EMERGING MARKETS

the role and changing environment of agricultural trade reform

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- **With the cycle of international agricultural trade reform negotiations slowing appreciably — the next round of negotiations is not likely to be concluded before 2015 to 2020 — it is clear that a successful conclusion to the current Doha Round of multilateral trade negotiations is of paramount importance to the future of millions of people worldwide.**

- **Some important elements of the changing environment of international agricultural trade reform are identified here, with specific reference to the emerging markets of China and India.**

- **By virtue of their sheer size, India and China both have the potential to significantly influence world agricultural markets. Equally they have the potential to lift millions of the world's poor out of poverty, not only in their own countries but also elsewhere. Both India and China (but particularly India) have also assumed a leadership role among developing country members of the WTO.**

- **Whether and how the Doha Development Agenda delivers concrete outcomes for these countries is likely to strongly influence the positions they assume during negotiations. This in turn is likely to be critical to the success of the Doha Round itself. But the prospects of China and India do not hinge solely on success in trade reform. A range of building blocks need to be put in place to ensure opportunities, both domestically and internationally, can be taken up in a positive manner.**

Developing countries in the Doha Round

The current round of World Trade Organisation (WTO) multilateral trade negotiations — the Doha Development Round — aims to foster the development and growth of developing countries by establishing a balanced and fair set of trade rules and by increasing trade opportunities, particularly for developing countries, by improving access to markets. The Doha Ministerial Declaration signed in November 2001 commits WTO members 'to make positive efforts to ensure that developing countries secure a share in the growth of world trade commensurate with the needs of their economic development'.

Critically, the Doha Ministerial Declaration recognises the importance of trade for development and poverty alleviation: trade as the so-called 'engine for growth'. The Doha Ministerial Declaration also recognises the need to enable developing countries, and especially the least developed countries, to benefit from the multilateral trading system, as well as the need to establish a fair and market oriented trading system in order to correct and prevent restrictions and distortions in world agricultural markets.

That trade is an engine for economic growth is well recognised in international and development economics. However, the interconnections between trade liberalisation, economic growth and poverty alleviation are not automatic, nor

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straightforward. National market conditions reflecting domestic policies, leadership and/or unique national circumstances are also critical to ensuring that opportunities for growth can be taken up in a positive way.

Global poverty: the foundation stone of the Doha Development Agenda

Developing countries currently account for about three quarters of the total membership of the WTO. As a result of this, the current round of negotiations — the Doha Development Round — is focused on issues of particular relevance to developing countries. That the needs and interests of developing country members of the WTO would be central to the current round was agreed in the Doha Ministerial Declaration of 14 November 2001 (see box 1; a full copy of the declaration is available on the WTO web site – www.wto.org).

The moral and economic imperatives underpinning the Doha Development Agenda are well known, but given that the figures are so staggeringly large, there is a danger of becoming inured to their significance. For this reason some key statistics are repeated here.

- According to the United Nations Development Program (UNDP 2004) approximately 1.1 billion people worldwide live on less than US$1 a day: 432 million in south Asia; 323 million in sub-Saharan Africa; and 261 million in east Asia and the Pacific. Another 1.6 billion people are estimated to live on US$1–2 a day.
- More than 830 million people are estimated to be undernourished: 312 million in south Asia; 212 million in east Asia; and 185 million in sub-Saharan Africa. In this context, undernourished is defined to mean consumption of less than 1960 calories a day (one cup of rice is equivalent to 216 calories).
- According to the Food and Agriculture Organisation, hunger and malnutrition result in the death of more than 5 million children every year, resulting in lost productivity and national income in developing countries (FAO 2004).
- The direct costs of hunger worldwide are estimated to be roughly US$30 billion a year and include, among other things, the estimated

Box 1: Extracts from the Doha Ministerial Declaration

(paragraph 2) 'International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The majority of WTO Members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration. Recalling the Preamble to the Marrakesh Agreement, we shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programmes have important roles to play.'

(paragraph 3) 'We recognize the particular vulnerability of the least-developed countries and the special structural difficulties they face in the global economy. We are committed to addressing the marginalization of least-developed countries in international trade and to improving their effective participation in the multilateral trading system. We recall the commitments made by Ministers at our meetings in Marrakesh, Singapore and Geneva, and by the international community at the Third UN Conference on Least-Developed Countries in Brussels, to help least-developed countries secure beneficial and meaningful integration into the multilateral trading system and the global economy. We are determined that the WTO will play its part in building effectively on these commitments under the Work Program we are establishing.'

Source: WTO (2001)

medical costs of treating problem pregnancies and deliveries of anaemic, underweight mothers and the severe and frequent illnesses of children whose lives are threatened by malaria, pneumonia, diarrhoea or measles because their bodies and immune systems have been weakened by hunger.

- The indirect costs of hunger worldwide are estimated to be between US$500 billion and $1 trillion, and include the estimated cost of lost productivity and income caused by premature death, disability, absenteeism and lower educational and occupational opportunities (FAO 2004).
- In the past ten years, China's growing economy has reportedly lifted 150 million people out of poverty (UNDP 2004).
- As reported by Stoeckel (2004) in a report prepared for the Australian Rural Industries Research and Development Corporation, the World Bank has estimated that a successful round of trade liberalisation would potentially lift 320 million people out of poverty and lift world income by US$2.8 trillion by 2015, of which US$1.5 trillion would accrue to developing countries.
- In examining the impact of a reduction in tariff rates on agricultural trade alone (a 20 per cent reduction in applied tariffs by developing countries and a 30 per cent reduction by developed countries), Roberts, Buetre and Jotzo (2002) estimated that national incomes for developing countries would increase by around US$5 billion a year by 2010 and US$7 billion a year for developed countries.

Trade liberalisation and poverty alleviation

The issue of agricultural trade liberalisation and the potential effects on developing countries' output, incomes and trade was examined in detail by Buetre et al. (2004). They noted that agriculture is the largest employer and a major sector (in terms of national income) in most developing countries. In the case of India the agriculture sector accounts for around 60 per cent of the workforce and approximately 23 per cent of gross domestic product (Connell et al. 2004). Buetre et al. also note that agricultural incomes tend to be lower than urban incomes in developing countries, and that poverty rates are higher in rural areas. One implication of this is that increased incomes for participants in agriculture could help alleviate poverty in a relatively direct manner, and that one route to increased incomes for developing countries is trade liberalisation.

Trade barriers, particularly in agriculture, are major impediments to developing countries' abilities to exploit their comparative advantage and increase rural incomes. Trade barriers on agricultural products tend to be greater than barriers for other goods. In addition, the domestic support and export subsidy policies of developed countries tend to further depress world prices for agricultural commodities. This not only disadvantages developing countries that export agricultural products but tends to depress returns to farmers in all developing countries.

As discussed in Roberts et al. (2002), most of the distortions to international agricultural trade and markets have arisen from protection by developed countries (see also Tyers and Anderson 1992). These include a combination of barriers to imports, market distorting domestic support and export subsidies — the so-called 'three pillars' of the current round of multilateral negotiations.

There is no question that these measures hurt the economies of many developing countries through restricting their access to markets and by subjecting their farmers to competition from subsidised products. Improving access to developed country markets, reducing trade distorting domestic support and eliminating export subsidies will unambiguously improve trade opportunities, and hence incomes, for developing countries. Furthermore, if the costs and benefits of reducing government intervention in international agricultural trade were assessed on a full economywide basis, it is likely that the benefits to consumers in developed countries (such as in the United States and the European Union) would in fact outweigh the 'costs' incurred by producers, not to mention the benefits that would also accrue to other agricultural exporting countries such as Australia.

Of course the actual impact on any particular country will differ depending on their individual circumstances. Comparative advantage is important, as are the essential building blocks for growth such as essential infrastructure, legal and social institutional arrangements, well defined and enforced property rights, standards of governance and political leadership, the scope of existing trade relationships (including preferential trade access arrangements) and differences in existing protection measures.

As noted in the UNDP (2003, p. 30) report, 'No country has developed simply by opening itself to foreign trade and investment'. It is important to combine the opportunities offered by global markets with strategies to develop (or reform) domestic institutions and develop business environments conducive to investment and entrepreneurship. This point is echoed in Buetre et al. (2004) who note that there are a number of additional factors that can improve incomes in developing countries, other than trade liberalisation, including education, health standards, infrastructure, institutional arrangements for good governance, commerce and the provision of public goods.

Some of these points can be highlighted by comparing and contrasting the recent experience of countries such as China, India, Viet Nam and Haiti.

China

As discussed in Opalinska-Mania and Roberts (2004), China's emergence from what was effectively a closed hegemony has been occurring for more than two decades with the gradual introduction of reforms that permitted market incentives to have a greater influence on what farmers were producing and selling. Those reforms reflected a change in China's attitude toward the role of trade and a recognition of the shortcomings of the old system. Fundamentally, the old approach entrenched the inefficient use of available resources and resulted in trading activities often being inefficient; enterprises lacked exposure to competition and responded relatively slowly to changing circumstances; governments were continually required to support exporters; and shortages of foreign exchange were common.

China's trade reforms culminated in their accession to the WTO in 2001, signalling a greater preparedness to accept imports and embrace the opportunities provided by export markets. The opportunities created for China through increased trade liberalisation and globalisation, particularly in manufacturing but also in agriculture, have been critical to China achieving sustained economic growth at annual rates not lower than 7 per cent since 1990. As noted by Opalinska-Mania and Roberts, this provided significant benefits in raising living standards, modernising industry and moving China's trade pattern closer to its comparative advantage.

