Assessing Australia’s Trade and Investment with Asia

Business Council of Australia contribution to the development of a strategy for Australia in the Asian Century
Economic growth in Asia, especially China, has been a key driver of the Australian economy over the last decade. Strong ties with major economic partners in Asia were the basis of our resilience during the global financial crisis.

But these achievements do not bring any guarantees for the future. Australian business is acutely aware that while there continues to be a vast array of economic opportunities for us in Asia, realising them involves facing up to some complex challenges.

It requires business, government and Australian workers to work together to vastly improve the overall competitiveness of the Australian economy.

In this context, the decision by the Australian Government to commission the development of a white paper on *Australia in the Asian Century* is timely and welcome.

As an early contribution to this process, the Business Council of Australia commissioned ITS Global to prepare a report, *Assessing Australia’s Trade and Investment with Asia*. The report highlights what is at stake for Australia in coming to terms with the Asian century.
Key Findings

Economic engagement

Our current and future economic engagement with Asia is of vital importance to Australia. In 2010, our exports to Asia were worth more than $175 billion. The proportion of Australia’s total exports going to Asia has increased from 50 per cent just five years ago to 63 per cent last year. It now accounts for more than 13 per cent of GDP.

While Asian countries accounted for 10 per cent of the total level of direct overseas investment in Australia in 2006, that figure has now almost doubled to 19 per cent. As foreign investment is directed towards key export industries, it allows those markets to grow and prosper.

While the United States continues to be seen as our most important economic partner overall, China has become Australia’s largest and most important trading partner.

The growth of the middle class in Asia is expected to underpin future growth in demand for a wide range of resources, energy, agricultural products (especially food) and services. Securing supplies of energy and food are key priorities for Asian nations.

No room for complacency

At the same time, there are risks to Australia’s future trade and investment with Asia. China, India and other resource and energy importers are seeking alternative suppliers, which will put pressure on Australian suppliers. Our resources sector faces increased competition from emerging economies such as Brazil. Businesses in North and South America, in Europe and in Africa want to win new markets in Asia. Our industries also face new competition from within Asia.

We need to be mindful that the financial crisis in Europe and continuing economic uncertainty in the United States could affect emerging economies of Asia that rely on export markets in those parts of the world.

The ITS Global report also raises questions about whether Asian countries have the requisite institutions, governance and policy settings for sustained economic growth. Australian businesses wanting to invest or enter services markets in most Asian countries can face multiple barriers.

Fundamentally, the report calls for policy reform to make the Australian economy more competitive by:
- reducing the cost of trading
- reducing the regulatory burden
- improving labour market flexibility including skilled migration arrangements
- reducing the corporate tax rate
- reducing government spending and deficits.

A plan for the future

The findings from ITS Global reinforce the need for Australia to widen its perspective on Asia. While China and India are key trading partners, Australia continues to have deep economic engagement with Japan. Important economic relationships for the future should be cultivated in South Korea, Vietnam, Malaysia and Indonesia.

When it comes to large-scale trade with Asia, our current export focus represents a narrow base. We should not underestimate the importance of education and other non-resource and energy exports and better recognise the success and opportunities of manufacturing, including niche manufacturing in Asian markets.

All of these developments mean that the current and future competitiveness of the Australian economy will be pivotal to our future engagement with Asia. This involves supporting broader-based engagement, but also supporting the continued success of sectors that are already performing strongly.

Key questions for the white paper to address

In light of the findings of the ITS Global report, the Business Council of Australia has identified the following key questions we would like to see addressed by the Australia in the Asian Century White Paper.

- What are, or should be, the top priorities for Australia arising from our engagement with Asia, and do we have an effective strategy to realise them?
- What are the opportunities for Australia to extend trade and investment links with Asia, and how realistic is it to expect Australian industry to take up these new opportunities?
Priorities for government and business

The Business Council of Australia’s report from ITS Global provides valuable insight into the increasing interdependence between Australia and Asia.

It also demonstrates that this mutually beneficial engagement – economic, strategic and cultural – is not guaranteed to continue, let alone develop.

The ITS Global report underscores the reality that Australia cannot afford to be complacent. It highlights the key risks and challenges involved in maintaining and building our current share of trade and investment with Asia.

The Business Council of Australia is concerned that Australia is not moving fast enough to lift our productivity and improve the competitiveness of industries already deeply engaged with Asia or to take up new opportunities or expand existing ones.

An important aspect of this is changing the Australian mindset. While our nation’s past is steeped in the history of Europe, our future is inextricably linked with Asia.

The *Australia in the Asian Century* White Paper is an opportunity to set a bipartisan foundation by identifying policy changes and actions that governments and businesses can take to address the issues raised by ITS Global report.

In the view of the Business Council of Australia, these include:

- Domestic economic reforms focused on improving competitiveness, attracting finance and investment, and enabling businesses to continue to compete effectively in Asia.
- Working effectively with Asian governments to remove or reduce regulatory restrictions and other barriers to trade and investment that prevent or restrict Australian and other foreign businesses from entering local markets.
- Lifting the capabilities of business and governments in Australia, including the capabilities of the workforce, to build mutually beneficial relationships with governments and businesses in Asia.

In addressing these priorities, the white paper should set out a timetable for rolling out a plan for broadening and deepening our engagement with Asia, including short, middle and longer-term objectives for what might be achieved 10, 20 and 30 years into the future.

It should also explore how Australia might better mesh foreign and economic policy to provide greater consistency and a clear message that we are an open economy committed to broad, long-term engagement in our region.

The Business Council of Australia will focus its attention on these areas through our ongoing contribution to the development of a strategy for Australia in the Asian century.

Jennifer Westacott
Chief Executive
Business Council of Australia
Assessing Australia’s Trade and Investment with Asia

For the Business Council of Australia

NOVEMBER 2011
Executive Summary

The Business Council of Australia commissioned this study of Australia’s trade and investment engagement with Asia to assess the strategic opportunities to enhance those relationships. For this purpose the study focuses on ten economies — China, India, Indonesia, Japan, Malaysia, the Republic of Korea, Singapore, Taiwan, Thailand and Vietnam — hereafter referred to as the Asia-10 for ease of reference.

The Asia-10 economies are growing at historically unprecedented rates. Since 2005 China, India, Singapore and Taiwan have each grown at more than twice the rate of the global economy and five of the remaining six economies had significantly faster rates of economic growth.

