SENATE FOREIGN AFFAIRS, DEFENCE AND TRADE COMMITTEE INQUIRY INTO AUSTRALIA'S RELATIONSHIP WITH CHINA

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STATEMENT BY THE DEPARTMENT OF INDUSTRY, TOURISM AND RESOURCES

Introduction

This statement outlines the key elements of the Department's current engagement with China. It covers the proposed free trade agreement, investment flows with China, resources and energy, the automotive, TCF and tourism industries and intellectual property. Owing to the ongoing FTA negotiations it is difficult to make more than general comments on the future of that aspect of the relationship.

Australia-China Free Trade Agreement (FTA)

On 18 April, Prime Minister John Howard and Premier Wen Jiabao of China agreed that Australia and China should commence negotiations on a Free Trade Agreement (FTA) following consideration of the joint FTA Feasibility Study. The feasibility study, completed in March of this year, concluded that an FTA would enhance output and employment in both countries – benefiting the Australian economy by an estimated A$24.4 billion over a ten year period.

Negotiating a FTA provides Australia with an opportunity to consolidate and improve its position in the Chinese market. A FTA is expected to create more opportunities for Australian industry by providing a framework for dealing with the range of tariff and non-tariff barriers currently encountered by exporters and investors. A FTA would also help to create a level of certainty for those Australian businesses already operating in China.

In proceeding to negotiations, the Australian Government agreed to treat China as a market economy for anti-dumping purposes. This means that Australia will treat China the same as other World Trade Organization (WTO) members for the purpose of anti-dumping. Australian industry's capacity to take anti-dumping action against China is undiminished in effect.

Investment

China is the 14th largest investor in Australia, having invested a total of $2.86 billion as at the end of 2003. Major Chinese investments have been made in the mining, mineral processing, manufacturing, leather processing, wool processing, property and agricultural sectors. Chinese outward investment is growing rapidly, as Chinese companies look to globalise, secure vital resources, and establish a presence in foreign markets for their exports. There is very strong interest from China towards investing in Australia's energy and minerals industries in particular.

During his recent visit to Australia, Mr Wu Bangguo, Chairman of the Standing Committee of China's National People's Congress, called for Australia and China to step up mutual investment and enhance enterprise cooperation. He indicated that both countries "should firmly seize the new opportunities presented by our rapid economic growth at home, further expand our direct investment in light of our respective advantages, develop new areas and new modalities of investment and keep moving forward our economic and trade cooperation. ...We should make closer enterprise cooperation a priority in our efforts to deepen China-Australia economic partnership and urge our large and competitive enterprises to invest and carry our business and technological cooperation of various forms. China will encourage its enterprises to invest in Australia and welcome active participation by Australian enterprises in China's efforts to develop its Western region and reinvigorate its old industrial bases in the Northeast, so as to enhance the vitality of China-Australia economic cooperation." This is a very strong signal from the Chinese leadership that investment in Australia is a key priority, but also welcoming investment from Australia in China.

Invest Australia within the Industry, Tourism and Resources portfolio is actively seeking to capture Chinese investment for Australia. Invest Australia has offices in both Beijing and Shanghai, and is planning to establish a presence in southern China in the near future. Through these offices, Invest Australia is working with many of China's largest enterprises to promote the benefits of investing in Australia. Invest Australia has also established formal Memoranda of Understanding with both the Ministry of Commerce (MOFCOM) and the Chinese National Development and Reform Commission (NDRC) in China. These MOUs aim to establish deeper relationships between these government bodies in order to develop economic and industry relations, strengthen bilateral cooperation and promote mutually beneficial foreign direct investment.

Chinese foreign direct investment (FDI) directed A$2.2 billion into Australia in 2004, focusing on energy and resource developments to secure a continuous and competitive supply of materials needed to fuel China's ongoing industrial and economic expansion. Targeted developments included LNG production, iron ore and steel. ABARE projects Chinese investment in the Australian resources sector will continue to grow strongly over the next decade.

Resources and Energy

In 2003-04 Australia's minerals resources exports were valued at A$52.3 billion, or 36 per cent of total export earnings. Of this, China accounted for A$5.1 billion or 9.7 per cent of total minerals resources export. In 2004, Australia's major exports to China included iron ore), crude petroleum and coal.

