Level 3, Walter Turnbull Building
44 Sydney Avenue
Forrest ACT 2603
POST:
PO Box 4497, Kingston ACT 2604

Telephone (02) 6233 0600
Facsimile (02) 6233 0699
Internet www.minerals.org.au

ACN 008 455 141
ABN 21 191 309 229

13 May 2005

Ms Kathleen Dermody
Committee Secretary
Senate Foreign Affairs, Defence and Trade Committee
Department of the Senate
Parliament House
Canberra ACT 2600

Dear Ms Dermody,

Please find enclosed a copy of the submission to the Committee's inquiry into Australia's relations with China' prepared by the Minerals Council of Australia.

I am grateful for your forbearance in granting the MCA an extension of time to complete our submission, thus enabling us to incorporate into our submission the outcomes of a recent visit to Beijing and Shanghai and discussions with Chinese officials, Embassy representatives and China-based executives of Australian and foreign owned minerals companies.

We look forward to appearing before the Committee to elaborate on the views outlined in the submission, and to studying the Committee's eventual report.

Yours sincerely,

MITCHELL H HOOKE
CHIEF EXECUTIVE

SUBMISSION

TO THE SENATE FOREIGN AFFAIRS AND TRADE COMMITTEE INQUIRY

TO AUSTRALIA'S ECONOMIC AND POLITICAL RELATIONSHIP WITH CHINA

MAY 2005

TABLE OF CONTENTS

Minerals Council of Australia
Walter Turnbull Building
44 Sydney Avenue
Forrest Canberra ACT 2604
T: 02 6233 0660
www.minerals.org.au

OVERVIEW

China has enjoyed stunning economic growth over the last two decades. Since its economic reforms began in 1978, China's real GDP has grown 9 fold, and it now ranks behind only the US, Japan, Germany, Britain and France in terms of its economic strength (at market exchange rates). China's economic growth has been more than matched by its increasingly influential role in global commerce, with its share of global trade has increased from 0.6 per cent to nearly 6 per cent in 2003. Despite the scale of its recent growth, and continuing shortcomings and distortions in its economy, China's near-term economic outlook is regarded as positive. But estimates suggest that even a hard landing in China – characterised by a 10 per cent decline in imports and a fall in commodity prices – would result in a half to 1 per cent fall in Australia's GDP, with the impact felt only after a few years.

China's appetite for imported mineral commodities is large and growing larger. It presently accounts for 4 per cent of global GDP, but 16 per cent of the world's metal consumption, with estimates it could reach 30 to 40 per cent by 2025. This will create substantial opportunities for Australia's minerals sector, with commodity forecaster ABARE estimating that Chinese imports of iron ore will nearly double by 2010, its coal imports will increase by nearly 60 per cent and its nickel imports will grow strongly.

Australia has the minerals resources to meet a significant share of this demand. While the sheer speed of China's growth has surprised most, Australia's minerals sector has been gearing up for a number of years to meet the extra demand. There are 43 minerals projects at an advanced stage - either committed or under construction, with total estimated investment of around $13.6 billion.

The impact of China's emergence in global trade has already made a big contribution to the Australian economy, not least through to an unexpected turn around in Australia's terms of trade over the last decade or more. Government estimates suggest that Australia's terms of trade will improve a further 12.5 per cent in 2005-6, taking them to their highest level in 50 years. The scale and strength of this surge suggests that China's emergence leading a structural change in global markets, not just a cyclical bounce. But with these opportunities and rewards come responsibilities. And the task for governments – both federal and state – to make sure that that the longevity of that expansion is not limited by supply capacity constraints.

While the minerals trade between Australia and China is already expanding very rapidly, a bilateral free trade agreement stands to significantly reduce the costs of doing business, expand Australian exports of mining services and technologies, and substantially increase two-way investment flows.

From a minerals industry perspective, the free trade negotiation must address both traditional and 'post border' barriers to trade and investment. Despite its dependence on imported minerals commodities, China retains commercially significant tariff barriers on a number of products. While these tariffs are not high enough to prevent trade flows, they operate as an unnecessary cost borne by exporters. For example, the tariffs on nickel, coal and aluminium impose additional costs of up to $50 million annually on Australian minerals companies. China's recent decision to introduce import licences for iron ore should also be reversed. If not, the Australian Government should promptly examine the legality of the move under global trade rules.

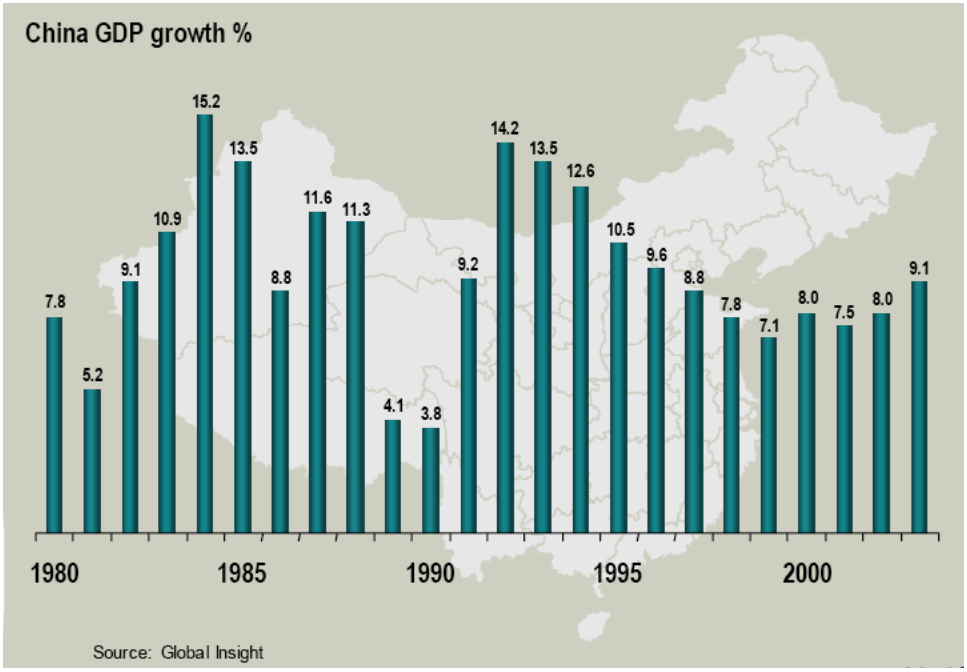
China has considerable potential for investment from Australian minerals producers. The International Energy Agency projects that 34.4 per cent of the world's coal mining investment over the next 20 years will be in China. It also has large reserves of many other minerals resources. But despite the promise of China's minerals sector, there are restrictions to investment in China at nearly every point in the process – from determining the prospectivity of particular regions, securing approvals for exploration, exploring for minerals reserves, securing a mining right, undertaking mining operations, and then marketing or exporting those minerals. Improvements in these areas should also be a key negotiating priority for the bilateral free trade agreement.

CHAPTER 1: ECONOMIC DEVELOPMENTS IN CHINA

A generation of robust economic growth…

China has enjoyed stunning economic growth over the last two decades. Since its economic reforms began in 1978, China's real GDP has grown 9 fold, and it now ranks behind only the US, Japan, Germany, Britain and France in terms of its economic strength (at market exchange rates). An economic lightweight only two decades ago, China accounted for nearly one-quarter of world growth in the period 2001-2003 (using global purchasing power parity-based GDP).[1] Figure 1 shows the strength and durability of China's strong growth since 1978.

Figure 1:



An emerging giant in global trade…

China's economic growth has been more than matched by its increasingly influential role in global commerce, with its share of global trade has increased from 0.6 per cent to nearly 6 per cent in 2003.[2] In the period between 2000 and 2003, China accounted for a larger share of global trade expansion than any other country, including the United States. In that 3 year period, the United States' trade expanded by $US17 billion while China's grew by $US377 billion.[3] In 2004, China passed Japan to become the world's 3rd largest trading nation.[4]

China's emergence has been driven to a large degree by foreign corporations, integrating its fortunes with the rest of the world to a greater degree than is generally appreciated. Sixty-two per cent of its export growth over the past decade was generated by the China-based subsidiaries of Asian, European and United States owned

[1] Eswar Prasad and Thomas Rumbaugh, *China's Growth and the World Economy : Prospects and Challenge*, International Monetary Fund, Occasional Paper No.232, Washington. 2004.
[2] Nicholas Lardy, 'China – the Great New Economic Challenge?' in C. Fred Bergsten, *The United States and the World Economy*, Institute of International Economics, Washington DC. 2005.
[3] Ibid.
[4] World Trade Organisation, 'World Trade 2004, Prospects for 2005,' *Press Release/401*, 14 April 2005.

corporations.[5] Estimates suggest that 10 million Americans owe their jobs to the trade in goods from China, and that 15 per cent of the profits on the Standard and Poors index of the top 500 companies come from mark-ups on Chinese products.[6]

