

The ACTU is affiliated with several international union organisations and represents Australian organised labour at the International Labour Organisation [ILO]. Our position and submissions on issues relating to international trade negotiations and agreements reflect our solidarity with working people worldwide.

In general the ACTU believes multilateral arrangements are preferable to bilateral arrangements. We reject the view that unilateral free trade is optimal. Moreover, we do not support free trade agreements in the abstract or for their own sake. Our support for trade agreements is rather directed to improving the human condition; accordingly *free* trade agreements must provide for trade to be *fair* for all parties involved.

Market Economy Status

Since the late eighties the Chinese economy has undergone significant restructuring based on certain 'market economy' precepts.

This restructuring has not been accompanied by increased openness in Chinese society.

Without social openness and respect for basic human rights, an essential element of a *free* market economy is missing.

In short, China has had much economic *perestroika* but little social or political *glasnost*.

Chinese working people have no effective right to organise.

The All China Federation of Trade Unions [ACFTU] is the sole union federation in China. It is sanctioned by the government, and is officially and legally subservient to the policies of the government and the communist party.

The ACFTU is not independent. Nor is it a true trade union. Independent trade unions are outlawed, and any strikes are rapidly repressed.

While workers' protections exist on paper local authorities rarely enforce them. Freedom of association is a fiction, and repression of workers' rights is a systematic part of state policy [ref www.ICFTU.org]

Imprisonment of unionists for 'illegal demonstrations' is well documented. [Ref ICFTU Annual Survey of Violations of Trade Union Rights, 2003]

China has never ratified ILO conventions 87 and 98, which provide for the right to organise and bargain collectively.

The suppression of workers' rights and failure by China to enforce its own minimum labour code has been estimated by the AFL-CIO to have cut the price of Chinese labour by between 47% and 86%. [Ref www.aflcio.org]

A first-hand window on these issues is available from the experience of the Maritime Union of Australia [MUA] and the Global Union Federation ITF to which the MUA is affiliated. The MUA and ITF have some understanding of dealing with the China through the Flag of Convenience [FOC] Shipping campaign and highlight the following concerns which should be considered in the context of a FTA feasibility study.

The international campaign against flag of convenience has focused on a perceived threat of Chinese seafarers' becoming the lowest paid group of workers in the world prepared to sail on the world's FOC fleet as well as the large Chinese national line ships, COSCO.

There are tens of thousands of workers now trained and gradually replacing workers from traditional labour countries, like Filipino seafarers, on the FOC fleet. It is extremely difficult to communicate with these workers because their employment conditions and rates of wages are considered national secrets and to divulge this information to anyone including the ITF is regarded as an act of treason. In many cases and on many routes COSCO still employ a political commissar on board to protect the interests of the Chinese government.

The ITF has evidence suggesting that Chinese seafarer ratings are paid less than three dollars a day and a little more for officers. Even when the ship is covered by an ITF agreement there is little that can be done by the ITF to police the higher level of wages and even less to confirm that any of the seafarers concerned really receive the correct (agreement) rate.

The ACTU considers it would be wholly inappropriate to accord China status as a full market economy in such circumstances.

These reservations are magnified by several additional critical considerations. The secretive nature of Chinese society and suppression of political dissent makes it difficult to quantify the true extent of these considerations, but reports are sufficiently authoritative and frequent to establish the existence of a substantial and continuing violation of market economy precepts. [Refer submission to this Inquiry by Chris Nyland and Anne O'Rourke.]

First, China's 'Laogai' is an extensive prison system with estimates of the number of inmates ranging from 10 to 20 million. The Laogai system incorporates the view that state criminals must be stripped of their exploiter ideology and taught to work like members of the proletariat. Accordingly inmates are required to work during their incarceration with food rationed according to personal output [The New Internationalist 2001].

The Laogai are operated as businesses and seek to recoup most of their costs in sales of goods. Prison output in contemporary China is substantially consumer goods, and finds its way to export markets.

Second, child labour is common and widespread in the manufacture of fireworks, textiles and toys.

Third, the country's own occupational health and safety standards are not enforced, resulting in appalling working conditions and atrocious records of work related accidents and disease.

Fourth, failure by China to establish and/or enforce effective environmental laws and standards delivers an unfair competitive advantage to Chinese industry.

The ACTU considers it would be utterly retrograde and against Australia's national interest to proceed with a free trade agreement with China in the face of these substantial concerns.

This is heightened by concerns related to the capacity of Australian governments to pursue effective industry development policies under the provisions of certain FTAs. By way of illustration an FTA should focus on the inclusion of the maritime industry in Australia not only for the employment of seagoing workers but also in the development of shipbuilding and associated domestic industries.

