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Current and Future Benefits to Australia from China's Economic Reforms?

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ABSTRACT

The primary focus of this paper is to assess the implications of China's international opening up for Australia. We seek to answer two main questions. What are the factors in China that have given rise to the current resources boom and might there be similar trade and investment opportunities for Australia arising from China's ongoing development in the future? China began its economic reform process in 1979 largely because its economic performance, although not dismal, had failed to keep up with those countries with which China liked to compare itself. Under the new economic emphasis, China's economy continued to grow and the rising incomes of the Chinese people generated an increasing demand for consumer goods which had been relatively unknown in China. This, in turn, gave rise to the need for basic products which China had little capacity to produce. By late 1990s early 2000s basic processing plants had begun to flourish in China giving rise to a world-wide boom in commodities such as ore and coal. This boom continues through to today and Australia, to this point, has been one of the chief beneficiaries. In all likelihood, the commodities boom will continue well into the future although a number of risks are apparent. Australia is confronted by both opportunity and threat. To the extent that the commodities boom continues Australia benefits. But anything that disrupts that boom will have severe consequences for Australia. In addition, the continuation of the boom may be distracting Australians from other potential opportunities that exist in China.

1. INTRODUCTION

There were many remarkable events of economic significance in the last part of the 20th Century. The demise of almost all socialist regimes was possibly the most notable. Within this context, economic reform in China stands out because it happened without any apparent economic crisis to bring it on and because it has largely been considered a resounding success[1]. In 1979, after three decades of an authoritative central planning system (and just a few years after the death of its architect Mao Ze Dong), the Chinese authorities decided to gradually (and to some extent methodically) open up the economy to the influence of market forces – both domestic and, subsequently internationally[2].

It is China's international opening up, and the implications that this has for Australia, that is the primary focus of this paper. We seek to answer two main questions. What are the factors in China that have given rise to the current resources boom and might there be similar trade and investment opportunities for Australia arising from China's ongoing development in the future? We begin in section 2 by briefly analysing the reasons behind China's economic reform. In section 3 the changes themselves and the impact that they have had on the Chinese economy are examined. Consideration is given to China's "opening up" and the resulting changes in external economic relationships in section 4. In section 5 we examine the impact that growth in China had on Australia's resource industry and the likelihood that Australia will continue to benefit. In Section 6 we review the opportunities provided by China's continued emergence in terms of the impact on trade in services. Section 7 concludes.

2. WHY CHINA REFORMED

It is important to understand why China underwent a period of economic reform because we need to assess China's commitment to the philosophy of change, the Chinese authorities' acceptance of the consequences of the change and their resolve to continue the change process. Business between countries flourishes in an environment where there is confidence in the expectations about the future and destabilising and unexpected events are kept to a minimum.

Chinese socialism and western capitalism as practiced in Australia are but two examples of the types of economic system that exist in the world[3]. The basic difference between these two system types arises from the different treatment of the ownership of property (or capital). In a market economy, capital can be privately owned (either by individuals or by corporations controlled by individuals (Rosefielde, 2002, p.42)) but in a socialist economy, the ownership of capital is vested in the state[4].

When private individuals are able to acquire ownership of the means of production, it can be expected that they will allocate the resources in their own self-interest. That is they will pursue a profit. The search for this profit will be largely directed by market determined prices. In contrast, the socialist system is based on the philosophy of the Marxist-Leninists who, Carson (1997) argues, claim that the price mechanism is so poor in generating outcomes that are beneficial to society that it should be replaced by state intervention so that all economic decisions of any consequence are planned and administered by the government or its agents.

Given that market economies and socialist economies are very different, it is reasonable to expect that the outcomes that they deliver will be very different also. Indeed, in the west we tend to believe that socialist states would not have the necessary processes to achieve any significant advance in economic well-being and point to the decline of European socialist states to give succour to our bias. The question arises, therefore, in the case of China, if it might be the failure of the socialist system to deliver significant economic advances that may lie at the root of the 1978 decision to undertake economic reform?

The evidence is mixed. During the period 1965-78, real GDP more than doubled according to World Bank data[5]. Indeed, throughout this period the growth of real GDP was typically higher than was the case for Australia (see figure 1). And this was so despite the adverse impact on economic growth during the Cultural Revolution of the early 1960s, which saw real GDP decline in 1961 and 1962[6]. Somewhat less reliable data suggests that the Chinese economy's performance during the 1950s may have been even stronger (Pyle, 1997, pp.3-5).

However, there is no escaping the fact that, not withstanding high real growth rates over the period, real GDP per capita was only $US160 in China by 1978 compared with over $US13,000 in Australia. Thus Chinese residents, one of the poorest groups on the planet in 1965, remained so at the time of the decision to open up the economy.

We see, therefore, that throughout the 1960s and 1970s, the absolute size of the Chinese economy continued to grow strongly with only a minor impact on the economic condition of its people. Yet, there is clearly no suggestion that the economic welfare of the Chinese population declined. This is important as it refutes any suggestion that China was in economic crises at the time of the decision to open up. To us, economic crisis – as exhibited in the collapse of European socialism – involves a breakdown of the entire economic system. Usually, although not always, this is followed by a considerable period of "wasted time" in which the former socialist society wallows in an economic no-man's land. This certainly did not occur in China. Indeed, in view of the data we have presented, China's economic performance was marginally adequate under "the plan" and showed no signs of disintegration.

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However, as a number of authors have pointed out[7], China was very concerned with comparing itself with those countries that make up the group of “Asian tigers” – particularly Japan, Korea and Singapore. Figure 2 does this for annual growth rates of GDP for the period 1966 to 1978.[8]

China’s growth performance over this period was generally inferior to that of the other countries in the diagram. Whilst China was the “pace-setter” in four of the thirteen years, it was at the “back of the pack” – last or second last – for eight years over this period. And, apart from Japan during the oil crisis of 1974, it was the only country to experience periods of negative economic growth. Indeed, China experienced negative growth on three occasions over this period.

Pyle (1997, p.6), relying on the work of White (1993) proposed three interacting forces – economic, political and social – leading to the decision to undertake economic reform. The economic explanation centred on the superior economic performance of the countries with which China compared itself. Shen’s (2000, p.40) judgment was even more direct when he stated that China, at the end of the 1970s, “… could not compete with these neighbouring Tigers”.