This growing interdependence of China's economy with that of its competitors is demonstrated by the case of US retailer Walmart, which enjoys revenues 8 times those of Microsoft. It employs more people than General Motors, Ford, General Electric and IBM put together, and last year imported products worth $US18 billion from China. Underlining this relationship is the fact that 5000 of Walmart's 6000 suppliers are in China.[7]

The medium and near-term economic outlook…

Despite the scale of its recent growth, and continuing shortcomings and distortions in its economy, China's near-term economic outlook is regarded as positive. In its quarterly update on the Chinese economy released in April 2005, the World Bank said:

> "The macroeconomic outlook for 2005 remains favourable. We expect moderate underlying inflation pressures, and strong fiscal and external positions."[8]

There are, however, concerns that China's current rate of economic growth cannot be sustained. A key concern, say China watchers, is the outsized role being played by investment in China's economy. Investment, says Professor Wang Tongsan, from the Chinese Academy of Sciences, is growing too rapidly, and is already too high as a share of GDP.9 Others who share these reservations about the sustainability of China's economic growth include New York University economist, Nouriel Roubini:

> "In many ways, China looks like East Asia in the mid-1990s before the crisis of 1997-98: a country where connected and directed lending, poor corporate governance and severe political interference (especially at the provincial level) in the credit allocation system is leading to many distorted and low return investment projects that will eventually go bust with a serious crisis."[10]

Others, like Morgan Stanley chief economist, Stephen Roach, have different concerns, worrying that China is vulnerable to a slowdown in the US economy:

> "In large part, that's because the structure of the Chinese economy is very much the mirror image of the US. Unlike America, which is a consumer-driven spending machine, exports and export-led investment remain the name of the game in China. Personal consumption in the US currently stands at a record 71 per cent of US GDP, whereas in China the share of household consumption stands at a rock bottom 42 per cent. Chinese exports have grown from 20 per cent of GDP in 1999 to 35 per cent in 2004, while the fixed investment share is now approaching an astonishing 50 per cent. And, of course, China's biggest export market is the United States, the destination for exactly one-third of overseas Chinese shipments in 2004. By implication, that puts an externally-dependent Chinese economy very much in the cross-hairs of a Fed tightening that is now taking dead aim at the American consumer."[11]

Despite these concerns, the overall weight of recent evidence and economic opinion leans towards a 'soft' landing for the Chinese economy. Robina points to strengths in the Chinese economy that mean it is not likely to repeat the lessons of the East Asian economic downturn.

> "China, differently from East Asia in 1997-98, has large amounts of foreign reserves, low short term external debt (while growing), a current account surplus and capital controls."[12]

---

[5] Stephen Roach, Morgan Stanley Global Economic Forum, May 9, 2005.
[6] Andy Xie, Morgan Stanley Global Economic Forum, May 9, 2005.
[7] Fareed Zakaria, 'Does the Future Belong to China,' *Newsweek*, May 9.
[8] World Bank Office Beijing, *China Quarterly Update*, April 2005, p.4.
[9] Professor Wang Tongsan, 'China's Prospects for economic growth and investment,' *Address to China's Resource and Manufacturing Future Conference*, Canberra. 22 June, 2004.
[10] Nouriel Roubini, 'China: Impressions and Surprises,' Global Macroeconomic and Financial Policy Site - www.stern.nyu.edu/globalmacro/ March 23, 2005.
[11] Stephen Roach, 'The Fed and China', Morgan Stanley Global Economic Forum, March 28, 2005.
[12] Ibid.

Despite his concerns about China's external exposure, Stephen Roach remains "fundamentally optimistic" on China.

> "The nation's steadfast commitment to reforms over the past 27 years is at the heart of the macro tradeoffs it now faces. That is a huge positive for China and the rest of the world. With the Chinese leadership remaining steadfast in its commitment to dismantle the state-owned economy, it is taking enormous risks by eliminating some 8-10 million jobs each year. The delicate balancing act between investment-led growth and stability arises out of the need for Chinese policy to compensate for the extraordinary employment pressures that arise from these reforms -- a Herculean task that we in the West often lose sight of."[13]

For its part, the World Bank expects Chinese economic growth to slow to 8.3 per cent in 2005 and to 7.5 per cent in 2006, growth rates that it believes 'largely embody the soft-landing view.'[14]

The impact of a hard landing …

Nevertheless, with China looming increasingly large in Australia's economic fortunes, concerns have been raised about the potential impact of a protracted hard landing in the Chinese economy on the Australian economy.

Recent analysis by the IMF, however, suggests that a hard landing in China – characterised by a 10 per cent decline in imports and a fall in commodity prices – would result in a half to 1 per cent fall in Australia's GDP, with the impact felt only after a few years.[15]

[13] Ibid.
[14] World Bank Office Beijing, *China Quarterly Update*, April 2005, p.4.
[15] International Monetary Fund, Australia: Staff Report for the 2004 Article IV Consultation, August 30, 2004, p.22.

CHAPTER TWO:
RECENT TRENDS IN THE MINERALS TRADE BETWEEN AUSTRALIA AND CHINA

Strong growth in the bilateral minerals trade …

China is already one of the Australian minerals sector's most important markets. Minerals exports currently account for more than half of Australia's total goods exports to China, and have grown by a massive 470 per cent growth over the last decade.

Despite the prodigious growth of recent years, minerals exports continue to accelerate robustly. In 2004, Australian iron ore exports to China grew by 41 per cent to reach $2.4 billion, helping China to overtake Japan as the world's largest iron ore importer.

Coal exports surged by 72 per cent to $417 million, nickel exports grew by 88 per cent to $142 million, copper sales expanded by 35 per cent to $156 million and sales of aluminum by around 26 per cent to more than $1.2 billion.

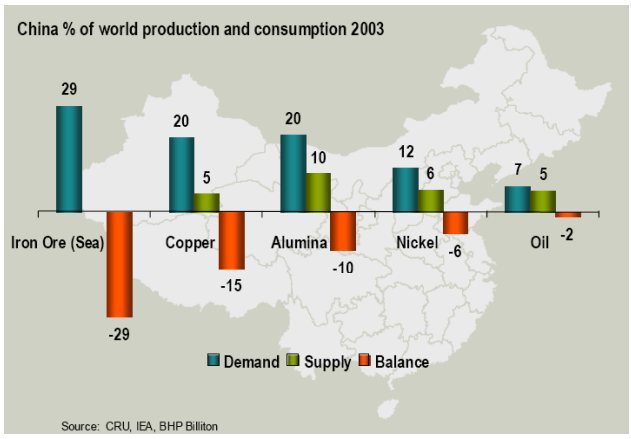
China trade still dwarfed by Japan …

It is important to note, however, that despite the recent strong growth, Australian minerals exports to China ($5 billion in 2004) are only just over one-third of the sales to Japan ($14 billion). The value of Australia's coal trade to Japan alone is more than the entire value of Australia's minerals exports to China. In overall terms, the value of Australian merchandise exports to Japan ($25.6 billion) is more than double that to China ($12.2 billion). A short paper on the broad outlook for Australia's minerals exports is at Attachment 1.

But China's appetite for resources is enormous …

China's appetite for imported mineral commodities is large and growing larger. It presently accounts for 4 per cent of global GDP, but 16 per cent of the world's metal consumption. That could reach 30 to 40 per cent of global metals consumption by 2025, according to some estimates.[16] It is now the largest consumer of copper, tin, zinc, steel, iron ore and coal. It is the second largest consumer of aluminum, petroleum and lead, the third largest consumer of nickel, and the fourth largest user of gold.

China's iron ore imports increased *10 fold* between 1990 and 2003 from 14 million tonnes to more than 200 million tonnes. China now consumes 35 per cent of the world's iron ore, with Australian producers accounting for nearly 40 per cent of its iron ore imports. It produces more steel than the US and Japan combined, and yet still imported 40 million tonnes last year. The gap between China's minerals output and its consumption is shown in Figure 2, below.



[16] Cited in David Hale, 'Will China Need a Blue Water Navy to Protect Commodity Imports', *China Online (www.chinaonline.com)*, accessed 31/03/05.

And the growth outlook is strong …

This demand for minerals commodities to supply China's expansion is likely to continue to grow strongly, driven by rapid urbanization and industrialization.

To illustrate this growth trajectory, a World Bank report last month suggested that infrastructure spending in China will reach $US800 billion over the next 5 years. Separate estimates suggest that China will need to build 400 million homes in the next decade. Moreover, research by Goldman Sachs suggests that the number of autos in China will increase from 8.5 million in 2000 to 514 million in 2050.[17]

To meet this urban and industrial expansion, commodity forecaster, ABARE expects Chinese steel production to reach 417 million tonnes by 2010, a 53 per cent increase on the production output of 272 million tonnes in 2004. According to ABARE, China will account for 55 per cent of the increase in global steel consumption over this period.[18]

China's iron ore demand expected to nearly double by 2010 …

To fuel this expansion of its steel industry, ABARE estimates that Chinese imports of iron ore will nearly double from 208 million tonnes in 2004 to 392 million tonnes in 2010. This will lead, in turn, to strong growth in demand for high quality iron ore, with Australian and Brazilian producers are expected provide the lion's share.

