EXECUTIVE SUMMARY:

TRADE IMPACT STUDY FOR SOUTH AUSTRALIA IN RELATION TO THE CHINA-AUSTRALIA FREE TRADE AGREEMENT (ChAFTA)

Commissioned by:

SOUTH AUSTRALIA

Government of South Australia

INSTITUTE FOR INTERNATIONAL TRADE

THE UNIVERSITY of ADELAIDE

EXECUTIVE SUMMARY

The China-Australia Free Trade Agreement (ChAFTA) is a comprehensive agreement that includes 17 Chapters over 161 pages that set out the rules by which liberalised trade will be facilitated between Australia and China, six side letters, two related Memoranda of Understanding (MoUs) and approximately 1000 pages of specific trade commitments from both Australia and China. As China is the world's second largest economy and still one of the fastest growing, and is Australia's largest trading partner with nearly $160 billion in two-way trade in 2013-14, this agreement represents the largest in terms of potential value for Australia of any of Australia's current bilateral trade agreements. Further, as one of only a few bilateral trade agreements that China has concluded with developed countries, ChAFTA not only liberalises trade with a huge partner, but provides early access for Australia to the Chinese market, while equalising imbalances that may have existed with China's other FTA partners.

The provisions in ChAFTA cover not only goods, services and investment, but also procedural and regulatory controls, including such areas as Sanitary and Phytosanitary Measures (SPS), Technical Barriers to Trade (TBT), Rules of Origin (ROO) and Intellectual Property (IP). Further, ChAFTA also contains administrative provisions crucial to the implementation and ongoing exploitation of the agreement, such as institutional provisions (setting up an FTA Joint Commission) and Dispute Settlement. Together, all of these provisions are crafted to work together to fully facilitate the operation of ChAFTA, and allow stakeholders to access and take advantage of the benefits offered under the agreement.

China is also South Australia's largest trading partner, and ChAFTA has the potential to have a significant positive impact on the South Australian economy. In goods, services and investment, whether in established two-way markets or by creating new opportunities for Australian and Chinese businesses and investors, ChAFTA provides unprecedented, broad-based opportunities across many sectors, including:

- Wine
- Meat and edible offal
- Aquaculture products
- Copper
- Lead
- Iron Ore
- Education services
- Financial Services
- Health and Social Services
- Creative Industries
- Tourism and related services

Party Secretary Jiang Yikang and Premier Jay Weatherill at the signing of the South Australia-Shandong Friendly Co-operation Action Plan 2015-2018 in Adelaide

TRADE IN GOODS

South Australia has exhibited positive economic impact from the implementation of previous FTAs, particularly in regard to manufactured goods, but also in certain agricultural areas as well. What ChAFTA provides is the potential to augment areas where South Australia currently enjoys a comparative advantage and can potentially increase important exports, as well as highlight areas where comparative advantage has been created or increased where export opportunities to China have been limited to date but have real potential for growth.

In quantitative terms, all goods exported from South Australia to China in 2014 were exported under specific tariff lines, with 83 per cent of those tariff lines subject to Chinese tariffs (having a tariff rate higher than 0). Once ChAFTA is fully implemented, that percentage will drop to 5 per cent, and that does not take into account any products that may be exported under tariff lines that were not utilised in 2014 (potentially including new export opportunities).

In qualitative terms, a drop in tariffs does not automatically equate to an increase in exports. It is important to identify products and sectors where the trade liberalisation measures instituted under ChAFTA can lead to a real and positive effect on exports, and where more work is necessary to remove non-tariff barriers to market entry.

EXPORT OPPORTUNITIES TO CHINA HAVE BEEN LIMITED TO DATE BUT HAVE REAL POTENTIAL FOR GROWTH.

HORTICULTURE

Certain tariffs for horticulture products will reduce to zero under ChAFTA. However, China has traditionally had very closed markets to products such as stone fruits (peaches, cherries, etc.). Traditionally, the barriers faced have been not only in tariffs, but in non-tariff measures such as sanitary and phytosanitary (SPS) regulation. Accordingly, although markets exist, South Australia to date has seen no significant exports to China.

