



The China-Australia Free Trade Agreement: Implications for Canada

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Preface: Canada-China Relations and the Prospects for a Free Trade Agreement

This study was finalized in the autumn of 2018, during a period of notable public debate in Canada on the concept of a free trade agreement (FTA) with China. No date had been announced for the start of formal negotiations, and some observers had strong concerns over the non-market economy chapter of the newly concluded United States-Mexico-Canada agreement, which appeared to limit Canada's ability to conclude an FTA with China. The Public Policy Forum published its study of Canada-China relations, including a proposal for sectoral trade negotiations, which led to confused messaging from the Canadian government: some ministers endorsed the idea as a basis for Canada's approach to strengthening trade ties with China, only to be overruled by Prime Minister Trudeau, who reaffirmed Canada's desire for a comprehensive agreement.

Since then, China-Canada relations have gone into a steep decline, with the detention of Huawei Chief Financial Officer Meng Wanzhou, who is the subject of an extradition request from the United States, and China's detention, in response, of Canadians Michael Kovrig and Michael Spavor. Bilateral tension has further increased with China's very public decision to re-try, on more serious charges, a Canadian accused of drug smuggling, who could face a death sentence if found guilty.

In such a bilateral climate, all talk of a free trade agreement with China has been pushed to the back burner and will not re-emerge until after the next election. A Liberal victory would bring the issue back to the table (the Conservatives have made their opposition clear), but would still require more stability in bilateral ties.

This is probably a good approach. As this study points out, free trade with China should be approached carefully. Alternatives to a standard, comprehensive agreement should be considered, especially given the significant gaps in the rule of law in China that China has demonstrated in its response to the Huawei case.

But whether these discussions happen this year or next the questions this study poses, and the conclusions it reaches, will still be relevant. The government will have to address the issue of its trade relationship with China, and how best to advance Canada's interests in a complex and challenging market.

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Executive Summary

- Australia's experience with the China-Australia Free Trade Agreement (ChAFTA) is a useful point of reference as Canada considers its trade agreement options with China. This experience suggests that negotiating a Canada-China free trade agreement (FTA) would likely be complex and protracted. Maintaining momentum would require sustained political non-partisan support and leadership from the top, as well as sustained stability in bilateral relations. Such stability would need to transcend changes in government and would require successful navigation of sensitive issues like human rights and national security, as well as strategic use of negotiating leverage.
- ChAFTA is a significant achievement that expands market access for Australian companies and has the potential to enhance Australia's competitive edge in China. But it also has its shortcomings. While ChAFTA's tariff reductions benefit a number of sectors, the agreement does not yet seem to have had a strong impact on Australia's goods exports. Australia's gains in in market access for services are more limited, with some commitments weighted in China's favour, and a number of gains made less relevant by China's reforms right after ChAFTA was signed
- ChAFTA does not really add or deepen disciplines on regulatory or systemic issues that frequently serve as barriers to business in China, nor does it substantively promote further transparency and predictability. In an FTA with China, Canada should ensure that it more actively and thoroughly addresses systemic issues and key 21st century issues like intellectual property and competition policy. Canada should be negotiating for the future, with an eye to nascent technologies and issues and their impact on bilateral and international trade.

Sommaire exécutif

- L'expérience de l'Australie quant à l'Accord de libre-échange entre la Chine et l'Australie (ChAFTA) est un point de référence utile alors que le Canada examine ses options d'accord commercial avec la Chine. Cette expérience suggère que la négociation d'un accord de libre-échange (ALE) entre le Canada et la Chine serait probablement complexe et longue. Une telle négociation nécessiterait un soutien politique non partisan et soutenu, ainsi qu'une stabilité durable des relations bilatérales. Une telle stabilité devrait aller au-delà des changements de gouvernement et nécessiterait une navigation réussie sur des questions sensibles telles que les droits de la personne et la sécurité nationale, ainsi qu'une utilisation stratégique du pouvoir de négociation
- Le ChAFTA est une réalisation importante qui élargit l'accès au marché des sociétés australiennes et qui pourrait renforcer l'avantage concurrentiel de l'Australie en Chine. Mais il a aussi ses défauts. Bien que les réductions tarifaires du ChAFTA profitent à un certain nombres de secteurs, l'accord ne semble pas encore avoir eu un impact important sur les exportations de marchandises de l'Australie. Les gains de l'Australie en matière d'accès aux marchés pour les services sont plus limités, certains engagements étant pondérés en faveur de la Chine, et certains gains rendus moins pertinents par les réformes entreprises par la Chine juste après la signature de l'Accord.
- Le ChAFTA n'ajoute pas et n'approfondit pas vraiment les questions réglementaires ou systémiques qui entravent souvent les affaires en Chine, et ne favorise pas davantage la transparence et la prévisibilité. Dans un accord de libre-échange avec la Chine, le Canada devrait s'assurer qu'il s'attaque de manière plus active et plus approfondie aux problèmes systémiques et aux problèmes clés du XXIe siècle, tels que la propriété intellectuelle et la politique de la concurrence. Le Canada devrait négocier pour l'avenir, en tenant compte des technologies et des problèmes naissants et de leur impact sur le commerce bilatéral et international.

- ChAFTA's labour mobility provisions, which facilitate temporary movement of skilled Chinese workers into Australia, have been very controversial, particularly at the time of ratification of the agreement. In practice the impact has been more limited. But similar provisions would likely be on the table in Canada-China negotiations and will need to be addressed seriously, particularly with respect to the protection of workers and the enforcement of Canadian labour standards.
- Based on the ChAFTA experience, it is likely that the treatment of state-owned enterprises will be one of China's priorities in FTA negotiations. Canada should be prepared to address the issue pragmatically, taking a fact-based approach, balancing potential benefits of SOE investment with national security priorities.
- Australia has invested a great deal in post-ChAFTA outreach, making businesses more aware of ChAFTA's provisions and providing information on navigating the China market. Increased knowledge and understanding of China by Canadian governments, companies and institutions is important for long-term success in China, and especially to enable Canadians to take full advantage any

expanded market access provided by a trade agreement. Raising competence should start before any trade talks are launched and well before the conclusion of any agreement.

- Given the challenges demonstrated by Australia's ChAFTA experience, a standard agreement with China may not be the most effective approach. In order to navigate the challenges of the US-Mexico-Canada Agreement (USMCA) and respect WTO commitments, Canada should consider establishing a broad umbrella agreement with China, overseeing an ongoing process to enhance trade ties, strengthen engagement on systemic and regulatory issues, and seek areas of mutual cooperation on global issues.

- Les dispositions du ChAFTA relatives à la mobilité de la main-d'œuvre, qui facilitent l'arrivée temporaire de travailleurs chinois qualifiés en Australie, ont été très controversées, en particulier au moment de la ratification de l'Accord. En pratique, l'impact a été plus limité. Toutefois, des dispositions similaires seraient probablement à l'ordre du jour dans les négociations Canada-Chine et devront être examinées sérieusement, en particulier en ce qui concerne la protection des travailleurs et l'application des normes du travail canadiennes.
- Sur la base de l'expérience acquise dans le cadre du ChAFTA, il est probable que le traitement des entreprises d'État sera l'une des priorités de la Chine dans les négociations avec le Canada. Ce dernier devrait donc être prêt à aborder le problème de manière pragmatique, en adoptant une approche factuelle, en équilibrant les avantages potentiels des investissements dans les entreprises d'État avec les priorités en matière de sécurité nationale.
- L'Australie a beaucoup investi dans la sensibilisation après l'entrée en vigueur de l'Accord, informant les entreprises des dispositions de cet accord et fournissant des informations sur comment naviguer le marché chinois. Une connaissance et une

compréhension accrues de la Chine par les gouvernements, les entreprises et les institutions du Canada sont importantes pour avoir du succès à long terme en Chine, et en particulier pour permettre aux Canadiens de tirer pleinement parti de tous ces accès élargis aux marchés fourni par un accord commercial. Le renforcement des compétences devrait commencer avant le début des négociations commerciales et bien avant la conclusion de tout accord.

- Compte tenu des difficultés démontrées par l'expérience australienne, un accord standard, vaste et complexe avec la Chine n'est peut-être pas la solution la plus efficace. Afin de relever les défis de l'Accord États-Unis-Mexique-Canada (USMCA) et de respecter les engagements pris dans le cadre de l'OMC, le Canada devrait envisager d'établir un accord global avec la Chine, supervisant un processus continu visant à renforcer les liens commerciaux, renforcer l'engagement concernant les questions systémiques et réglementaires et rechercher des domaines de coopération mutuelle sur des questions mondiales.

I. Context

- The China-Australia Free Trade Agreement (ChAFTA), signed in 2015, is the first FTA between China and a major western economy. It is a significant achievement that expands market access for Australian companies and has the potential to enhance Australia's competitive edge in China. But it also has its shortcomings. Australia's experience with the ChAFTA is a useful point of reference as Canada considers its trade agreement options with China

A Canada-China free trade agreement (FTA) has been a key element in the Trudeau government's China policy. The idea was discussed during the back-to-back exchange of visits between Prime Minister Justin Trudeau and Chinese Premier Li Keqiang in September and October 2016. Formal negotiations were expected to be launched in December 2017, during Trudeau's second visit, but the launch did not take place, reportedly because China disagreed with including sensitive issues like labour rights—part of the Government of Canada's "progressive trade agenda".¹

A free trade agreement with China would be a complicated and politically sensitive undertaking. The draft US-Mexico-Canada Agreement (USMCA), negotiations for which concluded in October 2018, further complicates the issue with its potential restrictions on negotiating an FTA with China.² This does not appear to have dimmed Canada's interest, though, as both Trudeau and Trade Diversification Minister Jim Carr have rejected any claims that Article 32.10 limits Canada's trade options with its second largest trading partner.³ Contradictory (and confusing) signals that Canada may be exploring the possibility of sector-by-sector negotiations with China, as opposed to a broad, comprehensive deal, have been disavowed.⁴

An FTA with China is not a new idea. It was explored briefly and faded away during the Conservative government of Stephen Harper, but not before Canada and China produced an economic complementarities study that was seen as setting the stage for possible FTA discussions.⁵

Despite political sensitivities in Canada, support for free trade with China has been growing. According to a study by the University of British Columbia in 2017, 69 percent of Canadians supported free trade with China but remained uneasy about Chinese foreign direct investment into Canada.⁶ The figures in the Asia Pacific Foundation of Canada's annual surveys of Canadian attitudes toward China are lower than those of the UBC study, but still show growing acceptance of free trade with China. According to its 2018 survey, 59 percent now support Canada-China FTA, despite continued misgivings over Chinese investment in Canada, and concerns about human rights.⁷

However, such support may be less solid than it appears. Increased support for free trade with China may in part have arisen out of growing difficulties with the US market, and a recognition that Canada needs to diversify its international trade to secure a more stable future. China's response to the detention of Huawei Chief Financial Officer Meng Wanzhou, and in particular the arrest of Canadians Michael Kovrig appear to be hardening attitudes in Canada. These actions have also drawn attention to widely-shared concerns about the rule of law in China, which is an important consideration in evaluating prospects for an FTA. These circumstances have made launching FTA talks less likely in the near future.

1 Alex He, Hongying Wang and Susan Ariel Aaronson, "[Obstacles Ahead for Canada-China Trade](#) (Centre for International Governance Innovation, December 6 2017). See also Hugh Stephens, [57](#) (University of Calgary School of Public Policy and Canadian Global Affairs Institute Joint Paper, October 2018) for a good discussion of Canada's "progressive trade agenda" and implications for an FTA with China.

2 Article 32.10 of the USMCA requires each party to give three months' notice before launching free trade negotiations with a "non-market economy", and to provide a full text of the agreement 30 days before signature. It also provides for the other two parties to terminate the USMCA and replace it with a bilateral agreement. See [United States-Mexico-Canada Trade Agreement](#) draft text, Articles 32.1, 32.3 and 32.4

3 "[Trudeau affirms China trade aspirations after some say USMCA implodes any deal](#)" CTV News, Oct 2 2018.

4 Nathan Vanderklippe, [Ottawa shifts gears, now seeks smaller sectoral trade deals with China](#), *Globe and Mail* November 9 2018; [Ottawa says it's still pursuing broad trade deal with China](#), *Globe and Mail*, November 13 2018

5 Government of Canada, Global Affairs Canada, *Canada-China Economic Complementarities Study*, August 15 2012.

6 Paul Evans and Xiaojun Li, *Canadian Public Attitudes on China and Canada-China Relations*, University of British Columbia, School of Public Policy and Global Affairs, October 17 2017), pp. 2-3

7 Asia Pacific Foundation of Canada, [National Opinion Poll 2018: Canadian Views on Asia](#). June 2018, p. 26

In the longer term, though, China remains Canada's second largest trading partner, and the government of Canada remains committed to deepening bilateral trade ties. In this context the issue of a free trade agreement is likely to return, and this option warrants serious discussion.