Australia: A resourceful partner

Australia's ability to supply…

Australia is well placed to meet China's minerals needs.

- Australia is the third largest minerals sector by value of production of any country (after the US and South Africa)
- The world's largest global producer of bauxite, alumina, diamonds [by volume], ilmenite, rutile and zircon;
- Second largest producer of zinc ore (after China)
- Third largest producer of iron ore (after China and Brazil), nickel (after the Russian Federation and Canada) and gold (after South Africa and the US)
- Fifth largest producer of aluminum (after the US, Russian Federation, China and Canada) and coal (after China, US, India and former Soviet Union)
- World's largest resources of uranium – 23 per cent of world production

Australia's minerals sector has geared up for the expansion …

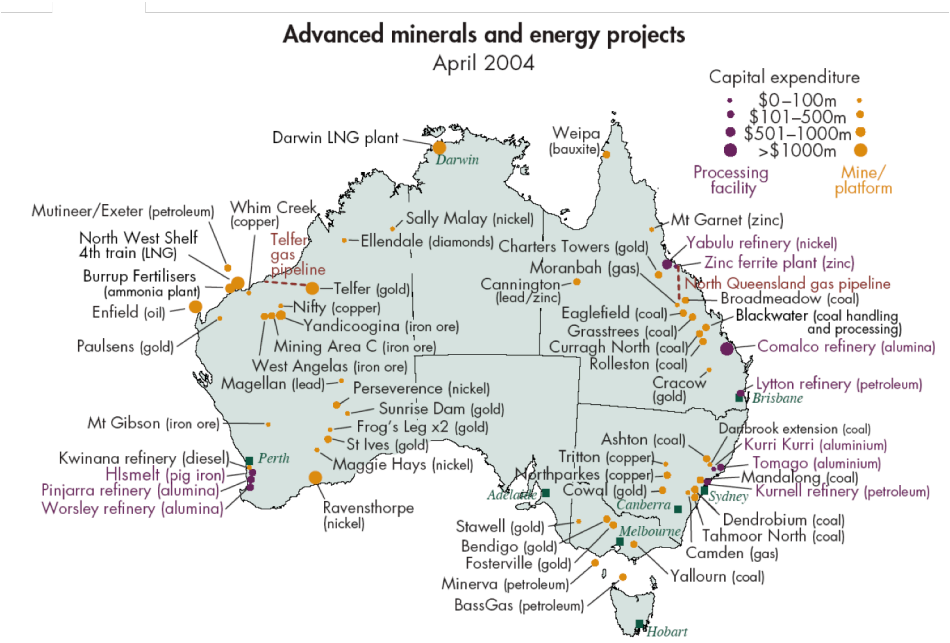
While the sheer scale of China's growth has surprised most, Australia's minerals sector has been gearing up for a number of years to meet the extra demand. There are 43 minerals projects at an advanced stage - either committed or under construction, with total estimated investment of around $13.6 billion (see Figure 3). New investment is continuing to grow, with expenditure on plant and equipment expected on to increase by 60 per cent in the 2004/05 financial year, to $8.2 billion from $5.1 billion.[19]

Spending on related infrastructure projects has also been accelerating, growing by 50 per cent since 1997. According to Access Economics' *Investment Monitor*, the industry has committed more than $4.5 billion to current infrastructure projects. No other sector contributes so directly to the cost of the infrastructure it uses than the

[17] Ibid.
[18] ABARE, *Australian Commodities*, Vol.12, No.1, March Quarter 2005. p.104-5.
[19] Minerals Council of Australia, *Minerals Industry Survey*, December 2004.

minerals industry. Since 1967, the minerals sector has built 26 towns, 12 ports, 25 airfields, and more than 2000 kilometres of railway line.

Figure 3:



Australia's iron ore exports to grow by 60 per cent, coking coal by 40 per cent, and nickel by 28 per cent …

The fruits of this expansion of capacity, and growth in Chinese demand will be borne over the next 5 years. ABARE expects Australian iron ore exports to grow by 60 per cent from 211 million tonnes in 2004 to 338 million tonnes in 2010. Australian coking coal exports are also estimated to increase from 115 million tonnes in 2004 to 160 million tonnes in 2010, in response to an increase in demand from China and India, and a shrinking of US production. Nickel, used in the production of stainless steel, is another minerals commodity expected to benefit from China's expansion. Australian nickel exports are expected to grow by 4 per cent annually to reach 274 kilotonnes by 2010.

China's impact on rising commodity prices…

The scale and acceleration of China's demand for minerals commodities has had an inevitable and sizeable impact on global prices. According to the World Trade Organisation, the US dollar price of fuels and metals rose by 31 and 36 per cent respectively in 2004, compared with an average price increase for internationally trade goods of about 11 per cent.[20] In particular, it is was China's outsized contribution to *extra* demand that has helped fuel the surge in commodity prices. As the World Bank put it:

"Although China's share in world demand for oil (7 per cent) and metals (19 per cent) is still modest, the country's take in *additional* demand is high: about one-third of additional oil demand and almost half of additional metals demand in 2004."[21]

A big contribution to Australia's improving terms of trade …

The rise of China in global trade has also made a big contribution to an unexpected turn around in Australia's terms of trade over the last decade or more. As the International Monetary Fund has noted, the conventional wisdom since the 1950s has been that there has been a secular decline in the price of primary products relative to

[20] World Trade Organisation, 'World Trade 2004: Prospects for 2005', *Press Release 401*, 14 April 2005.
[21] World Bank, *China Quarterly Update*, April 2005, p.2.

the prices of manufactured goods.[22] For commodity producing nations like Australia, this suggested a steady, and likely irreversible decline in its terms of trade.

But this trend has been broken over the last decade or more, with Australia's terms of trade improving by 40 per cent since its most recent trough in 1998.[23] This is a significant economic boost for the Australian economy. The Reserve Bank of Australia estimates that the projected increase in Australia's terms of trade in 2005 is equivalent to an increase in Australia's real income of around 2 per cent of GDP, following a similar effect in 2004.

China has contributed to this turnaround in two ways. First, China's increasing importance in manufacturing trade has put significant downward pressure on [imported] manufactured goods. Second, China's voracious appetite for raw materials has driven up demand for, and the prices of, key minerals commodities. As the IMF put it:

> "The rapid decline in the prices of Australia's imports of goods of which China is a major world exporter is the single most important contributing factor to the steady improvement in [Australia's terms of trade]. The rise in the world market prices for the commodities that Australian exports is the second most important factor."[24]

Rising prices: an issue of contention …

Although surging Chinese demand is the key reason for commodity price increases, Chinese officials and steel companies executives have been aggressive in their efforts to pressure Australian minerals producers to artificially lower prices, especially for iron ore exports.

In fact, Australian producers have been selling iron ore to China at around 8 per cent below the market for the past decade or so. They did this to demonstrate their commitment to a long-term relationship with their customers.

Even now, the freight-adjusted differential between the prices charged by the Brazilian producer and its Australian competitors is the largest it has been.

Meanwhile, efforts by the Chinese to find alternate sources have only compounded their problems, as Indian producers have been selling primarily on the spot market at prices 50 per cent higher than the contracted prices of their Australian counterparts.

The outlook for prices …

Opinion is divided on the longevity of the recent bounce in commodity prices. Commodity forecaster ABARE expects prices for iron ore and coking coal to fall back over the medium term as additional supply comes on stream. Some private sector analysts suggest that these price declines could be as high as 40 per cent from the recently negotiated contract prices.[25] After all, past cycles suggest that expansions in supply are often stronger than necessary, resulting in an over correction in supply, with a consequent downward influence on prices. The Reserve Bank of Australia, however, argues that:

> ". given the consolidation of the global resources sector over recent years, over-investment is likely to be less of a factor than in earlier episodes."[26]

At the core of the debate over prices is the question of whether the recent changes in the global market are cyclical or structural. For its part, the RBA adds that the advent of China as a major consumer makes the current increase in demand 'partly structural', concluding that:

> "Hence, even if the prices of some commodities did fall back over coming years, it is likely that a substantial part of the recent strength in commodity prices will be maintained over the medium term."[27]

For his part, US economist David Hale expects global commodity prices to remain robust, arguing that China will become an increasingly more important influence on commodity prices than the old industrial economies of

[22] International Monetary Fund, *Staff Report for the 2004 Article IV Consultation,* August 30, 2004, p.22.
[23] Reserve Bank of Australia, 'Commodity Prices and the Terms of Trade', *RBA Bulletin*, April 2005, p.1.
[24] Ibid.
[25] Cited in Reserve Bank of Australia, 'Commodity Prices and the Terms of Trade', *RBA Bulletin*, April 2005. p.7.
[26] Ibid.
[27] Ibid.