The South Australian Government can petition the Commonwealth Government to engage their Chinese counterparts in the Committee on Sanitary and Phytosanitary Measures created under Article 5.11 of ChAFTA, to seek the loosening of these non-tariff measures, in order to gain access to the Chinese market for South Australian horticulture products such as stone fruits. If this is not achieved, the continued operation of non-tariff measures to block imports of stone fruit and other products will constitute a barrier to realising the benefit of the tariff reduction, and no real benefit from the removal of tariffs will be achieved under ChAFTA.

Source: Horticulture Exports Australia (HEA)


Nippy's Fruit Juice

For example concerning wine, we have identified that full implementation of ChAFTA, including a reduction in Chinese tariffs to 0 per cent in five years, would equate to an additional 10 megalitres of Australian wine exported to China by 2018, offsetting what would have been a 1megalire loss to NZ and Chile, pursuant to implementation of their respective free trade agreements with China. While Australia is already China's second largest wine supplier, and South Australia is the largest supplier to China in Australia supplying two-thirds of Australian wine exports to China), this implies that not only will South Australia's comparative advantage be increased against other regions exporting wine to China, but also that South Australia has the potential to maintain its strong position against its domestic counterparts and capture a proportional measure of the expected increase in exports. Further, as the trend in exports is towards premium wine, the 10 megalitres translates to approximately $135million for Australian producers, and approximately $90million for South Australian producers.

SOUTH AUSTRALIA HAS THE POTENTIAL TO MAINTAIN ITS STRONG POSITION ...

