

AWI Trade Briefing – February 2006

Highlights

- **Australia-China FTA** Negotiations on the Australia-China FTA continued on 22 February, when draft text and the structure of negotiations were discussed.
- **Outcomes from WTO Doha Round: Hong Kong, Davos** There were very limited outcomes from Hong Kong negotiations and from subsequent negotiations since.
- **New bilateral trade agreements on textiles forged.** The US, EU and Brazil now all have Memoranda of Understanding with China that regulate clothing exports.

Australia- China Free Trade Area (FTA) negotiations

The outcome of the FTA is of critical importance to the wool industry. Australia faces a tariff rate quota and other barriers to trade in wool with China. China is the most important market for Australian wool.

Developments in the negotiations are being monitored closely and AWI, through its China FTA Trade Committee, is developing a series of initiatives to ensure the best possible outcome for the industry in the negotiations.

There are reports wool has been omitted from the FTA China has just completed with Chile. Chile is not a key wool producer; this could mean China was seeking a precedent to exclude wool from its FTAs.

Timing

Negotiations on the Australia-China FTA continued on 22 February, when draft text and the structure of negotiations were discussed. Australia will now seek to have further rounds of negotiations in May, August and November. Trade officials do not expect the FTA to be finished early and are setting into a long haul, at least 2 years more.

Agriculture is a key sticking point in the negotiations for the Chinese.

Modalities

At the time of writing, Australian officials were seeking to hold discussions in the February

round on the “modalities” for negotiations on goods. In general terms, this means they would talk about the scope for negotiations on goods. They want to agree on these modalities in April and to begin discussion on modalities in services in August.

The “modalities” agreed will be crucial for shaping the structure of the negotiations and how interests are addressed.

China’s attitude

China has expressed a desire in the past to carry out negotiations on goods first and then to negotiate on services. China has concluded FTAs that have left out services altogether, promising to cover them in later negotiations. Australia has rejected this idea. Australian officials see concurrent discussions on goods, services and investment as a precondition to participating in FTA negotiations.

Australian negotiators have already begun informal discussions on the liberalisation of services with their Chinese counterparts. Chinese negotiators are reported to be unconvinced of the benefits of including chapters on investment and some services in an FTA.

A key sticking point in the negotiations on goods is agriculture. In a speech to the Asia Society in Melbourne late last year Chinese Ambassador to Australia Madam Fu Ying warned that “agriculture, on the Chinese side, will be the most difficult part of the (Australia-China FTA) negotiations”, citing concerns over the stabilisation of the sector which employs

800 million. She added that “both sides would have other sensitive areas in the negotiations, such as manufacturing as an Australian concern and the services sector as a Chinese worry”. Sources report that negotiators in New Zealand are still encountering entrenched reluctance to liberalise agriculture in their FTA negotiations with China.

The Department of Foreign Affairs and Trade will hold conferences in China—on services in April and agriculture in August or September—which will seek to demonstrate the benefits of liberalisation to the Chinese economy.

Chinese PM to visit

Another development likely to impact on the negotiations is that Chinese Prime Minister Wen Jiabao will visit Australia in April. Australian officials will be seeking to secure a high level commitment from the Prime Minister for a comprehensive result on the FTA.

China’s wool quota

While China’s raw wool quota on wool was either filled or came very close to filling in 2004, it is not clear whether it filled in 2005. We are examining this in greater detail and will report on it in subsequent editions. There are also reports that China was flexible on its cotton quotas in 2004 and 2005. This is of relevance when analysing quota fill for raw wool in previous years. We are also investigating the flexibility on cotton quotas and will report on it in subsequent editions of the reporter.

Outcomes from WTO Doha Round: Hong Kong, Davos

There were very limited outcomes from the Hong Kong negotiations and in negotiations since. Genuine progress in agriculture and non-agricultural market access was limited to agreement to remove export subsidies.

WTO negotiations are significant to Australian wool exporters because unprocessed wool faces tariff and non-tariff barriers in two of its most important markets, China and India.

The outcome of the agricultural negotiations in the Doha Round is relevant to the wool industry in two main areas: the potential for tariffs on wool in some key markets to be

reduced; and the potential for Tariff Rate Quotas (TRQs) to be expanded.