America, Europe and Japan. Hale concedes that a dip in commodity prices is likely if China encounters an investment slowdown. But he argues that a protracted slump is unlikely:

> "…as China is unlikely to experience a full scale recession anytime during the next decade, there will be steady, if not always spectacular growth in her demand for raw materials. By 2015, her share of global metal consumption could be 50 per cent larger than America's."[28]

Infrastructure capacity must match the demand …

If, as the facts suggest and the MCA considers, China's demand is an enduring change to the global market, Australia's infrastructure capacity must be up to the task. As noted, the minerals industry has expanded its spending on infrastructure substantially over the last decade. The Minerals Council of Australia (MCA) has proposed a 10 Point Plan to address current export bottlenecks, and to pre-empt the emergence of longer-run supply capacity constraints on Australia's minerals export potential. In its submission to the Prime Minister's Infrastructure Taskforce, the MCA said that only an overarching, nationally co-ordinated strategy involving all levels of government and all players in the export corridors could address the capacity constraints that threaten to limit the nation's minerals export potential.[29]

[28] David Hale, 'Will China Need a Blue Water Navy to Protect Commodity Imports', *China Online (www.chinaonline.com)*, accessed 31/03/05.
[29] The MCA submission to the Prime Minister's Export Infrastructure Taskforce is available at www.minerals.org.au.

CHAPTER 3
AN AUSTRALIA CHINA FREE TRADE AGREEMENT: THE MINERALS INDUSTRY CASE

The MCA has been a consistent and forthright supporter of the negotiation on a bilateral free trade agreement between Australia and China, and welcomed the decision by both governments to launch talks on an FTA. A copy of the MCA's July 2004 submission to the Department of Foreign Affairs and Trade scoping study on a bilateral FTA is Attachment 2. An MCA fact sheet, prepared in April 2005, detailing the minerals sector's interests in an FTA is at Attachment 3.

The minerals sector considers that an FTA between China and Australia will provide a critical government-to-government framework capable of strengthening an already impressive trade relationship. While the minerals trade between Australia and China is already expanding very rapidly, an FTA stands to significantly reduce the costs of doing business, expand Australian exports of mining services and technologies, and substantially increase two-way investment flows.

There are three key planks to a China/Australia FTA.

First, an FTA will add a new and formal dimension to the bilateral political and strategic relationship, the benefits of which will inevitably flow through to stronger economic ties.

Second, while Australian and Chinese companies are already investing in a long-term partnership, there will be greater certainty in security of supply and market access for both partners under a formal trade and investment agreement.

Third, a bilateral FTA provides the opportunity to remove practical obstacles to two-way trade and investment in the exploration, production, processing, and trade in minerals and related technology and services.

This chapter explores, in detail, the specific barriers to trade and investment that the MCA believes should be addressed in a bilateral trade deal between Australia and China.

BORDER BARRIERS

Elimination of traditional barriers …

Despite its dependence on imported minerals commodities, China retains commercially significant tariff barriers on a number of products. While these tariffs are not high enough to prevent trade flows, they operate as an unnecessary cost borne by both the Chinese importer (and eventually downstream consumers) but also the exporters, including Australian minerals companies. The tariffs serve no apparent industry policy purpose and appear to have been retained solely as revenue raising measures.

Relevant tariffs include the following[30]:

- 5.5 percent on manganese
- 3 percent on zinc
- 3 to 6 percent on coal
- 3 to 6 percent on various copper products
- 7 percent on aluminum alloys
- 3 percent on lead, and
- 3 to 4 percent on unwrought nickel.

[30] Data sourced from the Department of Foreign Affairs and Trade.

While lower than in many other sectors, the scale of the minerals export trade means that these tariffs are commercially significant. For example, the 3 to 6 per cent tariff on the $387 million coal trade costs exporters $11.6 million to $23.3 million, the 5 to 7 per cent tariff on the $261 million aluminum trade is worth $13 million to $18.7 million, while the 3 per cent tariff on the $186 million nickel trade adds $5.5 million in business costs. That means, in the 3 commodities alone, the tariffs add costs of between $31 million to $47 million.

Another feature of China's minerals tariff regime is the problem of tariff escalation, whereby the greater the scope for industrial transformation or processing of the raw commodity, the higher the tariff.

Removal of import licences on iron ore …

Earlier this year, the Chinese Government announced a plan to impose import licences on all imports of iron ore, effective 1 May. The measure is designed to place a downward impact on iron ore prices by reducing the number of buyers in the market. The initial impact has been negligible, and the initial reaction in the spot market was a small bounce in prices. Perhaps worrying, however, is 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. The measure may also breach China's commitments under its accession to the World Trade Organisation. The Chinese authorities should be encouraged to reverse the plan to impose the licences.

Addressing non-tariff barriers …

The minerals sector considers that the FTA should also address, as a priority, those non-tariff barriers which can add significantly to the costs of doing business in and with China. This includes greater mutual recognition of standards and duplicative conformity assessment arrangements. More streamlined customs and quarantine procedures should also be a significant component of the bilateral treaty negotiations. China must also be pressed to strengthen its intellectual property regulation and enforcement, and measures considered to limit trade distortions caused by monopoly purchasing practices employed by state-owned or controlled trading enterprises. Updated arrangements which can facilitate the easier movement of business personnel should also be implemented.

Lowering the barriers to mining technology services …

Australian exports of mining technology services have grown strongly over the last decade, and are expected to reach $1.24 billion in 2004/5.[31] These services comprise several categories, including exploration and other mining services, construction services like mine site preparation, scientific research services, and consultant engineering services. The sector also includes mining related computer services, reflecting the fact that 60 per cent of the world's mining software is written in Australia.

Despite its massive domestic mining sector, China remains largely off-limits to Australian providers of mining technology services. This is illustrated by the fact that Australian exports of mining technology services to China amounted to only $90 million last year, less than one-third of Australian exports of similar technology services to Indonesia.

The potential of the Chinese market for mining technology services is limited by a number of formal and informal barriers. These restrictions, both generic and specific to the minerals sector have either slowed or discouraged foreign investment in China's mining sector, thus limiting the market for associated suppliers of mining technology services. The nature and impact of these restrictions is more fully explored below. In addition, the attraction of the Chinese market for mining technology services is heavily compromised by the lack of rigorous and effective intellectual property protection.

BEYOND BORDER BARRIERS

Tackling the barriers to investment in China's minerals sector …

Every year, a respected Canadian think-tank, the Fraser Institute (www.fraserinstitute.ca) surveys hundreds of global minerals industry executives to determine their attitudes to investment in more than 60 jurisdictions around the world. China routinely rates highly as having significant minerals potential, a not surprising finding given the

[31] Leanna Tedesco and Robert Curtotti, *Mining Technology Services: A Review of the Sector in Australia*, ABARE Ereport 0.5.5, April 2005.

scale and value of its minerals reserves. However, the Fraser Institute's most recent survey of executives from 259 global mining companies reveals continuing concern about the prevailing policy and regulatory environment in China.

Seventy-five per cent of respondents said regulatory duplication represented a mild or strong deterrent to investment in China.[32] One in 4 respondents said the problem would lead them to defer investing in China. Uncertainty concerning the administration and interpretation of regulations was a concern raised by 68 per cent of respondents, with 28 per cent saying it was a serious enough problem to deter them from investing in China. The third priority concern raised by minerals industry investors was the quality, and restricted access to pre-competitive geoscientific data, with 29 per cent saying it would put them off investing in China.

Investment links remain modest …

Despite the rapid growth of the bilateral minerals trade, the investment relationship in the sector is relatively modest, although growing. In economy-wide terms, China is Australia's 18th largest investment destination with $1.2 billion invested. Meanwhile, Australia is China's 14th largest investment destination with $2.2 billion in Chinese investment. A significant proportion of this investment is directed to the minerals sector, and by June 2003, 15 Chinese resources and mining companies had invested a total of $328 million in Australian projects.[33]

In part, this reflects the fact that China is increasingly an investor in minerals production abroad, with more than 52 per cent of Chinese outward FDI is destined for minerals and energy ventures.

China has considerable potential for investment from Australian producers. The International Energy Agency projects that 34.4 per cent of the world's coal mining investment over the next 20 years will be in China. If the range of existing barriers can be addressed (see below), there are many other opportunities as well in energy, base and precious metals.

Confronting restrictions at every stage of the investment cycle …

Despite the promise of China's minerals sector, the reality is that there are restrictions to minerals investment in China at nearly every point in the process – from determining the prospectivity of particular regions, securing approvals for exploration, exploring for minerals reserves, securing a mining right, undertaking mining operations, and then marketing or exporting those minerals. Foreign business is confronted by an array of restrictive regulations that are applied inconsistently across all levels of government through differing interpretations of regulations and procedures for investing, importing and exporting in China.

