

EXECUTIVE SUMMARY

Entering the WTO marks an important further step in China's integration with the world economy, although WTO accession represents a continuation of its successful 25 year reform journey, rather than a major turning point. Most visibly, China committed to further cutting trade barriers and significantly improving access for foreign direct investors, particularly in services, providing many new opportunities for Australian businesses.

However, beyond the headlines, China also committed to a raft of other institutional and economic reforms that will generate broader and deeper change than just freer trade and foreign investment. Such structural measures should further strengthen ongoing legal and bureaucratic change and reinforce reforms in corporate governance, financial markets, distribution, transport and telecommunications. In the long term, these may prove even more important for China's economic development and the expansion of its commercial relationship with Australia. Not only will these measures assist China maintain high growth rates and move further towards becoming a modern and more predictable market oriented economy, they also will contribute to further gradual improvement in China's still challenging business environment. However, this will not happen rapidly. Authorities accept that accomplishing its WTO and other reform programs involve overcoming significant challenges.

DOING BUSINESS AFTER WTO ENTRY

China's ambitious and far-reaching WTO entry package commits the Government to adopting a range of trade and investment creating measures that will impact gradually upon the challenging business environment. While WTO entry will not immediately create a radically easier setting for Australian businesses operating in China, it will build on the reforms since 1978, reinforcing progress towards a market oriented economy and further dismantling inefficient state industries and reducing state intervention. For example, a major legal review introduced as part of WTO entry will help improve Chinese commercial statutes, boosting transparency and predictability. The Government also is using WTO entry requirements to motivate essential bureaucratic reforms, eventually reducing the bureaucracy's discretionary role in the economy and hence increasing certainty for foreign and local businesses.

A more market oriented Chinese economy will demand more high quality Australian goods, services, technology and investment in order to compete better in world markets and meet rising consumer demand. Further, by amplifying benefits from domestic reforms, WTO entry should help sustain strong long term growth, generating popular support for further reform and boosting incomes and demand, including for imports.

ECONOMIC OVERVIEW

To prepare for WTO entry and avoid an Asian-style crisis, Chinese authorities continue to reform the economy, including restructuring state owned enterprises and banks, dealing with non-performing loans and further deregulating the private sector. As a result of reforms, the economy's structure continues to change rapidly, with the private sector increasingly displacing the state owned and collective sectors and manufacturing and services expanding at the expense of agriculture. Consequently, China remains the world's fastest growing large economy, achieving impressive gains in poverty reduction and boosting local markets' size and sophistication. Looking ahead, China's real gross domestic product should grow by about 7 per cent per year for the next decade, barring major social or political disruption or fiscal crisis.

Nevertheless, the economy faces several serious inter-related challenges which the Chinese Government recognises it must tackle to maintain strong growth. First, failure to advance further banking system reform and deal with the current burden of non performing loans could increase seriously the Government's fiscal burden and undermine growth prospects. Second, the authorities must continue to reform state owned enterprises to improve their efficiency, allow the rapidly expanding private sector room to grow and improve the quality of bank loans. Finally, the Government needs to address funding shortfalls for massive social security and retirement benefit liabilities or it will undermine long term fiscal sustainability and slow essential state enterprise reforms.

THE AUSTRALIA-CHINA COMMERCIAL RELATIONSHIP

Strong trade complementarity drives the large and rapidly expanding commercial relationship between Australia and China. China is currently Australia's third largest merchandise trading partner, up from only ninth in 1990. Australia exports large quantities of primary commodities to China, particularly metal ores and wool, and increasingly education and tourism services. China mainly exports labour intensive manufactures to Australia, but their value added and sophistication is increasing.

Australia has not been a prominent investor in the sector attracting most foreign direct investment to China, labour intensive manufacturing. Hence, while hundreds of Australian firms invest in China, most are small and their total investment is between \$2 billion and \$4 billion. About one third of these firms are in manufacturing, one third in property and business services and the remainder in a diverse range of other sectors. By contrast, Australia is a major destination for Chinese foreign direct investment, which totals just over \$3 billion. Most of this investment is in the resources sector, particularly iron ore; the remainder is spread across many smaller Chinese businesses operating in manufacturing and a range of service sectors.

OPPORTUNITIES IN AGRICULTURE AND AGRIBUSINESS

Market opening under WTO and Chinese agricultural reforms should ensure an expanding market for Australian agricultural products in China. In 2001, Australia supplied almost \$2.4 billion worth of agricultural commodities to China, mostly wool, barley and canola seeds, up from around

\$1.6 billion in 1997. WTO related tariff cuts and new agricultural tariff rate quotas should increase export opportunities for Australian farmers. Also, reduced state intervention, competition and environmental pressures are encouraging Chinese farmers to focus more on their competitive strengths in labour intensive agriculture, expanding markets for Australian land intensive crops and some livestock products. Australia also should access increasing opportunities to supply agricultural equipment, services and technologies to Chinese farmers seeking to improve productivity.