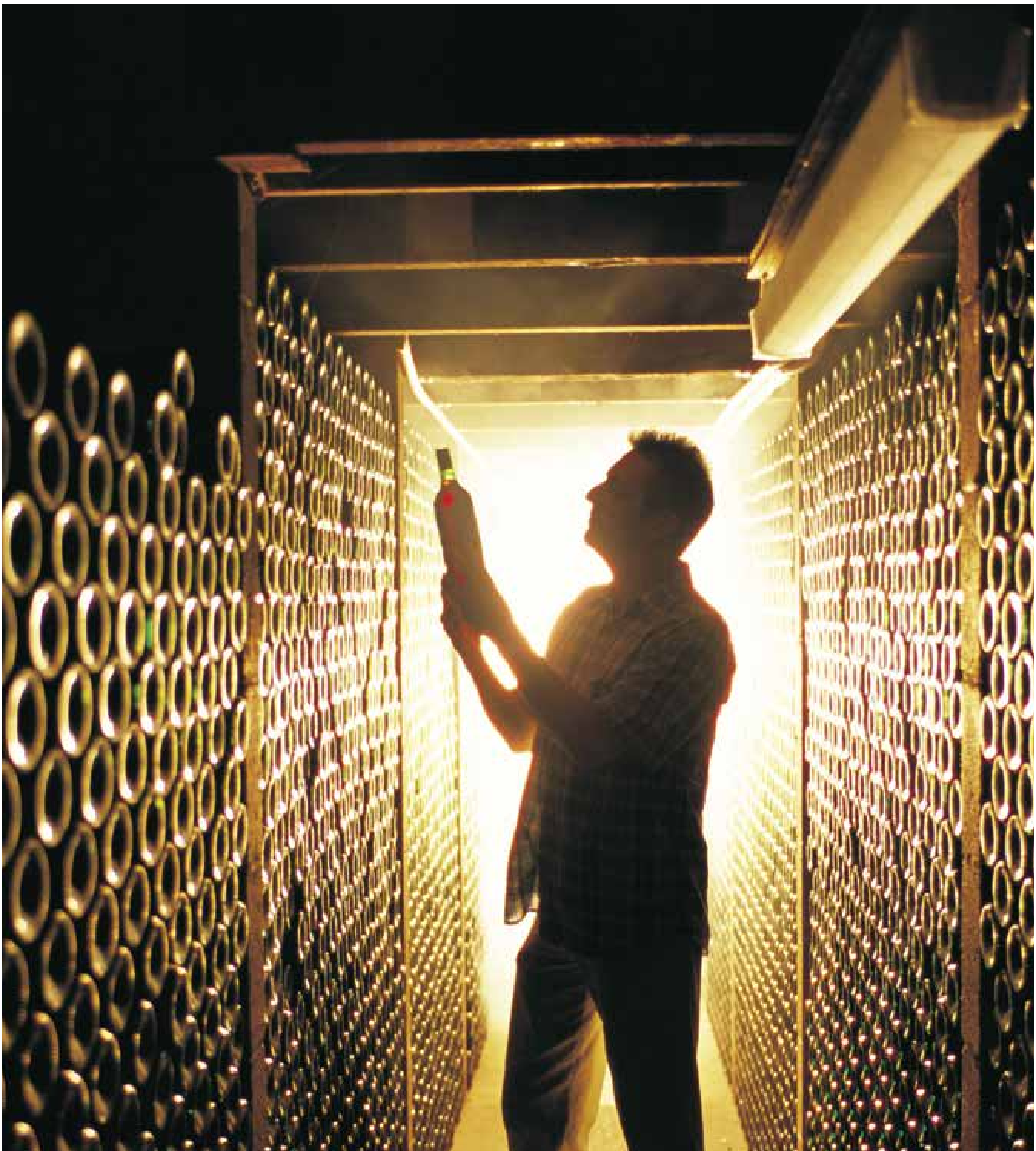
WINE

While this paper goes to great lengths to describe opportunities in wine exports for South Australia, citing the expected huge growth in exports over the next three years until 2018 and beyond, there are still non-tariff measures to contend with that make navigating trade in wine with China more of a risky undertaking than is trade in wine elsewhere.

Excluding China, every year it can be expected that a handful of wine export consignments around the world will be either held up or blocked due to regulatory concerns. In their nascent stages, it is still unclear what the legal or scientific grounding is for some of China's wine regulations. However, in 2014, 165 wine export consignments were blocked from entering China, exponentially more than normally expected. While South Australia was not singled out for this treatment, Australia's wines were rejected at a rate proportional with Australia's share of the wine export market in China.

The South Australian Government can engage with Wine Australia to better understand these anomalies, determine their status and ongoing nature (is it "growing pains" for the regulatory scheme or a systemic problem in China?), and advise the Commonwealth Government on the potential impact for South Australian exporters, so that the situation can be addressed under ChAFTA.

Source: Wine Australia



While meat is a large South Australian export to China, in a subcategory that may not get public attention, guts, bladders and stomachs, China accounts for almost 93 per cent of all South Australian exports, equal to $14.2 million in 2014. This sector currently incurs a 19.3 per cent tariff, which will be reduced to 0 per cent upon full implementation of ChAFTA, indicating an area where we can grow our only substantial export market for these meat by-products.

In the mining sector, aside from products regularly discussed in public forums, South Australia is a world leading exporter of lead (holding nearly 10 per cent of the world market), with only 1.5 per cent of our exports already going to China (with much more going to another potential FTA trading partner, India). The significant drop in Chinese tariffs on lead can strengthen South Australia's comparative advantage, and grow our exports to China as well as our share of the world market.

MULTIPLE METALS: MARKET ACCESS, RESEARCH & DEVELOPMENT, INFRASTRUCTURE AND FDI UNDER ChAFTA

MAGNETISED IRON ORE

South Australia has tremendous reserves of magnetite that can serve Asian markets for decades. Unlike other reserves in Western Australia and around the world, while containing a relatively high iron concentrate, SA magnetite contains relatively low concentrations of silica, phosphorous, aluminium and sulphur, which means processing can be cleaner for the steel producer.

In combination with the advantages of ChAFTA, South Australia can do more than take advantage of available markets. Tariff elimination and encouraged and enabled FDI for research and development and infrastructure from China can work together to create an enabled production capacity and strong, lasting market for a premium raw product, that will also allow China to achieve a goal of achieving cleaner, more environmentally friendly steel production.

