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Grading the China-Australia Free Trade Agreement

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Abstract

This paper aims to grade the China-Australia Free Trade Agreement (ChAFTA) by placing its trade liberalisation commitments in a comparative perspective. Specifically, ChAFTA is benchmarked against Australia's other major bilateral free trade agreements (FTAs) with the US (AUSFTA), Japan (JAEPa) and Korea (KAFTA). Key findings include:

1. Prior to ChAFTA being enacted at the end of 2015, Australia's agricultural exports to China faced average tariff rates that were three times higher than to the US. Australia's FTA with the US came into force in 2005.
2. Australia also recently completed FTAs with Japan and Korea, in January 2015 and December 2014, respectively. In all three cases, Australian exporters gain significant advantages over their competitors.
3. Tariffs on Australia's agricultural exports are removed at a faster pace in ChAFTA than in JAEPa and KAFTA.
4. By 2019 the simple average tariff rate on Australia's agricultural exports to China will be lower than to the US, Japan and Korea.
5. Upon full implementation, ChAFTA contains a higher proportion of agricultural product lines that are tariff-free for Australia's exports than AUSFTA, JAEPa and KAFTA.
6. Amongst Australia's 'big four' bilateral FTAs, ChAFTA contains the lowest proportion of agricultural product lines that were excluded from offering concessions.

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Data sources used in this paper are referenced throughout. A stand-alone copy of the full data set in Excel format is available from the authors upon request.

1. Introduction

In a 12 month period between December 2014 and December 2015, Australia clinched free trade agreements (FTAs) with Korea (KAFTA, enacted December 12 2014), Japan (JAEPA, enacted January 15 2015) and China (ChAFTA, enacted December 20 2015). A decade earlier, Australia had sealed an FTA with the US (AUSFTA, enacted January 1 2005). The combination means that Australia now has FTAs with its four biggest overseas customers. As many observers have noted however, FTAs are not Free Trade Agreements, as such, but rather *Freer* Trade Agreements. In each of Australia's bilateral FTAs, some product lines have been excluded from the concessions agreed to by both countries. Commitments to reduce trade barriers such as tariffs for many product lines were also to be phased in gradually rather than eliminated overnight. Further, even upon full implementation, tariffs for some product lines will remain, albeit often at a reduced level.

This raises questions around the quality of the respective agreements. Prior to the recently completed round of FTAs, which country had the highest tariff wall against Australian exports? How quickly are tariffs reduced in ChAFTA compared with JAEPA and KAFTA? And after the commitments contained in Australia's FTAs are full implemented, how significant will residual tariffs be in China compared with other major export markets? To shed light on these questions, this research benchmarks ChAFTA against AUSFTA, JAEPA and KAFTA.

2. The starting point

Using World Trade Organization (WTO) data, Table 1 shows the tariff rates that Australian exporters faced in 2014 on the eve of the trifecta of Northeast Asian FTAs being enacted. By that time the tariff reduction measures contained in AUSFTA had already been fully implemented. The tariff rates in Table 1 are expressed in terms of a simple average and also on a trade-weighted basis, and cover agricultural and non-agricultural products. What is immediately clear is that in trade-weighted terms, tariffs on Australia's non-agricultural exports such as mining and energy output are negligible. The same, however, cannot be said for agricultural goods. Australian agricultural exports faced the lowest tariff barriers in the US. Meanwhile, tariffs in both simple average and trade-weighted terms were roughly three times higher in China. They were greater again in Japan and around nine times higher in Korea.

Table 1. Simple average and trade-weighted (in brackets) tariffs facing Australian exports in 2014

	US	China	Japan	Korea
Agricultural products	5.1 (6.8)	15.3 (18.5)	25.2 (21.7)	49.3 (49.8)
Non-agricultural products	N/A	8.7 (0.1)	2.5 (0.1)	6.6 (0.8)