Measured by bilateral trade and inward and outward foreign direct investment (FDI), Australia is well engaged with the Asia-10 but greater engagement is both feasible and desirable. In 2010 Australian exports to the group totalled $175 billion; the stock of Asia-10 investment in Australia was valued at $92 billion, while the stock of Australian investment in the Asia-10 stood at $23 billion.

Over the past five years Australia’s economic engagement with Asia has grown rapidly. In 2006 the Asia-10 took one-half of Australia’s exports; by 2010 it was nearly two-thirds. Over the same period the stock of Asia-10 investment in Australia has more than doubled, while Australia’s stock of investment in the Asia-10 has nearly doubled. Although Australia’s trade and investment relationships with the Asia-10 have generally grown more slowly than their rates of economic growth, this is to be expected given Australia’s natural resource endowments and the impediments to their economic integration. The appropriate test is how much Australia has reduced its domestic impediments to engagement.

Over the past five years the Asia-10 has accounted for a rapidly rising share of Australia’s global exports. Virtually all of this growth occurred in China, India and the Republic of Korea. So much so, China is now Australia’s largest export market — in 2006 it was Japan — while the export shares of some Asia-10 economies have fallen — notably Indonesia, Japan, and Singapore.

The growth in Australia’s exports to the Asia-10 has been completely dominated by mineral exports, particularly exports of iron ore and coal to China, India, and the Republic of Korea. The agriculture, manufacturing and services sectors have each lost export share in the Asia-10, as well as in the rest of the world. There are, however, a number of Australian manufacturers and businesses in the services sector that, having invested in Asian markets, deliver their products and services in those markets. These businesses are an important component of Australia’s overall trade and investment with Asia which are not fully captured by current trade and investment data.

Exports of certain elaborately transformed manufactures (ETM) to the Asia-10 continued to grow in real terms over the last five years, however, and in some cases very rapidly, even if it was off a relatively modest base. At the four-digit level of the Harmonized System of product classification, exports of Medical dental and veterinary apparatus were the standout — by growing at over 31 per cent per year over this period. They were followed by Parts for lifting and earthmoving machinery — at 8.5 per cent per year — and Medicaments — at 8.3 per cent per year.

The crowding-out of non-mineral exports at the aggregate level reflects a series of profound structural changes in the Australian economy. The rapidly industrializing
economies have driven commodity prices to record levels and encouraged expansion of mining operations with the consequent relocation of labour and capital away from the non-mining sectors of the Australian economy. The parallel appreciation of the real exchange rate has added to this pressure by reducing the returns from non-mineral exports. At a sectoral level, manufacturing has been hardest hit by the pincer effect of these changes.

Although cross-border exports of services have also been adversely affected by these changes, they understate the sales of services to the Asia-10 by Australian businesses. An important mode of export involves establishment of a commercial presence abroad. Sales of services by affiliates of Australian-based businesses in the Asia-10 are likely to be more significant than generally recognised. For example, ITS Global has previously estimated that global sales of services by foreign affiliates of Australian-based businesses in 2010-11 were about $100 billion per year, compared to $55 billion for cross-border services.

Establishing a foreign commercial presence generally requires the business in question to invest abroad. The stock of FDI by Australian businesses in the Asia-10 has traditionally been less than the equivalent levels in Europe or North America, where the markets are generally much larger and more open to foreign entry.

Nonetheless, compared to its industrialised peers Australia has performed well in both inward and outward FDI in relation to the Asia-10. For example, it has received almost twice as much FDI from Asia-10 as Canada, despite receiving around 50 per cent less FDI than Canada from all sources. Japan is the largest Asia-10 investor in Australia — with an FDI stock of $52 billion in 2010 — and Singapore is second largest — with an FDI stock of $21 billion — but both are well behind Australia's largest foreign investor, the US with a stock of more than $120 billion. Although China's FDI stock in Australia has risen rapidly, by 2010 it was only $13 billion, less than 11 per cent of the US level.

The stock of Australia's outward FDI in the Asia-10 is relatively modest when compared to its stock in the rest of the world, particularly North America, Europe and New Zealand. The policy impediments in the Asia-10 are significantly more restrictive than those in Australia's traditional investment destinations.

That said, investment is generally becoming more important than trade to international economic engagement. From an economic perspective, foreign investment is more of a complement to cross-border trade in goods and services than a substitute for it. Global trade in goods is dominated by intra-industry and intra-company trade due to increasing vertical specialization, which is associated with foreign direct investment. Global trade in services is ultimately dependent on services providers having a commercial presence across national borders, which also requires foreign investment.

As the Asia-10 mature, their consumption of services will grow rapidly and will come to dominate household budgets. The efficiency of local service providers will become an increasingly important consideration in domestic policy formation and will increasingly require relaxation of the policy barriers to domestic entry into and foreign participation in their services markets.

As this report makes clear, there continue to be major opportunities for Australian industry from the exporting of commodities into Asia. At the same time, there is a risk that a rapid change in external economic circumstances could reduce the price or demand for Australian commodities in Asia. Australia’s policy settings need to take
account of the ability of the Australian economy, including the resources and the non-resources sectors, to adapt to such a change.

The policy impediments to raising productivity, including in the non-resources sectors of the economy, represent important challenges to greater economic engagement with Asia across all sectors. They include:

- regulation of trade and the international movement of merchandise;
- business regulation and taxation generally;
- the inflexibility of labour market regulation;
- restrictions on entry of foreign skilled labour and access to local natural resources for their exploitation; and
- entry barriers in foreign markets to both domestic and foreign businesses.

ITS Global has recommended that Australian Governments adopt a two-pronged strategy to reduce and remove policy impediments to further economic engagement. One element of the strategy aims to address the domestic impediments, while the other targets the external ones. Its recommendations are spelt out in detail in Chapter 8 of the main report.

The six high level recommendations outlined in Chapter 8 are:

1. Reduce the transaction costs that regulation and government red tape impose on Australia’s international merchandise trade.

2. Reduce the burden of regulation and government red tape that Commonwealth, State and Local Governments impose on domestic businesses.

3. Reduce the burden of taxation that Australian governments impose on business and its ability to create jobs.

4. Improve the operation of the Australian labour market.

5. Improve the domestic environment for business investment, particularly in the traded goods sector.

6. Improve the international environment for Australian business by working with governments in Asia to reduce restrictions on trade and investment.

