



# The 'China advantage'

*What price a free trade agreement with China?*



Commissioned by the Victorian Branch  
of the Electrical Trades Union

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CPI Strategic provides communication and strategic advice for the management of public policy issues and for corporate and stakeholder relationships.

# List of acronyms

ACFTU	All-China Federation of Trade Unions
AMWU	Australian Manufacturing Workers Union
AUSFTA	Australia-US Free Trade Agreement
CGE	computable generated equilibrium
CIE	Centre for International Economics
CLB	China Labour Bulletin
DFAT	Department of Foreign Affairs and Trade
EPI	Economic Policy Institute
FIRB	Foreign Investment Review Board
GDP	Gross Domestic Product
IAC	Industries Assistance Commission
ILO	International Labor Organisation
NAFTA	North American Free Trade Agreement
Unions NSW	NSW Trades and Labour Council
WTO	World Trade Organisation



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Mail: P. O. Box 240, Kew, Victoria, 3101

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# Foreword

It is hard to believe that we are continuing negotiations for a Free Trade Agreement with China under a Labor government. These negotiations were instigated by John Howard and are now up to round 14. What else could we possibly concede that has not already been offered up under Howard?

As a free trade agreement aims to reduce or eliminate barriers to trade, the reduction of tariffs, quotas, specialisation, labour division and comparative advantage (that a country focuses on what it does best and imports everything else) may be the topics of discussion.

This report aims to spark further public debate on this important national interest issue. Astonishingly, there is currently very little public debate. It is a social justice matter that all Australians should be concerned about. This report highlights the dangers posed by a FTA with China – which would not only be a threat to jobs, but also impact the employability of our children.

Australia's track record of other signed free trade agreements (FTA's) is telling. Australia has FTA's with Singapore, Thailand and USA. Our imports from these countries has increased faster than our exports to them. Research released in 2007 indicated that 26,000 jobs have been lost since these agreements were signed. The same report indicated that an FTA with China could create 12,000 jobs but cost 170,000 manufacturing jobs.<sup>1</sup>

Australia increased trade liberalization with China under John Howard. Australia has had a cumulative trade deficit with China for 75 of the last 79 quarters.<sup>2</sup> Australia is increasingly spending more on value added products from China than we have earned from selling raw products. Meanwhile, manufacturing as a proportion of Australian exports, has fallen over the last decade from 45 to 33%.<sup>3</sup>

Given these statistics it is not surprising that under the Liberal-National Government, over 100,000 Australian manufacturing jobs have been lost.<sup>4</sup> The economic impact has been a decrease in the diversity and sophistication of Australia's economy and an increase in our vulnerability as a small trade exposed predominately raw product exporter.

When Kevin Rudd became Prime Minister he said he did not

*'want to be Prime Minister of a country that doesn't make things any more ... I want there to be a long-term manufacturing industry for this nation.'*

We support the Prime Minister, but signing a free trade agreement (FTA) with China is not the way to go.

Glenn Stevens, Governor of the Reserve Bank of Australia in a speech on 28 July 2009, highlighted economic concerns and uncertainties;

<sup>1</sup> Dr. Jim Stanford and Pat Conroy, *The potential employment impacts of an Australia-China free trade agreement*, (2007) Australian Manufacturing Workers Union.

<sup>2</sup> Reserve Bank of Australia, *Balance of Payments Statistics*, taken from various pages including [www.rba.gov.au/statistics/Bulletin/H03hist.xls](http://www.rba.gov.au/statistics/Bulletin/H03hist.xls) Viewed 27 August 2009.

<sup>3</sup> Australian Bureau of Statistics, *Trade Statistics, 1998-2008*

<sup>4</sup> Dr. Jim Stanford and Pat Conroy, *The potential employment impacts of an Australia-China free trade agreement*, (2007) Australian Manufacturing Workers Union.



*Over the medium term, the emergence of China and other countries such as India will continue, and will offer opportunities for Australia. But China's emergence also presents challenges. If commodity prices do stay at their current relatively high levels, the mineral extraction sector ... will expand. Other sectors will, relatively, contract over time.*

*Moreover, if we are more integrated into China's expansion, we will be similarly more exposed to the consequences.... So our understanding of how the Chinese economy works, and of what risks may be accumulating there, will need continual work.*

Concerns raised by Glenn Stevens regarding China's economic differences have been raised by the international trading community, including the US and the EU. Major international trade and diplomacy issues are coming to the fore, including:

- **Chinese practices of selling goods at below their true cost of production** (commonly known as dumping). According to the World Trade Organisation, China is the most frequently investigated violator of 'antidumping' rules.<sup>5</sup> Low production costs are already a feature of Chinese products due to labour rights suppression, dangerous and low paid employment.
- **Chinese control of the value of its currency to keep its exports cheap**  
Through under-valuing the Yuan and selling its products at artificially low prices, China has accrued foreign currency reserves of \$2,132 US billion the largest in the world, growing at 12% per year.<sup>6</sup>
- **China using trading surpluses to buy out foreign commodity suppliers, at 'fire sale' prices, to secure cheap supply**  
China is investing its global surpluses of foreign reserves on buying-out foreign suppliers of commodities. This has recently been witnessed in Australia with the rise in Foreign Investment Review Board approvals for Chinese investment in minerals exploration and development: As well as the recent Chinese investments in the indebted Fortescue, to decrease future prices of iron ore.<sup>7</sup>
- **FTA's with China increase deficits of its trading partners**  
The US Chinese Free Trade Agreement 2005, has decimated the US economy and contributed to its fall in industrial production, unemployment and gross debt. The US deficit is dominated by the trade deficit in manufactured goods dominated by imports of Chinese goods. In June 2009 China's share of the US goods trade deficit was 83%.<sup>8</sup>
- **China's labour and environmental standards are below the international norm.**  
China's refusal to fully participate in international organisations' efforts at raising standards of employment and environmental management is a legitimate concern which cannot continue to be ignored. As succinctly put by the Victorian Government 'An FTA will only be desirable if it is soundly founded on environmental and labour standards which are appropriate, rigorous and enforced'.<sup>9</sup>

<sup>5</sup> World Trade Organisation, *Anti Dumping Notifications database*. Taken from [http://www.wto.org/english/thewto\\_e/countries\\_e/china\\_e.htm#notifications](http://www.wto.org/english/thewto_e/countries_e/china_e.htm#notifications) Viewed 26 August 2009.

<sup>6</sup> The People's Bank of China, Release '*Money Supply Continues Rapid Growth*' submitted at 14 August 2009. Taken from <http://www.pbc.gov.cn/english/detail.asp?col=6400&id=1413> Viewed 25 August 2009.

<sup>7</sup> Foreign Investment Review Board, *Annual Report 2007/08*, <http://firb.gov.au/content/publications.asp?NavID=5> Viewed 25 August 2009.

<sup>8</sup> Robert E. Scott, *China dominates U.S. non-oil trade deficit in 2009*, Economic Policy Institute <http://www.epi.org/publications/entry/intlpic20090723/> Viewed 25 August 2009.

<sup>9</sup> Victorian Government, *Victorian Government Submission to the Australian China Free Trade Agreement Feasibility Study (2004)*, [http://www.dfat.gov.au/geo/china/fta/submissions/cfta\\_submission\\_8st01.pdf](http://www.dfat.gov.au/geo/china/fta/submissions/cfta_submission_8st01.pdf) Viewed 25 August 2009.



Like many other union officials and employers I have seen first hand the appalling condition in which many Chinese people live and work. Most Chinese workers have not had a real increase in pay since the mid 1990s despite the economic boom. I have also seen trade unionism, China style, which has done little to improve the wages and conditions of workers. Without the right to take industrial action to improve the standard of living, Chinese workers will never improve their lot in life.

This report is not an attack on China – far from it. China remains an important trading partner and we should support its democratisation and the creation of 'free trade unions'. As free trade agreements require scrutiny however, this study reveals a much greater and more complex challenge than many Australians are aware of. China is not just another Japan, Taiwan or South Korea. Certainly there are major flaws in free trade theory. But we also need to appreciate the range of unfair practices in which China engages, including exploiting its own people and its environment. These practices make it impossible for both developed countries like Australia and developing countries to compete against China on a level playing field.

Australian needs a public interest assessment, recognising the views of other important economic, trading, regional and security partners. Global geopolitical tensions over fair trade and human rights are increasing during the global economic downturn. Our aim is to encourage our Government to ensure that Australia's national interest, and the international interest of fair trade, are upheld.

As this report demonstrates, facing the China challenge must be an urgent priority. We support Mr. Rudd's aspiration, but if this challenge is not addressed, China's unfair practices will be the last nail in Australia's manufacturing coffin.

**Dean Mighell**  
**Secretary ETU, Victorian Branch**



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# Executive Summary

Free trade advocates have promised more jobs, better-paid jobs and better living standards. However, free trade theory has failed to deliver. For example, it has been estimated that three trade agreements signed by Australia could have cost up to 26,000 jobs.<sup>1</sup> Despite these failures, free trade advocates want Australia to sign a free trade agreement (FTA) with China.

This paper discusses the stark danger that a FTA with China would pose, threatening the foundations and long-term performance of the Australian economy. It argues that a number of key issues must be addressed before Australia even contemplates entering into a FTA with China.

The first section of the paper – The decline of manufacturing in Australia – examines the importance of the manufacturing industry to the Australian economy. It also discusses the decline of that industry in recent years in the context of Australia's trade policy.

Our current FTA negotiations with China illustrate that we have not learnt the free trade lessons of the past and we are heading in the wrong direction. In fact we have already handed over a major concession in these negotiations by agreeing to give China "market economy status".

Section two – The 'China advantage' – explores some of the factors that create an uneven playing field between China and Australia in terms of trade. These include China's hukou or household registration system, which keep wages and labour standards of 'migrant' or rural workers low, and China's lack of concern for human rights or the environment. For this reason, China has more than an economic advantage over other countries - it has a human rights advantage. These factors enable China to significantly undercut global competitors in the market for manufactured goods.

Research overseen by a US academic highlights the extent to which China's advantage is the

result of unfair trade practices. These practices disadvantage other developing countries as much as they do countries like Australia. The section concludes with a summary of some threshold issues that must be at the forefront of any discussions with China about a FTA.

The third section of the paper – Free trade: theory and reality – explores the theory of free trade in more detail, including comparative advantage. It analyses the negative impact that free trade policy has had on the Australian economy and other economies around the world in terms of jobs and skill losses. The section then explores the impact of trade liberalisation between Australia and China, and China and other countries.