Step 1: The geological database is limited …

A credible pre-competitive geological database is an essential feature of any regime seeking to promote inward foreign investment in the minerals sector. But the availability of geological data in China is heavily restricted, for a number of reasons. These include the reluctance of provincial departments of Land and Resources to contribute local data to a central database, or make available data to foreign companies. In other cases, data is withheld for national security or confidentiality reasons. In still others, foreign companies complain that the data cannot be transmitted abroad for due diligence. As Austcham Beijing pointed out last year:

> "…sufficient scale geological data is not available for purchase whereas in Australia this information is freely available. China is denying itself foreign investment in the mining industry by not making this information available. Without access to this data, foreign mining firms are not in a position to make an investment decision."[34]

To remedy these shortcomings, clear and consistent regulations are required to specify what data is to be made publicly available.

[32] Fraser Institute, Annual Survey of Mining Companies,
[33] Australian Department of Foreign Affairs and Trade and China's Ministry of Commerce, *Australia-China Free Trade Agreement: Joint Feasibility Study*, April 2005. p.83.
[34] Austcham Beijing, *2004 Business Issues Paper*, August 2004. pp37-38.

Step 2: Exploration permits are difficult to secure …

Under existing arrangements in China, minerals exploration licences can only be granted to qualified "geological exploration units registered in China." But foreign mining companies operating in China point out that no foreign mining company has yet been granted such a qualification. Instead, the foreign explorers must enter joint venture arrangements with qualified provincial groups. Even then, strict rules apply to the knowledge and experience of China's geology and mineral deposits, and experience in exploring for the nominated minerals deposits.

Step 3: Approvals process are uncertain and open-ended …

Foreign minerals companies regard the current project approval process for Sino-Foreign Joint Ventures as slow and uncertain. Different levels of government can issue exploration and mining licence all with little co-operation or co-ordination between different departments and worse still, all levels of government. Initial approval at provincial level does not guarantee project approval. The national government can impose different conditions and project terms after a bankable feasibility study is completed and significant investment incurred.

This is partly due to the threshold approach to project approvals whereby investment projects over $State Ministries must approve US30 million, while investments below $US30 million need only be approved by the relevant provincial Development and Planning Commission. A further complication is the fact that the criteria for state level approvals can be difficult to establish in advance, and there are no clear time-frames or time limits for approvals.

Step 4: Even if exploration is successful, mining rights aren't guaranteed ...

If a foreign explorer secures exploration rights, and locates a commercial resource, there is still no guarantee that the company will secure the right to mine that resource. Current regulations give the holder of an exploration licence a "privileged priority to obtain the mining rights to the mineral resources in the exploration area (Regulations for Transferring Exploration Rights and Mining Rights Art 3.1). But this provides no *guarantee* that the party holding the exploration licence will obtain the mining licence (even if they comply with all necessary environmental and other regulations). It is clear that the right to mine for investors in exploration should be protected, subject to compliance with transparent, applicable regulations.

Step 5: Not all minerals resources are treated equally …

In China some minerals commodities are 'more equal' than others. Depending on the mineral resource, projects will be 'encouraged', permitted or restricted. For example, Chinese authorities are keen to encourage exploration in certain base grade metals like copper, lead and zinc. But authorities are much more reluctant to support foreign exploration of more precious metals like silver and gold. The better the resource potential, the more difficult for foreign investors to access. In addition to the obvious restrictions imposed by this policy approach, the law can also lead to significant complications if and when different minerals are found at the same location.

Step 6: Tax Treatment is uncertain …

There is an urgent need for greater harmonisation of tax incentives for domestic and foreign direct investment. While some provinces have adopted preferential tax treatment for foreign mining investment, clarification is needed as to which government department can authorise tax terms and pre-conditions to be filled. Moreover, the tax treatment for mining not aligned with other resource sectors (eg oil and gas). In addition there is no provision for the grouping tax of losses, and as a result, the costs of unsuccessful exploration cannot be recovered. There is no provision for Australian companies to keep Australian dollars accounts or accounts in the currency of choice, and the absence of a tax treaty between Australia and China can result in double taxation. Under current arrangements, senior Australian based representatives pay Chinese tax for the days they spend in China, and Australian staff that spend more than 183 days in China pay Chinese tax.

Step 7: Trading/export Rights are limited …

Currently trading rights for foreign companies are limited. If the venture is a wholly owned foreign enterprise it cannot obtain a full import/export licence. This is in contradiction to the WTO's 'national treatment' rules that provide for foreign providers to be treated 'no less favourably' than local investors. To help resolve this issue, a timetable to relax export controls consistent with WTO obligations will help investors assess project risk.

Step 8: An overall need for greater transparency and legal certainty …

While not confined to the minerals industry, there is a pressing need for greater transparency and certainty of legal processes for foreign investors operating in China. This includes greater clarity of rights of appeal and dispute resolution. This also means an operating environment that attaches no artificial conditions to investment such as local content provisions, trade balancing requirements or non-trade considerations.

Much improved intellectual property regulation and enforcement is also a significant issue for high technology, innovative companies that make up the Australian minerals sector. For these companies intellectual property is a major source of their competitive advantage. Enforcement of registration of, and respect for, property rights will be an integral element in overcoming an otherwise significant deterrent to investment in China.

THE OUTLOOK FOR MINERALS EXPORTS

A.1 Australian exports and Asian industrialisation: an update

Australia's minerals industry is a key channel through which China's rising prosperity is expected to support Australian economic growth over coming decades.

Australia's minerals industry is the world's best supplier of industrial inputs to developing Asia – and Asia has been developing particularly fast.

East Asia accounted for less than 8 per cent of the global economy in 1965. Rapid industrialisation saw that share climb to over 25 per cent by the mid-1990s. The initial climb was driven by Japan, but Chinese Taipei, Korea, Hong Kong and Singapore joined the climb in the 1960s, while Thailand and Malaysia joined in the 1970s, and China joined in the 1980s.

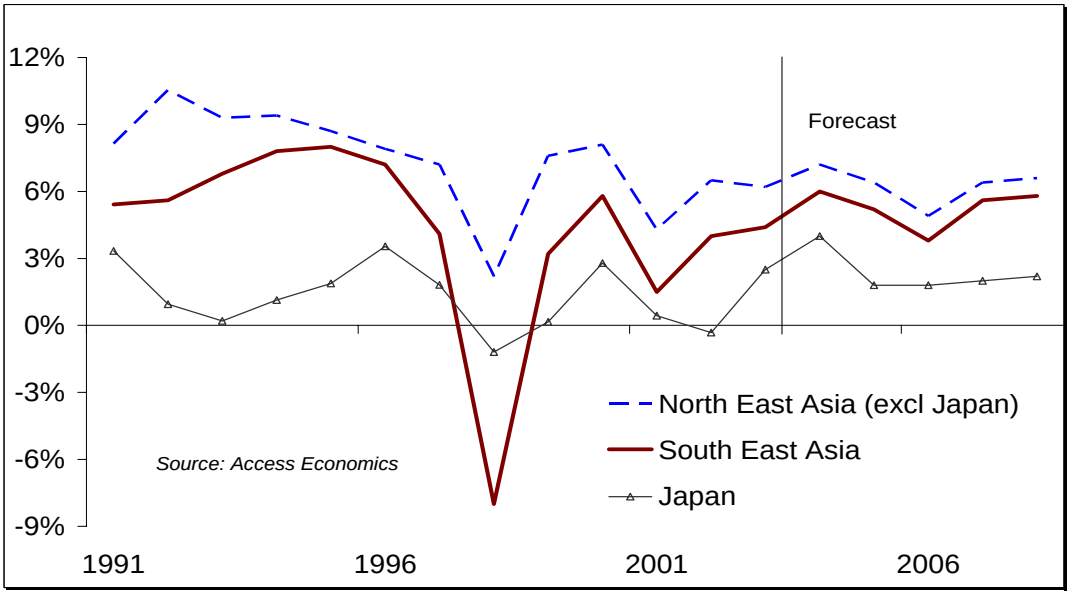
That growth, in turn, fed rising demand for Australian minerals.

While east Asia as a whole has shrunk as a share of the global economy in the past decade due to developments in Japan, that has not resulted in stagnating demand for Australia's mineral commodities. That is because the growth in Australian mineral sales tends to be to 'industrialising Asia' rather than to 'industrialised Asia'.

Or, as a generalisation, Australia sells commodities into Asia's heavier industries, and part of the reason for the relative stagnation of Japan has been that its industrial base has been increasingly transferred to lower cost locations elsewhere in Asia.

In particular, China has been increasing its share of the global economy, admittedly off a low base. East Asian economic growth picked up pace since global weakness in 2001. 2004 saw good growth, with prospects seen as remaining reasonable across non-Japan Asia over the next few years (see **Chart A.1**).

