

Business
Council of
Australia



Business Council of Australia

Submission

**To The Senate Foreign Affairs, Defence And
Trade References Committee
Inquiry Into Australia's Relations With China**

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1 INTRODUCTION

The Business Council of Australia (**BCA**) and its Members support the continued development of a strong economic, political and social relationship between Australia and China. It is well recognised that there are substantial potential benefits to the Australian economy and business stemming from China's growth outlook. These benefits will be further enhanced if Australia is able to develop deeper economic relations and improved market access with China and if Australian business is able to compete effectively with domestic producers in the Chinese market and the many other countries who also wish to benefit from China's growth.

China is an increasingly large source of trade and investment for Australia as well as being a dominant force in regional trade and an increasingly important political influence in the region.

Australia's economic and political relationship with China needs to be managed strategically so that the Australian economy and business can benefit from the relationship. This submission identifies key areas for consideration in that context, focusing on economic and business aspects.



2 CHINA'S ECONOMY

China ranks as the sixth largest economy in the world (at market exchange rates)¹ and one of the fastest growing. China's GDP growth has averaged almost 8 per cent over the last two decades².

China's integration into the world trading system has been impressive, with its overall share in world trade rising from less than 1 per cent in 1979 to around 6 per cent in 2003³. China's economic influence in the East Asian region has increased accordingly, and on current trends China is likely to become the region's main export market within the next few years.⁴

China's economy has the potential for sustained growth over the medium term supported by⁵:

- attractiveness as a destination for FDI;
- a high domestic saving rate;
- reduced barriers to internal and external trade (therefore resulting in underlying improvements in productivity); and
- significant surplus labor.

China does confront significant challenges in the future however, including population ageing and the need to relocate resources and workers from less productive sectors to those that are internationally competitive and rapidly growing.

China should benefit from its market liberalisation commitments under the WTO, as those measures will underpin increased productivity, competition and growth – but this will not be without some adjustment costs.

¹ Prasad, Eswar and Rumbaugh, Thomas, '*China's Growth and Integration into the World Economy: Prospects and Challenges*', IMF 2004, page 1

² Prasad, Eswar and Rumbaugh, Thomas, '*China's Growth and Integration into the World Economy: Prospects and Challenges*', IMF 2004, page 1

³ Prasad, Eswar and Rumbaugh, Thomas, '*China's Growth and Integration into the World Economy: Prospects and Challenges*', IMF 2004, page 1

⁴ Smith, H, Day, G, Thomas, B, Yeaman, L, '*The changing pattern of East Asia's growth*', page 49 http://www.treasury.gov.au/documents/958/PDF/05_changing_pattern.pdf, accessed April 2005

⁵ Prasad, Eswar and Rumbaugh, Thomas, '*China's Growth and Integration into the World Economy: Prospects and Challenges*', IMF 2004, page 4



The extent to which Australia will benefit from China's ongoing growth and economic development will depend in large part on China's management of its domestic or 'within border' policy structures and regulation, as well as Australia's ability to respond quickly to China's economic development, changing demands and the like.

2.1 Opportunities

China's imports are dominated by raw materials for energy and infrastructure development. For example, China's oil imports rose by 30 per cent last year to make China the World's second largest oil importer.⁶

Australia's trade with China has grown in line with China's strong growth, and in 2003 China was Australia's third largest export market (accounting for 8.4 per cent of Australia's export market) and its third largest source of imports.

China's rapid industrialisation has meant there has been greater demand for Australia's mineral and energy exports. Australia's merchandise exports to China are dominated by primary products and mining products. The highest value imports from Australia are in iron ores (worth around US\$3.3 billion in 2004), alumina (worth around US\$1.1 billion in 2004), wool and energy⁷ (see Table 1).

⁶ Unless otherwise stated, all statistics in this report have been provided by ITS Global consultants.

⁷ Australian Government, Department of Foreign Affairs and Trade, *Australia – China Free Trade Agreement: Joint Feasibility Study*, March 2005, page 10.