Australia continues to play an important role in the rapidly growing Chinese economy as a reliable and competitive supplier of energy and minerals commodities, investing

A$1.2 billion in 2004. China's demand for Australia's mineral commodities is expected to grow strongly over the next decade. ABARE research (2004) predicts the real value of Australia's exports of mineral commodities (ores and concentrates, excluding coal) to China to grow at an average annual rate of 5.7 per cent from 2004 to 2015, if China's economy continues at its current pace.

Bilateral Dialogues

In January 2000, Australian and Chinese cooperation arrangements in the resource and energy sector were enhanced by the signing of a Memorandum of Understanding with China's State Development Planning Commission, entitled *Establishment of a Bilateral Dialogue Mechanism on Resources Cooperation*. The purpose of the bilateral dialogue is to promote trade and investment in energy and mineral resources and resource processing, to enhance long-term bilateral cooperation, to exchange information on energy and minerals policies and stimulate the development of bilateral commercial relationships.

Liquefied Natural Gas

Australian LNG producers are well positioned to benefit from China's increasing demand for energy, particularly natural gas. ABARE forecast that China's demand for gas will increase by 6.6 per cent annually through to 2015, with LNG imports reaching 8 mtpa in 2010 and 18 mtpa in 2015. To meet this demand, China is investing in domestic LNG import and distribution infrastructure and in Australian production infrastructure. In 2001, China gave the go ahead to construction of the country's first LNG receiving terminal, in Guangdong province. The North West Shelf Joint Venture won the phase 1 contract to supply the terminal with 3.3 mtpa over 25 years, worth up to $25 billion. Supply is expected to commence from mid-2006. Seven additional Chinese LNG import terminal projects are under development for active consideration and the North West Shelf, Gorgon, Woodside and BHP Billiton are all pursuing LNG sales contracts to supply these projects.

Coal

Australia has a cooperative relationship with China, both in terms of export of coal, alignment of Government energy and coal industry policy, and in the sharing of knowledge of coal mine safety, mining technology services (including deployment of clean coal technologies) and workplace training and education. Australian coal exports to China have almost quadrupled in volume from 1.2 million tonnes in 2000 to over 6.4 million tonnes in 2004, valued at around $230 million. ABARE research indicates that there is the potential to build this to a $2 billion pa market if China realises its maximum potential import coal.

The Australia-China Bilateral Coal Summit initiative is an example of the Australian and Chinese Government and industry cooperation on coal issues. The summit will be held in Australia in early July 2005, with a reciprocal summit in China later this year.
There has already been significant bilateral collaboration with China in the areas of clean coal technologies and coal mine methane.

Uranium
China has expressed strong interest in purchasing Australian uranium. To satisfy its increasing electricity for its economy, China is proposing to increase its nuclear energy output from 10 to 40 gigawatts by 2020 (or about 4 per cent of total power supply). WMC Resources approached Mr Downer in 2004 seeking support to sell Australian uranium to China.

Australian uranium is sold under a strict regime of bilateral nuclear safeguards agreements to ensure it does not contribute in any way to any military purpose (nuclear weapons, nuclear propulsion or depleted uranium munitions). A bilateral nuclear safeguards agreement with China is required before uranium can be sold to China. Australian Safeguards and Non-Proliferation Office (ASNO) is currently investigating the possibility of negotiating such a bilateral nuclear safeguards agreement with China (Questions on this should be directed to DFAT).

Iron Ore
Australia had a 38% share of Chinese iron ore imports in 2004, worth $2.4 billion, an increase of 41% over the previous year. Australian iron ore enjoys several advantages in the China market. Australian iron ore is of better quality, with a higher iron content than Chinese product, and Australian ore is more accessible by time, reliability and cost for sea freight than ore supplied by competitors such as Brazil. China’s iron ore requirements are expected to increase as its domestic steel production capacity continues to expand. China has a stated strategic interest in acquiring secure iron ore supply. It has already entered into several joint ventures with existing Australian iron ore producers, and is also exploring direct investment for opening new iron ore deposits for development.

