

Chapter 7

Trade in minerals and energy

7.1 The strength of the complementarity that exists between the economies of China and Australia is most evident in the minerals and energy sectors. Australia's natural endowment as a resource rich country fits well with China's growing appetite for such commodities. This chapter discusses China's growing demand for minerals and resources and the opportunities for Australia to take advantage of China's expanding market. It looks specifically at China's concern with the limited capacity of its domestic market to supply its energy needs, the policies it has adopted to secure its supply and their implications for Australia. The chapter also examines specific commodities, including liquefied natural gas (LNG) and iron ore to highlight their particular significance for Australia and the impediments to trade in these commodities.

China's demand for minerals and resources

7.2 According to the Minerals Council of Australia, China's consumption of minerals, as a percentage of the world's total, is doubling each decade. It is the largest consumer of copper, tin, zinc, steel, iron ore and coal; the second largest consumer of aluminium, petroleum and lead; the third largest consumer of nickel and the fourth largest consumer of gold. China also accounts for 50 per cent of the world's usage of cement.¹

7.3 Furthermore, China's demand for resources does not appear to be a short term phenomenon. For example, the demand for electricity in China is expected to more than triple by 2025 and the number of cars has been growing by 20 per cent a year and 'the potential growth is almost unlimited'.² The Minerals Council of Australia maintained that an underlying structural change in the global market is taking place. It stated in evidence:

Essentially, what we are seeing is a profound shift in the global market in terms of demand...That is largely a consequence of the impact of the emerging economies in North Asia, China in particular, which aims to quadruple its GDP by 2020, which equates to about a seven per cent per annum growth. We see China following the path of industrialisation and urbanisation that history records occurred in the 1890s in the United States of America and again in the 1950s and 1960s in the United States but also Japan and South Korea.³

1 *Committee Hansard*, 22 June 2005, p. 2.

2 Energy Information Administration, *International Energy Outlook 2005*, Office of Integrated Analysis and Forecasting, U.S. Department of Energy, Washington, DC, July 2005, pp. 18, 22.

3 *Committee Hansard*, 22 June 2005, p. 1.

China's domestic capacity

7.4 Much of China's demand for minerals has been generated by strong growth in the export of manufactured goods, coupled with the government's intense program of infrastructure development—railways, ports, power stations and highways. Indeed, China is at the 'minerals intensive stage of its development where infrastructure, urbanisation and manufacturing make a heavy demand on steel, aluminium and electricity...'⁴

7.5 China has stated emphatically that it 'will stay on the new road of industrialisation'.⁵ The government has indicated that it will strengthen basic industries like the energy industry and important raw materials industries, as well as infrastructure development in 'water conservancy, transport and communications'.⁶ Clearly, as noted by the Minerals Council, China's requirements for minerals and energy are now operating from a new higher plateau.

7.6 Although China has its own extensive reserves of minerals, demand exceeds its domestic supply capacity. Improving domestic capacity forms an important aspect of China's economic and social development plan. China is focusing on developing large coalmines and expanding coal transport facilities such as railways and embarkation ports and to renovate and upgrade coalmines for production safety.⁷ It intends 'to accelerate major projects for liquefying coal, exploiting petroleum and natural gas, generating power by natural gas, and utilising renewable energy sources and develop hydroelectric power'.⁸

7.7 Despite the measures taken to increase domestic supply, China acknowledges that it remains dependent on overseas supplies to satisfy its requirements for minerals and resources. At the beginning of 2005, China noted that supplies of energy, raw and processed materials and transportation had increased significantly over the past two years but that supply lagged far behind demand for coal, electricity, petroleum and

4 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

5 *Report on the Work of the Government*, delivered by Premier Wen Jiabao at the Third Session of the 10th National People's Congress, 5 March 2005.

6 *Report on the Work of the Government*, delivered by Premier Wen Jiabao at the Third Session of the 10th National People's Congress, 5 March 2005.

7 *Report on the Implementation of the 2004 Plan for National Economic and Social Development*, submitted to the Third Session of the 10th National People's Congress, 5 March 2005.

8 *Report on the Implementation of the 2004 Plan for National Economic and Social Development*, submitted to the Third Session of the 10th National People's Congress, 5 March 2005.

transportation.⁹ It announced that it would 'carefully organize the import of energy, raw and processed materials, key technologies and major equipment that are badly needed and in short supply in China'.¹⁰ Chapter 2 discussed China's energy needs and noted that the country experiences power shortages.

Australia as a producer of minerals and resources

7.8 Australia is one of the world's most significant suppliers of minerals. It is the third largest mineral sector by value of production of any country after the US and South Africa.¹¹

7.9 Currently, China is an important market for the Australian minerals sector. Minerals account for more than half of Australia's total goods exported to China and have grown by 470 per cent over the last decade.¹² China is now Australia's second largest customer for mineral and energy commodities after Japan.¹³ China's highest value imports from Australia are iron ores, aluminium, copper, wool, coal and flat rolled iron. Minerals exports to China are in the order of \$3.5 billion—or just less than 10 per cent of total Australian minerals exports.¹⁴

7.10 The main impetus behind the increasing importance of China as an export destination for Australia is its growing demand for resources. Australia is well placed to take advantage of this growing demand. According to the Minerals Council, Australia's mining sector has been 'gearing up for a number of years to meet the extra demand'.¹⁵ They noted that there are 43 minerals projects at an advanced stage—either committed or under construction—with total estimated investment of around \$13.6 billion.¹⁶

7.11 Mr Charlie Lenegan, Managing Director, Rio Tinto, Australia, warned of forecasting the shape of future trade with China, which in his view is inherently risky.