Table 1: China's Top Ten Merchandise Imports from Australia US\$ million, 2001 to 2004

	2001	2002	2003	2004
Iron Ore	945	995	1,632	3,346
Alumina	523	589	998	1,103
Wool	639	682	588	900
Crude Petroluem	154	242	445	467
Coal	28	146	208	387
Wheat	8	10	1	364
Gases	74	87	127	273
Aluminium	96	135	196	261
Barley	211	229	133	239
Manganese ores	46	56	104	227

Source: Australian Government, Department of Foreign Affairs and Trade, *Australia – China Free Trade Agreement: Joint Feasibility Study*, March 2005, page 14; China's Customs

China's highest value exports to Australia are data processing machines, video and digital cameras and clothing (see Table 2). As Australia's third largest source of imports (in 2003), China accounted for 11 percent (or A\$14.2 billion) of all goods imported to Australia. While exports of China's textiles, clothing, footwear, toys and furniture to Australia continue to grow, the manufactured exports from China to Australia are increasingly in higher-value added products such as computers and telecommunications equipment⁸.

⁸ Australian Government, Department of Foreign Affairs and Trade, *Australia – China Free Trade Agreement: Joint Feasibility Study*, March 2005, page 10.



Table 2: Australia's Top Ten Merchandise Imports from China US\$ million, 2001 to 2004

	2001	2002	2003	2004
ADP machines	303	476	735	1,273
Video and digital cameras	67	104	250	501
Women's or girls' suits	191	212	272	324
Office machines	100	169	229	298
Toys	177	205	246	297
TV and videos	47	74	122	280
Footwear	141	183	210	265
Travel Goods	144	157	191	252
Furniture	69	102	156	245
T-shirts	119	123	163	219

Source: Australian Government, Department of Foreign Affairs and Trade, *Australia – China Free Trade Agreement: Joint Feasibility Study*, March 2005, page 14; DFAT, STARS database

Accordingly, one of Australia's main sources of opportunity is deeper and broader trade relations with China. Indeed, the Department of Foreign Affairs and Trade in its publication entitled *"China's Industrial Rise: East Asia's Challenge"*, notes⁹:

"Vastly different Australian and Chinese economic endowments and strengths mean Australia faces relatively little competition from China in export markets and strongly compliments China as a trading partner. As a net exporter of many products China demands, particularly minerals, energy and agricultural commodities, Australia is well placed to benefit from its rapid growth. Australia also is a large net importer of goods China supplies to world markets, including a wide variety of more labour intensive consumer goods. This strong trading partnership will continue to generate considerable benefits for Australia and China."

⁹ http://www.dfat.gov.au/publications/chinas_rise/summary.html, accessed 14 April 2005



While these 'traditional' complementarities in trading relations between China and Australia are important, over time the challenge for Australia is to ensure that its trade and investment relations evolve as China develops. In this regard, Australia has important comparative advantages in many key services sectors and should be looking to develop these fully. The ability of Australian business to compete in domestic markets in China in the provision of services will be an important determinant of how much we benefit from sustained strong Chinese economic activity over time.

As China liberalises its market under its WTO commitments and through the negotiation of a Free Trade Agreement (**FTA**) with Australia, areas of potential benefit to Australia identified by BCA Members, include:

- reductions in barriers to doing business and accelerated market penetration;
- increased freedom to invest and operate in China;
- simplification of approval processes to eradicate local protection and encourage competition;
- cheaper imports;
- lower production costs;
- improved export capacity to third markets; and
- better market integration, labour division and resource allocation.



Box 1 below outlines the key principles that the BCA considers should apply to the outcomes sought by Australia in the negotiation of an FTA with China.

Box 1- Key principles

To ensure that Australia is able to maximise the benefits from a broader relationship with China, and an FTA in particular, the BCA suggests the following **key principles** to be pursued through the economic and broader ties between the two countries:

- China's full transition to a market economy (and the development of appropriate legal and regulatory frameworks to achieve this);
- China's full and ongoing participation in the WTO as a leading global economy;
- Long-term commitments and obligations from China, bound by international law and subject to compulsory processes of dispute settlement, to enable Australia to operate freely in China's market;
- Any agreement must be comprehensive - that is it must incorporate reductions in barriers to trade in goods and services as well as assessment of broader issues relating to investment, the business environment for foreign businesses acting in China, and reduction of the scope for government intervention in business to the extent it impacts foreign business operations;
- Mechanisms for ongoing, regular, formal and informal consultation and cooperation between China and Australia.



