



**The Hon Craig Emerson MP
Minister for Trade**

**‘The next generation opportunities between
Australia and China’**

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Australia’s modern economic story as we move towards two and a quarter centuries of European settlement is a story of a former British colony taking its place in the Asian region in the Asian Century.

Just as the Hawke Government made history 25 years ago opening up the Australian economy and “enmeshing” it with Asia, the Gillard Government is making history by taking Australia up the value curve, widening and deepening our economic integration with Asia.

Pushing up the value curve in the Asian century will create more jobs and better jobs for working Australians.

It is a noble endeavour, one that has everything going for it and nothing against - unless, of course, you are nostalgic for our economic ties with Mother England or prefer the Economic Hansonist model of Fortress Australia.

Every thinking Australian would support the Prime Minister’s Asian Century White Paper project designed to put Australia in the right place at the right time.

Pushing up the value curve, the next phase of Australia’s economic integration with Asia, involves identifying the next-generation opportunities between Australia and its Asian neighbours.

Today I will concentrate on the next-generation opportunities with our largest trading partner, China, though the Gillard Government is engaged in similar exercises with other neighbours such as Korea, Japan, India, Indonesia, Malaysia and Vietnam.

At present, minerals and energy exports contribute 72 per cent of Australia's exports of goods and services to China.

These minerals and energy exports are high-volume but low value per unit exported.

Yet the Australians engaged in their production earn relatively high wages, since production methods are highly efficient and capital intensive, making for high labour productivity.

But less than 5 per cent of the Australian workforce is directly engaged in minerals and energy production for export.

The benefits of Australia's biggest mining boom in at least 140 years are being spread more widely through the community via a range of mechanisms, including to those Australians working in industries financing the mining boom, and those who receive a share of the profits of big mining companies as direct shareholders and as indirect investors through their superannuation accounts.

From 1 July 2012, the benefits of the mining boom will be further spread by the Minerals Resource Rent Tax, as workers begin receiving extra superannuation contributions and small business owners enjoy extra tax breaks.

For at least the first half of the 21st Century, minerals and energy commodities are likely to contribute a majority share of Australia's exports of goods and services to China, fuelling its industrialisation and more particularly its urbanisation.

China's urbanisation is a phenomenon in the history of human presence on earth.

By 2020 China is expected to have 93 cities at least as large as Sydney.

Its middle class will have swollen to 670 million people looking to buy sophisticated goods and services.

They will choose to include much more animal protein in their diets.

They will seek further and higher education.

And they will travel.

Will the phenomenon of China's modernisation persist beyond the end of this decade?

We already have an insight into China's future economic performance. Today's productivity growth is tomorrow's prosperity.

So a reliable predictor of a country's future economic growth rate is its recent trend productivity growth rate. In the first decade of the Asian Century, China's labour productivity grew by an estimated 10 per cent per annum, Europe's [EU] by less than 1 per cent, America's by 2 per cent and Australia's by just over 1 per cent.

Yet China's labour productivity levels are still only 14 per cent of those of the United States, which is usually regarded as being at the productivity frontier.

China began opening up its economy only 25 years ago, so it still has enormous scope to catch up to the productivity levels of the United States.

Every subsistence Chinese farmer who moves into factory work, producing even low-value clothing or footwear, achieves a productivity gain of several hundred per cent. And as eastern China itself moves up the value chain, transferring low-value manufacturing to China's west and to countries such as Bangladesh and Laos, its workers achieve further quantum increases in labour productivity.

Yet it's not as if China's west is consigned to producing low-value goods. The city of Chengdu, which I visited with an Australian services sector business delegation in August, produces one-third of the world's iPads. Chengdu hosts virtually every luxury car dealership and fashion house in the world. This city of 14 million is engaged in intense rivalry for domestic and foreign investment in sophisticated manufacturing and service industries with the 30 million-strong nearby municipality of Chongqing.

In its 12th Five-year Plan, China has committed to rebalancing its growth away from over-reliance on exports towards domestic consumption. It is spreading growth from the eastern seaboard through the west, lifting living standards throughout the country.