9 *Report on the Implementation of the 2004 Plan for National Economic and Social Development*, submitted to the Third Session of the 10th National People's Congress, 5 March 2005.

10 *Report on the Implementation of the 2004 Plan for National Economic and Social Development*, submitted to the Third Session of the 10th National People's Congress, 5 March 2005 and *Report on the Work of the Government*, delivered by Premier Wen Jiabao at the Third Session of the 10th National People's Congress, 5 March 2005.

11 Minerals Council of Australia, *Submission P55*, p 8; and *Committee Hansard*, 22 June 2005, p. 2.

12 *Submission P55*, p. 7.

13 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

14 *Submission P55*, p. 3.

15 *Submission P55*, p. 8.

16 *Submission P55*, p. 3.

He surmised that the 'country's human capital, its commitment to change and its ability to leapfrog technology guarantee surprises'.¹⁷ Even so, Mr Lenegan indicated that 'China's soaring demand for iron ore and other minerals is depicted as a bonanza for resource companies like Rio Tinto'.¹⁸ He explained further:

Ultimately, a nation of 1.3 billion whose economy is at the minerals intensive stage of development is going to see significant growth in consumption of minerals and energy. There will be imports of resources and other products/services where Australia enjoys a competitive advantage, and exports of goods in which China enjoys a competitive advantage.¹⁹

7.12 Indeed, most analysts predict that trade in resources and energy will continue to grow rapidly in response to demand pressures generated by China's industrialisation. DFAT stated:

These trades are underpinned by sizeable long term contracts, for example for iron ore and the sale of liquefied natural gas into the Guangdong market from 2005, and will remain the basis of Australia's export trade for many years to come.²⁰

China's concern with dependency on overseas supplies and energy efficiency

7.13 As noted above, China's domestic sources cannot satisfy its growing demand for minerals and energy and it must rely on overseas suppliers. Even with imported energy resources, China experiences power shortages that make it particularly conscious of the importance of conserving and using energy more efficiently. China is taking a number of steps to enhance its energy security including diversity of supply, use of alternative or substitute products and increased efficiency of use.

Security of supply an important consideration

7.14 It is natural for a country dependent on overseas sources for vital raw materials to adopt an opportunistic and pragmatic policy aimed at securing its supplies. China is no exception. It is following a multi-pronged approach to ensure that it has ready and reliable access to essential resources.

17 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

18 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

19 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004. See also *Submission P34*, p. 6.

20 *Submission P19*, p. 7.

7.15 China is looking to diversify its sources of minerals and energy to guarantee greater certainty in accessing supply. The Department of Industry, Tourism and Resources (DITR) did not envisage China's energy efficiency policy as a problem for Australian exporters of minerals. It told the committee:

We do know that China, like many other economies, would be trying to diversify its sources of energy supply from an energy security perspective. I think the demand that they will need to meet their growing energy needs will be such that that really would not be an impediment to Australia exporting to that country.²¹

7.16 China is also seeking alternative sources of energy with Australia again well placed to assist China. Australia and China have recently entered into an agreement that will see Australia supply China with liquefied natural gas. This is discussed in greater detail later in this chapter at paragraphs 7.35–7.45.

7.17 Nuclear power is another area with the potential for huge growth. Australia is the second largest producer of uranium after Canada and is a preferred supplier of uranium because of its low cost reserves and its political and economic stability.

7.18 Australia's uranium is sold strictly for electrical power generation and there are well-established safeguards in place to ensure that nuclear material remains exclusively for peaceful use.²² China has made it known that it is very keen to enter into negotiations with Australia on the supply of uranium.²³ Indeed, at the beginning of 2005, Canberra and Beijing began informal talks on uranium sales. In August later that year, the government announced that Australia would formally commence negotiations on a nuclear cooperation agreement with China. The Minister for Foreign Affairs stated that:

Australia has an estimated 40 per cent of the world's low-cost uranium resources. Opening up this export opportunity with China is consistent with the growing trade and economic relationship between our two countries, and Australia's position as a secure supplier of energy resources.²⁴

7.19 Australian Uranium exports are currently not allowed to China because Australia does not have a bilateral nuclear safeguards agreement with China. The Treasurer, the Hon Peter Costello, MP, made it clear that there would be no sales of uranium to China unless it agreed to Australia's nuclear safety controls.²⁵ A necessary

21 *Committee Hansard*, 21 June 2005, p. 39.

22 DFAT, Senate Foreign Affairs, Defence and Trade Legislation Committee, *Estimates Hansard*, 17 February 2005, p. 93.

23 *Committee Hansard*, 22 June 2005, p. 9.

24 The Hon. Alexander Downer, MP, Minister for Foreign Affairs, 'Negotiation of Nuclear Cooperation Agreement with China', Media Release, FA100–9, August 2005.

25 The Hon. Peter Costello MP, Treasurer of the Commonwealth of Australia, Doorstop Interview, Beijing, China, 17 October 2005.

part of the negotiations now underway will involve both countries reaching such an agreement.

7.20 The committee notes that diversity of suppliers and the use of alternative commodities itself do not necessarily offer security of supply if the suppliers cannot be relied upon to deliver on time and without difficulties. Australia has a distinct advantage in this regard.