2.2 Challenges

2.2.1 Exploiting Australia's comparative advantages

Australia's opportunities to compete are in higher value-added and high technology sectors including manufacturing, services, raw materials and agriculture. In order to benefit further from these comparative advantages, Australia obviously needs to be able to achieve improved market access in China. While in many countries the key obstacle to improved market access revolves around external barriers to trade and investment, in China 'within boarder' issues are also very important. 'Within boarder' issues relate to Government policies and interventions that can impact on the capacity of foreign business to compete effectively with domestic suppliers. For example, different and more cumbersome licensing processes, limits on market access in certain products or services, the need to joint venture with Chinese partners, Government procurement policies, etcetera, can all create additional and costly barriers for foreign businesses operating in China. It will be important to ensure that China manages its 'within border' issues in a fair and transparent way to ensure that real and effective market access is delivered in practice.

Australia's policy framework should be focused on maximising Australia's ability to make the most of comparative advantages and to compete with Chinese businesses, while at the same time recognising that China must be afforded the same types of opportunities in Australian markets. The outcome is that both countries will produce that which they do best. Ultimately this results in higher economic growth for both, and the availability of a wider range of cheaper, quality goods and services for consumers in both countries to enjoy.

Such an outcome not only requires China to proceed with its internal reforms (including market liberalisation in areas such as telecommunications, financial services and insurance), but also requires Australia's domestic policies to support productivity and competitiveness. The BCA's current policy agenda is targeted very clearly at achieving higher productivity, competitiveness and growth. Specific issues that the BCA has identified in regard to enhancing Australia's own growth prospects and competitiveness centre on the need for a reinvigorated reform agenda in the areas of workplace relations, infrastructure, regulation and taxation. In addition, Australia must continue to strengthen training, education and skill development and outcomes so that our workforce supports a highly productive and innovative business sector. Detailed policy positions and reform proposals in each of these areas are available at the BCA website www.bca.com.au.



As the IMF notes¹⁰:

“Individual countries can maximise their gains from China’s emergence and minimise the associated costs by increasing the flexibility of their economies through structural reforms.....Affected countries would do best to speed up their own liberalisation and integration, which will improve resource allocation and allow them to better pursue their own comparative advantage. For advanced countries, this will likely entail shifting factors of production to skill- and capital-intensive activities.”

The BCA considers that the Australian Government needs to pursue a relationship that maximises the ability for the Australian economy to supply a broader range of goods, services and investment to China and broadens Australia’s economic relationship with China. Accordingly, in addition to meeting the key principles outlined in Box 1 above, Australia must make efforts to:

- maximise agreements and arrangements that prioritise Australia’s importance as a private investment partner with China (rather than purely in a trade export capacity);
- maximise agreements and arrangements to position Australia as a services and technology provider (rather than purely as a provider of primary goods to China);
- maximise the ability for Australia to provide high-end technological and value-added development; and
- ensure that China meets its commitments, both legal and non-legal, to bring about change to comply with commitments under the WTO particularly in areas such as property rights, intellectual property rights and transparency of the judiciary.

Some sectors of the business community are concerned about the scope and potential for significant dumping of Chinese products in the Australian market, particularly in the event of a significant slowdown in Chinese or global growth. Assurances have been provided by Government agencies that the pursuit of an FTA and the granting of market economy status to China will not inhibit Australia’s ability to prosecute legitimate cases of dumping to the full. It will be important nonetheless to ensure that Customs generally, and the relevant divisions within the Department, are adequately resourced and that cases are dealt with transparently and consistently over time.

¹⁰ Prasad, Eswar and Rumbaugh, Thomas, ‘China’s Growth and Integration into the World Economy: Prospects and Challenges’, IMF 2004, page 13



2.2.2 *Free Trade Agreement*

In light of the above discussion, the BCA considers that negotiations of possible bi-lateral FTA between China and Australia present an important avenue for achieving improved market access and deeper economic, trade and investment opportunities between the two countries. The standards by which any such negotiations should be judged, include the key principles outlined in Box 1 above. The aim, from the perspective of the BCA is for an FTA to deliver improved outcomes and opportunities for business in practice and on the ground in China. Ultimately it must be the strength of the tangible benefits in practice that will flow to Australian businesses and the economy that determines whether and how an agreement is finalised.

Any special negotiations, or areas of specific interest to Australian business can only be identified if business is adequately consulted whilst the negotiations are being conducted and before final decisions are taken. Accordingly, it is essential that negotiations are as transparent as possible and that adequate consultation with private sector interests is undertaken in a timely and effective manner. The BCA will continue to work closely with the Department of Foreign Affairs and Trade to ensure that there is appropriate and adequate business input and consultation throughout the negotiations.



