

China FTA Taskforce

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SCIENCE INDUSTRY ACTION AGENDA

Submission to the

Department of Foreign Affairs and Trade on the

Australia – China Free Trade Agreement

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Introduction

The Science Industry Action Agenda is pleased to present the following submission to DFAT on the Australia-China Free Trade Agreement (FTA) in response to its call for submissions in April 2005.

The Science Industry Action Agenda is a collaboration between leaders from: the Australian science industry; the Department of Industry, Tourism and Resources and the Department of Education Science and Training to develop a strategic plan for the industry. The action agenda process is aimed at identifying impediments to the industry's growth and defining and implementing long-term strategies to overcome these impediments.

In its 10-year vision, the Australian science industry aims to increase its exports from around A\$1 billion per annum to more than A\$3 billion per annum by 2015. To achieve this goal, a key priority in the Science Industry Action Agenda's nine recommendations is to increase the industry's exports in terms of both the volume of exports and the number of science industry exporters. Other related priorities are to progress the harmonisation of regulations and standards relevant to the science industry within Australia and aligning them with relevant international ones.

The Australian science industry is highly export-oriented, and the industry sees its future in exporting. The larger manufacturers and laboratory service companies export more than 90 percent of their production. While the value of exports from small and medium sized science companies is equal to that for the larger ones, the small and medium sized science companies have a significant potential to increase their participation rate in exporting. The small and medium companies have benefited from Austrade's assistance recently through its *Trade Start* workshops and networking facilitation services at the international exhibition, Pittcon 2005, in the United States of America.

The science industry's principal overseas markets for its products are the United States of America, European Union and Japan. Laboratory and technical service companies export mainly to Asia, European Union and the Americas. These traditional markets and the emerging markets of China, South East Asia and South America present new opportunities for future growth.

Key Australia-China FTA negotiation issues for the Australian science industry

The Australian science industry generally views the economic development of China as a significant commercial opportunity, and is broadly supportive of the Australian Government pursuing an FTA with China.

The key trade negotiation issues for the Australian science industry regarding the Australia-China FTA are:

- **Safeguard the intellectual property of Australian companies in the science industry, particularly in the areas of scientific products; and**
- **Improve market access, particularly through the harmonisation of China's product certification and registration requirements and reducing the frequency of changes in these regulations.**

What is the Australian science industry?

The science industry is defined as:

“research and development, design, production, sale and distribution of laboratory-related goods, services and intellectual capital used for measurement, analysis and diagnosis of physical, chemical and biological phenomena.”

The industry comprises:

- Manufacturers of high value added scientific and laboratory equipment and clinical diagnostic equipment;
- Analytical laboratories and technical service companies;
- Importer/distributors; and
- Research organisations.

In Australia, this industry is outperforming most others in terms of its growth, innovation and exports.

Australia's domestic market for science industry products and services for 2002-03 was estimated to be A\$6 billion, of which imports were A\$2.8 billion and domestic sales were A\$3.2 billion. Employment was approximately 47 000. Exports of science industry products and services in the same period accounted for an estimated A\$780 million.

The industry's manufacturers invest 7.9 percent of their total annual sales in research and development, which is ten times higher than the manufacturing industry's average. Complementing this is the industry's highly educated workforce, with over 50 percent of its staff having at least a bachelor degree. By comparison, the manufacturing industry's average is 13 percent.

The industry is growing at more than 10 percent per annum, which is more than twice the national average, and it expects this pattern of growth to continue in the medium term. Its small and medium-sized enterprises, large enterprises and multinational corporations have world recognised strengths in providing instruments and services that can measure very low concentrations of substances and identify microscopic components present in minute quantities of matter. In some instances, Australian scientific products have significant global market shares.

Industry issues

The Australian science industry generally views the economic development of China as a significant commercial opportunity, and is broadly supportive of the Australian Government pursuing an FTA with China. Increased access to a large and growing market would allow Australian manufacturers of scientific equipment and diagnostic reagents to further exploit competitive strengths in established areas.

However, in addition to improving market access, particularly through the elimination of non-tariff barriers, **the FTA must safeguard the intellectual property of Australian companies in the science industry.**

Scientific equipment manufacturers

Scientific goods tend to be highly innovative and very knowledge-intensive. The high intellectual property content in Australian scientific equipment adds significant economic value. This has led to Australia being recognised as a global leader in scientific products such as spectrometers and *in vitro* diagnostic equipment.

The potential impediments to freer trade with China include the protection of intellectual property rights, and non-tariff and tariff barriers.

The protection of intellectual property rights and non-tariff barriers are significant impediments to increased trade with China in scientific equipment, and are critically important issues in trade negotiations.

Several Australian producers noted the difficulties confronted by Chinese authorities safeguarding the patents, copyright and other forms of intellectual property of overseas producers, the undue appropriation of which also appears to be facilitating China's move into areas of scientific equipment production. For example, Chinese companies have the ability to copy successful equipment designs then produce the equipment at a substantially lower cost and compete with the foreign owner of the patent. This has happened to a United States company with a Chinese subsidiary that manufactures automated pre-analytical equipment.

