

The Western Australian Farmers  
Federation (Inc)



Submission  
‘The response from the WA grain industry  
to the proposed Australia – China Free  
Trade Agreement’

to

DFAT

Australia – China Free Trade Negotiations

17 June 2005

## **RECOMMENDATION**

**That-**

**The proposed Australia – China Free Trade Agreement removes the barriers to trade apparent or inherent in the following structures;**

- **Tariffs**
- **Quotas**
- **Sanitary and phyto-sanitary standards (biosecurity)**
- **Customs procedures, documentation and charges**
- **Trade rules and regulations**
- **Designated trader regulations, end user certificate procedures**
- **Statutory inspection and testing**
- **Customs valuations**
- **Licensing and intellectual property (protection)**
- **Product conformity**
- **Contracts and dispute resolution**

**in regards to the arguments presented in this paper.**



### **China's Market for Grain**

A Free Trade Agreement (FTA) between Australia and China which allowed unimpeded path to the importation of Australian grain into China, should be advantageous to Australia and reflect the comparative advantages of the two countries. According to most pundits China with an abundant labour force relative to its land base, has a comparative advantage in labour intensive agricultural products such as fruit and vegetables and manufactured agricultural products, however but has a declining comparative advantage in grains and other land intensive crops. The general hypothesis is that the Chinese import market for grain and oilseeds will grow over the coming years.

It is difficult to determine just how much demand there will be for grain imports, whether they be foodgrains or feedgrains. In 1995 Lester Brown, President of the Earth Policy Institute, released the book 'Who Will Feed China', it painted a gloomy picture of massive world food price increases as China dealt with growing shortages, and provoked a lot of controversy around the world. Brown wrote that rising living standards, increased factory construction that is consuming massive amounts of cropland, shrinking grain production, a depletion in water resources, and the increasing loss of arable land to desertification this means that the surplus world grain production capacity and cheap food of the last half-century may soon be history. He states in an article in *The Globalist*<sup>1</sup> that, 'Moving grain from the United States to China on the scale that is needed will likely involve loading two or three ships every day'<sup>2</sup>. Brown estimates that China's need for grain will have risen to over 200 million tons by 2030, which exceeds the current level of total world grain exports.

As noted these arguments have been controversial, but many studies agree on the point that China will need to import more grain in the future, but it is likely that the main imports will be food grains. As incomes rise, China is beginning to follow the same pattern of consumption as wealthier Japan, Taiwan and South Korea, all of which diversified their diets away from a starch staple, rice, to one that included much greater consumption of meat, eggs, milk and other livestock products. It takes two kilograms of feed grain to produce a kilogram of poultry; pork requires four kilograms of feed and beef needs seven. 'Feedgrains Market Development in China and Implications for Australia', a report compiled by GRDC, China Agricultural University, and University of Sydney, states that China's demand for feedgrains will exceed its demands for foodgrains by 2010. Not only does this make it easier for the China's domestic market to keep up with demand for grain, it limits Australia access to the market, as the predominant food grain in China is corn which is mainly supplied by the US, and a few South American exporters. A benefit of this shift in diet in China has been the countries increased consumption of beer, and as a result the growth in the sale of Australian malted barley to China for brewing.

There are others who believe China can maintain self sufficiency in grain for the foreseeable future despite the problems that Brown lists. Chinese economists point out that China only has to lift its annual production of grain by 1% to achieve the sufficiency needed until 2030 when China expects its population to peak at 1.6 billion. The US Department of Agriculture has argued that, were China to adopt world-class

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<sup>1</sup> <http://www.theglobalist.com/DBWeb/StoryId.aspx?StoryId=3827>

<sup>2</sup> As Brown points out though, China's \$120 billion trade surplus with the United States is enough to buy the entire U.S. grain harvest twice over.

agricultural technology, it could improve yields by as much as 30%. The Chinese government calculates that 10 per cent of the nation's grain crop is lost due to mishandling and inefficiencies in administration and distribution; other analyses put the losses as high as 30%. Whatever the situation in regards to China's need for grain, the most important point to remember is that there is a dearth of reliable data about anything to do with China, particularly trade.