Australia's reputation as a supplier

7.21 A country seeking to secure access to essential resources values a supplier who can be relied on to deliver the goods as required, efficiently and cost effectively. Australia stands out in this regard. Its established reputation as a dependable and reliable supplier of goods is one of its strongest credentials as a trading partner (see paragraphs 7.16, 7.36, 7.42 and 8.32). Countries relying heavily on imports for their strategic commodities such as iron ore look for certainty of supply. DITR told the committee:

We take every opportunity we have during our bilateral dialogue and also when we have incoming and outgoing delegations to promote ourselves as a very reliable supplier of energy and resource commodities. Particularly, we look to our very good track record—say, with LNG, in our exports to Japan—in that we have never ever missed a shipment. They have all been on time. So we use the avenues we have available to us to continually promote our very good track record and our political stability in this country.²⁶

Committee view

7.22 Australia's reputation as a reliable and dependable supplier of commodities holds it in good stead in the international trading community. It provides a solid foundation to further expand Australia's trading links with China. Reputations, however, are easily tarnished and in such a highly competitive market Australian companies need to maintain and promote their good reputation.

Energy efficiency and conservation

7.23 While China has made remarkable advances in economic and social development, its leaders acknowledge that there has been a cost to the environment. Premier Wen was forthright on this matter:

The reckless expansion of cities, blind pursuit of large-emission automobiles capacious residential apartments and luxurious packages for some products, which are quite common in some cities, have intensified the

26 *Committee Hansard*, 21 June 2005, p. 41. See also, the Hon Peter Costello, MP, Treasurer of the Commonwealth of Australia, 'The Emerging Global and Regional Architecture—Moving Ahead', Address to the China–Australia Chamber of Commerce, Beijing, 17 October 2005.

conflict between the supply and demand of resources and environmental pollution.

Currently, China's consumption of energy resources, raw materials and water for per unit of GDP (gross domestic product) is far beyond the world's average level.²⁷

7.24 China will continue to promote economic growth but is serious about implementing measures to 'build a resources-saving society'. It has called for energy conservation in major energy-consuming industries and enterprises, the development of oil substitutes and other energy saving products, the promotion of the use of renewable energy such as water, wind, solar and biological energy and a raft of practices designed to reduce energy use.²⁸

7.25 Australia recognises the direction that China is taking to encourage energy efficiency. DITR told the committee that:

The Chinese government are taking very seriously energy efficiency and are looking to be a good citizen in trying to reduce emissions. They are doing a lot of work in the international arena in attempting to move towards renewable energy and, as I said, to undertake work to introduce energy efficiency procedures into their government operations as well as into the general consumption of energy in that country. So they are doing a lot of work in that area.²⁹

7.26 Although Australia supplies China with resources, it is also well placed to assist China in its endeavour to improve the efficient use of resources through the application of new techniques and the development of new products.

7.27 Coal is currently the most important source of China's energy. According to ABARE, in 2001 coal accounted for 69 per cent of total Chinese primary energy consumption compared with 80 per cent in 1990.³⁰ Currently, coal makes up 65 per cent of China's primary consumption. China is both the largest consumer and producer of coal in the world.³¹ Although coal's share of the overall Chinese energy consumption is expected to fall, coal consumption is on the rise and will remain a crucial source of China's energy.³² Coal, however, is a substantial green house gas emitter and China's heavy use of unwashed coal results in large emissions of sulphur

27 Premier Wen in 'Premier Wen urges gov't organs to save energy', *People's Daily Online*, 4 July 2005.

28 Premier Wen in 'Premier Wen urges gov't organs to save energy', *People's Daily Online*, 4 July 2005.

29 *Committee Hansard*, 21 June 2005, p. 42.

30 *Australian Commodities*, vol. 1, no. 2, June quarter 2004, p. 299.

31 *Country Analysis Briefs, China*, August 2005, <http://www.eia.doe.gov/emeu/cabs/china.html> (accessed 21 September 2005).

32 *Country Analysis Briefs, China*, August 2005, <http://www.eia.doe.gov/emeu/cabs/china.html> (accessed 21 September 2005).

dioxide and particulate matter. China is projected to experience the largest absolute growth in carbon dioxide emissions between 2005 and 2025.³³

7.28 Australia exported almost 6 million tonnes of coal to China in 2004 and, according to the Treasurer, could export as much as 56 million tonnes a year by 2010, 'if China's markets were fully open to foreign suppliers.'³⁴ Australia also relies heavily on coal as a major source of energy. Although there are less environmentally-damaging alternatives, the reality remains that coal-fired electricity will be the mainstay of China's and Australia's static power supply for many years to come.

7.29 As exporters and heavy consumers of coal, both countries have a genuine interest in developing technologies that will reduce the emission of green house gases and are working cooperatively to find solutions to this problem. DITR informed the committee that China is active in international arenas in developing practical solutions to address environmental problems such as greenhouse. They explained further:

It is a member of the Carbon Sequestration Leadership Forum, which is aimed at developing the technologies to capture and store carbon dioxide from coal powered stations. It has recently joined the methane to markets initiative, which is all about trying to capture and utilise methane emissions from coalmines and natural gas operations—once again, to reduce greenhouse emissions. China is working with Australia under a bilateral agreement, the climate action partnership, which is aimed at trying to facilitate the development of practical solutions to address greenhouse between our two countries...As well as that, China is working with Australia to implement clean coal technologies that we have developed such as ultra clean coal. There are some very serious negotiations at the moment to perhaps develop an ultra clean power station within China.³⁵

7.30 Most recently, in July 2005, six Asia-Pacific countries—the United States, Japan, China, India, South Korea and Australia—formed a partnership on clean development and climate. According to the Minister for Foreign Affairs and the Minister for Environment and Heritage, this group 'will sensibly put technology cooperation front and centre'.³⁶ The ministers anticipated that the inaugural meeting of the partnership to be held in November 2005 would begin 'a long-term, practical

33 *Country Analysis Briefs, China*, August 2005, <http://www.eia.doe.gov/emeu/cabs/china.html> (accessed 21 September 2005). It noted a 1998 WTO report that suggested that seven of the world's ten most polluted cities are in China. See also EIA, *Country Analysis Briefs, 'China: Environmental Issues'*, July 2003. See also chapter 2, paragraphs 2.61–2.63.