The recent gas deal signed by Howard for \$28Billion gave absolutely no consideration to Australia to provide hardware or workers for the delivery of essential gas supplies from the Australian fields. Our information is that this requirement will double in 7 years.

The delivery of LNG from the W.A. North West gas fields is a clear example of how the Australian unions and industries can be included with Australian ships and crews being tasked with one third of the transport requirements with an unblemished record of industrial cooperation.

Alternatives to a China-Australia FTA

The ACTU understands many Australian firms to hold grave misgivings about investment in China, because of the absence of effective and transparent enforcement mechanisms under the Chinese legal code. These misgivings are most pronounced with administrative arrangements in the non-coastal precincts of the country.

Such concerns can be, and have been addressed in other contexts, by means of bi-lateral investment agreements explicitly incorporating specific and agreed disputes settlement procedures. A full FTA is not necessary for such concerns to be met.

The Australia – China Trading Relationship

In October 2003 Australia and China signed a Trade and Economic Framework agreement. Paragraph one of that agreement states:

“By means of all-round economic and trade co-operation, the parties will co-operate to achieve balanced and comprehensive trade and investment facilitation and liberalisation.”

(Source: Trade and Economic Framework between Australia and the People's Republic of China accessed via DFAT web site).

Getting more balance within the Australia-China trading relationship would be a most welcome development.

Table One below shows that the current trading relationship is almost solely based on Australia exporting largely unprocessed commodities and importing manufactures. Greater balance in the trading relationship would involve substantial increases in Australia's exports of elaborately transformed manufactures (ETM's) to China.

Table One: Australia's Merchandise Trade with China: 2002-2003			
Main Exports (A\$ Million)		Main Imports (A\$ Million)	
Confidential items	1,979.1	Computers	991.5
Iron ore	1,690.7	Toys, games & sporting goods	893.5
Wool	1,308.5	Clothing of textile fabrics	770.7
Crude petroleum	527.4	Women's or girls' clothing (not knitted)	625.2
Coal	215.3	Footwear	623.2
Aluminium	212.3	Telecommunications equipment	493.2
Barley	212.3	Furniture	456.8
Copper ores	182.2	Men's or boys' clothing (not knitted)	419.2
Pig iron	177.2	Computer parts	374.7
Non-ferrous base metal waste	172.6	Other articles of plastics	333.5
All Exports	8,793.3	All Imports	13,791.6

Table Two shows that China is well on the way to becoming the world's second largest importer of ETM's after the United States. One can draw the following observations from the table showing ETM imports for eight of the major ETM exporters and importers in the global economy.

- In 1992 China imported \$51.4 billion of ETM's which was 4.4% of the \$1169 billion of ETM imports for the 8 countries shown in the table. During the 1992-97 period China's ETM imports increased by \$37.8 billion (to \$89.2 billion) which was 7.2% of the increase in ETM imports by the eight countries.
- By 2002 China's ETM imports (\$207.9 billion) accounted for 9.2% of the total ETM imports for the eight countries shown in the table. However over the 1997-2002 period China accounted for 21% of the increase in ETM imports by the eight countries.
- By 2012 China is likely to account for almost 18% of the ETM imports for the 8 countries shown in the table. However over the 2002-2012 period China is likely to account for 25% of the \$2528 billion increase in ETM imports by these eight major nations.

<p align="center">Table Two:</p> <p align="center">Major Importers of Elaborately Transformed Manufactures</p> <p align="center">ETM Imports: \$ Billion U.S. Current Prices</p>				
	1992	1997	2002	Projection 2012
United States	364.4	608.8	850.4	1977
Canada	88.7	144.0	172.6	294
Germany	259.3	260.0	321.1	399
U.K.	140.5	207.4	250.0	444
France	147.4	167.7	210.0	299
Japan	78.6	149.6	171.4	373
Korea	38.7	68.7	79.7	164
China	51.4	89.2	207.9	841
Total of Above countries	1169.0	1695.4	2263.1	4791

Source: Centre for Strategic Economic Studies: Report to MMIC Export Subcommittee 1 Dec 2003 Table 3.2. We have calculated the projection for 2012 based on the trend growth rate 1992-2002.

Clearly the opportunity to export ETMs to China is significant.

However there are serious questions about Australia's capacity to realise these opportunities.