CHART A.1: EAST ASIAN GROWTH PROSPECTS



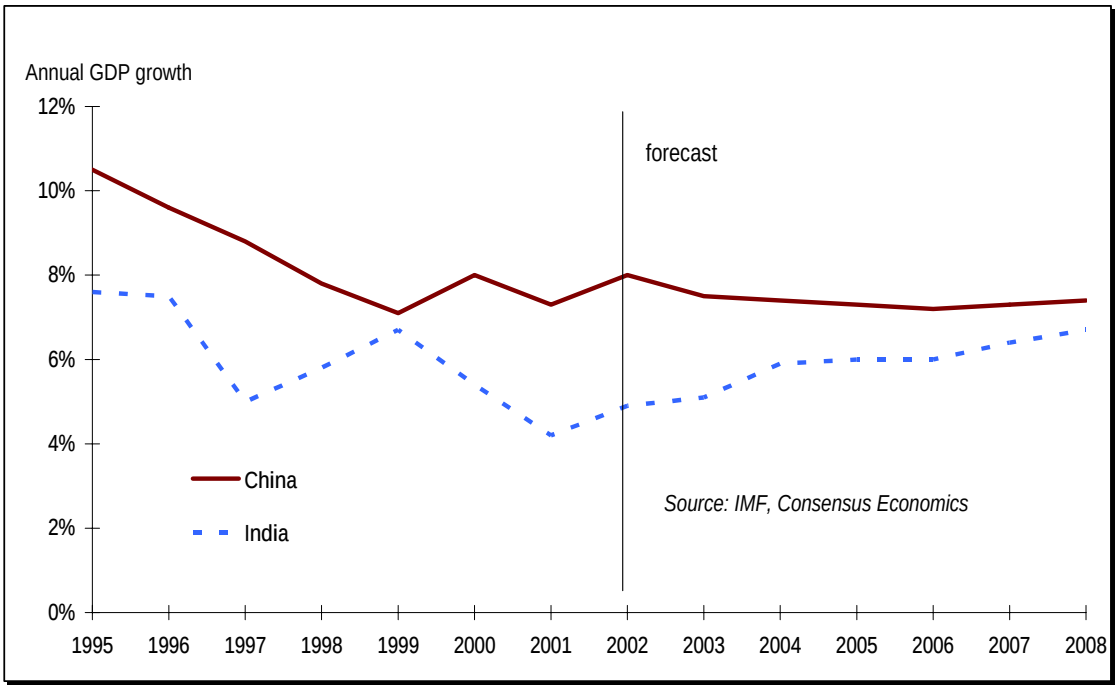
Source: *Access Economics*

China's rise is good news for Australian exporters, as it will continue to provide a key source of demand for the raw commodities Australia produces so well and this trend is set to continue and grow for some time.

There are also risks to balance against these opportunities.

China's recent growth has been unsustainably high, and the local authorities are taking steps to ease this back. That will imply a weakening investment share and rising consumer spending share within China's economy in the next few years. However, as the forecasts in **Chart A.2** note, the general expectation is that the pull back in China's investment share will be modest, and overall output growth rates are expected to remain robust.

CHART A.2: LONG-TERM OUTPUT GROWTH OUTLOOK



Source: *IMF, Consensus Economics*

A.2 The changing demand for minerals

If the further industrialisation of China aids Australian economic growth via the attendant demand for our minerals exports, then that would merely continue the same process Australia has seen for many decades.

The trade 'boomerang' charts real income against the demand for imports (see Chart A.3). It shows the relationship between a country's stage of development and its need for raw material imports.

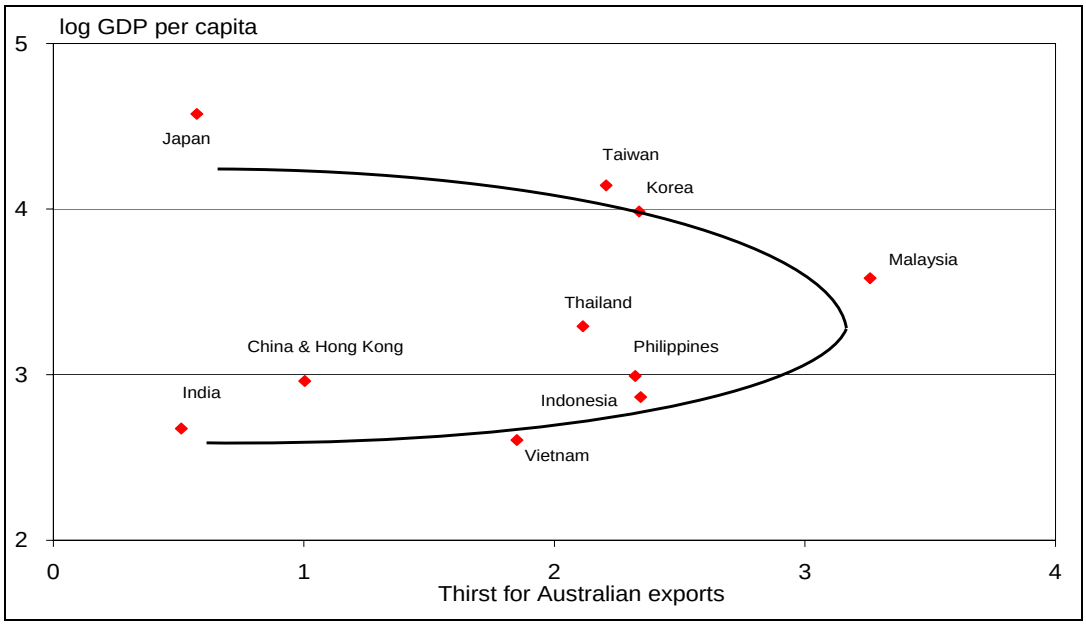
Japan illustrates this relationship well. It completed a traverse from the lower left of the boomerang in the 1950s, along the bottom of the curve to the right in the 1960s, around the curve in the 1970s and 1980s to a position at the upper left position today. It has been the years since 1960 that have seen Australia's minerals sector really develop its international focus. The initial impetus of this change was the economic growth of Japan followed by Chinese Taipei and South Korea – markets geographically close to Australia with a need for coal and iron ore.

Thailand, Indonesia and the Philippines are a little further up the ladder of economic development than China or India, and their relative need for Australian exports is accordingly higher.

The boomerang starts to bend backwards when heavy industry is at the core of the economy and incomes are continuing to rise, as with Malaysia today.

The trade 'boomerang' holds great promise for Australian exporters and the minerals industry in particular. Of these major trading partners, there are 930 million people on the 'low opportunity' upper wing and bend of the boomerang (all those countries and regions north of Malaysia in **Chart A.3**), but 2,740 million on the 'high opportunity' bottom wing.

CHART A.3: AUSTRALIA'S TRADE 'BOOMERANG'



Source: *Access Economics*

For example, if China had the same level of economic development and requirements for our exports as say, Thailand, then nearly half of all our exports of goods in 2000-01 would have been just to China.

That is not to say that China is not already an important player for Australian exporters. Australia has benefited from the rapid growth of China's trade, such that China is now Australia's fourth largest trading partner, up from tenth position in 1990. While Australian manufactured exports have more than doubled, resource exports have grown at an average 15 per cent per annum rate over the past decade.

THE MINERALS COUNCIL OF AUSTRALIA

SUBMISSION

TO

DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

ISSUES FOR CONSIDERATION

in a

AUSTRALIA / CHINA FTA FEASIBILITY STUDY

JULY 2004

Summary

China is a major market for the Australian minerals industry with strong and sustained growth predicted for the foreseeable future. China also offers potential investment opportunities for the minerals sector in exploration and development. Chinese equity in Australian resource developments is also increasing.

Despite this positive outlook, there are a number of rigidities and impediments to enhanced trade and investment with China and the MCA and its member companies would wish to see these addressed in the feasibility study of a Free Trade Agreement between Australia and China.

The key issues or themes identified by the MCA for feasibility study consideration are:

- Maintaining China's momentum for full transition to a market economy and its full participation in the WTO as a leading global economy;
- Reaffirmation of existing commitments enshrined in the WTO
- Extension of the scope or application of WTO rules;
- Reductions in tariff and non-tariff barriers;
- Capacity for Australian business interests to operate more freely in China's market, including domestic trading rights;
- Measures that are not provided for in the WTO, but which enhance opportunities to improve the business environment
    - Removal of import licence restrictions
    - Certainty with respect to intellectual property rights
- Transparency with respect to legislative and regulatory arrangements
    - Certainty of legal process
    - Rights of appeal;
    - Dispute resolution, and
    - Overlap and duplication between different levels of government.
- Issues specific to minerals exploration and mineral development in China:
    - Access to pre-competitive geological data
    - The complexity of the licence approval processes
    - The right to mine and export
    - The absence of a double taxation agreement
    - China's need to recognise that reforms of current laws and regulations are in its interests

Background

- China is not yet a full market economy;
- China is simultaneously moving to institutionalise a market economy and encourage national industries with policies of economic preferment;
- Bureaucratic interference in the internal business environment in China may create greater Impediments to business than controls on trade at the border;
- China's accession to the WTO provides a template of commitments to replicate or seek to extend in an FTA;
- Australia is one of a few reliable places where China can source raw materials critical to its future economic growth, which together with an open and stable investment climate enhances its

leverage, to mount a case to Beijing that China should conclude an FTA with Australia;

- Australia's economic importance to China is as a major supplier of raw materials (iron core, steel, metals), wool and agricultural products.