Regardless of any FTA's being concluded between China and any state, it is important to consider how important the agricultural sector is to domestic stability. As the Chinese economists and politicians have argued 'it is imperative for the government to ensure a high rate of grain self-sufficiency as a necessary condition for stability'. With a rural labour workforce of 400 million and mindful of the lessons of its own history, China sees grain production as crucial to maintaining the incomes of farmers, which have lagged markedly behind urban incomes, and stimulating employment in the countryside.

All the evidence we have looked at makes it seem likely that China will become a net importer of grain, and if as the evidence suggests China is almost through its surplus grain stocks which it has been using to support domestic supply, then it will be soon be trying to fill large contracts in the global marketplace.

Many countries currently have a trade deficit with China and see agriculture as a way to balance that deficit, so it is important for Australia to attempt to secure its markets in China.

### **Barriers To Trade**

Australia has had important trading ties with China since 1978 and primary products have been at the core of our exports, forming over 60% of our total exports. China is our biggest market for wool, and is a significant destination for grain exports. Since China's accession to the WTO in 2001 China has made significant progress in reducing tariffs, increasing import quotas, provided greater access for private traders to purchase and market agricultural products and reduced or eliminated the monopolistic role of State Trading enterprises, yet there remain significant barriers to trade with China. For example commentators have noted something of a slowdown in implementation of WTO requirements over the last two years or so particularly in areas of agricultural reform, intellectual property protection and trade in services, this has also involved preferential treatment for domestic businesses at the expense of foreign businesses Any FTA that is concluded between Australia and China will have to deal with these issues.

The main barriers to entry are as follows:

- Tariffs
- Quotas
- Sanitary and phyto-sanitary standards (biosecurity)
- Customs procedures, documentation and charges
- Trade rules and regulations
- Designated trader regulations, end user certificate procedures
- Statutory inspection and testing
- Customs valuations

- Licensing and intellectual property (protection)
- Product conformity

The main problem with trading with China is that controls and regulations at the border are relatively transparent, but post – border procedures and arrangements are uncertain and inconsistent.

### **Tariffs & Tariff Rate Quotas**

Tariffs have come down considerably from the 40% mark that stood before China's accession to the WTO. The average tariff rate is around 9%, but agricultural tariffs are closer to 15% due to protectionist policies in regards to agriculture (not dissimilar to many other countries). There is also a difference in tariff rates in agricultural commodities, the bound rate for lupins, a major WA feedgrain export, has fallen in line with agreements between Australia and China to 9%, the bound rate of soybeans the main competitor to lupins is also 9%, but due to intense lobbying by soybean importers from the US and other American countries, has seen an 'applied' tariff of 5% being applied. It is precisely this lack of transparency, and fairness that needs to be addressed in a FTA. Tariff rate quotas apply to a number of agricultural exports from Australia. Under these arrangements, guaranteed *global* access is provided for a specific volume of imports (although this volume need not be fully utilised) at a preferential or low tariff. Imports above the agreed volume are subject to a much higher, generally prohibitive, tariff rate.

Non-tariff barriers, such as the administration of the quota system, statutory inspection, and biotechnology regulations remain the biggest source of frustration to exporters, and are a particular barrier to agricultural trade, many exporters believe the system is unnecessarily bureaucratic and lacks transparency.

After accession to the WTO China set up the quota system and portrayed it as a way of opening up a transparent trading system. Soon after implementation in 2002 once implementation began, all of the available information indicated that SDPC (State Planning and Development Commission) had decided to allocate TRQs in a manner that would protect domestic farm interests and maintain state trading enterprises. SDPC operated with only limited transparency, refusing to provide specific details on the amounts and the recipients of the allocations. At the same time, SDPC reserved a significant portion of the TRQs for the processing and re-export trade, despite China's commitment to provide market access and national treatment for imported products. SDPC also allocated a portion of the TRQs for some commodities in smaller than commercially viable quantities, and it employed burdensome licensing requirements. Bilateral trade delegations from all countries have attempted to build more fairness and transparency into quota administration with some success, and negotiations for a FTA must support this.