Section four – Trade liberalisation: the new spin – discusses some of the more recent claims made by free trade advocates. There have been renewed efforts to talk up the benefits of free trade, particularly given the policy's failure to live up to its promise of universal wealth. Reports commissioned by the Federal Government point to the supposed benefits of free trade between Australian and China including access to cheaper, high quality consumer goods.<sup>2</sup> However, US research suggests that the wages of 70 per cent of US workers are lower because of free trade and that the loss of wages outweighs any benefit these workers have received from access to cheaper consumer goods.<sup>3</sup>

Section five – Lies damned lies and econometric modelling – shows the inherent flaws in the econometric modelling that underpins Australia's free trade agreements. An approach based on more realistic assumptions points to a much bleaker outcome for Australian jobs if Australia enters into a FTA with China. Even the econometric modeling used by free trade advocates predicts that in Victoria the primary industry sectors would benefit, but the manufacturing sectors would lose under a FTA.<sup>4</sup>



Section six – China takes all – discusses the fact that free trade and comparative advantage theory are not equipped to deal with the key factor that underpins the Chinese economy. This is: an authoritarian regime that not only has an economic advantage, but also a human rights advantage.

The view that Australia could lose manufacturing jobs to overseas companies whilst increasing other exports in relation to services, innovation, research and development has proved to be at best optimistic. Increasingly China is becoming the international centre for research, development and innovation. This section illustrates the fact that Australia loses much more than jobs when manufacturing skills are moved offshore.

Section seven is titled Exploitation. It examines in more detail China's lack of labour rights and its low standards and poor enforcement of regulations in relation to child labour, occupational health and safety and environmental protection. These factors provide China with a disturbing advantage, particularly in relation to manufacturing.

Section eight – Liberalising trade: reversing political influence – points out that free trade theory cannot respond to the challenges presented by the Chinese economic and political system which integrates investment decisions with broader political and strategic objectives. Advocates of free trade tend to argue that increased trade links with countries with poor democratic and human rights records will help positively influence social outcomes in these countries. In China the reverse has been the case.

This section examines the current mechanisms used by Australia to control foreign ownership

in Australian companies. It also discusses the way that politics and commerce are inextricably linked in China due to the authoritarian regime. The chapter concludes by pointing out that increased trade with China has actually reduced other countries' political influence in China, rather than increasing it.

Section nine contains the paper's Conclusion and recommendations. Australia should call a halt to FTA negotiations with China until rigorous research is undertaken on the benefits of a free trade agreement. The outcomes of the North America Free Trade Agreement (NAFTA) and other agreements that Australia has signed should be used as a benchmark for this research. The basis of any fair trade agreement with China must include specific provisions that ensure China stops exploiting its workers and the environment and also removes unfair trade practices.

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## Endnotes

- 1 Dr. Jim Stanford and Pat Conroy, *The potential employment impacts of an Australia-China free trade agreement*, April, 2007, Section III
- 2 See Centre for International Economics, *Benefits of trade and trade liberalisation*, May 2009, p. 20 and The Allen Consulting Group, *The benefits to Australian households of trade with China*, 1 January 2009
- 3 Dean Baker and Mark Weisbrot, *Will new trade gains make us rich?*, Centre for Economic and Policy Research, Washington, October, 2001
- 4 Centre for International Economics, *Study into the impacts of an Australia-China free trade agreement on Victoria*, November, 2007, p. 16



# I. The decline of Australia's manufacturing industry

***'I do not want to be Prime Minister of a country that doesn't make things any more. I don't want to be Prime Minister of a country that doesn't manufacture things any more. I want there to be a long-term manufacturing industry for this nation.'*** (Kevin Rudd)

## Introduction

This section examines the importance of the manufacturing industry to the Australian economy and the decline of that industry in recent years.

In this context the section discusses our current FTA negotiations with China and the major concessions we have already made, in contrast to many other developed countries, by agreeing to give China "market economy status".

## A manufacturing industry in trouble

Mr. Rudd is the first Australian prime minister for at least 25 years to make a vibrant, significant manufacturing industry a measure of his prime ministership. His statement underlined the importance of manufacturing to the prosperity and wellbeing of the nation.

The manufacturing industry generates the technology, research and investment that are a foundation for skilled, well-paid jobs and it is critical to our balance of payments. According to tax and industry policy consultant and former Industries Assistance Commission (IAC) director, Martin Feil:

*Adding value to resources is what employs workers.  
Adding value to our exports and manufacturing*

*products that substitute for imports is what will employ Australians at our wage levels and reduce our current account deficit.<sup>2</sup>*

However, the Australian manufacturing industry has declined significantly in recent years. Annual average employment for manufacturing was 1,081,300 people in 2001–02, which was equal to about 12 per cent of total employment. In 2006–07 it was 1,063,900 which was 10 per cent of total employment. However, employment in the wider economy grew at an average annual rate of 2.4 per cent.<sup>3</sup>

A report commissioned by the Australian Manufacturing Workers Union (AMWU) estimates that between 2001 and 2006 there was a net loss of 66,000 jobs to China alone.<sup>4</sup> Between 2001 and 2005 manufacturing exports fell by \$1.3 billion, manufacturing imports grew by almost \$28.4 billion and the manufacturing trade deficit increased to \$89.5 billion.<sup>5</sup>

Over the five years ending 2006–07, the annual average growth rate for manufacturing was just 1 per cent, compared with 3.2 per cent for the wider economy. Growth rates in the major manufacturing states of New South Wales and Victoria were very weak. This trend was completely the opposite in Queensland and Western Australia,<sup>6</sup> reinforcing the Australian economy's reliance on the mining and agriculture sectors and, when the Australian dollar is weak compared with other currencies, tourism.



In 1997, then Australian Workers Union National Secretary and now Parliamentary Secretary for Disabilities and Children's Services, Bill Shorten warned:

*Anyone that just wants to get out the white flag and surrender on Australian manufacturing needs to have a good look at themselves in the mirror. Do we still want to make things in Australia or do we want to turn off the lights and wave goodbye to every manufacturing job in Australia?*<sup>7</sup>

Since then the trend has not changed. The latest examples occurred in early 2009 when Pacific Brands announced it was closing plants in Australia and transferring 1850 jobs to China. Unions NSW revealed that the NSW Government had given contracts for everything from police uniforms to railway carriages to China and that 10,000 jobs had been lost as a result. The NSW Premier was dubbed the Premier for Workers in China.

According to Channel Nine finance editor Ross Greenwood a key issue is the fact 'there is no protection for manufacturers in this country, so they are absolutely open to foreign competitors, foreign importers, to come in and really wipe their operations out.'<sup>8</sup>

As a result of our increasingly monochrome economy Australia has become more vulnerable, a point that was highlighted in March 2009 by Stephen Roach, Chairman of Morgan Stanley Asia. He noted the global commodity boom had also gone bust catching Australia without much diversification or a backup plan: 'it's the old adage, you just don't want to put all of your eggs in one basket.'<sup>9</sup>

## Free trade with China – the wrong path

The major reason for this development is the ascendancy over the last 30 years of free market theory and with it free trade theory. Free trade theory or comparative advantage theory has not delivered on its promises. However, it continues to heavily influence major political parties, federal and state bureaucracies, influential commentators

in the media, and academics - especially those in business schools and commerce faculties.

As a result, Australia is continuing to pursue a FTA with China. Trade Minister Simon Crean has visited China five times already to talk up a potential agreement. The Government is relying on econometric modellers whose forecasts are being used by the Department of Foreign Affairs and Trade (DFAT) to justify proceeding with the negotiations.

According to the forecasts cereal grains, wool, wool tops, minerals, and non-ferrous metals are the Australian industries that will gain the most benefit from a FTA with China. The Chinese industries that would benefit most from the FTA are manufacturing industries, especially textiles, apparel, and miscellaneous manufactures such as toys and sporting goods.<sup>10</sup>

When the Howard Government commenced negotiations in 2005 in relation to the FTA, the Chinese Government insisted that Australia agree to accord China "market economy status". Given that a number of commentators have pointed out that China was not and is not 'a complete market economy',<sup>11</sup> this major concession is a concern.

*Europe Agri* has noted that many of Beijing's other trading partners have not accorded China with market economy status because of concerns that Chinese authorities still interfere too much in business.<sup>12</sup> These trading partners include the European Union and the USA. The European Commission cited a number of reasons for its decisions including the weak rule of law in China and state interference, as well as poor standards of corporate governance.<sup>13</sup> In fact the US Commerce Department has issued an 86-page report explaining why China is still well short of operating as a market economy.<sup>14</sup>

This Australian concession is important to China. Recognising China as a market economy makes it harder to claim that China is "dumping" or selling goods to Australia at a price below the cost of production or below home-market prices. To calculate dumping margins for a state economy that is not a market economy, the prices and other information used to determine the percentage by which the normal price exceeds the dumped



price would not be taken from the country under investigation. Instead they are taken from a surrogate country that has market economy status.

The implications of this decision for Australia could extend well beyond the price of goods such as steel. The automotive industry, for example, might well come to have a need for effective anti-dumping measures.<sup>15</sup>

Australia has granted this concession, enabling China to use Australia's decision as part of its global campaign to be accorded market economy status. However, Australia has not obtained anything in exchange.

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## Endnotes

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 2 Martin Feil, 'Australia entree on Chinese menu', *The Age*, 5 September 2005  
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 5 *ibid.*, Introduction  
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 11 For example, Malcolm Farr, 'There's no Chinese elephant in the room', *Daily Telegraph*, 30 March, 2009, p. 18  
 12 'Commission rebuffs British push for Chinese market-economy status', *Europe Agri*, 22 July, 2005  
 13 'Commission rebuffs British push for Chinese market-economy status'  
 14 Rory Carroll, 'China market economy status is far off', *American Metal Market*, 6 September 2006, p. 4  
 15 Projections to 2010 show a 3 million unit annual difference between projected domestic Chinese auto sales and assembly capacity (*Auto Report*, International Metalworkers' Federation, Geneva, Switzerland, p. 35)



## 2. The China advantage

*..a government that terrorizes its own citizens and steals U.S. secrets and property can hardly be trusted as a fair trading partner. So for all those who religiously adhere to the principle of free trade, a question: Would you buy a used car from a man who just beat up his wife in front of you? And then stole your car?' (J. Peter Freire)*

### Introduction

In this section we begin to examine some of the factors that ensure that Australia is not on an even playing field in terms of trade with China. These include China's hukou system, which is used to keep wage and labour standards low, and China's lack of concern for human rights. These two factors enable China to significantly undercut global competitors in the market for manufactured goods.