China's trade

China is the world's fourth largest exporter and third largest importer.

China's increased exports over the last decade have in large part been attributed to Chinese subsidiaries of multinationals and foreign joint-venture partners.

China's imports are dominated by raw materials for energy and infrastructure development. China is now the world's second largest oil importer and accounts for half of the world's consumption of cement, 30 percent of coal, and 36 percent of steel. China's copper and nickel imports have risen substantially.

China's economy and policy directions

Over the last two and a half decades, China's economy has recorded an average annual growth rate of close to 9 percent. This rapid expansion has lifted China's economy to the position of the sixth largest in the world. China has also become increasingly integrated into the global economy

The main policy thrusts of the Chinese government include attracting foreign direct investment as a channel for technology and expertise, investment in higher education, investment in research and development and investment in infrastructure.

To achieve its policy goals, China needs to overcome some of the weaknesses in its domestic financial markets including a fragile banking system, ineffective prudential supervision, weak central bank regulation and supervision of commercial banks, a large build-up and lack of accountability for non-performing loans

Trade Liberalisation

China's accession to the WTO highlighted its desire to liberalise and increase economic integration by taking part in the rules-based international trading system. China has since liberalised most industrial and agricultural goods.

However, China is still a relatively new participant in the multilateral trading system and has not yet made the full transition to a market economy and its capacity to give legal force to commitments under WTO rules is in some important respects still to be demonstrated by practice.

While China's WTO accession documents make no mention of its status as a non market economy, she has accepted that investigating authorities in other WTO Members may apply non-market methodologies in antidumping and subsidy-countervailing investigations for fifteen years from accession. Nevertheless, China has since made it clear that she wishes to be viewed as a market economy.

Australia has agreed to recognise China as a market economy if, through the findings of its feasibility study, it decides to negotiate an FTA with China

Australia's Resource Exports to China

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% of total Australian minerals exports.

Rapid industrialization in China has created great demand for Australia's mineral and energy exports, which now make up the single largest export group. China is now Australia's third largest customer for resource products after Japan and Korea.

Iron ore is Australia's biggest single resource export to China and alone was worth over $1.6 billion in 2003. Aluminium is the other major mineral export, surging to just over $1.2 billion in 2003.

China buys around a third of Australia's copper ore and related concentrates, making Australia the second largest supplier after Chile.

The sale of intermediate and finished metal products to China has been positive.

Investment

Two-way Foreign Direct Investment (FDI) between Australia and China is modest, with large investors accounting for the bulk of Australian investment in China.

At June 2003, China was Australia's 18th largest investment destination ($1.2 billion) with a fairly even division between manufacturing, mineral exploration, legal, banking and education services. At June 2003 China was 14th largest investor in Australia with investments of $2.2 billion in resource and property sectors.

The absence of capital account convertibility in China means that the ability of capital to flow instantaneously in and out of the country is limited.

Limitations on service sectors where Australia has competitive advantage in skills (mining, financial services and broad acre agribusiness), have lessened the demand for investment.

Minerals industry interests in an FTA

China is emerging as a leading economy in the world economy and the MCA would expect that an FTA would optimize opportunities to participate in that growth.

While tariff barriers at the border are quite low in a number of cases for minerals products, the MCA considers an FTA provides the opportunity to eliminate all tariffs on minerals and energy and potentially increase Australia's market share for mineral resources.

The MCA also considers an FTA should focus on other features of regulation in the Chinese economy, which inhibit trade, investment and business. In particular, the minerals industry would wish to see greater freedom to invest in China, liberalisation of domestic trading rights including import licence restrictions and an enhanced capacity for the movement of business personnel.

Implementation of domestic trading rights has lagged China's commitments in the WTO accession protocol. Non-tariff barriers remain in the form of import licence restrictions with priority given to State Owned Enterprises or favoured companies, resulting in uncertainty for exporters and an impediment for some Chinese importers.

The MCA would support arrangements in an FTA which facilitated Australian companies working with Chinese business partners (through research and training programs) to develop common business interests.

Impediments to Trade and Investment

At a fundamental level, Australian business benefits increasingly the more Chinese law protects property rights, provides freedom of business to operate and gives legal protection for foreign companies against discrimination. This is the protection which the WTO seeks to strengthen through international law. The legal foundation for a free market in China is still weak. WTO law and practice is an important buttress. The more Chinese law and practice accords with WTO rules and procedures, the more Australian business benefits.

To the extent it is practicable, it is desirable that an FTA strengthens the legal foundation for a free market in China and enhances implementation by China of its WTO obligations.

With respect to minerals exploration in China, not all areas are open to foreign investment. The Chinese government has produced a list of guidelines for foreign mineral and energy investment that provides for some liberalisation, not subject to WTO discipline, while retaining some limitations. These

guidelines categorise resources into three categories “encouraged”, “restricted” and “prohibited”. Essentially, the better the resource potential, the more difficult for foreign investors to access.

The protection of intellectual property is a key consideration for potential investors in the minerals sector. A fragmented bureaucratic apparatus means that in the enforcement of intellectual property rights including the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS), China consistently fails to meet its WTO obligations. The key Chinese bureaucracies are the Intellectual Property Office (formerly the Patent Office), the Copyright Bureau, and the Trademark Office within the Administration of Industry and Commerce. All are discrete bodies and belong to distinct bureaucratic clusters.

Issues for Inclusion in the Feasibility Study of a FTA with China

General Issues

Australia should seek to:

- support and not detract from China’s full transition to a market economy and its full participation in the WTO as a leading global economy;
- secure commitments from China, bound in international law, which enable business to operate more freely in China’s market;
- re-state the commitments already enshrined in the WTO, in particular:
    - not to use non-tariff measures;
    - not to allow technical standards to restrict trade unreasonably;
    - to provide right of consultation on implementation of technical standards that may impede trade;
    - to ensure state trading enterprises do not distort markets or trade; or
    - to set the basis for quarantine barriers and not allow them to unreasonably distort trade.
- make commitments that extend the scope or application of WTO rules, limited by WTO obligations not to discriminate among WTO members
    - not to subsidise trade between countries (preferential cross-border import tariffs are enjoyed by some countries);
    - to harmonize technical standards;
    - to agree on terms of administration of contingent protection (particularly anti-dumping)
    - to strengthen protection of intellectual property
- agree on measures that are not provided for in the WTO, but which improve opportunities to improve the business environment:
    - to remove or reduce restrictions on foreign investors;
    - to liberalise domestic trading rights for foreign companies, including the removal of restrictions on import licences;
    - to cross recognize technical standards;
    - to facilitate trade through improved administration of customs and border controls (Chinese documentation requirements for Australian exports are more onerous and time consuming than for other Asian countries);
    - to facilitate the movement of business personnel;
    - to develop understandings governing supply of products of strategic significance to China’s economy;

- to agree on collaboration to improve the functioning of institutions and procedures central to the success of business, for example:

  - joint research;

  - provision of training and capacity building; and

  - education and exchanges.

Specific Issues for the minerals sector

Tariffs

- Elimination of all tariffs on imports of mineral products by China

Corporate Structures

- Flexible structures are needed to respond to the uncertainty associated with investment in exploration;
- The requirement to lodge registered capital does not encourage exploration investment;
- Processes to accomplish recovery of capital eg termination of a Joint Venture are slow and subject to approvals.

Approval Processes

- Current project approval process for Sino-Foreign Joint Ventures is complex;
  - Different levels of government can issue exploration and mining licences
  - A clear and simplified process is needed
- Investment projects over $US30 million must be approved by State Ministries;
- Investments below $US30 million need only be approved by the relevant provincial Development and Planning Commission;
- Investment in mining projects is typically staged, with early stages often less than the threshold and the overall cost greater than the threshold
- Initial approval at provincial level does not guarantee project approval – the State can impose different conditions and project terms after a bankable feasibility study is completed and significant investment incurred.
  - Criteria for State level approval difficult to establish in advance;
  - SDPC approval after a successful bankable feasibility study completed;
  - Investor needs to deal with three agencies (MOLAR, MOFTEC and SDPC);
  - No clear timeframes or time limits for approval
- Exploration licences can only be granted to qualified “geological exploration units registered in China”
  - No foreign company has been granted such a qualification;
  - Foreign companies have to Joint Venture with qualified provincial –based groups
  - Strict rules apply to qualification including
    - Knowledge and experience of China’s geology and mineral deposits
    - Experience in exploring for nominated commodities;
    - Staffing and equipment in China

Mining Rights

- No certainty regarding the right to mine if exploration is successful
    - Current regulations give the holder of an exploration licence a "privileged priority to obtain the mining rights to the mineral resources in the exploration area (Regulations for Transferring Exploration Rights and Mining Rights Art 3.1);
    - No guarantee that a party who holds the exploration licence will obtain the mining licence (even if they comply with all necessary environmental and other regulations);
    - The right to mine for investors in exploration should be protected, subject to compliance with transparent applicable regulations;
    - Many projects contain a mix of metals – base metals are "encouraged", while gold is "restricted";
    - No harmonisation of exploration and mining rights by different levels of government;
    - When local authorities are investor and regulator, can lead to confusion when rights conflict.