### **Statutory Inspection and Testing**

A second non – tariff border issue which has caused (and continues to cause) concern and disruption – as well as additional costs to importers (and exporters as any costs would undoubtedly be passed back in the form of price limits) is mandatory inspection. This generally involves a requirement for certain strategic or sensitive imports (usually food and fibre) to be subjected to sampling and testing by Chinese authorities (AQSIQ) prior to acceptance. While China has agreed as part of its WTO

commitments to adopt international standards for product assessment and conformity there are many examples where this is still not the case. In many instances Chinese domestic standards have precedence over international standards, resulting in delivery delays, quality claims and accusations of corrupt payments to officials for release of goods. There are continuing arguments about inconsistency between Chinese domestic sampling and testing standards and international standards and this is the area which is still to be effectively addressed. This issue is of particular relevance to Australia as our agricultural products have a well deserved reputation for being well above international standards in their level of quality.

### **Sanitary and Phytosanitary Measures**

The above issue is closely linked to the provision in the WTO agreement for sanitary and phytosanitary measures that can be taken to protect China's environment and people. While China's rights to protect its borders against imports of infected animals, animal products and contaminated food stuffs is not in question, again it is the strategic and sensitive imports mentioned above that seem to be mostly affected. China has imposed a maximum residue level (MRL) for selenium that is below the international standard and threatens all wheat exports to China. In addition, China has imposed an MRL for vomitoxin in wheat in the absence of any international standard. Although these measures are problematic, exports of wheat to China increased dramatically in 2004, as China does not appear to be enforcing them. China has according to Australian sources launched spurious quarantine action over a fungal grain pest, which has never affected Australian wheat. A possible FTA must attempt to clarify these issues.

### **Customs Valuations**

The WTO Agreement on the Implementation of GATT Article VII (also known as the Agreement on Customs Valuation) is designed to ensure that determinations of the customs value for the application of duty rates to imported goods are conducted in a neutral and uniform manner, precluding the use of arbitrary or fictitious customs values. Adherence to the Agreement on Customs Valuation is important for exporters, particularly to ensure that market access opportunities provided through tariff reductions are not negated by unwarranted and unreasonable "uplifts" in the customs value of goods to which tariffs are applied. China agreed to implement its obligations under the Agreement on Customs Valuation upon accession, without any transition period. In addition, China's accession agreement reinforces China's obligation not to use minimum or reference prices as a means for determining customs value. Nevertheless, China has not uniformly implemented these regulations exporters continue to report that they are still encountering valuation problems at many ports. For example, even though the 2002 regulations provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, many Chinese customs officials are still improperly using "reference pricing," which usually results in a higher dutiable value. A FTA must work towards solving these problems.

### **End User Certificates**

There has been much concern from grain councils in Australia over the need for end user certificates, the arduous process in acquiring them, and the belief that they contravene the WTO agreement. An example of this is the export of barley into China. Australia exports approximately 1 million tonnes of barley to China each year, worth

in excess of A\$200 million (representing around 40% of all barley imports into China). Current research indicates that in the medium term, the demand for barley will continue to rise in line with China's increasing consumption of beer. Since China's admission into the World Trade Organisation (WTO), it was agreed that barley imports should be subject to 3% customs duty along with a 13% value added tax. In reality the Chinese Government has used CIQ (Custom Import Quotas) as a tool to control imports.

Current procedure in China for an organisation wishing to purchase barley is that they must first find an "end user" such as a malt house or brewery to provide certification confirming that they will accept the barley in question. The applicant must then submit this certificate to the local CIQ administrator who dispatches an inspector to undertake a site investigation of the malt house/brewery. Following local CIQ approval, the applicant then must submit an application to the central CIQ administrator in Beijing for final approval, the whole approval procedure taking around one month for completion with the final certification required prior to the performing vessel being loaded. We believe that that this policy contravenes WTO terms and is an impediment to free trade.