34 The Hon Peter Costello, MP, Treasurer of the Commonwealth of Australia, 'The Emerging Global and Regional Architecture—Moving Ahead', Address to the China–Australia Chamber of Commerce, Beijing, 17 October 2005.

35 *Committee Hansard*, 21 June 2005, p. 43.

36 Joint Ministerial Statement, Minister for Foreign affairs and Minister for Environment and Heritage, 'Asia–Pacific Partnership on Clean Development and Climate', 11 August 2005.

collaboration that will promote low-carbon technologies, reduce the greenhouse gas intensity of our economies, and put us on low-emissions growth trajectories'.³⁷

7.31 China also has a poor safety record in the mining industry. Again, Australia is well placed to assist China improve its mining procedures and techniques. The Queensland Government has entered into two agreements with China to address mine safety. It noted the following initiatives:

- In January 2005, the Safety in Mines Testing and Research Station (SIMITARS) within the Queensland Department of Natural Resources and Mines signed a Memorandum of Understanding with the State Administration of Work Safety (SAWS) to supply China with safety technology designed to prevent underground mine disasters. SIMTARS has also signed an agreement with the China Coal Research Institute with similar objectives.
- The Queensland Department of Natural Resources and Mines has also entered into a Cooperation Agreement on Mine Safety Education and Training Cooperation with Shandong Coal Mine Safety Education and Training Centre in China.
- On 8 July 2005, the Queensland Department of Natural Resources and Mines signed a Memorandum of Understanding with the Ministry of Land and Resources, People's Republic of China, for more collaborative arrangements between the two governments regarding mining technology, mining safety, land management and water issues.
- In August 2004, the Queensland Department of Natural Resources and Mines signed a five-year contract with China's Ministry of Land and Resources to assist Chinese bureaucrats with training in land administration and registration.³⁸

Recommendation 8

7.32 The committee recommends that Australia as a major exporter and consumer of coal take a lead role in promoting the cleaner use of fossil fuels and encourage further joint research and development between China and Australia in the area of environmental protection and climate control.

Committee view

7.33 The committee notes Australia's reputation as a reliable and secure source of raw materials and the importance of protecting and building on its image as a dependable and valued supplier. The committee also acknowledges that Australia offers China a number of alternative sources of power—nuclear and LNG—and is working with China to improve its efficiency in energy use.

37 Joint Ministerial Statement, Minister for Foreign affairs and Minister for Environment and Heritage, 'Asia-Pacific Partnership on Clean Development and Climate', 11 August 2005.

38 *Supplementary Submission PIA*, p. 3.

7.34 The committee believes that it is important at this stage of the report to again note the concern expressed by a number of witnesses, in chapters 3 and 6, about Australia's reliance on the export of raw materials to boost its balance of trade figures. For example, taking a longer term look at the pattern of Australia's exports, Mr Martin Feil, a former director of the Industries Assistance Commission, pointed to the fact that Australia adds 'virtually no value to natural resources and raw materials other than extraction and some logistical services'. The AMWU noted that for every plasma television Australia imported, it had to export 'in the vicinity of 150 tonnes of iron ore'.³⁹ The committee encourages Australian energy and resources companies to capitalise on the opportunities presented by a rapidly industrialising China but urges them and the Australian government to look on Australia as much more than a quarry.

7.35 The following section examines a number of key commodities traded with China and the advantages for Australia in forming strategic partnerships in the minerals and energy sector. In particular, this section examines the successes that Australia has achieved in gaining access to China's markets and some of the difficulties producers face in exporting their product to China.

Liquefied natural gas (LNG)

7.36 Although natural gas is presently a minor fuel in China there are clear indications that the consumption of natural gas in China will grow.⁴⁰ The Energy Information Administration's *International Energy Outlook for 2005* indicated that natural gas is expected to be a favoured choice for new electricity generation capacity built over the next two decades. Natural gas offers China a number of benefits. Its relative environmental advantages and efficiency make it an attractive alternative to coal fired generation. It also provides China, which is looking to diversify its energy supplies, with an alternative energy source.

7.37 In August 2002, an Australian consortium, Australia LNG, won a major contract to supply liquefied natural gas to China's Guangdong Province—the largest foreign contract ever awarded to an Australian Company. This was China's first LNG project.⁴¹ The Chairman of Woodside Petroleum Ltd, Mr Charles Goode, remarked at the time that:

The North West Shelf has an excellent record over more than a decade as an efficient and reliable supplier of LNG. The Australian tender, therefore, had the sound credentials of an efficient existing operation, good reserves and strong management.⁴²

39 See chapters 3 and 6, paragraphs 3.21, 3.23, 6.64 and 6.66.

40 Energy Information Administration, *International Energy Outlook 2005*, Office of Integrated Analysis and Forecasting, U.S. Department of Energy, Washington, DC, July 2005, p. 43.