Coelli and Prasada Rao (2003) estimated total factor productivity (TFP) growth in agriculture for 93 countries for the period 1980–2000. Their estimate of the average growth in TFP for China over this period was 6.0 per cent a year, the highest estimate recorded across all 93 countries. Importantly a significant part of this improvement in productivity (4.4 percentage points from the total of 6.0 per cent) stemmed from what Coelli and Prasada Rao refer to as 'catchup', or Chinese industry benefiting from access to technologies, information or business practices that their peers had already enjoyed but which were not readily available in China. China's ability to catch up in this manner directly reflects their increased openness to trade and foreign investment.

Building on this, China has effectively leveraged the information and technology set of their peers and improved even further, expanding their TFP frontier by an average of 1.5 per cent a year. In comparison, the average growth rates in TFP for Australia and the United States over the period 1980–2000 were estimated to be 2.6 per cent a year, which involved no catchup at all. The average growth rate in TFP for India was estimated to be 1.4 per cent over the same period.

Looking forward, China's economic performance is now integrally linked to its international trade performance and its emerging role as a country fully integrated into the global economy. In this environment, China's willingness to embrace an international trade reform agenda in a positive, albeit managed, way is understandable.

India

In contrast, while India is the world's largest democracy, its agriculture has a long history of 'command and control' policies — approximately forty years of policy intervention have left Indian agriculture in a parlous state. As pointed out by Acharya and Chaudhri (2001, p. 3) 'Indian agriculture, on the eve of the third millennium, is in urgent need of a strategy and policy shift … [mainly because of] our unflattering record in putting together less than effective solvents of nutritional poverty'.

Achieving food security has been one of the main focuses of Indian agricultural policy since independence in 1947. As discussed in Connell et al. (2004), the major policy measures currently in place in India were largely introduced in the mid-1960s and include farm input subsidies, minimum price support, public food distribution and trade protection. More recently, it has become increasingly apparent that forty years of national and household food security policies have cost India dearly, not only directly (the food subsidy is estimated to be US$5.9 billion in 2004-05) but also indirectly through lower levels of investment in infrastructure and lower rates of productivity improvement (see the discussion of TFP estimates earlier).

Reflecting these factors, significant economic change is now under way in India. However, with such a high degree of reliance on the agriculture sector for employment (around 60 per cent of the Indian workforce is employed in the agriculture sector), reforms to agriculture are likely to proceed slowly. The dynamics of the relationship between the central and state governments are also likely to moderate the pace of change.

As discussed in Connell et al. the three states of Uttar Pradesh, Bihar and Maharastra make up around a third of the country's population. With their strong agriculture base, the governments of Uttar Pradesh and Bihar strongly advocate anti-poverty programs, rural subsidies and more rural development schemes. In contrast, the government of Maharastra, with its stronger industrial base, argues for more programs favoring infrastructure development, better telecommunication services and industrial development.

Given this situation, it is not surprising that India (as is the case with many developing countries) has expressed concern about the potential short term adjustment costs associated with increased trade liberalisation and appear less inclined to embrace a wide ranging liberalisation agenda within the Doha Round without a range of special safeguard provisions.

Viet Nam

China's success appears to be mirrored in the recent experience of its smaller southern neighbor, Viet Nam. Viet Nam is described as a country that has taken a gradual approach to economic reform (UNDP 2003). Yet, while it has pursued a form of centralised mercantilism — engaging in state trading and using import monopolies, quantitative trade restrictions and high tariffs on agricultural and manufacturing imports — it has rapidly integrated with the world economy, achieving GDP growth rates of more than 8 per cent since the 1980s. By doing so, Viet Nam has attracted considerable foreign investment, expanded trade and sharply reduced domestic poverty (UNDP 2003, p. 28).

Haiti

In contrast, the economy of Haiti has stagnated and all its social indicators are deteriorating (UNDP 2003, p. 28). Despite being a member of the WTO and despite having pursued a comprehensive program of trade liberalisation in the mid 1990s, little progress has been made in integrating with the global economy. In the case of Haiti, essential building blocks for growth, such as good governance and government leadership, have not been developed (or at least have deteriorated rapidly) and have compromised its success.

'Special and differential' treatment

As discussed in Roberts et al. (2002), the provision of special and differential treatment (S&D) to account for the particular circumstances of developing countries is now well established and accepted by the WTO membership. In the current round of negotiations, developing countries are being asked to make lesser cuts to tariffs and domestic support than developed countries and the least developed countries will not be required to make such commitments at all.

It is important, however, that S&D provisions target the development needs and at risk groups in developing countries, and not simply be designed to avoid any obligations at all. Hence, as noted by Roberts et al. an important step in designing S&D conditions is to identify the main underlying problems that developing countries face. Clearly, developed countries' protective measures harm developing countries' economies. However, many of the fundamental problems are wider than that and include internal economic structures and institutions in developing countries that often impede the efficient functioning of markets such as poor government regulations or governance, rigidities in labor markets or a lack of access to capital (Stiglitz 1999).

For countries to take advantage of trade liberalisation to advance their economic well being, Stiglitz notes that markets need to be working well so that resources can flow readily from less productive to more productive activities. If countries pursue trade liberalisation without appropriate market infrastructures being in place, they risk incurring adjustment costs (associated with reducing levels of domestic support and competing internationally) without necessarily enjoying the benefits of a resource reallocation. For example, managing the movement of labor from agriculture to other sectors of the economy is clearly an issue that China has been grappling with for some time.

In the case of China, labor intensive manufacturing (as well as some labor intensive agriculture) has provided, and continues to provide, a productive destination for displaced labor. However, it is not obvious that this is the case in India where poorly functioning markets and a lack of capital infrastructure hamper restructuring efforts. Reparatory domestic policy reform, in addition to any trade reforms, are also required to address entrenched problems affecting market efficiency and industry productivity in India.

Having said that, S&D provisions still need to target the specific development needs of developing countries and not be designed to avoid any obligations at all.

It is also worth noting that many trade distorting protection policies are being pursued by developing countries, slowing both their own development and that of their trading partners, including other developing countries. While a large proportion of developing country exports go to developed countries, a significant proportion of developing country exports also go to other developing countries. For example, over 51 per cent of exports from developing countries in Asia and the Middle East are destined for other developing countries. Similarly, over 30 per cent of exports from developing countries in Latin America and Africa are destined for developing country markets.

With incomes growing much faster among developing countries, trade opportunities with these countries will be critical to future export growth prospects, particularly for the developing countries themselves. If S&D treatment is used to preclude reform in the most protected sectors among developing countries, the broader liberalisation agenda is likely to be compromised. Perhaps more importantly, developing countries themselves, and the poor within these countries, will be the most obvious losers.

The opportunity to alleviate poverty is time critical

To the casual observer it would seem the Doha Development Round lacks the enthusiasm or imperative of the Uruguay Round, at least on the part of the major developed country members of the United States and the European Union. There are no lakes of milk or mountains of butter looming large over the current negotiations, and as noted by Stoeckel (2004, p. 1), 'some believe that without the tragic events of September 11, 2001, there would be no Doha Round of trade talks launched at all'.

Regardless of whether the major developed countries are genuinely up to the task of reforming international agricultural trade, it is evident that the cycle of agricultural trade reform negotiations, held under the auspices of the WTO, is slowing appreciably.

As discussed in Roberts, Nair and Jacenko (2005), not only has the period between each round of negotiations increased, but the time taken to conclude each round of negotiations has also increased, reflecting both an increase in the number of WTO members and an increase in the technical complexity of the negotiations. The Uruguay round of negotiations commenced in 1986 and was concluded in 1994. The current round of negotiations commenced in early 2000 and is due to be completed in December 2005 at the earliest. If this trend continues as it is expected to, the next round of negotiations is unlikely to commence before 2010 and may not conclude before 2015 to 2020. Hence, the outcomes of the current round — enhanced market access, balanced rules, reduced levels of domestic support, etc — will prevail for many years to come.

However, bringing the current round to a successful conclusion will require an enormous effort. International agricultural trade negotiators are planning to meet in Geneva for one week every month throughout 2005 in the leadup to the sixth Ministerial meeting of the WTO in Hong Kong in December. This will likely need to be matched by the research effort of analysts and researchers worldwide who support national negotiators and who, together with negotiators still hold out hope that the Doha Development Round can be completed in time.

Conclusions

Developed and developing countries alike have an opportunity to gain significantly from the Doha Round, but only if negotiators are successful in delivering real and positive reforms. The outcomes of the current round will also be critical to the economic prospects of all WTO members, but especially developing countries, for many years to come and so a successful conclusion to the current round is especially important.

China appears to be well on the way to emerging as a sophisticated and dynamic economy fully integrated into the global economy with a tremendous opportunity to take advantage of the opportunities being presented by international trade liberalisation and globalisation.

For India, however, much more needs to be done than simple trade reform to establish the essential building blocks for growth that they need to maximise the opportunities inherent in their comparative advantage. However, achieving broad consensus on a reform agenda that will inevitably include both winners and losers in the world's largest democracy may well prove to be even more difficult than drawing the current round of WTO negotiations to a successful conclusion.