- During the first half of the 1990's Australia's ETM exports to China only accounted for 0.4% of China's ETM imports; and between 1997 and 2002 Australian ETM exporters only accounted for 0.3% of the increase in China's ETM imports.
- As highlighted in Table three below a growing imbalance has developed in Australia's ETM trade with East Asia in general and China in particular. Between 1995 and 2002 Australia's ETM trade deficit with China surged from \$3 billion to more than \$10 billion, our ETM trade deficit with East Asia increased from \$16.6 billion to \$35.2 billion and our ETM exports to East Asia (\$7.1 billion in 1995 and \$7.3 billion in 2002) stagnated.

Table Three: Australia's ETM Trade (\$Billion)

	Imports From		Exports To	
	1995	2002	1995	2002
China	3.5	11.2	0.5	0.9
U.S.A.	13.7	19.7	1.7	4.8
Europ. Union	15.1	23.6	1.9	3.4
Japan	11.0	14.6	0.8	0.7
East Asia	23.7	42.5	7.1	7.3
N.Z.	1.7	2.2	3.8	4.7
All	58.6	95.7	17.0	25.6

Source: DFAT: Exports of Primary and Manufactured Products Australia 2002

The work of Robert Scott and other economists at the Economic Policy Institute in the United States is a useful guide in quantifying the costs to Australia of its unbalanced trading relationship with China and East Asia in ETM's.

With each \$1 billion of ETM trade sustaining/creating approximately 15,000 jobs (similar to ICN input-output analysis but less than the "super multiplier effects" that NIEIR would include) the following conclusions can be drawn:

- Australia's ETM trade deficit with China went from \$3 billion (1995) to \$10.3 billion (2002). This \$7.3 billion increase in the ETM trade deficit equates to nearly 110,000 jobs.
- Australia's ETM trade deficit with East Asia (including China) went from \$16.6 billion (1995) to \$35.2 billion (2002). This \$18.6 billion increase in the ETM trade deficit equates to nearly 280,000 jobs.

This deterioration of Australia's ETM export performance, the loss of market share in China and other East Asian economies and the growing imbalances in the ETM trading relationship was not the scenario that Australia's politicians and policy makers had expected. In the decade to the mid 1990's it was recognised by Australia's Prime Ministers, trade and industry ministers and the Board of the Australian Trade Commission amongst others that:

- a) The leading importers of ETM's over the next several decades would continue to be the United States and the European Union. Australian ETM exporters would need to secure their share of the growth in these leading edge markets.
- b) While 20% or more of Australia's ETM exports would continue to go to New Zealand and the Pacific region, there was a most significant opportunity to increase ETM exports to the rapidly expanding Asian economies particularly China, Korea and Asean.

- c) Intra-Asian trade was likely to increase significantly and a multi faceted strategic response was required to position Australian firms within the emerging supply chains linking Asian economies and the broader global economy.
- d) New forms of strategic engagement (political, social, economic and cultural) with East Asia would be a key success factor in sustaining the double digit growth rates being achieved across a very wide range of Australia's ETM exports. In addition the whole notion of Australia winning more international business opportunities in East Asia also encompassed an emerging understanding of the need for:
 - Investment linkages and new foreign direct investment in ETM's in greenfield export capacity.
 - Understanding the strategic alliances/rivalries between large global American, European, Japanese and emerging East Asian firms and the supply chains that were being forged through intra and inter firm trade within and between East Asian economies.

In a recent discussion the Australian manufacturing Workers Union (AMWU) put these issues on the Australia China/East Asia ETM trading relationship in the following terms:

``Another unfortunate aspect of the loss of momentum since the mid 1990's has been how Australia engages with East Asia in general and China in particular.

If the Commonwealth Government's political and bureaucratic leadership continues with the narrow perception of China/East Asia as large LNG contracts, a potential resources boom and an issue in WTO/APEC as well as national security we will be well on our way to resurrecting the quarry and the sheep's back as the nation's chosen engine of growth.

East Asia was viewed very differently in the 1980's and early 1990's. The way Peter Cook and the leading CEO's in Australia's auto component industry promoted "the concept car" in ASEAN was one of many examples of the strategic engagement with the region that took place. The speech that Austrade's then Chairman Bill Ferris delivered to CEDA in December 1992 was representative of the broader perspective held at the time of the role of Australian manufactured and service exports to the region.

"A few weeks ago Ralph Evans and I flew up to Singapore to join the Prime Minister and his delegation there. Our 747 was guided in with the aid of Australian navigation gear. As we walked through the impressive Changi Airport, we noted the lighting systems were Australian, so too were the decorative fountains. And the floor tiles had

been set with Australian made speciality ceramic glues. Our taxi downtown was guided by Australian designed and installed traffic control systems. The next morning our hotel breakfast included fresh fruit and dairy products from Australia; and later that day, my ferry ride across Batam was courtesy of one of our uniquely designed, high speed aluminium ferries made in Australia. Even much of Singapore's well celebrated port facilities are managed by an Australian company with Australian stevedoring software and systems. Welcome to Australia in Asia - indeed Australia inside Asia. And the people that are making it happen are Australian companies, backed by commitment, vision and the pursuit of excellence."