41 Australia LNG Pty Ltd changed its name to North West Shelf Australia LNG Pty Ltd in March 2003.

42 Woodside Australian Energy, News Release, 'China LNG Success: Woodside Chairman offers congratulations', 8 August 2002.

7.38 He also recognised that there had been a 'well coordinated marketing program to China over a number of years which had the strong support of the Western Australian and Commonwealth governments'.⁴³ At the time of the announcement, Mr John Akehurst, Managing Director of Woodside Energy Ltd, stated:

This is a great outcome for Australia and for the North West Shelf. It is the result of a sustained effort by many people over a long period. Cooperation between industry and governments could not have been better and Australia LNG, which is our marketing arm in China, has done a great job.⁴⁴

7.39 Two months later, a 25-year LNG sale and purchase agreement between the North West Shelf LNG Sellers and the Guangdong LNG project proponents was signed. Under the agreement, from mid-2006 Australia is to supply 3.7 million tonnes of liquid natural gas each year for 25 years.⁴⁵ The agreement is worth up to \$25 billion and was the result of many years of 'hard, diligent and meticulous work'.⁴⁶

7.40 This announcement put in train a series of other arrangements. In May 2003, the North West Shelf Venture Participants and CNOOC Ltd⁴⁷ formalised agreements that provided for CNOOC subsidiary, CNOOC NWS Private Ltd, to acquire an interest in NWS Venture titles and to secure rights to use NWS Venture infrastructure to process gas.⁴⁸

7.41 In October 2003, North West Shelf Australia LNG signed a Memorandum of Understanding for the Management and Implementation of the Australia-China Natural Gas Technology Partnership Fund. This initiative is 'aimed at providing

43 Woodside Australian Energy, News Release, 'China LNG Success: Woodside Chairman offers congratulations', 8 August 2002.

44 'Australia Wins China LNG Bid', 8 August 2002, <http://www.supplybase.com.au/news/views.asp?id=35> (accessed 17 May 2005).

45 Australia LNG, Media Release, 'North West Shelf Venture to Assist in Developing China's Natural Gas and LNG Industry', 24 October 2003.

46 Stock Exchange Release, Woodside Australian Energy, 8 August 2002. Australian Bureau of Statistics, *Year Book Australia*, 2003, International Relations: Australia's bilateral relationships, Catalogue no. 1301.0-2003; Australian Bureau of Statistics, *Year Book Australia*, 2003, International Relations: Australia's bilateral relationships, Catalogue no. 1301.0-2004. See also Chairman's Address, 32nd Annual General Meeting, Woodside Petroleum Ltd., Sydney, 15 April 2003.

Mr Arthur Dixon, President of Australia LNG, noted that it had taken five years and 12 days since the first official mission from Australia visited China in search of an LNG deal. He stated that it had been 'a long haul'. Australia LNG, News Release, 'Australia Signs China LNG Agreements', 18 October 2002.

47 The China National Offshore Oil Corporation, one of the largest oil companies in the People's Republic of China. Through its subsidiaries, it explores, develops, produces and sells crude oil and natural gas.

48 'North West Shelf Venture-CNOOC Formalise Acquisition Agreements', 16 May 2003, <http://www.australialng.com.au/newsItem.aspx?id=8> (accessed 17 May 2005).

opportunities for training, research and technology transfer between the people of China and Australia in the natural gas and Liquefied Natural Gas (LNG) industry'.⁴⁹

7.42 In December 2004, the North West Shelf Australia LNG and the Guangdong LNG Company Ltd finalised the sale and purchase agreements for LNG supply to Guangdong.⁵⁰ Mr Wu Zhenfang, Chairman of Guangdong Dapeng LNG Company Ltd, recognised this step as a major milestone in the development of the Guangdong LNG Project, marking 'the start of a very long journey for China in developing a world class natural gas industry'.⁵¹

7.43 DFAT cited this agreement as an example of how 'close collaboration between Australia's Government and industry can advance the national interest'. It noted that other Australian companies are working hard to build on the North West Shelf Venture's success in the China market, including Gorgon Australian Gas, Woodside Petroleum and BHP Billiton'.⁵²

7.44 This arrangement showcases the opportunities that are available for Australia to deepen its economic links with China. Mr Peter Jennings, Acting Director, the Australian Strategic Policy Institute, noted that the LNG deal clearly demonstrated the potential to develop 'an economic relationship that, in scope, goes well beyond simple trade ties' and which in large part stems from their complementary economies:

Australia offers China a combination of essential resources and long-term political stability underpinning a guaranteed supply. China offers Australia almost limitless demand and the potential to broaden the relationship beyond providing raw materials to include a huge requirement for services.⁵³

7.45 Indeed, the success of this agreement has paved the way for further expansion. The Western Australian government with the government of its sister state, Zhejiang,

49 Australia LNG, Media Release, 'North West Shelf Venture to Assist in Developing China's Natural Gas and LNG Industry', 24 October 2003.