In this context, it is useful to look at Australia's experience with the China-Australia Free Trade Agreement (ChAFTA), which was signed in June 2015 after ten years of negotiations. ChAFTA has been praised for breaking new ground as the first agreement between China and a major western economy. Andrew Robb, Australia's Trade and Investment Minister when ChAFTA was signed, called the agreement "the most liberalising trade deal that China ... has done with any other developed country," and "the best FTA Australia has done with any country."⁸ Many business groups and industry organizations echo this praise. The Australian Minerals Council, for example, has called ChAFTA "the best available option for advancing Australia's broader commercial interests with our largest trading partner."⁹ Others support ChAFTA as a vehicle for deeper integration of the Australian and Chinese economies and broadening the economic and political relationship.¹⁰ For its part, the government of China describes ChAFTA as representing China's "highest level of overall trade and investment liberalization."¹¹ Chinese academics assert that ChAFTA is a more ambitious undertaking for China than, for example, the China-ASEAN FTA.¹²

ChAFTA is a significant accomplishment. In terms of scope, it is arguably the most ambitious bilateral FTA China has signed, addressing issues like intellectual property and e-commerce, and with expanded commitments in the services sectors. That said, these commitments are still not extensive or deep, and are not as ambitious as agreements like the Canada-EU Trade Agreement (CETA) or the Trans-Pacific Partnership.¹³

At the same time, the agreement has been criticized for being unbalanced in China's favour, for being less ambitious than Australia's FTAs with Japan and Korea, signed around the same time, and especially for its controversial labour mobility elements, which have loosened the visa requirements to bring skilled Chinese workers to Australia. The Australian Fair Trade and Investment Network (AFTINET) calls ChAFTA "an incomplete and poorly negotiated agreement", lacking in balance, and one that will deliver few tangible economic benefits to Australians.¹⁴ Australia's Construction, Forestry, Maritime, Mining and Energy Union (CFMEU), particularly troubled by the labour elements of ChAFTA, has called it "the worst trade agreement that an Australian government has ever signed and attempted to impose on the Australian public".¹⁵

Free trade agreements are as much political as commercial initiatives, and are inherently and unavoidably controversial, especially in an open and democratic society. Australia's experience with its free trade agreement with China can serve as a valuable reference point for Canada's own policy decisions. The two countries share a number of similarities. They are both advanced, but not dominant, western economies committed to the liberal international rules-based system. Natural resources play an important part in their trade with China, and they are generally like-minded on most international issues.

There are differences as well. Canada's economic structure is much more diverse than Australia's, with a larger manufacturing sector that includes production of transportation, telecommunications and environmental goods and services. In terms of goods, China is Canada's second largest trading partner, but still accounts for only 4.3 percent of Canadian exports and 12 percent of Canada's imports, compared with 75.8 and 51.3 percent for the United States.¹⁶ Although Canada is seeking to diversify its international trade away from the United States and into European and Asian markets, the realities of geography and personal connections mean that the US is unlikely to lose its prominence as an economic partner for Canada in the coming decades. On the other hand, China was

8 Government of Australia, Minister for Trade and Investment, "[Legislation for historic trade deal with China introduced into Parliament](#)" Media release, September 16 2015

9 *China, Minerals and Energy and the China-Australia Free Trade Agreement (ChAFTA)*, Minerals Council of Australia policy paper, June 2015, p. 5

10 Peter Drysdale, "[Australia and China after their FTA](#)"; *East Asia Forum*, November 18 2014

11 "[China, Australia sign landmark free trade agreement](#)", China.org, June 18 2015

12 Prof. Li Chunding and Prof. Zhang Lin, Chinese Academy of Social Sciences, Interview, March 1 2018

13 Heng Wang, "An Analytical Introduction to ChAFTA: Features and Challenges", in Colin B. Picker, Heng Wang, and Zhou Weihuan, eds., *The China-Australia Free Trade Agreement: A 21st-Century Model*. (Oxford and Portland, Oregon, Hart Publishing, 2018) pp. 19-20

14 Australia Fair Trade and Investment Network (AFTINET), [Submission to the Joint Standing Committee on Treaties Enquiry into China Australia Free Trade Agreement](#) July 2015, pp. 3-5

15 [The Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China \(ChAFTA\)](#), CFMEU Submission to Joint Standing Committee on Treaties, August 2015, p.4

16 Global Affairs Canada, [Annual Merchandise Trade 2018](#)

a much more significant trading partner with Australia when negotiations started in 2005, and is now Australia's top export market and trading partner. From a trade perspective, China, while offering great opportunities, is less important to Canada than it is to Australia.

ChAFTA has significant implications for Canada. From a competitiveness perspective, it has given Australia an extra advantage in exports of products like copper, coal, seafood and wine. From the perspective of trade negotiations, Australia's experience offers Canadian policy makers an opportunity to reflect on how best to approach free trade with China, should Canada decide to launch negotiations with this large, complicated, and challenging trading partner.

II Negotiating ChAFTA

- The ten years it took to negotiate ChAFTA reflect the complexity and challenges of broad-based FTA negotiations, as well as their potential vulnerability—especially in the case of China—to shifts in bilateral relations.
- For Canada, extensive and protracted negotiations with China would require the capacity to sustain stability in bilateral relations, despite potential changes in government, and especially in light of sensitive issues like human rights.
- Canada-China FTA talks would take place in circumstances very different from those when ChAFTA was launched—a stronger, more economically nationalistic China, a growing global protectionism, and ongoing China-US trade tensions. Launching free trade negotiations with China could also have an impact on Canada-US trade and security relations, so this would have to be carefully managed.
- Successful navigation of Canada’s negotiations with China would require careful management of bilateral relations (especially on sensitive issues like human rights and national security), strategic use of negotiating leverage, and sustained political support and leadership from the top.

ChAFTA negotiations were launched by Prime Minister John Howard and Premier Wen Jiabao in 2005 and continued through the Labor governments of Kevin Rudd and Julia Gillard (and Keven Rudd again) before being finalized during Tony Abbott’s Coalition government. The agreement was signed in 2015 by Andrew Robb, Trade Minister under Abbott.

Australia’s interest in a free trade agreement with China grew out of a strategy in the early 2000s to better position itself in the Asia-Pacific region. The main objectives when negotiations started were expanding commercial relations with China and securing preferential market access in the agriculture and services sectors before other major western economies.¹⁷ It was also a way of strengthening political ties with China, although Prime Minister John Howard was also careful to stress that the progress of the negotiations themselves should not be seen as an indicator of the health of the bilateral relationship, stressing that “whatever happens on the free trade agreement front, Australia has a huge and positive and growing trade relationship with China.”¹⁸

Starting negotiations with China further expanded and balanced Australia’s approach to trade agreements, following its FTA with the United States, which came into effect January 1, 2005. A 2005 Senate report on the possibility of free trade with China, while recommending the launch of FTA negotiations, noted the “upward trajectory” of trade relations with China, which at the time stood as Australia’s third largest trading partner after Japan and the United States. The report also noted the “complementary” nature of the two economies—a perspective also promoted by the Chinese ambassador to Australia, Fu Ying.¹⁹ China’s economic transformation was seen as offering great potential for increased sales of Australian goods and services, and for small and medium-sized enterprises finding in niche markets in China.²⁰

China was also recognized as a difficult market with its own inherent challenges. In addition to tariff reductions and market access, the Senate report recommended that Australia address systemic issues in China: local-level industrial subsidies, lack of transparency in taxation, and China’s implementation of its WTO obligations on intellectual property rights and sanitary and phytosanitary measures.²¹ There were also concerns that a trade relationship overly dependent on resources would undermine Australian manufacturing,²² while other organizations flagged issues of human rights practices in China, and the potential for China to use an FTA to pressure Australia

17 [The Australia China Story: Free Trade Agreement](#) (Canberra: Australian National University, Australian Centre on China in the World, p. 1

18 Michelle Grattan and Marie-Anne Toy, “Rudd Confronts China on Human Rights”, *The Age*, April 10 2008

19 Government of Australia, Senate, [Opportunities and Challenges: Australia’s Relationship with China](#), Foreign Affairs, Defence and Trade References. September 2005, pp. 34, 35-37

20 *Opportunities and Challenges*, p. 39

21 *Opportunities and Challenges* p. xxv

22 *Opportunities and Challenges*, p. 40

to do less business with Taiwan.²³ While favourably inclined to negotiate a China FTA, Howard was aware of the challenges—including domestically—of doing this. Publicly he indicated that he expected negotiations to be difficult and would not speculate on how long they would take.²⁴

China's approach to ChAFTA reflected both bilateral commercial objectives and other, broader strategic interests. Securing access to natural resources was a key consideration. China saw the relationship mainly as one in which Australia would supply minerals, energy and some food products, as well as investment capital, while China would supply manufactured goods and possibly labour. Australia's natural resource endowment, though, one analyst observed, outweighed "China's advantages in labour endowment"²⁵, and was seen by the Australian side as providing strategic leverage in FTA negotiations.²⁶ China was also interested in market access for its manufactured products, and in sending skilled Chinese workers to Australia to work on China-invested projects. As Australia was a small market with a low average level of tariffs and fewer systemic barriers, Chinese analysts believed that Australia would gain more direct economic benefits than China from an FTA.²⁷

Launching free trade talks with Australia was also consistent with China's policy of establishing FTAs with countries in each region of the world. This was part of a strategy not only to secure better access to natural resources and markets for Chinese products, but also to boost China's political influence and economic leverage. Gaining more support for issues like China's market economy status, and (according to some) guarding against Taiwan's ambitions to expand its relations with China's trading partners (including diplomatic recognition) also entered into the calculus.²⁸ China also had developed an interest in regional trade agreements, partly out of frustration with the slow pace of negotiations to join the WTO and the global emergence of regional trade agreements like NAFTA and the ASEAN Free Trade Area (AFTA).²⁹ This led to the establishment of the China-ASEAN Free Trade Agreement in 2002, which focused primarily on tariff reductions within the region. In addition to an opportunity for further diversification of international trade, China also saw in Australia something of a test case for China for FTAs with larger players like the US or the EU, a concept that Australian officials emphasized in bilateral discussions.³⁰

China also had defensive interests in entering into FTA talks. Negotiations started just four years after China's accession to the WTO, which had resulted in substantial tariff cuts on China's part. These cuts had put the Ministry of Commerce at odds with agencies like the Ministry of Agriculture and China's key economic agency, the National Development and Reform Commission. Further tariff cuts in agriculture sectors would be a tough sell. Although economic modelling by Chinese academics had indicated that the outcome of an FTA would be slightly positive for China but more beneficial for Australia, there were concerns about its potential impact on food security and on the dairy, wool and textiles sectors.³¹ Protection of the sugar industry was also a priority, and although China was moving away from its policy of grain self-sufficiency, it still aimed at maintaining existing tariff levels for wheat. As for newer and (at the time) emerging issues like e-commerce and competition policy, let alone environment and labour standards, China was not willing to consider any serious commitments.³²

23 Tony English, Curt Andressen and Geoff Upton, [An Australia-China Free Trade Agreement: Managing an Elephant](#) (Flinders University School of Commerce, Research Paper Series 05-10, 2005), pp. 9, 15-16, 24-25

24 Grattan and MacDonald (April 19 2005)

25 Cheng Da Wei, "A Chinese Perspective on the China-Australia Free Trade Agreement and Policy Suggestions" (*Economic Papers*, Vol. 27, No. 1, March 2008) p. 35

26 Jeffrey D. Wilson, "The Challenges of Australia's Resource Power Moment", in Beeson, Mark, and Hameiri, Shahar, (eds.) *Navigating the New International Disorder: Australia in World Affairs 2011-2015* (Oxford University Press, 2017) p. 169

27 Cheng (2008), p. 38

28 Henry Shuchao Gao, "China's Strategy for Free Trade Agreements: Political Battle in the Name of Trade" *Asian Regional Workshop on Free Trade Agreements: Towards Inclusive Trade Policies in Post-crisis Asia* (December 8-9 2009, Bangkok), pp. 10-14

29 Gao (2009), p. 2

30 Prof. Li Chunding and Prof. Zhang Lin, Chinese Academy of Social Sciences, Interview March 1 2018; Interviews, with Australian officials, February 22 2018; Cheng (2008), pp. 38, 40

31 Chaoying Qi and James Xiaohu Zhang, "The Economic Impacts of the China-Australia Free Trade Agreement—a General Equilibrium Analysis." *China Economic Review*, 47 (2018), p. 3; Li and Zhang Interview, March 1 2018

32 Gao (2009), p. 7

China did enter ChAFTA negotiations with a tactical advantage in that Australia had granted China Market Economy Status (MES)—a key Chinese goal in other FTA talks—as part of the process that launched the negotiations.³³ MES refers to the method used in determining the pricing of products in the home market of a country when it is the target of an anti-dumping action. Because China's economy, particularly in a number of key sectors like the steel industry, was considered not to have made a full transition to market mechanisms, the practice in anti-dumping cases was to use another economy to determine the appropriate level of export prices. Without this third-party, market-based reference point, determining the negative impact of subsidies on the industries of trading partners would be difficult. The results could understate the harm caused to these industries and thus limit the ability of the country to respond adequately by increasing duties. In the case of China, the economy used most frequently for this reference point was Taiwan.