The recent World Trade Organisation Ministerial in Hong Kong has been criticised for its failure to generate concrete achievements. By contrast, Australia has viewed the outcome positively as proof that we are on the pathway to concluding the round.

Developments in agriculture since Hong Kong have also been modest. At Hong Kong a deadline was set for 'full modalities' to be agreed by April 2006. A week of discussions among WTO members, held from January 23-26 in Davos, focused solely on procedure. Nothing concrete was achieved.

Our assessment is that if the Doha Round is concluded in 12 months, the results will be very modest, because the EU cannot undertake significant liberalisation by then.

Progress in agriculture poor

At Davos, WTO members agreed on the need to develop text on a number of technical matters in the agricultural negotiations. It was agreed these matters must be finalised by the end of April. These issues include formulas and figures for reducing farm tariffs and subsidies.

The outcome on some agricultural TRQs will be determined by the negotiations on so-called “sensitive” or “special” products, which are products slated for lower tariff cuts than normal products, and this matter is covered below.

Tariffs currently affect wool products in a number of markets: there are low tariffs on wool and tops into markets such as the EU and US, higher tariffs into India and Russia. Russia is not yet a member of the WTO and so is unaffected by the Doha Round.

Progress on non-agricultural goods also slight

The outcome of non-Agricultural Market Access (or NAMA) negotiations will determine tariff reductions in manufactured goods, like wool tops. Australia is no longer a significant exporter of wool tops.

Textiles and apparel were discussed in the sectoral tariff component of the NAMA

negotiations at Hong Kong, with no concrete result apparent. At Davos, discussion on NAMA was limited to confidence building. The basic modalities on NAMA—that were sought prior to Hong Kong—were still not agreed.

The text produced in Hong Kong linked the level of ambition for agriculture and NAMA. This linkage is an unfortunate outcome for both manufacturers and farmers, since there is clearly little on offer in agriculture.

The question of special and sensitive products

Discussion of “sensitive products” and “special products” has dominated discussions since Hong Kong. Sensitive products are those for which lower reductions in protection would apply than those negotiated for agricultural goods generally. Special goods are those sensitive goods identified by developing countries, for which even lower reductions in protection would apply.

Various proposals have been put up on how to deal with sensitive products since the Hong Kong meeting.

In the context of wool imports, China could argue there is a reasonable basis for finding wool to be a sensitive product, since the Chinese wool industry is mainly the reserve of an ethnic minority. AWI has argued to the government that this designation should not be acceptable to Australian negotiators.

Removal of cotton export subsidies

Given that cotton competes against wool as a fibre in textile and clothing uses, the outcome of the negotiations on cotton are relevant for the wool industry. In Hong Kong, agreement was reached that developed countries would give duty free and quota free access to least developed country exports of cotton as of the conclusion of Doha Round negotiations.

Developed countries (i.e., the US) would eliminate export subsidies for cotton in 2006 and provide faster elimination of cotton subsidies than for other domestic support.

The overall reductions and the implementation schedules for domestic farm subsidies must be agreed before the depth and speed of cuts in

domestic subsidies for cotton can be negotiated. Domestic subsidies make up over 80 percent of total US support for cotton (estimated at estimated around USD 3.8 billion in 2004). The impact of the WTO negotiations on flows of trade in cotton and competing fibres looks to be slight for the foreseeable future.

China’s position in the WTO

Under the Doha Ministerial Declaration, it is recognised special consideration must be granted to recently acceded members who have undertaken extensive market access commitments at the time of their accession.ⁱ China views itself as having made more concessions in a short time than any other WTO member,ⁱⁱ and Pascal Lamy has sanctioned the idea of China seeking a “rebate” on liberalisation, to make up for its earlier commitments.ⁱⁱⁱ In this context China is likely to liberalise very little in the Round.

New bilateral trade agreements on textiles forged

The US, EU and Brazil now all have Memoranda of Understanding with China that regulate clothing exports. The EU agreement was reached in June 2005 and made more flexible in September, the US agreement was reached in December 2005 and the Brazil agreement in February 2006.

