



The turn of the new millennium has seen the world's most populous nation, China, emerge as an economic powerhouse. In 2004 China will lay claim to 6 percent of world trade and analysts predict this will rise to a staggering 15 percent by 2015. China's recent entry into the World Trade Organisation (WTO) marks another important step in its integration with the world economy.

The implications of China's economic coming of age are significant. There will be few countries whose own economies will not be affected. In this article we look at the factors driving China's emergence as an economic giant and also provide some insight into how this might affect Australia's investment markets and the opportunities and threats China's growth poses to Australia's economy in the years to come.

Population and change

Strong economic growth is not something new for China. In fact, China has experienced average GDP growth of about 8 percent for the past 25 years. This steady growth has been driven by a combination of factors including a rising population, changing culture and education, as well as structural changes to a number of key industries such as manufacturing and agriculture.

China's population is currently about 1.3 billion and is expected to rise slowly to reach about 1.4 billion by 2015*, even though the country's one child policy means the fertility rate in China has dropped by more than half since the 1970s. However, the population continues to grow because the number of people born each year still outnumbers the number of deaths by 2 to 1.

More significantly, China is slowly transforming from a state controlled collectivist economy to a market based system. As a result, more and more Chinese are moving from rural areas to live in cities. Chinese society is also changing as more and more people turn to education in order to become successful. In 2000, nearly 46 million Chinese completed university and 141 million completed high school.

As China becomes more urbanised and educated and incomes rise, the Chinese consumer is demanding higher standards of quality and hygiene. New supermarkets and shopping malls are starting to open in major Chinese cities everywhere to meet the changing needs of Chinese consumers, particularly young well-educated professionals.

With China having a massive low cost workforce, it is rapidly becoming a world force in labour intensive processing industries. Going forward, more raw materials will be required to process into products on behalf of other countries, particularly those in nearby Asia. China's economic structure is expected to continue to change rapidly with the private sector gradually replacing the state-owned sectors and the manufacturing and services sectors growing at the expense of agriculture.

Accession to World Trade Organisation (WTO)

After years of negotiation, China entered the WTO in 2001. This has resulted in the gradual introduction of a number of structural changes to China's trading position designed to limit barriers to international trade. These changes are expected to improve access for foreign direct investors and provide many new opportunities in business for Australia and other countries.

Entry into the WTO is a significant challenge for China because it commits the government to adopting a raft of trade and investment changes that will gradually open its economy to the challenging forces of global competition. While mineral and energy tariffs have been low for several years, China's entry into the WTO should gradually promote more commercially based trading arrangements. At the same time, China is also undergoing other essential reforms in the finance, agriculture and infrastructure sectors and is making significant reforms designed to strengthen its regulatory regime.

*United Nations median estimate

There is a concern that the huge pool of low cost labour that exists in China means that China will eventually dominate world manufacturing. However, many of its exported products are made using a high number of imported components from its Asian neighbours. Therefore, the large increase in trade between China and the rest of the world needs to be seen in the context of the increase in overall trade with Asia.

At present, Australian firms export a range of raw materials including iron ore, crude petroleum, wool, aluminium and coal to China and Australia imports a range of products including clothes, shoes, toys and computer equipment. China is also buying more and more services especially in the areas of education and tourism. The gradual opening up of the Chinese economy will mean more export opportunities for countries like Australia.

Impact on investment

While many Australian companies invest in China, most are small. About one third of these companies are in the manufacturing sector, one third in property and business services and the remainder in a diverse range of other sectors. With China's need for foreign direct investment, there will be more investment opportunities for Australian companies.

Australia is already a major destination for Chinese foreign direct investment. Most of this investment is in the resources sector, particularly iron ore and the remainder is spread across many smaller Chinese businesses operating in manufacturing and a range of service sectors.

In global commodity markets, China is a heavyweight consuming approximately 31% of global coal, 27% of steel and 25% of aluminium. While some of China's growth has been fuelled by western demand for its exports, much of the investment boom occurring in China is driven by the country's internal needs eg. construction of infrastructure and housing in new cities.

There is little doubt that China's growth has underpinned the performance of Australia's resources sector over the past few years. Many commentators have questioned the ability of China to maintain these strong growth rates and it is inevitable some slow-down will occur particularly as China adjusts to meet WTO requirements.

A slow down in the Chinese economy would undoubtedly have a negative effect on commodity markets. However, on average forecasters, including the Australian Bureau of Agriculture and Resource Economics (ABARE), predict that China's economy in 2005 will continue to grow at a similar rate to its average for the past 25 years (about 8 percent).

Opportunities for the Australian economy

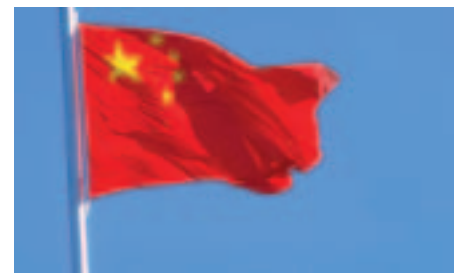
China has become a very important trading partner for Australia. The most recent figures reveal that China has risen to become Australia's second largest export market with total merchandise exports to China worth just under \$10 billion. Like other countries, Australia is looking to position itself for the next stages of China's growth with trade policies that match China's increasingly open and flexible economy.

WTO related tariff cuts and agricultural reforms in China should ensure an expanding market for Australian agricultural products in China. China currently imports raw materials such as wool, barley and canola seeds from Australia and with Chinese consumers expected to spend more on food products including meat there are more opportunities in this area in the future. Although competition for a share of this market will be intense, Australia has an advantage in that it is seen as being a source of clean, safe and wholesome food products.

Over the past 10 years China has experienced huge growth in its industrial and infrastructure sectors. This is expected to continue for at least the next decade and should underpin continued high Chinese demand for Australian minerals and energy exports. Reforms to China's mining sector should see the closure of many uncompetitive Chinese mines and this should also benefit Australian producers of iron, copper and alumina. Further, as ongoing mining reforms encourage more foreign investment, there is likely to be higher demand for Australian mining equipment, inputs, services, technology and knowledge.

China's rapidly expanding manufacturing sector is a two edged sword for Australia. Some Australian manufacturers, particularly those in the textile and apparel industries, will find it very difficult to compete against low cost Chinese imports. But higher consumer incomes and domestic demand in China should lead to new opportunities for some Australian manufactured input suppliers and finished goods exporters.

China's services sector now accounts for about one third of economic activity. Up until recently tight restrictions have limited China's purchasing of foreign services and foreign investment in the services sector. China's entry in the WTO commits it to gradually opening most of its service sectors including the finance, education, tourism, telecommunications and professional services industries. These reforms are expected to create many new opportunities for Australian service suppliers.



Conclusion

Not only is the Chinese Dragon awake, it is breathing fire and its ascension to the WTO means it will soon have a powerful set of wings. Little wonder some of the world's major economies are nervous about the growing power of this economy.

Australia's economy is not big enough to be threatened by China. Its huge supply of natural resources and relative close proximity compared to Europe and America, means Australia is very well positioned to benefit from increased trade and investment opportunities with China.

The main threat to Australian markets from China is the possibility of any significant slowdown in the Chinese economy. However, although analysts expect some slowing of China's economy in the next year, over the long-term most agree the country's GDP growth will average a very healthy 8 percent per annum.