MES was thus a sensitive issue for China. It had been a subject of ongoing debate during China's WTO accession negotiations, both among trading partners and within the Chinese government. It was a technical issue, but it had strong political overtones: leaders had little patience for technical explanations of anti-dumping procedures, and argued that by not granting MES, other countries were negating China's core policy of reform and opening up. China had demanded MES as part of its accession to the World Trade Organization, when it would become subject to the WTO Anti-Dumping Agreement. Instead the WTO set a target date of 2016 for China to bring its industrial policies in all sectors into line with market forces, at which time WTO members would treat China as a market economy. However, a number of members, including Canada, do not consider China to have made the necessary changes to its industrial policy to warrant MES status, and have not yet agreed to granting it to China.³⁴

Australia's decision to grant MES was purely political, and was buttressed by arguments that the trade and economic gains of an FTA would outweigh the potential losses from any anti-dumping cases Australia might pursue with China. Furthermore, it was argued, granting MES would not affect Australia's ability to protect industry from dumping or to arrive at appropriate calculations of injury.³⁵ Giving up this important negotiating leverage, however, no doubt contributed to the slow pace of negotiations.

There were other reasons. Negotiating such a complex agreement between two large economies is inevitably challenging and time-consuming. Australian officials and the Australia China Business Council point to the large number of navigate: Australia's demands for lower sugar tariffs, for example, and China's demands to relax its policy of reviewing all investments by state-owned enterprises (SOEs). Human resource constraints also may have played into it. In the early years of the negotiation especially, China's Ministry of Commerce, the lead negotiating ministry, was also understaffed on the trade front and coping with burgeoning demands arising from its new WTO membership.

Tensions between China and Australia during the early years of the Kevin Rudd government, which succeeded the Howard government in 2007, also had an impact. Rudd's public criticisms over human rights in China, especially in a public lecture at Beijing University during his first official visit, drew a sharp response from China. Other issues added to bilateral tensions. These included Australia's release of a Defence White Paper labelling Chinese military modernization as a cause for concern, the granting of a visa to Uighur World Congress President Rebiya Kadeer (a supporter of rights for China's Uighur minority), and China's arrest of Australian Rio Tinto executive Stern Hu on bribery and corruption charges (which some argue was in response to Rio Tinto backing out of a business deal with a Chinese state-owned corporation).³⁶

The Labor government also faced domestic pressure from manufacturers and unions concerned about competition from imports of Chinese goods and labour. Pessimism about reaching a full agreement reached such a point that in 2013 the Gillard government proposed a limited trade deal, focused on agriculture, but this approach was reversed by Kevin Rudd when he returned as prime minister.³⁷

33 Michelle Grattan and Hamish MacDonald, "[China, Howard drink to trade talk pact](#)", *theage.com.au*, April 19 2005. Hu Xiao, "[Agreements Pave Way for China-Australia FTA](#)", *China Daily* April 19 2005.

34 Puccio, Laura, [Granting Market Economy Status to China--an analysis of WTO Law and selected WTO Members' policy](#). (European Parliamentary Research Service, November 2015), pp. 2-3

35 See Andrew Stoler, "[What it Would Mean for Australia to Treat China as a Market Economy: Impact of Removing China from EIT Status for Antidumping Purposes](#)", Institute for International Business, Economics and Law, n.d.; Puccio (2015) pp. 1, 10

36 "[Kevin Rudd and Australia-China Relations](#)" The Australia-China Story Archive, Australian National University, Australian Centre on China and the World, n.d.; Grattan and Toy, "[Rudd Confronts China on Human Rights](#)"; Hu was released from prison in July 2018

37 Roman Callick and Damon Kitney, "[China trade deal scaled back as Beijing seeks \\$1bn investment approval threshold](#)", *The Australian*

The Abbott government brought a stronger economic emphasis to the relationship, which set the stage for the negotiations to accelerate. The government was impatient with the pace of talks and wanted to see concrete results, which meant finalizing the market access discussions so that Australian industry could start to reap some of its benefits. Shortly after Abbot's government took power in 2013, Trade Minister Robb signaled his intention to conclude outstanding FTA negotiations with Japan, Korea and China within the government's first term.³⁸ The goal was not only to demonstrate Australia's commitment to the region, but also to underline that Australia had other trade options, in the hope of encouraging China to move forward with finalizing ChAFTA.³⁹

Long years of talks, though, had not led to a satisfactory conclusion on a number of systemic issues, and there were still some outstanding tariffs to address. As a result, concluding ChAFTA also involved agreeing to return to the table by the end of 2018 for new talks to address unresolved systemic issues and possibly to negotiate further market access commitments—in other words, kicking some of the more difficult issues down the road.

It took high-level leadership on both sides to push ChAFTA to its conclusion. Minister Robb engaged frequently with his counterpart, China's Minister of Commerce Gao Hucheng, through the negotiations. Australian officials also note the crucial role played by Wang Yang, China's Vice Premier in charge of trade issues, at critical moments in the final stages of negotiations, and especially in resolving outstanding roadblocks in China.

Implications for Canada

A launch of Canada-China FTA negotiations would take place under global circumstances very different from those of ChAFTA. Resurgent protectionism, rather than the impetus for multilateral, regional and bilateral trade liberalization of the 1990s and 2000s, has become the new global context. The United States appears to be retreating from its former leadership position in trade liberalization, sounding increasingly hostile to global trade institutions and the rules-based system. Tensions between China and the United States continue to rise, and the two countries are in the midst of a trade conflict that China sees as part of a broader strategy to contain or roll back its global economic and political rise.⁴⁰

Canada is also in a different position from Australia going into such negotiations. If Australia's status as a significant western economy and G20 member was instrumental in finalizing ChAFTA, Canada's status as a G7 member with a larger and more diverse economy would be even more attractive to China.

China has also changed significantly in the 13 years since ChAFTA was launched. Its GDP has grown from US\$2.29 trillion in 2005 to US\$12.24 trillion in 2017, it the China the second largest economy in the world.⁴¹ In addition, China is shifting from an export-driven to a consumption-driven economy, which is likely to have a long-term impact on growth rates. Under President Xi Jinping, China has taken a high international profile, presenting itself as a global leader with a development model to rival the standard Western approach of open markets and growing democratic institutions. Both the establishment of the China-backed Asian Infrastructure Investment Bank and the launch of the Belt and Road Initiative—China's bold plans to support infrastructure development in Asia, Central Asia and Europe—reflect China's growing economic clout and broader global ambitions.

Although WTO membership has led to improvements and more openness in China's commercial system, it still lacks transparency and consistency. Corruption and business practices that favour local companies (in violation of WTO rules) remain major concerns. Moreover, there has been a shift from the growing openness of China's early WTO period to growing economic nationalism.

The Made in China 2025 policy is an example of this economic nationalism. Launched in 2015, Made in China 2025 aims to raise Chinese high-tech manufacturing capabilities and to encourage domestic innovation in ten advanced industries, with the goal of raising the Chinese content of components and materials to 40 percent by 2020 and to 70 percent by 2025. Critics, including many foreign companies and trading partners, argue that the subsidies

Business Review, April 19 2013; *The Australia China Story: Free Trade Agreement*, p. 1

38 Sid Maher, "[Coalition vows FTAs with China, Korea and Japan](#)", *The Australian*, October 3 2013

39 Interview, Andrew Robb, February 19 2018

40 See comments by Chinese officials and analysts in Nathan Vanderklippe, "[China shows restraint in trade talks with U.S. but experts fear Trump agenda](#)", *Globe and Mail* August 24 2018

41 World Bank, [China GDP Historical Data](#); *Trading Economics*, [China GDP figures](#)

involved in Made in China 2025, and the *de facto* exclusion of foreign firms from them, are a further violation of WTO rules on subsidies.⁴² In this context too, foreign companies are pressured into transfers of technology as part of commercial contracts. Companies such as Hewlett-Packard, Cisco and Microsoft have been forced to sell a majority stake in their Chinese business to a Chinese partner. Siemens' and Bombardier's rail designs are now sold by their Chinese partner, CRRC, in Europe.⁴³

Adding further complexity to potential FTA negotiations are growing concerns about security issues surrounding Chinese investment and practices in the information sector. Chinese overseas investments in technology burgeoned since 2015, not only in areas like information technology, but also in artificial intelligence, pharmaceutical and health technology, and some areas with potential for military applications. The value of such investments into the US, for example, tripled between 2015 and 2016, from US\$15 billion to US\$45 billion.⁴⁴ Some of these investments were made by state-owned enterprises, others by the private sector.

Some of this growth may have been strategically directed by the Chinese government, but some of it may have also reflected a rush on the part of China's entrepreneurs to move money overseas in the face of looming restrictions on capital outflow. Nevertheless, the US government is increasingly inclined to view technology investment as potential military threats. Canada and Australia have both blocked Chinese SOE acquisitions of companies involved in management or construction of critical infrastructure, with Australia stopping the sale of electricity distributor Ausgrid in 2016, and Canada blocking the sale of the construction company Aecon to China Communications Construction Company.⁴⁵ Australia has also excluded the Chinese telecommunications giant Huawei from its fibre broadband and 5G mobile networks, while the government of Canada, despite urging from the United States, resists making the same decision with respect to 5G.⁴⁶

With the growing influence of the Chinese Communist Party within private companies as well, the distinction between the goals of these companies and those of SOEs has become blurred. There are also growing concerns on the part of many countries about cyberattacks from China. This includes accusations that Chinese enterprises have hacked into the systems of foreign companies in the midst of sensitive bilateral transactions. All of these concerns create a different political context for FTA talks, not only from the Canadian public, but also in consideration of the potential reaction from the security organizations of the US government.

Canada's strategic goals in a free trade negotiation would reflect these changing circumstances as well as the improvement of market access and the business environment for Canadian companies. Trade disputes with the United States, including ongoing threats of other tariffs from the US despite the conclusion of the USMCA, have heightened the Liberal government's focus on diversifying Canada's presence in international markets—a goal policymakers have kicked around intermittently for over thirty years, and which is reflected in the new job title for Canada's trade minister: Minister for International Trade Diversification. Canada's trade agreement with the EU and its participation in the TPP (or more accurately the Comprehensive and Progressive Trans-Pacific Partnership), as well as its exploration of an FTA with ASEAN, all are elements of this goal.

Diversification is a laudable goal, but negotiations with China would need to be played carefully. A Canada-China FTA—even the launch of negotiations—would send a clear message to the United States that Canada has other trading partners, but, given the current state of China-US relations, and in the context of Article 32.10 of the USMCA, it could also result in a strong backlash from the White House. Canada would also have to ensure that it sufficiently addresses China's cyber activities and other security challenges, not only to safeguard national security, but to reassure key trading and security partners like the US.

Until late 2018, China continued to urge the launch of an FTA. China continues to urge the launch of an FTA. This is

42 Scott Kennedy, [Made in China 2025](#) (Center for Strategic and International Studies, June 1 2015). See also ["Made in China 2025: The Domestic Tech Plan That Sparked an International Backlash"](#), Sup China June 18, 2018

43 Canadian Security Intelligence Service (CSIS), ["Exploring China's Innovation Potential"](#) *China and the Age of Strategic Rivalry: Highlights from an Academic Outreach Conference* (World Watch: Expert Notes series publication No. 2018-05-02), May 2018, pp. 108-9.

44 ["Chinese Investment in Critical U.S. Technology: Risks to U.S. Security Interests"](#) Council on Foreign Relations, October 16 2107

45 Peter Hartcher, ["Revealed: Why the sale of Ausgrid to Chinese buyers was vetoed"](#), *Sydney Morning Herald*, May 28 2018; Robert Fife and Steven Chase, ["Trudeau cabinet blocks Chinese takeover of Aecon over national security concerns"](#), *Globe and Mail*, May 24, 2018

46 Maggie Lu-yue Yang, ["Australia blocks China's Huawei from broadband tender"](#), *Reuters*, March 26 2012; Raymond Zhong, ["Australia Bars China's Huawei from Building 5G Wireless Network"](#), *New York Times*, August 23 2018; Steven Chase and Robert Fife, ["Trudeau refuses to let 'politics slip into' decision on Huawei"](#), *Globe and Mail*, October 16 2018

at least partly linked to rising China-US tensions and the message that would be sent to the US by an FTA between its largest trading partner and China. China's other goals in an FTA with Canada would be primarily strategic: as with Australia, Canada's tariffs are generally low, with the exception of a few sectors. China is likely to focus on access to natural resources, MES, increasing mobility and work opportunities for Chinese skilled workers on China-invested projects, and on reducing obstacles to SOE investment in Canada, as well as on market access issues.

The Australian negotiation experience offers some important lessons for Canada. The first is that a comprehensive FTA could take a long time to negotiate. If the standard FTA approach is taken—that nothing is agreed until everything is agreed—a long negotiation delays benefits to Canadian companies. As circumstances in both countries change and new technologies and trade challenges emerge, an FTA risks being less relevant the longer that negotiations drag on.

