Transcript

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Item: **RIDING CHINA'S BOOM: PROSPECTS, POSSIBILITIES, PRESSURE POINTS.**

CONFERENCE HOSTED BY MONASH UNIVERSITY AND ASIA INC FORUM, WITH FORMER PRIME MINISTER, BOB HAWKE, AUSTRALIAN INDUSTRY GROUP CEO, HEATHER RIDOUT, AND BUSINESS COUNCIL OF AUSTRALIA PRESIDENT, HUGH MORGAN.

SPEAKER: HEATHER RIDOUT, CHIEF EXECUTIVE, AUSTRALIAN INDUSTRY GROUP

HEATHER RIDOUT: Good morning everybody, and it’s a pleasure to be here as a presenter of Australian perspective, and it’s a great pleasure to share the platform with Dr Fan Gang, a fellow economist of course; Bob Hawke, who’s a very distinguished Australian, an old friend of our organisation; and Hugh Morgan from the Business Council, who are also very close to the Australian Industry Group.

We’ve had a very long association with China. Mr Wang Jinzhen is here from the CCPIT (China Council for the Promotion of International Trade) and we heard him speak last night.

We've had an MOU with CCPIT organisation and MTIA for 25 years. We had the very first dedicated Austrade officer in China for metal and engineering products, over 20 years ago, and the Chinese, at a very different stage of their development, working with us all over Australia, all through that period. So, it's been a very long engagement and a very rich one, and I hope it continues.

As many of the speakers have said today, the impact of China on the affairs of the world is momentous; it goes to the power balance in Asia, to shaping the future of world industry.

China is setting, very importantly in our industry, the world price for manufactured goods, not just the Chinese price, it's the world price. And it's providing, as we've seen, the major growth driver for the world economy.

The Economist recently commented that global inflation, interest rates, bond yield, house prices, wages, profits and commodity prices are now being increasingly driven by decisions made in China and that Wall Street should be named Great Wall Street, which is quite amusing. They also argue that in fact this situation will continue for a couple more decades.

But as Dr Fang has noted, the economy is going through a number of transitions and some at a very fast pace.

The first is from an essentially feudal to a modern economy which is engaged with the rest of the world. And when I visit our factories in Suzhou, for example, and I meet young people who just months ago were from peasant regions, now working in very modern factories, enjoying Western lifestyles, going to nightclubs like my kids do – my older ones anyway, I hope – in Shanghai at night. And in such a short period these transitions are made; it’s quite remarkable.

The second change is a political one which is clearly much more difficult for Chinese authorities to acknowledge. While the political system established in 1949 is essentially intact, it needs to be broken down to accommodate the increasing wealth and the impact of modern technology. However official resistance remains.

The third transition is an economic one. When you compare the China of today with a decade ago, as we’ve all noticed, it’s quite extraordinary. But the one figure I’d like to talk about is that out of the 832 million people in the world brought out of poverty in the last 20 years, 727 million of those have been in China. So if there’s ever an argument for economic development, China has really made it and now I know it’s a pretty fine line, but it is an extraordinary achievement.

The fourth transition is from a humble country to one which is much more confident about its future and one that is demanding its place and status in the world. The Chinese are seeking a Grand Slam tennis tournament. They want, and arguably deserve, a place at the G7 table. They are planning an extensive space and satellite program and they no doubt aspire to hosting the best ever Olympic Games – but we'll fight you on that one.

China's increasingly aware of the power that they possess and that's the proof of development.

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So what's our perspective on all of this? When I visited Beijing in March, as a guest of the Chinese Government to present a symposium on the FTA, I kept getting told there was this natural fit between Australia and China: 'You have resources, we have manufacturing, you don't have manufacturing, we have resources'. This wonderful word, complementarity.

But I had to ring the bell, because we do have a manufacturing sector in Australia and it's the biggest sector accounting for 13% of the Australian economy, and 45% of Australia's exports are manufactured products. Manufacturing conducts the largest share of private R&D by a country mile in Australia. We provide the largest full time employment sector in Australia.

And the industry, as Bob Hawke would know, has changed remarkably. His Government really started those changes with the deregulation of the product market in the '80s and the changes to capital flows and exchange rates, et cetera. But we are alive and well in Australia, I mean, we're not about to cede our position.

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Australia's Chinese trade, we've talked a bit about that, about 29 billion, $7 billion merchandise deficit, 26% of our exports to China are manufacturing products. Of course, they're dominated by STMs, but they're not without stories of quite remarkable competitiveness in the food industry. Even in the textile industry, Australian companies export fire protection clothing to China, for example. Also mining technology is an area of very strong Australian involvement and I think in the future we can see some improvements in that.

The imports are, of course, so hugely dominated by manufacturing products. And the prices for those are falling constantly. Despite the fact that over the last 12 months our members have recorded around 12% rise in import costs, only half of them have been able to pass on only half of those increases. So the pricing power of industry has been deeply affected.

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The trade deficit between China and Australia is growing and, as you can see, there's a blue line of imports, but the pink line is exports and there's no doubt about it, it's $7 billion and it is growing.

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We did a survey of 848 of our members last year on the impact of China on Australia and 68% said it was the most critical issue affecting their business. Ninety per cent of those 68 are restructuring their businesses in response to China. So that's a remarkable figure.

In terms of the turnover, 40% of companies are restructuring and outsourcing their businesses to China and other countries in Asia, as a response to Chinese competition.