50 ASX Announcement, Woodside, 'CNOOC Equity Agreement', 20 December 2004.

51 Australia LNG, Media Release, 'Guangdong LNG Agreement', 13 December 2004. At this time, Woodside announced that: A new joint venture, called the China LNG joint venture had been established within the overall North West Shelf project to accommodate CNOOC and to supply LNG to the Guangdong LNG project in China. CNOOC will hold a 25 per cent share in the new joint venture, with each of the existing NWS Venture participants taking 12.5 per cent. CNOOC will be entitled to gas and associated liquids approximately equivalent to a 5.3 per cent interest in the gas in North West Shelf Venture titles. CNOOC will pay a tariff to the North West Shelf Venture participants to use infrastructure to produce and process gas and associated liquids from its acquired resources. ASX Announcement, Woodside, CNOOC Equity Agreement, 20 December 2004.

52 *Submission P19*, p. 14.

53 P. Jennings, *Submission P2*, pp. 3–4.

have set up a feasibility study on gas and LNG.⁵⁴ As an example of close cooperation, Mr Satchwell told the committee about the eight Chinese gas utility executives who were in Western Australia for six months undertaking training in modern business operation and in particular the operation of competitive gas markets.⁵⁵

Committee view

7.46 The committee acknowledges the achievements of all parties to the LNG agreement and the contribution it has made to developing closer ties with Chinese industry. It has enhanced Australia's image as an enthusiastic, innovative and reliable trading partner. It provides a model for other Australian enterprises to emulate and is a source of encouragement for them to enter joint ventures with Chinese enterprises.

Iron ore

7.47 Different commodities in the minerals and energy sector confront different trade barriers. In chapter 4, the committee discussed in broad terms some of the impediments to trade with China. It noted that tariffs on minerals, although not high, still resulted in unnecessary costs to the exporter. The export of iron ore to China however, is subject to another form of restriction—import licences.

7.48 China relies on overseas sources for its much needed supplies of iron ore. ABARE records that in 2004, China's imports of iron ore rose by 60 million tonnes to 208 million tonnes, representing 35 per cent of world seaborne iron ore.⁵⁶ In 2002–03 China imported 32 per cent of Australia's total iron ore export⁵⁷ and in 2003–04 this increased to 36 per cent.⁵⁸ According to Rio Tinto, the latest import data from China for the first six months of 2005 showed that Australia's iron ore exports to China increased by a substantial 60 per cent, or nearly 20 million tonnes. In comparison, supplies from Brazil increased by 21 per cent and from India by 42 per cent.⁵⁹

7.49 China is Australia's second largest importer of Australian iron ore after Japan and on recent trends, its demand is set to rise. According to Rio Tinto, China is now its largest iron ore importer. Charlie Lenegan, Managing Director, Rio Tinto, Australia, has stated that:

China needs iron ore to supply the growing demand from its steel mills. With nine mines and three ports in the Pilbara, RTIO is well placed to

54 I. Satchwell, *Committee Hansard*, 1 August 2005, p. 5.

55 *Committee Hansard*, 1 August 2005, p. 5.

56 *Australian Commodities: forecasts and issues*, vol. 12, no. 2, June quarter 2005, p. 328.

57 Australian Bureau of Statistics, *Year Book Australia*, International accounts and trade: International merchandise trade, Catalogue no. 1301.0–2004, p. 811.

58 Australian Bureau of Statistics, *Year Book Australia*, International accounts and trade: International merchandise trade, Catalogue no. 1301.0–2005, p. 829.

59 W. Hart, *Committee Hansard*, 1 August 2005, p. 50.

satisfy that demand. The company plans to ship over 170 million tonnes per annum in 2006, up from the 2003 figure of 118 tonnes, also recognise the stimulus that Chinese growth has given to the rest of Asia.⁶⁰

Licence requirement—example of trade barriers

7.50 From 1 May 2005, China limited the number of companies licensed to purchase iron ore from the spot market from 523 to 118 (48 traders and 70 steel makers).⁶¹ This decision seemed to contradict the message China is sending to the international business community that it is opening up its economy. DITR explained:

The Chinese describe the licensing system as an automatic registration system. They do not use the word 'licensing'. I understand that certain companies have queried whether or not the regime that was introduced is compliant with China's World Trade Organisation obligations.⁶²

7.51 Taking account of China's viewpoint, DITR told the committee:

If we step back a little and try to think what is happening, I would suggest that last year there were over 500 purchasers of iron ore in China, from Australian and other iron ore suppliers. The Chinese regarded this as very disorderly marketing—in other words, lack of central control, perhaps, of the prices—and thought that if they could limit the number of purchasers there might be more orderly purchasing arrangements.⁶³

7.52 The department was of the view that limiting the number of purchasers would not affect the quantity of Australia's exports to China and the price negotiated between the commercial parties would be determined by supply and demand.⁶⁴ Consistent with this view, ABARE also suggested that the motive behind this move was to improve logistical efficiencies. It also surmised that it may have been an attempt 'to limit China's exposure to volatility in the spot market'.⁶⁵

7.53 The Minerals Council provided a similar interpretation of the reasons China imposed a licensing requirement, though they believed that the SOEs were exerting influence. It stated:

The state owned enterprises are politically pretty powerful. They have coalesced themselves into a group whereby they are essentially seeking to control what they call 'undisciplined' growth, the argument being that they will take some heat out of the market. The top 75 or so steel mills, for

60 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

61 *Australian Commodities: forecasts and issues*, vol. 12, no. 2, June quarter 2005, p. 329.

62 *Committee Hansard*, 21 June 2005, p. 44.

63 *Committee Hansard*, 21 June 2005, p. 44.

64 *Committee Hansard*, 21 June 2005, p. 44.