Second, political leadership is critical to a successful conclusion. Moving negotiations along at a good pace requires successful management of the overall bilateral relationship and the cultivation of good personal ties at the leadership level, especially with the senior Chinese leader responsible for the agreement. This also means sustained commitment to the project on the part of Canada's senior leadership (including the prime minister, members of cabinet, and key provincial premiers), and strategic management of sensitive issues.

Third, it is critical to negotiate from a position of strength—or more accurately, that negotiating leverage not be given away in advance. China may argue that it has less to gain from a free trade agreement, and demand a price for starting FTA negotiations, such as Market Economy Status. Canada should not give away anything that could be used in the negotiations themselves. Granting MES to China ahead of the negotiations put the Australian team at a disadvantage; it could have been traded for more concessions from China.

Fourth, a big and high-profile project like an FTA is vulnerable to political leverage and backlash from the Chinese government. China has the will and capacity to mobilize disparate elements of a bilateral relationship to accomplish a large political aim—usually to send a message of displeasure to the other side, as was shown with the slowing of ChAFTA negotiations during the Rudd government. China is unlikely to agree to launch FTA negotiations, or to actively move them forward, when relations are cool.

III. Market Access

- ChAFTA's tariff reductions are generally ambitious, and Chinese tariffs on most Australian products (with the exception of some agricultural products) will be eliminated in 2019. This provides Australian exports with significant market access opportunities, which has further increased Australia's competitive edge in China. However, ChAFTA contains no tariff reductions on canola oil and wheat, two products of interest to Canada, but which China will resist opening up.
- ChAFTA does not yet seem to have had a strong impact on Australia's *overall* goods exports. Australian exports continue to be dominated by iron ore, which was tariff-free before ChAFTA. Australia's exports have also responded to other factors, including demand, marketing and changing tastes in China. Individual sectors have benefited from reduced tariffs and the higher profile ChAFTA has given them, although regulatory and systemic barriers--especially in agriculture, ICT and manufactured product--remain key factors that limit market access.
- ChAFTA's gains in market access for services, while important, are more limited. Most-Favoured-Nation commitments are asymmetrical—China's are restricted to certain sectors. Some of Australia's gains in services market access were also made less relevant by unilateral reforms by China that took place during negotiations or shortly after ChAFTA was finalized.
- A sectoral approach to tariff reductions has been proposed as an alternative to a full-scale, broad-based FTA. To be consistent with WTO rules, however, sectoral tariff reductions outside a free trade agreement would have to be made available to all WTO members. Such measures have precedents and could benefit consumers, but are unlikely to have political support in either Canada or China.

Market Access for Goods

The most significant accomplishment of ChAFTA for Australia is the increased market access it provides for Australian exports of goods to China—access that the Australia China Business Council describes as “unprecedented”⁴⁷. ChAFTA appears to benefit many sectors of the Australian economy, although it has not had a great impact on Australia's overall goods exports this early in the agreement.

Tariff Cuts under ChAFTA

ChAFTA's program of staged tariff reductions began immediately upon signature in 2015 and will lead to tariff elimination for most products—with significant exceptions—by January 2019. At that point close to 93 percent of Australia's goods exports will be imported by China duty-free or at preferential rates, with this figure rising to 97.9 percent in 2029.⁴⁸

Table 1 shows tariff reductions for key Australian products under ChAFTA.⁴⁹ Iron ore, Australia's top export, was already free of tariffs when ChAFTA went into effect, but three of Australia's top four exports to China (wool, coal and copper) benefit significantly from the agreement's increased market access. Tariffs on iron and steel products, and indeed most non-agricultural Australian exports, will be eliminated by 2019, including those on machinery and construction equipment.

Agriculture and agri-food products are usually the most sensitive goods in bilateral trade negotiations. Under ChAFTA, tariffs on a number of Australian agri-food exports (for example wine, seafood and fruits), follow the same schedule of tariff elimination by 2019. Other tariff reductions will phase in over a longer period: tariffs on beef, as well as on most dairy products) will be phased out by 2024.

47 Australia China Business Council, “[ChAFTA Training Program](#).”

48 Government of Australia, Department of Foreign Affairs and Trade, [China-Australia Free Trade Agreement: Outcomes at a Glance](#)

49 ChAFTA Schedule of Chinese Tariff Commitments; ChAFTA, Annex 2-B, “Special Agricultural Safeguard Measures”; ChAFTA Schedule of Chinese Tariff Commitments; ChAFTA, Annex 2-B, “Special Agricultural Safeguard Measures”

However, there are limits on exports of three key Australian products receiving tariff cuts. Wool is subject to a country-specific tariff quota, which means that duty-free access will be applied only until imports reach the level of quota. As shown in Table 1, this quota started at 30,000 tonnes in 2015 and will rise to 44,234 tonnes in 2024.⁵⁰ Australian beef and dairy exports are also subject to a special safeguard—a temporary, exceptional trade measure applied if import levels of a specific product cause or threaten injury to similar domestic products. Safeguards are governed by WTO rules, and additional rules can be negotiated in a bilateral agreement, as was the case with ChAFTA. The “trigger levels” for imports of Australian beef and milk or cream—the import levels at which China could legally impose trade measures—are set out in Table 1; these levels rise annually over the first 16 and 17 years of the agreement. While this does place an upward limit on Australian exports, there seems to be little chance, at least in the near future, that exports will reach these levels. With the exception of 2013, Australian exports of the two dairy products, for example, have only reached as high as around 12,000 tonnes.⁵¹

While ChAFTA sets out important reductions in tariffs on some agri-food products, others have been left out. There are no tariff reductions on canola and sunflower oil (seeds already had no tariffs) and wheat. China did eliminate tariffs on barley and oats, which the industry estimated would be worth about US\$ 50million to its producers.⁵² China’s 50 percent tariff on sugar also remains in place.

China also gained significant market access in ChAFTA. Australian tariffs on eighty-five percent of Chinese products were eliminated in the first year of the agreement, and a total of 98.4 percent reached zero in 2018. Australia committed to eliminating its 5 percent tariff on paper products from China (the second highest paper exporter in the world) in the first year, along with tariffs on chemicals, coal, rubber, fruits and nuts, beauty products, paints, wool fabric, cotton yarn, and a range of consumer items. Australia also eliminated tariffs on electronic and mechanical products, as well transportation equipment. Tariff elimination on some steel and plastic products is being phased in over three to five years. China’s Ministry of Commerce has estimated that by the third year of implementation, tariff exemptions would be worth US\$1.6 billion.⁵³ As with many western countries, Australia’s tariff level at the start of ChAFTA negotiations was already low, leading China to seek additional concessions elsewhere in the agreement, outside market access commitments for goods and services.

50 ChAFTA, Annex 2-A

51 Jesse Goldman, et.al., *Canada Announces Consultations on Provisional Safeguards* Borden Ladner Gervais Publication 5372, August 17 2018; UN Comtrade database: [International Trade Statistics](#)

52 Grain Growers, *Submission to the Joint Standing Committee on Treaties Inquiry into ChAFTA*, July 2015, p. 3

53 Australia tariff schedule; Government of China, Ministry of Commerce, *Interpretation for the China-Australia Free Trade Agreement* <http://english.mofcom.gov.cn/article/policyrelease/Cocoon/201510/20151001144954.shtml>

Table 1: Chinese Tariff Reductions of Key Australian Exports under ChAFTA

Product	Pre-ChAFTA Tariff Rate (%)	Current Tariff Rate (%)	Year of Tariff Elimination	Other Measures
Iron ore	0	0	N/A	N/A
Wool	5	0	2015 (upon signature)	Country-specific tariff quota (tonnes): 30,000 (2015) rising to 44,234 (2024)
Natural gas	5	0	2015 (upon signature)	N/A
Coal	3	0	2015 (upon signature)	N/A
Copper foil, wires, bars and pipes	4 to 7	1.2 to 1.4	2019	N/A
Wine	14 to 30	2.8 to 6	2019	N/A
Seafood	10 to 12	2 to 2.4	2019	N/A
Beef	12 to 25	12 to 15	2024	Safeguard (tonnes): 170,000 (2015) rising to 248,729 (2031)
Milk and cream	15	9	2024	Safeguard (tonnes): 17,500 (2015) rising to 34,649 (2032)
Cosmetics	6.5 to 15	1.3 to 3	2019	

ChAFTA's Impact on Australian Exports

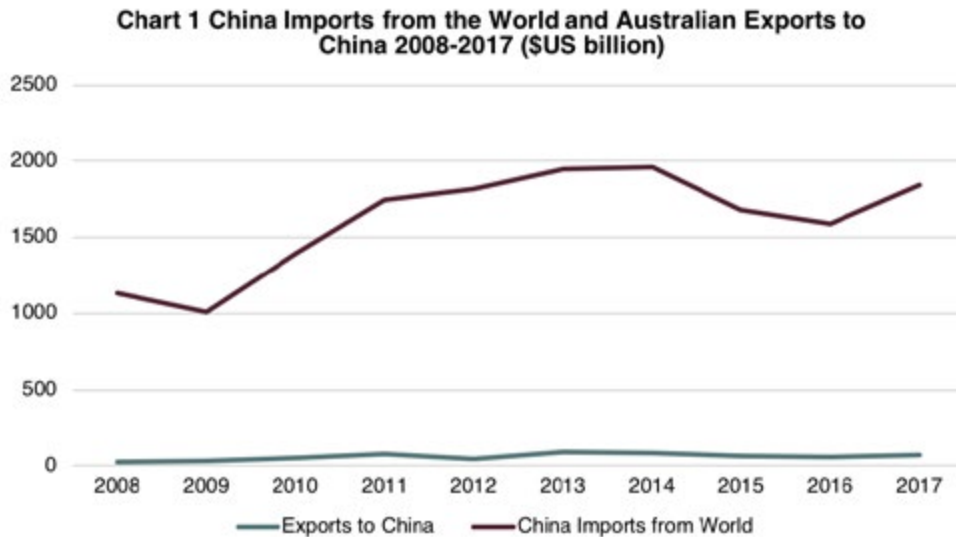
Three years after the signing of ChAFTA and the start of the phased-in tariff cuts, the agreement does not seem yet to have had a significant effect on Australia's *overall* export performance in China. More analysis needs to be done on the precise impact of ChAFTA to take into consideration the impact of other factors, such as shifts in China's economic growth model, aggressive marketing, and changing consumer patterns.

However, the general trend of Australia's exports to China was already upward prior to ChAFTA. Although imports from Australia have never been particularly significant in China's overall imports (See Chart 1), exports to China grew from A\$8.8 billion in 2001 to A\$77 billion in 2011, an average annual growth rate of 25.6 percent, and over that period China rose from being Australia's third largest trading partner to its largest.⁵⁴ Australia's merchandise exports to China have generally tracked the pattern of China's global imports, dropping between 2015 and 2016, for example, and growing over 2016-2017 (Charts 1 and 2). Since 2013, as China's economic growth and import levels slowed, Australia's overall share of China merchandise trade imports has held steady or even declined, from 5.07 percent in 2013 to 3.7 percent in 2017.⁵⁵

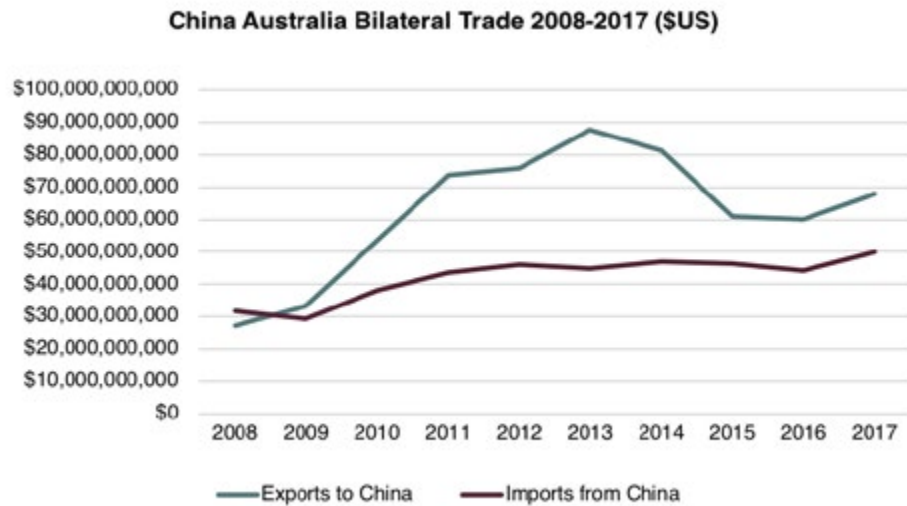
⁵⁴ Government of Australia, Department of Foreign Affairs and Trade, *Australian Exports to China 2001 to 2011: Opportunities and Challenges* (2005), p. 34

