

# SUBMISSION



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Submission to the

Department of Foreign Affairs and Trade

in response to:

A Request for Submissions on the  
feasibility study into a Free Trade  
Agreement with China

June 2004

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## **Introduction**

As China increasingly embraces more liberal economic policies, and seeks a greater external orientation, it is having a profound impact on global product and commodity markets. China now accounts for almost six percent of global trade, compared with less than one per cent 20 years ago, and is the second largest economy in the world.

Growth in China for 2003 officially stood at 8.3% and the forecast for 2004 is above 7%. It is the powerhouse driving the Asian economy with a population of nearly 1.3 billion people it obviously represents a highly attractive investment opportunity for a range of Australian companies. Investment in China is a long term option and there are numerous challenges that need careful consideration. The Chinese market is highly fragmented between a growing middle class and a extremely large peasant and subsistence population. Investment and oversupply is creating a high level of competition.

As with many other countries, Australia also finds itself becoming more closely integrated with China. China is now the destination for 8.5% of all Australian merchandise exports, compared with 2.5% in 1990. Similarly, China accounts for 11% of all Australian merchandise imports, up from 3% at the start of the last decade. China has also played an important role in the turnaround of Australia's terms of trade, providing a further source of support for Australian national income.

## **Key Issues**

Like other Australian manufacturing sectors, the China market presents the food and grocery sector with a wide range of challenges and opportunities.

The number of companies committing to or considering direct investment in the Chinese market in the past two years is small but has the potential to grow significantly. China's major impact has been as a growing source of low cost inputs for Australian food manufacturers.

There are significant barriers and impediments to exploiting the Chinese market. In addition, China is quickly building internationally competitive strengths in various aspects of food processing.

China is considered a major threat at the low and medium quality end of the food services or consumer goods markets, while Australian producers appear to be enjoying some success targeting more affluent quality focused Chinese consumers.

There are numerous factors that are curbing the potential for further Australian trade, investment and effective competition with China.

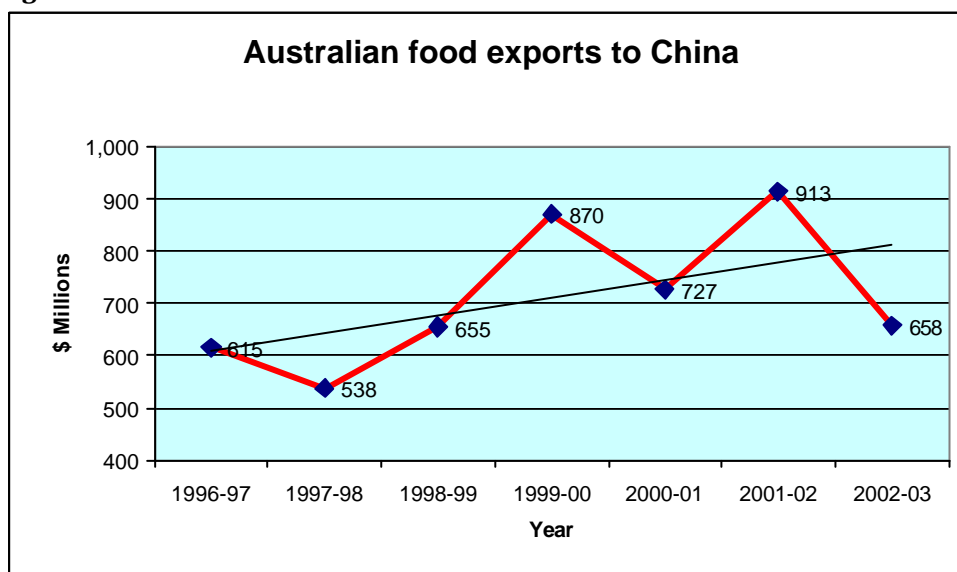
These factors include:

- Tariffs and non-tariff restrictions (including environmental, product safety and labeling issues);
- The legal and regulatory environment and broader 'cultural differences' (including within China);
- China's exchange rate potentially being undervalued;
- Inadequate Chinese infrastructure;
- An inadequate number of potential joint venture partners or agents;
- Potential difficulties in maintaining scale of supply to the large Chinese markets;
- Large set-up costs and inadequate market information;
- Competition in the Chinese market from other Chinese and international producers