Research overseen by a US academic highlights the extent to which China's advantage is the result of unfair trade practices. These practices disadvantage other developing countries as much as they do countries like Australia.

The section concludes with a summary of some of key issues that must be addressed if Australia is to contemplate entering into a FTA with China.

### China's hukou system

The hukou system was established in the 1950s to ensure that the basic needs of China's urban populations were met by limiting geographical mobility. To live in a different locality it was necessary to obtain a permit. Although driven by a different motive, the restrictions imposed by the hukou system can be likened to apartheid. This system has been retained and is currently used to suppress wages and labour standards.

Each city, or in some cases district, sets its minimum wage which is supposed to be between 40 and 60

per cent of the average wage paid in that city or district. However, in most provinces the minimum wage is well below this. For example, in 2006 in Beijing and Shanghai, the minimum wage was around 20 per cent of the average monthly wage. This meant that the gap between the minimum wage and the average monthly wage was 2,703 yuan. The gap between the minimum wage and average monthly living expenses in Beijing was as high as 595 yuan.<sup>2</sup>

A recent survey administered by the All-China Federation of Trade Unions found that 65 per cent of migrants were working in so-called "Three-D jobs" (dirty, dangerous and demeaning).<sup>3</sup> These are the jobs which attract minimum wages.

As well as low wages, migrant workers run the risk of not being paid at all. In 2005 the Ministry of Labour and Social Security reported that the total wages in arrears bill across China from 2005 to July 2007 was 66 billion yuan.<sup>4</sup> Indeed the non-payment of migrant workers' wages has become so widespread that one Chinese newspaper has described the problem as an 'incurable disease'.<sup>5</sup>

The system also makes it easy to dispose of workers who have outlived their usefulness, for example where a worker cannot maintain the speed required by their employer, or they have an industrial accident.<sup>6</sup> The system therefore allows employers to avoid satisfying minimal, if any, health and safety requirements and to require migrant workers, as they are known, to work excessive hours over prolonged periods.

Local authorities also benefit from having migrant workers who are not entitled to the medical, housing or unemployment benefits payable to the



urban population. Local authorities in addition minimise their obligation to provide education because migrant workers are not allowed to bring their families when they come to the coastal regions to work.

As ANU economist Song Ligang pointed out China's export-driven economic policies have been characterised by an inequitable income distribution system and the lack of a reliable and universal social security system. This has meant the enrichment of a few and the continued impoverishment of the majority. The result has been enforced savings as the less affluent save for an uncertain future, and weak domestic consumption, as most of the population, the poor, have not had the option to spend.<sup>7</sup>

This reality calls into question the 'trickle down' effect or the idea that everyone benefits equally from economic prosperity, an idea which underpins the argument of free trade advocates.

The exploitation of migrant workers highlights the fact that human rights abuses in China are not only a moral issue, but also an economic issue. Professor of Sociology at Tsinghua University, Qin Hui noted:<sup>8</sup>

*Aside from the traditional advantages of low wages and welfare, China does more to artificially lower the prices of the four prime factors of production (human capital, land, financial and non-renewable resources) with its "advantage" in "low human rights."*

Qin Hui believes the low human rights advantage really makes "Chinese competitiveness" unstoppable. He notes that this is 'not only — not even mainly — a shift of industries from high-wage to low-wage regions. It is instead a shift of industries from regions of "high" to "low" human rights.'<sup>9</sup>

In relation to this issue Yvette Pena Lopes, of the International Brotherhood of Teamsters argues:

*No government should gain a comparative advantage in global markets by keeping labor costs down by violating its own workers' human rights. It is time to end this current climate of*

*allowing companies to profit by taking advantage of vulnerable workers in one country to produce goods to sell to a more wealthy consumer in another country...*<sup>10</sup>

## The China price

Research led by Professor Peter Navarro from the Merage School of Business at the University of California-Irvine provides evidence for the fact that China has a 'human rights' advantage. The research was undertaken between October 2005 and March 2006 and involved the identification of the major drivers of what Professor Navarro calls the 'China Price' by a large group of MBA students'.

The research found that a number of the drivers of the China Price allow Chinese manufacturers to undercut global competitors by as much as 50 per cent or more over a wide range of manufactured goods.<sup>11</sup> At least five of the eight major drivers of Chinese competitiveness could be traced to unfair trade practices. A complex web of export subsidies, tax preferences, and other related violations of the World Trade Organization agreement account for 17% of the advantage.

Professor Navarro's research also found that many Chinese manufacturers benefit from subsidized energy, water, rent and/or cheap or free land and preferential access to land by local and regional governments. China's state-owned banks also continue to hold non-performing loans, which are often issued without expectation of repayment. This provides many Chinese enterprises with essentially free money. China also continues to use an extensive value-added tax rebate system for its export industries.<sup>12</sup> The following table (page 12) lists all the drivers except for industrial clustering.<sup>13</sup>

As a result of the China Price, China has over 70 per cent of the world's market share for DVDs and toys, more than half of the share for bikes, cameras, shoes, and telephones. China also has more than a third of the world's market share for air conditioners, colour TVs, computer monitors, luggage, and microwave ovens. It has established dominant market positions in everything from



### Economic Drivers of the “China Price” & Their Mercantilist Elements

PURE MERCHANTILISM	Share	DIRECT, INDIRECT, OR HIDDEN EXPORT SUBSIDY
1. Subsidies & Tax Preferences	17%	<ul style="list-style-type: none"> <li>Subsidised energy, water and telecommunications</li> <li>Free or subsidised land or rent and preferential land access</li> <li>Free or subsidised capital, loan forgiveness, preferential loans</li> <li>Tax rebates for exporters</li> </ul>
2. Currency Manipulation	11%	<ul style="list-style-type: none"> <li>Exchange rate distortion: “Exports cheap, imports dear”</li> <li>Export demand stimulant via interest &amp; mortgage rate effects</li> </ul>
3. Piracy & Counterfeiting	9%	<ul style="list-style-type: none"> <li>Reduced IT costs</li> <li>Reduced R&amp;D and Marketing Costs</li> </ul>
4. Lax Health & Safety Regulations & Enforcement	2.5%	<ul style="list-style-type: none"> <li>Reduced compliance costs (capital, O&amp;M, labor)</li> <li>Lower compensation &amp; liability costs</li> </ul>
5. Lax Environmental Regulations	2.5%	<ul style="list-style-type: none"> <li>Reduced compliance costs (capital, O&amp;M, labor)</li> </ul>
Subtotal	42%	
<b>MIXED MERCHANTILISM</b>		
Foreign Direct Investment	3%	<ul style="list-style-type: none"> <li>Attracted by lax health &amp; safety and environmental standards</li> <li>“Round Tripping” of capital = lower production costs</li> </ul>
Low Labor Costs	39%	<ul style="list-style-type: none"> <li>“Slave labor”, indentured servitude &amp; union-busting</li> <li>Non-enforcement of minimum wage</li> <li>Lax health &amp; safety standards</li> </ul>
Subtotal	42%	

Source: Peter Navarro, Report of the China Price Project, UC Irvine, July 2006. Download at [www.peternavarro.com](http://www.peternavarro.com)

furniture, refrigerators and washing machines to clothes. China’s progress does not end there. It is moving up the value chain as well as across it — heavy engineering, automobiles, aircraft and biotechnology and pharmaceuticals. This is discussed in more detail in section six.

### Issues that must be addressed in any FTA with China

On the basis of his research Professor Navarro believes that a number of issues should be high on the lobbying agenda of non-Chinese corporations:

*If American and other manufacturers around the globe are ever going to be able to compete on a level playing field with China, it is all the more crucial that the policymakers around the world take very aggressive policy steps to address China’s export subsidies, undervalued currency, counterfeiting and piracy, and the maintenance of lax environmental and worker health and safety regulatory regimes that are far outside the norms of international standards.<sup>14</sup>*

In fact, the Victorian Government has stated that

any agreement with China must address six key issues. They are:

- freedom of association of labour in China and that the cost of labour is able to move to its natural market level
- floating the Yuan to prevent trade distortions which could disadvantage local manufacturing
- effective intellectual property protection to secure local innovation and new products/processes from illegal copying
- ensuring effective measures against the dumping of goods into the Australian market
- any FTA must be comprehensive, covering both tariff and non tariff barriers to trade and investment
- ensuring that any such agreement has application to all levels of government including sub-national and provincial governments.<sup>15</sup>



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# 3. Free trade: theory and reality

**...the China paradox is simple. The more we trade with China the more we will undermine the economic foundations of Australian society. We will basically export natural resources and raw materials to China and import manufactured goods from China.<sup>1</sup>** (Martin Feil)

## Introduction

This section examines the theory of free trade, including comparative advantage. It then analyses the negative impact of this policy on the Australian economy and other economies around the world in terms of jobs and skill losses.

The section concludes by examining the impact of trade liberalisation specifically between Australia and China, and China and other countries.

## Comparative advantage – a nice theory

The theory of 'comparative advantage' was the creation of a British economist, David Ricardo, in the 19<sup>th</sup> century. His idea is that if every country focuses on what it does best and trades for whatever else it needs, global efficiency will be maximised. As a result, the living standards of everybody improve and we all are better off.

World Trade Organization Director Supachai Panitchpakdi articulated what the theory promised: for every United States job threatened by imports, a growing number of high-paid, high-skilled jobs are created by exports.<sup>2</sup> This statement reflects what was known in the 1990s as the

"Washington Consensus". Clinton Administration Labor Secretary Robert Reich described this as a promise: 'that trade liberalization would bring growth and prosperity to South America, Asia, and elsewhere.'<sup>3</sup>

Free trade is a seductive theory. Nobody loses. However, the results of free trade tell a completely different story.