### **Contracts and Dispute Resolution**

Lastly, a main impediment to trade is the approach to contracts between the trading partners, particularly in relation to cultural differences and in ways of conducting business, and the lack of a dispute resolution process. While contracts do not represent a formal barrier to entry, they nevertheless represent a major impediment to efficient business development and are to the ultimate disadvantage of both China and Australia. Many Chinese buyers tend to conduct business on the basis of relationships and subsequently negotiating with suppliers 'when things go wrong'. Little emphasis or reliance is placed on written contracts – due partly, (according to Chinese colleagues) to the inability of the legal system in China to effectively resolve business disputes. In contrast, Westerners rely much more heavily on a written contract which should incorporate clear details and specifications of goods and services to be transacted, payment, shipment and documentary requirements, and procedures to be followed in case of claim or dispute. The wool industry's dealings in China from the 1990's provides an example of what happens when things go wrong and attempts at righting the situation. Contract defaults and disputes were prevalent at that time mainly (but not exclusively) as a consequence of Chinese buyers responding to falling international prices. This led to forced renegotiation of already agreed contracts and prices, failure to open Letters of Credit, spurious quality claims, and minor documentary discrepancies. Wool exporters often sought financial retribution by subsequently delivering poorer quality, cheaper components in deliveries – which often resulted in another round of disputes! This essentially became a no-win game for the mill end-users who suffered processing difficulties and sub-standard product quality – a situation which was not in the interests of Australian wool producers or Chinese manufacturers – while Australian exporters experienced high financial risks and, in some cases, financial collapse.

This issue prompted the Chinese and Australian Governments to form an industry and government working group to develop an improved contractual framework for wool trading. After an extended negotiating process, a Model Wool Contract was finally introduced. This incorporated 3 essential features:

- A greatly improved specification format for the materials being contracted, based on use of internationally accepted scientific test methods
- General terms and conditions covering payment, shipment, documentation and claims procedures, based largely on Incoterms 2000
- Dispute resolution process based on CIETAC arbitration and provision for selection of expert arbitrators through a panel of internationally approved wool trade experts.

It would be incorrect, however, to suggest that this contractual framework has been universally embraced by both sides. Much is still needed in educating businesses in both countries about the benefits of proper contracts, not just as a safety net in case of dispute, but as an accurate means of specifying the goods or services to be supplied, obligations on both parties for payment, shipment and documentation and an agreement to an approved, credible dispute resolution process. More education is required to highlight the importance of contracting consistent with international practice – notwithstanding reluctance by some parties to change ‘historical’ practices. This should be about good risk management and clear statements about what is being transacted, with the obligations on both parties clearly stated. It will also be of increasing importance for processors who have direct responsibility for raw material purchasing to ensure that they get the correct supplies to meet customer requirements.

### **Conclusion**

Regardless of these problems, and in every sense of the word they are teething problems as the new WTO trading system has only been operating for four years, and we are dealing with another non-Western country. China is an important export market for Australian grain and grain products. We welcome the FTA as an important step in securing this market. It should help Australia in competing against subsidised product coming out of the US. In the case of feedgrains this will be a massive benefit as there is the strong possibility of wheat, lupins and barley being substituted for corn as the basis for feed if the price is competitive, as there is little nutritional difference and such substitution has already taken place to a degree. We also feel that if the worse case scenarios of China’s need for grain should come true, or even partly true, there will be little need for a free trade agreement with China for grain, but we believe that a FTA will be important in establishing a more suitable legal framework for trade between Australia and China.

What we believe should not happen with an FTA is that trade with China being seen as a panacea, and thus we can disregard other trading efforts. As previously stated many other countries see agricultural trade with China as a way to balance their trade books, and competition for the market will be strong. Also it is important to remember the importance of agriculture to Chinese society, and the distinct likelihood that internal pressures will mean that it will remain protected to a degree, regardless of WTO agreements.