In relation to recommendation 6, given that external impediments are outside Australia’s jurisdiction, progress there is likely to be incremental. Moreover, policy reform in China, our largest trading partner, has lost some momentum and it is difficult to assess whether there will be significant reform in the foreseeable future. Japan, our second most important trading partner, has been in a similar position for over two
decades. Australia will therefore need to pursue a strategy based on a careful assessment of realistic opportunities in Asia to facilitate and encourage external liberalisation efforts, while putting most of its efforts into domestic reform.

The buoyant outlook for resources and energy represents an historic economic opportunity for the Australian mining sector. While this study has primarily examined the domestic impediments to its expansion, as part of Australia's broader trade and investment performance within Asia, we see merit in the BCA commissioning an examination of the policies and priorities of the emerging economies to ascertain whether their resources sectors can be expected to gain a competitive advantage over the Australian industry.
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<tr>
<td>ABS</td>
<td>Australian Bureau of Statistics</td>
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<td>ANZSIC</td>
<td>Australia New Zealand Standard Industrial Classification</td>
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<tr>
<td>ASEAN</td>
<td>Association of South East Asian Nations</td>
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<td>BoP</td>
<td>Balance of Payments</td>
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<td>CPI</td>
<td>Corruption Perceptions Index</td>
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<td>DFAT</td>
<td>Department of Foreign Affairs and Trade</td>
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<td>WB DBI</td>
<td>The World Bank Doing Business Index</td>
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<tr>
<td>EC</td>
<td>European Community</td>
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<td>ETM</td>
<td>Elaborately Transformed Manufactures</td>
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<td>ETIC</td>
<td>Enterprise Turnaround Initiative Corporation (Japan)</td>
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<td>EU</td>
<td>European Union</td>
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<td>FATS</td>
<td>Foreign Affiliate Trade in Services</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FIEs</td>
<td>Foreign-Invested Enterprises</td>
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<td>FIRB</td>
<td>Foreign Investment Review Board (Australia)</td>
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<td>FISIM</td>
<td>Financial Intermediation Services Indirectly Measured</td>
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<tr>
<td>FSC</td>
<td>Financial Services Commission (Korea)</td>
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<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<tr>
<td>GATS</td>
<td>General Agreement on Trade in Services</td>
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<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>GFC</td>
<td>Global Financial Crisis</td>
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<td>HS</td>
<td>Harmonized System</td>
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<td>I-O</td>
<td>Input-Output tables</td>
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<td>IPOs</td>
<td>Initial Public Offerings</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>M&amp;A</td>
<td>Merger and Acquisition</td>
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<td>MFN</td>
<td>Most Favoured Nation</td>
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<td>NIEs</td>
<td>Newly Industrializing Economies</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<tr>
<td>REER</td>
<td>Real Effective Exchange Rate</td>
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<td>ROW</td>
<td>Rest of the World</td>
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<td>SOCBs</td>
<td>The State Owned Commercial Banks</td>
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<td>SOEs</td>
<td>State-Owned Enterprises</td>
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<td>TRI</td>
<td>Trade Restrictiveness Index</td>
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<td>TRQs</td>
<td>Tariff Rate Quotas</td>
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<td>TWI</td>
<td>Trade Weighted Index</td>
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<td>UN</td>
<td>United Nations</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>VCEC</td>
<td>Victorian Competition and Efficiency Commission</td>
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<td>WEO</td>
<td>World Economic Outlook</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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<td>PTA</td>
<td>Preferential Trade Agreement</td>
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1. The Assignment

The Business Council of Australia has commissioned research and analysis of Australia’s trade and investment position with key Asian markets. The study assesses the extent and patterns of Australia’s exports of merchandise and services to Asia and the inward and outward direct investment flows between Australia and Asian economies. It provides an assessment of the strategic opportunities in Australia’s trade and investment relationships with its key Asian economic partners.

The results of the consultancy will be used to guide the BCA in its policy formulation and advocacy in support of its members.

For the purposes of this analysis, ten Asian economies were selected by the BCA for review. They are: China, India, Indonesia, Japan, Malaysia, the Republic of Korea, Singapore, Taiwan, Thailand and Vietnam (‘Asia-10’ hereafter).

The approach used by ITS Global involved collecting and analysing data on Australian merchandise exports from the United Nations COMTRADE database and from the Australian Bureau of Statistics (ABS) on cross-border exports of services. ITS Global has also drawn on inward and outward investment data from the ABS, the United Nations Conference on Trade and Development, and statistical agencies of other countries. The approach is described further in Annex A.

Primary analysis of this data has been combined with desk research of literature relating to Australia’s economic engagement with the region. ITS Global has analysed the recent historical data on exports and investment over the period from 2006 to 2010, as well as the outlook for the following five years. Based on its analysis ITS Global has sought to identify the immediate export and investment opportunities for Australian business for this interim report.

The report includes:

- An analysis of recent and prospective developments in trade in goods and services and inwards and outwards direct investment.

- Identification of the nature and the extent of the opportunities and risks inherent in these developments and an assessment of their implications for the Australian economy.

- An analysis of the impediments that would inhibit the ability of businesses in Australia exploiting these opportunities and averting the risks. They include both domestic and international impediments.

- Identification of the changes to public policy that would be required to remove the identified impediments. This encompasses both changes to existing policy settings or changes to public policy measures.

This report highlights the profound structural changes that are working their way through the Australian economy. The rapidly industrializing economies of Asia have driven minerals prices to record levels and expanded Australia’s mineral exports. The exchange rate consequences of these changes have put strong competitive pressure on the non-minerals economy, particularly manufacturing.
Manufacturing exports have, on average, lost ground, both absolutely and relatively. Nevertheless, this is not a sign of Australia reverting to pre-1980s position of a commodity producer that is internationally uncompetitive in manufacturing. Despite the extent of the structural shift towards mining, there are many bright spots where diverse sub-sectors of manufacturing are enjoying the benefits of rapidly growing markets for their products in Asia and are demonstrating increasing international competitiveness in the process. They may be niche producers and are certainly not household names but their gains are real and their export performance impressive. There are also large manufacturers that have invested and are successfully delivering their products in Asian markets. Similar considerations apply to cross-border exports of services.

As for investment, while Australia received almost 50 per cent less FDI than Canada from all sources in 2009, it received almost twice as much FDI as Canada from the Asian economies that are the focus of this assignment. This is an important finding. It supports the broad conclusion of this study that so far Australia’s performance is quite satisfactory. Australia is successfully riding the Asian rise.