## The reality of free trade

Between 2003 and 2005 Australia negotiated FTAs with Singapore, Thailand and the USA. Much was promised. Then Deputy Prime Minister and Trade Minister Mark Vaile said that the agreement with the USA was 'worth billions of dollars and will create thousands of jobs.'<sup>4</sup> A study of the impact of these agreements commissioned by the AMWU reveals that Australia's imports from each of these countries have increased much more quickly than our exports to them. In the case of Singapore, our exports have gone backwards. As for jobs, it appears these agreements have cost up to 26,000 jobs in the manufacturing sector.<sup>5</sup>

In the case of Thailand not only has the balance of trade changed, but the composition of the trade has also changed. Exports of Australian components have almost doubled from \$38



million in 2004 to \$74 million in 2007. However, exports of vehicles fell from \$4.6 million in 2005 to \$1.8 million in 2007, while imports of motor vehicles have more than tripled from \$1 billion in 2004 to \$3.2 billion.<sup>6</sup> Now Ford is abandoning plans to build the four cylinder Focus in Australia and instead to import them from Thailand under the FTA.<sup>7</sup>

Turning to the Australia-US FTA, Martin Feil has pointed out:

*In the past 22 years, Australian imports of goods and services from the US have exceeded exports to that country by \$260 billion. In the 18 years before the agreement, our trade deficit with the US averaged \$10.95 billion a year. And in the four years since the USAFTA started, Australia's deficit has increased to \$15.36 billion a year....<sup>8</sup>*

Feil also notes Australia's exports of unprocessed and processed foods have fallen during the agreement's life and our manufactures exports have increased by about half a billion dollars, but US exports to us have gone up by five times that amount.

Feil points to Australia's income deficit in our balance of payments noting it has increased by \$13 billion between 2005-06 and 2007-08. He believes that this 'is the statistical area where we simply don't know what is going on, except that we are paying out much more than we are receiving.'<sup>9</sup>

Other countries have experienced similar issues flowing from FTAs. Bill Clinton said a free trade agreement with Mexico and Canada would create American jobs, make Mexicans better off and stop the Mexican invasion across the border.<sup>10</sup> In fact hundreds of thousands of American jobs headed south, real wages in Mexico's manufacturing sector fell, two million Mexican farmers were forced off their farms and a Mexican Government report estimates that 500,000 Mexicans will find their way to the USA every year for the next 15 years.<sup>11</sup>

In the USA there are supporters of free trade who have admitted that the outcomes have not matched their expectations. For example, Robert Reich stated:

*Free trade is still good for America overall. But it's been much better for high-wage, highly skilled American professionals than for American blue-collar workers, whose jobs are vanishing and whose wages are becoming less and less secure.<sup>12</sup>*

Reich's sentiments have been echoed by Paul Krugman, a professor of economics and international affairs at Princeton University:

*Trade between high-wage countries tends to be a modest win for all, or almost all, concerned.... By contrast, trade between countries at very different levels of economic development tends to create large classes of losers as well as winners.... workers with less formal education either see their jobs shipped overseas or find their wages driven down by the ripple effect as other workers with similar qualifications crowd into their industries and look for employment to replace the jobs they lost to foreign competition. And lower prices at Wal-Mart aren't sufficient compensation.<sup>13</sup>*

The theory of free trade is that less-skilled jobs associated with labour-intensive activity will be replaced by higher-skilled, knowledge-based, better-paid jobs. In fact, even without FTAs in place, we are witnessing the reverse.

In a statement to a Congressional committee, the American Forest and Paper Association raised concerns about the substantial expansion in China's production and exports in the paper and wood processing industries over a very brief period. The Association described the corresponding drop in market opportunities for US manufacturers as incongruous. China does not have the fibre resources necessary for a competitive forest products industry.

China's imports from the United States increasingly consist of raw materials in the form of wood pulp and recovered paper and of logs and lumber. In 2006, China's imports of these products from the USA amounted to US\$1.86 billion, or 66 percent of total US forest products shipments to China. Imports of recovered paper from the US increased by over 182 percent in the 2002-2006 period to US\$1.27 billion.

In addition, China's hardwood logs imports from the USA almost quadrupled during this period



to US\$109 million. In contrast, Chinese exports of forest products to the USA increasingly consist of processed and finished products.<sup>14</sup> The Association says that these developments reflect not comparative advantage but 'economic and trade distorting practices'. One consequence is that the potential for increased exports of US wood and paper products is not being realised.

The story in Australia is similar. Initially Australia lost the manufacture of benches and chairs. However, that was supposed to leave high quality, residential furniture in which the local industry would have a comparative advantage. The reality, ten years later, is that nearly all residential furniture, including quality brands such as Moran, is made overseas, predominantly in China. The same has largely occurred in the clothing industry, although there are examples of niche markets.<sup>15</sup> Country Road's managing director told the Allen Consulting Group that 'in China you now have high-quality production, state-of-the-art equipment and quality control as good as any in the world.'<sup>16</sup>

We now export timber to China and import wooden furniture. A legacy of free trade theory in practice is less skill rather than more skill — a trend that a free trade agreement only would exacerbate. According to Martin Feil:

*During the industrial revolution, Britain and Europe obtained resources and raw materials from their colonies, added value and sold them as manufactured goods. We are reversing this process. We provide natural resources and raw materials and buy manufactured goods. Economically, we perform the role of a 19th century colony.*<sup>17</sup>

New York Democrat, Senator Charles Schumer, and an Assistant Secretary of Treasury in the Reagan Administration, Paul Craig Roberts state:

*...when (David) Ricardo said that free trade would produce shared gains for all nations, he assumed that the resources used to produce goods — what he called the "factors of production" — would not be easily moved over international borders. Comparative advantage is undermined if the factors of production can relocate to wherever they are most productive: in today's case, to a*

*relatively few countries with abundant cheap labor. In this situation, there are no longer shared gains — some countries win and others lose.*<sup>18</sup>

According to Richard Dorvill, a Tasmanian vegetable grower and organiser of the Fair Dinkum Food Campaign, free trade 'now means corporations move to the area of least regulation where resources, environment and labour can be exploited at the least cost.'<sup>19</sup>

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## 4. Trade liberalisation: the new spin

**...most of the forms of trade liberalization currently being considered would redistribute income from workers to corporations, and from lower wage workers to higher wage workers. <sup>1</sup>** (Dean Baker and Mark Weisbrot)

### Introduction

**T**his section explores the current claims of free trade advocates, which attempt to address the fact that free trade in practice has not lived up to its promise of universal wealth. The section also examines these claims in light of the impact of trade with China.

### Trade liberalisation: what are they promising now?

Free trade ideologues are now responding to concern about the impact of free trade on jobs by talking up access to cheaper, better quality consumer goods and the wider benefits for the economy. In early 2009, the Department of Foreign Affairs and Trade commissioned the Centre for International Economics (CIE) to produce a report on the benefits of trade and trade liberalisation.

The report concludes that trade liberalisation adds between \$2700 and \$3900 to the real, annual income of the average family. The CIE says that part of this “dividend” is attributable to ‘dynamic productivity and employment effects’.<sup>2</sup>

The “savings” acquired through cheaper consumer goods represents the profit side of a ledger or the benefit of trade liberalisation. However, the question is whether there are any losses.

Productivity is central to the model, but equity and distributional considerations are generally disregarded.<sup>3</sup> In other words the model does not factor in questions about the distribution of the fruits of increased productivity. It also does not take into account the cost of unemployment, which is part of the price for our access cheaper consumer goods.

The effect of trade liberalisation is described by Yvette Pena Lopes from the International Brotherhood of Teamsters as follows:

*Since 1980, labour productivity has increased over 80 percent, and yet the average American worker is making only a nickel [5 cents] more per hour in inflation adjusted terms than in 1973... ... Were it not for trade agreements that pit U.S. workers in a race to the bottom with poverty wage workers worldwide, U.S. workers' wages would better reflect productivity increases, and workers in developing countries would be better equipped to fight for higher wages.<sup>4</sup>*

Dean Baker and Mark Weisbrot from the Center for Economic and Policy Research argue that trade liberalisation redistributes income from workers to corporations, and from lower wage workers to higher wage workers.

*It is entirely possible that for most workers, the lost wages due to the upward redistribution caused by trade liberalization outweigh the overall gains to the economy. This is especially true if trade liberalization results in long-term unemployment for workers in the affected industries; but even*



*under the assumption of full employment, it is very possible for trade liberalization to cause a net loss of income for the majority of the labor force.*<sup>5</sup>

The flawed assumption that free trade ideology would create a net benefit to the average Australian is not the only issue in the CIE's report. The report estimates the number of the jobs in transport, storage and logistics associated with exports or imports. It does not estimate how many of these jobs would be associated with the movement and storage of those goods if they were made domestically.

The report denies that jobs are being exported to countries such as China and India. It seeks to calculate the number of jobs generated by trade, but it does not address the argument that the bilateral merchandise trade relationship with China has led to a net loss of up to 66,000 jobs.<sup>6</sup> The CIE merely asserts its theory that 'while employment shrinks in one industry it expands in another'.<sup>7</sup>

It is difficult to reconcile this theory with a 2003 study by Monash University into displaced textile, clothing and footwear workers. The survey of over 300 displaced workers found that only 54 per cent had found work in the three years since retrenchment. One in five had found work broadly commensurate with their former jobs in terms of pay, hours and conditions. Although 96 per cent had worked full-time prior to retrenchment only 21 per cent then had a full-time job.<sup>8</sup>

The Allen Consulting Group earlier this year also produced a report on the benefits of free trade to Australian households, this time in the context of trade with China. The report was produced for the Australia China Business Council.

The Allen Consulting Group estimated that, at its peak, trade with China is likely to have been worth \$3400 on average to every household.<sup>9</sup> The report also discussed access to cheaper, higher quality consumer and industrial goods, lower inflation, increased employment in mining and manufacturing, improved infrastructure and more sustainable public services, personal tax cuts and dividends to shareholders in publicly listed companies involved in the import and export trade.<sup>10</sup>

It should be noted that State and Federal Government taxes derived from the resources boom in Western Australia and Queensland does not guarantee a substantial trickle-down to the average Australian.

The report refers to a 2006 Australian Industry Group survey, which found that 'Australian manufacturers were increasingly looking to China as an export destination'.<sup>11</sup> However, it does not refer to another Australian Industry Group survey of 848 manufacturing companies. That survey found that:

- 55 per cent see China as a competitive threat in the domestic market
- 32 per cent see China as a competitive threat in export markets
- 44 per cent see China as an *opportunity* for sourcing low cost inputs
- 20 per cent see China as an *opportunity* as an export destination.<sup>12</sup>

The consultant reports on increased employment in the mining sector. However, there is no mention of the net loss of jobs that has resulted from the bilateral merchandise trade relationship, estimated to be 66,000.<sup>13</sup> The report canvasses the benefit of the jobs created to mining communities in Western Australia and Queensland — it does not canvass the impact of lost manufacturing jobs on regional communities in the other states. Similarly, the consultant discusses the benefit to the economy of every dollar of corporate spending outsourced to a developing country, but does not compare the value of the labour and capital added to natural resources with the value added to manufactured goods.<sup>14</sup>

The high price Australia has received for its minerals in recent years, and the contribution, which that has made to Australia's terms of trade, is attributed to the demand driven by China. The report is silent on the cost to agriculture, manufacturing and services which have been 'squeezed'<sup>15</sup> because the value of our dollar is higher than it would have been otherwise. Equally while the affordability of consumer goods is highlighted, there is no mention of the extent to



which this affordability has been a factor driving Australia's current account deficit.

