

## **Australia-China Youth Dialogue**

### **THE CHINA AUSTRALIA RELATIONSHIP: RECOGNISING THE CHALLENGES, GRASPING THE OPPORTUNITES**

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14 October 2011

## **Introduction**

Thank you Henry for that introduction. It's a great pleasure to be here with you tonight.

After your rich program of speakers this week, you don't need me to stand here and tell you how important Asia – and especially China – is to Australia.

That's a given. It's why the Prime Minister has announced a White Paper looking at Australia's engagement with Asia. It's a recognition that Australia needs to become even more Asia-literate, to better understand Asia in all its dimensions – political, economic and cultural – and to position our economy and society appropriately to respond to the challenges and opportunities that the Asian century will create. And China's role in that Asian century is central.

Forums such as this can make an important contribution, bringing together the people that are the future of the Australia-China bilateral relationship.

You've already covered a wide range of issues, from the role of the Chinese diaspora to Australia's indigenous challenges, our trade relationship, the creative industries of both countries and, of course, China's international role.

What I would like to focus on tonight, as you wrap up the 2011 Australia-China Youth Dialogue, is a few of the key challenges and opportunities that you will face as future leaders and drivers of our bilateral relationship.

### Challenges for Australia

Let me start with two key challenges for Australia. First, we are facing a situation where our major economic partner is not one of our major strategic partners – what does this mean and how should we respond? Second, how do we effectively manage the sheer scale of our economic relationship?

Australia's economic relationship with China is crucial. Australia's strategic relationship with the United States is at the heart of our overall approach to foreign and security policy. How China and the United States interact with each other in the decades ahead is of fundamental importance to Australia and the region as a whole. As a significant regional economy and a strategically important country to both China and the United States, how Australia manages its bilateral relationships with these world powers matters.

We have a strong and complementary economic relationship with China which benefits both our countries. We should do all that we can to continue to build on it – in traditional sectors such as resources and energy (for Australia) and in manufacturing (for China), but also in the services sector and agriculture. But we shouldn't just trade – we should also build the investment relationship in ways that ensure we both prosper as our economies grow.

But our different histories, political systems and strategic interests mean there is potential for tension that each country will need to work at if we are to manage our relationship.

We must recognise there are some areas where we will have to agree to differ, while respecting each others view points.

It is also important that we have systems in place to help minimise or address these tensions to ensure they don't impinge on the development of our strong, overall relationship.

At a government level, we have a strong network of bilateral dialogues which provide opportunities for our two countries to engage on issues ranging from economic ties to climate change, defence relations to human rights.

To further these contacts I will be travelling to China myself in November to meet with a range of senior officials, business people and other experts.

But broader people-to-people links are also crucial and Australia needs to strengthen its 'China literacy'; in a literal sense, as well as commercially and culturally. We need more people like yourselves, studying each other's languages, histories and cultures and, most importantly, developing friendships.

We could also be making greater use of less formal engagement, for example through social media networks. These networks, blogs and so on can help us understand the issues that concern our respective societies and that are being debated by the general population.

Our strong trade relationship with China is itself another challenge for Australia. China's rise has been accompanied by a rapidly growing demand for energy and mineral commodities. And growth in China's manufacturing sectors has led to an increased global supply of low cost manufactures.

Australia, as a net exporter of resource commodities and a net importer of manufactured goods, has benefited from China's development, and our terms of trade are at record levels. But this has also contributed to our 'two-speed economy'.

Our trade-exposed industries outside the resources and energy sector have come under great pressure. The high exchange rate resulting from the terms of trade has undermined the competitiveness of parts of our economy, while the profitability of the resource and related sectors is bidding away skilled labour. As I have said elsewhere, it is as if we woke up one morning to find the world had made us richer. But to benefit, we need to accept that labour and capital will need to be deployed differently to the past, and that some sectors and firms will need to grow more slowly so that the more productive can grow faster.

We need policy settings which facilitate these changes, rather than trying to impede them. This means policies to promote investment, innovation, education

and skills – policies which can increase our ability to innovate and capture new opportunities and which will deliver the productivity gains we need to continue to lift our living standards.

Given the volume of our bilateral trade, an issue that attracts great attention is Australia's exposure to policy missteps or major economic fluctuations in China. This is important, but of itself is nothing new. In the past we have been reliant at various times on markets in the UK, US and Japan. What is new is that, unlike China, those economies were not themselves trying to manage their own massive structural transformation – which, in turn, raises the probability of policy mis-steps. China is not unique in this respect – those of us old enough need only think back to the challenges of adjustment, including our own policy mis-steps, as we opened our economy in the 1980s and early 1990s.

As a result, though, it means that it is imperative we ensure the Australian economy retains the flexibility to adjust to shocks. This sort of flexibility has been a defining feature of our strong economic performance in recent decades; a performance that has seen us ride out the Asian financial crisis, the dot-com bubble and the global financial crisis, delivering two decades of uninterrupted economic growth and lifting living standards significantly.

The flexibility of our currency; the independence of the RBA; a clear medium term fiscal framework; and a strong and well-regulated financial sector – all of these are fundamental to Australia's ability to manage the impacts of external volatility.

As are the right domestic policy settings in areas such as taxation and competition policy, water and energy pricing, labour and infrastructure. This will help ensure that we are in a position to maximise the benefits to Australia from our relationship with China, including from investment inflows that are likely to both expand and diversify across many areas of our economy.

We have a strong relationship, but we must not be complacent about it – we need to be aware of the challenges the relationship presents for Australia and to think actively about how we should address these.