During our services mission, we visited Changsha, which grew at 14 per cent last year; Wuhan, which grew at 23 per cent; Chengdu at 15 per cent; and Chongqing at 17 per cent. On an earlier visit, in May, I travelled to Tianjin, southeast of Beijing, which grew at 17 per cent in 2010, and Shenyang in the northeast, which achieved growth of 14 per cent last year.

China's economy will double in size within the next nine years, and by 2026 it will be three times its present size.

Through the Asian Century White Paper project the Gillard Government is identifying the next-generation opportunities in the Australia-China relationship.

In doing so, we will respect the iron laws of comparative advantage. These laws dictate that Australia cannot be comparatively good at producing everything and selling it to China. Nor, incidentally, can Australia be comparatively bad at producing everything, necessitating a Fortress Australia, as the Economic Hansonites preach.

China's massive industrialisation and urbanisation will require vast quantities of minerals and energy.

Just as Australia has established itself as a reliable supplier over the last quarter century in meeting China's minerals and energy security needs, Australia can establish itself over the next quarter century as a reliable supplier, assisting China to meet its food security needs.

As literally hundreds of millions join China's middle class during the coming quarter century, China's demand for animal protein will soar. This market, and other growing Asian markets, provides an opportunity for our primary producers to maximise productivity and produce more food from our agricultural land.

Since the time of European settlement we have always relied on foreign investment to develop our farms and sheep and cattle stations.

Rising real food prices associated with population increase, urbanisation and burgeoning middle classes in emerging countries such as China will make new technologies in water conservation, storage and transportation economically viable.

Australia is exquisitely placed in helping meet China's demand for animal protein through the supply of beef and sheep meat to global markets, supplementing domestic Chinese supplies and offering technical support in the form of animal husbandry, water conservation, storage and transportation.

To this end, I have agreed with my counterpart, Commerce Minister Chen Deming, on an exchange of study tours between our two countries involving agricultural experts and private business representatives.

The Chinese delegation, comprising 26 representatives from government, business and banks in the agricultural sector, will visit Australia from 8 to 14 December. They will look at opportunities for new production capacity in Western Australia and Queensland, and will meet with government officials and private industry.

In the New Year an Australian delegation will visit China.

Both delegations will prepare a report for consideration by both Australia's and China's Governments.

At the Australian end, the joint report will provide valuable input into the Asian Century White Paper exercise.

In our discussions, Minister Chen and I have agreed that our two countries can work together to ease global food security pressures. Australia can play its part, and aims to increase agricultural production to meet the needs of an extra two billion people as the world's population increases from seven billion to nine billion by 2050.

This will assist China, and indeed Australia and the world, by keeping world food prices lower than they otherwise would be, and by ensuring plentiful supplies on international markets. It will not involve the growing of food exclusively dedicated to the Chinese domestic market, as some scaremongers have asserted.

I trust the exercise will attract bipartisan support here in Australia.

At the turn of this century, mining and agriculture were widely regarded as old economy, to be discarded in favour of the weightless new economy of information and communications technology.

Old-economy mining has made a stunning comeback in less than a decade. Old-economy agriculture is set to do the same this decade. Both will be star performers in the 2020s. And Australia has a strong comparative advantage in both.

Does this mean Australia is consigned to remain predominantly an exporter of primary commodities?

Though we can't, by definition, be comparatively good at producing everything, we can be comparatively good at producing many things, both tangible and intangible.

My recent services sector mission to China amply demonstrated the truth of this proposition.

Who would have thought that Australian businesses might be highly competitive in the supply of architectural services? PTW Architects has proved we are.

Who would have thought we would be successful in kitchen design for assembly in China? A former brickie who put together \$250,000 and is now running a multi-million dollar export business from China in collaboration with the University of New South Wales has proved we are.

Who would have thought we would be good at managing the savings of wealthy Chinese business people? Gao Fu is proving we are.

Australia's higher education institutions are host to more than 126,000 Chinese students each year.

Australia's tourism industry receives 453,000 Chinese tourists a year.

Australia's banks have seven branches operating in China.