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Emerging Markets: China and India – Trade policies and future opportunities

'Doing business in China and potential barriers to growth'

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Introduction

I have been invited today to speak on the subject of doing business in China and potential barriers to growth, particularly with regard to Australia's agricultural trade with China. Perhaps the major challenge is being able to do this in 15 minutes given the size and complexity of the China market. I'm always reminded of the quote by the American humorist Will Rogers during a visit to China in the 1920's when he observed that 'the trouble with me is, I been in China too long. If I had stayed a couple of days, I would have had a better idea of China….the more you see, the less you know!"

At the outset I would make a couple of preliminary points:

- China is no longer 'emerging' - it has well and truly 'emerged'. China is now Australia's 3rd largest merchandise trading partner with trade in excess of $25 billion in 2003/04. It is the 3rd largest importer of Australian agricultural raw materials and products, while Australia is China's 6th largest destination for exports of its agricultural goods. While we are currently enjoying a surplus in our agricultural trade with China, this is more than compensated for by an overall trade deficit with China which currently exceeds A$5 billion.. This of course highlights our competitive advantage in rural commodities while China dominates our trade in areas of simple manufactures such as clothing and footwear and increasingly, higher value added products such as electronics and computers. It is also worth considering that China is now the world's second largest consumer of oil, the largest copper user (22% of the world's production), and takes 21% of the world's aluminium (the U.S. uses around 20%). It also produces more steel than Japan and the US combined.

- The second comment I would make is that anyone looking for a standard model or template for doing business with China is going to be disappointed. There are examples of successful businesses with China arising through chance meetings, opportunism and luck. The chances of developing good, sustainable, business will however, be greatly enhanced through a well informed strategic approach involving comprehensive market analysis, planning and due diligence– not surprisingly the things which you would, or should focus on, in establishing any new business, whether in China, or Australia for that matter. There are certainly unique characteristics associated with the China market and I will refer to some of these a little later. However, I sometimes think that these 'differences' are often overplayed and tend to benefit mainly the many authors of books about 'how to do business' in China. This I believe, is particularly the case these days as a new generation of business people, often internationally educated and trained, emerge as the new managers and business decision-makers of an increasingly market oriented and privatised Chinese economy.

In making these comments I don't intend to trivialise the problems of doing business in China. This does often involve frustrating bureaucratic processes, a confusing and complex array of regulations and procedures and other less transparent traps for the unwary new entrant. (Just to keep things in context, one rural newspaper recently carried an article concerning a report by the Victorian Competition and Efficiency Commission about doing business in Victoria which highlighted that ‘businesses had to deal with 69 regulators, 170 Acts of Parliament and 176 sets of regulations covering Workcover, taxation and permits and licences for a whole range of activities’.[1])

However, there is no shortage of people who lost more than their shirts dealing with China. Hopefully, some of my comments today will help people manage their risks more effectively in the future.

The main issue today is to consider how real are the opportunities for Australia to further expand its trade in agriculture with China and what we need to do to capitalise on these opportunities.

Firstly, I will provide a brief outline of the present situation in Australia China bilateral agricultural trade.

<u>Australia - China bilateral trade</u>

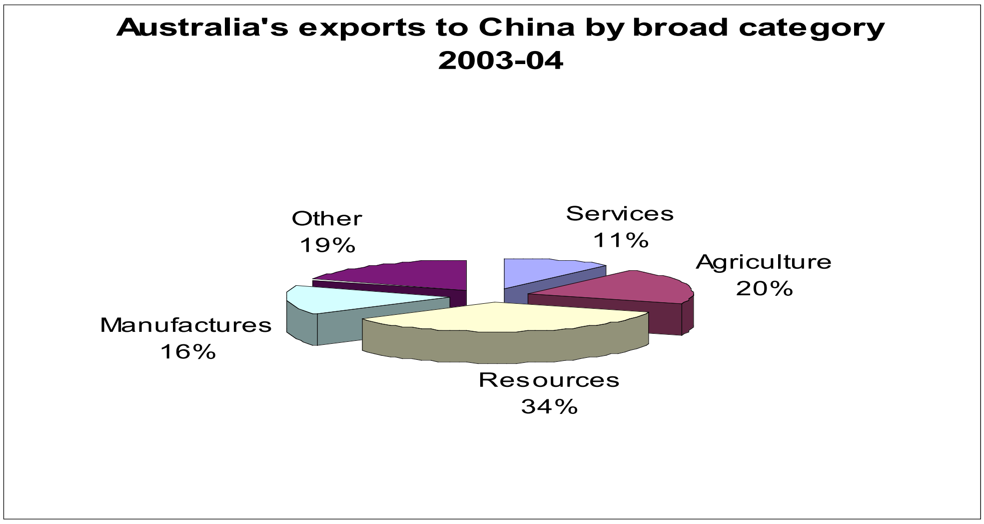
China is now the 7th largest economy (2nd in PPP terms after the USA and having surpassed Japan). During the 1990’s its GDP trebled and it is expected that between 2000 and 2020 its GDP will further quadruple. It is Australia’s fastest growing trading partner with expectations that it will take over as our largest trading partner from Japan, by 2020.

To put this into international context the following table reflects Australia’s merchandise trade with major partners in 2003-2004.

Country (A$mill)	**Japan**	**USA**	**China**
Exports	19,798	9,453	9,912
Imports	16,101	19.945	15,339
Total Trade (exp + imp)	35,899	29,399	25,252
Trade surplus (deficit)	3,697	(10,942)	(5,427)

In 2004, Australia’s trade with China was broadly represented as follows:

[1] The Weekly Times ‘Rules kill job hopes’ Wed. Feb 2, 2005.



Source: DFAT

Much of Australia's export trade growth with China reflects the huge demand which the latter has for raw materials and energy to fuel its economic growth. However, demand for rural products is also increasing significantly and the chart does not reflect the negative impact that the drought and more recently, the appreciation of the Australian dollar relative to the Chinese Renminbi, has had on growth in exports of these products. Australia is well placed to meet China's requirements although these opportunities should in no way be taken for granted or approached with complacency.

China is well aware of the risks of placing too great a reliance on one supplier and is partly responsible for the FTA's which China is pursuing with a wide range of trading partners. While China's accession to the WTO will underpin further developments in trade liberalisation and economic growth, many of the internal structures, regulations and still burgeoning bureaucracy will focus the need for Australian firms to approach the market with up-to-date knowledge… and with caution.

Given continued improvements in Chinese consumers' incomes and standard of living, growth in the so-called 'middle market' and increasing demand for processed foods, China's demand for imported agricultural commodities is forecast to grow by an average of 15% to 2010 with 13.5% per annum expected for minerals and energy[2]. Other research suggests that these projections may be very conservative.

In 1998, China represented around 5.7% of total agricultural exports from Australia and by 2003 this share had increased to 7.3%

Major market growth is expected in broad acre farming such as grains (mainly barley but possibly wheat, if present restrictive and monopolistic marketing arrangements are removed) oil seeds and wool together with livestock and dairy products. Opportunities exist also with beef and sheep meats following new market access agreements negotiated in 2004 as well as with certain horticulture and vegetable products. However, the latter will prove difficult given Chinese intransigence on certain quarantine and regulatory standards which I will mention in more detail a little later on. With regard to industrial raw materials, iron ore will remain our major export item with natural gas projected to increase significantly.

[2] *China Embraces the World Market* (Economic Analytical Unit, 2002)

Australia's Agricultural Trade with China[3]

In 2004, Australia's main agricultural exports[4] to China were:

Export Item	Value (A$M)	% of total
Wool	1,245	49.9%
Cotton	211	8.5%
Raw Hides & Skins	191	7.7%
Barley[5]	144	5.8%
Live Animals	140	5.6%
Animal Oils & Fats	130	5.2%
Crustaceans	69	2.8%
Crude animal materials	63	2.5%
Dairy	63	2.5%
Meat (excl. bovine)	58	2.3%

Australia's key agricultural imports from China included:

Import Item	Value (A$M)	% of total
Crustaceans	56	14.7%
Cereal preparations	34	8.9%
Other food products	33	8.6%
Fruit juices	32	8.4%
Sugar confectionary	26	6.8%
Preserved vegetables	25	6.5%
Fresh vegetables	20	5.2%
Preserved fruit preparations	18	4.7%
Fruit and nuts	15	3.9%

China's Share of Selected Australian Agricultural Exports 2000-2004

Export Item	% 2000	% 2004
Greasy wool	34	52
Raw cotton	1	22
Cereals (mainly wheat & barley)	5.3	2.6
Oil seeds	43	0
Live Animals	1.5	17
Raw Sheepskins	54	39
Animal fats	40	59
Meat & Offal	1	1
Dairy	2	3

[3] Source: DFAT 2005
[4] Note: Wheat export value is not included and is recorded as a confidential item.
[5] Jan-June 2004 only – latter 6 months 'confidential item'

Sugar & confectionery	2	2
Fruit & nuts	1	1
Seafoods	2	6
Wine	0	0
Wood	2	7
Wood pulp	6	31
Paper	7	6

Australia's Share of China's Imports 2004:

Export Item	**% 2004**
Greasy wool	84
Raw Sheepskins	66
Animal fats	63
Live Animals	49
Cereals (mainly wheat & barley)	27
Dairy	12
Wine	12
Sugar & confectionery	9
Meat & Offal	8
Raw cotton	6
Wood	2
Paper	2
Wood pulp	1
Fruit & nuts	1
Oil seeds	0
Seafood	0

<u>Prospects for Trade Growth</u>

The bulk of Australia's export trade with China is made of primary commodities and agricultural products worth an estimated A$5.3 billion in 2003. Total bilateral agricultural trade was A$2.2 billion of which Australian exports made up A$1.8 billion and imports from China were worth A$337 million.