The South Australian Government contribution would therefore be less onerous to make the venture successful. China looks to governments to make and endorse big deals. The South Australian Government's imprimatur of support for a scheme of South Australian business combining with Chinese investment to develop and grow a niche and lucrative export market can be the catalyst, with FDI funding the growth and expansion of the trade in magnetite.

Source: SACOME

COPPER

Copper is a main focus currently in South Australia, and with good reason. With rich reserves, a market set to expand, and favourable tariff treatment under ChAFTA, the export market is set to expand. One constraining element is the fact that much of the copper reserve is found in conjunction with uranium. The ability to "clean" copper, removing uranium from the copper, can lift South Australian production to a level as much as four times the current level of production.

Under ChAFTA, not only will we have a more open market due to tariff elimination, but again our comparative advantage makes the industry a prime target for FDI from China. Chinese FDI in research and development of production methods for clean copper can incentivise and grow the sector to its full potential, without the need for great expenditure on the part of the South Australian Government. Chinese investment in business based solutions here can expand South Australia's capacity to serve growing markets in China and beyond.

Sources: SACOME; Institute for Mining and Energy Resources, The University of Adelaide

LEAD

Lead is a commodity seldom spoken of in policy circles, for various reasons. However, it is important to point out that South Australia has a large competitive advantage in the sector, supplies nearly 10% of the lead in the world market, and sells relatively little in China.

While lead brings with it obvious environmental factors of which to remain aware, lead is also still a prominent commodity in the manufacture of such environmentally friendly technologies as power cells and batteries for use in hybrid and electric cars and elsewhere. Further the technology around those products is advancing, making them safer and with a view towards recycling of materials.

South Australia can not only take advantage of the growing global need for lead, but is in a prime position to do so, traditionally holding advantage in the market, and taking advantage of eliminated tariff status under ChAFTA.

Source: SACOME

Nystar lead smelter at Port Pirie

With primary products such as those listed above, and specifically including mining, meat and wine currently constituting the largest export sectors from South Australia to China, South Australia needs to focus on these areas as having a good potential for continued growth. However, the future may evolve around what currently are minor or even non-existent exports that can grow and become important economic drivers under ChAFTA.

In this category might be included a broader range of agricultural goods, beyond wine, where South Australia has strong capabilities that have not translated into significant exports to China. Here, tariff reductions, in the context of the comprehensive framework of ChAFTA (including regulatory liberalisation aimed at addressing behind-the-border issues), can potentially provide opportunities for market access and growth for South Australian agricultural exports.

LIVE LOBSTERS

Until now, South Australian live lobster exports, for which there is strong demand in China, have mainly travelled via Hong Kong, and often entered China indirectly via grey market channels. ChAFTA opens the aquaculture markets in China, and will not only facilitate direct imports to serve local markets, but can also open a broader market to legitimate trade, potentially simultaneously raising demand and streamlining market access for South Australian live lobsters.

Source: Focus Group discussion with Seafood Industry, conducted by the Institute for International Trade, The University of Adelaide

Food and wine ambassador and Executive Chef Wong Wing Chee

TRADE IN SERVICES

The fact that trade in services accounts for approximately 70 per cent of Australia's productive activity highlights its importance to the South Australian economy. As distinct from goods, the factors affecting trade in services have less to do with tariffs, and more to do with the regulatory framework under which service providers can act. For this reason, a comprehensive FTA like ChAFTA is necessary to address the factors necessary to liberalise trade in services.

Services can act as enablers for trade, facilitating both trade in goods, by reducing trade costs and administrative burdens associated with trade, as well as for other services. Good examples of services which act as enablers are financial services, telecommunications and transport. For example, the opening of the financial services market in China may have the most significant direct impact in Australia's East Coast financial centres, but will also facilitate South Australian businesses to more easily and securely deal with Chinese businesses and customers, including in the making and receiving of payments.

Other collateral benefits of a robust services market include the contribution of services as inputs in production for other services, manufacturing and agriculture. The benefit of the services contribution to productivity acts in both directions, with Australian services expertise now more readily exploitable in the Chinese market to boost their capabilities in such sectors as mining and wine production, and Chinese services available to help Australian enterprises more competitive, including in specialised infrastructure projects.