Further relaxation of restrictions on foreign investment post WTO entry should make it easier for Australian firms to invest in Chinese agricultural and agribusiness sectors. However, due to land purchase restrictions and an uncertain business and policy environment, these sectors will remain challenging for investors; medium term investment opportunities are more likely to open up in food processing, where many overseas investors already are present.

OPPORTUNITIES IN MINERALS AND ENERGY

Over the next decade, rapid industrial and infrastructure growth along with mineral processing and mining industry reforms should underpin strong Chinese demand for Australian minerals and energy exports. China is an increasingly important global minerals and energy trader, importing \$4.4 billion worth of resources from Australia in 2001, representing more than half of total Australian exports to China. This makes China our third largest customer for resource commodities after Japan and the Republic of Korea.

While mineral and energy tariffs have been low for several years, WTO entry gradually will promote more transparent and commercially based trading arrangements, potentially increasing the certainty, profitability and scope of this trade. Also, as uncompetitive Chinese mines exit the industry and processing demand expands, Chinese markets for Australian iron and copper ore, alumina and liquefied natural gas, among others, should continue to grow rapidly. Further, as ongoing mining regime reforms encourage more foreign investment, increased activity and competition should generate increased joint venture and local mine demand for imported mining equipment, inputs, services and technology.

Restrictions on foreign participation in mining and an uncertain policy environment mean foreign direct investment in mining is small; foreign investors participate more in minerals processing and oil and gas production. Due to continued policy uncertainty, foreign greenfield mining investment is unlikely to expand strongly in the short term, but foreign participation in minerals processing and oil and gas sectors should expand more rapidly. In the medium to long term, mining investment prospects look brighter, although opportunities are contingent on more encouraging policy developments.

OPPORTUNITIES IN MANUFACTURING AND INFRASTRUCTURE

China's large, increasingly open and rapidly expanding manufacturing sector will be a major beneficiary of WTO entry; its enormous, growing but sometimes inefficient infrastructure sector also should benefit. WTO entry will open new markets for Chinese exports of textiles and apparel to Europe and

the United States. China also will further cut manufactured tariffs, boosting import competition, improving local industry productivity and product quality, and generating higher consumer incomes and domestic demand. This will lead to new opportunities for Australian manufactured input suppliers and finished goods exporters.

Rapid economic growth is straining China's infrastructure network, resulting in low quality services and supply shortfalls in some industries, and creating opportunities for foreign suppliers. WTO entry will ease restrictions on foreign participation in several major infrastructure sectors including airports and ports. Combined with ongoing regulatory reforms and strong economic growth, these developments should increase opportunities for Australian infrastructure equipment and services providers and investors.

OPPORTUNITIES IN SERVICES

China is an increasingly active international services trader and, with WTO entry, committed to further liberalise services trade. While tight restrictions have to date limited foreign services investment, WTO entry commits China to gradually open most service sectors including financial, education, tourism, telecommunications, environment and professional services, creating many new opportunities for Australian service suppliers. China's services sector now accounts for about one third of economic activity. Throughout the economy, rising local and international competitive pressures will increase Chinese businesses' demand for foreign services expertise and more affluent Chinese consumers also increasingly will demand international tourism and high quality overseas education.

IMPLICATIONS FOR BUSINESS AND GOVERNMENT

WTO accession should further enhance the dynamic Australia-China commercial relationship, ensuring strong and sustainable long term trade and investment growth. Not only will China reduce trade and investment barriers but WTO entry should reinforce China's massive on-going reform program, helping build a sounder legal and regulatory system and delivering a progressively fairer and more predictable business environment for Australian and local businesses. By increasing the Chinese economy's competitiveness, WTO entry also will boost incomes and local business and consumer demand for goods, services, capital and technology, including from Australia.

Nevertheless, China faces a massive task in implementing WTO commitments, completing other essential reforms in state enterprises, pensions, banking, agriculture and infrastructure and in strengthening key economic policy making and regulatory institutions. Australia and other donors have contributed significantly to China's reform process through a wide range of technical, training and other assistance. Drawing on Australia's strong institutions and reform experience, Australia usefully could continue to direct a significant part of its development assistance to addressing these challenges. Such assistance would help China meet the core policy and institutional strengthening issues it faces in the next decade, helping it become a prosperous, modern, more market oriented economy, further reducing poverty and enhancing opportunities for bilateral trade and investment flows.