As mentioned earlier, our supplies of minerals and energy will play an important role in meeting China's increasing demand for raw materials to fuel its industrial growth. At the same time, increasing population growth, improved income levels and living standards and increasing pressures on China's domestic food production will see demand for food imports increase by an estimated 24% over the next two decades.

Australia is well placed to respond but we will need to address significant problems in accessing the market.

<u>The Chinese Agricultural sector</u>

In order to appreciate the significance of agriculture to the Chinese (and indeed, the world) economy it might be useful to provide a brief profile. This might also point to certain areas of sensitivity within the agricultural sector which leads authorities to sometimes take what appears to outsiders, as irrational protectionist actions.

It should be recognised however, that China is also a large agricultural exporter in its own right, particularly in products such as horticulture and vegetables, poultry, aquatic and seafood products which accounted for 68% of farm exports worth US$12 billion in 2004. China also now exports live sheep and cattle to markets in the Middle East (after some 8 years suspension). It is also significant that the majority of Chinese farm exports are handled by foreign-funded and private businesses.

To a large extent agriculture and regional development have lagged behind overall economic progress because of previous central planning approaches which focused on sectoral development programs rather than adopting more integrated strategies. This has resulted in segmenting and fragmenting the economy with inefficient utilisation of resources. The sector has also suffered from a combination of distortions resulting from production subsidies, price intervention and a range of taxes on farmers to fund rural infrastructure. Recently steps were taken to remove taxes in 22 rural provinces which should help to improve farmer incomes.

However, despite recent growth in farm incomes (from all sources) it is sobering to consider that the average yearly income of Chinese farmers was still only around US350 in 2004 while annual income directly from agricultural production accounts for US$211 per rural family.

Around 800 million of China's 1.3 billion people rely on agriculture and the sector employs around 50% of the total workforce. However, less than half of rural incomes are now derived directly from agriculture. In general, rural incomes are substantially below those in urban areas, often 40% or less, and the income gap is increasing. At the same time, unemployment (and underemployment) continues to rise and in some cases, are accelerating as reforms are introduced to increase productivity. This highlights the continued sensitivity of the agricultural sector in China to increased market access. In fact, some estimates suggest a further 70 million people will become unemployed from agriculture (added to current estimates of around 100 million surplus or under-employed workers) during the current decade to 2010. The vast majority will exit agriculture not because of WTO but because of productivity improvements and restructuring which would have been required in any event.
This presents a major challenge to Chinese authorities and has been the basis for rising concerns about social security and stability. It is also one of the reasons that Chinese agricultural development is focusing on labour intensive rather than land intensive crops. Concerns about water availability and land degradation are also of increasing concern and key drivers to restructuring agriculture.

The sector is also constrained by lack of opportunity for private ownership of land in order to aggregate production and achieve better scale economies and provide for increased mechanisation to raise output and productivity. Until fairly recently, land was owned by village collectives and was leased to farmers. Leases were of relatively short duration which provided little incentive for development and little opportunity for land to be use as collateral for rural credit. Lack of rural credit facilities has been a major constraint on development. There are indications that the situation is gradually improving. However, while the agricultural sector was one of the first to be given flexibility in production, prices and marketing in response to market forces rather than government intervention (with the exception particularly of wheat which continues to be controlled and subject to intervention), government continues to play a major role in Chinese agriculture.

Apart from income disparity, the rural sector is also well behind urban development in terms of education, and other social benefits – although recently taxes have been lifted which will help redress some of the financial disadvantage.

However, the education issue is a very significant one, particularly if authorities are to improve work force skills and productivity and also, provide greater opportunities for value adding to agricultural production. Much of the requirement is for practical training and re-skilling programs and the Australian TAFE system provides a potentially valuable model for rural capacity building.

There is clearly a need for effective action to address some of these challenges in the Chinese rural sector and there are equally, opportunities for Australia to use its expertise to assist.

The danger in not doing so increases the possibility of provincial authorities seeking protectionist measures to restrict access and competition – something to watch in any event.

<u>Entering the China Market</u>

Since entering the WTO in 2001 China has continued to dismantle its restrictions on market access for many imported products although there is some disagreement about the true extent of these changes. It has however, made significant progress in reducing tariffs, increased import quotas, provided greater access for private traders to purchase and market agricultural products and reduced or eliminated the monopolistic role of State Trading enterprises (the role of COFCO as the designated single procurement agency for wheat is a notable exception – but then we need to be a little careful on the subject of single desk activities ourselves!).

However, there remain significant barriers to entry in the Chinese market, both official and unofficial, at and beyond the border.

Barriers to Market Access

A wide range of areas can represent barriers to entry for products and services imported into China. Border issues tend to be relatively transparent while post –border procedures and arrangements can be quite opaque. Some of the main barriers to entry are as follows:

- Tariffs
- Quotas
- Sanitary and phyto-sanitary standards (biosecurity)
- Customs procedures, documentation and charges
- Trade rules and regulations
- Statutory inspection and testing
- Customs valuations
- Licensing and intellectual property (protection)
- Product conformity

Following China's accession to WTO commitments were negotiated for:

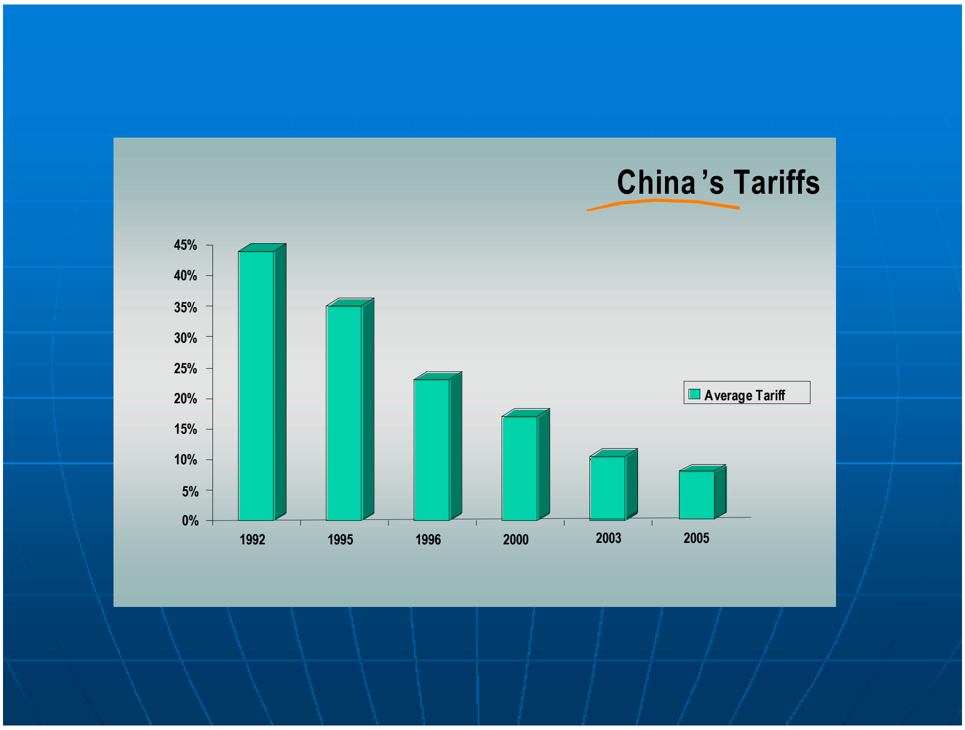
- Secure, improved market access (with built in growth)
- Tariffs bound (i.e. guaranteed)
- Elimination of unjustified non-tariff measures
- Phase out of designated trader regulations and procedures
- Adoption of international standards for testing and product conformity
- Increased transparency of rules, regulations and administrative procedures

In practice China has met many of its obligations although progress in reform of certain of the above list is open to debate.