However, other commentators (Pyle (1997) and White (1993)) argue that other factors were important. In the socio-political field, China was said to want “… a change from the Maoist dogma of the 1950s, 1960s and 1970s” (Pyle 1997, p. 6). The popular mood was said to be in favour of some sort of less administered economic system and it was argued that the post-Mao political authority of China went for it in order to direct attention away from the political turmoil and the "… catastrophes of the previous two decades which had brought China to the brink of collapse" Pyle (1997, p.6). The "catastrophes" were, of course, political and social in nature – not economic. Subsequent developments tend to support the primacy of the economic argument. EIU (2007) agrees that greater economic freedom did give rise to demands for greater political freedom but, as we discuss further below, the latter were harshly dealt with as the movement for political freedom was crushed in the events of Tiananmen Square and its immediate aftermath. Notwithstanding this, economic reform continued pretty much unabated and, if anything, was spurred by the political events of Eastern Europe (EIU, 2007).

3. THE PROCESS OF CHANGE

The process of implementing China's economic reform was substantially different from the approach taken in most other reforming countries[9]. China did not face any severe economic crisis during that period nor did they confront any stringent conditions from the international financial institutions. The Chinese authorities therefore considered that they could afford to follow their own strategy and introduce reforms gradually, thereby avoiding any major imbalance within the socio-economic-political system[10].

Naughton (1995) has explained[11] that the reform process in China is one of improvisation. It is not planned as was 'European Rationalising Reform' (e.g. in Hungary) or 'Big Bang' – the destruction of the old system in a single blow (e.g. in Poland)[12]. The Chinese "Dual Track Model" is based on the co-existence of the plan and the market system. Private firms participate on a market basis, state-owned enterprises (SOEs) stick to the Plan (and participate in the market at the fringe). In addition, the size of the state sector was to be held constant. This would result in its relative decline over time as the economy as a whole grew Naughton (1995) argued. He refers to this as "growing out of the plan" and he considers it the key to the successful transition in China. In other words, the authorities basically did nothing to directly change the behaviour of SOEs. They simply permitted private firms to establish and allowed their success to bring about the desired economic change. Thus, as the EIU (2007) explains, economic reform was “piecemeal” and “ad hoc”.

However, as we have already indicated, despite this somewhat liberal approach to the economy, there was no suggestion that there would be a similar liberalising process in politics or the wider society. Indeed, at the very beginning of the reform process it was made clear that the reforms could “not deviate” the economy from the “principal objective” of creating a “socialist state” and that reform “must be carried out under the leadership of the [all powerful] Communist Party” (Shen, 2000, pp.41-43). For Shen, the evidence that the authorities remained intractably committed to this approach was illustrated in the events of Tiananmen Square some ten years after the commencement of reform.

As explained by Pyle (1997) and Shen (2000), the economic reform process in China since 1979 can be broadly divided into phases[13]. During the first five years (1979-84) the emphasis was mainly on agricultural reforms[14]. During this period, communes were phased out and a semi private system introduced which permitted households to sell on the open market any output that was not procured by the government (EIU 2007). Thus, attempts were made to restore “material incentives” and “private initiatives” and thereby to improve allocative efficiency. Pyle (1997, p.9) argues that the attempts were fairly successful.

The second period (roughly 1985-1990) was mainly concerned with industrial reforms Shen 1997, p.43). It was during this period that the introduction of the market mechanism was attempted[15]. In essence, private production was permitted as, according to Naughton (1995),

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the government gave up its industrial monopoly. In addition, the SOEs, whilst still required to meet the needs of the central plan (both in terms of production and the price at which that production was sold) could sell any excess production in the open market at market prices (Pyle 1997, p.14). However, in the event, the application of the process was more complicated than it was initially thought it would be. The development of a market sector exposed the inefficiency of the SOEs which began to stagnate and social unrest appeared as unemployment of dispossessed rural workers and, eventually laid-off SOE workers, rose.[16]

The late 1980s and early 1990s saw official attention shifted to financial sector reforms (including foreign trade and investment areas) in the third phase (Pyle 1997, p.9). Shen (2000, p.51) argues that the authorities had recognised the need for a "smooth financial flow" to accompany the much greater "product flow".

China's leadership recognised at an early stage in the reform process the need to encourage both exports and foreign direct investment (FDI) in order to stimulate growth. However, it was not until after 1990 when, according to Pyle (1997, p.17) ten cities were opened up to the outside world and six development zones were established that the opening up to the international economy really got under way[17]. Also during this period, the functions of the banking system were reformed.[18].

4. THE CHANGES TO EXTERNAL ECONOMIC RELATIONSHIPS

After 1949, China's economic interactions with the rest of the world were severely restricted. Indeed, apart from limited trade with "ideologically similar nations" – monopolised by the State, China followed a "closed door" policy. During 1952-78, China's total trade (exports plus imports) remained around 10 percent of national income and fell as low of 5.2 percent in

1973 (Pyle 1997, pp. 4 and 104). The situation was similar in the area of foreign investment. It was simply not allowed (Zhang 2000).

After the commencement of reform, the situation began to change as the authorities accepted that the economic growth of China was being severely handicapped by the restrictions on international interactions. Consequently, an “open-door policy” became one of the main planks of the reform process (Ma 2000). This liberty was extended to both trade and investment policies. As Ma (2000) points out, the authorities realised that there was an incredible pent up demand for imports and that with the freeing up of trade imports would surge. Achieving a balance of trade would require a similar expansion in exports, but the moribund and domestically oriented SOE’s were not up to it. The official solution was to encourage foreign investment – particularly in the traded goods sector.

Foreign Direct Investment

The first foreign loans came from international institutions such as the International Monetary Fund and the Asian Development Bank (Ma 2000). However, a low foreign debt, membership of the IMF and World Bank (in 1980) and the enactment of legislation that ensured foreign companies were guaranteed the right to remit profits resulted in the world financial community taking a positive view of investment in China (Ma 2000).

Initially all foreign investments had to be in joint ventures, in 100 percent export-oriented units and they must use high levels of technology. The conditions were relaxed in 1983 when wholly owned foreign enterprises were allowed (Ma 2000). They were also allowed to sell parts of their products in the domestic market. However, higher concessions for exports

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continued. The initial response of the foreign investors was very cautious because uncertainty existed in relation to the continuity of the reform process. As a result, Ma (2000) argued, the Chinese authorities needed to convince the international investors that they were sincere about reform and engaging commercially with the international community. The entire decade of 1980s was spent on creating and expanding facilities for foreign investors and consequently, enhancement of exports (Ma 2000).