The Allen Consulting Group suggests that if Australia did not import manufactured goods from China, it would import them from the country with the next lowest cost of production. This suggestion misses the point. China has more competitive prices because of its 'human rights advantage' and 'mercantilist' policies. China is not like the other Asian tigers and it cannot be assumed that another country would have had the authoritarian control necessary to adopt China's model. Like other free trade advocates, the consultants' commitment to comparative advantage theory blinds them to the difference between China and other low wage countries.

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# 5. Lies, damned lies and econometric models

***Before economists are really satisfied with the results of any piece of econometric modeling, they put it through the laugh test, and the laugh test is, can someone who knows the real world, that's meant to be described by the modeling exercise look at the results and not laugh. And I don't think that this exercise passes the laugh test.***<sup>1</sup> (Ross Garnaut)

## Introduction

This section examines in more detail the inherent flaws in the economic modelling that underpins Australia's FTAs.

It also discusses the danger and potential impact on the Australian economy of pursuing agreements based on free trade ideology.

## The pitfalls of econometric modelling: AUSFTA

The case for Australia's entering into various FTAs, including the proposed agreement with China, rests on econometric modelling. Some economic commentators have been sceptical about the veracity of this modelling. For example in 2007 the Sydney Morning Herald's economics editor Ross Gittins wrote about the Department of Foreign Affairs and Trade's (DFAT) tender process for the 'job of modeling the costs and benefits of our preferential trade agreement with the United States.'<sup>2</sup> According to Gittins, the 'contract went to the firm whose preliminary study was more favourable to the agreement.'<sup>3</sup>

The successful consultant, CIE, concluded in its 2001 report that, with the immediate removal of all trade barriers, 'Australian GDP could be 0.33 per cent higher by 2006. This gap would then continue to widen, levelling off by 2010 at 0.4 per cent of GDP — an annual increase in that year of

nearly US\$2 billion.'<sup>4</sup>

CIE qualified this finding by saying: 'whether this is politically feasible or not has not been the subject of this study.'<sup>5</sup> However, this assumption appears to be unrealistic, given the level of skepticism among primary producers about US willingness to reduce tariffs on commodities such as sugar and beef significantly.

Ultimately the USA refused to remove the tariff on sugar and only agreed to phase in the removal of tariffs on beef and dairy over 18 years. The CIE was commissioned to produce another report. Even though the major benefit of entering into an agreement was in tatters, in its report CIE claimed that:

*Over 20 years the present value of net benefits are \$52.5 billion for Australian welfare (real GNP) and \$57.5 billion for real GDP. All states gain from the liberalisation of trade in merchandise, services and government procurement. The benefits to workers comprises a mix of extra employment and real wage growth that changes over time. Initially there is a rising trend in employment, peaking at nearly 0.3 per cent of jobs in 2012 before falling to the baseline 'natural rate of full employment', by which time the gains are received as higher real wages 1.4 per cent above baseline.'*<sup>6</sup>

Ross Garnaut was scathing about by the modeling in CIE's report stating, 'I don't think that this exercise passes the laugh test.'<sup>7</sup>

In addition, Australian Financial Review journalist,



Mark Davis commented on the intense lobbying behind the scenes in Canberra and Washington that brought about the AUSFTA:

*...business leaders in Australia played a catalytic role creating a pro-FTA constituency designed to build, marshal and maintain political and bureaucratic support for the agreement... That effort, conducted largely behind the scenes in Canberra and Washington, was arguably the most successful public policy intervention by Australia's corporate sector since the Business Council of Australia spent several years... putting enterprise bargaining on the agenda.<sup>8</sup>*

It is in this context that the drive for a free trade agreement with China, and the econometric modeling which supports it, should be considered.

In deciding to initiate negotiations with China in 2005, the Government relied heavily on the econometric modeling undertaken for DFAT by the Centre of Policy Studies at Monash University. Under the most optimistic scenario, GDP increases by 0.37 per cent over a ten year period.<sup>9</sup>

CIE has produced an updated forecast for the Australia China Business Council. It estimates an increase of 0.7 per cent in the GDP over a 20-year period. It also notes that 'modeling results should only be used to infer the outcome of liberalization (positive or negative) and the magnitude of such impacts (small or large).<sup>10</sup> Presumably these small margins fall within the margin for statistical error.

Both consultants used a computable general equilibrium (CGE) model, the same model used to forecast outcomes of the previous free trade agreements into which Australia has entered and also NAFTA. This raises the question: if this model produced inaccurate forecasts previously, why should the predictions of the Centre for Policy Studies and the CIE be more accurate on this occasion?

The assumptions which underpin the CGE model have certainly been called into question. According to Dr. Jim Stanford and Pat Conroy, the authors of the AMWU-commissioned report, CGE's 'quantitative predictions are highly ambiguous, completely dependent on both the theoretical

specification and quantitative calibration that has been performed by the modeler.'<sup>11</sup> They nominate some dubious assumptions that predetermine the outcomes of the modeling. These include the following:

- all labour is employed both before and after trade liberalization
- complete equality in factor pricing (e.g. all jobs pay the same)
- all of a country's economic resources will be fully utilised which means that a country never can experience aggregate job loss or a recession from any economic change
- every family is assumed to share equally in all the income, wealth and consumption of the nation
- the movement of capital is treated in an artificial way so that in many models no capital flows between countries are allowed and only in very few cases do CGE models explicitly consider the investment location decisions of multinational corporations
- there will not be any change in a country's overall trade
- every product is inherently distinguished by the nation where it is produced so that the ability of multinational corporations to shift the location of production to the highest profit centre is not taken into account.<sup>12</sup>

Stanford and Conroy believe that the 'extreme and unrealistic assumptions of neoclassical CGE models means that their predictions cannot in any way be interpreted as "evidence".'<sup>13</sup> They argue that 'novel' modeling techniques have also been employed. For example, the Centre for Policy Studies assumes liberalization-induced improvements in average productivity, as well as a reduction in the required rate of return for investment in Australia. The CIE modeling takes into account 'dynamic productivity gains' which account for nearly 64 per cent of the real GDP gains.<sup>14</sup>



In contrast, Stanford and Conroy have forecast the impact of a free trade agreement with China adopting a more realistic approach that does not assume full employment or balanced trade. Their best-case prediction, which makes the unlikely assumption that Australia's exports grow more quickly than its imports, is that an agreement would cost 7,000 jobs. Using the assumption that the increase in the import of manufactured goods exceeds the increase in the export of agriculture and minerals, job losses rise to 40,000. Their final scenario, which assumes a similar trend to that which followed the signing of other free trade agreements, leads to a net loss of about 160,000 jobs.<sup>15</sup>

The CIE undertook a study on the impact of an agreement on Victoria. It conceded that under its modeling 64 per cent or 61 out of 95 industry sectors identified would experience contraction in sectoral output by 2030.<sup>16</sup> The study concludes that the primary sectors will benefit, but the manufacturing sectors will lose.<sup>17</sup> However, while an FTA may generate greater exports of wheat and wool to China, it would be likely to intensify China's efforts to export agricultural equipment to Australia.<sup>18</sup>

However, even the conclusion that the primary sector will benefit requires further examination. China produces almost half the world's fruit and vegetables and has set an export target of \$40 billion by about 2010. Apple and pear growers fear that '(u)nfettered Chinese apple and pear imports have the potential to destroy the Australian apple and pear industry in a short period, whereas Australian apple exports to China will never be more than a small and seasonal niche market.'<sup>19</sup> Then Victorian Farmers Federation horticulture president Peter Cochrane said it is impossible to compete with China's fruit and vegetable exports.<sup>20</sup>

The CIE also acknowledges that 'Queensland and Western Australia stand to benefit considerably more from a trade and investment agreement with China than do the other states/territories.'<sup>21</sup> Thus an agreement with China would reinforce the Australian economy's heavy and risky reliance on primary industries.

In 2005 Labor's finance spokesman, Lindsay Tanner wrote:

*the Government's trade policy is all about agriculture and mining. We need opportunity for export manufacturing at the heart of our trade negotiations with countries like China. We don't need a revival of the quarry-farm mentality of the 1960s.*<sup>22</sup>

Unfortunately, the current Labor Trade Minister Simon Crean appears to have virtually given up on the manufacturing industry, instead talking up the services sector. But faith in the services industry to help diversify the Australian economy appears to be misplaced. CIE has admitted that in Victoria, for example, the change in the services sector would be small, despite its major focus on international students.<sup>23</sup> Martin Feil has noted:

*We won't sell enough services to China to fill the trade void. Europe and the US are much larger and much more important customers than Australia for China's manufactured goods... Australia is not a natural global supplier of services. We are too far away and have too small a domestic economy.*<sup>24</sup>

Chinese academic Dawei Cheng notes that Chinese exports to Australia mainly consist of industrial manufactured goods<sup>25</sup> and that China is keen to make Australia one of its key suppliers of raw materials.<sup>26</sup>

As the Former Foreign Affairs Secretary, Deputy CEO of the Australian Stock Exchange and senior Labor adviser Michael Costello, puts it: 'let's hope that Labor will reject out of hand any future free trade agreements with large economies such as Japan and China.'<sup>27</sup>

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# 6. China takes all

**When manufacturing jobs began leaving the US, no-think economists gave their assurances that this was a good thing...<sup>1</sup> (Paul Craig Roberts)**

## Introduction

Free trade advocates argue that Australians have nothing to fear from giving up low-paid jobs because they will be replaced by better, higher-paid jobs. The level of sophistication of China's industry and research puts paid to that idea.

This section discusses the fact that free trade or comparative advantage theory is not equipped to deal with the key factor that underpins the Chinese economy. That is: an authoritarian regime that not only has an economic advantage but also a human rights advantage.

The view that Australia could lose manufacturing jobs to overseas companies whilst shoring up our economy through strong innovation, research and development has proved to be at best optimistic. Increasingly China is becoming the international centre for research and development and innovation. This section argues that Australia loses much more than manufacturing jobs when they are lost to foreign interests.

