

Inquiry into Australia's relations with China – Melbourne, 27 June 2005

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China will certainly be important to Australia's future. In this brief note I wish to set out several issues that I believe are relevant to the terms of the committee's enquiry, and take questions on these issues during my appearance. The note address issues of 1) statistical reporting of investment and services, 2) the character of Australia's relationship with China, and 3) the need to raise our China capacity through training.

What do we know about Australia-China business-economic relations?

More accurately, what do we don't know. The answer is 'a lot'. Crystal ball gazing is not something that committees, public officials or academics have had success. In this context it is sobering to recall the report in mid-1976 of two of the architects of the Australia-Japan economic relationship, who wrote:

“[O]f special regional interest is the emergence of China and the development of her relations with Asia-Pacific countries over the long term. ... even if China achieves very remarkable rates of income growth and trade growth she is likely to remain a relatively small factor in commerce alongside the established economic relations of the larger economies for some decades.”

Australia, Japan and Western Pacific economic relations: A report to the Governments of Australia and Japan, by Sir John Crawford and Dr. Saburo Okita, Canberra: AGPS, 1976, p. 111.

Several months later Mao Zedong died; two years later Deng Xiaoping chaired the plenum committee of the Chinese Communist Party that endorsed tentative change in economic direction which would shift China to embrace foreign investment and shift the economy towards a market orientation. From being the 33rd largest trading nation accounting for about 1% of world trade, China has catapulted itself to 4th rank and 6.6% of world trade. What might the future hold? Perhaps a return to the days before the industrial revolution when the Chinese economy was the world's largest. Certainly many economists predict that will occur in the lifetime of my children, if not mine.

While we might be pleased that Australia will have an important bit part in China's new century, we are not very good at measuring or analyzing our part. We can very easily describe how much iron ore, wheat or wool we sell to China, and from which State it came, and how many socks, panties, computers and other widgets we import. We cannot easily or accurately enumerate the services we sell to China, or from where these services might originate from within Australia. Similarly we are unable to accurately identify the amount, type and destination of our foreign direct investment (FDI) in China. The Chinese FDI data for Australian investment in China does not agree with the Australian data, and the discrepancy is often some order of magnitude.

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Of course there are statistical difficulties with measuring investment flows and services trade, but it seems to me that the US Department of Commerce and other agencies do a far better job of collecting and reporting these types of data than Australia's government agencies.

This should be a worry. How can Federal or State governments develop policy to facilitate the capacity of Australian firms to better enter or compete in the Chinese market when we know very little about who has done what in China? Given that the economic relationship with China is far more complex than the relationship with Japan, and goes beyond mere export of mineral and energy to participating in the Chinese domestic economy, we need to better track the movement of capital and intangibles in our growing economic relationship.

What can be done? Perhaps the committee might recommend that more effort be put into reporting and analyzing Australian FDI and services trade. The Australian Bureau of Statistics should be involved in such a task. It would also be desirable for support to be given to government-industry-academic collaborative research and modeling of these more complex economic relationships.

Is China Australia's new Japan?

At a superficial level there are strong parallels between Australia's trade with China and the trade with Japan that developed from the Australia-Japan trade agreement in 1957. Australia exported valuable "dirt" and imported finished manufactured products. From the 1960s to the 1990s half of Japan's iron ore and coking coal imports came from Australia. A simple but powerful image of Australia's contribution to Japan's economic miracle is that about half of any Japanese-made car was at one time dirt in Australia. Today China is a major market for Australian iron ore and energy. The recent growth of these exports has narrowed the widening trade deficit that Australia has had with China since 1989. Part of the reason for the growing merchandise trade gap is that as China has grown, its economy has changed, and it increasingly imported goods that Australia did not make (such as intermediate electronic components) relative to the total import mix. Despite the similarities with our Japan trade, there are big differences between China now and our past "special relationship" with Japan.

China is a relatively open economy, and has become increasingly open as a result of the WTO protocols acceded to in late 2001. Japan has opened slowly and reluctantly to foreign investment. Today it is more difficult to invest in Japan than it is in China, notwithstanding all the complexities and uncertainties of the regulatory environment in China's transitional economy. Many of the more successful Australian firms are those engaged in a range of business and property services. These, though, are the very sort of firms that we have insufficient data about and that are most constrained by "behind the border" regulatory issues. They are also the firms that any free trade agreement (FTA) should strive to promote better access (more below). While there are genuine complementarities between China and Australia based on China's cheap manufacturing capacity and Australia's cheap minerals and energy, we need to think beyond such complementarities towards a more balanced and sophisticated economic relationship. Such a relationship should be premised on increasing access for retailers, technology, property, education and business services firms, and our negotiators are rightly focused on the institutional and market obstacles that will frustrate these firms.

