

# **Australia-China FTA: China's Domestic Politics and the Roots of Different National Approaches to FTAs**

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Upon Chinese President Hu Jintao's visit to Australia in October 2003, China accepted Australia's proposal of an Australia-China Free Trade Agreement (AUCFTA), and the two governments signed the Australia-China Trade and Economic Framework, in which they agreed to look into the feasibility of a bilateral free trade agreement. The Joint Feasibility Study was finished in March 2005, and formal negotiations commenced in April. Although the Feasibility Study was accomplished earlier than the October target, the progress of negotiations between China and Australia on an FTA has been extremely slow, characterised in particular by China's reluctance to accommodate Australia's requests. Given the announced mutual benefits for both countries, why has it been so difficult for them to reach agreement?

Based on the author's interviews with government, private and academic institutions in Beijing (from February to June 2006, and from April to May 2007), interviews in Australia, and documents obtained from Chinese and Australia sources, this paper provides an explanation for the slow rate of progress in the negotiations by looking into the policymaking process in China. First, I argue that it is not because China lacked motivation; in fact, Beijing did hope to achieve several national interest objectives through the FTA. Second, I will compare the different approaches of China and Australia to FTA negotiation as an explanation to the slow process. Third, I will look into Chinese domestic politics to explain China's stance. I will conclude by providing some general observations on China's policymaking on the AUCFTA and on where the potential for a breakthrough in the FTA negotiation lies.

## Beijing's Motivations

Before China agreed to launch FTA negotiations with Australia, political and economic analysis on the prospective FTA were conducted by think tanks and state ministries, which indeed identified several benefits for China's national interest.

On the political side, first, China judged that the political conditions were 'mature' enough. In other words, there was enough political trust between Beijing and Canberra, and they did not have 'fundamental differences'. In particular, Beijing appreciated Australia as offering First World goods and services without "the political baggage that comes with the Americans and the Europeans."<sup>1</sup> Second, China views Australia as an important country in the South Pacific but felt Sino-Australian bilateral relations were not close enough, which may reflect its concern with Australia's strategic alliance with the US and Japan. Beijing hoped the FTA would be a useful instrument to strengthen strategic relationship with Canberra, for instance, by upgrading it from 'friendly cooperation' to 'strategic partnership'.

On the economic side, there were two major motivations for China to form an FTA with Australia. The first motivation was that Australia had energy resources and raw materials that China needed for domestic economic development.<sup>2</sup> Securing a stable supply of resources had become a priority in China's foreign economic policy objectives, as well as a crucial part of national security—'energy security'. In recent years, Australia has become an increasingly important provider because Asia alone could not meet China's needs anymore. China's biggest minerals trading company, the state-owned Minmetals (*Wu Kuang*) Corporation regards Australia as a "trusted, long-term, First World trading partner", targeting resources like iron ore, copper, bauxite, nickel, lead and zinc, but it also hopes some restrictions to China's investment in

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<sup>1</sup> Interview with a researcher at CICIR, who participated in the preliminary evaluation, 18 April 2006, Beijing. Also see Rowan Callick, "A Mutual Attraction," *Australian Financial Review* 23 August 2004).

<sup>2</sup> Uranium is not included in the FTA negotiation agenda. The two countries signed the Australia-China Nuclear Material Transfer Agreement and Nuclear Cooperation Agreement in April 2006 to open Australian uranium sales to China, which was ratified in January 2007.

Australia and the tariff on mineral products can be removed through the FTA.<sup>3</sup> Specifically, China hoped to win the same treatment for its investments in Australia, mainly in resources, as those enjoyed by American investments under the US-Australia FTA.<sup>4</sup>

The second economic motivation was to ask for market economy status from Australia and subsequently use this to request the EU and the US to follow suit, which would ease the disadvantaged position of China as an economy in transition for 15 years in anti-dumping cases under the WTO.<sup>5</sup> China did not agree to start FTA negotiations with Australia until the latter granted China Market Economy Status in April 2005. Moreover, Beijing was comfortable to be the recipient of Australia's request for an FTA, because it believed in this way, China would be in a good position to negotiate favourable terms.

Because of the above motivations, China embarked on the Joint Feasibility Study and later on formal negotiations on an FTA with Australia. The Feasibility Study predicted real GDP growth of US\$18 billion for Australia and US\$64 billion for China between 2006 and 2015. At the same time, warm bilateral relations were represented by frequent high-level visits, when leadership in both countries gave their support for the proposed FTA. Upon his visit to Australia in April 2006, Chinese Premier Wen Jiabao said that he hoped the negotiations could achieve an important breakthrough in the next one or two years. Because of the political commitment of the leadership, Chinese trade negotiators were under much pressure to deliver an agreement. However, the negotiation process has been glacial. In the next two sections, I will analyze why the process has been so by highlighting the differences between Chinese and Australian approaches to FTA negotiations, and the obstacles in Chinese domestic politics.