### Challenges for China

For China the challenges are, of course, different, given both China's size and its stage of economic development.

Two particular challenges I see are fulfilling the role not just of a responsible stakeholder in the international community, but of a major global power, and also managing an increasingly complex economy to sustain growth even as China's population ages.

Greater economic weight will bring greater strategic weight. China is widely expected to be the world's largest economy within the next decade, measured in purchasing power parity terms, and is increasingly perceived as a rising global super power. The Pew Global Attitudes survey, released in July, shows that in 15 of the 22 nations surveyed, the balance of opinion is that China will replace, or has already replaced, the US as the world's leading superpower — and this view has increased substantially over the past two years.

Whatever the truth of that perception, with greater prestige and influence comes greater responsibility and an expectation that China will contribute to the provision of global public goods — and provide global economic leadership.

China's emergence has benefitted greatly from the existing rules-based multi-lateral economic, financial and trade system. The stability and further development of the world economy can only be a net positive for China.

China is a key member of the G20 and it has had its representation on the IMF and World Bank increased to more closely align with its economic weight.

However, greater representation doesn't guarantee greater effectiveness for these institutions.

China will need to work constructively to help address major global challenges, including rebalancing global growth, addressing climate change, finding a way forward for global trade liberalisation and supporting efforts in Europe to address the sovereign debt crisis.

By virtue of its sheer size, no major global public policy issue will be capable of resolution without China. But if China is not seen as engaging constructively on these issues, its interests will ultimately suffer.

Of course, while China looms large in absolute terms, it is still at a relatively early stage of development. GDP per capita, in purchasing power parity terms, is only 1/6<sup>th</sup> of US levels. And even by 2016, when it is expected to become the largest economy in purchasing power parity terms<sup>1</sup>, per capita GDP will still only be less than one quarter of that of the US.

China faces a daunting and complex domestic reform agenda as it shifts towards a more consumption oriented economy. As it confronts issues like financial market reform and climate change policy, China is at a stage of development where whole of economy reforms are more economically desirable and necessary, rather than isolated pilot-style reforms which have been used in the past. But whole of economy reforms require strong political will – just like in western democracies, China's leaders will need to tackle stubborn vested interests!

This alone is already a difficult task, yet it will also happen at a time when Chinese society is ageing – China's latest census shows its population is growing more slowly than in the past, but with a sharp rise in those aged 65 and

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<sup>1</sup> IMF World Economic Outlook database, September 2011

over. UN data projects that the share of people of working age (15-64) in the total population will start to fall from 2014.

While China will continue to benefit from freeing up relatively inefficient agricultural labour, there will no longer be an impetus to growth deriving purely from an expanding labour force.

Beyond this re-orientation of the existing workforce, China will need to increasingly rely on productivity to drive growth. Promoting technology innovation, industry upgrading and competitiveness will help. Importantly, this requires better resource allocation – and ultimately a more market-driven exchange rate.

That aside, it is worth noting that many of the challenges that China faces are also being grappled with by policymakers elsewhere, including in Australia. We are also anticipating the consequences of an ageing society and we also face the need to improve our innovative capacity and productivity performance.

So there is a common dimension to many of the challenges and it serves everyone to have an open debate, in forums such as this, about the challenges we face, and also the opportunities.

### Opportunities

In a relationship growing as fast as the Australia-China relationship there are of course a wealth of opportunities.

China is Australia's largest two-way trading partner with total two-way trade worth over \$100 billion last year.

The complementarity of our interests, particularly in resources, has long underpinned the relationship, but trade in services has become increasingly



important and shows great potential – particularly given the growing middle class in China.

China is our largest source of foreign students, making up nearly 30 per cent of all international enrolments as at August this year, and tourism from China has grown steadily.

But other services such as financial and professional services and mining services have considerable potential for increased cooperation.

Australia is also well-positioned to meet other demands of an increasingly affluent society, for example in foods and beverages – dairy, high quality meats, and of course our fantastic wines – which I hope you've all had a chance to sample over the last week.

There is also a great deal of potential in our bilateral investment relationship. Contrary to what some believe, Australia very much welcomes investment by Chinese companies, as demonstrated by the fact that between 2007-08 and 2009-10, the Government approved over \$50 billion of Chinese investment in Australia).

But while Chinese investment in Australia has increased considerably, it is starting from a low base. At the end of 2010, China had become our 12<sup>th</sup> largest investor. However, it still has less than 1 per cent of the total stock of inward investment – the largest investors are the US (28 per cent), UK (24 per cent) and Japan (6 per cent).

And investment is a two-way street. World-class Australian companies also want to invest in China and would like to see greater opportunities opened up to them.

Of course, Australia is not alone in seeking to increase and broaden its bilateral ties with China – the rest of the world is doing the same. The Shanghai World Expo in 2010 was the largest ever held, demonstrating the worldwide interest in China.

This means Australia cannot take the relationship for granted – we need to continue to work to strengthen and expand our ties. While capitalising on our complementary trade and investment relationship and our position in the Asia-Pacific region, Australia must also boost our engagement in other areas – including further strengthening our people-to-people links and improving our understanding of the Chinese language and Chinese history.

The transformation of the global economy currently underway will help define the coming century. As we stand at its start, the opportunities and challenges it presents will be a constant of your working life.

I hope you have found your dialogue to be productive and interesting – perhaps it has even challenged you to think about our two countries in new ways, or from different perspectives. For my part, I hope this dialogue continues and makes an ongoing contribution to the Australia-China relationship.

Thank you.