What does this mean for government policy? Should we be ploughing taxpayers' funds into kitchen design, architecture, fund managers, universities, tourism businesses and banks?

Chasing the commercial success of Australian businesses in China with taxpayer-funded cheque books is as unedifying as it is unwarranted.

A far more productive approach is to help create the commercial environment in which the entrepreneurial talent and flair of Australian businesspeople can flourish.

That means removing unnecessary government-imposed impediments at home and working through our Embassy, consulates and Austrade offices in China to remove unwarranted impediments in China and make the necessary introductions to Chinese counterparts.

Comparative advantage is self-selecting; it is never government-decreed.

Australia has distinct advantages on which our services and manufacturing businesses might be able to capitalise.

We are in the same time zone as China; Europe, North America and Latin America are not.

Australia is well regarded in China, not the least because the Whitlam Government moved quickly to establish diplomatic relations with the People's Republic of China in 1972 and the Hawke Government put an enormous diplomatic effort into engaging with the Chinese leadership. Indeed, President Hu Jintao visited Australia for a week as an 'up and coming leader' in 1986 at the invitation of the Hawke Government.

And Australia has generally welcomed foreign investment from China - in Mt Channar providing the first Chinese overseas mining investment project in 1987 and in the Portland aluminium smelter in 1998.

Since late-2007, Australia's Foreign Investment Review Board has approved around 280 applications for Chinese investment in Australia, only six with conditions or undertakings.

But surely the laws of comparative advantage dictate that Australia can't have a comparative advantage in manufacturing as well as in primary commodities and specific services.

Economic theories both simplify and generalise. Just as oils ain't oils, manufacturing ain't manufacturing.

Large-scale factories utilising low-wage employees to produce inexpensive socks and underpants bear little resemblance to steelworks, shipyards or aircraft production facilities.

Here's the truth: if Australia ever had a comparative advantage in producing cheap socks and underpants, it has lost it.

But based on Australia's rich endowment of iron ore, coal and other energy resources, it is conceivable that we could become a major steel producer for export to China and other Asian countries. One proposal involves an infrastructure corridor linking the iron ore deposits of the west with the coalfields of the east. Doubtless there will be other ideas.

Australia, too, could potentially have an advantage in the design and production of machine tools used in Chinese factories. If Germany can, maybe Australia can, too. But it would require a lift in Australia's vocational education effort to be genuinely competitive.

Recently completed Austrade research finds that Australian exports of sophisticated manufactured goods to China increased by 243 per cent during the last decade, reaching almost \$2 billion in 2010, compared with a fall of around 20 per cent in such exports to both the United States and Britain.

That said, the strong Australian dollar and intensifying global competition, particularly in the Asian region, has put Australian manufacturing under renewed pressure.

Competing internationally often means tough domestic reform, and Australian manufacturers have been innovating and restructuring since the country first began to lower its barriers to trade.

The Gillard Government is now looking at how best to address the latest challenges through the Prime Minister's Manufacturing Taskforce, of which I am a member.

Having agreed to consider the next generation of opportunities in the Australia-China relationship, I do not want to leave a mercantilist impression with you.

Australian consumers and businesses have benefited enormously from the rise of China.

For example, clothing and footwear is much less expensive now in real terms than it was 25 years ago, when high tariffs and severe quotas were applied to imports.

Children's clothing has fallen in price in real terms by 25 per cent, and footwear by almost half. The real price of whitegoods has fallen by 46 per cent, consumer electronics by half and motor vehicles by almost 40 per cent.

Not all these real price reductions have been due to less protection, but tariff cuts and the removal of quotas have certainly helped deliver lower prices of basic items to consumers.

These real price reductions for traded goods can be contrasted with real price increases for goods and services that are not traded and have therefore been subject to less competition over the same period.

Continued access to inexpensive Chinese consumer goods, including sophisticated electronics, will help limit cost-of-living increases in Australia and boost our own productivity.

These are a few thoughts about the next generation opportunities in the Australia-China relationship. Ultimately they are bounded only by our imaginations and entrepreneurial flair.

Through the Asian Century White paper project the Gillard Government, like the Hawke Government before it, is locking Australia into Asia's brilliant future.