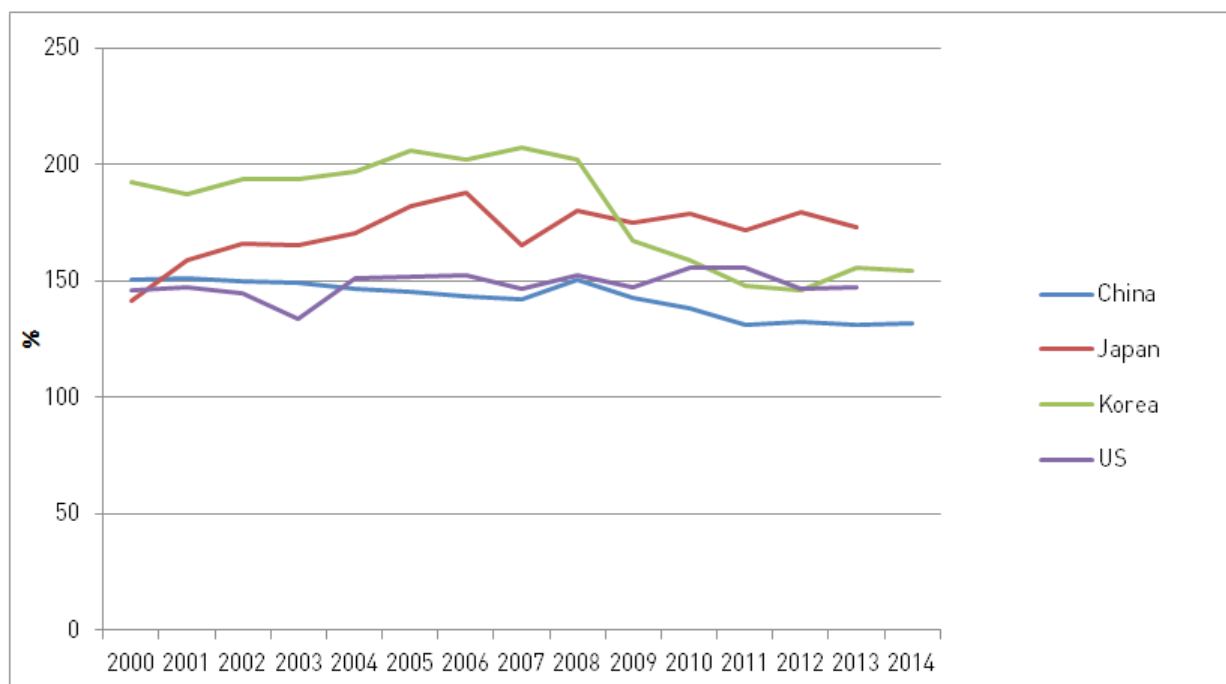
Source: World Trade Organization (2016).

Note: The data source only lists tariffs faced in the top five export destinations. The US has never been a top five destination for non-agricultural products and hence data is not available for this cell. The Korean figure for agricultural products is from 2012. It was not a top five destination in 2013 and 2014, the latter being the latest available year.

In addition to tariffs, trade in agricultural goods is also affected by a host of other barriers that take non-tariff form, such as phytosanitary conditions and quarantine regulations, as well as transportation costs that are elevated by the need to, for example, refrigerate some goods. The United Nations Economic and Social Commission for Asia and the Pacific and the World Bank maintain a database that provides estimates of 'total trade costs', which aims to capture both tariffs and these other trade costs. The database covers agricultural goods, manufactured goods and goods in aggregate. It also permits bilateral country comparisons, although it does not specify whether trade costs are chiefly associated with one country or the other. Nonetheless, if Australia is used as the reference country for all comparisons, then variations in trade costs across countries would presumably reflect differences in these foreign markets.

Figure 1 presents total trade costs associated with trade in agricultural goods between Australia and the US, China, Japan and Korea since 2000. Several observations stand out. First, when total trade costs rather than just tariffs are considered, China, not the US, emerges as the Australian partner where trade costs are lowest. In significant part this likely reflects higher transportation costs to the US rather than the US erecting higher non-tariff barriers against Australian exporters. Second, for all countries total trade costs are much greater than tariff costs. Recall from Table 1 that agricultural tariffs in Korea were the most significant at close to 50 percent. But total trade costs between Australia and all four countries start at 132 percent with respect to China and go up to 172 percent for Japan. Third, there is no clear trend in total trade costs. Since 2000 they have fallen by around 20 percentage points in the case of China but increased by 30 percentage points in the case of Japan.

Figure 1. Total trade costs between Australia and selected countries, agricultural goods



Source: United Nations Economic and Social Commission for Asia and the Pacific and World Bank (2016).

Note: The latest available data for China and Korea is 2014. For the US and Japan it is 2013.