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<sup>3</sup> Yufang Song, "Speech at the Australia-China Free Trade Conference" (Shenzhen, 28-29 June 2006).

<sup>4</sup> Under the Australia-US FTA, American investments in Australia are reviewed by the FIRB only if they are above AUD \$800 million, instead of \$50 million for those from all other countries.

<sup>5</sup> A total of 57 countries have accepted China's status as a market economy since New Zealand stood out as the first acceptor in April 2004, including Australia, Brazil, South Africa and Russia.

## Different Approaches

The difference in approaches to FTA negotiation and policy formulation between China and Australia is a major reason why the negotiation process has been slow and difficult. Because of very different economic and regulatory structures between the two countries, they spent a long time to get to know each other's systems and drafting the architecture of the agreement in the first five rounds of negotiations. Even after that, the negotiation process has been 'glacial' because of their contention over the breadth of the FTA's coverage, how much flexibility it should allow, whether it should include WTO-plus issues, and the understanding of the role of state and market in trade policymaking. While a 'commercially meaningful' comprehensive agreement has been the key aim for Australian negotiators, China's most important criteria for FTAs is that they are 'mutually beneficial', which means they bring profits to both Parties while avoiding costs as much as possible. Both Chinese President Hu Jintao and Premier Wen Jiabao expressed hopes that both sides could pursue the FTA under the guidelines of "mutual sympathy, mutual understanding, flexibility, pragmatism, and mutual benefit."<sup>6</sup>

### *Selective vs. Comprehensive*

China prefers a selective, gradual approach to trade liberalization under the FTA rather than a comprehensive 'single undertaking' as preferred by Australia.<sup>7</sup> Although the 'complementarity' between the economies of China and Australia has been emphasized by the Chinese and Australian governments, it has not automatically led to a smooth process of FTA negotiation. The different levels of development and industrial structures have so far seemed to be an obstacle to both sides' willingness to accommodate the other's interests because of sensitive domestic sectors. That is in contrast to China's FTAs with other developing countries under

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<sup>6</sup> Xiao Hu, "Agreements Pave Way for Chinese-Australian FTA," *China Daily (North American ed.)*, 19 April 2005.

<sup>7</sup> An exception may be found in the CEPA with Hong Kong. The MOFCOM admitted that the negotiations were not easy because it had to cover wide areas according to the WTO requirement while taking into account the possible impacts on mainland industries. However, China does not regard CEPA as a real FTA because Hong Kong is part of China, which was why the name was changed from the original plan as FTA to CEPA. Still the CEPA is a 'living' agreement, to which new contents are gradually added.

which they ‘understand’ each other’s difficulties in undertaking liberalization and have allowed each other to carve out sensitive sectors from the FTAs. And unlike what the US achieved through its FTAs with developing countries, Australia, although a developed economy, does not have enough bargaining power to impose on China a ‘commercially meaningful’ outcome as understood by Canberra because of its interests in the huge Chinese market. Chinese Vice Minister of Commerce, Liao Xiaoqi, said that “both sides need to consider the practical circumstances where the issues are tackled and ... fully acknowledge the economic development level and special characteristics of their respective economies and carefully consider and accommodate difficulties of each other.”<sup>8</sup>

China is not willing to open some sectors to Australian competitors, and Beijing thinks Canberra should also adopt a gradual approach to suit itself, without paying much attention to Australian belief in free trade or to the lobbying power of Australian export-oriented industries. That is probably why in the FTA negotiation with Australia, Chinese negotiators have been confounded by Australia’s ‘high demand’ that China give concessions on all sectors in one agreement, especially agriculture and some services sectors that China regards as fundamental to national economic security.<sup>9</sup> A MOFCOM negotiator said that Australia’s requests were too high for China’s realities; many of these demands required China to change laws or regulations; and “as the Chinese saying goes, one cannot arrive if too hasty.”

In its approach to the negotiations, Australia tends to put forward a comprehensive plan and then work on parts while China prefers to talk sector by sector, with relatively easy ones first.<sup>10</sup> China has preferred to negotiate trade in goods first and trade in services and investment later. The Early Harvest Programs with ASEAN and with Pakistan only included a narrow range of goods, and Chinese policymakers proudly call the Early Harvest Programs an excellent

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<sup>8</sup> Xiaoqi Liao, "Speech at the Australia-China Free Trade Conference" (Shenzhen, 28-29 June 2006).

<sup>9</sup> Interviews, April 2007.

<sup>10</sup> Australian DFAT, “Subscriber Update on the Sixth Round of Negotiations of Services and Investment” 13 September 2006. Australia’s stance is because domestic interest groups, such as the Australian Services Roundtable, demand a ‘single undertaking’ so as to maximise their leverage.