Services of particular interest to South Australia, in the context of ChAFTA, include education, tourism, mining-related services, agricultural services (including wine), financial services (in particular financial planning and wealth management), health and aged care services and the creative industries.

Education is South Australia's most valuable services export, with China being by far the largest source of foreign students, and growing in number by 75 per cent per annum. Importantly, 90 per cent of inbound Chinese students attend institutions included on the Chinese Ministry of Education's "White List", and under ChAFTA, within one year of entry into force, a further 77 Australian institutions will be added to that list. Conversely, another way for South Australian educational institutions to reach Chinese students is by establishing operations in China, which under ChAFTA will be much more easily accomplished, with the facilitation of investment and movement of education service professionals.

Tourism is another important sector for the South Australian economy, and the Chinese domestic sector has opened up for South Australian investment. While providing international travel services in China for Chinese nationals has been excluded, continuing to act in concert with key Chinese providers will remain an important avenue to attract inbound visitors. Meanwhile, investment in Chinese hotels and restaurants has been liberalised for Australian investors, creating opportunities to enter new markets offshore.

Mining-related services have been identified by some of our largest industry participants as a growing market in China. This market may provide a steady market in a field in which Australia has vast expertise, but that has otherwise been dominated, for better or worse, by the fluctuating world market prices for mining products.

South Australia has provided wine production related services in China for over a decade. With more acreage under grapes than Australia, China's domestic wine production is growing rapidly, and keeping pace is the need for quality wine production services. With the nascent stage of development of the Chinese wine industry, the rapid growth in the rate of consumption and the large and growing Chinese middle-class continuing to raise demand, the provision of wine production services can likely coexist with our ambitions in wine exports without fear of cannibalisation of markets, particularly where Chinese domestic wine production will inevitably grow in volume and quality regardless of who provides the expertise.

Public perception, rightly or wrongly, sees financial services as an Australian East Coast industry, with Sydney and Melbourne dominating. However, with ChAFTA liberalising wealth management, financial planning and insurance, a real opportunity exists in South Australia, home of the Self-Managed Super Fund Association and a critical mass of financial planning service providers. With China's aging population planning for the future, this poses real potential for establishing a hub for these services in Adelaide.


McLaren Vale

SELF-MANAGED SUPER FUND ASSOCIATION (SMSFA)

China has two demographic characteristics that, leveraged with the benefits under ChAFTA, make the superannuation advisory industry a key area for potential growth: An exponentially growing middle-class, and a large, aging population. China's growing and aging middle-class will hold a significant and growing percentage of the world's financial assets in the coming years. Australia has the recognised expertise to advise on investment, distinguishing itself in the region and ranked as a world leader in pension systems in the Mercer Global Pension Index.

According to SMSFA CEO Angela Slattery, "There will be opportunities across a range of services, including financial advice; fund administration; system design; retirement income policy expertise; and complex data storage, security and management."

"It will be imperative for these industries to offer world best practices to convert this opportunity. This can only be achieved by all industry participants maintaining a focus on increased professionalism and higher educational standards across both the superannuation and financial services sectors."

South Australia is home of the SMSFA and the International Centre for Financial Services (ICFS) at the University of Adelaide. The South Australian Government should encourage and enable this body of expertise and educational platform to grow and remain based in Adelaide, promoting South Australia a recognized centre of excellence in the field across Australasia.