During 1979-80, four Special Economic Zones (SEZs) with broad range of incentives for foreign investors were set up for the first time (Pyle 1997). These were all in the south-eastern coast of China – Zhuhai, Shenzhen, Shantou and Xiamen. The SEZs offered special tax concessions, higher profit repatriation facilities and were permitted to engage in market-based economic activities. Pyle (1997) considered that the SEZs provided a very valuable and successful experiment which resulted in the adoption further subsequent beneficial policies for the Chinese economy.

For example, to expand the coverage of incentives, 14 coastal cities north of the SEZs were declared as 'open cities' with special incentives in 1984. However, incentives offered in open cities were lower than those of SEZs. Subsequently, in the same year, 'open cities' status was extended to 24 inland cities as well. In 1988, the 'coastal strategy' resulted in the whole coastal strip being opened to foreign investors and market forces (Pyle 1997)

In 1990, the government eliminated time restrictions on the establishment of joint ventures, provided some assurances against nationalisation, and allowed foreign partners to become chairs of joint venture boards (Shen 2000). In 1991, China granted more preferential tax

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treatment for wholly foreign-owned businesses and contractual ventures and for foreign companies, which invest in selected economic zones or in projects encouraged by the state, such as energy, communications, and transportation sectors (Shen 2000). China also authorised some foreign banks to open branches in Shanghai and allowed foreign investors to purchase special "B" shares of stock in selected companies listed on the Shanghai and Shenzhen Securities Exchanges (*Economist* 2001). These "B" shares are sold to foreigners but carry no ownership rights in a company. China revised significantly its laws on Wholly Foreign-Owned Enterprises and China Foreign Equity Joint Ventures in 2000 and 2001, easing export performance and domestic content requirements (*Economist* 2001). As a result, EUI (2007) point out, FDI has increasingly been targeted at establishing manufacturing capacity to meet China's domestic market rather than export.

As a result of these initiatives net foreign direct investment (Net FDI) in China started rising significantly from the 1980s (Figure 3). The data shows a temporary pause in 1989 – the time of the Tiananmen Square incident – but begins to recover in 1991 and jumps to extraordinary levels in the mid-1990s. More recently, the data also shows that the Asian financial crisis of 1997 and 1998 bought a temporary decline in net FDI into China but that it rebounded strongly in 2002 prompted, EUI (2007) argues, by the acceptance of China into the World Trade Organisation (WTO).

EUI (2007) point out that although the FDI figures are slightly overstated (because of a deliberate strategy of Chinese investors to first send money out of the country and then return it to invest in tax advantaged projects – a strategy known as "round tripping") the numbers are still huge.

Trade

In the area of foreign trade, the opening up process was also gradual. As previously discussed, the Chinese authorities pursued export expansion as a strategy to avoid severe imbalances in the foreign trade sector. (Zhang 2000). Under the pre-reform system, the central government, through the offices of the Ministry of Foreign Trade, had effective monopoly rights on exports and imports. However, over time, this control was gradually relaxed (Zhang 2000).

Throughout 1980s China initiated a number of measures designed to facilitate the decentralisation of its foreign trading system and the integration of its economy with the rest of the world. In November 1991, China joined the Asia Pacific Economic Cooperation (APEC) group, which promotes free trade and “practical economic cooperation” (EIU 2007). China served as APEC chair in 2001, and Shanghai hosted the annual APEC leaders meeting in October, the same year. (DFAT online). After 15 years of long negotiations China formally joined the World Trade Organisation (WTO) in December 2001. As part of this agreement, China agreed to a wide range of trade reforms including lower tariffs and the abolition of various market impediments (DFAT online). By 2002, China had begun to implement its commitments under WTO and a large number of sectors, including banking and agriculture, were opened up to international trade (EIU, 2007) giving new opportunities for overseas service providers.

The recent history of China’s foreign trade activity is reported in figure 4.The level of both imports and exports fluctuated until the mid 1990s but there has been sustained growth in both since that time. Even the “Asian crisis” of 1997-98 had little apparent impact on this trend. In

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nominal terms, EIU (2007) points out that both exports and imports did fall briefly as a result of this crisis. EIU (2007) also argue that the much more rapid climb in both after 2002 can be attributed to China's entry into the WTO.

The outstanding growth in China's exports is attributed to the activities of foreign invested enterprises (FIEs). EIU (2007) reports data that indicates that between 1992 and 2005, merchandise exports of FIEs surged from 20 percent to 58.3 percent of total exports. This figure underscores the importance to China of FDI considered in the previous section.

As the data in figure 5 indicates, China's exports are dominated by the export of manufactured items. All other items pale into insignificance. The rise of manufacturing and the fall in importance in all other areas has been relentless. The change has been nothing short of dramatic given that, as EIU (2007) reports, that in 1985 primary goods accounted for around 50 percent of Chinese exports. Part of the explanation for this change is found in figures 6 and 7.

Figure 6 indicates that manufactured goods have dominated China's imports as well as China's exports – a finding that many might consider a little unusual. However, the explanation is to be found in the fact that a significant proportion of the manufactures imported consisted of partially finished products which would undergo further processing in China before being re-exported and capital goods destined for factories that would, in turn, produce further manufactured goods for export.[19]

EIU (2007) reports that much of the initial FDI to China came from Hong Kong. The move of manufacturing plants to the mainland sought to take advantage of the lower cost semi-skilled labour there for the production of textiles and toys. Over time FDI from other nations (Taiwan, Japan and Korea) also flooded the Chinese market as manufacturing plants for the further processing of more sophisticated products (electrical goods and machinery) were established.

However, there is a small, but perceptible change in the composition of imports beginning in the mid to late 1990s as the share of both fuels and ores in imports began to grow steadily. EIU (2007) argues that the massive amounts of intermediate materials – such as steel – imported throughout the 1990s actually gave rise to an enhanced ability of China to produce many of these goods itself through investment in and the construction of appropriate facilities. As these plants came on stream, the demand for basic commodities, mineral ores and fuel, grew rapidly. This change can be readily seen in figure 7 which depicts, in real terms, China's imports of ores and fuels up to 2004. An upward trend is apparent from the early 1990s. However, the trend moves upward sharply after 2000.