'innovation' of China to give confidence to the partner in the benefits of the prospective FTAs. Even for the final agreement on trade in goods, China prefers to exclude a wide range of sensitive products, and seems very understanding if the partner would like to do so as well. As a result, ASEAN, Pakistan, and Chile all excluded a long list of products from their agreement with China. For the FTA with Australia, the Chinese have reservations about the need for separate chapters on education, telecommunications, financial services, competition policy, electronic commerce and government procurement, and the sort of chapter that Australia wants on investment.<sup>11</sup>

The understanding of the two countries is different on complying with the requirement of GATT Article XXIV that FTAs cover "substantially all trade". China understands it as liberalization as much as the countries can bear, and as long as FTAs promote bilateral trade and investment, then Beijing believes it complies with the WTO. To China, Australia seems 'purist', in stipulating a high percentage (95-98%) of trade as meeting the "substantial" coverage requirement.

As a result, the two sides cannot agree to the structure of an offer and have only exchanged some requests instead of the 'usual' means of exchanging offers.

#### *Border vs. Behind-the-Border*

A scholar at the China Academic of Social Sciences believes that China can learn from Australia in regards to the political system, the legal system and other areas, which will help China's economic reform.<sup>12</sup> However, reports from the negotiations suggest that China is "badly under-prepared in these areas—or at least wishes to appear so."<sup>13</sup> Chinese regulators hold that many behind-the-border, or WTO-plus issues, such as intellectual property rights (IPR), transparency, technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures, cannot be changed overnight. China has been surprised by Australia's draft chapters on behind-

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<sup>11</sup> *Budget Estimates*, Australian Senate Standing Committee on Foreign Affairs, Defence and Trade, 29 May 2007, online at <http://www.aph.gov.au/hansard/senate/commtee/S10267.pdf>.

<sup>12</sup> John Taylor, "China Fears FTA's Impact on Farming," *ABC Australia*, 22 March 2005.

<sup>13</sup> Drake-Brockman, "Chinese Approaches to Negotiation".

the-border issues because it feels that Australia is attempting to alter the Chinese domestic regulation system, and China thinks this wholesale restructuring is not the task of an FTA, which is only supposed to give preferential treatment to the foreign partner under an *existing* domestic regime. Australian industries, in contrast, believed progress on these issues to be crucial for their business with China. There is a sense in Australia that China has learned the WTO model over the ten year accession process and that China is now a bit stuck on that model which is seen as 'safe'.<sup>14</sup> The lead negotiator of Australia, Rick Wells, said that the regulatory and behind-the-border issues in many sectors in China—such as a developing legal system, lack of capacity, unpredictable policy changes, the relationship between central and provincial governments and in particular enforcement of intellectual property rights—had become even more opaque and complex since China joined the WTO, and act as road blocks to doing business in China. Therefore, he said, Australia would need to be “extremely vigilant” in enforcing a deal.<sup>15</sup>

The IPR issue has especially been a point of contention. China prefers the IP chapter to be minimalist and non-binding, focused on general principles, cooperation and information exchange, and strongly resists going beyond existing international commitments.<sup>16</sup> Australian negotiators argue that its manufacturers cannot benefit from the Chinese market because of inadequate IPR protection in China. The Australian Director General of IP Australia, quoting a survey by the Australia Industry Group, identified IPR in China as the most important non-tariff barrier to trade between China and Australia.<sup>17</sup> The Federation of Automotive Products Manufacturers pointed out that the issue was not tariffs but the protection of intellectual property and non-tariff barriers; they also suspected that the Chinese central and provincial governments extended assistance to illegal activities of Chinese manufacturers.<sup>18</sup> Beijing has rejected this accusation, reasoning that

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<sup>14</sup> Ibid.

<sup>15</sup> Catherine Armitage, "Expert Dampens China FTA Hopes," *The Australian*, 22 June 2005.

<sup>16</sup> Australian DFAT, "Subscriber Update on the Sixth Round of Negotiations of Services and Investment".

<sup>17</sup> Ian Heath, "Intellectual Property and the Free Trade Agreement Process" (the Australia-China Free Trade Conference, Shenzhen, 28-29 June 2006).

<sup>18</sup> "Real Deal is in the Fine Print," *The Age*, 19 October 2005.