(Source: Bill Ferris: Really Making A Difference: page 151 from his address to CEDA Dec. 1992)

In the 3 years after Mr Ferris's speech Australia's ETM exports to East Asia increased by more than \$3 billion (Australian) or 77%. In the following 7 years (1995-2002) stagnation set in with our ETM exports to East Asia only 3% or \$200 million higher in 2002 than 1995. The need to re-engage with East Asia is all the more pressing given the emergence of China as a manufacturing power in the global economy."

Source: AMWU: Export and Innovation Led Growth Discussion Paper October 2003 pg 30

Australia's poor trading relationship in ETM's with China and other East Asian economies is a significant part of the explanation behind the slowdown in ETM export growth since the mid 1990's. Table Four below shows that:

- Between 1984-85 and 1993-94 the average annual growth rate of Australia's ETM exports was 17.7% per annum. Significantly 63 of the 81 product groups making up Australia's ETM exports had growth of more than 10% indicating how broadly based the expansion in ETM exports was.
- However, over the 1997 to 2002 period ETM export growth was only 3.4% per annum and only 17 of the 81 ETM product groups had double digit export growth.

Table Four

In the Decade to 1993-94 the strong growth in ETM Exports was broadly based across many Product Groups. Since then growth has slowed, been more narrowly based and post 1997 there has been stagnation

Number of ETM Product Groups With the following Annual Export Growth Rates	(A) Negative Growth	(B) Zero to 10%	(C) 10.1% to 20%	(D) Greater than 20%	(E) Total	(F) Average Annual Growth Rate
1984-85 to 1993-94	6	12	27	36	81	17.7%
1992 to 2002	10	46	18	7	81	8.5%
1997 to 2002	32	32	11	6	81	3.4%

Source: DFAT Exports of Primary and Manufactured Products Australia: 1993-94 Edition and 2002 Edition: ETM Exports are in Current Price

Addressing this situation is a matter of considerable urgency. As detailed in the Box below China has become a manufacturing powerhouse and in some industries like automotive components there is a real threat to Australia's future growth prospects unless a more comprehensive and strategic form of engagement is initiated.

This threat emerges in a number of ways:

- In the current sourcing decisions for the new Holden Commodore the China factor is being used to exact even larger cost downs from Australian component suppliers. It is expected that these pressures will also emerge in 2006 and 2007 when sourcing for the Toyota Camry and Ford Falcon occurs.
- Component suppliers have informed the unions of GM's "encouragement" to relocate capacity to China from Australia.
- With the exception of Toyota very little leadership is being exhibited by the car companies to assist component suppliers into China and other supply chains in Asia.
- The export drive of made in China auto components is not that far off. After the experience of AUSFTA where the negotiators sold out Australia's auto component workers by agreeing to component tariffs going from 15% to 0% from day one, there is a real concern about the same thing happening in a China FTA.

The Emergence of China as a Manufacturing Power

With 1.3 billion people, an economy whose GDP growth rate will probably average 7% per annum over the next decade and \$300 billion U.S. of foreign direct investment since the mid 1990's there are good reasons for many analysts to refer to China as the world's new manufacturing warehouse.

China already manufactures more than 50% of the world's camera's, 30% of the air conditioners and televisions, 25% of washing machines and 20% of refrigerators. The country has more than a dozen computer chip fabrication plants under construction, companies like Phillips have 23 plants in China and already produce 20% of their global production there, Motorola will have invested \$10 billion in China by 2006 and General Electric will source \$5 billion from China by 2004-2005.

Now China is moving to become a major player in the global auto industry. Since the country's 8th 5 year plan (1991-95) designated auto as a pillar industry to drive the economy in the 21st century:

- Domestic sales of passenger motor vehicles have gone from 400,000 (1995) to 1.1 million (2002) to an estimated 2 million in 2003.
- The global economy will produce around 6 million additional cars over the remainder of the decade (to around 47 million by 2010) and nearly 40% of the increase will be made in China.