5. AUSTRALIA'S MINERAL BOOM AND POTENTIAL THREATS

China's integration into the world economy appears to have had little positive impact on Australia until relatively recently - and then only in one, rather narrow, sector of the Australian economy. This impact, on the export of metal ores and coal, is illustrated in figure 8 which shows the sharp jump in the export of these commodities following the increase in demand from China. Indeed, Weemaes (2005) reports that Australia was China's largest source of imported coal, iron ore and nickel ore in 2005.

However, the surge in the export of these commodities is said to underpin much of Australia's sustained economic performance since 2000 and expectations of future prosperity are being increasingly built on it.

The questions arise, therefore, as to whether or not the mining export boom to China can be maintained and whether it can or cannot, is it all that China has to offer us? The first question is addressed in Basu *et. al*. (2007) where four major risks are identified.

The first is the risk of a cyclical economic downturn in China. Like any market economy China is subject to periodic swings in economic activity. However, unlike many western economies, China's mechanisms of for policy intervention are less sophisticated and, in the past, have been crudely applied. However, recent reforms have raised the potential for successful monetary and fiscal intervention. The People's Bank of China (PBC), China's central bank, continues to seek greater independence to conduct monetary policy and China's rigid, fixed exchange rate regime is being gradually softened (EIU, 2007). In addition, tax reform and reforms to the administration of the tax system have enhanced the ability of the government to pursue fiscal policy.

The second risk identified was the potential for a decline in China's demand for resources as the resource intensive phase of China's economic development wanes. However, although in the very long run such a decline is inevitable, it was seen as unlikely in the next 20-30 years given the large discrepancy in states of development across China's provinces[20].

The recanting of the philosophy of pursuing development through market based policies was identified as the third risk. Notwithstanding that China is, and is likely to remain, under the control of a single political party that will continue to refer to itself as "communist" there seems little chance of a return to the days of central planning. China continues to pursue international relationships which are presaged on a relatively open market and of meeting the requirements of the WTO. In addition, recent changes to CCP policy and subsequent legislative action have endorsed the concept of private property, its acquisition and protection. A factor of greater concern was the risk of political turmoil. The Western press is very quick to report on protests and demonstrations in China (usually in support of greater political freedom). Unfortunately the risk of social unrest in China remains a problem of some significance. While economic growth is maintained and all sections of Chinese society can be seen to be benefiting it will likely be held in check. However, any disruption to growth, or any failure to ensure that enhanced standards of living are passed on to all section of society – at least in some form – could presage trouble. This has been emphasised by decisions taken by the CCP to ensure that, in the next phase of development, emphasis is given to assisting those in rural communities. The IEU (2006) also reports that there are signs that decision-making has become less totalitarian than in the past.

In general, we conclude that, although risks exist, it is likely that the benefit Australia is receiving by way of China's demand for resources will continue well into the foreseeable future. However, that is no reason for Australia not to consider spreading the risk and focusing on the alternative opportunities that China offers. We believe that chief amongst these possibilities is the potential represented by China's need for the rapid development of its service industries. We turn to a discussion of this potential in the next section.

6. THE PROSPECT FOR SERVICES

In all likelihood Australia's export commodity boom, fuelled by demand from China, will continue for some time yet. However, we like to think of Australia as being a very sophisticated economy. Yet, to this point, there appears to be little evidence that Australian industry is fully grasping all of the opportunities presented by China's "opening up" - and the evidence is mixed with regard to us doing so in the future.

A number of reports[21] highlight education and tourism as being amongst Australia's largest export earners in trade with China[22]. However, the potential for trade in services with China is much greater than the trade represented by these two areas and even Australia's Minister for Trade has recognised that this potential is often overlooked[23]. Figure 9 provides some indication of the extent of the potential that exists. This diagram depicts the proportion of total value added in a year by the services sector in both Australia and China. The proportion in China is very low. Langdon-Orr (2006), commenting on information contained in DFAT (2005) points out that the proportion of the economy represented by services in China is not just low in comparison with Australia (and other OECD countries) it is also low when compared with economies that have a similar per capita income to China. The explanation reported by Langdon-Orr is that the former communist model emphasised the production of industrial goods as the expense of services. China therefore has a lot of catching up to do in the development of its services sector.

To some extent this "catch up" has begun as the services sector has been rising faster in China than in most other countries. Yueqin (2007) reports that the annual growth rate of the services sector in China has not fallen below 8 percent since 1999 – but this is still lower than growth experienced in the goods sector (CIS 2007). (Much of this growth is the result of government policy following the announcement in the Tenth Five-Year Plan (2001-2005) of plans to develop the services sector (DFAT 2005), however, clearly, there is a long way to go. It was estimated that the proposals put forward in the Tenth Five-Year Plan would result in a level of services production equivalent to 40 percent of GDP by 2010 (Yueqin 2007). However, it appears that the Eleventh Five-Year Plan for 2006-2010 substantially raises this expectation (People's Daily 2007a).

During this process of "catch up" considerable opportunities are going to exist for countries like Australia to export services to China. For example, architects, environmental designers and town planners are in demand in China (Weemaes, 2005) as are investment bankers, lawyers and professionals in the ports and recreation services (Age, 2007).

As pointed out in section 5, continued economic growth in China is very much dependent on the avoidance of chaotic social disruption. This in turn requires China's ever increasing workforce to be employed. In this context the services industry is critical. Between 1980 and 2004 employment in the services industry in China increased four fold, accounting of 30 percent of employment (Yueqin, (2007). Only a continued rapid growth in services offers the opportunity to absorb China's ever increasing labour force as services are labour intensive and generally will absorb a proportion of the workforce roughly equivalent to their share of GDP. Further, according to Yueqin (2007) FDI in China's services industry is largely concentrated in social services, the wholesale and retail trades, hospitality, real estate and transportation. There is a much lower level of involvement in other areas (such as finance and insurance and telecommunication) because of government restrictions. Social services account for about 24 percent of FDI in service and this is largely a result of Chinese government's recognition that continued social stability will require substantial advances in the levels of public health (Yueqin, 2007).

But China's need is not limited to social welfare. Continued expansion of China's international activities and the development of its internal infrastructure will also be dependent on the emergence of a more vibrant services industry (CSI 2007) and surveys of multinational companies operating in China have identified that the slow development of the service industry is adversely affecting the growth of China's manufacturing industry (Peoples Daily, 2007a).