These export and investment opportunities underline the fact that the key challenges for Australia are raising the productivity of the non-mineral economy sector, while facilitating the timely expansion of the mining industry. The boom in the terms of trade, while it may last for some time, will come to an end. It is only a matter of time. Australia needs to ensure that the post-boom economy is capable of sustaining the growth in living standards that the boom has created.
2. Australia’s trade with Asia: recent trends

2.1 Global context to Australia’s export trade

Any assessment of Australia’s trade with the Asia-10 economies, even one that focuses on what happened over the past five years, needs to be conducted with a clear and explicit understanding of how global trade has evolved over a much longer period and how it continues to evolve at the present time. This is a consequence of the profound structural shifts that have occurred in global trade, both since the Second World War as well as over the past decade.\(^1\)

Global trade has grown and continues to grow much faster than global output. Since the 1950s the value of world exports expressed as a percentage of world GDP has more than trebled — see Figure 2.1.

Most of the growth in world exports has occurred in non-commodity merchandise — especially high-technology products such as non-electrical machinery, electrical machinery, and transport equipment.\(^2\) The trade in unprocessed or lightly processed agricultural and mineral commodities, such as those that dominate Australia’s exports, represents a declining share of overall global trade. Despite this trend, there continue to be major opportunities for the export of commodities to Asia.

![Figure 2.1 World exports relative to World GDP, % growth, 1950-2010](chart)

Over this time horizon the expansion in global trade has reflected the combined influence of three distinct trends:

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\(^1\) This overview of the structural shifts in global trade draws heavily on two recent reviews of these changes by the ADB (2007) and IMF (2011).

\(^2\) The relevant Chapters or two-digit categories in the Harmonized Commodity Description and Coding System (HS) are: HS 84 (non-electrical machinery); HS 85 (electrical machinery); and HS 86-89 (transport equipment).
• The emergence of a succession of what are now called newly industrializing economies (NIEs) as systematically important trading partners. Historical examples include Japan in the 1960s, the Republic of Korea in the 1970s, and the Southeast Asian economies in the 1980s. The most recent examples are China and Vietnam.

• The increasing regionalisation of global trade flows. This trend has led to the emergence of regional manufacturing ‘hubs’ in Asia, the European Union, and North America. Between 1980 and 2009, trade among these three regions and the rest of the world, as a share of world GDP, was largely unchanged.

• The rising technological content of global trade flows. As shown in Figure 2.2, the shares of global trade that is accounted for by high and medium-technology products — such as machinery and transport equipment — has risen substantially, while the share of low-technology products — such as textiles, apparel, footwear, and raw materials — has fallen.

Figure 2.2 Composition of World manufacturing exports as a percentage of world exports, 1962-2007

Source: IMF 2011a

Until the 1970s the growth in global merchandise trade was largely driven by a combination of multilateral and bilateral liberalization of the barriers to merchandise trade, together with

3 A ‘hub’ is a location where a range of final products are produced or assembled, each from myriad flows of capital goods, raw materials and intermediate inputs through its supply chain. These hubs are not necessarily the locations where these processes are managed or organized.

4 This is based on the measurement of the technological intensity of merchandise trade that has been developed by the OECD (Hatzichronoglou 1997). The declining shares of textiles and apparel are probably at least partly due to the relatively high trade barriers to such products that were maintained by most of the developed economies over the period in question.
technological progress. Over this period Australia had largely divorced itself from these developments due to a policy of high tariff protection for the domestic manufacturing industry, which discouraged the emergence of a significant export manufacturing sector.

Since the 1970s, however, the growth in global trade has been one of the consequences of increasing vertical specialization in the production of manufactures. Vertical specialization is where the different stages of a production process are conducted in different countries. Such fragmentation seeks to take advantage of the most cost-effective location for each of the production stages.

Advances in information technologies, transport and communications have greatly facilitated the fragmentation of production, while the fragmentation process itself has led to the emergence of regional manufacturing trading hubs located in Asia, the European Union, and North America. The trend towards increased vertical specialisation has been particularly evident in the manufacture of high-technology products such as electronics, motor vehicles, and civilian aircraft.

Developed economies generally play a qualitatively different role in global trade than the newly industrialising economies. Developed economies have tended to specialise in the upstream stages of production — such as the production of industrial plant, machinery and machine tools, the design of final consumer products, and — in Australia’s case — the production of raw materials for manufacturing. From the late 1980s Australia progressively dismantled its previous policy of high tariff protection for domestic manufacturing and a significant export manufacturing sector has since emerged.

Vertical specialization by developed economies is reflected in the fact that their exports have relatively low levels of foreign content in them. As Figure 2.3 confirms, this is certainly true for Australia’s manufacturing exports. This is an impediment to broadening their participation in the downstream stages of manufacturing production.

In contrast, the newly industrialising economies have tended to specialise in the downstream stages of manufacturing. Moreover, the exports of these economies tend to have relatively high foreign content and much of that content is sourced from developed economies.

These differences mean that the exports of the two types of economies tend to respond quite differently to relative price changes — for example, those caused by movements in their exchange rates.

Much of this imported content is produced within the same industry classification that the export sector happens to occupy. This phenomenon is known as intra-industry trade and it has come to dominate global merchandise trade. Since the 1970s, the share of intra-industry trade in global trade has increased steadily, measured at the two-digit level of the Harmonized System (HS) of product classification, and is now highest in the case of the machinery and chemical categories of the HS.

---

6 Examples of these downstream production stages include the assembly of a final product or of a component or sub-assembly for such a product.
7 Intra-industry trade takes the form of: horizontal trade involving differentiated varieties of similar products; trade in vertically differentiated products; or vertical specialization of production involving trade in similar products at different stages of production (OECD 2002).
Figure 2.3 Gross & value-added exports as a percentage of GDP, 2004

Source: Koopman et al 2010, IMF 2011a

As a consequence, the foreign content of world exports almost doubled between 1970 and 2005 and has continued to increase since 2005. The supply chains that are centred on Asian hubs are much more dispersed than those centred on hubs in North America or in the European Union.

Figure 2.3 illustrates the point by comparing gross exports, which include both intermediate and final products, with value-added exports which deduct the import content of gross exports, for a selection of developed and developing economies, including Australia and New Zealand.

The Asian supply chains are notable for the fact that the intermediate products produced in those chains can cross national borders many times before they are incorporated into a final product. The much greater geographical dispersion of the intermediate stages of production therefore makes the Asian supply chain more vulnerable to disruption by external shocks, such as natural disasters. It also limits the participation of developed economies, such as Australia.