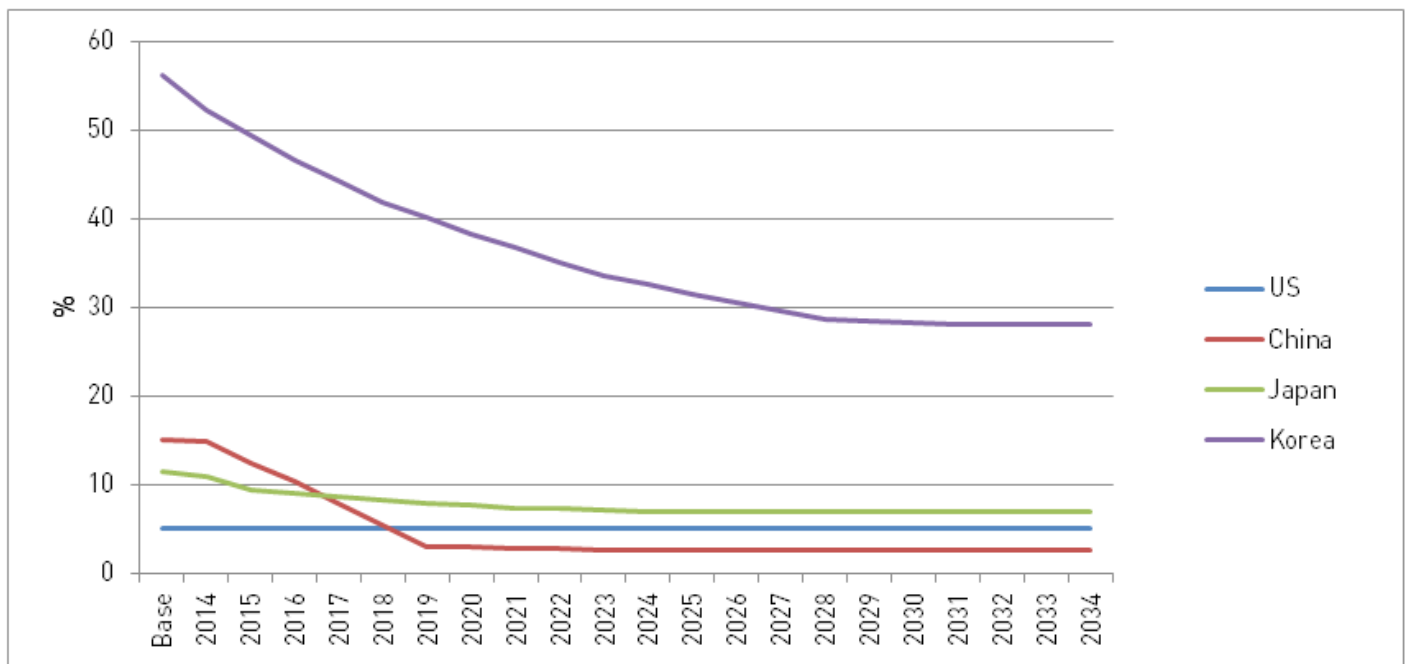
3. Trajectory and landing point

In contrast to recent multilateral trade agreements like the Trans-Pacific Partnership (TPP), Australia’s bilateral deals with the US, China, Japan and Korea are traditional in the sense that they focus on reducing tariffs and, to a lesser extent, non-tariff barriers such as quotas, while they largely leave so-called ‘beind the border’ trade barriers untouched. For this reason, in this section we seek to compare and contrast the scale and speed of tariff reductions proposed in ChAFTA, AUSFTA, JAEPA and KAFTA.

The analysis is confined to agricultural goods since this is where tariffs in each of these foreign markets are overwhelmingly applied, as shown in the previous section. The product lines comprising agricultural goods are defined by the WTO with reference to the 2012 Harmonized System nomenclature (WTO, 2016, p. 32). The base period is 2013 and the analysis stretches out to 2034, the year in which the last of the tariff commitments contained in JAEPA will be implemented.

