

Kangaroos and Dragons

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The rise of China is reshaping Asia and the world. It has grown by around nine percent per annum for more than 25 years. China is a momentum story, the biggest in a generation. Forecasts are for China's economy to be the world's largest in about a decade. China's hunger for raw materials has driven commodity prices to record levels. Australia's two way merchandise trade with China has trebled since 1999 in six years. Investment in the world's most populous nation shows no signs of abating as the Chinese government takes further steps to liberalize foreign ownership restrictions, although it has more than 150,000 state owned enterprises, with many still off limits to foreign investors. In terms of competition, China has its fundamentals right. Its people are challenged, determined and focussed. Australia and others need to stay awake if we are to take advantage of China's growth.

Against a backdrop of such statements, can anyone argue with my belief that as the information revolution replaced the industrial revolution, the next world economic period could be defined in one word – China!

I come here today as someone from a nation that in its trade and foreign investment has always been very different from China. Modern Australia began as an English settlement, dependent on another country for almost everything. Most of Australia's population came from other countries. For a long time, most of Australia's goods came from other countries. And a large slice of Australia's investment capital has

always come from other countries. That pattern has served Australia well.

China, of course, starts from the opposite position. For most of its history, China has been largely self-sufficient. It has been content to exist with only limited contact with the rest of the world. And that has served China well for most of its history. Notwithstanding our cultural, religious and language differences, I sense a "compatibility of comfort" between the people of China and Australia, that is a growing foundation for our relationship in the future.

Today I want to talk about how both countries can capitalise on their different histories.

Like several other countries, Australia is now discussing the framework for a free trade agreement with China. But what I want to emphasize goes beyond the details of specific trade agreements. I want to talk about the bigger forces driving the relationship between our two countries.

Today's economic relationship between Australia and China is essentially simple. Each does what the other does not do. China is a commodity importer whose economy is centred on the production of manufactured goods, developing rapidly into a technological powerhouse. We understand that China produces over 350,000 trained engineers each year. We also understand that over 25 percent of the science and engineering students completing PhDs in the US are Chinese. In the past, many of these PHD

graduates would have stayed in the US; now almost all return home.

Australia is quite different. It has never exported huge quantities of manufactured goods. Commodities such as iron ore and coal dominate Australia's exports; notwithstanding that China is the world's largest coal producer. Services dominate Australia's domestic economy: services account for 56 percent of GDP and employ three-quarters of all employed Australians.

So Australia's relationship with China has long been one of mutual benefit. As China has grown, Australia has grown too. Our country has had 14 years of uninterrupted economic growth. In that period, China has overtaken the United States as Australia's second-largest export market. On top of commodities exports to China, Australia has built a successful world-class education sector – a sector that attracts large numbers of fee-paying Chinese students. Meanwhile, Australian goods imports from China have grown even more rapidly than our exports to China. Australian imports were less than \$7 billion in 1999. They reached \$18 billion in 2004.

Like many countries, Australia has experienced some strains in its relationship with China. Australian factories have closed as Chinese manufactured goods underprice those manufactured with more expensive Australian labour. Right now, in the industry that I worked in for 40 years – the automotive industry – Chinese competition is the source of great pressure. Economic transformation and economic openness have their price, and some in Australia are paying that price.

As the might of China's automotive industry grows and penetrates world markets, I strongly appeal to Chinese authorities to study the lessons learned by the Japanese in the '70s and '80s. As the Japanese swamped such markets as the United States, and thousands of American jobs were lost, people damaged Toyotas in car parks to show their emotions – then came a us/Japan temporary voluntary restraint of 1.6 million exports from Japan to the USA – then came NUMMI, a GM/Toyota joint venture in California that introduced the lean manufacturing concept to America – now the Japanese have around 20 “greenfield best practice” plants in the USA – jobs for Americans, profits for the Japanese. Lessons for China!

Australia comes to the discussion of China's future with optimism, rather than fear. China has been a force for good in the Australian economy. And it should continue to be so.

The Committee for Economic Development of Australia (CEDA) sees the complementary relationship continuing, though probably at a marginally slower pace of growth. China's manufactured goods continue to become more sophisticated, more reliable and more popular with Australians. Australia's commodities seem likely to stay in demand; indeed, we're about to start new exports of liquid natural gas to China.

In two senses, then, we have a relationship made of iron. It's a relationship based on turning commodities into goods.

CEDA believes we're now ready to take the next step in the relationship. We want to go beyond the relationship made of iron, to a relationship based on much closer interaction. Australia, as I said, is to a large degree, a services economy. CEDA sees Australia substantially deepening its involvement in services industries in China.

Australia and China start with almost a clean slate here. Because Australia has never been a global manufacturing power, Australians have invested relatively little in China. China's investments in Australia have been similarly limited.