Carbon Sequestration Leadership Forum
The Carbon Sequestration Leadership Forum (CSLF) is an international climate change initiative aimed at developing international collaboration on carbon dioxide capture and storage (CCS). It provides a mechanism for forming partnerships, facilitating the coordination of CCS activities, strengthening international collaborative efforts on technology development and mobilising international resources. China is an inaugural member of the CSLF and recently participated at the 2nd Ministerial Meeting which Australia hosted in Melbourne 13-15 September 2004.

Technology transfers and partnership arrangements
Chinese Government enterprises are showing keen interest in technology transfers and partnership developments. Recent examples include Chinese investment in the development of the HIsmelt technology and licence agreement negotiations for take-up of the technology in China; and development of the $25m *Australia - China Natural Gas Technology Partnership Fund*.

Given the rate of generating capacity scheduled to come online in China, continued participation by China in the CSLF is seen as critical for capacity building for developing countries and as an excellent opportunity for Australia/ China bi-laterals.

Automotive Industry

The Australian automotive industry is small by world standards – its four manufacturers produced over 405,000 vehicles in 2004. There are also over 200 automobile component firms supporting vehicle producers and the aftermarket. Industry value added was over A$5 billion in 2002-03. The automotive industry accounts for about six per cent of total manufacturing value added and employment.

China is currently the third largest global manufacturer of vehicles, and is expected to grow to the largest by the end of the decade. China's 100 or more car makers produced 5.1 million vehicles in 2004, across the full model range. China also has over 4,000 component producers. In June 2004, foreign car makers announced plans to spend a further US$13 billion to expand capacity for passenger motor vehicles. In addition, domestic manufacturers are also investing in domestic production and are investigating investment and export prospects overseas. The components sector has fewer restrictions on foreign investment, and is growing in parallel with the manufacturing sector. The sector is moving towards the manufacture of sophisticated key components – 25 factories dedicated to engine and transmission manufacture are currently under construction. Foreign manufacturers are increasingly looking towards China as a global parts and components supplier.

China has designated the automotive sector as a 'pillar industry' of the national economy. It aims to position domestic manufacturers as suppliers of vehicles and components to the global market in the near term. The *Automotive Industry Development Policy Statement*, released in June 2004, outlines key objectives for the industry.

Current Bilateral Trade

Currently, there is limited auto trade between the two countries. China does not rank in the top twenty as either an import source or export destination for vehicles. This may change in the medium term as an expected overcapacity in vehicle production may lead to Australia becoming an export destination for passenger vehicles.

Impact of Tariff Reductions under an FTA

China's automotive industry is protected by a range of relatively high tariff and non-tariff barriers. The removal of these tariffs under an FTA could result in increased demand for Australian components and vehicles (principally prestige models) as they become more price competitive relative to other imports. It could also lead to greater integration of Australian component producers in the supply chains of the fast growing Chinese vehicle producers, and could also lead to Australian component producers further increasing their foreign direct investment in China.

However, some Chinese-based production of components could replace component exports from Australia.

Foreign direct investment and market access could be further improved if the FTA addresses import licensing and other customs issues, intellectual property rights enforcement, distribution restrictions, competition policy and non-tariff barriers such as automotive standards and conformance.

The Government has indicated a disinclination to alter the current industry arrangements for autos and textiles clothing and footwear (TCF) in the context of any FTA with China. Accordingly , discussion of the implications of any change would be speculative and only of relevance some considerable time into the future, if ever.

Future Predictions

China has experienced a rapid growth rate in vehicle manufacturing and is expected to remain at 10-15 per cent annually for the foreseeable future.

Industry analysts predict that 13 per cent of domestic production will be exported by 2010.

TCF

Since Australia abolished its textiles and clothing quotas in 1993, there has been a relatively free trade environment between Australia and China for textiles and clothing. In recent years Chinese clothing and knits have accounted for around a third of all clothing and knits consumed in Australia, whilst imported Chinese textiles are around one quarter of all textiles imported into Australia. The drop in Australia's textile and clothing tariffs in January this year is expected to facilitate further trade with China.

Matters of mutual interest have also been discussed between industry associations of our two countries. The Council of Textile & Fashion Industries of Australia has undertaken consultations and expects to have further discussions in China next month and the Carpet Industry of Australia was part of the recent World Carpet and Rug Council meeting in Shanghai which was jointly hosted by the Chinese Carpet Association and the Japanese Carpet Association.