⁵⁵ UN Comtrade database

ChAFTA also has no impact on exports of iron ore, which entered China tariff-free before the agreement, and which dominates Australia’s trade with the country. Exports of iron ore grew significantly in the years before ChAFTA, rising from A\$1.4 billion to A\$44 billion⁵⁶ between 2001 and 2011. The sharp drop in the value of Australian exports to China between 2013 and 2015, for example, parallels the sharp drop in world iron ore prices, which went from US\$154/tonne in February 2013 to US\$40.88 in December 2015. Australian shipments of iron ore to China increased by 42 per cent over this period, from 463 million tonnes to 656 million, but because of the low prices, revenues from these exports fell from US\$51 billion to US\$29 billion. The rebound of Australian exports to China over 2016-2017 parallels a rebound in iron ore prices over the same period.⁵⁷ Early indications of an 11 percent increase in overall Australian exports in 2018 at least in part reflect the increase in iron ore prices early in 2018.⁵⁸



Source: UN Comtrade Database, [International Trade Statistics](#)

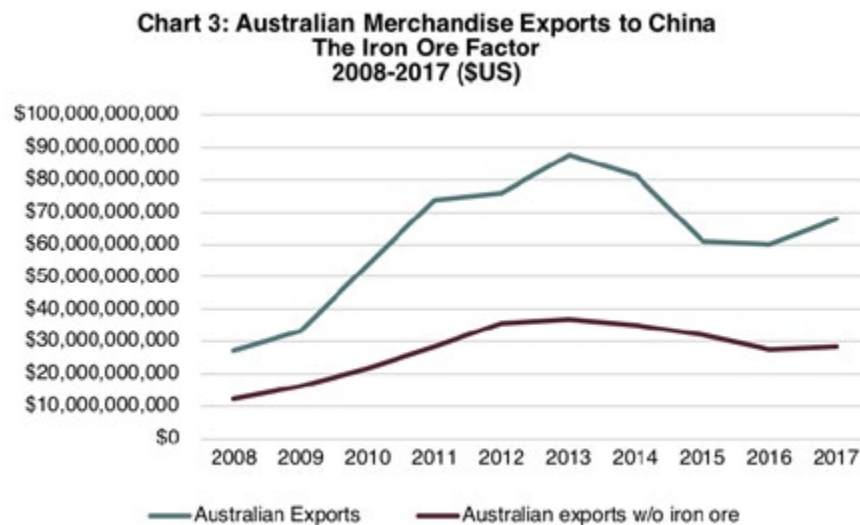


Source: UN Comtrade Database, [International Trade Statistics](#)

56 [Australian Exports to China 2001 to 2011](#)

57 Iron ore peaked at US\$88/tonne in February 2017 before dropping to around \$60/tonne in May-June 2017. International Monetary Fund, Global price of Iron Ore [[PIORECRUSD](#)], retrieved from FRED, Federal Reserve Bank of St. Louis, October 27 2018

58 Government of Australia, Department of Foreign Affairs and Trade, [Monthly Trade Data, August 2018](#), p.3



Source: UN Comtrade Database, [International Trade Statistics](#)

Taking iron ore out of the export picture, since it is unaffected by ChAFTA, makes it even more difficult to discern clearly any impact of the agreement on Australian merchandise exports. Non-iron ore exports during 2013-2017 have hovered between A\$36 billion and A\$28 billion annually, dropping in 2016 and rising slightly in 2017. ChAFTA does not yet appear to have increased the non-iron ore share of overall Australian exports, which in recent years was as high as 53 percent in 2015, but since has dropped to 41 percent (Chart 3).⁵⁹

Export figures, of course, do not capture other activities, like increased numbers of Australian exporters traveling to China to do business since the signing of ChAFTA. All on-the-ground reports confirm a higher level of Australian activity since 2015, some of which has yet to be transformed into actual exports.

Some sectors of the Australian economy have seen significant gains as a result of ChAFTA. One example is Australia's wine industry, the exports of which have grown from less than 40 million litres (worth A\$250 million) in 2013 to 152.8 million (A\$723 million) in 2017. Part of this growth has been driven by increased Chinese demand for wine, which has doubled since 2015. But since exports of Australian wine have tripled in the same period while exports of US wine, whose tariff remain at 14 percent, have remained at the same level, the impact of ChAFTA on this industry's sales in China is evident. China is now Australia's top export market for wine, with 19 percent of export volume and 33 percent of export value—an indication that China's wine purchases tend to be toward the top end.⁶⁰

Australia's wine industry has benefited not only from ChAFTA's tariff reductions, and growing demand for imported wine, but also from its ability to navigate China's regulatory system. Under ChAFTA, Australian wine enters China already certified for import and distribution, and China recognizes Wine Australia's certification of Australian wine for import into China.⁶¹ No certification in China is needed, which means fewer problems and speedier delivery to distributors.

As Chinese tariffs on cosmetics have lowered, its imports of cosmetics from Australia have also increased. Between 2016 and 2017 China's purchases of Australian cosmetics jumped from US\$45 million to US\$75 million, increasing Australia's share of that market from 1.3 to 1.6 percent.⁶² This may not register as more than a blip when China's total cosmetic imports are over \$100 billion, but it is significant for Australian manufacturers.

⁵⁹ UN Comtrade database, International Trade Statistics

⁶⁰ Wine Australia, Australian Wine Export Market Snapshot—China, PRC-Year ended December 2017; " [Australian Wine Exports Soar Under ChAFTA](#)", US Foreign Agricultural Service, *Global Agricultural Information Network Report AS1802*, January 22 2018;

⁶¹ Steve Guy, Wine Australia, Interview February 19 2018

⁶² UN Comtrade database: Chinese imports of cosmetics from world and from Australia

Tariff reductions for beef have a longer phase-in period than most other Australian products. Nearly three years after ChAFTA was signed, beef tariffs range between 7.2 and 15 percent, and will not be completely eliminated until 2024. In general, exports of Australian beef to China have grown rapidly since 2011, peaking at nearly 155,000 tonnes in 2013, but have been lower in the two years following ChAFTA's signature, reaching only 110,000 tonnes in 2017. Indications are that there will be significant improvement in 2018, however, with export levels in June up 46 percent over 2017. It should be noted that these figures do not include beef exports to China through “grey markets” via Hong Kong and Macau, although exports to Hong Kong, after a drop in 2016, appear to have returned to previous levels of about 7,000 tonnes per year.⁶³

Negotiating lower tariffs is a central component of trade negotiations. However, the experience of the beef industry highlights the fact that tariffs are just one factor in market access. Consumer preferences, marketing, government policy and the regulatory system all have a critical impact. In the case of beef, Chinese consumer preferences are shifting, with greater demand for chilled beef (as opposed to fresh or frozen) as standards of living rise and China gives greater attention to food safety (where Australian beef has a very positive image). At the same time, exports of beef require plant inspections in source countries and bilateral protocols on food safety, and these measures can make them vulnerable to sudden and sometimes capricious decisions to forbid imports. In July 2017, for example, six meat plants in Australia were temporarily shut out of Chinese markets on account of regulatory issues, which had the effect of lowering overall sales to China.⁶⁴

Seafood exports are another example. Despite lower tariffs, Australian exports have not taken off. This is due mainly to regulatory issues, such as the slow process of getting new species added to China's approved list of seafood imports and Chinese rules on sulphur dioxide in seafood. China's current anti-corruption campaign also works against exports of Australian rock lobsters, which are more expensive than North American lobsters.⁶⁵

In the case of coal, ChAFTA committed China to an immediate elimination of the 3 percent tariff on coking coal and a staged elimination of the 6 percent tariff on thermal coal. This put Australia in a more competitive position against Indonesia, which had tariff advantages under the China-ASEAN FTA.⁶⁶

Market Access for Services

China accounts for approximately 9 percent of Australia's total services exports. Australian exports of services to China have grown at an average annual rate of 18.6 percent since 1996 and jumped 40 percent from A\$11.3 billion to A\$15.8 billion between 2016 and 2017. Much of this has been driven by the growth of education-related travel services—travel of students and scholars to study in Australia—which accounts for over half of all Australian services exports to China. Chinese exports of services have held at a lower level, reaching A\$2.9 billion in 2017.⁶⁷

ChAFTA improves market access for Australian service providers in a number of sectors. Overall, though, the increase in market access provided by ChAFTA is more incremental than dramatic, and some this market access has overtaken by China's ongoing reforms in some parts of the services sector.⁶⁸

ChAFTA represents a small step forward in that China makes partial use of a negative list approach to set out its services commitments. This approach, which Australia and Canada both take, involves only listing limitations on market access, which means that market access is unlimited if it is not specifically mentioned. This tends to be more liberalizing in its impact, as it limits the capacity to protect new and emerging sectors. China has not been comfortable with it. Even a partial use of a negative list is a step forward, and China has also agreed to make use of the negative list approach in further negotiations with Australia, as part of ChAFTA's built-in agenda.⁶⁹

63 Meat and Livestock Australia, [Australian Beef Exports to Greater China: Monthly Summary, June 2018](#) pp. 1-3

64 Patrick Hutchinson, Australia Meat Industry Council, Interview February 19 2018

65 Michael Fabinyi, [The Chinese seafood market: opportunities and challenges for Australian exporters](#) (University of Sydney, Australia-China Research Institute, 2018), pp. 22, 25

66 Mark Davis, Director of Strategy and Communications, Mineral Council of Australia, Interview February 21 2018

67 Government of Australia, Department of Foreign Affairs and Trade, [Australia's Trade in Services with China](#), January 2018, pp. 1-3; Government of Australia, Department of Foreign Affairs and Trade, [Australia's Trade and Investment Relationship with China](#); Government of Australia, Department of Foreign Affairs and Trade, [Trade in Services Australia 2016](#) August 2016, pp. 7, 56, 79

68 Shi, Jingxia, “Services Liberalisation in ChAFTA: Progress Assessment and the Way Forward”, in Picker et al. (2018) p. 114; Heng Wang (2018), p. 26

69 Shi (2018), pp. 123-124; Government of Australia, Department of Foreign Affairs and Trade, [China-Australia Free Trade Agreement: Summary](#).

A few key Chinese services commitments are as follows:

Tourism and travel-related services:

- Australian services suppliers can construct, renovate and operate wholly Australian-owned hotels and restaurants in China and establish wholly Australian-owned subsidiaries in China to provide a range of travel services.⁷⁰

Education services:

- 77 new Australian private higher education institutions have been added to China's list of approved institutions, making a total of 105.⁷¹
- Australian ownership is allowed for branch campuses and joint schools.⁷²

Legal services:

- Australian law firms are allowed to establish commercial associations with Chinese law firms in the Shanghai Free Trade Zone (SFTZ) and to offer Australian, Chinese and international legal services without restrictions on where clients may be located.⁷³
- In a side letter to ChAFTA, China and Australia also agreed to work to strengthen cooperation and mobility between lawyers from each country involved in trade and investment work.⁷⁴

Financial services:

- Joint venture futures companies with up to 49 per cent Australian ownership are allowed.
- More access given to China's statutory third-party liability motor vehicle insurance market
- Australian pension service providers are also allowed to establish foreign-invested or sole for-profit pension institutions in China.
- Elimination of requirement to set up a representative office before being able to establish operational foreign-funded banks⁷⁵

Health care sector

- Establishment of profit-making aged care institutions and wholly foreign-owned hospitals in three municipalities (Beijing, Tianjin and Shanghai) and four provinces (Jiangsu, Fujian, Guangdong and Hainan).

ChAFTA contains somewhat increased Australian market access in other sectors. In **telecommunication services**, Australian companies have gained more access for some value-added services, and for wholly-owned Australian companies to provide a range of services hitherto limited to joint venture operations. Other sectors also made incremental gains. China has lifted some restrictions on the operations of Australian **construction** companies established in the SFTZ that are undertaking joint projects with Chinese counterparts in Shanghai.

of ChAFTA Chapters and Annexes

70 ChAFTA, Annex III, Part 2, Schedule of Specific Commitments on Services, People's Republic of China (Hereafter "China Services Schedule"), II.9.A and 9.B. p. 1092

71 China Services Schedule, Section II.4. p. 1078

72 Shi (2018), p. 118

73 China Services Schedule II.I.A (a), pp. 1060-1061; Government of Australia, Department of Foreign Affairs and Trade, *China-Australia Free Trade Agreement: ChAFTA and Trade in Services*; Shi (2018), p. 118-119

74 ChAFTA Agreement Side Letter, Trade and Investment Minister Andrew Robb to China's Minister of Commerce Gao Hucheng, June 17 2015

75 Government of Australia, Department of Foreign Affairs and Trade, *China-Australia Free Trade Agreement: Trade in Services*

In **manufacturing services**, wholly-owned Australian subsidiaries can provide contract services in a range of manufactured products, and Australian **mining services** suppliers may provide technical consulting and field services in coal bed methane and shale gas extraction. China has also guaranteed access for Australian suppliers to provide a range of services related to exploiting oil and gas, iron, copper and manganese resources in cooperation with Chinese partners, but this commitment is the same made in a number of China's other FTAs.⁷⁶

China's increased access to Australia's services market includes reduction of the capital costs of branches of Chinese banks by lowering the ratio of required liquidity coverage from 100 percent to 40 percent, and the ability to establish international schools in Australia. Australia's commitment on this last point is actually quite weak, as authority over international schools lies with state and territorial governments.⁷⁷ In addition, China and Australia negotiated a number of side agreements on labour mobility, which are covered in the next chapter.