65 *Australian Commodities: forecasts and issues*, vol. 12, no. 2, June quarter 2005, p. 329.

example, doing the business see the next 1,000 mills as being responsible for the undisciplined growth so import licences are issued to the top 75 or so mills to take some of that 'undisciplined' growth out of the market place.⁶⁶

7.54 This move by the Chinese government is a reminder that China is sensitive to the problems of the supply and demand of such important commodities. They rely heavily on regulation to ensure that the government retains what it believes to be appropriate control over the supply and distribution of minerals and resources. Although the initial effect was negligible, the Minerals Council was concerned by:

...the fact that the move is indicative of a broader sentiment within China that market prices can be influenced by official and/or unofficial intervention.⁶⁷

Committee view

7.55 The committee notes the Mineral Council's concerns.

Other important export commodities

7.56 A number of other commodities are important to Australia's export trade to China. For example, in 2003–04 China took 14 per cent of Australia's crude petroleum products. Alumina exports to China are also set to rise. According to Rio Tinto, despite China's stricter domestic investment guidelines, its alumina demands are also expected to continue to grow. They stated:

The Comalco Alumina Refinery (CAR), now nearing completion in Gladstone, will add value to the Weipa resource. CAR, the first greenfields alumina refinery to be built anywhere in the world in the last twenty years is, in part, a response to China's growing demand for alumina imports. So, too, is the expansion and upgrading of the Weipa operation that has been carried out to guarantee CAR's raw material needs.⁶⁸

Australian investment in the minerals and resources sectors in China

7.57 China has adopted a two-way investment promotion plan where the outbound investment strategy is 'integrated with the continuous effort to promote foreign capital inflow to boost China's overall involvement in global economic cooperation'.⁶⁹

7.58 In chapter 9, the report examines the broad investment environment that exists between Australia and China. The minerals and energy sector, however, presents a

66 *Committee Hansard*, 22 June 2005, p. 5.

67 *Submission P55*, p. 13.

68 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth—Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

69 *Asia Times*, 13 September 2001.

unique set of circumstances for investors. The nature and extent of that investment is examined in the following section.

7.59 Australian companies, with their experience in research and development, exploration and mining, are ideally suited to assist China to promote the efficient use of energy and the development of their mineral resources. China recognises the advantages to be gained from close collaboration between the two countries in the area of research and development in the minerals and energy sector. For example, Mr Wu Bangguo, Chairman of the Standing Committee of the National People's Congress, suggested that to raise mutually beneficial cooperation between the two countries to a new level, they should:

- deepen cooperation in energy and mineral resources and realise mutual benefit; and
- expand mutual investment and strengthen cooperation between the business of the two countries.⁷⁰

7.60 According to Rio Tinto, however, little foreign direct investment (FDI) has gone into the minerals and energy sector in China, citing reasons related to 'the adequacy of legal systems, views on property rights and prospectivity'. Mr Lenegan explained further:

China is well explored, but new global ore models open up prospects of major discoveries in a large range of geological settings. While gradually improving, the exploration regime suffers from the fragmentation of data and a complex regulatory system. At this stage, there does not appear to be much support for foreign investment in this sector.⁷¹

7.61 The Minerals Council of Australia endorsed this view. While commenting on the opportunities available for foreign investors in China's minerals sector, it noted that 'the reality is that there are restrictions to minerals investment in China at nearly every point in the process'.⁷² In its experience, there are obstacles from determining the prospectivity of particular regions, securing approvals for exploration, exploring for mineral reserves, securing a mining right, undertaking mining operations to the marketing of those products.⁷³ In general it found the approval processes uncertain and open-ended, with limited scope for a wholly owned foreign entity to trade. It cited the following specific impediments to Australian investment in the minerals and energy sector in China:

70 Embassy of the People's Republic of China, 'Wu Bangguo Attends the Opening Ceremony of China-Australia Economic and Trade Forum and Delivers a Keynote Speech', 23 May 2005, <http://www.chinaembassy>1t/eng/xwdt/t197115.htm> (accessed 21 July 2005).

71 Address by Charlie Lenegan, Managing Director, Rio Tinto, Australia, 'China's Growth— Implications for Australia's Mining Industry', ABARE conference, Canberra, 22 June 2004.

72 *Submission P55*, overview.

73 *Submission P55*.

- the restricted availability of geological data—a credible pre-competitive geological database is an essential feature of any regime seeking to promote inward foreign investment in the minerals sector;
- the difficulty in securing an exploration permit which may involve two or three levels of government;
- the licensing regime—licenses can only be granted to qualified 'geological exploration units registered in China and to date no foreign mining company operating in China has been granted such a qualification—foreign explorers must enter joint venture arrangements with qualified provincial groups';
- the requirement for joint venture and to provide capital for that joint venture but with no exit clause to have the capital returned if the venture fails;
- the current project approval process for Sino–Foreign Joint Ventures, which is regarded by foreign minerals companies as slow and uncertain;
- no guarantee that a company that secures a foreign explorer right and locates a commercial resource will have the right to mine that resource;
- a policy approach that means that minerals commodities are not treated equally—authorities encourage exploration in certain base grade metals like copper, lead and zinc but are reluctant to support foreign exploration for more precious metals such as silver and gold;
- tax treatment that lacks certainty and is complex;
- limited trading rights for foreign companies for example if the venture is a wholly–owned foreign enterprise it cannot obtain a full import/export licence; and
- lack of transparency and certainty of legal processes for foreign investors operating in China.⁷⁴

7.62 The Minerals Council was of the opinion that many of these impediments are in contradiction of the WTO agreements and China's succession protocols. In summary, it argued that there is 'an overall need for greater transparency and legal certainty with legal processes for foreign investors operating in China...'⁷⁵

Committee view

7.63 Although China promises more and better investment opportunities for Australian companies, particularly in the minerals and energy sector, substantial hurdles remain that discourage Australian investors. Many of these obstacles restrict the flow in trade and investment that would be of great benefit to both countries. This area should be singled out as a priority for reform.