Tourism

China is one of Australia's key inbound travel markets with over 251,000 Chinese visitors travelling to Australia in 2004, contributing in excess of $1 billion to the economy. In the long term, the Tourism Forecasting Committee estimates that China will be Australia's fastest growing inbound market, generating over 1.2 million visitors by 2014 (average annual growth rate of 16 per cent).

In 2004, 182,000 Australians travelled to China (excluding Special Administrative Regions and Taiwan Province) as their main destination, an increase of over 59 per cent compared to 2003 (although numbers in 2003 were down by over 16 per cent due to the SARS outbreak)

The Approved Destination Status (ADS) scheme – which provides the framework for Chinese group leisure travel to Australia – will be a key contributor to growth in visitor numbers from China.

As a result of ongoing cooperation between the Australian and Chinese Governments, agreement was reached to expand the ADS scheme in October 2003, extending it beyond Beijing, Shanghai and Guangdong, to include Chongqing, Hebei, Jiangsu, Shandong, Tianjin and Zhejiang. This expansion increased the total ADS catchment to around 432 million people for the nine regions. The Government is exploring options to expand the ADS catchment areas throughout China.

To ensure Australia's competitive position in the market is maintained, the Australian Government is implementing a number of operational reforms within the ADS scheme, including measures to manage the delivery of high quality products to Chinese visitors and the removal of rogue operators. The administration of these reforms will be the responsibility of the Minister for Citizenship and Multicultural Affairs and the Minister for Small Business and Tourism.

The Government will be working to seek the Chinese Government's cooperation in adopting complementary measures in China to support the quality related initiatives we are implementing in Australia. These issues will be discussed with the Chinese later in 2005.

The Government is presently developing an Emerging Markets Strategy addressing long term growth potential of the China and India markets. The Strategy will be developed by a Consultative Group, chaired by the Hon Warwick Smith. It is anticipated that the Strategy will be completed by November 2005. This work will be supported by the National Tourism Investment Strategy which will address impediments to private investment in meeting the anticipated demand from these (and other) markets.

The Government has also committed to broadening Chinese knowledge of Australia as a unique travel destination through the launch of the new Brand Australia campaign by Tourism Australia in March 2005. The first phase includes campaigns in Beijing, Shanghai and Guangzhou.

The liberalisation of air service arrangements between Australia and China will also strengthen the bilateral tourism relationship, particularly through the lifting of restrictions on services to and from regional areas in both countries. Capacity increases under the arrangement with Hong Kong, a key travel hub for North Asia, will also strengthen access to the China market.

Intellectual Property

IP Australia is the Australian Government agency that grants patent, trade mark, design, and plant breeder's rights.

IP Australia has developed good working relationships with China's intellectual property (IP) authorities through meetings between officials. The purpose of these meetings is to exchange information and develop a better understanding of our respective IP systems.

Officials from IP Australia visited the State Intellectual Property Office (SIPO) of The People's Republic of China in April 2004 and return visits by SIPO officials took place in August and December 2004. The Outcomes of these meetings were that the parties agreed to continue their exchanges of information, support visits by IP experts, and investigate closer cooperation on mutual recognition of patent search and examination results.

It is expected that a delegation from government IP agencies in China will visit Australia in July to further Australian's understanding of the Chinese IP regime. It is expected the delegation will make presentations in Sydney and Melbourne on topics such as protecting IP in China and the expansion of business in China through IP protection.

China became a member of the Patent Cooperation Treaty in 1994, the Madrid Protocol in 1995, and the World Trade Organisation in 2001 thus transforming its IP system into one governed by international principles and standards.

In terms of patent activity, over the last decade applications for invention patents filed by foreign applicants has out-numbered those filed by domestic applicants. However, this pattern reversed in 2003 with the number of domestic applications in China exceeding the number of foreign applications.

Patent applications filed in Australia by applicants from China have been quite low through the 1990s. However, there has been quite strong growth since 2000.

In relation to trademarks, domestic filings in China have out-numbered foreign filings over the last decade, but this has also been the case in many other countries. Trademark activity in Australia by applicants from China has been quite low, however this situation is changing. It is interesting to note that China was until recently ranked as our twentieth most active applicant country – it now ranks eleventh. Similar shifts are being experienced in the USA.

These trends in patent and trademark activity suggest a growing awareness in China about the value of intellectual property rights.