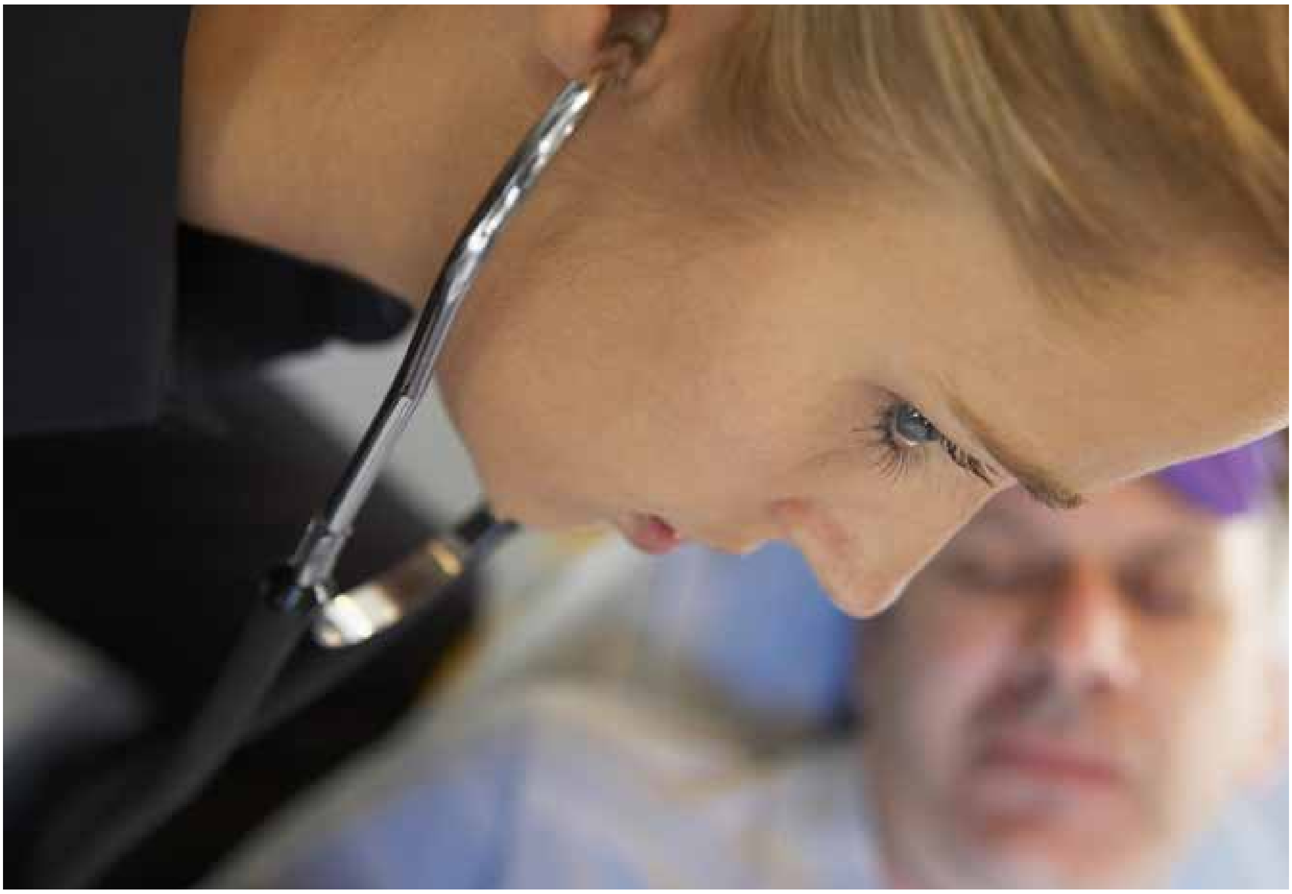
Sources: SMSFA; Shed Media (on behalf of SMSFA); ICFS, University of Adelaide


Adelaide

A real area for potential growth under ChAFTA arises in the health care and aged care sectors, where all of China has opened up for wholly Australian owned, for profit aged care facilities, and a great area of China has opened up for Australian owned hospitals. Further, medical and dental professionals can now enter into the Chinese market as well, including in partnership or collaboration with Chinese partnerships and practices.

Finally, the creative industries in South Australia can realise benefit from ChAFTA as well. Foreign investment in film production can be of particular interest, with South Australia's high-level service capabilities, including major motion picture production and favourable regulatory conditions making it an attractive destination. Further, film, sound recording and magazine distribution in China is now open to Australian investors (subject to Chinese content regulations), and cinema theatre ownership and construction will be allowed, if done through joint partnership with minority Australian ownership.

A REAL AREA FOR POTENTIAL GROWTH UNDER ChAFTA ARISES IN THE HEALTH CARE AND AGED SECTORS, ...