## The impact of free trade on economies

Advocates of free trade assume that everybody shares equally in the benefits of greater efficiency and productivity. These benefits manifest themselves in higher wages. Over time as wages in low wage countries rise the demand for consumer goods increases and the comparative advantage in

wages diminishes.

To demonstrate their case, free trade advocates point to Japan, and in more recent years, Singapore, Taiwan and South Korea. However, as Professor Krugman noted:

*The original "newly industrializing economies" exporting manufactured goods — South Korea, Taiwan, Hong Kong and Singapore — paid wages that were about 25 per cent of U.S. levels in 1990. Since then, however, the sources of our imports have shifted to Mexico, where wages are only 11 per cent of the U.S. level, and China, where they're only about 3 per cent or 4 per cent.<sup>2</sup>*

China's low wage levels constitute a comparative advantage that cannot be matched. China also has been able to attract and accumulate capital, technology and research while keeping wages low. Thus instead of China's living standards being driven up, China is being used as a lever to drive down living standards in other countries to compete. This phenomenon is not restricted to developed countries such as Australia. It is also evident in countries such as Mexico. China is depriving other developing countries of the capital of multinational corporations which otherwise might have been invested in them. For example, annual investment flows in the automobile industry to developing nations as a whole fell by 26 per cent between 2001 and 2003, but rose by 22 per cent for China. Countries like Brazil, South Africa, Poland, Mexico and Thailand suffered double-digit percentage declines.<sup>3</sup> The question is what is the alternative comparative advantage with which even these countries can compete with China?



Comparative advantage theory is not equipped to deal with an authoritarian regime that not only has an economic advantage but also, as Professor Qin Hui describes it, a human rights advantage. Australia must find answers to some difficult questions. Should we:

- ignore the human rights advantage, as free trade ideologues do
- match this 'advantage' by sacrificing our commitment to human rights
- refuse to become part of a comprehensive economic relationship with China until there is a level playing field?

However, free trade advocates tend to ignore these moral and social issues. For example Dr. Alan Moran of the Institute of Public Affairs argues that classing China's exports 'as dumped products would overwhelm anti-dumping systems' and damage the Australian economy.<sup>4</sup> According to Dr Moran, Australian companies must 'hold their own against the best in the world if we are to improve or even retain living standards.'<sup>5</sup> Nevertheless, Hills Industries CEO, David Simmons has stated that 'illogical' Chinese pricing are a major problem for Australian manufacturers.<sup>6</sup>

A number of other commentators also have dodged some of the fundamental issues in relation to trade with China and its impact on the Australian economy, instead opting for platitudes. A February 2009 Age editorial noted it would be unconscionable if Australia were to emerge as solely a provider of commodities and services to the rest of the world. It went on to suggest the following:

*The alternative is to foster industries that will draw on and increase the educational advantage of Australian workers over those in low-wage economies, and create new markets for Australian products.....To be a clever country,Australia needs first to be clever in deciding what industries are sustainable in the global markets in which we compete.<sup>7</sup>*

This position is not particularly realistic given current trends. Certainly GUD Holdings' managing

director Ian Campbell agreed with it, stating that manufacturers must focus on making complex and profitable products.<sup>8</sup> But apparently this proved more difficult in practice. GUD Holdings closed the manufacturing operations at its Ryco automotive filter division in 2004 and began importing products.

Journalist James Thomson has said that 'the biggest change that smart manufacturers are making is to focus less on making things and more on design, development and innovation.'<sup>9</sup> However, the then President of the Design Institute of Australia pointed out in 2005 that '(t)he lesson of history is that design jobs will follow manufacturing jobs in moving to China. Not all jobs obviously, but a significant proportion of them.'<sup>10</sup>

Alan Brown, Associate Editor of *Mechanical Engineering* also noted the fact that design, development and research is moving offshore noting that technology centers 'support manufacturing operations in China and do R&D in India. General Motors, for example, hired 400 researchers in Bangalore within two and a half years.'<sup>11</sup>

Former Reagan Administration Treasury Assistant-Secretary and a former assistant editor of *The Wall Street Journal*, Paul Craig Roberts, put platitudes in perspective last year:

*When manufacturing jobs began leaving the US, no-think economists gave their assurances that this was a good thing....The US would do the innovating, design, engineering, financing and marketing, and poor countries such as China would manufacture the goods that Americans invented. ...The assurances that economists gave made no sense. If it pays corporations to ship out high value-added manufacturing jobs, it pays them to ship out high value-added service jobs. And that is exactly what US corporations have done.<sup>12</sup>*

## China takes all

The following statistics are telling:

- next year China will produce more PhDs



in science and engineering than the USA<sup>13</sup>

- China is 'training engineers at a mind-boggling rate — currently they have 14 million engineers, but only 120,000 lawyers'<sup>14</sup>
- Major Australian universities are contemplating the future of manufacturing engineering courses<sup>15</sup>
- IBM's research laboratory in China has a team of 200 mainly Chinese-trained computer scientists and is directed by a person with a US doctorate<sup>16</sup>
- the aircraft leasing arm of US conglomerate, GE, has ordered five ARJ21, a 70 seat jet, for which GE is supplying the engines, from the Commercial Aircraft Corporation of China with an option to buy another 20 and with the first scheduled for delivery in 2013<sup>17</sup>
- Airbus, which has a US\$80 million world-class training and support centre in Beijing, has entered into a joint venture with a consortium led by Tianjin Free Trade Zone which is establishing an A320 family final assembly line and planning to assemble four aircraft a month by 2011<sup>18</sup>
- BYD Company, the leading small-battery company in the world has developed the world's first mass-produced, battery-powered hybrid car that could recharge on normal household current<sup>19</sup>
- Ford and General Motors have told suppliers they must meet a 'world price' — increasingly set by China — or build a plant in China which, prior to the global financial crisis, wanted to export up to US\$100 billion worth of vehicles and components by 2010 and which already is exporting more advanced and higher value-added components.<sup>20</sup>

Professor Navarro believes the case of biotechnology and pharmaceutical companies may be particularly instructive.<sup>21</sup> These companies are great examples of American science. The new

drugs they create provide exceptional health benefits, the industry employs over half a million Americans at very high wages, contributing billions of dollars to the US economy.<sup>22</sup> But these industries are being increasingly offshored to China. The benefits of this are low wages and lower regulation and standards in relation to the environment and drug development.

*According to the China Daily, China's biopharma sector now has US\$74B in total investment and fixed assets. China currently spends 1.2 per cent of GDP on R&D and plans to increase this to 2 per cent by 2010 and to 2.5 per cent by 2020. In contrast, U.S. spending on biopharma R&D is 2.7 per cent of GDP. By leveraging its multitude of cost and price advantages, however, output of Chinese research per dollar is higher than America's.<sup>23</sup>*

Professor Navarro is of the view that this trend has very important implications for US education and economic development.

*America is losing to China the very innovation that has provided it with a comparative advantage and high standard of living.... If we lose that advantage to China — as is becoming more and more apparent — the effects on our economy will be far-reaching. This is precisely why China's latest "long march" up the economic value chain should be a wakeup call to any U.S. policymakers who still believe that China's economic dominance can be contained to highly polluting and relatively low value-added manufacturing industries.<sup>24</sup>*

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# 7. Exploitation

*... forced labor or child labor is far from an isolated phenomenon. It is rooted deeply in today's reality, a combination of capitalism, socialism, feudalism and slavery.*<sup>1</sup> (Howard French)

## Introduction

China has more than an economic advantage over other countries - it has a low human rights advantage. China discriminates against its own workforce by suppressing wage increases for a large proportion of the workforce, depriving them of access to housing and medical assistance and ignoring the use of child labour and unsafe working conditions. It also exploits its environment.

In this section China's exploitation of its workforce and the environment is discussed in the context of free trade theory. China's lack of labour rights and its low standards and poor enforcement of regulations in relation to child labour, occupational health and safety and environmental protection provide it with a disturbing trade advantage, particularly in relation to manufacturing.

## Labour laws in China

Last year China introduced new labour laws aimed at reducing the worst abuses to which workers are subjected. The major provisions of the new laws are:

- written contracts are compulsory for all workers; may be for a fixed term, open-ended or until completion of a specific job; and should contain job descriptions and compensation
- payments should be made in full and on time

- probationary periods are limited in relation to the length of the contract and payments during the period should not be less than 80 per cent of that agreed in the employment contract
- work quota standards apply so that overtime cannot be disguised; occupational health and safety rules are tighter; personal property of workers such as identification cards may not be withheld
- sackings must be on specific grounds
- part-time work is better defined
- labour hire is regulated.<sup>2</sup>

Much of the content of this new law is contained in existing Chinese laws and regulations.<sup>3</sup> Under these laws, labour contracts were supposed to stipulate wages, basic terms of employment and the duration of employment. However, 70 per cent of rural workers and 15 per cent of urban workers did not have contracts. In the construction industry 40 per cent of workers did not have contracts and 60 per cent of contracts country-wide were for three years or less.<sup>4</sup>

In December 2007, a Forum on Collective Bargaining and Corporate Social Responsibility, co-hosted by the Shenzhen Federation of Trade Unions and the Shenzhen Lawyers' Association, heard that 'most collective agreements are not worth the paper they are written on.'<sup>5</sup> For this reason, one of the purposes of the new law is to make basic conditions easier to enforce.<sup>6</sup>

In addition, over the last 10 years wages particularly in rural China have not kept pace with



the country's economic development. Journalist Joseph Kahn has reported that:

*Guangdong [province] has grown by more than ten percent annually for the past decade. But its factory workers, mostly migrants from the interior, earn no more than they did in 1993...China is living through a Gilded Age of inequality, whose benefits are not trickling down to the 700 million or 800 million rural residents who live off the land or flock to the cities for factory or construction jobs.<sup>7</sup>*

Despite the exploitation of rural workers and the need to enable better enforcement of basic conditions, a number of business groups actively lobbied against the proposed law and were successful in having it watered down. They included the American Chamber of Commerce in Shanghai (representing more than 1,300 corporations), the US-China Business Council (with more than 250 members) and the European Union Chamber of Commerce in China (850 members). Members of these organisations include Wal-Mart, Google, Microsoft, UPS, Nike ATT and Intel. Other corporations such as Proctor and Gamble and General Electric lobbied directly.<sup>8</sup>

This experience exposes the flawed logic of free trade advocates and hypocrisy within their ranks. Free trade theory assumes that the benefits of comparative advantage are distributed evenly. In the case of China, much is made of the size of the Chinese market which free trade theory suggests will develop with the success of free trade. Yet, the increase in wages necessary to create this consumer market is not occurring. Further, at least some of the influential advocates of free trade theory have demonstrated that nothing stands in the way of maximising profit, even if that means preventing the evolution predicted by the theory they purportedly support.