Australia's increased access to China's services market is an accomplishment, but its importance should not be overstated. MFN commitments are unequal: while Australia guarantees that it will give Chinese companies at least the same access it gives those from other countries, China's commitment is limited to ten sectors. Australian companies operating in other sectors in China do not have the same guarantee.⁷⁸

Similarly, China has not committed to the principle of national treatment (i.e. providing treatment that is the same as the treatment of domestic companies) in the education sector. Its present commitments on cross-border supply of education can be altered to limit market access without violating ChAFTA.⁷⁹ There remain problems with approval processes and other procedures, which are often difficult to navigate.⁸⁰

Allowing Australian law firms to set up commercial associations with Chinese firms is an attempt to address the significant restrictions placed on foreign law firms in China, which are required to set up foreign representative offices (FRO)s, and have not been able to directly practice Chinese law or hire Chinese lawyers. This had led to the practice of foreign law firms establishing "entrustment" arrangements with Chinese law firms, which allows the FRO to directly instruct members of the entrusted Chinese law firm. Allowing the commercial association in many ways regularizes what has become an informal, common practice among foreign law firms. This gain became much less relevant one day after ChAFTA was signed, when China announced that it would allow any legal FRO to form these commercial associations within the Shanghai Free Trade Zone.⁸¹

Ongoing Chinese liberalization also essentially overtook the market access gains in ChAFTA. China has announced a further opening of the financial sector that overtakes other ChAFTA's gains. For example, the foreign ownership limit for futures, fund management and securities companies has been lifted to 51%, and will disappear over the next three years.⁸² ChAFTA's impact in these sectors, ultimately, is less about opening up new access now and more about locking in market opening measures in the unlikely event that China retreats from these recent reforms.

ChAFTA's opening of the health care system, while important, is still limited geographically. While large markets, Beijing and Shanghai are also extremely competitive. Outside these cities, the sector is difficult to navigate and because of regulatory gaps it is full of risky operators. So far there has been little or no take-up by Australian companies of opportunities in this sector.

76 Department of Foreign Affairs and Trade, *ChAFTA and Trade in Services*

77 Side letter on education from Trade and Investment Minister Andrew Robb to China's Minister of Commerce, Gao Hucheng, 17 June 2015, p. 2

78 DFAT, *Summary of ChAFTA Chapters and Annexes*

79 Eva Chye, "Trade in Education Services under ChAFTA: What does it Mean for Australia?" in Picker, et al., (2018), p. 174; ChAFTA, Australia Services Schedule, p. 1041; China Services Schedule, Section II.5, p. 107

80 Chye (2018), p. 183; Alex Smith, Insearch, Interview February 23 2018

81 Zhou Weihuan and Xi Junfang, "Breakthrough or Standstill? China's Liberalisation of Legal Services under ChAFTA", in Picker et.al. (2018), p. 26

82 Miller Canfield, [China Further Opens up its Financial Sector to Foreign Investors](#), May 25 2018

Implications for Canada

Goods

Despite its limitations, ChAFTA will help strengthen Australia's competitive position in the China market, including in sectors where Australia and Canada are direct competitors, such as copper and many agricultural products. In an FTA negotiation, getting similar access should be an obvious starting point for Canada., Canada will also want to address tariffs on key Canadian export products that were not subject to tariff reductions in ChAFTA, including wood pulp and paper, canola and wheat.⁸³ Negotiating lower tariffs in wheat is likely to be tough, especially given Chinese inclinations to protect them for food and grain security reasons.

Canadian tariffs, with notable exceptions, are quite low. The mean rate of applied tariffs for manufactured goods is 0.97 percent; for all primary products the mean rate is 2.73 percent.⁸⁴ This gives Canada fewer sectors to trade off in a broad trade negotiation, but there are still a few sectors (for example auto parts, shoes and clothing) where tariffs are at least in the 5-6 percent range. Under supply management, dairy tariffs remain high, and Canada also has tariff quotas on beef, veal, chicken, turkey and eggs. Negotiating lower tariffs or other changes to the import system for these products, though, would be politically challenging.

ChAFTA's broad range of tariff reductions includes a range of manufacturing sectors, such as automobiles, transportation and telecommunications. Such reductions would be important for Canada as well, even though Canadian companies have joint ventures with Chinese companies for production in China. China would be likely to seek reciprocal tariff reductions in some of these sectors as well.

Services

At present, China accounts for 2.4 percent of Canada's services exports, so there is room for growth. In negotiating market access in services, Canada should be firm about only negotiating based on a negative list approach. Canada should not agree to the systemic limitations ChAFTA has put on Australian service providers—neither limits on the sectors to which the principle of MFN will be applied, nor limits on national treatment in the education sector.

As for market access in the services sector, Canada should go significantly beyond ChAFTA's important but limited gains, particularly in telecommunication and financial services, and build on China's recent market openings. Canada should also seek to expand access for education services and education-related travel, which have directly benefited Australian services exports. China's approval under ChAFTA of 77 Australian schools is most likely a direct cause of the jump in Australia's services exports to China over 2016-2017. Canada, which is already promoting health care and especially elder care in Asia, can also build on Australia's gains in health care services, and should aim for market access without the geographic limitations ChAFTA applies to Australian firms.

But to gain access to the important services market in China, Canada will have to give some thought to the sectors in which China will seek increased access to the Canadian market—such as telecommunications—and the attendant political implications. The prospect of Chinese telecommunications service providers operating in Canada, and the real or imagined security challenges these present, would be politically controversial, given the serious allegations that have been made against the telecom equipment manufacturer Huawei.

Canada will also want to keep a close eye on changes to China's services sector that might be taking place as negotiations continue. Some of Australia's advantages in services market access under ChAFTA were compromised by reforms that took place in China parallel to the ChAFTA negotiations.

83 Terry Fries, "Chinese demand boosting Canadian wheat, barley exports", *Western Producer*, July 18 2018 <https://www.producer.com/2018/07/chinese-demand-boosting-canadian-wheat-barley-exports/>

84 *Trading Economics*, "Canada - Tariff rate, applied, simple mean, manufactured products"; World Bank, "Tariff rate, applied, weighted mean, manufactured products (%)"

A Sectoral Approach?

Market access issues lie at the core of free trade agreements. A full FTA negotiation offers the opportunity for trade-offs in market access concessions between and across different goods and services sectors. Such a negotiation with China, however, could be a long and complex process, which means that the market access gains for the private sector can be a long time coming.

The Public Policy Forum has suggested an alternative sector-by-sector approach in its strategy for Canada-China relations.⁸⁵ A sectoral agreement would have to adhere to WTO rules, and in particular the most-favoured nation (MFN) principle. This rule prevents members from reducing tariffs for one trading partner without providing the same benefits to all members, unless this is done through a bilateral or regional FTA.⁸⁶

This does not necessarily preclude a sectoral approach, but it makes it more complicated for initiatives like tariff reductions. To adhere to WTO rules, Canada and China could each agree to unilaterally reduce certain tariffs on an MFN basis, meaning that all WTO Members would have access to the same tariff reductions. These would, presumably, happen in sectors where the other side already has a competitive advantage, and would therefore be likely to benefit the most from lower tariffs. This would be a bold action on the part of each country, but there are precedents. In the past, Canada has unilaterally reduced tariffs to increase Canadian competitiveness⁸⁷, and China has recently unilaterally reduced tariffs for non-US trading partners as part of its trade battle with the United States⁸⁸.

Such measures would offer potential benefits to consumers in each country, but they are likely to be politically difficult. China in particular may see the political and economic challenges of such a unilateral tariff reduction outweighing its potential benefits. There are opportunities, however, for enhancing trade through non-tariff sectoral initiatives, which will be discussed in a later chapter.

85 Public Policy Forum, *Diversity not Dependence: A Made-in-Canada China Strategy* (October 2018), pp. 18-19

86 [The General Agreement on Tariffs and Trade \(GATT 1947\)](#) Articles I and XXIV (8) (b)

87 "[Canada reduces tariffs on manufacturing inputs and machinery](#)", World Trade Organization 2010 News Items April 29 2010

88 "[China cuts some tariffs--but does not address US complaints](#)", *Financial Post*, September 26 2018

IV. Labour and Labour Mobility

- ChAFTA's labour mobility elements, which facilitate temporary movement of skilled Chinese workers into Australia, have been very controversial, particularly at the time of ratification of the agreement.
- Despite this controversy, there is little evidence that the enhanced movement of Chinese skilled workers has had a negative impact on the Australian labour market.
- It is likely that such issues will be on the table in a negotiation with China. The government of Canada will need a comprehensive strategy to protect labour standards and to engage with stakeholders well in advance of the conclusion of any agreement.

Australian commitments to facilitate temporary entry of Chinese workers into Australia have arguably been the most controversial elements of ChAFTA.⁸⁹ General commitments are covered in Chapter 10 (Movement of Natural Persons), which sets out ways in which each side will facilitate processes related to the movement of temporary skilled labour (including at the management level). This includes the commitment that for certain sectors set out in ChAFTA, neither side will limit the number of temporary work visas to be granted, nor “require labour market testing, economic needs testing or other procedures of similar effect as a condition for temporary entry.”⁹⁰

A number of side agreements build on this general commitment and offer what DFAT describes as “increased labour flexibilities” to support investment into Australia. Most prominent and initially controversial is the Investment Facilitation Arrangement (IFA), a memorandum of understanding between China and Australia that provides Chinese companies investing in infrastructure projects worth A\$150 million greater flexibility to bring in temporary skilled labour.⁹¹ Under the IFA, Chinese companies negotiate specific project agreements, and have flexibility to negotiate such issues as the occupations covered by the agreement, English language proficiency, qualifications and experience requirements; and calculation of salaries.⁹² All employers and workers are required to comply with applicable Australian laws, including workplace law, work safety law and relevant Australian licensing, regulation and certification standards.⁹³

Other labour mobility commitments were captured in a side letter in which Australia agrees to remove mandatory skills assessment requirements for ten skilled occupations, and in a memorandum of understanding in which Australia agrees to put in place a work and holiday visa arrangement. This program grants up to 5000 one-year visas annually to Chinese citizens between the ages of 18 and 31, with a minimum of two years of undergraduate study and functional fluency in English, to travel and work in Australia.⁹⁴ Australia has also agreed to allow four-year visas for 1800 Chinese professionals in fields with “Chinese characteristics” — traditional Chinese medicine practitioners, Wushu instructors, Mandarin language teachers and Chinese chefs — per year to enter Australia for four-year terms.⁹⁵

These side agreements are not reciprocal. While Australia benefits from China's commitments in Chapter 10 and in its services schedule, there is, for example, no equivalent of a work and holiday program for Australian youth.

Labour organizations have been critical of ChAFTA in general, and particularly critical of these labour mobility arrangements. As Parliament was considering ratifying the agreement, the Construction, Forestry, Maritime, Mining and Energy Union (CFMEU) called for renegotiation of the labour elements of ChAFTA to bring reciprocity to the work and holiday program, to raise the level of English demanded of Chinese participants, and to limit the

89 Government of the People's Republic of China, Ministry of Commerce, *Interpretation for the China-Australia Free Trade Agreement* June 19 2015 p. 9

90 ChAFTA, Chapter 10, Article 10.4.3a and 10.4.3b, p. 113

91 Government of Australia, Department of Foreign Affairs and Trade, *China-Australia Free Trade Agreement: ChAFTA and Movement of Natural Persons* <http://dfat.gov.au/trade/agreements/in-force/chafta/fact-sheets/Pages/fact-sheet-movement-of-natural-persons.aspx>

92 ChAFTA, *Memorandum of Understanding between the Government of Australia and the Government of the People's Republic of China on an Investment Facilitation Arrangement* (“Australia-China IFA MOU”), Article 4

93 Australia-China IFA MOU, Article 11

94 *China-Australia Free Trade Agreement: ChAFTA & Movement of Natural Persons; Memorandum of Understanding Between the Government of Australia and the Government of the People's Republic of China on a Work and Holiday Visa Arrangement*

95 ChAFTA, Article 10.11, p. 118

scope of Chapter 10 to “those categories genuinely associated with international trade in services by China-based enterprises”.⁹⁶ Some observers have raised concerns about lack of Australian capacity to enforce labour standards, the vulnerability of the skilled Chinese labourers in Australia to poor treatment by their employers, the impact of the labour mobility arrangements on wage levels, and the constraints on labour market testing.⁹⁷

The Australian Council of Trade Unions (ACTU) saw the labour mobility elements of ChAFTA partly as an attempt by the Conservative government to undermine unions, and was instrumental in organizing widespread demonstrations against ChAFTA to block ratification of the agreement, lobbying unsuccessfully for the support of the Labor party. The rhetoric became heated to the point where the ACTU was accused of racism, which it vehemently denies. The ACTU remains concerned about the labour mobility measures, including the low investment threshold in the IFA and the waiving of labour market testing, which it sees as undermining access to jobs for Australian workers, but it believes that its early lobbying on the IFA led to stronger language on a number of issues, including rights of workers on projects, minimum rate of pay, and skills assessment.⁹⁸

Nearly three years after ChAFTA was signed, the impact on labour in Australia has been minimal, and certainly not as disastrous as was predicted by the labour movement. Companies are making use of the relaxed rules on labour mobility, and the work and holiday program is functioning. There has been no flood of Chinese workers arriving in Australia, and the IFA, negotiated at a time of high resource prices and low labour availability, has yet to be utilized. Changed economic circumstances may lead to increased uptake and utilization of the IFA. Observers do note, however, that the Australian government seemed unprepared for the opposition to ChAFTA’s labour mobility elements, and seemed to be on the defensive on this issue as it moved ChAFTA toward ratification.