The emergence of international supply chains has allowed the newly industrializing economies to raise the technological content of their exports. These include their exports of intermediate inputs that are used to manufacture high-technology products in the developed economies. For example, since 1995 the technological content of Chinese exports has increased markedly.

In this process the manufacturing industries in these economies have progressively moved upstream along the value-added chain to such a degree that the newly industrializing economies are increasingly being positioned as competitors to the developed economies in the production of high technology products. NIEs now make a significant contribution to global exports of such products. This represents a challenge to manufacturing exports from Australia that have relatively low technological content.

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In light of the above developments, any changes in relative prices, such as those caused by exchange rate changes, can have profound implications for global trading patterns. On the one hand, a downstream position in the supply chain can cushion the impact of relative price changes on a country’s exports due to the relatively high import content of those exports. On the other hand, an upstream position means the country in question has much greater exposure to the consequences of a given relative price change, other things being equal.

The growing role of global supply chains is associated with increasing propensities to trade. Over the past decade China and the United States have emerged as systematically important trading hubs. This reflects the size of their trade and the number of their trading partners. Moreover, there is a nearly complete alignment between the systematically important trading hubs and the systematically important global financial centres, which has significant implications for global stability in both areas of economic activity.

2.2 Recent trends in Australia’s global exports

Like most developed economies, Australia’s export specialization is in the upstream stages of the production process but, unlike most of its peers, it has concentrated on producing raw materials for industry rather than capital goods. The technological content of its exports is low by comparison to its peers.10

Traditionally, Australian exports of goods and services have been heavily dominated by agricultural and mineral commodities. With the progressive decline in high levels of manufacturing protection from the late 1980s, this dominance had tended to recede with the emergence of significant exports of services and medium- and high-technology manufactures. The traditional dominance has, however, begun to re-assert itself with the international developments of the last five years, particularly the continued rapid ascent of the newly industrializing economies of East Asia.

Over the past five years the aggregate value of Australian exports of goods and services to all its trading partners has grown strongly, rising by 18 per cent in real terms to $280 billion a year, expressed in mid-2011 prices.11 Table 2.1 has the details of the exports by each of the industry sectors during this period.

The strong growth in the value of exports over this period was in spite of the Global Financial Crisis. The Crisis emerged in late 2008 and caused a sharp contraction in global trade in the following year. Although much of the international trading activity, which was lost as a consequence of the Crisis, has subsequently been recovered, as of 2010 the recovery was incomplete and the real value of exports of goods and services in that year was still below the 2008 level of $294 billion.

Table 2.1 shows clearly that almost all of the growth in the aggregate value of Australia’s exports of goods and services to all countries since 2005 has been accounted for solely by the mining sector, whose exports rose by an average of nearly 14 per cent per year in real terms over this period. In sharp contrast, the real value of the exports of agricultural exports declined by 3.4 per cent per year and manufacturing exports dropped by 3.1 per cent per year. Services exports, on the other hand, grew by a modest 1.1 per cent per year.

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10 Ibid;
11 Real prices were estimated using the implicit GDP deflator (IMF 2011).
Table 2.1 Exports of goods & services by sector to the world, 2006-2010, $ billion (a)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>CAGR (b) (% per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>29.0</td>
<td>24.6</td>
<td>27.9</td>
<td>28.0</td>
<td>25.2</td>
<td>-3.4</td>
</tr>
<tr>
<td>Mining</td>
<td>78.4</td>
<td>75.6</td>
<td>129.1</td>
<td>105.9</td>
<td>131.5</td>
<td>13.8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>77.1</td>
<td>79.7</td>
<td>80.0</td>
<td>69.1</td>
<td>68.1</td>
<td>-3.1</td>
</tr>
<tr>
<td>Services (c)</td>
<td>52.4</td>
<td>54.6</td>
<td>56.8</td>
<td>57.6</td>
<td>54.7</td>
<td>1.1</td>
</tr>
<tr>
<td>All exports of goods &amp; services</td>
<td>236.9</td>
<td>234.4</td>
<td>293.7</td>
<td>260.6</td>
<td>279.5</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011); (b) Compound average growth rate from 2006 to 2010; (c) Cross-border exports of services, i.e. by Mode 1 of the WTO General Agreement on Trade in Services (GATS); excludes exports by Modes 2, 3 and 4

Source: UN COMTRADE, IMF and ITS Global estimates

Table 2.2 expresses these monetary values in terms of the sectoral shares of the aggregate value of all exports of goods and services. The absolute changes in value then translate into a 14-percentage point increase in the share of mineral exports, such that the mining sector accounted for nearly half of all exports in 2010. Of the other industry sectors, the share accounted for by manufacturing exports had slipped some eight percentage points to 24 per cent of the total, while the share of services contracted by 2.5 percentage points to just under 20 per cent.

These figures mean that commodity exports currently account for 56 per cent of all Australia’s exports, up from 45 per cent just five years previously. Clearly, Australia’s traditional comparative advantage in the production of commodities has been strongly reinforced over this period and, in the process, has significantly ‘crowded out’ exports by the manufacturing and services sectors, albeit in a very uneven fashion as we shall see. We will also address the reasons behind these adjustments later in this report.

Table 2.2 Share of exports of goods & services to the world, by sector, 2006-2010, % of total value

<table>
<thead>
<tr>
<th>Sector</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Change 2006-10 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>12.3</td>
<td>10.5</td>
<td>9.5</td>
<td>10.7</td>
<td>9.0</td>
<td>-3.3</td>
</tr>
<tr>
<td>Mining</td>
<td>33.1</td>
<td>32.2</td>
<td>44.0</td>
<td>40.6</td>
<td>47.0</td>
<td>13.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>32.5</td>
<td>34.0</td>
<td>27.2</td>
<td>26.5</td>
<td>24.4</td>
<td>-8.1</td>
</tr>
<tr>
<td>Services (a)</td>
<td>22.1</td>
<td>23.3</td>
<td>19.3</td>
<td>22.1</td>
<td>19.6</td>
<td>-2.5</td>
</tr>
<tr>
<td>All exports of goods &amp; services</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

Notes: (a) Cross-border exports of services, i.e. by Mode 1 of the WTO General Agreement on Trade in Services (GATS); excludes exports by Modes 2, 3 and 4

Source: UN COMTRADE and ITS Global estimates
2.3 Recent trends in merchandise exports to Asia

When one turns to the Asia-10 economies that are the focus of this report one finds that there are significant differences and similarities compared to the trends that have been described above in relation to Australia’s global exports.