But as China's industrialisation proceeds, Chinese investment in Australian business will almost certainly grow dramatically. China is already investing more offshore, and the Chinese government is encouraging and helping to fund that investment. There will probably be real advantages for China in securing its supply chain for energy, metals and other raw materials. I see a situation where China will not only be signing long-term contracts and taking equity positions in projects, but also investing in infrastructure off shore.

At the same time, more Australian firms will be attracted to the Chinese market. In particular, China will attract Australian services firms.

As Chinese households become more financially sophisticated, the Chinese services sector will grow. As that happens, Australian expertise will become more relevant.

Australian services firms that have internationalised are often in real estate development, finance and insurance, logistics and health technology. These are the service industries where Australia has a specific expertise. These are the service industries where Australian firms have outgrown the home market.

And in most cases, Australian services expertise is expected to flow into China through foreign investment. The bulk of Australian services expertise will arrive in China through Australian firms setting up Chinese operations.

Let me reflect a little on the Chinese services sector from an Australian perspective. In economies around the world, the share of the economy given over to services grows as the economy itself grows. In China, however, that doesn't seem to be true. The Chinese services sector grew from 22 percent of GDP in 1981 to 34 percent in 1992. But it doesn't seem to have grown much since.

As a result, China appears to produce fewer services than its economy warrants.

The Chinese government itself has already recognised that it must speed up the development of the services sector. On joining the world trade organization, China committed to liberalising services. By the end of 2006, we expect China will have implemented very liberal, market-based reforms. We expect after that to see many service industries grow fast. And with that will come significant levels of services-related foreign investment.

That growth will probably be centred in China's coastal provinces. These are the provinces of course, which have dominated economic development over the last decade. The top five such provinces have high GDP per person, and strong growth. The Chinese government developed infrastructure and industry in these provinces through the 1980s and 1990s. These regions now know most about deregulating markets, granting licences, attracting and accommodating foreign investment, and doing all the other things that encourage growth and foreign participation. These are the places where we expect Australian investment in services will be strongest. Equalizing growth in all provinces is, of course, another subject.

But what do countries like Australia offer? If China liberalises to let foreign services firms invest and grow in China, what will China get in return?

Chinese finance is liberalising at a very important time. China faces a wave of new demands on its financial system. Nearly 30 percent of the world's new deposits over the next five years are expected to be in China. The volume of new savings will be higher than those in either all of Europe or the United States. The Chinese

banking system will need to handle twice the value of savings it handles today.

"Finance and insurance" is Australia's second-largest service industry, responsible for 12 percent of all services value-added. Each of our big four banks is among the 50 largest banks world-wide and each is a top performer globally in shareholder value creation. Their capabilities are world-class. Their technologies are highly developed. Two of Australia's big four, commonwealth bank Australia (CBA) and ANZ bank, have (or are close to) investments in China already. Outside the two global giants (HSBC and Citigroup), these investments will put ANZ Bank and the CBA in the front rank of universal banks operating in China in any substantial way. At the same time, the highly innovative smaller Australian financier Macquarie bank has pioneered foreign investment in the Chinese mortgage market, with mortgage and securitisation operations in Shanghai.

Today, services investment in China remains a daunting prospect for most Australian firms. Years of Chinese emigration to Australia has left us better equipped than most "western" countries to deal with geographic and linguistic hurdles. But many aspects of Chinese business governance provide challenges.

For instance, as our speakers have mentioned, China has put in place an intellectual property framework that is compatible with international standards. It's done it in a very short time. CEDA has been at pains to point out in its work just how much has been accomplished. But China does, I believe, need to keep working to build a system that works well in practice. Intellectual property is one of the developed countries' greatest gifts to China. Arguably intellectual property, more than anything else except perhaps simple access to developed-country markets, has enabled China to grow at the rate it has over the past two decades. Today, firms in countries like Australia remain a little wary of China's intellectual property protection. Similarly, the Chinese legal system can better support existing laws on contracts and investment. And it can allow explicit, judicially reviewable contracts to play a more substantial role in building successful partnerships.

By improving its governance framework in these and other ways, China will make investment more attractive.

Protecting the rights of Australian service providers will also be a key to the success of the Australia-China free trade agreement that the

two countries are now planning. Australian government officials, in their comments to CEDA, have made this clear.

If China can reduce the risks of investment, we believe, the China-Australian relationship can take on a new dimension.

China has very strong reason to want the best possible foreign investment arrangements between itself and countries like Australia.

As China's economy matures, I would like to think that its relationship with Australia, grounded in clear mutual benefit, can continue to show the way for many.

Good returns for foreign investors mean little if the standards of governance, accounting practice, health and safety, environmental sustainability and ethics do not meet international benchmarks. Much has been done – there is more to do for all of us.

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