While there is a great deal of potential for the delivery of service in China there are also some significant problems. DFAT (2005) has identified that notwithstanding China's entry into the WTO, China continues to apply restrictions on ownership, business scope and geographical coverage of the service sector in China. The Chinese authorities continue to apply an "opaque" regulatory process and licensing arrangements. Service providers are frustrated by operating requirements, lack of legal transparency and a failure to apply laws consistently and to enforce laws on intellectual property rights.

Other writers and commentators have also raised these difficulties. CIS (2007) point out how foreign companies wanting to enter the Chinese service sector continue to be hampered by the "erratic implementation" of China's WTO commitments in the areas identified above. This results from frequent changes to laws, regulations and administrative practices and in a general failure to apply them uniformly.

However, no-one should be surprised by this as it represents a consistent philosophy of gradual development and opening up by the Chinse authorities. China has been immensely successful in changing from a communist state to a market economy without the dislocation that has plagued other former communist nations. There is, therefore, no reason to expect anything other than a continual improvement in access to the Chinese market for services. The Chinese know that this is in their interests and the teething troubles can be seen more of their lack of experience in dealing with this sector of their economy (resulting from their past focus on industrial production) rather than a reticence to provide ongoing and transparent access.

7. CONCLUSIONS

China began its economic reform process in 1979 largely because its economic performance, although not dismal, had failed to keep up with those countries with which China liked to compare itself. Although the changes have had a dramatic impact on the economy of China – and consequently on the rest of the world – they were not, of themselves, drastic in the sense of bringing about a sudden change in the way the country functioned. Rather, change was gradual. The old structures of state-owned enterprises were retained but increasingly a private sector was allowed to emerge. Within a few years the new private sector had become the dominant engine of growth. With the development of a vibrant private sector came the inflow of funds from abroad – largely from other Asian economies – seeking to take advantage of China’s cheap labour. Joint ventures were established which were largely oriented to export and China, which had previously had little involvement in international trade began to emerge as an important trading nation.

Under the new economic emphasis, China’s economy continued to grow and the rising incomes of the Chinese people generated an increasing demand for consumer goods which had been relatively unknown in China. As well as importing these items, companies began to establish in China to meet the rising domestic demand. This in turn gave rise to the need for basic products (such as steel) which China had little capacity to produce. However, by late

1990s early 2000s basic processing plants had begun to flourish in China giving rise to a world-wide boom in commodities such as ore and coal. This boom continues through to today and Australia, to this point, has been one of the chief beneficiaries.

In all likelihood, the commodities boom will continue well into the future. However, a number of risks are apparent. First, China like all economies is prone to cyclical swings in economic activity. This can be a major problem in the case of China as their weapons of macroeconomic control are not well developed and may not serve to avoid wild swings in activity which could prove damaging, not just for China, but also for those countries like Australia that are dependent on their China trade. Fortunately, in recent years, progressive changes in both fiscal and financial areas have taken place, but it is still to be seen whether or not the policy weapons will be able to cope when put under severe stress.

Because China is starting from such a low level, and because many areas of China are still substantially undeveloped the risk of a downturn, or even a flattening, in the growth trend appears remote so that cyclical swings aside, the underlying demand for resources will continue. A factor that has been of some concern is the potential for China to regress from the pursuit of developing a market economy. However, all the evidence is that the authorities are totally committed – to the point of upsetting some of the older communists in the Party –to the extension of market principles. A far more worrying issue is the continued political repression of the people. Increased economic freedom tends to call forth demands for political freedom as well, but the CCP is not willing to permit any challenge to its authority. This with thousands of protests taking place annually the authorities must keep a constant vigil. It is not clear how long this can continue and what the circumstances of any future attempt to break free of this repressive yoke may be. However, the history of other nations suggests that if violent change does occur, the economy will be one of the first victims.

Thus Australia is confronted by both opportunity and threat. To the extent that the commodities boom continues Australia benefits. But anything that disrupts that boom will have severe consequences for Australia. In addition, the continuation of the boom may be distracting Australians from other potential opportunities that exist in China. As a country that seeks to have balanced economic growth, we should endeavour to spread our risk in China and to position ourselves to take advantage of new opportunities – especially in the services sector – as they arise.

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Figure 1: GDP growth rates – China and Australia