## Australian food trade with China

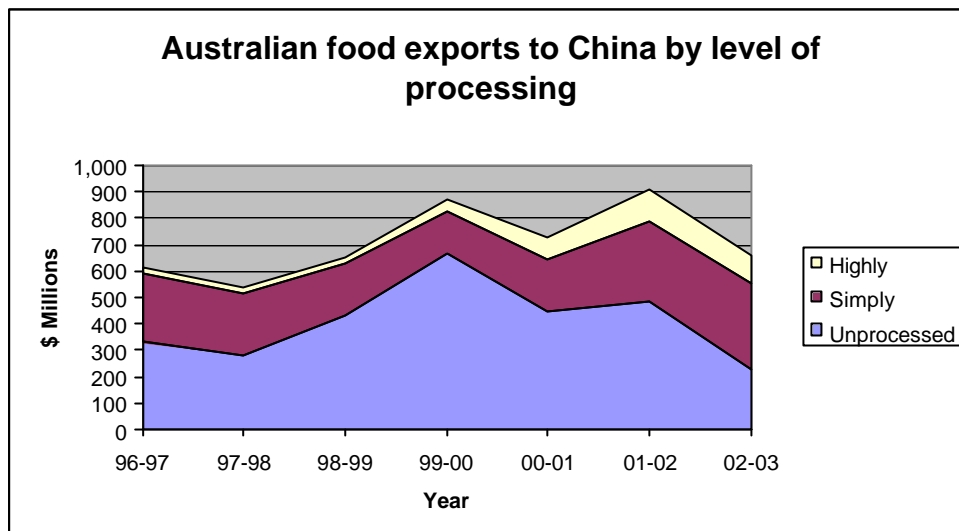
The value of Australia's food exports to China have trended upwards since 1996 from around \$600 million to over \$900 million in 2001 while reducing in 2002-03 largely as a result of the drought (Figure 1). Major exports include grains, meat and dairy products. While total food exports have fluctuated in value, the highly processed foods sector has steadily increased from \$21 million in 1996-97 to over 100 million in 2002-03 demonstrating the potential growth of the Chinese market. The major growth in the processed sector is attributed to increases in the dairy and meat sectors. The Australian industry's shift toward more value adding is further demonstrated by the decline in the value of unprocessed food exports of almost \$100 million down from \$329 million in 1996-97 to \$225 million in 2002-03 (Figure 2).

Figure1



Source AFGC database.

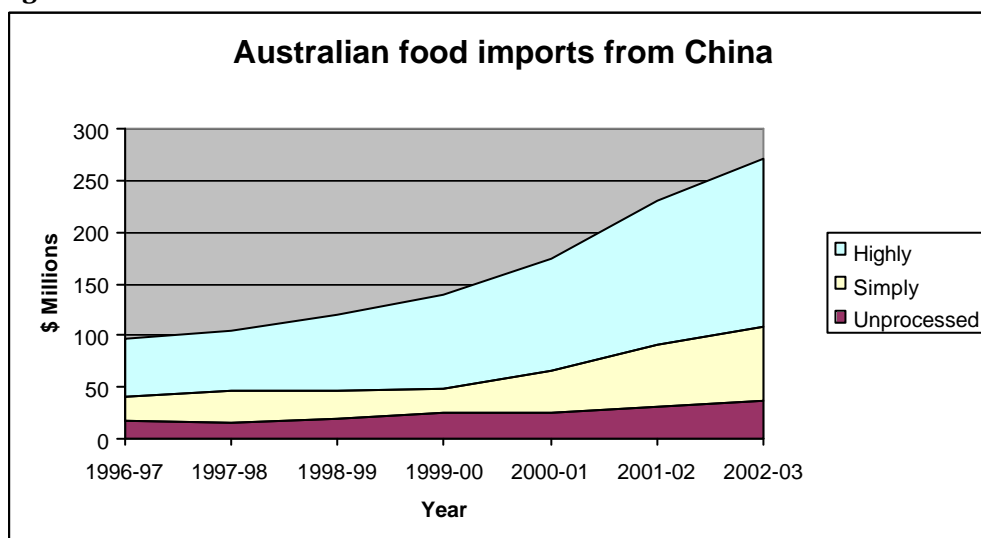
**Figure 2**



Source AFGC database.

Australian imports of food from China have increased significantly from \$97 million in 1996-97 to \$273 million in 2002-3 (Figure 3). The major increase has been in the areas of highly processed goods with the value rising from \$56 million in 1996-97 to \$163 million in 2002-03. Major processed products include grains other than wheat, barley and rice, horticulture and confectionary. This clearly illustrates China's capacity to impact on Australia's processed food market.