The results are presented in Figure 2. Given that the commitments in AUSFTA had already been implemented before the base period, the simple average tariff rate facing Australia's agricultural exports to the US is taken to be its current value of 5.1 percent (Table 1). The simple average tariff rates for China, Japan and Korea are calculated based on the tariff schedules in ChAFTA, JAEPA and KAFTA. For China and Korea the estimated base values align with those presented in Table 1. In the case of Japan, however, Table 1 claims a starting average tariff of 25.2 percent, whereas the calculation in Figure 2 based on the JAEPA tariff schedule is just 11.6 percent. The reasons for the difference are not clear but suffice to say that readers should be aware that Figure 2 may understate the starting point of Japan's tariffs barriers. This possible anomaly aside, several findings are noteworthy. First, in all three Northeast Asian FTAs, Australian exporters gain significant advantages over their competitors. For example, the starting average tariff to China is around 15 percent. This will continue to be the scale of the barrier that other countries will face unless they too negotiate free trade agreements with China. Meanwhile, the average tariff facing Australian exporters to China falls to just three percent by 2019. Second, tariff reductions in ChAFTA are phased in rapidly compared with JAEPA and KAFTA. Further, while Figure 2 shows that tariffs applied by the US have historically been lower than those applied by China, this will no longer be the case from 2019. By 2023 Australian agricultural exports to China will face average tariff rates just half the level to the US. Third, Korea has committed to the largest tariff reductions over the implementation period, around 28 percentage points. But this needs to be balanced by a significant proportion of these reductions coming later in the deal and also by the fact that tariffs in Korea started the transition at a much higher level. Tariffs will remain much higher in Korea than elsewhere even after all KAFTA commitments have been implemented.

Figure 2. Simple average tariff rates faced by Australian agriculture exports



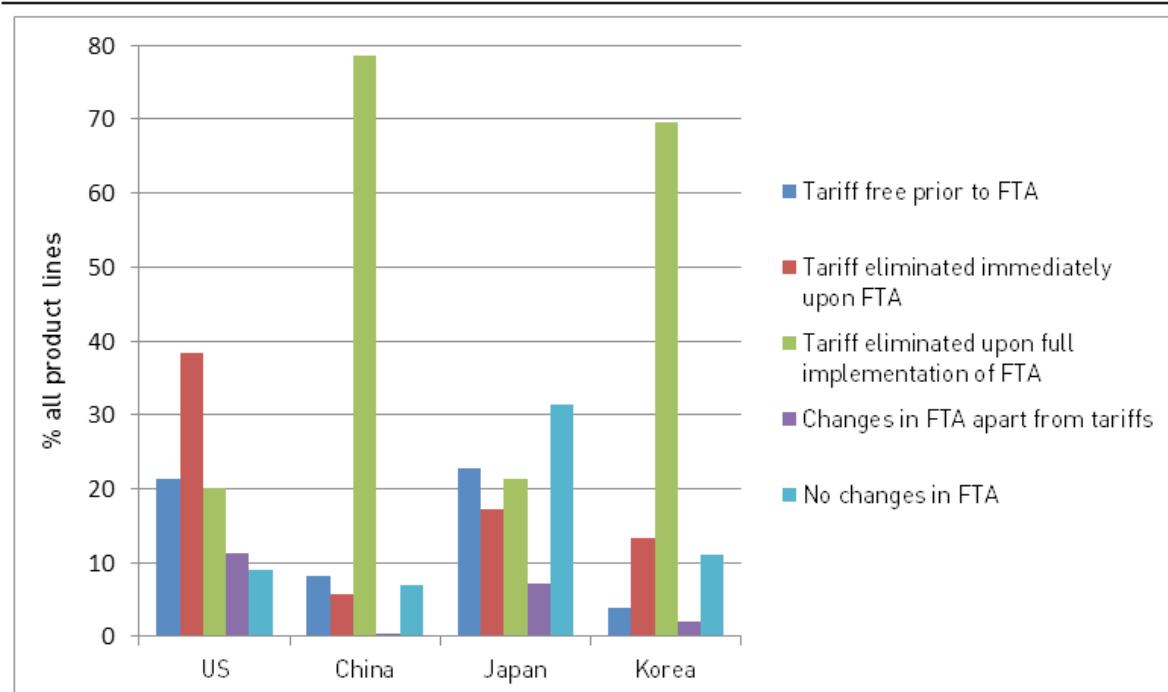
Source: US - see Table 1; China - Department of Foreign Affairs and Trade (2016a); Japan - Department of Foreign Affairs and Trade (2016b); Korea - Department of Foreign Affairs and Trade (2016c).