## A lack of labour rights

While the lobbying of multinational corporations passed largely unnoticed, the fact that China is the first country in which Wal-Mart<sup>9</sup> has become unionised did attract headlines. Encouragingly, the

All-China Federation of Trade Unions (ACFTU), has said that Wal-Mart has raised part-time workers' wages to six yuan (75 US cents) per hour, above the minimum wage 5.5 yuan. It has also abolished the probation period for part-time workers. Further, the Wal-Mart store in Shenyang has negotiated the right to have one day off a week.<sup>10</sup> However, when the union chairman at Wal-mart's outlet in Nanchang attempted to add specific clauses to the framework agreement negotiated by the ACFTU and senior Wal-mart management, he was bypassed.<sup>11</sup>

Regardless, workers in China have few fundamental labour rights: the right to strike was removed from China's constitution in 1982; freedom of association is prohibited; and there are not any independent trade unions. Defending workers rights and protesting against rights violations can be a risky business in China. China Labour Bulletin (CLB) knows about 12 labour rights activists in prison. Their crimes include organising an independent trade union, organising demonstrations to claim wages and entitlements and planning to establish a human rights commission. CLB believes that over the last 12 months authorities have preferred to use short-term detentions, intimidation and harassment to suppress workers protests. They have also turned a blind eye to beatings at factories.<sup>12</sup>

The ACFTU is state-controlled and CLB has concluded that the ACFTU's role as a defender of workers' rights is secondary to its role as a servant of the Chinese Communist Party (CCP) and the government.<sup>13</sup> As ACFTU Chairman Zhao Wangguo put it in a 2006 speech:

*Trade union organisations at every level must consciously accept the leadership of the Party, resolutely follow the Party's line, principles and policies and comply with Central Committee decision-making. ... [they must] pragmatically combine their responsibilities to the Party and the masses of workers.<sup>14</sup>*

According to the CLB, 'the ACFTU is now essentially a charitable organisation, providing assistance only after workers' rights have been violated.'<sup>15</sup> The result is that the ACFTU does not



defend the rights and interests of employees on the shop-floor. For example,

*State-financed construction projects often fail to pay the workers they hire. The reason, it is assumed, is that bureaucrats and favored businessmen pocket the money. Many coal mines do not install safety equipment, and the death toll in accidents has been well in excess of 5,000 annually. (China in 2003 produced about 40 percent more coal than the United States but had at least 130 times more mining fatalities.)*<sup>16</sup>

Private sector corporations have nothing to fear from China's union movement, especially when it recruits, not by organising workers, but by high-level officials talking to management. Overwhelmingly, the newly formed enterprise unions are controlled directly or indirectly by management. For example, in 2006 the proportion of union chairmen serving concurrently as corporate officers at private domestic and foreign companies in Guangzhou was as high as 98.7 percent.<sup>17</sup>

The exploitation of workers in China extends beyond wages. Not only are unsafe working conditions a daily reality, but so is the practice of covering up industrial accidents. For example, when a fire in an underground mine about 100 miles from Beijing killed 35 miners in July 2008, fake reports were issued, journalists were bribed and relatives were bought off. Authorities in Beijing found out about the accident and the cover-up three months later by accident. Somebody had the courage to publish the cover-up on the internet. As journalist Sharon LaFraniere commented:

*From mine disasters to chemical spills, the 2003 SARS epidemic to the past year's scandal over tainted milk powder, Chinese bureaucrats habitually hide safety lapses for fear of being held accountable by the ruling Communist Party or exposing their own illicit ties to companies involved.*<sup>18</sup>

The exploitation of children is also common. China has ratified the International Labor Organisation convention that prohibits child labour. Nevertheless as the scandal involving the kidnapping of children to work in Shanxi brickyards<sup>19</sup> in 2007 demonstrates, child labour exists in China and the authorities seem to be

unconcerned about the issue.

It is not possible to know the extent of the use of child labour because that information is 'highly secret.'<sup>20</sup> Local government labour bureaus, which are responsible for enforcing laws concerning child labour, do so haphazardly. Employment bureaus do not verify the age of workers when exporting them to other areas.<sup>21</sup> Factory visits are undertaken by prior arrangement and easily negated.

There is also the case of rural junior high school students from Sichuan Province. The students were being abused through a work-study program that supplied young workers from western China to an electronics assembly plant in the town of Dongguan in the south east. Labor officials from Yilong County, where the students came from, and officials at the provincial labor bureau in Guangdong Province, which has oversight over Dongguan, said it had nothing to do with them.<sup>22</sup>

China-based, Australian journalist Holly Williams says child labour is 'an open secret.'<sup>23</sup> Hu Jindou, a professor of economics at Beijing University of Technology notes:

*Everything is about the economy now, just like everything was about politics in the Mao era, and forced labor or child labor is far from an isolated phenomenon. It is rooted deeply in today's reality, a combination of capitalism, socialism, feudalism and slavery.*<sup>24</sup>

The AUSFTA contains provisions concerning labour principles and rights. This is a precedent that should not be ignored when contemplating an FTA with a country such as China which has an appalling worker and human rights record. The areas of abuse include:

- discrimination between citizens on the basis of where they live through the *hukou* or household registration system,
- the refusal to allow independent unions and the repeal of the constitutional right to strike in 1982,
- the persecution and arbitrary detention of labour activists, environmental activists, members of Falun Gung, religious



dissidents and lawyers who represent activists and dissidents,

- persecution of members of families of activists and dissidents,
- arbitrary judicial processes, and
- torturing of prisoners and the use of forced labour.

## Exploitation of the environment

In addition to exploiting its people, China also exploits its environment. This exploitation is totally pervasive. For example, toxic waste from the powder coating on commercial furniture can be found flowing down street. In Australia manufacturers must spend substantial sums to ensure that the waste does not flow into drains and then into water systems.

On a larger scale, the Alliance for American Manufacturing commissioned comprehensive research on China's steel industry which produces more steel than the USA, Russia and Japan combined. China produces a third of the world's steel, but generates half of the world's carbon dioxide from steel making.<sup>25</sup> China is also the world's largest producer of sulphur dioxide. The levels of pollution are three to 20 times higher per ton of steel produced in China than in the USA.<sup>26</sup> The study found that in the Chinese steel industry enforcement of existing standards is weak, the permit system is ineffective, and facilities do not adequately monitor their own emissions and discharges. Further, financial penalties for violations are too low to have a substantial deterrent effect.<sup>27</sup>

In addition, China devotes minimal resources to enforcing the laws that do exist. The Ministry of Environmental Protection (MEP) has 200 to 300 employees and has limited authority. It cannot, for example, close down offending companies or remove local officials.<sup>28</sup> The MEP is dependent on provincial and local governments and their Environment Protection Bureaus (EPB), which employ 60,000 environmental officers. However, 'historically EPBs have been weak institutions.'<sup>29</sup>

By contrast the US Environment Protection Authority has 9,000 employees in Washington alone and is a major government agency.

The financial consequences are substantial: the total operating and maintenance costs for the Chinese steel industry in terms of air and water pollution control has been estimated to be \$4.85 per ton, compared to \$8.83 per ton in the USA.<sup>30</sup>

Studies of comparable industries would produce similar results. The introduction of emission trading schemes or carbon tax schemes could well see corporations transferring production to China, thereby compounding the problem.

The advantage that China derives from exploiting its people and its environment is substantial. The evidence lies in the results of the project undertaken by Professor Peter Navarro and the advice that the CIE gave the Victorian government that:

*...if China increased its real wages or reduced air and water pollution, that would have a negative effect on its GDP and welfare. It would also have a negative flow-on effect to the Australian economy, primarily for two reasons:*

- lower GDP in China would mean less demand for Australian exports; and
- higher production costs in China as a result of the changes would mean higher prices for Chinese imports, leading to higher costs for inputs into production for Australian firms and consumables.<sup>31</sup>

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## 8. Liberalising trade: reversing political influence

*...the growing economic interdependence between China and the global economy has enabled China to intervene in the political conduct of leading democracies, but not vice versa.<sup>1</sup> (Guongang Wu)*

### Introduction

Advocates of free trade tend to argue that increased trade links with countries with poor records in terms of human rights and democracy will help to influence better social outcomes. In China's case the reverse has been the result.

This section examines Australia's current mechanisms to control foreign ownership in Australian companies. It also discusses the way that politics and commerce are inextricably linked in China due to the authoritarian regime. The chapter concludes by pointing out that increased trade with China has actually reduced other countries' political influence in China, rather than increasing it.

Free trade theory cannot respond to the challenges these issues represent. Nor can it respond to the way that an authoritarian regime is able to integrate investment decisions with broader political and strategic objectives, to use multinational corporations as de facto lobbyists to protect its unfair trade practices and to muzzle criticism of its human rights record.

### Foreign ownership

Australia maintains control over the foreign

ownership of Australian companies via the Foreign Investment Review Board (FIRB). However, our FTA with the USA has relaxed those constraints. Except for companies in a few prescribed industries,<sup>2</sup> the AUSFTA removes the need for FIRB approval for takeovers to companies with a capitalization of \$800 million. With indexation that figure has actually risen to around \$950 million. For non-US companies the threshold above which approval must be obtained is about \$110 million.

There could be serious implications if China sought the inclusion of the same provision in a free trade agreement with Australia.

In recent months the spotlight has focused on Chinalco's proposed investment in Rio Tinto and also Minmetals buyout of OZ Minerals and Sinosteel. However, a number of developments have occurred in this area recently:

- South Australia-based iron ore explorer Centrex Metals sold a 50 per cent interest in two of its Southern and South Central magnetite deposits for \$180 million to China's third-largest steelmaker, Wuhan Iron & Steel.
- Mount Gibson Iron brokered a rights issue and share placement to Chinese interests, with two major companies taking a stake of up to 40 per cent and securing



discounted off-take agreements.