Implications for Canada

Canadian companies, particularly in the resources sector, have brought in temporary foreign workers from China, and this has at times been controversial. As labour mobility is almost certain to be on China’s agenda, Canada will have to be prepared to manage this issue effectively, balancing the needs of investing companies with concerns from the labour movement. Governments at all levels would need to ensure compliance to Canadian labour standards, including paying Canadian-level wages for Chinese staff posted in Canada.

If Canada considers loosening temporary foreign worker visa and other requirements in the context of a trade negotiation with China, the government will also need to be out front on the issue and engaging constructively with both labour and business. Canada should also explore reciprocity on visa issues and especially on initiatives like a work and holiday program.

⁹⁶ Construction, Forestry, Maritime, Mining and Energy Union (CFMEU), *The Free Trade Agreement Between the Government of Australia and the Government of the People’s Republic of China*, Submission to the Joint Standing Committee on Treaties, June 17 2015, pp. 6-8

⁹⁷ Joanna Howe, *The Impact of the China-Australia Free Trade Agreement on Australian job opportunities, wages and conditions*, University of Adelaide, September 2015; AFTINET Submission, p. 7

⁹⁸ Australian Council of Trade Unions, Interview with officials, February 20 2018

V. Regulatory and Systemic Issues

- ChAFTA focuses on market access and does not really add or deepen disciplines on regulatory or systemic barriers to business in China, nor does it substantively promote further transparency and predictability.
- The agreement's treatment of key 21st century issues like intellectual property and competition policy breaks no new ground, and its treatment of e-commerce is limited, despite the importance of the sector in China and its growing relevance to a bilateral trade deal.
- In trade negotiations with China, Canada should seek to go beyond ChAFTA. It should take a robust approach to systemic issues, pushing not only for increased disciplines but also seeking ways to strengthen cooperation and increase capacity in standards and regulations. Canada should be negotiating for the future, with an eye to nascent technologies and issues and their impact on bilateral and international trade.

Tariff reductions and increased access for service providers are excellent tools for trade liberalization but, as commentators from the Australian government, academia and the private sector have noted, regulatory and systemic obstacles can often undermine these gains. In its 2015 submission, the Australian industry group Grain Growers noted that technical access to the Chinese market had become “increasingly difficult, protracted and expensive in recent years.”⁹⁹ It suggested that, in future negotiations, robust treatment of technical barriers could at least as valuable to the wheat industry as elimination of the 3 percent tariff.¹⁰⁰ Many industry organizations and companies speak of the challenges presented by technical barriers, and some argue for the need for a more formal process to address non-tariff barriers.

In these systemic areas, however, ChAFTA breaks no new ground. Its chapters on technical barriers, sanitary and phytosanitary issues, trade remedies, and intellectual property do not push the boundaries or contain commitments beyond existing international obligations. Various committees have been established under several chapters of ChAFTA, but it is not clear that these committees are active or effective. An exchange of letters between Trade Minister Andrew Robb and Commerce Minister Guo Hucheng commits the two sides to further cooperation in financial services, including expeditious processing of applications and derivatives regulations, but these are essentially commitments to best efforts with little enforceability.¹⁰¹

These systemic issues remained unresolved as the Abbott government moved to finalize the ChAFTA negotiations and to lock in market access gains. With this impetus to bring things to a close, Australia, despite being the first major western economy to negotiate an FTA with China, is unlikely to have had the leverage to push significant systemic change. It took significant and sustained effort by all China's major trading partners to bring about systemic change in the WTO accession process—a one-sided negotiation that puts the applicant at a particular disadvantage. China joined the WTO in 2001, and its economic and political clout grew significantly since then and especially during the period of ChAFTA negotiations.

If ChAFTA was unable to bring about significant systemic change in China, it might have been more effective if it had put in place a more robust bilateral process for addressing emerging disputes over technical issues and other non-tariff barriers. Indeed, dispute settlement in all the ChAFTA chapters is weak.

Beyond regulatory issues, ChAFTA's handling of other systemic and emerging trade issues is minimal. E-commerce is booming in China, growing at rates of over 30 percent between 2016 and 2017, and is expected to account for 25 percent of total retail sales in China by 2020. Yet ChAFTA's approach takes what one analyst has called “a 20th century approach to a 21st century issue,” repeating existing international obligations and with weak enforcement language.¹⁰² E-commerce is also excluded from ChAFTA's dispute settlement process.¹⁰³ Since ChAFTA, China has tightened up and then backed off on e-commerce restrictions, causing Australian companies to shift strategies. A stronger chapter may have given Australian industry more certainty or more recourse.¹⁰⁴

99 Grain Growers Submission, 2015, p. 5

100 Luck Matthews, Grain Growers, Interview February 23 2018

101 Side Letter, Trade and Investment Minister Andrew Robb to Commerce Minister Guo Hucheng, June 17 2015

102 Henry Gao, “E-Commerce in ChAFTA: New Wine in Old Wineskins?” in Picker et. al. (2018), p. 301

103 ChAFTA, Chapter 12, Article 12.11

104 Brian McDonnell, “[Why cross-border eCommerce is the future for Australian businesses](https://www.theaustralian.com.au/business/technology/opinion/why-crossborder-ecommerce-is-the-future-for-australian-businesses/news-story/)” *Australian Business Review* March 24 2017

ChAFTA's treatment of other systemic issues is also weak. The chapter on intellectual property simply reaffirms existing international obligations, even though this continues to be an important and challenging issue for foreign companies in China. The issue of forced technology transfer also is a significant concern, especially when such transfers threaten companies' own long-term viability. The European Union sees these as clear violations of WTO rules and has launched a case against China.¹⁰⁵

Competition policy language revolves around enhanced cooperation, and any move toward dealing with government procurement (unlikely as long as China is not party to the Government Procurement Agreement) is put off until the next round of negotiations under ChAFTA's Built-in Agenda.

Implications for Canada

Tariff reductions and enhanced access for service providers are the heart of any free trade agreement. But these market access gains can be meaningless if systemic challenges are not also adequately addressed in a trade agreement. As tariffs fall, exporters often come face to face with new or existing regulatory barriers that undermine or counteract any gains made by tariff reductions or expanded access for services. These can be difficult to navigate or address, especially in a market like China, where the regulatory system has improved significantly since China's accession to the WTO but still lacks transparency, predictability and local-level enforcement.

A 2016 survey of Canadian businesses noted four top obstacles to doing business in China: lengthy and complicated certification processes, local content requirements (including at provincial and municipal levels), customs procedures and labelling requirements.¹⁰⁶

Problems with regulatory barriers can mean a significant financial hit for companies. The Canadian beef industry faced significant losses, and lost opportunities, when was bone-in beef was banned from the lucrative and growing China market from 2003 to 2016.¹⁰⁷ In the mining sector, lack of clarity in mining regulations means that local administrations can impede license applications from reaching provincial levels for approval, while minimum capital requirements and bidding procedures requiring many representatives to be on site on short notice discriminate against small and foreign companies.¹⁰⁸

It is therefore important that an agreement address these issues in a robust way and incorporate commitments or processes that go beyond existing international obligations. For Canada, as with Australia, the challenge is a lack of leverage to bring about systemic change within China. Such change requires continued broad international pressure and engagement by larger economies. Two features could help improve the regulatory climate for business: establishing a robust fast-track system to address specific market access questions, and embedding a sustained process of regulatory cooperation more clearly and firmly in an agreement.

A fast-track process for addressing non-tariff barriers (NTBs) could operate apart from the regular committee process to address barriers to trade at the national, provincial and local level. Such a committee would need to be able to bring together senior officials on both sides as needed, in person or virtually. It would also need to commit to responding quickly, especially in the case of agricultural products, where delays can mean spoilage of products and loss of entire shipments.

This kind of troubleshooting is not the only way to address regulatory challenges; cooperation and information sharing are extremely important. Information exchange and reciprocal inspection visits take place now between Canadian and Chinese regulators, but a more structured, formal process of cooperation would be a valuable long-term approach to complement and support both troubleshooting and *ad hoc* engagement. There is reference to this

[e8d570b7fe56931b88b622e76793f0eb](https://doi.org/10.1017/9781009000000.000)

¹⁰⁵ “China--Certain Measures on the Transfer of Technology: Request for Consultations by the European Union” EU Submission to the WTO, June 2018 http://trade.ec.europa.eu/doclib/docs/2018/june/tradoc_156910.pdf.pdf

¹⁰⁶ Sarah Kutulakos, Wendy Dobson, Walid Hejazi, and Daniela Stratulativ, *Canada China Business Survey 2016* (Canada China Business Council and Rotman School of Business, April 25 2017), p. 3

¹⁰⁷ Nathan Vanderklippe, “China lifts parts of 13-year ban on Canadian beef”, *Globe and Mail*, September 22 2016

¹⁰⁸ Canada China Business Council, Government of Canada Sector Report, *Mining Sector*.

in ChAFTA, but Canada could build on the idea to establish a mechanism that seriously advances a comprehensive regulatory cooperation agenda, building on discussions that took place during the first Canada-China Economic and Financial Strategic Dialogue of November 2018.

ChAFTA, with its focus on goods and targeted but limited gains in services, represents a static snapshot of the state of Australia-China trade at the time of negotiation. Canada should seek a broader and more forward-looking approach to issues like e-commerce, innovation, and support of transformative technologies. In e-commerce, it should seek to include effective provisions, as in CETA, on security and protection of personal information, as well as the use of e-commerce by SMEs. Canada could also push for stronger language on intellectual property issues, and in particular find ways to address the practice of pressuring joint venture partners into giving up IP as part of an investment deal.

Australia's experience shows that advancing all these issues will be difficult in a negotiation with China, so Canada will also have to have a clear sense of which of them take priority in a negotiation. What is important is that Canada goes into these discussions with a vision for the future that economic and technological change will bring to the relationship.

VI. Investment

- ChAFTA's treatment of investment is more limited and imbalanced than Canada's bilateral investment agreement with China.
- The ChAFTA experience shows the importance China attaches to the issue of the treatment of its state-owned enterprises (SOEs). Canada should be prepared to address the issue with pragmatism and an open mind, taking a fact-based approach and keeping in mind possible trade-offs as well as national security priorities.

The investment chapter in ChAFTA replaces a long-standing and outdated bilateral investment treaty from 1988. This is a step forward, but it is an incomplete step. The treatment of investment in the agreement is limited in scope and commitments by each party are unequal. As part of ChAFTA's built-in agenda, which arose from the Abbott government's impetus to finalize ChAFTA swiftly, the two sides have committed to review the investment legal framework within three years of entry into force of the agreement (that is, by the end of 2018), and to negotiate a more comprehensive agreement, the timeline for which is not specifically set out in the text.¹⁰⁹

The investment chapter covers broad principles like national treatment and most-favoured nation (MFN) status, as well as issues such as denial of benefits and investor-state dispute settlement. It does not address issues usually covered in bilateral investment agreements such as minimum standard of treatment; expropriation; transfers; performance requirements (beyond existing WTO obligations); and the composition and treatment of senior management and boards of directors.

As with trade in services, China's obligations in investment are more limited than those of Australia. Under Article 9.9.1, Australia provides a broad commitment to non-discriminatory treatment of Chinese investments. China's commitment on non-discrimination, however, does not include the establishment and acquisition of investments by Australian companies.¹¹⁰ This allows China to give preference to its own companies for early stages of investment activity. The Canada-China investment agreement, which was completed in 2012 and ratified in 2014, contains national treatment provisions that are fully reciprocal,¹¹¹ so it is not clear why Australia did not insist on the same reciprocity.¹¹²

In setting out its market access commitments, Australia takes the negative list approach, listing measures that do not conform to full liberalization, while China's approach is to have a positive list, outlining all the market access commitments made in ChAFTA. China has agreed to start switching to a negative list approach in the subsequent negotiations for expansion of the chapter, whenever this takes place.

The investor-state disputes elements of the investment chapter have also been criticized for lacking scope and ambition, and for the lack of a functional enforcement mechanism.¹¹³ ChAFTA's approach to this issue is more limited even than other FTAs China has signed. This may reflect not only increased conservatism in China on the investor-state dispute issue, but also reluctance on Australia's part to make more ambitious commitments in an increasingly controversial area of trade and investment policy.¹¹⁴ The Australian government's public presentation of these elements of ChAFTA stresses the defensive elements and the limits to its application.¹¹⁵

109 ChhAFTA, Chapter 9, Articles 9.9.1 and 9.9.3, p. 90; [China-Australia Free Trade Agreement: Summary of ChAFTA Chapters and Annexes](#)

110 ChAFTA, Chapter 9, Articles 9.9.1 and 9.9.2 p. 90. Australia commits to according Chinese investors "treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.."