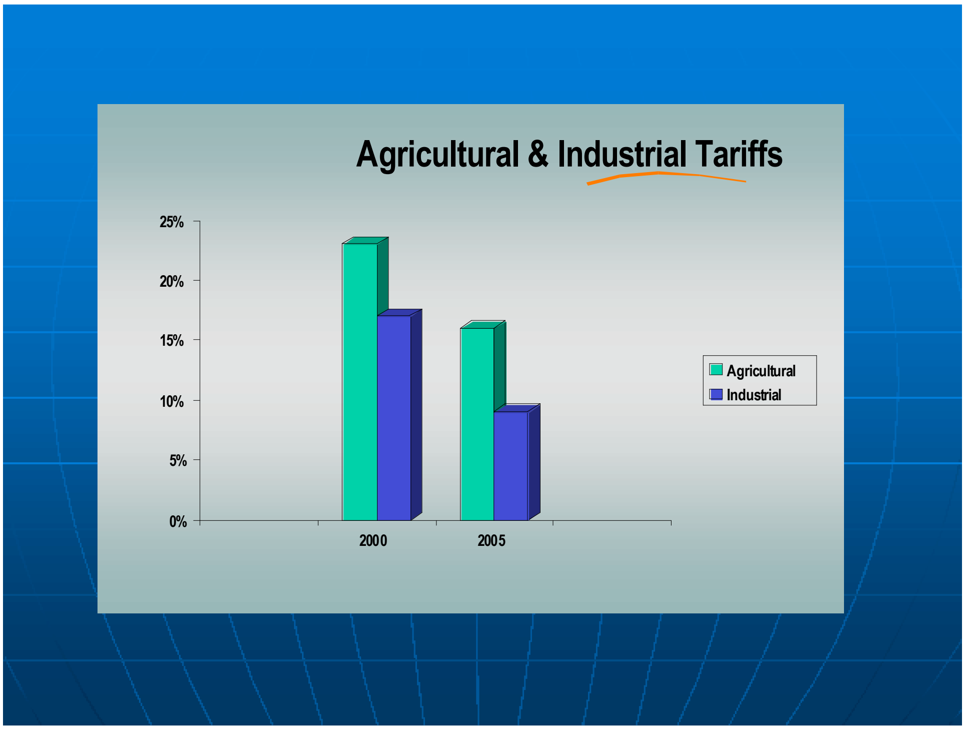
Overall, the Chinese government has made positive progress in addressing many of the systemic issues associated with agricultural imports and quota administration. However, many commentators noted something of a slowdown in implementation of WTO requirements over the past year or so particularly in areas of agricultural reform, intellectual property protection and trade in services. This has also involved preferential treatment for domestic businesses at the expense of foreign businesses (differences in registered requirements for foreign compared with domestic companies is one case in point).

Tariffs

The following chart demonstrates China's progress in reducing tariffs:



Turning initially to tariffs the average tariff rate has fallen from around 40% in 1992 to 15.3% in 2001 and 8.9% in 2005. However, the tariff reductions affect industry and agriculture differently. Industrial tariffs will fall to around 9.8% while agricultural tariffs are likely to remain higher at 15.8%.



Post WTO tariff adjustments on selected Agricultural products

Product	Pre WTO Tariff	2004 Tariff
Chilled Beef Cuts	45%	12%
Milk Powder	25%	10%
Apples and Pears	30%	10%
Lobsters & Prawns	30-35%	10-15%
Oranges	40%	11-12%
Barley		3%
Grapes	40%	13%
Wine	65%	20%

Non tariff barriers exist mainly as tariff rate quotas which apply to a number of agricultural exports from Australia. Under these arrangements, guaranteed *global* access is provided for a specific volume of imports (although this volume need not be fully utilised) at a preferential or low tariff. Imports above the agreed volume are subject to a much higher, generally prohibitive, tariff rate.

Post WTO quotas (Tariff Rate Quotas – TRQ)

Product	Global Quota Volume -2004	In-quota tariff
Sugar	1.94 mill tonnes	15%
Rice	5.32 mill tonnes	1%
Cotton	894,000 tonnes	1%
Raw wool/wool tops	367,000 tonnes	1% - 3%
Canola	1.243 mill tonnes	9%
Soybean Oil	3.59 mill tonnes	9%
Rapeseed Oil	1.243 mill tonnes	9%
Wheat	9.6 mill tonnes	1%

The real issue however, is not so much the volumes involved but the quota allocation process which can be unnecessarily bureaucratic and non-transparent.

Quota Administration

Certainly, in the past this was a major area of concern, particularly given the lack of transparency associated with quota administration. With wool for example, Chinese authorities operated a system which involved release of quota to approved or designated traders up the 3 times each year, although release dates and volumes were often not announced until release. In addition, the quota was subsequently divided again between those buying for domestic consumption ('general' trade) and those buying for processing and re-export ('processing' trade). In addition, the authorities further complicated matters by also operating what was known as 'political' trade. No one knew how much wool was available in each category but preference was given to export trade. This caused considerable trade disruption, price spikes, development of a secondary market (leading to higher domestic prices) and often delivery of what was available rather than what was required to produce cost effective and good quality product by the mills. Many of the designated or licensed importers were traders with little interest in quality, only trading margins.

New arrangements are now in place from 2005 which will see quota allocated once a year and cessation of the designated trader system. However, while quota will be allocated on a first come first served basis, applicants will be granted quota on the basis of previous performance. New applicants will however, be restricted to 300 tonnes in the first year. Quota therefore, remains an obstacle for certain Australian exporters into China.

Statutory Inspection

A second non – tariff border issue which has caused (and continues to cause) concern and disruption – as well as additional costs to importers (and exporters as any costs would undoubtedly be passed back in the form of price limits) is mandatory inspection. This generally involves a requirement for certain strategic or sensitive imports (usually food and fibre) to be subjected to sampling and testing by Chinese authorities (AQSIQ) prior to acceptance. While China has agreed as part of its WTO commitments to adopt international standards for product assessment and conformity there are many examples where this is still not the case. In many instances Chinese domestic standards have precedence over international standards, resulting in delivery delays, quality claims and accusations of corrupt payments to officials for release of goods. There are continuing arguments about inconsistency between Chinese domestic sampling and testing standards and international standards and this is the area which is still to be effectively addressed.

This does not necessarily suggest dismantling China's import inspection regime and in fact, there are examples of poor quality products and livestock being delivered to China which would tend to reinforce arguments for such border protection. The argument however, is that adoption of international standards and proper contract specifications (which I will address in more detail in a moment) which accurately describe the goods or services being supplied and which are supported with internationally accepted test certificates and documentation, should exempt such goods from unnecessary bureaucratic delays and procedures.

Sanitary and phytosanitary measures (SPS Agreement)

Provision has been made within WTO for an agreement covering food safety and animal and plant import controls known as the SPS Agreement.

Clearly, these are important issues particularly given recent experiences in China (and other countries) with imports of infected animals, animal products and contaminated food stuffs. Border biosecurity will remain a high priority and a sensitive trade issue and we need to ensure that SPS measures do not become an excuse for domestic protection – although international experience including actions by both China and Australia suggest that this might be wishful thinking!

As an example, an update on progress regarding market access for a wide range of agricultural products was obtained recently from the Australian embassy in Beijing[6].

A summary of various of these is presented below:

- *Wheat and barley* – former subject to monopoly buyer and thus has significant market power. China's market strength is highlighted by the fact that it is the largest wheat market representing one-sixth of world consumption and responsible for imports of around $700 million. However, measures have been taken to protect the domestic market including production subsidies and spurious quarantine action over a fungal grain pest.

- *Wool* – subject to continued bureaucratic intervention through quota administration and mandatory inspection based on domestic sampling and testing standards. Different tariff rates and quota apply to raw wool (despite the fact that this includes some semi-processed wool) and to wool tops. While a new more flexible quota arrangement came into effect this year, there was a delay between termination of the 2004 quota allocation and release of the new 2005 quota. This created uncertainty and higher risk for shippers over the intervening period.

- *Cotton and Sugar* – are also subject to quota administration which is bureaucratic and lacks transparency. It is difficult to obtain information on quota holders and the size of their quota allocation. This can also precipitate contractual defaults when contracts are entered into with buyers who do not have quota or insufficient quota. A potentially significant development for Australian cotton exporters is a decision by the NDRC and AQSIQ to reform the system of cotton quality classification with international standards based on tested parameters (High Volume Instrument Testing – HVI). If adopted, this will replace subjective appraisal to domestic standards by Chinese authorities which has resulted in quality disputes and contractual problems. However, it is expected that it will take five years to phase in the reform during which both systems will co-exist with potential for further confusion.

- *Livestock* –there are concerns about testing of live animals for diseases which are either not present in Australia or are present in both Australia and China. Chinese authorities will not permit vaccination of animals and refuse to recognise certain disease free zones in Australia. In addition, Chinese slaughter-houses are State controlled with little option but to co-operate with whichever facility livestock importers are allocated.

- *Meat and offal* – China is Australia's third largest market in North Asia for sheep meat and the second largest offal market. Not withstanding significant existing trade, access agreements had to be negotiated and meat processing facilities individually approved by Chinese authorities. New labelling requirements were introduced partly to reduce smuggling and product substitution. However, at this stage approvals have not been obtained for tripe (the largest export item in this category), pork, poultry or game.

[6] Private Communication M. Schipp Australian Embassy Beijing

- *Tallow* – faces similar import testing problems as wool. Results are often different to those using international standard test methods and occasionally, between testing facilities at different ports.

- *Semen and embryos* – the current requirements are for collection of genetic material to be supervised by an AQSIQ veterinarian. This challenges the viability of the trade.

- *Dairy* – Australia is the third largest exporter of dairy products to China and is responsible for a quarter of its total imports. Dairy cattle exports increased dramatically over the past few years, particularly after a successful program by Dairy Australia associated with the Chinese government's introduction of milk to school children. More than 60,000 live cattle were exported last year although there were some concerns by Chinese authorities abut the quality and condition of some consignments presumably due to shipment of drought affected stock. The problem with dairy product exports is that these are restricted to shelf-stable products due to import testing requirements which involve products being held until completion of testing. Perishable products are negatively affected by this requirement. There is also increased sensitivity and surveillance by Chinese authorities regarding quality and malpractice in food production and marketing following a major scandal involving soy substitution in milk last year.

- *Seafood and crustaceans* - while there is significant trade it is difficult to obtain import permits which promotes 'grey' or illegal trade. Much of the trade is controlled through Hong Kong based interests.