IPR breaches happen in China despite the central government's best efforts, because of problems in local implementation. The Secretary General of the State Intellectual Property Office of China holds that China has already developed a sound IPR legal framework, IPR protection and enforcement, and therefore foreign companies should be able to find solutions through China's legal procedures if they encounter IPR problems.<sup>19</sup>In the 9<sup>th</sup> round of negotiations in June 2007, China reiterated its strong concerns regarding the scope and content of Australia's draft IP chapter, and the negotiations remained characterised by two strongly divergent visions for the IP chapter.<sup>20</sup>

China's preference for the chapter on investment is to focus on investment promotion and protection, while Australia prefers liberalization. Because Australia's regulatory arrangements are more open and more developed than those in China, the requests Australia tabled were more extensive than those China tabled with Australia. When Australia tabled a number of barriers affecting investment (predominantly in the mining sector) at the March 2007 round of negotiations, China was surprised that they go to the heart of domestic regulation that underpins market access.<sup>21</sup> A Chinese scholar at CASS argued that FTAs are a means through which developed countries pursue their Singapore Agenda (named after the 1996 Singapore ministerial meeting of the WTO--basically measures to liberalize investment, competition policy, and government procurement policy but failed because of objection from developing countries), which will hurt the autonomy of developing countries.<sup>22</sup> Therefore, although theoretically FTAs could help countries streamline their governance to the standards of market economies by including behind-the-border issues, it actually depends on the preference of individual countries and the relative power between the negotiating Parties.

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<sup>19</sup> Zhonghua Chen, "Speech at the Australia-China Free Trade Conference" (Shenzhen, 28-29 June 2006).

<sup>20</sup> Australian DFAT, "Update: Ninth Round of Negotiations", 29 June 2007.  
<http://www.dfat.gov.au/geo/china/fta/>

<sup>21</sup> Australian DFAT, "Update: Eighth Round of Negotiations", <http://www.dfat.gov.au/geo/china/fta/>.

<sup>22</sup> Fan He, "Bing bu ziyou de ziyou xieding [FTAs Not Free]," *The Economic Observer*, 18 December 2005  
<http://finance.sina.com.cn/j/20051218/18092207715.shtml>.

### *Flexible vs. Rigid*

Another difference lies in the Chinese flexible approach and Australian rigid approach. When Chinese State Councillor Hua Jianmin met with Mark Vaile in January 2006, he said that he hoped “both sides could act in a flexible and pragmatic spirit to advance the negotiations in a positive and steady manner”.<sup>23</sup> As mentioned before, this difference was already exemplified during the Feasibility Study. When China agrees to a proposal of an FTA, it usually says the FTA will bring both opportunities and challenges but on the whole it will be beneficial, without specific assessments. In this way, the central decision makers try to dismiss potential costs on both sides. China thinks Australia’s market is already very open (average tariff is below 10%), and so China’s prospective benefits from the FTA will not be as much as Australia claims. It is probably part of the Chinese diplomatic culture that they give an in-principle approval if there is no crucial problem. Implementation of the in-principle agreement usually means selecting benefits while avoiding costs to the domestic economy. In other words, China tries to promote export and to avoid import competition for itself, which is apparently not desirable for the FTA partner.

China’s attempt to hide challenges does not always succeed. On the one hand, when Australia presented quantitative results of their potential loss, China was doubtful but it could not provide an alternative calculation. As mentioned before, the Australian manufacturing sector has been strongly opposed to the FTA on the grounds of prospective loss of 170,000 jobs, while China tried to say that Australia did not have comparative advantage in manufacturing anyway. On the other hand, Chinese negotiators are often in an embarrassing situation at the negotiating table whereby Chinese domestic industrial sectors provide inaccurate or inconsistent statistics and offers.

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<sup>23</sup> “Bilateral Relations”, China MFA website at <http://www.fmprc.gov.cn/eng/wjz/zjg/bmdyys/gjlb/3377/default.htm>

The differences between Chinese flexible and Australian rigid approaches also reflect on the following issues:

**Rules of Origin:** China prefers a regional value added approach,<sup>24</sup> which allows China to have a different set of Rules of Origin for each of its FTAs, while Australia prefers the change of classification approach which applies the same rules for all its FTAs and requires less administrative workload.

**Dispute Settlement Mechanism:** China acknowledges the importance of stipulating a dispute settlement mechanism in the FTA, according to a MOFCOM negotiator, but China prefers bilateral negotiation and friendly consultation, with third-party adjudication as the last resort. A Chinese negotiator pointed out that NAFTA members have used the dispute settlement mechanism under the FTA only once but resorted most of the time to the WTO. China also prefers a simple and practical procedure for dispute settlement to the complicated procedure under the WTO.<sup>25</sup>

**Negotiation Scheduling:** Australia has very specific plans for the FTA negotiation but China cannot decide on many details including the schedule of negotiations because the government has to deal with many domestic issues and the negotiation team is overstretched. That is seen by Australia as a sign of lack of sincerity. Moreover, China seems to have difficulty committing quickly to written text. Draft text on about three quarters of the proposed structure tabled at the negotiating round in May 2006 was drafted by Australia.<sup>26</sup> In the round in May 2006, Australia complained that China failed to meet the promise to give a new improved offer on tariff reduction but Chinese negotiators said that they could not have made such a promise given the difficult situation and limited capacity. China's failure to table a specific offer on tariff reductions

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<sup>24</sup> The requirement under an FTA that a certain percentage of the value of the final product should be added in the region if that product is to be recognized as made in this region.