The FTA and Australia

Any trade economist will acknowledge that a free trade agreement is a second best option to a multilateral agreement such as those governed by the WTO – one only turns away from multilateral arrangements when these breakdown or perform inadequately. FTAs cause trade distortion through privileging the trade of one country or group over another; they reverse the WTO principle of non-discrimination that underpinned growth in world trade since the 1940s. We ultimately risk a zero-sum game reminiscent of the beggar-thy-neighbor trade regime of the interwar years that the GATT, the forerunner of the WTO, turned around, and did so with huge success over the five or more decades from the mid-1940s. Australia needs a FTA with China to re-balance the distortions that perversely the US-Australia FTA has or will inflict on our trading relationship with China. The rules of origin, for example, could preclude Australian high-tech producers using components or sub-assemblies produced in China in products they may wish to sell in the USA and attract benefit under the US FTA. In return, China may tit-for-tat discriminate. Hence, we are trapped by the failure of multilateralism into negotiating bilateral arrangements to re-establish or maintain open trade.

The proposed FTA has been embraced with enthusiasm, but clearly caution and realism is needed in accessing any benefit. Gains for Australia, I have suggested, are greatest in increased access to China's domestic market for a wide variety of services. This is the business sphere where "behind the border" regulatory environment is so uncertain and faltering, despite China's commitment to introduce a raft of market-enhancing and institutional reforms. In our negotiation of a FTA with China, one must seriously ask: Is it reasonable to expect China to grant Australian companies any concessions over and above those agreed to under the WTO accession protocols? I would suggest it is probably unreasonable to expect and unlikely to occur.

Who will benefit from a FTA? Australian minerals and energy exporters do not face any real obstacles – it will be mostly business as usual. There might be some new opportunities for exploration and downstream development in China, but probably unlikely. Australian manufacturers such as the footwear, textile and clothing sector have more or less adjusted, and better than those in the USA and Europe based on the vociferous complaints since the MFA terminated in January (they did have 10 years to prepare!), though there will still be a few shocks (closures). Probably the big issues for manufacturers are those in the higher technology, higher value-added, sectors.

Two issues matter. Firstly, as discussed above, there is the question of the extent to which other FTAs will distort the ability of Australian firms to source inputs most effectively and economically. The second issue is that China is rapidly moving up the technological ladder. We are foolish to think that "we do the hi-tech stuff; China does the lo-tech stuff". Even in something as sophisticated and experimental as nano-technology, China is the fourth major player after the US, Europe and Japan. Many international firms have begun to relocate R&D functions to their Chinese subsidiaries. For a car maker, where better to develop and trial a plastic, fuel-efficient personal transporter than a city such as Shanghai, with its traffic congestion and its relatively cashed-up emerging middle class? Certainly mobile phone makers such as Motorola have done so in a market now with more than 350 million handsets – they developed and trialled their first PDA phone in China in the later 1990s before releasing it to the world market.

Training and education of China specialists

We need more and better trained people with China/Chinese capabilities, from low-level awareness of matters Chinese for the handling of projected huge numbers of Chinese tourists to sophisticated research/analysis capabilities for the conduct of policy and other matters. Unfortunately, we are not well prepared. The study, teaching and research of China/Chinese in Australia are inadequate, despite the importance of China to trade and geo-political balance in the region. While we have scholars of China and Asia of international reputation, and punch above our weight, a crisis is emerging in our Chinese/Asian capacity. In brief, we do not have enough studying Chinese or China at upper high school and undergraduate levels; many of our scholars are lured overseas for higher salaries and more congenial research environments; and others will retire in the next decade or so. We struggle to find resources to regenerate these capacities; at times we cannot maintain existing capacity. Weaknesses in our capacity to respond to events in our neighborhood include finding specialist advice for Iran, Afghanistan, Timor, and the Indonesian tsunami. A major meltdown in China, for example, would stretch the capacity of the intelligence and defence services to provide advice to government, let alone for business and civilian interests.

Others are better placed than I to comment on the teaching of Chinese, but let me indicate some of the issues as a Chinese-equipped China researcher. Enrolments in Chinese have risen, but many of those who study Chinese are foreign students who do not add to Australia's capacity unless they subsequently obtain residency. A non-ethnic Chinese student in my Chinese business subject who sought my advice this week on career options told me that only eight of the 80 students who began with her in the Diploma of Modern Languages (Chinese) have stayed to third year, and four are overseas students. In business and economics we see few students who are competent to undertake higher-degree research on business, economics and management about China using Chinese. The same can probably be said for other discipline areas.

My concern is not the training of Chinese speakers, but the training of specialists in various disciplines who are able to conduct themselves in Chinese too. We have seen a broadening over the past decade or more, which is welcomed. Only about one-third of the 32 or so Chinese-competent China specialists at the University of Melbourne are in the language-focused unit, the Melbourne Institute of Asian Languages and Societies. But we need to do better. We need to develop a corp of expertise trained in the disciplines of economics, management, law, politics, government and sociology, as well as extending to the applied disciplines of architecture, engineering and so on.

There are various measures that might expand our capacities. We could encourage the numbers taking Chinese and the quality of their command of the language with more support for in-country language study by Australian students who had completed at least one or two years of undergraduate study. One semester in China would be at least equivalent to two-years of full-time study in Australia, in my view, and improves their social and cultural knowledge that underpins effective communications. Chinese-language major students in many countries – the UK, for example – are required to do one year in China and they seem to have access to university or public schemes that allow them to study in China. The prospects of a supported or part-supported study abroad in China would be a useful incentive to encourage more students to enroll in Chinese and to raise our capacity in Chinese. Otherwise, we have graduates without practical experience of the lived language and low competency.