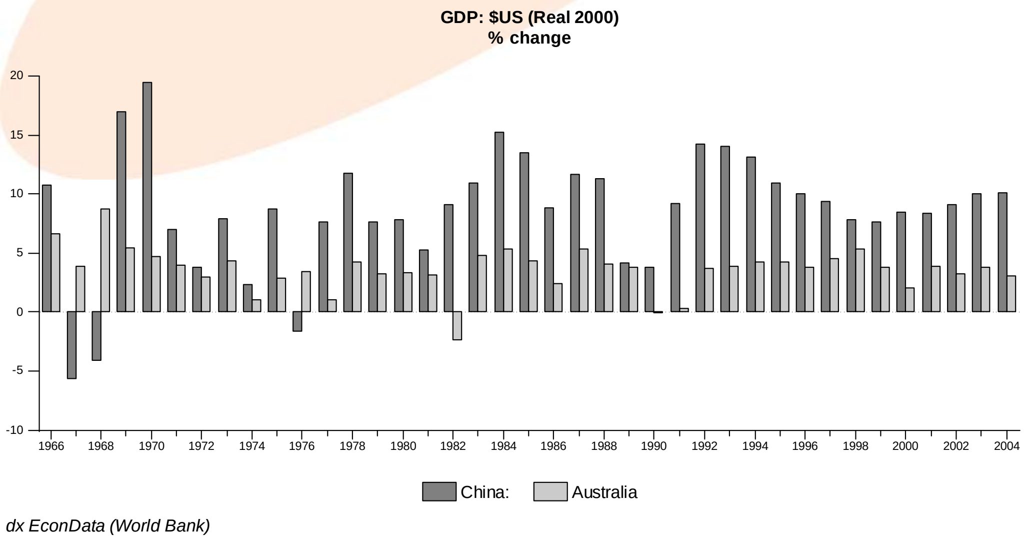

Figure 2: GDP growth rates – China and Asian Tigers

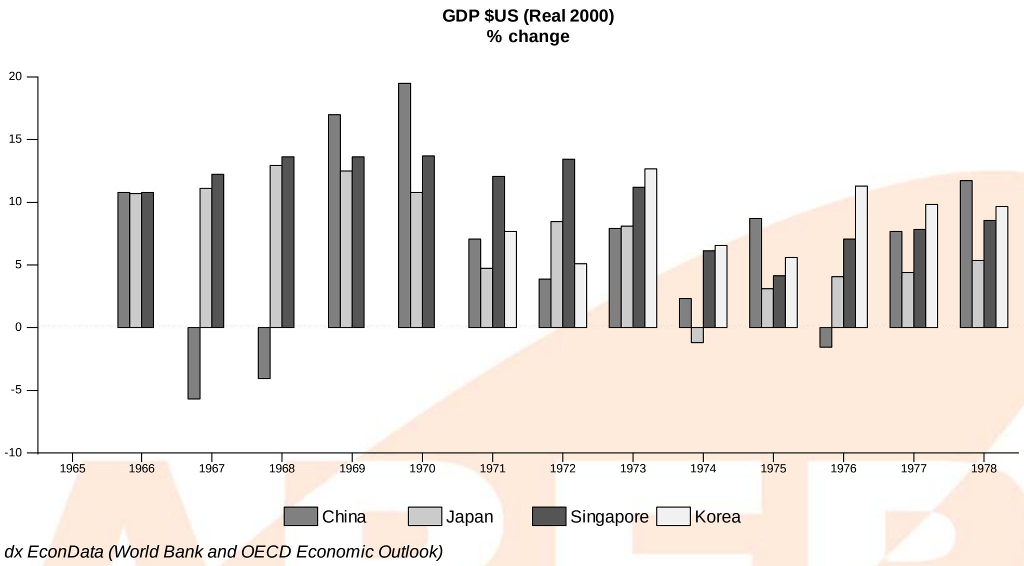

Figure 3: China – Net FDI

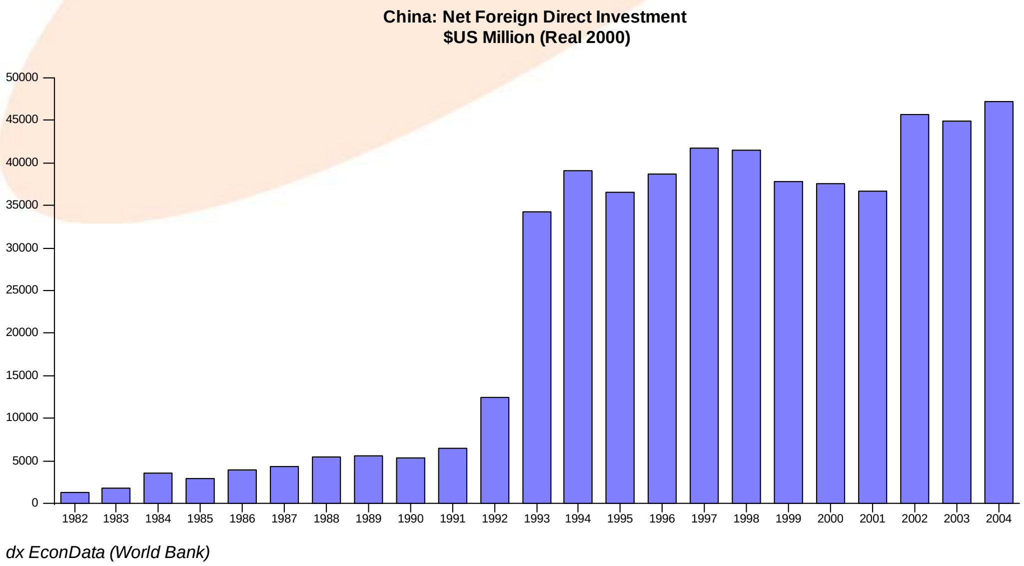

Figure 4: China – Exports and Imports

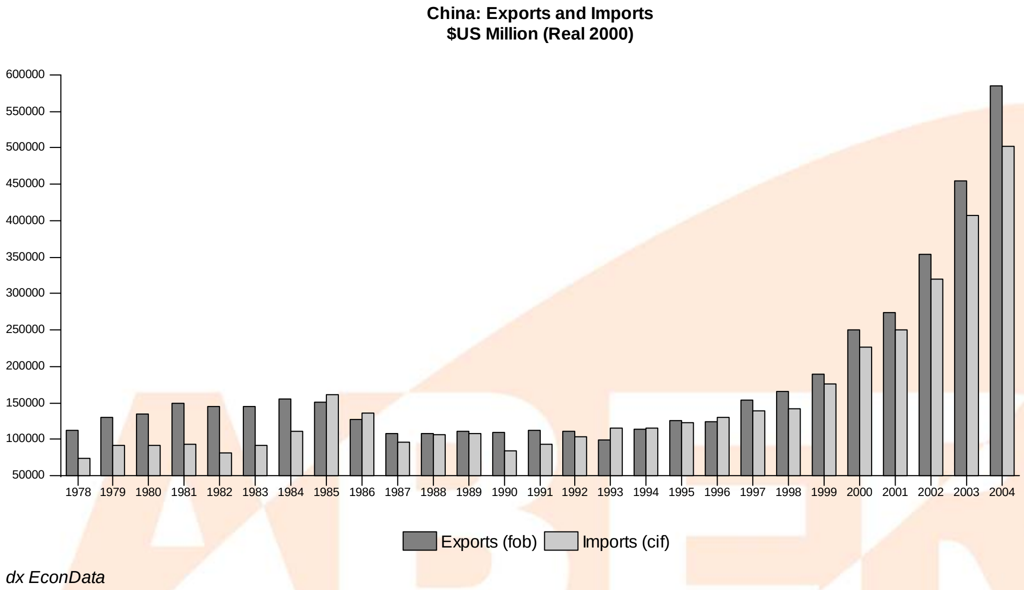

Figure 5: China – Composition of Exports

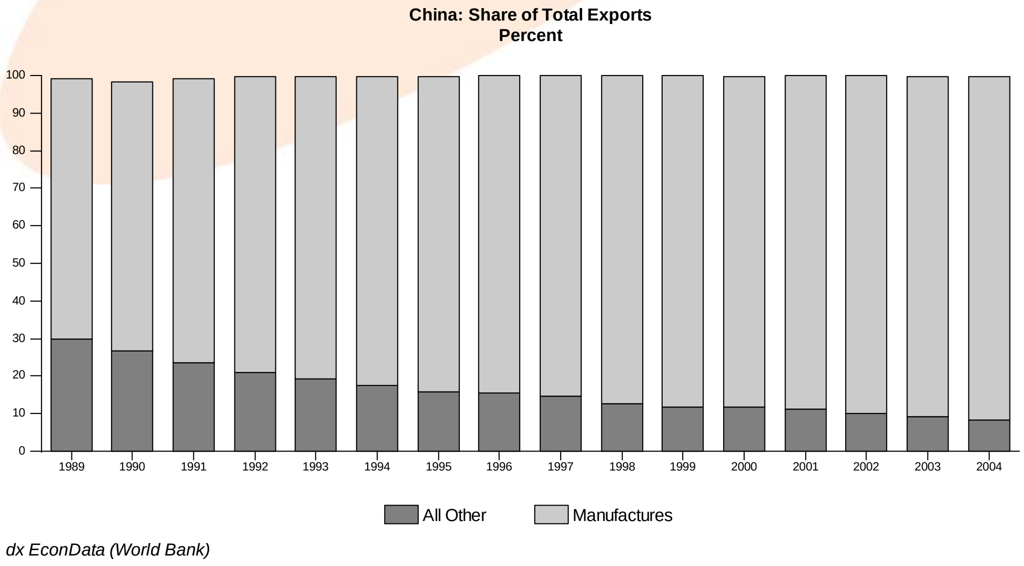

Figure 6: China – Composition of Imports

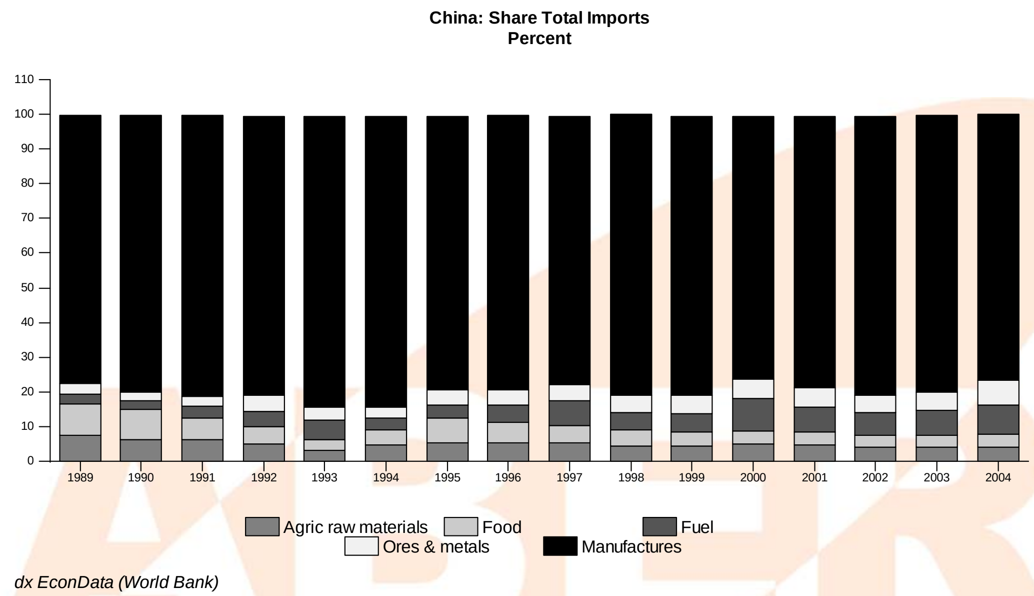

Figure 7: China – Imports of Ores and Fuel

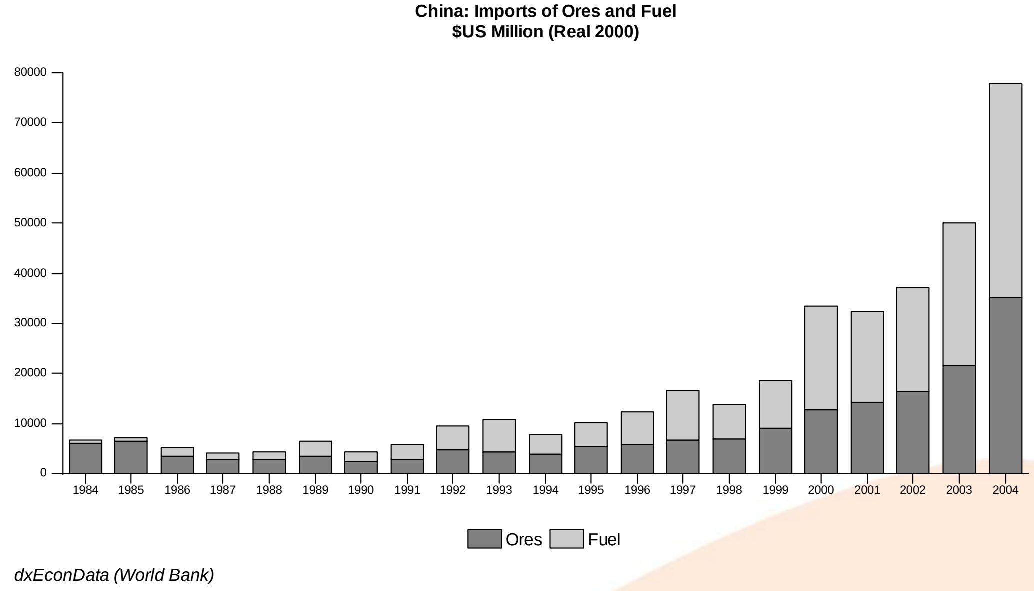

Figure 8: Australia – Exports of Ores and Coal

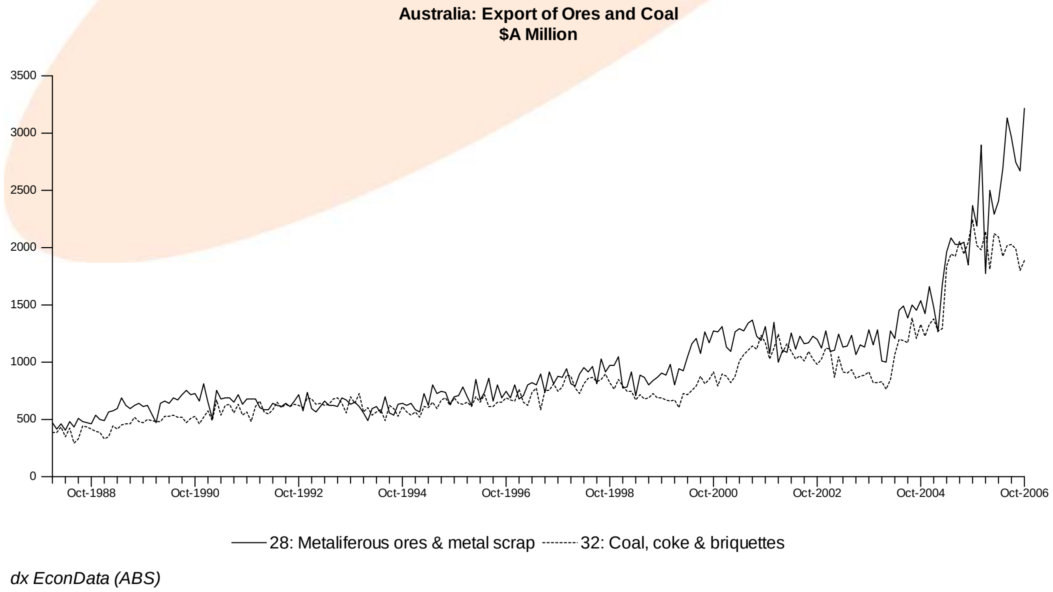

Figure 9: China and Australia – Contribution of services

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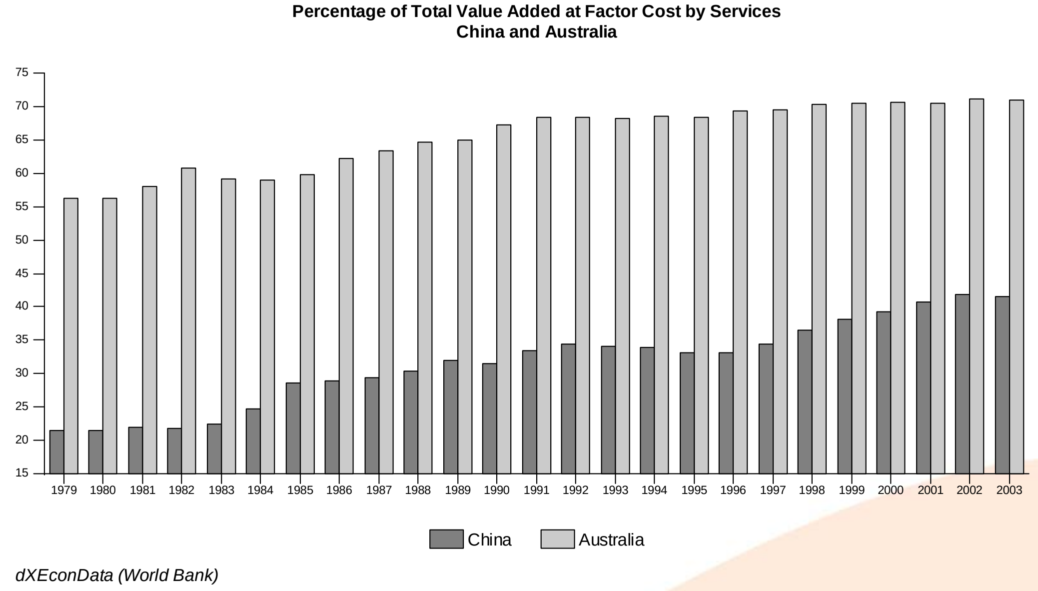

[1] This point is made by a number of authors including Pyle (1997), Shen (2000) and Naughton (1995). We draw heavily on the work of all three authors in this paper.

[2] Pyle (1997, p.8) and Shen (2000, p.40) report that the formal decision to reform the economy was made at the Third Plenum of the CCP Central Committee in December 1978. Both noted that this approach to reform would be gradual.

[3] See for example Rosefielde (2002, p.42) who identifies eight distinct economic systems. Interestingly, Rosefielde distinguishes between socialism and communism. This distinction is also made by Carson (1997, p.7).