<sup>25</sup> Australian DFAT, "Update on the Negotiations", 11 Nov. 2005, <http://www.dfat.gov.au/geo/china/fta/index.html>. Min Rong, "Speech at the Australia-China Free Trade Conference" (Shenzhen, 28-29 June 2006), 144-45.

<sup>26</sup> Drake-Brockman, "Chinese Approaches to Negotiation".

in September 2006 made Australian negotiators frustrated, who then put their offer on hold. After the seventh round of talks in December 2006, Australia refused to continue talks on tariffs unless the Chinese submitted a substantially better offer. Chinese officials have since repeated that they were preparing to submit a better offer, but the timing remained vague.<sup>27</sup>

#### *State vs. Market*

Many of the above differences, in particular those on the behind-the-border issues, are either a reflection of the systemic differences between China as an economy in transition and Australia as a market economy; or, more state versus more market for the formulation and implementation of foreign economic policy, although FTA negotiations are between the governments. For instance, as mentioned previously, China requested Australia to include a clause on the stable supply of resources into the FTA. He Yafei, Director of North America and Oceania Department of MFA, told Australian media before Howard's visit in April 2005 that while the increase of iron ore prices was a commercial matter, Canberra "can certainly encourage companies to take a long-term point of view in setting prices...don't just look at the benefits under their noses."<sup>28</sup> Whereas the Australian government insists that prices are purely business decisions by private companies, some of which are multinational corporations; the government should not and cannot intervene because Australia is a market economy.

China believes the Australian government has the decision power over the FTA, and that the only difference compared with China is that the Australian government gathers more information from and communicates more with industries.<sup>29</sup> That perhaps is why China does not have as wide or deep consultations with domestic private sectors as Australia does; nor does it run a substantial advocacy program in Australia. Australia runs an extensive program of advocacy on the China FTA, attempting to change domestic opinion within China, which takes the form of

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<sup>27</sup> Mary-Anne Toy, "China Free Trade Talks Drag on, and on, and on," *Sydney Morning Herald*, 23 June 2007.

<sup>28</sup> Hu, "Agreements Pave Way for Chinese-Australian FTA."

<sup>29</sup> Interview, Beijing, April 2007.

visits to Australia by journalists who, on their return to China, have written articles in favour of the FTA in various areas of interest to Australia, including agriculture and services. They have also invited influential Chinese in government and academia in the hope that they could “build a more receptive mood in China for the FTA”. However, for China’s offensive interests, China does not have a similar program of advocacy in Australia.<sup>30</sup> Australian industries felt that “China seemed to have got away with largely leaving advocacy in Australia of the Australia/China FTA to the Australian Government to handle.” They pointed out that “Chinese Embassy public commentary focused more on delivering a message regarding China’s sensitivities in for example agriculture, than on any advantage of an FTA for the Australian industry audience.”<sup>31</sup>

Because of the above mentioned differences between China and Australia, the FTA negotiations have remained, as the Australian Trade Minister Warren Truss described, “tortuous”.<sup>32</sup>

### **Domestic Politics**

A lot of explanation for China’s policies towards the AUCFTA can be found in the domestic policy making, including the resistance from domestic industries on the one hand, and the structure of the policymaking institution on the other.

#### *Domestic ‘Interest Groups’*

Chinese central policymakers do not enjoy so much autonomy in conducting economic diplomacy as conventional wisdom holds. Instead, various domestic sectors try to express their interests and they can be quite stubborn. In this case, domestic resistance in China to further liberalizing trade and investment to Australia beyond the level of WTO commitments has come mostly from agricultural and services sectors, as will be discussed below.

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<sup>30</sup> *Senate Estimates*, 114.

<sup>31</sup> Drake-Brockman, "Chinese Approaches to Negotiation".

<sup>32</sup> Graeme Dobell, "China Trade Negotiations 'Tortuous' Says Truss," *ABC News*, 16 June 2007 <http://www.abc.net.au/news/stories/2007/06/16/1953209.htm>.