Not surprisingly investment in capacity expansion in China's auto industry is booming. Volkswagen, the dominant player in China (which is VW's second biggest market after Germany) will invest \$6.8 billion U.S. over the next 5 years to double capacity from 800,000 to 1.6 million. Nissan's \$2 billion joint venture with Dong Fong will enable the group to make more than 500,000 cars and commercial vehicles in China by 2006. Kia's \$600 million in a second plant will give it capacity of 300,000 by 2007 and General Motors (who invested \$1.5 billion in the late 1990's) will invest somewhere between VW's \$6.8 billion and Nissan's \$2 billion by 2007 to expand capacity. Add to this what Delphi, Bosch, Visteon, Denso, Lear, JCI, TRW, Valco, Siemens, Dana and the other global auto component manufacturers will invest and one begins to appreciate the enormity of what is emerging. And this is even before we consider China's home grown players and the ambitions the country's political and bureaucratic leaders have (as exemplified in the draft 2006-2010 plan) to get more technology, intellectual property, patent access, design processes and systems engineering capability into existing/new joint ventures and significantly increase auto component exports (which at \$2 billion in 2002 are 2½ times such exports from India and 5 times those from Thailand).

While a source of massive jobs growth the new generation of leadership in China's Communist Party understands all too well:

- 7% annual growth gives the country 8 million new jobs each year but 13 million (mainly rural) new workers join the labour market each year and the State owned enterprises are continuing to downsize, while adjusting to import competition post WTO admission is challenging.
- In America 2.3 million manufacturing jobs have been lost since 2000, China's trade surplus with the U.S. is more than \$150 billion, and Europe is experiencing similar problems. This helps to explain the push for China to revalue its currency and the emergence of increasing geopolitical tensions in a world of global excess capacity in steel, auto, chemicals and several other manufacturing industries.

How Australia engages with China and the region of East Asia in the next decade will go a long way to determining whether export and innovation led growth becomes a reality.

(Source: N. Apple: An Australian Perspective on Tension and Conflict in the Global Auto Industry. Presentation to the Korean Trade Union Leaders Group August-September 2003.)

Rebalancing Australia's Trading Relationship with China: Moving beyond FTA's

The ACTU has argued in this paper that without a recognition/enforcement of core labour standards by China there is no basis for an Australia-China FTA or recognition of China as a market economy.

Importantly, Australia does not need an FTA with China to improve the ETM trading relationship. In addition Australia certainly does not need, nor will ordinary Australians tolerate an FTA such as the one negotiated with the United States which amongst other things compromises the sovereignty of future Australian Governments and their capacity to act in the national interest (PBS, foreign investment, intellectual property, procurement etc).

The best way of engaging with China in the commercial relationship and in the process accelerate Australian ETM exports to East Asia in general and China in particular requires addressing the following five priorities.

1. A significant driver of ETM export growth is business investment in R+D particularly by Australian manufacturers. However:
 - After real annual R+D growth of 11.4% (business R+D economy wide 1986-87 to 1995-96) Australia's business R&D growth slumped to 2% annual growth (1995-96 to 2001-02).
 - For manufacturing R+D growth over the same period fell from 10.5% per annum to -1.9% per annum.

Going well beyond the current Governments approach to stimulating business R+D is an essential pre condition for long run sustainable ETM export growth.

2. Australia's trade and investment promotion resources are poorly deployed and under utilised as the pre occupation with bilateral trade treaties has diverted attention from more important issues. Amongst other things a fundamental overhaul of the Australian Trade Commission and its Board is required. This was done with the help of the McKinsey Consulting Group in the 1990 Review and an independent review, restructuring and refocusing of the Commissions mission and resources, particularly in East Asia is an urgent requirement. This should also be combined with much more attention to the multilateral trading system where Australia always will gain the most.
3. The most important strategic resource to enhance the competitiveness of Australia's exporters in the next two decades will be public investment in infrastructure. Planning this now, prioritising the real needs of the nations exporters, scheduling the pipeline of infrastructure projects and funding them appropriately (particularly through Government debt) is a most important task for the next Australian Government.
4. Australia is underinvesting in the next generation of born global start up firms that are knowledge intensive and very much a part of the next generation of ETM exporters. Over the 7 years to 2002 our investment of

venture capital in such firms at the seed, start-up and early expansion stage was less than 50% of what was invested in Canada and less than two thirds of what was invested in Europe. Building a world class private equity infrastructure is imperative to the future growth of ETM exports.

5. Finally the relationship with East Asia in general and China in particular needs a far more substantial investment in new form of economic, political, social and cultural co-operation. Since 1996 the Commonwealth Government has focused too much on the important American relationship at the expense of our engagement with Asia.

What is required is political leadership to change this. This is likely to require both a change of Government at the Commonwealth level and a significant overhaul (both personal and structures) of those involved in our international relationships.

By effectively and efficiently pursuing these five priorities Australia's ETM exports to China and the East Asian Region will once again accelerate with substantial benefits for working people in this country.