Regulations and standards are an important feature of the science industry's business environment. A strong regulatory framework that operates in concert with international regulations and standards is essential to preserve public trust and support trade in the industry's products and services. While the Australian science industry sees opportunities for the internal harmonisation of Australian regulations and standards with relevant international ones, it supports the maintenance of Australia's strong regulatory regime.

It is well understood that variations between countries in product certification and registration requirements are a major impediment to trade, whether they are imposed to deliberately discriminate against imports or to ensure imported goods conform to stricter standards. Conversely, regulatory approval of a particular good can be considered a major source of added value. So, once a product complies with a foreign country's certification and registration requirements it is able to compete more effectively with substitutable products. The company that manufactures the compliant product then tends to remain in that foreign country.

Some Australian producers believe the Chinese regulatory and legal environment is characterised by the same complexities, inconsistencies, and instability evident in the area of product standards.

Regarding standards, **an Australia – China FTA should ensure that minimum product standards are not employed as a means of discriminating against Australian scientific equipment exporters.** Standards should be transparent and consistent, particularly those of the Chinese provinces.

In trade negotiations, Australia has few concessions to offer China in terms of tariff levels, market access or market size. Australia's tariffs on scientific and laboratory equipment are very low, and are therefore less important as an issue. There is currently direct competition for Australian products such as platform scales and load cells, because in Australia the Chinese product is generally perceived to be of significantly lesser quality. Australian producers are therefore unlikely to be affected by additional declines in industry protection in the medium term that would most likely be embodied within an Australia – China FTA.

The range of scientific goods attracting punitive Chinese duties also appears to be relatively small and **Chinese tariffs are not a widespread concern of Australian scientific equipment manufacturers.**

In support of this view, a recent survey by the Australian Industry Group¹ found only 13.2 percent of all Australian manufacturers believed an Australia – China FTA would be beneficial to their individual firms while 45.2 percent saw little or no benefit, and 41.7 percent of respondents were unsure. However, among a relatively small group of scientific equipment producers responding to the Australian Industry Group's survey, and those contributing to this submission, support for an FTA was considerably stronger.

In contrast to much of Australian manufacturing industry, scientific equipment manufacturers presently confront little direct competition from China. China's competitive strengths are in the production of lower value-added, labour intensive goods and services.

China's low cost base also provides opportunities for Australian scientific equipment manufacturers to source components for their products. However, world-class quality management systems will be required to ensure that the Australian products maintain their global reputation.

The Australian science industry believes that the Australian Government should remain mindful of China's capacity to move quickly into the low-to-medium value-adding areas of scientific equipment manufacturing. It is likely that China will seek to develop its production of scientific equipment in the medium term to support its industrial development and improve the quality of life

¹ 'Australian Manufacturing and China: Opportunities and Challenges', Australian Industry Group, August 2004.

of its citizens. It is also reasonable to believe that China's scientific expertise will develop further as Chinese educational infrastructure is broadened and deepened.

The size of the Chinese market and the current absence of major Chinese competitors in the science industry's products provide the Australian science industry with significant opportunities to grow its exports. This will enable the Australian science industry to grow and meet its 10 year export target of more than A\$3 billion per annum by 2015.

In recognition of the cost advantages of manufacturing in China, a number of international scientific equipment producers are already well established in China, typically in partnership with local Chinese companies. This facilitates the transfer of technology to local Chinese producers. The Science Industry Action Agenda is also aware of at least one internationally-owned Australian company importing scientific instrumentation from an affiliate company in China.

There are many instances of successful Australian exporters establishing 'beachheads' in a particular market, paving the way for other Australian producers in allied industries to follow. For example, an Australian company manufacturing instruments for the measurement of grain quality, initially leveraged on Australia's position as a large net exporter of cereals to China.

Laboratory and technical services

Other growth areas identified by the Science Industry Action Agenda include industrial quality and environmental testing equipment. However, at this stage, there appears to be little Chinese demand for Australian science services. It may require much greater development of the Chinese science industry and greater penetration of Australian laboratory and technical service companies into the Chinese market before scientific services feature as a key Australian export to China.

Diagnostic reagents

In the diagnostic reagent test kits market segment, Chinese expertise and technology is improving. There are numerous such companies in China today with an increasing number that engage in exporting. This is evidenced by the 15 companies exhibiting at the main international clinical chemistry exhibition, American Association of Clinical Chemistry, in Los Angeles in 2004.

The issues already discussed regarding protection of intellectual property rights and non-tariff barriers are also valid in this market segment. Up until 2002, the end-user price for Hepatitis C (HCV) kits made in China was much less than the worldwide royalty payment, honoured everywhere except China. While there is no recent data, the science industry doubts that this situation would have changed with cost pressures.

However, for reagents with five percent import duty into Australia, imports into China face tariffs of 30 to 90 percent. There is a sizeable 'imported technology' culture in China that means Australia can effectively export diagnostic/medical/biotechnology reagents and be cost effective in at least that top end of the market. From there, joint venture opportunities would potentially arise from technology transfers to service the wider Chinese market.

Related areas that also provide opportunities in the rapidly growing Chinese market are biotechnology and medical devices.