The participation of industries in the policymaking for this FTA is still largely limited to the channel of state ministries and commissions, although some big state-owned enterprises seem to have an increasing role. Australian industrial sectors observed that China might be neglecting to put in an equivalent effort into consultation and advocacy with non-governmental stakeholders for its FTA negotiations as it had done for the WTO.<sup>33</sup> MOFCOM did send out an online survey to Chinese companies on their opinions on the China-Australia FTA in November 2006.<sup>34</sup> It received very few email or telephone answers to the online survey. MOFCOM also conducted surveys through ministries and local governments because “China is too big to gather opinions directly” unlike Australia, where business associations can do a lot of work in this aspect.<sup>35</sup> Chinese national business associations are non-governmental but are usually funded by the government and affiliated with a state ministry or commission; therefore they are generally supportive of government policies, especially the policies of the government institution they are affiliated with.<sup>36</sup>

### Agriculture

Agriculture has been the most difficult sector in the FTA negotiation on goods. From the first round of negotiations, “the Chinese were at pains to say that they were on the defensive on agriculture and would resist liberalization there”.<sup>37</sup> An Agriculture Working Group was organized between the two countries at the second round of negotiations to deal with agricultural and quarantine issues.

The incidence of peasant protests has been on the rise in recent years, a problem the Hu-Wen government must solve in its “construction of a harmonious society” as the overarching

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<sup>33</sup> Ibid.

<sup>34</sup> The text of the survey is available on the website of MOFCOM:

<http://www.mofcom.gov.cn/aarticle/h/redht/200308/20030800117248.html>, accessed 14 Aug. 2007.

<sup>35</sup> Interviews with MOFCOM officials, April to May 2007.

<sup>36</sup> For the studies on business associations in China, see Bruce J. Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change*, Cambridge Modern China Series (New York: Cambridge University Press, 2003), 69-85. Scott Kennedy, *The Business of Lobbying in China* (Cambridge, Mass.: Harvard University Press, 2005). Christopher E. Nevitt, "Private Business Associations in China: Evidence of Civil Society or Local State Power," *China Journal* 36 (July 1996).

<sup>37</sup> Alan Kohler, "FTAs Protectionism in Disguise: Garnaut," *Inside Business, ABC Australia*, 24 April 2005.

social and political objective. Therefore the government put solving ‘three agricultural’ problems—peasant, rural area, and agricultural production—on the top of the government policies at the 16<sup>th</sup> National People’s Congress; the three agricultural problems have remained on the No.1 Central Documents, which carry state policies of the highest priority.<sup>38</sup> There is no farmers’ union in China, but the agricultural problem has become so prominent in China that the MOA gained influence in Chinese policymaking through assuming the role of the representative of farmers. MOA has been the most stubborn opponent to the prospective opening of Chinese agriculture to Australia.<sup>39</sup> MOA asserted that Chinese trade negotiators had already made too many concessions under the WTO. For instance, MOA claimed that wool production in China was almost completely lost because of foreign competition after the WTO accession, which disproved what MOFTEC had said about the benefits of liberalization on domestic productivity. In particular, MOA argues, in China agricultural production is still organized in the unit of families and they have very little resource to update technology.

Compared with China’s FTA with ASEAN, the potential agricultural trade volume between China and Australia was much bigger,<sup>40</sup> and the area to be affected by the potential FTA was much wider. According to MOFCOM officials, the representatives at the National People’s Congress (NPC), traditionally a venue to discuss domestic issues and merely a ‘rubber stamp’, have now become more concerned with the impacts of foreign economic policy, including FTAs, on local economies. And the NPC has gained power in China’s policymaking as a legislative body vis-à-vis the government.

Moreover, the provinces in North China that may be affected by the FTA (Xinjiang, Gansu, Ningxia, and Inner Mongolia) are also areas where many ethnic minorities reside,

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<sup>38</sup> Interview, Beijing, 2006 and 2007. See “*Zhongyang guanyu zengjia nongmin shouru ruogan zhengce de yijian*” [The central government’s view on policies to increase peasants’ income”, *People’s Daily*, 9 February 2004.

<sup>39</sup> The information on MOA’s views is based on the interviews with MOA officials, May 2006, Beijing.

<sup>40</sup> The volume of imported agricultural products from ASEAN and Australia in ... was respectively..... Statistics needed here. Agricultural imports from ASEAN in 2005 were 3.68 billion USD, exports \$2.42 billion, with a deficit of \$1.26 billion.

including Muslims and Mongolians, most of whom rely on cattle farming for a living. Ethnic issues have become more sensitive in recent years in China's domestic politics, with increasing incidence of violent conflicts between the Han majority and Muslims.<sup>41</sup> At a bilateral conference on FTA agriculture issues in Xi'an in September 2006, a researcher from the Xinjiang Uygur Autonomous region advised the Chinese government to open wool trade gradually so as to avoid adverse impacts on Chinese fine wool growers, which is essential to "protect the ethnic minorities' economy and maintain the border stability".<sup>42</sup>

Australia argued that Chinese producers of textiles and processed foods would benefit from cheaper raw materials from Australia.<sup>43</sup> The MOA, however, noted that intra-industry trade was already happening and profiting the processing industries, while further tariff reduction would damage raw material producers in China because their income barely meets livelihood needs.