Legislative Clarification and Transparency

- Certainty of legal process, including rights of appeal and dispute resolution
- Restrictions on the availability and use of geological data are counterproductive to the promotion of investment in the mining sector in China
    - Rules are not consistently applied and depend on interpretation by local authorities;
    - Assessment of the value of assets (eg rights, data) is limited to agencies accredited by MOLAR who don't necessarily have arms length relationship
    - Regulations do not permit the transfer of data offshore for due diligence;
    - Regulations needed as to what data is available publicy
    - Physical presence of the "legal person" required to sign documents leads to cost and delay
- Obsolete laws and regulations adopted in the early 1990s limiting foreign direct investment in the mining sector should be repealed;
- Clarification is needed on the treatment of investment in mines producing a combination of minerals falling into different investment categories (eg gold – "restricted" and copper, zinc and lead – "encouraged");
- Conflicting regulations and modes of implementation between governments at the national and provincial level.

Tax Treatment

- Harmonisation of tax incentives is needed for domestic and foreign direct investment
    - Some provinces / regions have adopted preferential tax treatment for foreign mining investment;
    - Clarification needed as to which government department can authorise tax terms and pre-conditions to be filled
    - Tax treatment for mining not aligned with other resource sectors (eg oil and gas)
- No provision for grouping tax losses – costs of unsuccessful exploration cannot be recovered

- No provision for Australian companies to keep Australian dollars accounts or accounts in the currency of choice
- Absence of a tax treaty between Australia and China can result in double taxation
    - Senior Australian based representatives pay Chinese tax for the days they spend in China;
    - Australian staff who spend more than 183 days in China pay Chinese tax.

Trading / Export Rights

- Current export rights are limited
- A timetable to relax export controls consistent with WTO obligations will help investors assess project risk.

The MCA would welcome the opportunity to be fully consulted as work progresses in the scoping study and before the results are finally concluded with the Chinese.

Minerals Council of Australia

7 July 2004

Contact:

Rob Rawson

Director Safety and Health (& Trade)

Tel: 02-6233 0651

Mobile: 0421 059 828

MINERALS COUNCIL OF AUSTRALIA

> FACT SHEET - THE AUSTRALIA CHINA MINERALS TRADE

APRIL 2005

THE CASE FOR A FREE TRADE AGREEMENT

How important is the Chinese market for Australian minerals exports?

China is already one of the Australian minerals sector's most important markets, and was worth nearly $4.5 billion in 2004. Minerals exports currently account for 60 per cent of Australia's total exports to China, with minerals and energy exports accounting for 7 of Australia's top 10 merchandise exports to China. Since 1995, minerals exports to China have grown by a massive 470 per cent.

This expansion continued in 2004:

- iron ore exports to China grew by 41 per cent to reach $2.4 billion and overtake Japan as the world's largest iron ore importer; and
- coal exports surged by 72 per cent to $417 million, nickel exports grew by 88 per cent to $142 million, copper sales expanded by 35 per cent to $156 million and sales of aluminium grew by 26 per cent to approximately $1.2 billion.

How big is China's thirst for minerals imports?

China accounts for 4 per cent of global GDP, but 16 per cent of the world's metal consumption. China is the:

- largest consumer of copper, tin, zinc, steel, iron ore and coal;
- second largest consumer of aluminium, petroleum and lead;
- third largest consumer of nickel; and
- the fourth largest user of gold.

China's iron ore imports increased *10 fold* between 1990 and 2003 from 14 million tonnes to more than 200 million tonnes.

- China now consumes 35 per cent of the world's iron ore; and
- produces more steel than the US and Japan combined, and yet still imported 40 million tonnes last year.

China's imports of alumina have increased 5 and a half times over the last decade.

China has large minerals reserves itself. Will China's demand for imported minerals continue?

China has large reserves of some minerals, including 54 per cent of world manganese reserves, 23 per cent of lead reserves, 22 per cent of silver reserves, 12 per cent of coal reserves, 11 per cent of vanadium reserves, and 6 per cent of copper reserves.

- China is very dependent upon commodity imports, with China's imports of minerals commodities topping $US140 billion last year.

What complementarity is there between China's resources needs and Australia's minerals reserves?

Australia and China are a natural strategic fit. Australia is the third largest minerals sector by value of production of any country (after the US and South Africa). It is:

- the world's largest global producer of bauxite, alumina, diamonds [by volume], ilmenite, rutile and zircon;
- second largest producer of zinc ore (after China);
- third largest producer of iron ore (after China and Brazil), nickel (after the Russian Federation and Canada) and gold (after South Africa and the US);
- the fifth largest producer of aluminium (after the US, Russian Federation, China and Canada) and coal (after China, US, India and former Soviet Union); and
- the world's largest resources of uranium - 23% of world production.

Minerals Council of Australia

ACN 008 455 141
ABN 21 191 309 229

FACT SHEET - THE AUSTRALIA CHINA MINERALS TRADE

How has the Australian minerals sector responded to the opportunities provided by the Chinese market?

Investment in additional production cpacities, is expected to increase by 60 per cent in 2004/05, to $8.2 billion from $5.1 billion:

> there are 43 minerals projects at an advanced stage - either committed or under construction, with total estimated investment of around $13.6 billion; and

> spending on related infrastructure projects has incresed by 50 per cent since 1997.

What are the prospects for increased two-way investment in the resources sector?

The existing investment relationship is modest, but growing. China is Australia's 18th largest investment destination with $1.2 billion. Australia is China's 14th largest investment destination with $2.2 billion in Chinese investment, primarily in the resources and property sectors:

> as at June 2003, 15 Chinese resources and mining companies had invested a total of $328 million in Australian projects; and

> this reflects the fact that China is increasing its investment in minerals production abroad, with more than 52 per cent of Chinese outward FDI destined for minerals and energy ventures.

China has considerable potential for investment from Australian producers.

> the International Energy Agency projects that 34.4 per cent of the world's coal mining investment over the next 20 years will be in China; and

> if existing barriers can be addressed,(see below), there are many other opportunities as well in energy, base and precious metals.

How an Australia/China free trade agreement expand the bilateral minerals trade?

On market access, the FTA should eliminate or reduce the remaining tariffs on imported minerals including;

> 5.5 per cent on manganese;

> 3 per cent on zinc;

> 3 to 6 per cent on coal;

> 3 to 6 per cent on various copper products;

> 7 per cent on aluminium alloys;

> 3 per cent on lead; and

> 3 to 4 per cent on unwrought nickel.

Will a Free Trade Agreement (FTA) provide better access for providers of mining services and related technologies?

A key goal of the FTA should be to reduce the barriers to providers of mining related services

> the value of Australian exports of mining technology services globally is expected to reach $1.24 billion in 2004/5; and

> 60 per cent of the world's mining software is written in Australia.

Despite its massive domestic mining sector, China remains largely off-limits to Australian providers of mining technology services. This is underlined by the fact that Australian exports of mining technology services to China amounted to only $90 million last year, less than one-third of Australian exports of similar technology services to Indonesia.

In addition to the array of restrictions governing companies' investment and operations in China, the attraction of the Chinese market for mining technology services is heavily compromised by the lack of rigorous and effective intellectual property protection.

What are the so-called 'post border' measures that the minerals sector wants addressed in the FTA ?

The respected Fraser Institute study of the global mining industry (www.fraserinstitute.ca) released in March 2005 showed that China's 'minerals policy index' is continuing to improve.

But problems still remain, including:

- confusion over the status of tenements or exploration rights;
- long delays in approvals for projects;
- difficulty in securing exploration qualifications which are essential to obtain exploration licences;
- unwieldy corporate law requirements;
- access to infrastructure; and
- very limited geological data.

The FTA should remove or reduce restrictions on foreign investors by:

- liberalising domestic trading, and import and export rights for foreign companies;
- improving access to, and certainty in, exploration and the right to mine;
- providing for national treatment – non discrimination against foreign companies that must meet local content requirements;
- removing restrictions on exploration and production for minerals and ore grades; and
- harmonising tax incentives, including by developing a double tax treaty and providing for grouping of tax losses, especially exploration.

Will the FTA also promote technical co-operation between the Australian and Chinese minerals industries?

The Minerals Council of Australia (MCA) sees the FTA providing a useful umbrella for a closer technical co-operation, especially in the promotion and application of sustainable development practices:

- our Chinese counterparts have already expressed considerable interest in our concept of our 'social licence to operate'; and
- it's a concept which goes beyond simple regulatory approvals but recognises that minerals operations are not sustainable if they don't have the support of their communities at the local, regional and national level.

In practical terms, some areas ripe for such co-operation include:

- mine safety practices and technology;
- leading environmental practice and technologies; and
- clean coal technologies.