In the five years to 2010 the value of exports of goods and services to Asia-10 grew by over 10 per cent per year in real terms. This is nearly two and a half times faster than the rate of Australia’s global export growth in real terms over the same period.

Table 2.3 Exports of goods & services by sector to Asia-10 economies (a), 2006-2010, $ billion (b)

<table>
<thead>
<tr>
<th>Sector</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>CAGR (c) (% per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>11.4</td>
<td>10.3</td>
<td>11.9</td>
<td>12.5</td>
<td>12.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Mining</td>
<td>54.1</td>
<td>53.9</td>
<td>89.4</td>
<td>85.7</td>
<td>108.1</td>
<td>18.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>34.1</td>
<td>34.3</td>
<td>34.1</td>
<td>32.5</td>
<td>32.7</td>
<td>-1.1</td>
</tr>
<tr>
<td>Services (d)</td>
<td>19.2</td>
<td>20.3</td>
<td>22.1</td>
<td>23.1</td>
<td>22.1</td>
<td>3.5</td>
</tr>
<tr>
<td>All exports of goods &amp; services</td>
<td>118.9</td>
<td>118.8</td>
<td>158.0</td>
<td>153.8</td>
<td>175.3</td>
<td>10.2</td>
</tr>
</tbody>
</table>

Notes: (a) Exports to Peoples’ Republic of China, India, Indonesia, Japan, Republic of Korea, Malaysia, Singapore, Taiwan, Thailand and Vietnam; (b) real prices estimated using the implicit GDP deflator (IMF 2011); (c) Compound average growth rate 2006 to 2010; (d) Cross-border exports of services, i.e. by Mode 1 of the WTO General Agreement on Trade in Services (GATS); excludes exports by Modes 2, 3 and 4.

Source: UN COMTRADE, IMF and ITS Global estimates

Table 2.4 Share of all exports of goods & services to selected Asia-10 economies (a), by sector, 2006-2010, % of total value

<table>
<thead>
<tr>
<th>Sector</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Change 2006-10 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>9.6</td>
<td>8.7</td>
<td>7.5</td>
<td>8.2</td>
<td>7.1</td>
<td>-2.5</td>
</tr>
<tr>
<td>Mining</td>
<td>45.5</td>
<td>45.4</td>
<td>56.6</td>
<td>55.7</td>
<td>61.7</td>
<td>15.2</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>28.7</td>
<td>28.9</td>
<td>21.8</td>
<td>21.1</td>
<td>18.7</td>
<td>-10.0</td>
</tr>
<tr>
<td>Services (b)</td>
<td>16.2</td>
<td>17.1</td>
<td>14.0</td>
<td>15.0</td>
<td>12.6</td>
<td>-3.6</td>
</tr>
<tr>
<td>All exports of goods &amp; services</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

Notes: (a) Exports to Peoples’ Republic of China, India, Indonesia, Japan, Republic of Korea, Malaysia, Singapore, Taiwan, Thailand and Vietnam (b) Cross-border exports of services, i.e. by Mode 1 of the WTO General Agreement on Trade in Services (GATS); excludes exports by Modes 2, 3 and 4.

Source: UN COMTRADE and ITS Global estimates

As a consequence, the share of all exports that have gone to these 10 destinations has increased from 50 per cent in 2006 to nearly 63 per cent in 2010. In absolute terms, their exports totalled $175 billion in real terms in 2010 (see Table 2.3 & 2.4).

2.3.1 Sectoral composition of merchandise exports to Asia
The growth in exports to Asia-10 was reflected in all industry sectors, with the exception of manufacturing, whose exports fell by an average of 1.1 per cent in real terms. Unsurprisingly mineral exports lead the way, almost doubling in real terms over the period for an average growth rate of nearly 19 per cent per year. The growth in exports by other industry sectors, however, was decidedly modest by comparison with mineral exports — 3.5 per cent per year for services and 2.1 per cent per year for agriculture (see Table 2.3).

The growth in exports to Asia-10 was so strong that exports to the Rest of the World (ROW) over this period fell by an average of 3.1 per cent per year in real terms. The falls occurred in every sector including mineral exports, which contracted by 0.9 per cent per year. In manufacturing exports to the ROW the rate of decline was 4.7 per cent per year.

Table 2.5 Share of all exports of goods & services to world, by economy (a), 2006-2010, % of total value

<table>
<thead>
<tr>
<th>Economy</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Change 2006-10 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>10.3</td>
<td>11.1</td>
<td>12.4</td>
<td>18.5</td>
<td>22.1</td>
<td>11.8</td>
</tr>
<tr>
<td>India</td>
<td>5.0</td>
<td>5.4</td>
<td>6.0</td>
<td>7.4</td>
<td>7.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2.1</td>
<td>1.9</td>
<td>1.5</td>
<td>1.8</td>
<td>1.8</td>
<td>-0.3</td>
</tr>
<tr>
<td>Japan</td>
<td>15.0</td>
<td>13.8</td>
<td>15.8</td>
<td>13.9</td>
<td>13.4</td>
<td>-1.6</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>6.1</td>
<td>6.6</td>
<td>6.8</td>
<td>6.7</td>
<td>7.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.8</td>
<td>2.1</td>
<td>1.8</td>
<td>1.8</td>
<td>1.8</td>
<td>0</td>
</tr>
<tr>
<td>Singapore</td>
<td>3.6</td>
<td>3.4</td>
<td>3.5</td>
<td>3.2</td>
<td>2.7</td>
<td>-0.9</td>
</tr>
<tr>
<td>Taiwan</td>
<td>3.1</td>
<td>3.0</td>
<td>2.9</td>
<td>2.6</td>
<td>3.1</td>
<td>0</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.3</td>
<td>2.5</td>
<td>2.3</td>
<td>2.2</td>
<td>2.5</td>
<td>0.2</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0.9</td>
<td>0.8</td>
<td>0.8</td>
<td>0.9</td>
<td>0.9</td>
<td>0</td>
</tr>
<tr>
<td>Asia-10</td>
<td>50.2</td>
<td>50.7</td>
<td>53.8</td>
<td>59.0</td>
<td>62.7</td>
<td>12.5</td>
</tr>
</tbody>
</table>

Notes: (a) includes cross-border exports of services, i.e. by Mode 1 of the WTO General Agreement on Trade in Services (GATS) and excludes exports by Modes 2, 3 and 4.
Source: UN COMTRADE and ITS Global estimates

The shift in exports away from the ROW to Asian destinations underlines the fact that Australia’s export trade is becoming more regionalised, in line with the global trend in that direction that was discussed in Section 2.1. The shift in export destinations has, however, been very uneven as far as Australian exports are concerned.