[4] See for example, Rosefielde (2002, p.42) and more particularly Carson (1997, p.7) who identifies communism as a system in which *communal* property rights prevail as distinct from state ownership. Carson goes on to point out that while communal property rights may exist in virtually every form of economic system, they rarely, if ever, predominate. Accepting his argument, we opt to use the term socialist system rather than communist system in referring to the economic system in China.

[5] Unless otherwise stated, World Bank data in this paper refers to data obtained from the *dX EconData* service. *dX EconData* state that “World Bank [The International Bank for Reconstruction and Development] World Tables Database contain all time series data from the World Tables published for the World Bank by the Johns Hopkins University Press.”

[6] The fact that the “Cultural Revolution” was a political and social disaster is beyond dispute.

[7] See Shen (2000), Pyle (1997), and White (1993).

[8] Unless otherwise stated, Economic Outlook data in this paper refers to data obtained from the *dX EconData* service. *dX EconData* indicates that the *dx EconData* OECD Economic Outlook Database is based on the *OECD Economic Outlook: Statistics on Microcomputer Diskette* and *OECD Economic Outlook Reference Supplement*, and that supporting documentation is contained in *OECD Economic Outlook*.
[9] This point has been made by a number of authors, in particular see Naughton (1995).
[10] See Shen (2000, p.55).
[11] As quoted in Riskin (1996) while reviewing Naughton (1995).
[12] The term "big bang" is also used by Pyle (1997) in this context.
[13] Xu (1996) also identifies phases. However, they cover slightly different periods and emphasise different events. Our description of the phases is primarily based on Pyle (1997) and Shen (2000).
[14] See Shen (2000, p.43) and Pyle (1997, p.9)
[15] As explained by Pyle (1997, p.12) in referring to White (1993).
[16] The problem of the SOEs is covered in Murphy (2002) for example.
[17] For example, Shen (2000, p.111) describes in detail the massive increase in DFI that occurred through the 1990s.
[18] See Shen (2000, p.51).
[19] This point is also made in Tisdell (2006).
[20] The origins of this inequality are discussed in Basu *et. al.* (2006b) which also provides a case study of one relatively wealthy city, Tianjin with one of the poorer areas, Changchun in Jilin province.
[21] See the Age (2007), Weemaes (2005)
[22] This point is also made by Tisdell (2007).
[23] Langdon-Orr (2006)