**Figure 3**

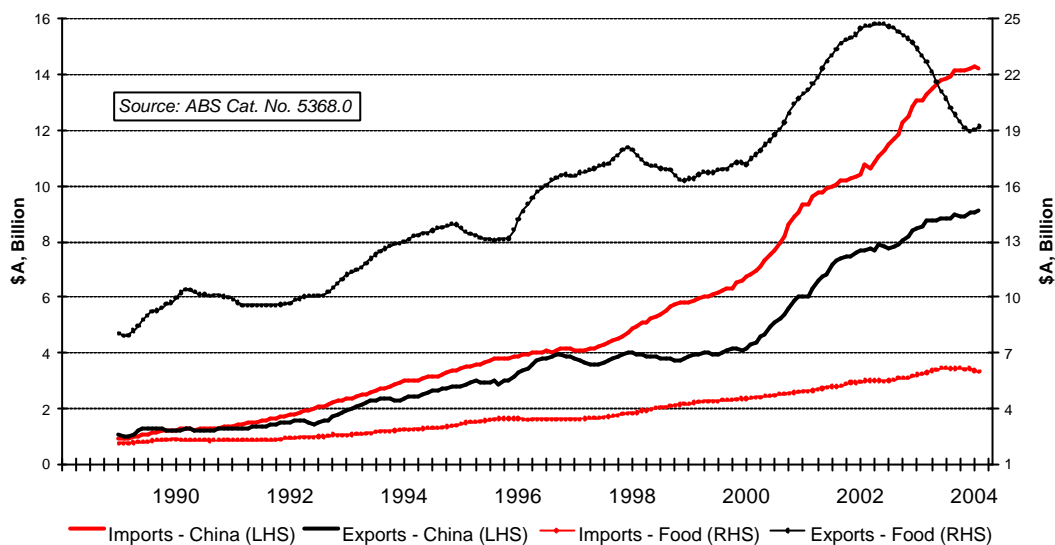


Source AFGC database.

Australia is exceptionally well placed to supply China with the commodities and raw materials needed for industrialisation. In turn, Australian producers and consumers benefit from China's ability to produce a wide range of products at lower cost, as well as from the accompanying growth in Chinese incomes and demand.

The Australian food manufacturing industry is closely intertwined in this process. Abstracting from the effects of the drought in recent years, Figure 4 reveals trade in food products has paralleled the broader pattern of trade between China and Australia. Clearly, China is a major impetus for the growing trade in processed food products.

**Figure 4: Selected components of Australian trade**



Source: AIG report for the AFGC 2004.

## China's impact on processed food markets

Given the variety of the above-mentioned impediments, the question of whether a free trade agreement (FTA) with China will deliver large benefits to Australian companies remains unanswered.

Regardless, the AFGC believes China will have a significant impact on the operations and strategies of Australian food manufacturers.

China is both an opportunity and a threat for Australian food manufacturers. China is providing a significant and expanding export market for domestic food producers. China is a growing source of low cost inputs and imported food products for Australian companies particularly in the lower quality end of the food services or consumer goods markets (eg generic branded products). Major product lines include fruit juice, refined sugar, canned fruits and vegetables, biscuits and confectionary.

In addition, China is rapidly developing domestic and export capabilities in a wide range of competing products and markets, and it is perceived that this will only quicken as Chinese infrastructure is eventually enhanced. Chinese producers appear to have been gaining a larger foothold in the Australian processed foods market. In addition to East Asian markets, Chinese producers are also seeking to aggressively expand processed food exports to the Middle East and India.

Australian producers are likely to be (indirectly) affected by the strength of Chinese demand for a wide range of commodities and semi-processed materials, which could have the effect of pushing up global (and Australian) raw material prices. The predominant issue facing many Australian food manufacturers is the relocation or relative strengthening of productive capacity in China.

## **Conclusion**

The food and grocery industry (AFGC) remains interested in the potential development of an FTA with China. However, given the early stages of the process there is a mixed view on the actual benefits and risks that may result. In light of recently agreed bilateral arrangements with Thailand and the US, it is perceived that any immediate benefits are likely to be in the form of a modest increase in exports and potentially a greater flexibility in cross-border manufacturing operations.

In contrast to that view, there is also the likelihood of a tangible negative impact resulting from the deluge of low-cost value added imports with the accompanying loss of income and employment particularly in regional areas of Australia. Further to that, there is a risk that Australia's capacity as a supplier of unprocessed raw materials may be compromised. Australia may become an innovative processing location developing niche products rather than bulk processing.

In summary Australian food processing companies are becoming increasingly aware of three broad issues in relation to China:

- the potential to exploit the growing Chinese domestic market;
- the impact of increased competition from Chinese business in some Australian domestic and export markets; and
- recognition of the significant opportunities which may be available via investment/cooperation in innovation and efficiency gains.

The AFGC encourages the Government to rigorously examine the realistic implications of the risks and opportunities inherent in the Chinese market and its impact on sectors of the Australian economy. The objective of such negotiations should be to produce a comprehensive agreement facilitating increased two-way trade which would flow from improvements in terms of tariffs, customs duties and non-tariff restrictions.

**The Australian Food and Grocery Council  
June 2004**

## References

Australian Industry Group, *China's impact on the Australian food manufacturing industry*, report conducted for the AFGC May 2004.