LABOUR MOBILITY, JOBS, AND 457 VISAS

ChAFTA provides access to Chinese service providers and skilled workers, under conditions very similar to those that exist now, including utilising the 457 visa process. While the agreement facilitates access to the Australian system for application to allow access for skilled Chinese workers, those workers will still need to have any necessary qualifications recognised, and the positions would most likely still need to be advertised locally before being made available to a skilled Chinese worker. Further, facilitated access for work on large infrastructure projects is predicated on the Chinese direct investment of at least $150 million in Australia. There is no provision for entry of unskilled labour. Accordingly, the provisions of ChAFTA appear to allow entry of skilled workers only, with provision for requiring appropriate certification of relevant skills, where equivalent expertise is unavailable in Australia, in order to provide necessary services in Australia or facilitate the attraction of large foreign direct investment in large infrastructure projects.

CHAFTA PROVIDES ACCESS TO CHINESE SERVICE PROVIDERS AND SKILLED WORKERS, ...

RECOMMENDATION: CODIFY THE PATHWAY DESCRIBED FOR CHINESE MIGRANT LABOUR; GIVE CERTAINTY CONCERNING THE AUSTRALIAN LABOUR MARKET AND REMOVE THE BOOGEYMAN

The issue of labour mobility has been a highly contentious issue under ChAFTA, causing some to balance the optics of the impact on the Australian job market with the overall economic benefits of the ChAFTA. This is largely unnecessary, as ChAFTA is not intended to cause a rift in the Australian labour market.

The South Australian Government should recommend to the Commonwealth Government that they codify the pathway for migrant Chinese workers who have been set out when explaining ChAFTA. By codifying processes and procedures to the extent practicable, the mystery and fear surrounding labour mobility will be addressed, while not changing any intended benefits afforded to China under ChAFTA.

Source: The Howe Report, The University of Adelaide Law School

FOREIGN DIRECT INVESTMENT (FDI)

Opportunities for FDI under ChAFTA include both inbound FDI from China and outbound FDI from Australia. In either case, the identification of areas where Australia has a comparative advantage, or of opportunities created where ChAFTA has given Australian investors access to a comparative advantage in China, will be good indicators for potential FDI opportunities.

Australia has made significant adjustments to encourage foreign direct investment from China, including raising the threshold for Foreign Investment Review Board (FIRB) review to US$1.094 billion dollars, matching the level already extended to the U.S., New Zealand and Japan. This rule carves out investments in agricultural land and agribusiness interests, for which the threshold for review is much lower, and investments from State Owned Enterprises (SOEs) for which any level of FDI is subject to FIRB review. A further service sector innovation that will encourage FDI will be the creation of an RMB clearing bank in Sydney, that will facilitate transfers and foreign exchange.

Sectors where inbound FDI into South Australia can be facilitated under ChAFTA include large infrastructure projects, the creative industries, agriculture, mining, research and development and high-end manufacturing services.

Sectors where potential outbound FDI into China can grow under ChAFTA include the health and aged care services sectors, tourism services including hotel, restaurant and cinema construction and ownership, and education services.

AUSTRALIA HAS MADE SIGNIFICANT ADJUSTMENTS TO ENCOURAGE FOREIGN DIRECT INVESTMENT FROM CHINA, ...

CHINESE FDI INTO AUSTRALIA

South Australia has been until now very open to trade with China. What might mistakenly be seen as a major concession by Australia in ChAFTA is the facilitation of Foreign Direct Investment (FDI) from China into Australia. While Australia has gained broad advantages in the Chinese market across various sectors, South Australia should continue to encourage Chinese FDI into the State, capitalising on the opportunities made available under ChAFTA, to maximise South Australia's capacity to serve both domestic and export markets, strengthen infrastructure, encourage innovation and development and create more South Australian jobs.

Source: Recommendation by researchers of the current study

Commissioned by:

SOUTH AUSTRALIA

Government of South Australia

INSTITUTE FOR INTERNATIONAL TRADE

THE UNIVERSITY of ADELAIDE