2.2.3 *The risks of a slowdown in China's growth rates*

China's recent economic performance has been remarkable, but no more so than that recorded by a number of rapidly industrialising Asian economies in the past (for example Korea and Japan)¹¹. Many believe that this means that there is significant scope for further growth and that it is likely that China will continue to grow strongly for the foreseeable future. Be that as it may, Australia needs to recognise that China faces important challenges that could impact on its growth performance, at least for a time, and that this in turn has significant implications for major trading partners. The implications of any such slowdown of course become more significant the closer our trade and investment linkages and the more important China becomes in intra-regional trade.

The sustainability of China's growth in the long term will depend, among others things, on China's ability to manage a significant the potential risks it faces, including:

- adjustments to increased competition stemming from a reduction of tariff and other barriers under its WTO commitments;
- response to increased competition in the financial sector in particular and the implications of financial sector deregulation for the availability of finance for the state owned enterprises and their performance;
- rapid population ageing;
- significant urban population growth;
- management of the transition of the stock market to a market system (it is currently thinly traded); and
- maintaining a socialist ideology with increased reliance on market forces in the economy.

¹¹ Prasad, Eswar and Rumbaugh, Thomas, '*China's Growth and Integration into the World Economy: Prospects and Challenges*', IMF 2004, page 6



To highlight the challenges presented for Australia, a recent analysis of countries potentially most exposed to a slowdown in China's economy showed that those whose exports are largely for domestic use face the greatest risks.¹² The results of the analysis indicate that over 70 per cent of China's imports from Australia are for China's domestic use, meaning that Australia could be highly exposed to a slowdown in China's growth. Further, there is growing regional interdependence of trade, making each economy more vulnerable to a slow down in China's growth, some authors highlighting that:

*'greater regional interdependence also makes East Asia more vulnerable to a slowdown in China than in the past (Goldman Sachs, 2004).'*¹³

3 POLITICAL ENVIRONMENT

China has become more politically and economically engaged in the region and more widely. This is not surprising, and as China's importance in the global economy continues to grow, so too will its political and strategic influence. In some ways this marks a continuation of a trend which has seen the G20¹⁴ (of which China is the current President) become more vocal and an alternative voice to the traditionally dominant G8 reflecting changing global economic realities and circumstances.

¹² Smith. H, Day. G, Thomas. B, Yeaman. L, 'The changing pattern of East Asia's growth', page 56, http://www.treasury.gov.au/documents/958/PDF/05_changing_pattern.pdf, accessed April 2005

¹³ Smith. H, Day. G, Thomas. B, Yeaman. L, 'The changing pattern of East Asia's growth', page 62, http://www.treasury.gov.au/documents/958/PDF/05_changing_pattern.pdf, accessed April 2005

¹⁴ The members of the G-20 are the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi-Arabia, South Africa, Turkey, the United Kingdom and the United States. Another member is the European Union, represented by the Council presidency and the President of the European Central Bank. The managing director of the IMF and the president of the World Bank, plus the chairpersons of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in the talks as ex-officio members.



While the growing political and strategic significance of China presents new challenges, the BCA believes that there are reasons to expect that Australia will be able to continue to engage positively and constructively with China on a wide range of issues. The significant goodwill between the countries is clearly evidenced by the agreement to commence negotiations on a FTA. In addition, there are other areas where China and Australia have worked constructively on intra-regional issues. As just one example, both countries committed to supporting supplementary financial packages to the IMF financial assistance during the Asian economic crisis.

4 CONCLUSION

Business is optimistic about the potential opportunities that could flow from deeper and broader integration of the Chinese and Australia economies and management of the political and social environment – but are also very aware of the challenges on both sides of the relationship

To date, Australia's economic relationship with China has predominantly been in merchandise trade, with Australia's merchandise exports to China being dominated by primary products and mining products. While these 'traditional' complementarities in trading relations between China and Australia should continue to grow and are significant, over time the challenge for Australia is to ensure that its trade and investment relations evolve as China develops. In this regard, Australia has important comparative advantages in many key services sectors, and a broader and deeper integration may ensure that Australia is able to more readily access such sectors in the future.

As noted above, in recognising the potential opportunities the BCA in no way seeks to downplay the many challenges in the management and planning of the relationship and a range of very important issues, that will need to be addressed, such as the way in which China handles its 'within border' issues if the Australian economy and business are to benefit as fully as possible from closer ties with China.

The BCA looks forward to being able to continue to input constructively into policy discussions and developments aimed at enhancing Australia's economic and political relationship with China.