This is significant because over 50 percent of Australian wool, by volume, goes to China. Of this, over 50 percent goes into garment making, of which a further large tranche is exported to the US and the EU.

Trade in textiles and clothing has increasingly been affected by bilateral agreements since the termination of the WTO Agreement on Textiles and Clothing (ATC) on January 1, 2005. Following the termination of the ATC, all quotas on textile imports were eliminated. However, goods from China are subject to “safeguard” actions through 2008, under the terms of China’s WTO accession.^{iv}

Following the removal of the quotas, Chinese apparel exports to the US and EU in certain categories surged. US apparel imports from China rose 200% in volume terms in February, doubling in the first two months of the quota-free era. EU imports also surged, with volumes

from January to May 2005 in some apparel categories, such as pullovers and men's trousers, increasing 485 percent and 468 percent, respectively.

In light of these surges, the US and EU governments resorted to the China-specific textile safeguard clause.

The EU MoU has broad, non-fibre specific categories that include wool product. It allows for between 8 and 10 percent annual growth per category, depending on the broad product category. The European MoU was re-negotiated in September, when the original quotas agreed in June filled too quickly, leading to a stock pile of 80 million goods at European ports. The disruption to market flows that ensued was sufficient that pressure was created for the Commission to seek an alternative. The EU negotiated a new agreement by September, which permitted more flexibility, with between 4 and 12.5 percent growth annually across various categories. It is not clear how wool is faring within the broad categories in the EU MoU.

The US MoU specifically covers woollen trousers, woolen socks, and men's and boys' woollen suits. It replaces all previous safeguards, restricts imports in 34 categories of apparel and textile and will run for three years. The volumes relate to imports last year with a small margin for growth in imports over the next three years. The US maintains the right to use safeguards on other textile imports from China, but has agreed under the MoU to "practise restraint."

Under the US MoU, Chinese imports of wool suits are permitted to grow at between 14.5 percent and 16 percent in 2007 and 2008 respectively.^v Imports of wool trousers are permitted to grow at 12.5 percent and 16 percent in 2007 and 2008 respectively.^{vi} There is a 3 percent margin for shifting quantities between years (forwards or backwards).

However, reports have emerged that while there is very high demand for licences to export some products under the US MoU, this is not the case for wool products at this stage.

In February, China signed another bilateral MoU, with Brazil. The agreement restricts Chinese exports of 70 textile and clothing

products to Brazil between 2006 and 2008. South Africa is also reportedly seeking a MoU with China restraining imports. These agreements, while nowhere near as significant as the EU and US ones, nevertheless indicate expansion of bilateral trade restraints that complicate trade in wool and can ultimately serve to reduce demand for wool internationally.

ⁱ World Trade Organization, WT/MIN(05)/W/3/Rev.2 18 December 2005, MINISTERIAL CONFERENCE, Sixth Session, Hong Kong, 13 - 18 December 2005, point 58.

ⁱⁱ Bo Xilai, Chinese minister of commerce, told the sixth WTO Ministerial Conference in Hong Kong in December 2005 that "no other member in the WTO history has made such a huge cut in such a short period of time, even the developed members." See www.gov.cn/misc/2006-01/19/content_164823.htm Accessed March 2, 2006.

ⁱⁱⁱ Chinese Government statement citing Lamy: "As to China's concern in future negotiations; Lamy said the country had reason to ask for a "rebate" on new market opening commitments because, as a recently acceded WTO member, it had already made more commitments than most developing countries. Lamy: 'China will be asking for a rebate on new market opening commitments. I believe the other members will not object, provided this rebate remains reasonable and China also brings its contribution to the round.' See www.gov.cn/misc/2006-01/19/content_164823.htm, accessed March 2, 2006.

^{iv} The authority for WTO members to implement textile safeguard restraints was a condition of China's accession to the WTO on December 11, 2001. Paragraph 242 of the Accession Agreement allows WTO members who believe imports of Chinese origin textiles and apparel products are, due to market disruption, threatening to impede the orderly development of trade in these products, to request consultations with the People's Republic of China with a view to easing or avoiding such market disruption.

^v Based on number of products, rather than a price.

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