The shift has been most evident in relation to exports of goods and services to China, which have expanded by an average of 26 per cent per year in real terms over this period, and to India, which have grown by nearly 14 per cent per year. By 2010 China and India together accounted for 56 per cent of all Australian exports to Asia-10 economies and 29 per cent of Australia’s global exports (see Table 2.5).

Two of the destinations evinced moderately strong growth rates — an average of 10 per cent per year for the Republic of Korea and six per cent per year for Thailand. However, these
seemingly high growth rates only translated into modest gains in their share of Australia’s global exports of goods and services.

The remaining six Asian destinations, however, experienced relatively poor export growth from Australia — with average growth of 4.6 per cent per year for Vietnam, 3.8 per cent for Taiwan, 3.7 per cent per year for Malaysia, 1.2 per cent for Japan, and 0.9 per cent for Indonesia — while exports to Singapore actually contracted in real terms by an average of 3.6 per cent per year. None of this group of six economies saw gains in their share of Australia’s global exports, however, and Australian exports marginally lost ground in terms of global share in three of the economies.

2.3.2 Selected merchandise exports to Asia

As was observed in Section 2.1, there are clear and unambiguous signs that a significant structural shift is underway in Australia’s exports of goods and services, generally towards mineral commodities and away from manufacturing exports. This shift is evident in both Asia-10 the ten Asian export markets, which are the focus of this report, as well as in the ROW.

Like all general statements, this characterisation conceals considerable variations which only become evident when the issues are addressed at a sub-sectoral level. For this reason a number of four-digit HS categories were selected for more detailed examination. The categories selected were:

- wheat (HS 1001);
- ammonia (HS 2814);
- medicaments (HS 3004);
- unwrought aluminium (HS 7601);
- parts for lifting and earth-moving machinery (HS 8431);
- motor vehicle parts (HS8704); and
- medical, dental and veterinary apparatus (HS 9019).

Table 2.6 has details of the real value of evolution of exports to the Asia-10 economies in each of the four-digit HS categories in each of the five years to 2010. It also has the corresponding sectoral detail for purposes of comparison.

The most notable message from Table 2.6 is that, as should be expected, there are sub-sectors that outperform the sectoral average in terms of real growth and some of these do so by a considerable margin. In the case of wheat, however, the nearly doubling of export value represents a clear anomaly as this change largely reflects a return to more normal seasonal conditions in most of rural Australia over the past year with the breaking of the recent severe drought.

Of the other four-digit categories, strong real growth has been recorded over the period in question by exports of medical, dental and veterinary apparatus (31 per cent per year), ammonia (10.6 per cent per year), and parts for lifting and earth-moving machinery (8.5 per cent per year), and medicaments (8.3 per cent per year).
Table 2.6: Exports of selected four-digit HS categories to Asia-10 economies, 2006-2010, $ million (a)

<table>
<thead>
<tr>
<th>Sector &amp; HS Category</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>CAGR (b) (% per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>11,395</td>
<td>10,281</td>
<td>11,908</td>
<td>12,544</td>
<td>12,398</td>
<td>2.1</td>
</tr>
<tr>
<td>Wheat (HS 1001)</td>
<td>175</td>
<td>278</td>
<td>913</td>
<td>2,003</td>
<td>2,627</td>
<td>96.7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>34,148</td>
<td>34,293</td>
<td>34,499</td>
<td>32,467</td>
<td>32,695</td>
<td>-1.1</td>
</tr>
<tr>
<td>Ammonia (HS 2814)</td>
<td>91</td>
<td>200</td>
<td>144</td>
<td>128</td>
<td>136</td>
<td>10.6</td>
</tr>
<tr>
<td>Medicaments (HS 3004)</td>
<td>1,285</td>
<td>1,290</td>
<td>1,312</td>
<td>1,637</td>
<td>1,770</td>
<td>8.3</td>
</tr>
<tr>
<td>Unwrought aluminium (HS 7601)</td>
<td>5,801</td>
<td>5,439</td>
<td>5,127</td>
<td>3,773</td>
<td>3,953</td>
<td>-9.1</td>
</tr>
<tr>
<td>Parts for lifting &amp; earth-moving machinery (HS 8431)</td>
<td>142</td>
<td>194</td>
<td>232</td>
<td>229</td>
<td>197</td>
<td>8.5</td>
</tr>
<tr>
<td>Motor vehicle parts (HS8704)</td>
<td>257</td>
<td>301</td>
<td>258</td>
<td>169</td>
<td>200</td>
<td>-6.0</td>
</tr>
<tr>
<td>Medical, dental &amp; veterinary apparatus (HS 9019)</td>
<td>22</td>
<td>25</td>
<td>44</td>
<td>61</td>
<td>66</td>
<td>31.2</td>
</tr>
</tbody>
</table>

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011); (b) Compound average growth rate 2006 to 2010.
Source: UN COMTRADE, IMF and ITS Global estimates

In all these HS categories, the growth in export receipts from Asia-10 over the period substantially outstripped those earned in the ROW. That said, the rates of real growth were very uneven across Asia-10, with examples of strong growth in some of the economies paralleled by strong contraction in others.

For example, high rates of growth were recorded for exports of medicaments to Japan (29 per cent per year), India (25 per cent per year), China (19.8 per cent per year), Rep. of Korea (14 per cent per year), Indonesia (10.6 per cent per year), Singapore (9.6 per cent per year), Vietnam (5.3 per cent per year), Taiwan (three per cent per year), and Malaysia (2.8 per cent per year), while export receipts from Thailand contracted by 5.4 per cent per year. This example is not atypical.

Although most of these growth rates were measured off relatively low aggregate values, this is not the case for medicaments. Exports of medicaments to the ten economies in question totalled $1.77 billion in 2010, which accounted for over five per cent of all manufacturing exports to those markets in that year and about one half of the global exports of this product category.