The previous comments concern existing agricultural trade items but it is worth mentioning that there is a list of new trade opportunities waiting in the wings which are also the subject of some protracted and frustrating market access negotiations.

Some of these include:

- *Citrus* – suggestions that Chinese authorities wish to extract further concessions or benefits notwithstanding that risk assessment has been completed for some time.

- *Apples* – although access for Tasmanian apples was negotiated in 1998 the relevant trade protocol requires Australian authorities to conduct surveys and testing for diseases which do not occur in Tasmania.

- *Mangoes* – access approved in late 2004 but requires that AQSIQ must inspect and approve orchards, packing houses and treatment facilities prior to export.

- *Table grapes, other stone fruit, bananas, lychees* – while AQSIQ has received applications for access it has yet to commence pest risk analysis.

- *Pork, poultry, game meat* – access negotiations commenced in 2000 and concluded late 2003.

While many of these issues and obstacles will be eventually overcome Australian exporters must face the prospect of continuing bureaucracy and intervention on the part of Chinese authorities, some of which might be the basis of legitimate concerns and some which might be considered disguised protection. It is also important to note that these actions will not only cause frustration at the border but we might also expect to run into various forms of domestic intra-provincial protection.

A brief overview of the Chinese agricultural sector might help to understand some of the issues affecting agricultural trade and attitudes to market access.

<u>Prospects for growth and implications for agricultural trade with Australia</u>

While China is largely self sufficient in food production, with it having the world's largest ratio of farmers to arable land, income growth exceeding population growth by an estimated 7% per annum and increased demand for land for residential and industrial developments likely to lead to a decline in available farming lands, China's dependence on food imports must be expected to increase.

For example, as mentioned earlier, the dairy sector is one which offers significant growth opportunities for Australia. However, milk production is also on a growth curve in China and is expected to reach 25 mill. tonnes by 2015 (a 270% increase over the level of production in 2000). Recent reports indicate that dairy production accounts for only 1% of China's total agricultural output compared with around 20% in many developed economies. In addition per capita consumption of dairy products is around 13kgs, well below the world average of 100kgs and nearly 300kgs in developed countries.

There are many factors which will significantly influence the nature and performance of the agricultural sector in China and its demand for imported agricultural products from suppliers such as Australia. These will involve economic, political, social and environmental considerations. I would like to touch on a few of these before getting down to some of the more basic issues of doing business in China.

It is also worth noting that Australia is highly regarded by the Chinese consumers for its natural produce and this is something which we need to capitalise on in future marketing and branding strategies. Recent market research confirmed that consumers rated the Germans as leaders in engineering precision, the Swiss for watches, French for style, Japanese for electronics, Americans for technological innovation and Australia for natural resources and related products.

Some of the key drivers likely to influence Australia China agricultural trade in the future include:

Continued economic growth both domestically and in those of major trading partners is clearly essential to China being able to maintain and expand its demand for imported commodities and raw materials. There are always issues of major external shocks or indeed domestic crises such as financial collapse with implications for social stability which can arise but China has demonstrated an ability to cope with such situations. However, there are plenty of expert commentaries on this subject and I will leave it to them to argue various scenarios. My view is that the probabilities are in favour of continued growth with extension of privatisation and market based systems, and improvement in legal and administrative support to complement these. This should strengthen future demand for Australian exports and investments, including in China's agricultural sector.

Future Agricultural Land-use Policy will in the main, reflect China's comparative advantage in labour compared with land. This position will underpin an increasing focus on labour intensive crops such as fruit, vegetables , aquaculture whilst land intensive production such as grains, cotton and corn will face increasing pressure from alternative land use options, including urban and industrial development (during a recent visit to China it was interesting to recall just how much of the land bordering the highway from Shanghai through Suzhou to Nanjing has now been transformed from farming land to satellite cities and industrial zones) and increasing environmental restrictions as a consequence of over grazing, excessive fertiliser use, inefficient water use and poor crop productivity. Greater focus will however, be placed on value-adding of raw products (including packaging, processing and distribution) which will increase farm returns and generate increased employment opportunities. This needs to be underpinned by more education and re-training programmes, an area where Australia has particular expertise and which is of increasing interest to the Chinese .

Considerable potential exists for substantial growth in exports to China of Australia's broad acre grain crops, particularly if the current interventionist policies concerning wheat marketing in China are removed while exports of Australian livestock, dairy, meat and fibre products derived from grazing, also offer significant growth potential – although. However, some of these activities have relevance to sensitive social and political issues.

Socio-political considerations are also important in China's agricultural policy.
There is of course the overall question of rural employment. It is suggested that China needs to generate more than 50,000 new jobs each day in order to cope with current unemployment, some 14 million school leavers entering the workforce each year and 10 million or so being shed from restructured ministries and State-owned enterprises. As indicated earlier, a large proportion of the unemployed and underemployed, come from the rural sector.

Grazing and livestock breeding are important elements of the rural economy and in some cases are the only form of enterprise available to some groups . In particular, maintaining the livelihood of certain ethnic minorities such as the Muslim Uighur people in the remote Western Provinces such as Xinjiang, is of concern to the Chinese Government. Wool production is one case in point – with the Chinese authorities concerned that they need to 'protect' the interests of such communities from the impact of imports from countries such as Australia. However, as applies to the agricultural sector more generally, protection is not the answer. Rather, adoption of new technologies, improved management practices, productivity improvements and more efficient rural marketing systems would yield a better overall result.

Water is looming as a major issue for China. On one hand it needs to increase food production to meet an expected peak demand from a population expected to increase from 1.3 to 1.5 billion people by 2030. Not only is there increased demand on water for agriculture but also increasingly to meet residential needs and industrial demands as development extends further into rural areas. Industry will most likely take precedence given greater product value and employment generating benefits. Lack of water availability particularly in the north which is also the location of most of China's current land intensive crops such as wheat, corn, soybeans and cotton, and in turn are heavily dependent on irrigation, has prompted some (such as the U.S. National Intelligence Council) to predict that China will need to import 175 million tons of grain by 2025 and over 200 million tons by 2030 – the current level of total world grain exports![7] (Australia's total wheat exports were around 11 million tonnes in 2003-03.) However, the latter NIC report highlights the likely inability to meet this demand with obvious consequences for international prices and potentially, international security considerations.

There are at the same time, opportunities for more efficient water use such as sprinkler and drip systems, to replace the mainly flood irrigation practices commonly employed. Australian expertise in irrigation systems and water recycling, particularly in the North where water shortages (river, catchment and aquifer) are becoming critical, offer would be relevant here. Water pricing will also be a critical issue and this will perhaps require a two-tiered approach taking into account that on the basis of product value and employment industrial projects will always win out against those in agriculture. The

[7] US National Intelligence Council projection

Chinese government will be anxious to ensure that future water use is will remain a priority for its agricultural sector.

Rural Infrastructure is a major constraint on production, marketing and distribution of Chinese farm products. Lack of roads, transport, storage, modern slaughter and meat processing facilities, freezer facilities and refrigerated transport are also lacking or are grossly underdeveloped and inefficient. It is estimated for example, that current rail infrastructure is meeting on one third of demand. Problems of distribution and cross border trading are also exacerbated by protectionist actions of some provincial authorities restricting access and imposing excessive regulations and requirements.

Again, there are also opportunities here for Australian organisations to establish joint ventures and other commercial relationships and enterprises to develop infrastructure and facilities.

Another consideration however, particularly for those investing in processing or manufacturing, is the problem of power availability, particularly in less developed cities and regions. Power blackouts and rationing have been increasing as China attempts to cope with the massive increase in energy demand. At this stage, development of power, distribution and other related infrastructure is falling well short or requirements. Can China respond? It's probably worth noting that the Chinese have added in 10 months the equivalent of Australia's total power-generating capacity and this will be doubled in 2005.

Exchange Rates have always played a significant role in Australia's trade with China particularly given the price sensitivity of many of our raw materials to Chinese buyers. There is some evidence that this is not as significant as in the past, reflecting greater emphasis on quality, last cost rather than first cost in manufacturing operations, and the fact that China simply needs these raw materials to fuel its economic growth. In the short term at least, it recognises that it has to pay higher prices that it might wish. As far as purchases from Australia are concerned this situation has been exacerbated as the US$ has depreciated against many international currencies including the A$. (The Chinese Yuan is pegged to the US$ at 8.26 Rmb to 1 US$.)

The US$/A$ exchange rate has declined as follows:

	1999/2000	2000/2001	2002/2003	2003/04e	2004/2005f
Exchange Rate US$	0.63	0.54	0.52	0.71	0.74

As a consequence, Chinese buyers have faced price increases for Australian goods in domestic currency terms of more than 20% since 2003 and expectations are for further increases due to a weaker US$ (and Renminbi) over the next year.

The Chinese government is under increasing pressure to revalue its currency, seek a new non-US$ peg perhaps through a trade weighted basket of currencies or widen the current trading range for the Yuan. The latter is considered the more likely and of course an appreciation of the currency would be good news for Australian exports. An exception perhaps is in the case of raw materials for goods to be re-exported where markets would face higher prices.

Changes in quota arrangements for trade in textiles and clothing are likely to be of particular benefit to China and indirectly, to fibre suppliers such as Australia.