111 [Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments](#), Articles 6.1 and 6.2

112 Vivienne Bath, "Substantial Provisions in ChAFTA's Investment Chapter" Picker, et.al. (2018), p. 213

113 Zhang Shu, "A Comparative Review of the Investor-State Arbitration Clause in ChAFTA from China's Perspective: Moving Forwards or Sideways?", Picker et.al. (2018), pp. 256-257

114 Zhang Shu (2018), pp. 245-6, 254

115 Government of Australia, Department of Foreign Affairs and Trade, [China-Australia Free Trade Agreement Quick Guide: Key Investment and Investor-State Dispute Settlement \(ISDS\) Outcomes](#)

Since Canada has an investment agreement with China, ChAFTA's approach is less relevant to Canada's plans, except perhaps if it signals a shift in approach to ISDS, which was a thorny issue in CETA. The issue of the treatment of Chinese state-owned enterprises, though, is more relevant. ChAFTA's treatment of SOE investment has been called a "step backward" because it lacks the concept of "competitive neutrality"—an approach to managing SOEs that is rooted in competition law—present in FTAs with trading partners like Switzerland, Singapore, Korea and Japan.¹¹⁶

This concept would not have appealed to Chinese negotiators, whose main objective was obtaining equal treatment for Chinese SOEs and private investment. Under ChAFTA, the review threshold for investments by privately owned enterprises in non-sensitive sectors has been raised from A\$252 million to A\$1.094 billion, but every potential SOE investment remains subject to review.¹¹⁷

Implications for Canada

Treatment of SOE investment will doubtless be a key objective for China in any FTA discussion with Canada. Currently Canada's investment threshold for review of whether an investment is a net benefit to Canada is C\$398 million for SOEs, and C\$1 billion for from privately-owned companies.¹¹⁸ This complex issue remains controversial, with concerns revolving around ownership and direction by the government of China, asymmetry in market access and national security.¹¹⁹ Canada has recently turned down significant Chinese SOE investments into Canada over national security concerns.

Unfortunately, political positions often outweigh nuanced analysis on this issue. SOEs are seen by some as solely arms of the state, advancing the agenda of the government of China, while others argue that they operate purely on a commercial basis. The distinction between China's state and private firms, however, continues to blur under President Xi Jinping, with the growing presence and influence of the Communist Party in the management and decisions of private companies as well. There are also those who argue that, being under more state scrutiny, SOEs tend to behave better as foreign investors.

If Canada is to navigate this issue effectively during an FTA discussion, it will need to have a clear view of the risks and potential negotiating opportunities involved. A realistic treatment requires a clear understanding of how SOEs are governed and their relationship to the Communist Party, of how this governance differs between different SOEs, and of the potential impact on Canada's commercial landscape. Canada's approach should be based on facts, not wishful thinking or ideology.

116 Takemasa Sekine, "The China-Australia FTA and Australia's FTAs with Other Asian Countries: Their Implications for Future SOE Regulation", in Picker, et.al., (2018), pp. 80-81, 98

117 [China Australia Free Trade Agreement: Investment and investor-state dispute settlement \(ISDS\)](#)

118 Government of Canada, [Investment Canada Act, "Thresholds"](#)

119 Wendy Dobson, "[China's State-Owned Enterprises and Canada's Foreign Direct Investment Policy](#)", *Canadian Public Policy*, (Volume 43 Issue S2, April 2017), pp. S29-S44

VII. Building on ChAFTA

- ChAFTA's "built-in agenda" of renewed negotiations three years after conclusion of the agreement remains vulnerable to downturns in bilateral relations. It is not certain that there will be any return to substantive talks in the near future.
- Developing greater understanding of China and competence in navigating the China market is an essential corollary to an FTA negotiation. Australia's program of outreach to communities and SMEs is a good starting point, but building China competence in Canada should start now as a nation-wide undertaking, and should involve governments and government corporations, the private sector, schools and other institutions.

ChAFTA has a built-in agenda that was supposed to include a return to the negotiating table in 2018, with a view to expanding the scope of the agreement and addressing some systemic issues, particularly in areas like investment, and to pursue further liberalization. This approach may have been useful in bringing negotiations to a conclusion in 2015, and to selling the agreement to those skeptical of its outcomes, but its implementation is a challenge. Postponing discussion of important systemic issues in an agreement with China increases their vulnerability to shifting political winds.

ChAFTA establishes a number of committees to review implementation of various chapters of the agreement, but observers report that the meeting schedule is not being met, and the process is moribund. With Australia-China relations at another low point, there is little indication that Chinese officials are willing to renew negotiations with their Australian counterparts. Australia, on the other hand, has little negotiating coinage to put on the table in a renewed round.

Australia's experience also highlights the importance of raising domestic competence in dealing with China. A free trade agreement, to be truly effective, should also be accompanied by an extensive program to develop more awareness of the agreement and to increase this China competency. Many Australian companies and institutions already enjoyed strong links to China and a significant level of China experience. To build on this in the ChAFTA context, the Australian government has initiated an extensive program of outreach to promote the agreement and to strengthen understanding of the China market, especially among SMEs and smaller players. Information sessions started in March 2015, a few months after the two countries had agreed on the text, and nine months before it came into effect. Nearly 100 were held in the first two years, usually led by senior officials or ministers, and were aimed not only at introducing the relevant elements of ChAFTA, but on conveying basic knowledge about the China market and connecting potential exporters to sources of knowledge in the government or the Australia China Business Council. The Council, with the support of the government of Australia, is continuing this program of education.

Developing a deeper and broader understanding of China continues to be an issue in Canada, and has been a focus of organizations like the Asia Pacific Foundation for some time. A program such as the one undertaken after ChAFTA would be essential to build awareness of an agreement and of the challenges and opportunities China presents. It would be better, however, not to wait until an agreement is reached. Indeed, the apparent lag between the signing of ChAFTA and large-scale take-up by the Australian private sector may in part be related to a lack of readiness by some Australian companies to deal with China. Whether China and Canada ever sign a trade agreement, China is an increasingly important trading partner. Understanding this country and its market must be addressed as a systemic issue, and this should start now.

This should be a nation-wide project. To have a significant impact requires a broad-based approach that encompasses not only training the business community, but also federal, provincial, territorial and municipal governments, along with government business institutions like Export Development Canada and the Business Development Bank of Canada. It requires close cooperation and sharing of talent among the private sector, government, civil society and academia. And it requires a comprehensive and coordinated pan-Canadian China strategy, led by the federal government, that includes an examination of Canada's competitiveness in trade financing, marketing and sales in China, and how best to support SMEs in the market.

It is still too soon for a definitive assessment of ChAFTA's long-term impact on Australia-China trade, but the agreement has provided some tangible market access for certain sectors of the Australian economy. There is also the intangible factor—the profile ChAFTA has brought to the China-Australia trade relationship, and the growth of interest on the part of Australian industry, especially SMEs, in pursuing business in the China market. Australian

observers on the ground have seen an increase in business travelers exploring the market, partly because having an FTA increases their comfort level with the China market, providing a better sense of security in trying to do business there. One Australian in China noted that for two years after the signature of ChAFTA, Australian companies had a far easier time getting meetings, and at senior levels, than they had in the past. ChAFTA opened doors. The Australia China Business Council has noted the increased interest in Australia on the part of Chinese companies, either at international exhibitions or in travelling to Australia. All this good press does provide more opportunity for advancing trade goals.

The buzz, however, doesn't last forever. The renegotiation and expansion of ChAFTA, anticipated in its built-in agenda, is not moving forward as anticipated, caught as it is in the current state of bilateral relations. This is unfortunate, because this second set of negotiations could have been an opportunity to put more ambition into ChAFTA, and to make it more forward looking.

Conclusion: Canada's Approach

- A free trade agreement with China can offer important opportunities, but brings with it many challenges as well. If Canada enters free trade negotiations with China, it should be ambitious in its goals, and this could take a long time to achieve.
- As an alternative to an FTA, Canada and China should consider a less formal umbrella agreement, under which the two countries could negotiate ways to enhance bilateral trade through engagement on systemic and regulatory issues, establish an effective trouble-shooting mechanism, and seek areas of mutual cooperation on global trade issues. Such a framework could be negotiated quickly, providing a high-level “win” for both sides and strengthening an important commercial relationship.
- This long-term approach could avoid the challenges of the USMCA constraints, while benefiting Canadian business and to bilateral relations, and setting the stage for potential c FTA talks in the future

A free trade agreement with China would require leadership, consistency and long-term strategic vision. If Canada embarks on such an enterprise with China, it should do so with the aim of going beyond ChAFTA's results, ensuring a strong governance structure, and address systemic obstacles to doing business.¹²⁰

An FTA could ultimately offer benefits to Canadian companies but would also be very challenging. Negotiations could take several years and would be subject to the vicissitudes of bilateral relations, all of which could delay these benefits. Implementing a legal agreement in a country where implementation of the rule of law is limited would remain a challenge; companies would still be faced with regulatory obstacles and irregular business practices, and other challenges that undermine or negate the gains made from enhanced market access. Successful management of an FTA would require Canada would also have to manage the reaction of the current White House, which is likely to be strongly negative. Sector-by-sector tariff reductions would avoid an American backlash but run up against WTO rules.

Under the circumstances, a standard FTA may not be the best option for Canada and China. Instead, they should consider a less formal Economic Partnership Framework, under which the two sides would undertake initiatives aimed at liberalizing and facilitating trade. Under such a framework, for example, the two countries could negotiate a series of sectoral agreements to address systemic and regulatory barriers to trade—barriers that have a concrete impact on bilateral trade. This framework could include a fast-track troubleshooting mechanism, staffed at senior levels on both sides, to address urgent problems in market access. It could strengthen cooperation and exchanges in areas like customs procedures, labelling, anti-dumping, and other issues, like currency convertibility, that have an impact on the conduct of bilateral trade. It could also develop an ambitious work plan to reduce regulatory and other barriers through exchange of information, mutual recognition agreements, and capacity-building, ultimately facilitating trade between the two countries. This approach would capture the Public Policy Forum's suggestion of a sectoral approach to trade with China,¹²¹ and could be a way of enhancing bilateral trade without coming into conflict with WTO rules or USMCA Section 32.10

There are other advantages to this approach. It allows for earlier resolution of regulatory or other systemic disputes, the promotion of systemic change in a less confrontational environment, and for exploration of newer elements of bilateral agreements where China has a lower comfort level: labour rights, for example. Since an EPF would have no end point for negotiations, it would also provide a framework for Canada and China to address new and emerging trade and economic issues—in other words, to be constantly negotiating with the future in mind. It would also create the opportunity for Canada and China to identify issues of common interest in the global trading system.

Such a framework might also be a means to gradually rebuilding the bilateral relationship, which has been damaged by China's actions in response to the Huawei case. If these initial obstacles can be resolved, this non-binding arrangement might be a way to begin to restore some semblance of equilibrium to the political relationship, in addition to its potential commercial benefits.

¹²⁰ Leblond, Patrick, *Toward a Free Trade Agreement with China: Opportunities, Challenges and Building Blocks for Canada*, Centre for International Governance Innovation, 2017, p. 1

¹²¹ See Public Policy Forum (2018), pp. 18-19; Philip Calvert, “[The US-Mexico-Canada Agreement: What's Next for Trade with China?](#)” (University of Alberta China Institute Commentary, October 3 2018) and commentary in China Research Partnership, “[USMCA and the Next Steps in Canada-China Relations](#)”

Australia's built-in agenda has created a living negotiation that, in theory, provides the opportunity for revision and improvement through further negotiations. But it is not clear when this new, second stage, will unfold. The EPF as an umbrella agreement would be an ever-evolving collection of processes and small agreements, each contributing to incrementally enhance the bilateral trade relationship, while building solid and multifaceted relationships among key players from both countries. As an ongoing, lower-profile undertaking, it might also be less vulnerable to political change, and more likely to survive downturns in the relationship and changes in government. Ultimately, if Canada and China decide to proceed with an FTA, the EPF would provide a solid and effective platform to facilitate a faster negotiation process.

ChAFTA, despite some of its limitations, has brought benefits both tangible and intangible to the China-Australian relationship. It was an important undertaking that, while perhaps less ambitious in results than some may have wanted, broke new ground with China. A free trade agreement with China may present opportunities, but has its challenges, particularly with respect to systemic challenges and the limits of the rule of law in China. The goal of any trade initiative should be enhancing business with China, and in this context a standard FTA may not be the best approach. China's global confidence is high and its inclinations toward economic nationalism are strong, and US discomfort with a Canada-China FTA is palpable. This requires a creative approach to China and to the opportunities that confront Canadian business in this important and challenging market.

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