So these are very, very important figures. Encouragingly, 20% of the companies see export opportunities in China, but I must say some 80% see only increased competition in the lo cal and export markets.

SLIDE 5

And we are losing market share as a result of China. One of the most important things to note is big multinationals are acting like multinationals now and changing their policies in response to China. And you can see, we're not holding our share of markets. The blue bars are the growth in our major trading partners, it's for manufacturing, right? So you can see the red line is our exports of elaborately transformed manufactures. This is Reserve Bank data.

Now the blue lines and the red lines usually go together. When we see world growth pick up, our ETMs pick up. In the last few years, we have not been getting our share of that market. Now you can say the currency has contributed to it and I agree, it's been a big factor. But China has also contributed extensively.

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Import share of national spending has grown by two full percentage points in the last couple of years, as has China's share of our markets.

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So there's no doubt, you can't hide from the figures, China is having a huge impact on Australian industry. Will this abate? Unlikely. The official push for growth as Dr Fan Gang has said is not going to let up. The pressure from the rural areas for greater wealth is unrelenting. But also the demographics of China really are driving this.

I was told by a very senior official 'we have to get rich before we get old' and that means it's a race until around 2020, when some of the demographic pressures will really start to cut in.

China's accelerating export growth is amazing. Over the last 24 years, they've grown from 1% of world trade to 6.5. IMA (Asia) expects them to be at 10% of world exports in two to three years time; 15% by the year 2015 and 20% by the year 2020. These are remarkable figures that I think we need to be very cognisant of.

Over-capacity in Chinese manufacturing is continually deflating world prices, and that issue is not going to go away.

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And also China is moving up the value chain. This is a McKinsey chart of US import penetration and it shows import penetration across a broad range of industries. In that dark blue line, by the year 2015, imports from China are going to take an ever increasing proportion of a wide spectrum of markets.

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And that doesn't mean they are vacating low value added industries for high value industries. As we all know, about 230 million or so Chinese live on the eastern seaboard and the great balance live internally. What will happen, in our view, is that low value added manufacturing in China will move increasingly inland. High value added manufacturing will stay on the coast and that will mean that China can do both. And will do both and will have a competitive advantage and a comparative advantage in doing both for the foreseeable future.

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How does this affect Australian industry? Well, we've already seen the impacts. The pressures will intensify. Over 40%, as I said, of our members will be offshoring, outsourcing overseas and that pressure is really intensifying. There's been a real reassessment of supply chains.

I emphasise the point that I made before. Multinationals are not just looking at China, they're looking at it as it shapes their whole strategies. And when multinationals start to act like multinationals, that has huge impacts and we're seeing that in the Australian manufacturing sector. Blow by blow, the sourcing patterns are changing, global investment patterns for R&D are changing, and that will impact on us.

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Increasingly specialisation is certainly happening and this is not without opportunity. But we need to lift our game if we're going to survive. We need increased investment in skills, we have to use our brains in Australia and if we don't, if we keep trying to battle away, descaling manufacturing, we won't make it.

Innovation. In the car industry in Australia, on an average basis, 30% of sales every year are new products, innovative products. In the manufacturing sector generally, that figure is around 19%. We need to get the general sector up to that 30%, which is the automotive benchmark.

Productivity is critical. People say we don't need any more reform in Australia. Well, that idea – and I hate to say the cliché – but it is a real recipe for going backwards. We are losing competitiveness and we have to do something about it.

So there's a broad range of issues there. It's not just wages, it's not just industrial relations reform, it's a broad range of reforms, but we have to do it.

And as the old Chinese proverb says, if you can't avoid it, welcome it, and I think we increasingly have to become more globally focused, looking to add solutions to our manufacturing and we'll be able to have opportunities in China.

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Meanwhile, we must, as I said, maximise these opportunities. The China/Australia FTA, now that we've got through to the start of negotiations, is a very important development. Whatever happens, whether or when we get to the end of that agreement, it will be a tough process.

But I think one of the great things that's going to come out of it is closer relations between Australia and China at a business level and we've already been forging those within our own organisation and I think that will be positive. We have an open mind. We hope we can make gains. We have to be cognisant in tariff and non-tariff areas, otherwise it's a waste of space for Australian industries.

IT is clearly high on our agenda. But, you know, you have to reflect back on the US when it industrialised in the 19th century. It copied European technology, the Japanese copied the US after the War, now China is copying world IT. The solution partly is one of legal protection clearly, but in all those other countries, legal protection only happened when they became inventors themselves and then they had to protect their own IT, so they started to actually support protection of IT.

So in conclusion, FTA or no FTA, we're going to have a very strong engagement with China in Australia and we welcome it. We need to lift our game if we are going to be competitive, there's no doubt about it. Australia as a whole needs to, industry has to. We're falling down the competitiveness scale of the World Economic Forum. Our ladder of competitiveness, our productivity in Australia is very weak compared to what it has been.

Industry has the lead role to look after its own back yard, but government policy has a role and Australia cannot trade off these high terms of trade forever. We made that mistake in the late '70s, when the then Head of Treasury made a very famous speech saying we don't need manufacturing any more in Australia. And it all ended in tears. So I think we just have to learn from the past. You should not make mistakes a second time.

So we welcome our engagement with China. We look forward to doing business with them. We know we have to lift our game if we are going to have success.

Thank you very much.

[Applause]

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