74 *Submission P55*, pp. 16–17; and *Committee Hansard*, 22 June 2005, p. 4.

75 *Committee Hansard*, 22 June 2005, p. 4.

China's investment in the minerals and resources sectors in Australia

7.64 In turning to outbound investment, China has adopted a 'go global' strategy designed to encourage Chinese firms to invest overseas.⁷⁶ This outward focused investment strategy is designed to integrate with China's effort to promote foreign capital inflow 'to boost China's overall integration in the global economic cooperation'.⁷⁷

7.65 As noted earlier, China is concerned about securing reliable access to essential minerals and resources. 52 per cent of their outward foreign direct investment is in minerals and energy.⁷⁸ Dr Davis, ACCI, maintained that China's approach is to buy the resources abroad. He stated:

They are not content to contract for the supply of oil and gas; they are going to buy oil and gas facilities. As one of my members said, Mr Costello will be worrying about another Woodside within the next two to three years, fairly certainly. In the popular press they are talking about CNOOC buying Unocal. That is just the first of many.⁷⁹

7.66 China's concern for securing market access is reflected in the direction of their investment in Australia. Invest Australia understood that China's investment strategy in Australia was tied to its desire to secure their supply chain with a particular focus on the resources industries.⁸⁰ According to the Minerals Council, Chinese companies have 'equity investments in the Pilbara and in aluminium smelting in Victoria, and most of that is driven by security of market access and commercial decisions'.⁸¹ DITR agreed with this view. It explained further:

I think China is looking to increase its foreign direct investment in other nations that have supply capacity. That would include Australia and Brazil—they would be the main nations that they would be looking to invest in regarding iron ore. They would also be interested in expanding their relationship with India for iron ore supply.⁸²

7.67 DITR told the committee:

They have made direct investments in a couple of mines within Australia, most recently a mine in the Hunter Valley, which had been closed by the

76 See From China about China, "'Go Global" Investment Strategy Needed for Chinese Enterprises', from People's Daily, 12 September 2001, <http://www.lianghui.org.cn/english/GS-e/19033.htm> (accessed 21 July 2005).

77 *Report on the Work of the Government*, delivered by Premier Wen Jiabao at the Third Session of the 10th National People's Congress, 5 March 2005.

78 *Committee Hansard*, 22 June 2005, p. 3.

79 R. Davis, *Committee Hansard*, 29 June 2005, p. 21.

80 *Committee Hansard*, 21 June 2005, p. 39.

81 *Committee Hansard*, 22 June 2005, p. 9.

82 *Committee Hansard*, 21 June 2005, p. 39.

previous owners because they had technical problems that they could not address. The Chinese are coming in with a new long wall mining technology which they want to demonstrate within our mining environment. As such, they have invested within that mine...The Southland mine. They had a fire there last year and the company that owned it just did not have the financial capacity to maintain the operation. That is an example where China is developing mining equipment and technology based on their huge industry, which they are looking to tailor to meet the needs of other countries as well. Increasingly, China is absorbing a lot of investment by the major mining equipment supply manufacturers around the world. In terms of changing trade relationships, I anticipate that instead of getting that equipment from Germany, the US or Japan, we will be getting that sort of equipment from China.⁸³

7.68 The Chinese investor in Australia is not only interested in accessing supplies of raw materials to export to China, but 'extends down the value added chain into the processing of materials'.⁸⁴ DITR provided the following example:

The investment by the China International Trust and Investment Corporation, CITIC, into Victoria's Portland aluminium smelter was a very early example of their desire to acquire not just raw materials—that is, bauxite—but a finished product, aluminium, which is several stages up the chain. The Chinese Shagang Corporation is a five per cent shareholder in the Rio Tinto led, HI-Smelt iron ore making project in Western Australia, where again the Chinese interest is not in acquiring the iron ore but in doing something to the iron ore and acquiring some materials further up the value added chain. Rio Tinto is trying to encourage the Chinese to look more actively at the HI-Smelt process, either in Australia or in China.⁸⁵

7.69 From the Chinese perspective, Australia encourages investment but the dominant criterion when considering whether to allow some forms of investment is 'Australia's national interest'. The Chinese consider that this criterion allows excessive discretionary power, and 'certain examination and approval procedures are short of transparency, which have impeded the access of foreign capital into Australia'.⁸⁶

Conclusion

7.70 China's growing demand for minerals and energy has created enormous opportunities for Australian companies to both export their commodities to China and to assist China with some of the problems they are grappling with such as environmental degradation. The committee believes that Australia and China, who are major greenhouse emitters and rely heavily on fossil fuels for their energy, have much

83 *Committee Hansard*, 21 June 2005, p. 40.

84 *Committee Hansard*, 21 June 2005, p. 51.

85 *Committee Hansard*, 21 June 2005, p. 51.

86 Ministry of Commerce, People's Republic of China, *Foreign Market Access Report 2005*, p. 33.

to achieve in the area of research and development toward the use of cleaner fuels and renewable sources of energy.