As part of the WTO's Agreement on Textiles and Clothing, quotas which have been in force for many years under the Multi-Fibre Agreement will be removed in 2005. Superficially at least this is good news for Australian fibre exporters with further growth expected in Chinese global textile and clothing exports and consequently, increased demand for raw materials. Exports of these goods has seen double digit growth rates in the past 3 years with the total value of textile and clothing exports expected to exceed US$90 billion in 2005.

However, it might be said that the 'forces of darkness' are gathering as many importing countries and regions, most notably the US and EU strive to limit imports from China with imposition of temporary safeguard measures including new quotas. China has attempted to deflect this action by imposing export taxes on textile products but further protectionist actions can be expected. If the Renminbi is revalued as some suggest, this will take some heat out of the situation. Overall however, this is unlikely to significantly affect Australia's exports of wool and cotton but it needs to be closely monitored.

A bilateral Free Trade Agreement between Australia and China is another factor which will loom large in bilateral developments between the two countries. I do not intend to deal with the issues surrounding the proposed FTA here as this will be the subject of numerous reviews, commentaries and reports over the coming months. However, I would like to make a couple of comments.

The first point is that it will not be 'free' trade - it will be about 'freer' trade.

If the subsequent negotiations lead to removing or reducing existing barriers to trade, 'fast-tracking' resolution of outstanding issues such as some of those mentioned earlier, an intellectual property rights protection regime which works in practice and elimination of formal and other less visible restrictions on effective business dealings, the exercise will be worth the effort. I am firmly of the view that this will be the case. We have to keep in mind also that China is already in negotiations with a number of countries which are competitors to Australia's exports to China and we need to ensure that we are not disadvantaged as a consequence of these.

Much has been made about Australia's acceptance of China as a 'market economy', as a prerequisite to negotiations. Some trading partners have already conceded this point, including New Zealand, another prominent agricultural exporter. While it might be argued that 45 million sheep can't be wrong, New Zealand doesn't have a significant manufacturing sector like Australia. The concern of Australia's manufacturing sector is primarily that by giving market economy status in to China in place of its present definition as an 'economy in transition' (EIT), this would reduce our ability to invoke anti-dumping legislation if warranted, on Chinese imports. This matter has been the subject of debate for some months and I do not intend to open up a 'new front' today. The issue is mainly about determination of a 'fair price' or 'normal value' for Chinese imports and use of surrogate, or third party pricing if anti-dumping claims can demonstrate that Chinese pricing is unreliable or not market based (e.g. fixed by the State). The assumption seems to be that by retaining EIT status, a surrogate pricing approach is essentially automatic in China's case, as a basis for establishing dumping margins. However, whether China is defined as a market economy or EIT for antidumping purposes, existing legislation appears to be adequate. In either case (i.e. as an EIT or a market economy), exporters are required to provide verifiable and accurate information to Customs officials. If this is not the case, surrogate or third party information will be used.

On this basis, there appears to be little argument for rejecting the market economy definition and jeopardising negotiation of matters of much greater importance to Australia's long term bilateral trade with China.

At the 'Coal Face' – working at the enterprise level

Perhaps a poor choice of words for this section given China's deplorable safety record in mining! It might however, serve a purpose in highlighting risks in approaching the China market and the need for effective risk management strategies. Entering the China market can be a daunting experience, particularly for those doing so for the first time. As one recent newspaper item noted, ‘where China is concerned there is a long history of foreigners shedding their normal caution and being transported by heady visions of limitless gain. Where else, after all, offers so many opportunities to participate in such a phenomenal growth story? And whatever the risks of plunging in. how much greater are the risks of being left out?[8]’

However, many of the things required to be done are in fact, no different than those which (should) apply to any market.

The positive is that we now know a lot more about doing business in China and there are now many resources available to assist new entrants navigate through the ‘front door’ and beyond. Certainly we have come along way down the track from the perceptive observation attributed to Charles de Gaulle that ‘China is a big country inhabited by many Chinese people’

Much of the information required needs to reflect the diversity and complexity of the Chinese market place. Not only are there 33 provinces, municipalities and special administrative regions, but there are 56 ethnic groups with 53 dialects, a wide range of climatic conditions throughout the country, diverse cultures and tastes all of which will influence consumer demand for products. And Beijing and Shanghai do not represent the rest of China, politically, economically or socially. In addition, the population is increasing by over 13 million a year, 25% of the population is under 15 years and 30% is urban based. Half the population earns less than US$2/day.

The Delegation – necessary… or nuisance

Delegations have been part of the China Australia trade relationship for the past couple of decades. They can be time consuming….and time wasting….but they are an essential part of doing business and can be important in generating new opportunities or enhancing existing relationships. The issue is to determine the delegation’s real motives for the visit, whether business or tourism (or perhaps a combination). Requesting details of the delegates and their positions, the organisations they represent and their objectives, and expectations from prospective meetings is a good starting point before agreeing to a meeting. It might also be prudent to seek advice about the delegation from Embassy or Consular officials for background and checking of bona fides of delegates.

The good news is that in the main, delegations today are serious about discussing business and will provide quite detailed, specific and sophisticated materials about who they are and opportunities they wish to discuss.

However, some initial background research can save considerable time and money.

Market research –realistic market projections

This highlights that an essential starting point is proper market research….and *realistic* market projections. It is not a matter of - 1 sock to every Chinaman …and that takes care of the Australian wool clip! A major mistake it to extrapolate demand for a particular product, particularly one which might only be relevant to a niche market.

Much of the necessary information is available and while official statistics are at times open to question, the China Statistical Yearbook is a ‘good read’. However, Australian government agencies such as DFAT, Austrade, ABS and ABARE all have comprehensive trade information. There are a number of web-based resources, commercial organisations (such as major legal firms operating in China), consultancies (such as TradeData Ltd which will help manipulate Chinese trade statistics to find out which countries are exporting, to where (including not just port of discharge but also

[8] Financial Times ‘Investors are drawn to China in spite of the risks’ Tues. Feb 1, 2005 p13

final destination) and price details, and Asian Demographics Ltd which will provide a detailed analysis of population structure, income distribution and other material relevant to your particular market segment or target) together with industry associations such as the Australia China Business Council, which provide regular briefings on the business environment in China as well as wide ranging business contacts with valuable experience in dealing in the China market.

However, 'on-the-ground' research has been rather more problematic. It is often difficult to get financial and performance details about particular firms and independent asset valuations can be difficult during due diligence activities. On many occasions in the past, requests to view facilities or particular processing operations have been met with the 'age-old' reply of 'the man with the key is missing'! In fact there have been books written on this subject.

Things are improving but 'transparency' still remains an obstacle to business dealings in China. The US Trade Representative Bob Zoelick referred to this in a paper last year in which he mentions that the concept of transparency is not widely recognised in commercial dealings and indeed, there is an old Chinese saying that 'fish that swim in clear water do not survive'![9]

Communication

Of course, communication represents a major barrier to doing business in China. It is important to ensure that you have someone to assist who can interpret what is being said rather than simply translating literally what is said. The subtlety here is to *understand* what is being said. It is also important that the person doing this job is working in your interests and is not simply saying things which you might like to hear! It is rare for Chinese to give a blatant 'no' to a question even though that's exactly what they might mean. Notwithstanding the many dialects, most discussion will be in Putonghua or Mandarin Chinese – although on occasions when things are getting' complicated, it is not uncommon for the discussions to break into Cantonese or Shanghaiese which can completely confuse your team. It is also important when arranging transliteration of documents that correct language is used and translated documents in English and Chinese have the same meaning and equal status.

As English speaking is becoming more common among Chinese there is also a risk of assuming that the Chinese party understands clearly what you are saying (Australian slang aside!) and also, that he or she is working in your best interests. This is often not the case and good spoken English should not be the only basis for selection of your interpreter or representative.

Representation

Associated with the above is the need for appropriate and effective representation in subsequent dealings with the Chinese market. Again, someone who is not only linguistically well equipped but understands Chinese 'thinking' and business practice can mean the difference between success and failure. From my experience this is a key decision point for those operating in the China market.

Personal Relationships

The importance of personal relationships has been a fundamental part of doing business in China. It certainly has precedence over formal agreements such as contracts and rule of law. Indeed, to a large extent it is probably as a consequence of the failure of rule of law and of legal processes failing to resolve disputes that so much emphasis is placed on

[9] USTR Robert Zoellick from a paper presented to the US Asia Society Annual Dinner 'China and America: Power and Responsibility' 24 Feb. 2004

building relationships. In some respects this is not too different from doing business elsewhere, except that in China's case when things go wrong, having to depend on the local legal jurisdiction is rarely considered a preferred option. This situation is changing but it still is well entrenched in Chinese business culture.

Much of this has historical roots, as one Chinese colleague informed me, 'we were brought up to be suspicious, even of one another'. With foreigners this is probably more accentuated given centuries of colonial exploitation. As a result in Chinese business negotiations, there is generally a fairly lengthy period of contact, including banquets and seemingly endless discussions before a business agreement is reached. It is about developing trust and loyalty which when established can be regarded as permanent.

Another side to the importance of the personal relationship is about being able to successfully navigate through the layers of bureaucracy and regulations which can test the finances and the patience of many newcomers – irrespective of their size and reputation.

Relationships can be invaluable in 'fast-tracking' the many bureaucratic headaches which can otherwise occur. Finding someone with good *'guanxi'* or connections to influential business operators or Government officials can be invaluable. But mind you, there will be no shortage of people purporting to have such contacts – and sorting out their bona fides should be a major priority for your Chinese representative of advisor.