### Services and Investment

Services trade and market access for foreign investments are closely related, and have been another most contentious area in the FTA negotiations between China and Australia. Although Australian services industries have been keen to enter the Chinese market, Chinese domestic service providers and relevant government institutions have been clearly resistant to significant liberalization beyond the WTO commitments. That reflects China's conservative position towards domestic reform under an FTA for consideration of economic security, as well as profits generated from monopoly.

In recent years China has paid more attention to developing the services sector rather than focusing only on manufacturing for industrialization. It also noticed that services trade has

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<sup>41</sup> Interviews, Beijing April 2006. Also see...

<sup>42</sup> Kechuan Tian, "Fine Wool Industry in China and the Free Trade between China and Australia" (the Australia-China FTA Agricultural Conference, Xi'an, 27 September 2006).

<sup>43</sup> "China FTA to Boost Wool Sales: Report," *The Age*, 10 October 2005.

become an important part of the multilateral and regional trade talks.<sup>44</sup> The government wanted to use the WTO to push forward domestic reforms because it was already very difficult for the government alone to carry out further reform.<sup>45</sup> WTO was a 'basic national strategy' at that time. However, Beijing is now taking a more conservative approach to reform in this area because economic security and stability have become the priority in China's current reform and opening strategy.

China is reluctant to open services trade under the FTA significantly beyond WTO commitments. The government thinks it made substantial concessions under the WTO and carried them out faithfully. Chinese services regulators hold that the impacts on domestic industries still wait to be seen, before any further liberalization can be experimented or committed.<sup>46</sup> For instance, the regulators of the banking sector believe that Chinese banks are still vulnerable to foreign competition. Australian negotiators try to persuade China that medium-sized Australian companies can enhance the competitiveness of Chinese companies without their facing the destructive force of big European and American companies, which is consistent with the rhetoric of some Chinese trade officials about the role of FTAs, China has been very cautious in such experiments. According to MOFCOM officials, imposing domestic reforms is not the starting point or motivation of the Chinese government in its pursuit of FTAs.

As for telecommunication and cultural industries, China has sought protection on the ground of national security. A more important reason some sectors resist opening under the FTA, such as telecommunication, transportation and mining, is that a huge amount of profits is generated from monopoly in those sectors, usually by state-owned companies that have become increasingly independent and powerful. Corruption is also a serious problem in these sectors as a result of partial reform.

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<sup>44</sup> MOFCOM, "Director of the Services Trade Department Hu Jingyan talks about China's Services Trade," 2007, <http://video.mofcom.gov.cn/video.asp?id=1853>.

<sup>45</sup> Interviews, May 2006 and April 2007.

<sup>46</sup> Australia DFAT, "Updates on Progress in the Negotiations", 2007, <http://www.dfat.gov.au/geo/china/fta/>; see in particular the 8<sup>th</sup> and 9<sup>th</sup> rounds of negotiations.

### Weak offensive interests

China obtained recognition of market economy status by Australia before the FTA negotiations began; as for energy and resources, the government has already achieved a few energy cooperation agreements outside the FTA framework. As a result, the potential beneficiaries from the FTA have not pressured Chinese negotiators to accelerate the negotiation.

Apart from the market economy status and energy resources, China does not have many strong offensive interests in the FTA with Australia. For Chinese manufacturers and horticultural farmers, Australia is not an important market because the population is small and tariffs in most sectors are already low; besides, they are not confident that the FTA would reduce many non-tariff barriers for Chinese exports because Australia is well known for its insistence on strict SPS and TBT measures. In services trade, China is most interested in better access to the Australian labour market in both skilled and unskilled categories (nurses, construction workers, seasonal agricultural labourers), in part because of rising pressure of domestic unemployment. China thinks that given the aging Australian population, Australia should welcome Chinese to make up for the labour shortage. China would like to use Chinese managers and workers for mining and contracted construction projects in Australia because Chinese companies feel it easier to manage Chinese workers, and lack confidence in dealing with Australian labour unions if any dispute arises with Australian workers.<sup>47</sup> However, Australia insists that no FTA could result in free movement of labour as recognized in all trade agreements including in the WTO, except in a special case—the highly politically unified EU, because that is a fundamental aspect of sovereignty.<sup>48</sup>

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<sup>47</sup> Interviews, May 2007. Also see the speech by the Vice President of China International Contractors Association, Chunhe Diao, "Strengthening Australia-China Cooperation in Engineering & Contracting and Promote the Common Development of Services Trade" (the Australia-China FTA Services Conference, Beijing, 24 April 2006).