- Gindalbie Metals was given a \$162.1 million boost from AnSteel, China's second-largest steelmaker. The move increased AnSteel's stake in the company from 12.6 per cent to 36.28 per cent.
- Grange Resources also looked to China and is set to merge with Australian Bulk Minerals, which is majority-owned by a Chinese steelmaker.<sup>3</sup>

According to the *Courier Mail*, during 2007 and 2008 the FIRB approved a Chinese investment every nine days. One of them was a \$500 million investment by Shenzhen Zhongxin, China's third largest zinc producer, to take a majority interest in Herald Resources.<sup>4</sup> Shenzhen Zhongxin also has bought a controlling interest in Perilya for about \$45 million<sup>5</sup> and Hunan Valin Iron and Steel has bought a 17.5 per cent interest in Fortescue Metals Group, Australia's third biggest iron ore producer, for \$645 million.<sup>6</sup> In the current financial climate the number of Chinese investment proposals in the mineral and agriculture<sup>7</sup> sectors is unlikely to diminish.

Critics of the FIRB say it is pointless since approval is merely a formality. In fact, in February 2009 former Treasurer Peter Costello wrote: 'I cannot recall Treasury ever recommending that I block or disallow the acquisition of an Australian company by foreign interests when I administered Australia's foreign investment laws.'<sup>8</sup>

Nevertheless, writing in 2004 John Edwards, then chief economist at the HSBC Australia and New Zealand argued that:

*It has been rightly said the FIRB approves nearly every application made to it. But of those approved last year, three-quarters were approved only with conditions. For takeovers of industrial companies these conditions may include requirements for a local board, a local CEO, or for commitments to R&D or manufacturing facilities.<sup>9</sup>*

## Mixing politics and commerce

The issue in relation to FIRB approval is not that these buyers are Chinese. According to analyst

Paul Monk the problem is that the buyer is actually the Chinese State.<sup>10</sup> For example: 'Chinalco is an arm of the Chinese state, not a normal commercial enterprise....' Monk points to the fact that in China there are 'state-owned resource companies, state-owned financial institutions and state-owned military enterprises, all run by a secretive and dictatorial party.' This means: 'the kind of information Chinalco would be privy to if it gets the stake it seeks in Rio Tinto is not available to the Australian or British governments, it will go directly to the Chinese Government'.<sup>11</sup>

Journalist Ian Verrender recognised the broader implications when corporations that are wholly owned by the Chinese Government attempt to buy strategic resource assets where the major customers are corporations wholly owned by the Chinese Government. 'Clearly, this creates a potential to manipulate global metal prices and potentially harm Australian export earnings.'<sup>12</sup>

Business commentator Terry McCrann noted the banks that were providing the money for the proposed investment in Rio Tinto: 'China Development Bank. The Export-Import Bank of China. The Agricultural Bank of China. And Bank of China.'<sup>13</sup> He also noted that the syndicate formed to fund the Rio deal did not include banks such as Citigroup and UBS. McCrann pointed out that this undermines the claim that the 'takeover was a market-driven transaction. As opposed to driven by China's sovereign strategic interests.'<sup>14</sup>

A further issue is control of the company. For example, senior management at Chinalco are overseen by a supervisory committee that reports to the Chinese Government.<sup>15</sup> The supervisory committee makes recommendations on appointments, dismissals, remuneration and other incentives.<sup>16</sup> The committee includes members who are employee representatives from the auditing and enterprise culture departments. The committee's chairman is He Jiacheng, president of China's state-owned assets supervision and administration commission, which reports to the State Council. Chinalco's previous president, Xiao Yaqing, stated the company would strive to become more internationally competitive "under the supervision of the (Chinese Communist Party)



Central Committee. Mr Xiao left Chinalco to become deputy secretary general in the Chinese cabinet.<sup>17</sup>

'In 2004 John Edwards drew attention to the significance of a company's ability to acquire 19 per cent of an Australian company without obtaining FIRB approval.<sup>18</sup> The latest decision of Fortescue highlights Edwards' perceptiveness. Fortescue, in which Hunan Valin is now the major shareholder, sells all its ore into China. Although it already is loaded up with debt, Chinese Government-backed financiers are going to lend it between an additional US\$5.5 and US\$6 billion. In exchange, Fortescue will sell its iron ore to Chinese steel mills at a lower price than the price paid by Japanese and Korean steel mills to Rio Tinto and BHP Billiton, thereby undermining Rio and BHP which must insist that Chinese mills pay the same price.<sup>19</sup>

The intertwining of commerce and politics does not end with investment decisions and financial support for those decisions. Because China is an authoritarian state it is also able to exploit its commercial relationships for political purposes.

The extent to which China will go to deter leaders of countries from meeting the Dalai Lama and to prevent pro-Tibet supporters from having access to forums is a good example.<sup>20</sup> Chinese sabotage of the Melbourne International Film Festival following the decision to show a documentary about exiled Uigher leader Rebiya Kadeer, and China's attempt to prevent the broadcasting of her speech to the National Press Club is another.<sup>21</sup> China also applies pressure to suppress criticism of its human rights record. As far back as 1997 it was left to Denmark, at the United Nations Human Rights Commission, to introduce a resolution condemning China's human-rights record. France and Germany refused to support the motion and it was defeated for the seventh consecutive year, despite backing from the USA.<sup>22</sup>

As China strengthens its economic position it is becoming more aggressive in muting criticism of its human rights record.<sup>23</sup> Joshua Kurlantzick of *Time International* noted:

*for the first time, Beijing has started warning the West not to take for granted its massive*

*investments in their currencies and bonds.... China has shored up its ties to repressive states such as Iran...and cracked down hard in Tibet for the 50th anniversary of the 1959 uprising. Yet Beijing has largely avoided high-level censure.<sup>24</sup>*

This is also highlighted by US Secretary of State Hillary Clinton's comments, in the wake of China's role in bailing out US banks: 'our pressing on (human rights) issues can't interfere with the global economic crisis, the global climate change crisis and the security crisis.'<sup>25</sup> Sonia Cardenas, associate professor of political science at Trinity College in Connecticut was critical of the Secretary of State's stance:

*...evidence suggests that human rights pressure — not just dialogue — is essential for eventual reform. In fact, some research indicates that the consistency of applying human rights pressure, even at the level of rhetoric, is more important than the intensity of pressure applied.<sup>26</sup>*

Australia's record of succumbing to China on human rights issues is no more impressive. Since 1997 the Federal Government has dealt with human rights issues in China through the Australia-Human Rights Dialogue. *The Australian's* Greg Sheridan believes this process is largely ineffectual. It simply enables the Government to claim it is raising human rights with China while never having to do the one thing China hates and that is raise the issue of human rights publicly.<sup>27</sup>

In June 2005 Australia declined to attend a summit, which the USA attended on Chinese human rights issues for fear of offending the Chinese Government.<sup>28</sup> More recently, Sheridan noted the 'assaults by pro-Beijing demonstrators against pro-Tibetan demonstrators in several Australian cities when the Olympic torch relay was held.'<sup>29</sup> The Government's response to this was the following statement:

*The Department of Foreign Affairs and Trade does not agree that the actions of the Chinese embassy in facilitating the attendance of Chinese students at the Olympic torch relay was a breach of the Vienna Convention on Diplomatic Relations.... The ambassador was told that under no circumstances were the students or Chinese community to have a security role.*



According to Sheridan 'no foreign embassy in Australia should have any role agitating among any group within Australia at all,'<sup>30</sup> but this does not appear to be the case in relation to China.

China's use of its economic power to exercise political influence is indirect as well as direct. For example, Carolyn Bartholomew, Vice Chairman of the U.S. China Commission, said that:

*Google, Yahoo, and Microsoft ... provide censorship mechanisms and, in the case of Yahoo, have even identified the authors of Internet content that the government found objectionable. At least one such cyber dissident was imprisoned as a result. Meanwhile, Google places limits on its Internet searches to avoid offending the government.... What is the conclusion here? Far from capitalism changing the Chinese government, it is the Chinese government changing capitalists.*<sup>31</sup>

New York Times columnist Nicholas Kristol recently discovered that Microsoft's search engine was censoring results in Chinese-language searches, even if they are conducted outside China. Having initially denied censoring outside China was occurring, Microsoft said that it was inadvertent and put the cause down to 'a bug'.<sup>32</sup>

These issues present another challenge to the free trade and free market lobbies. During the 1990s we were promised not only that everyone would be better off but also that economic reform would bring with it political reform. In the words of The Wall Street Journal: 'Sooner or later China's economic progress will create the internal conditions for a more democratic regime that will be more stable, and less of a potential global rival.'<sup>33</sup>

However, this has simply not been the case. Clyde Prestowitz, who served as counselor to the Secretary of Commerce in the Reagan Administration, has pointed out:

*The standard argument in U.S. economic and foreign-policy circles is that globalisation, by making nations richer, will also make them more democratic. In fact, the global corporation acts as a conveyor belt to carry non-democratic values into democratic societies.*<sup>34</sup>

Or as Tina Rosenberg puts it:

*America has a bipartisan human rights policy in China. It is called trade.... Because China is too lucrative a market to resist, American and European businessmen have ended up endorsing the party line through their silence — or worse. They are not moulding China; China is moulding them.'*<sup>35</sup>

China's strong economic performance means its government has been able to resist domestic pressure to implement any meaningful political reforms. In addition, China's growing economic interdependence with the rest of the world has increased its diplomatic clout. The Chinese government uses this to thwart criticism of its human rights record and water down international human rights norms.<sup>36</sup>

## Endnotes

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# 9. Conclusion and recommendations

**A**ustralia should call a halt to the negotiations until rigorous research is undertaken into the benefits of a free trade agreement based on the outcomes of NAFTA and the agreements Australia which has signed and which are in operation, and until China stops exploiting its own workers and environment and removes its unfair trade practices.

Australia should follow the example set by China. Just as China set a pre-condition before it would begin negotiations, Australia should do the same. These conditions should include China's:

- revoking any direct or indirect government action or inaction that unfairly stimulates export activity at the expense of trading partners<sup>1</sup>
- ceasing the undervaluation of the Yuan
- ratifying the major International Labour Organization (ILO) conventions it has not ratified<sup>2</sup>
- allowing independent unions and the right of workers to collectively bargain
- stopping discrimination in wages, working conditions and the provision of social services between citizens on the basis of place of residence
- guaranteeing and enforcing intellectual

property rights

- effectively enforcing labour, environment, health and safety and intellectual property laws, at a national, provincial and local level
- stopping the export of goods produced in prisons.

Given the poor record of China in implementing and enforcing commitments it makes, it is necessary that China demonstrates its willingness and ability to address these issues before Australia even begins investigating the possible benefits of a FTA.

Such an assessment should be based on the past performance of FTAs and realistic econometric models rather than the models which still remain in vogue.

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## Endnotes

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