'Face' is another character to be aware of in personal dealings within Chinese people. This is a difficult concept for Europeans to understand – myself included. In essence, it's about giving someone status or esteem in the eyes of their peers, and better still, their superiors, or in avoiding embarrassment to them. It is also one of the reasons why many Chinese officials and businessmen like to have photographs taken with important people, politicians, business leaders and celebrities. Giving someone 'face' can count a lot towards a successful business outcome. Conversely, I have seen foreigners criticise and make fun of Chinese individuals or their business operations making them 'lose face' in front of their countrymen. Loss of face to someone who might be in a position to influence a negotiation or agreement can be disastrous.

Again, I'm sure that if we were in the same position we would probably respond in the same manner.

Training and 'familiarisation' programs

Linked with the issues of communication and relationships are the benefits from building knowledge, loyalty and commitment to your particular product or service. The usual response from exporters is that Chinese buyers are only interested in paying the lowest price – considerations such as quality and service have been of low priority (except when market prices fall and they wish to make a claim). This has certainly been the case in the past but it is changing…slowly. It has much to do with the fact that much of the purchasing of raw materials and commodities was carried out in the past by designated traders, or State trading monopolies. These people were not so concerned with processing efficiency, manufacturing yields or consistent and higher quality.

As more and more Chinese firms are privatised, this situation will change. More attention will be paid to last cost rather than first cost as these firms focus more on their bottom lines. Assisting firms and buyers in this process by providing training in understanding the particular attributes of your product or in improved processing technologies which can contribute to improved profitability, and better quality products which in turn can command higher market prices, will lead to lead to increased demand and a stronger commercial relationship. Therefore, arranging training programmes in China and particularly in Australia where buyers and processors can have direct access to seeing how your product is grown, packaged and marketed and quality programmes associated with these activities, can be a very valuable investment.

An extension of this is to share more market information with your customers. During a market survey a couple of years ago which questioned Chinese buyers about the level of information their Australian suppliers provided to them, most were critical that very little was provided other than daily price quotes. Very few suppliers took the trouble to provide more detailed market reports.

In addition, many firms mentioned that they seldom met principals or senior executives of the Australian supplier companies, leaving such contact to their Chinese agents. This also can be a major mistake as it impacts directly on the strength of the supplier – buyer relationship and has negative implications for 'face' for both the buyer and for your agent who can benefit from having a senior executive visit with him or her. Like any such relationship it highlights that you care for the business and for the people directly involved in it.

Contracts and dispute resolution

The present 'flexible' attitudes to formal business arrangements, agreements and contracts are linked in many respects to a number of the issues just discussed

We often hear that Chinese place little reliance on contracts, preferring to use these as general guides and leaving considerable flexibility for negotiation…and potentially, claims. Perhaps it is a reflection of the importance that Chinese place on personal relationships (and these are indeed very important in business) or perhaps it's due to a lack of legal infrastructure to enforce contracts in case of dispute.

In contrast most Westerners rely much more heavily on a contract incorporating details of goods and services to be transacted, payment, shipment and documentary requirements and procedures to be followed in case of claim or dispute.

Personally, I have a view that much more education should be provided to the Chinese about the importance of contracting in line with international practice – notwithstanding reluctance by them to change 'historical' practices. This should be about good risk management and clear statements about what is being transacted and the obligations on both parties clearly stated.

It is also worth mentioning that we continue to see cases where Australians have visited China and returned with a Letter of Intent or Memorandum of Understanding which are often misinterpreted as some form of contractual obligation. In reality such documents mean little more than 'let's speak some more about this matter'!

The wool industry's experiences during the 1990's, is an interesting example on this subject.

Contract defaults and reneging were almost an art form at that time mainly (but not exclusively) as a consequence of Chinese buyers responding to falling international prices and wanting to renegotiate already agreed contracts and prices, failing to open Letters of Credit and implementing claims on sometimes (but not always!) spurious quality arguments, and minor documentary discrepancies. Wool exporters often sought financial retribution by subsequently delivering poorer quality, cheaper components in deliveries.

This essentially became a no-win game ('trench warfare' was a good description by one of my colleagues) for the mill end-users who suffered processing difficulties and sub-standard product quality – a situation which was not in the interests of Australian wool producers or Chinese manufacturers – while Australian exporters experienced high financial risks and in some cases financial collapse. In many respects, the situation was of the Chinese government's own making, as the problems were compounded through the fact that wool could only be purchased by so-called designated importers who were licensed to obtain import quota. Many of these traders had little regard for quality of deliveries and were interested only in extracting the highest trading margins possible. The authorities also issued quota twice or three times each year – announcements were not public and quota allocation was subject to considerable malpractice. To add to the market distortions created by the quota administration process, Chinese authorities also, unilaterally, further separated the quota into wool for the domestic (or general) trade, wool for the export (processing) trade and 'political' trade. Transparency was not a feature of the business and little information was made available about what quantity was allocated to which category. This inevitably led to a thriving black market in quota trade also with the consequence that mills had to pay a premium during periods of quota shortage and the chances of mills getting the correct quality of wool was often minimal.

This issue prompted the Chinese Minister for Trade, Wu Yi and Australia's Deputy Prime Minister and Minister for Trade, Tim Fischer to agree to the formation of an industry and government working group to develop an improved contractual framework for wool trading. After an extended negotiating process taking almost 3 years, a Model Wool Contract was finally introduced. This incorporated 3 essential features:

- A greatly improved specification format for the materials being contracted based on use of internationally accepted scientific test methods
- General terms and conditions covering payment, shipment, documentation and claims procedures based largely on Incoterms 2000
- Dispute resolution process based on CIETAC arbitration and provision for selection of expert arbitrators through a panel of internationally approved wool trade experts. (Dispute resolution through a credible arbitration system such as CIETAC has a better track record than pursuing claims through litigation. The critical issue is the ability to enforce awards or judgements and CIETAC appears to have the required channels to achieve this.)

It would be incorrect however, to suggest that this contractual framework was universally embraced by both sides. Much is still needed in educating businesses in both countries of the benefits of proper contracts not just as a safety net in case of dispute but as an accurate means of specifying the goods or services to be supplied, obligations on both parties for payment, shipment and documentation and an agreement to an approved, credible dispute resolution process.

It is also important that the contract should be written in English and Chinese and have equal meaning and status in both cases.

Governance and due diligence

Should the trading relationship lead to opportunities or proposals for investments, ventures or acquisitions the need for proper legal advice is essential. The further away these prospective ventures might be from the main business centres, generally, the greater the need for caution.

Ensuring proper asset valuation, compliance with local regulations, determining land ownership and so, can be difficult to establish. Quite often, extracting details of financial performance and other information from prospective Chinese partners or takeover targets will vary from challenging to impossibility.

Problems are compounded where State-owned assets are involved and as one observer commented recently 'the process in China is inherently flawed because the people who decide on what price should be paid for the assets are usually the officials who are leading the acquisition'. Alternatively as was the case a few years ago, asset valuations of some SOE's were based on replacement value rather than historical value despite the fact that many of these assets were obsolete. According to other reports, central and local governments also are happy to sell off smaller, loss-making enterprises while retaining control of the larger companies in strategic sectors. In 1998 there were 238,000 SOE's which have now been reduced to around 150,000.[10]

<u>In Conclusion…..</u>

China offers the most important growth opportunity for Australia's export trade for the foreseeable future. Improved incomes and living standards, continued urbanisation, pressure on land and water resources will all contribute to increasing demand for Australian raw materials, agricultural commodities and processed foodstuffs. Additional impetus will come from the forthcoming Beijing Olympics in 2008 and the World Expo in Shanghai in 2010. Both of these events will attract millions of international visitors and China will be anxious to showcase itself as a sophisticated, progressive economy. This will heighten demand for Western style products including more processed foodstuffs – a trend which is already underway.

But we won't have things all our own way.

Competition from other supplier countries, barriers to market entry involving increasingly, technical barriers, SPS issues and intra-provincial trade protection will represent major challenges. Internally, enforcement of intellectual property rights protection, an effective legal and arbitration system, improved corporate governance and transparency need to be seriously addressed. Progress has been made and is continuing to be made by China in improving the business and regulatory framework. Hopefully, the forthcoming bilateral trade negotiations will also assist this process although I suspect that certain issues might also be slowed down as the negotiating parties seek particular concessions.

We also need to take note that in our own 'back-yard' that we need to keep pressure on infrastructure development and productivity improvements in Australia, particularly in shipping, rail and road transport to ensure that we remain internationally competitive and continue to build a reputation as high quality suppliers of agricultural products and raw materials. Responsibility for our future export demand and performance does not rest entirely with China!

We will however, be dealing increasingly with a new generation of younger dynamic business people in China, many with Western education and business experience, who are pushing ahead hard for increased privatisation of the Chinese economy - and with it reduced government intervention and bureaucracy. This will be a positive driver in building a dynamic trade relationship.

As I have stressed today, the focus needs to be on Australia building its relationships with China – at the political, business and even personal level with key decision-makers. We need to demonstrate that we are reliable, efficient suppliers willing to work with China to build its marketplace and to develop new partnership opportunities with Chinese companies to jointly take advantage of other international markets.

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[10] Financial Times p8 Tues Feb 1