<sup>48</sup> *Senate Estimates*, 116.

### *Domestic Policymaking Institution*

Domestic interests have constrained Chinese negotiators' room for concession not only because of their assertiveness, but also because the features of the policymaking institution. In this section, I briefly analyse the main actors.

#### MOFCOM

MOFCOM is designated as the lead agency to negotiate the FTA, but it does not have the formal authority to settle conflicting domestic interests. Unlike the WTO accession, in China's FTA policymaking there has yet to be a 'Central Leading Group' made of a Premier and ministerial representatives to coordinate policymaking. Neither is MOFCOM expected to report directly to the leadership or the State Council on what are regarded as 'working issues'. Because MOFCOM has the same political rank as other industrial ministries and even lower than some national commissions, it is easily subject to pressure from other ministries and commissions to accommodate their interests. Moreover, because the power of trade, investment and industrial policymaking is fragmented among MOFCOM, the NDRC, and other ministerial-level government agencies, MOFCOM cannot propel trade liberalization without the consent of others.

MOFCOM officials are in general proponents of reform and liberalization, believing competition enhances productivity and free trade benefits consumers, but it has a lot of difficulty in persuading domestic sectors to subscribe to this belief. At the same time, MOFCOM seems to have more sympathy for the agricultural sector than they did during the WTO negotiations. Now they think that agriculture is a special and sensitive sector for every country because of political reasons and therefore it is natural that countries would not compromise their domestic interests in an FTA.

#### The NDRC

Domestic resistance to the FTA has also come from the National Development and Reforms Commission (NDRC), a powerful institution with oversight of China's industry policies. It seems to not only have inherited a conservative position on reforms and opening from its

former body, the State Planning Agency, but also enjoys increased power because part of the State Economic and Trade Commission was merged into the Agency to form NDRC. Other government agencies call the NDRC a 'small state council', because it has departments matching every sector of the economy, and holds a higher political position than the ministries. The Australian DFAT is concerned that NDRC has not been fully involved in the negotiations and therefore MOFCOM cannot move beyond traditional agendas.

### The Leadership

The Chinese leadership and the State Council still have a lot of autonomy in China's foreign economic policymaking. Chinese government agencies think that the FTA with Australia is going to be realized sooner or later because both President Hu Jintao and Premier Wen Jiabao have given support to it. In the negotiation round after Wen's visit to Australia in April 2006, China seemed to become more flexible on some issues (such as a single undertaking approach, and the inclusion of provisions on investment and government procurement) that had been highly sensitive.

However, compared with China's policymaking on the FTA with ASEAN, this FTA has been less driven by political motivations and there is less involvement of the leadership or the Ministry of Foreign Affairs in the policymaking of AUCFTA. Moreover, because of increasingly serious social problems in China, the leadership has raised 'building a harmonious society' as the highest policy objective. It has to consider possible social impacts of foreign economic policies, especially those associated with farmers and ethnic minorities. MOFCOM officials think that Wen Jiabao is more cautious than Zhu Rongji on reform; for instance, the central government policy priority is on agriculture and therefore would not ask much concession from the Ministry of Agriculture. At his meeting with the Australian Prime Minister John Howard in Shenzhen in September 2006, Wen said that in the FTA negotiation between China and Australia, both sides should demonstrate 'mutual understanding and *accommodation*' [italicization by the author].

## **Conclusion**

Although the Chinese government has significant interests in the proposed FTA with Australia, there have been several constraints to achieving an agreement.

Firstly, the two countries have different approaches to FTA negotiation resulting from their differences in the level of economic development, the understanding of FTAs and of the logics of market economy, political system, and culture. China has learned through the negotiation process more about market economy and about negotiating an FTA with a developed country, but it is still a question to what extent China would accommodate the requests by Australia as a market economy and developed country, or how differences in other aspects could be easily resolved.

Secondly, Chinese central policymakers do not enjoy as much autonomy as before or as conventional wisdom suggests, and domestic protectionist sectors can be quite stubborn and vocal in resisting opening under an FTA. The increased assertion of domestic interests comes from experience or resentment from the WTO accession for some sectors, and from partial reform that produced monopoly profits for other sectors. Their influence is further strengthened by the sensitivity of political and social problems in China. They have forced MOFCOM to take a conservative position at the FTA negotiations.

Thirdly, China's policymaking on the AUCFTA is less centralized, less politically motivated and more fragmented, compared with that on the WTO accession and the FTA with ASEAN. There is no leading inter-ministerial agency to coordinate different domestic preferences, nor does the lead agency, MOFCOM, have the authority or enough power to do so. The hope for a change in China's position in the negotiation lies in institutional change, such as the formation of a central coordination agency, or a stronger commitment from the leadership.