Aside from average tariff rates, another way to compare the various agreements is in terms of the number of product lines that are affected by commitments contained in FTAs. Commitments can be categorised according to how significant the changes are. In this paper we assign five classifications:

1. Product lines already tariff-free prior to the enactment of an FTA;
2. Product lines for which tariffs are eliminated immediately upon an FTA entering into force;
3. Product lines for which tariffs are eliminated upon full FTA implementation;
4. Product lines for which an FTA contains liberalisation of non-tariff form, such as the inclusion and / or expansion of a country-specific quota; and
5. Product lines excluded from commitments in an FTA.

Figure 3 shows the proportion of total agricultural product lines affected by these different categories of FTA commitments. The key findings are as follows. First, China and Korea had the lowest proportion of product lines that were already tariff-free prior to FTAs being enacted, at eight and four percent, respectively. This compares with 21 percent and 23 percent in the US and Japan, respectively. Second, China and Korea also lagged behind the US and Japan in terms of the number of product lines that were made tariff-free immediately after FTAs came into force. For example, the day after JAEPA was enacted, another 16 percent of product lines were made tariff-free. This compares with 5.4 percent and 13 percent in ChAFTA and KAFTA, respectively. Third, following full implementation, the number of tariff-free Chinese product lines rises dramatically. The proportion of Chinese product lines made tariff-free during the implementation phase is 79 percent. This will take the total proportion of tariff-free Chinese product lines to 92.3 percent. This compares with 87 percent for KAFTA, 80 percent for AUSFTA and 60 percent for JAEPA. Finally, China also records the lowest proportion of product lines excluded from FTA commitments. Only seven percent of product lines fall into this category under ChAFTA, compared with nine percent, 28.3 percent and 11 percent in AUSFTA, JAEPA and KAFTA, respectively.

Figure 3. Proportion of agricultural product lines affected by FTA



Source: See figure 2.

4. Conclusion

No bilateral trade deal is perfect but some are better than others. Australia's FTAs are largely traditional agreements that aim to reduce or eliminate tariffs and quotas on traded goods, particularly agricultural goods. This facilitates a comparison of the quality of FTAs according to how extensively and how quickly these trade barriers are removed. The analysis in this paper reveals that upon full implementation, ChAFTA will produce superior outcomes for Australian agricultural exports relative to JAEPA and KAFTA. Further, ChAFTA will also outperform AUSFTA on several metrics, such as the average tariff rate levied on Australian agricultural exports, as well as the proportion of agricultural product lines that were left out of FTA commitments.

Despite ChAFTA's strengths, there remain numerous obstacles to increased trade between Australia and China. In the 2016 Australian International Business Survey (Export Council of Australia, 2016) 78 percent of Australian companies with exposure to the Chinese market said that it was more difficult to do business in China than Australia, compared with only 10 percent who said it was easier. This cannot simply be attributed to differences in language and culture: only 49 percent of Australian companies said that Japan was more difficult to do business in. Barriers that exist behind the border have proven particularly challenging for Australian agricultural exporters to China (Zonca, 2016). Drysdale and Zhang (2016) argue that a common-sense approach would be to use ChAFTA as a platform for embarking on a more ambitious program of deepening economic engagement between the two countries. Specific opportunities include upgrading the bilateral investment treaty that Australia and China signed in 1988, as well as establishing working groups to home in on the behind-the-border trade barriers that prevent the gains from trade being maximised across sectors.

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About ACRI

For the first time in its history, Australia's most important economic relationship is with a nation very different in governance, politics and values. In the past, Australia's dominating economic relationships have been with the British Empire, the United States and Japan.

Today our most important economic partner is China.

China contributes now more to world economic growth than any other country. China absorbs 34 percent of Australian goods exports. By 2030, 70 percent of the Chinese population is likely to enjoy middle class status: that's 850 million more middle class Chinese than today.

In 2014 the University of Technology Sydney established the Australia-China Relations Institute (ACRI) as a think tank to illuminate the Australia-China relationship.

Chinese studies centres exist in other universities. ACRI, however, is the first think tank devoted to the study of the relationship of these two countries.

The Prime Minister who opened diplomatic relations with China, Gough Whitlam, wrote in 1973: 'We seek a relationship with China based on friendship, cooperation and mutual trust, comparable with that which we have, or seek, with other major powers.' This spirit was captured by the 2014 commitments by both countries to a Comprehensive Strategic Partnership and the 2015 signing of a Free Trade Agreement.

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