Another factor that should be appreciated is that exports of unwrought aluminium to the Asia-10 constituted nearly 17 per cent of all manufacturing exports to the ten economies in 2006 and 92 per cent of global exports of this product. Other things being equal, the rapid decline in the real value of exports in this HS category — of 9.1 per cent per year — was enough to account for virtually all of the loss in manufacturing export receipts from the Asia-10 economies over this period.

In the case of car parts, Australia’s principal export markets lie outside the Asia-10 economies selected for this study but exports receipts from both sources declined substantially in real terms — by 6.6 per cent per year collectively in the Asia-10 economies and 4.4 per cent per...
annum in the ROW. In the case of the 10 economies, every one of their export markets contracted, although the extent of the contraction did vary to a considerable degree.

### 2.4 Recent trends in services exports to Asia

The services sector is significant as a source of employment, economic growth, trade and investment. In developed economies such as Australia, Japan and New Zealand services comprises over two-thirds of GDP. In Asia-10 economies it accounts for more than one-third in China, Indonesia, Malaysia, Thailand, and more than two-thirds in Japan, Singapore and Rep. of Korea.

Ironically, however, services are the least studied sector in terms of value and potential for export growth in the region. This is evident in the lack of data available and the lack of understanding internationally about the role of services sectors as invaluable inputs to manufacturing and exports.

#### 2.4.1 Overview

The principle categories of cross-border services exports to Asia-10 in 2010 were Travel services (worth $17.6 billion), Transport services ($2 billion), and Other business services (around $1.5 billion). Financial Services accounted for $161 million.

The major Asia-10 markets for Australian cross-border services exports in 2010 were: China (28 per cent of total exports to the region), India (15 per cent), Singapore (12.5 per cent), and Japan (10 per cent). Contrast this with Taiwan (three per cent) and Vietnam (4.5 per cent) who accounted for the lowest share of our services exports.

In 2010, services exports to Asia-10 economies made up 10 per cent or more of Australia’s total services exports to the world in 11 of the 12 services categories. For instance, Travel services exports to Asia-10 accounted for 51 per cent of total Travel services exports; Transport accounted for 30 per cent; Other business services accounted for 19.5 per cent of global sector exports; Financial services 16 per cent; Insurance and Pension services was 39 per cent and Personal Cultural services 26 per cent of total exports.

These results are set out in more detail in the following section.

#### 2.4.2 Cross-border services exports to Asia-10

The WTO General Agreement on Trade in Services (GATS) recognizes four modes by which services are traded internationally:

- **Mode 1**: Cross-border supply;
- **Mode 2**: Consumption abroad;
- **Mode 3**: Commercial presence; and
- **Mode 4**: Presence of a natural person.

Of the four, only cross-border exports are recorded in the Balance of Payments. In 2010 cross-border services exports to the Asia-10 economies in question totalled $22.1 billion, after having increased from $19.2 billion in 2006 (see Table 2.7). Cross-border services exports to the 10 economies grew at an average of 3.5 per cent per annum over the

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12 APEC, 2010, Trade in services in the APEC region, Policy Support Unit.
2006 to 2010 period; equivalent to an overall increase of 14.9 per cent over the five years in question. In 2010 these exports were dominated by the following service categories:

- Travel ($17.6 billion);
- Transport ($2 billion);
- Other business services ($1.45 billion);
- Personal, cultural and recreational services ($208 million); and
- Telecommunications, computer and information services ($197 million).

Table 2.7: Cross-border exports of services to Asia-10 economies (a), 2006-2010, $ million (b)

<table>
<thead>
<tr>
<th>Economy</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>CAGR (c) (% per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China, Peoples' Republic of</td>
<td>4,043</td>
<td>4,583</td>
<td>5,188</td>
<td>5,901</td>
<td>6,213</td>
<td>11.3</td>
</tr>
<tr>
<td>India</td>
<td>1,854</td>
<td>2,373</td>
<td>3,264</td>
<td>3,992</td>
<td>3,292</td>
<td>15.4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,045</td>
<td>1,079</td>
<td>1,127</td>
<td>1,304</td>
<td>1,300</td>
<td>5.6</td>
</tr>
<tr>
<td>Japan</td>
<td>3,672</td>
<td>3,064</td>
<td>2,538</td>
<td>2,227</td>
<td>2,169</td>
<td>-12.3</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>1,985</td>
<td>2,148</td>
<td>2,007</td>
<td>1,979</td>
<td>2,016</td>
<td>0.4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1,489</td>
<td>1,558</td>
<td>1,671</td>
<td>1,790</td>
<td>1,738</td>
<td>4.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>3,320</td>
<td>3,523</td>
<td>4,139</td>
<td>3,202</td>
<td>2,725</td>
<td>-4.8</td>
</tr>
<tr>
<td>Taiwan</td>
<td>611</td>
<td>610</td>
<td>533</td>
<td>632</td>
<td>572</td>
<td>-1.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>839</td>
<td>944</td>
<td>1,017</td>
<td>1,170</td>
<td>1,059</td>
<td>6.0</td>
</tr>
<tr>
<td>Vietnam</td>
<td>371</td>
<td>444</td>
<td>660</td>
<td>934</td>
<td>1,012</td>
<td>28.5</td>
</tr>
<tr>
<td>Asia-10</td>
<td>19,229</td>
<td>20,328</td>
<td>22,145</td>
<td>23,129</td>
<td>22,097</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Notes: (a) excludes exports of services by Modes 2, 3 and 4 of the WTO General Agreement on Trade in Services (GATS); (b) real prices estimated using the implicit GDP deflator (IMF 2011); (c) Compound average growth rate 2006 to 2010

Source: ABS Cat. 5368.055.004, IMF and ITS Global estimates

Cross border exports of the other seven services categories were valued at less than $1 billion in 2010 and together accounted for exports worth $649 million.

Travel services comprised 80 per cent of all Australia’s services exports to Asia-10 and are worth nine times more than the second-ranked export category, Transport services. Travel services are defined as covering:

‘...goods and services for own use or to give away, acquired from an economy by non-residents during visits to that economy’ (IMF 2009).

Travel includes all personal travel by non-residents to and within Australia. Significantly, a large portion of this category involves foreign nationals coming to Australia to attend formal educational courses. The credits that are recorded in the Balance of Payments under this heading include education-related travel expenditure on a range of services including tuition.
food, accommodation, local transport and health services, and business travel services (IMF 2009).

Total exports in education services accounts for about $12.15 billion in 2010. This is comprised almost entirely by Education-related travel, a component of Travel services, which accounts for $12 billion (or 70 per cent of Travel services). A far smaller component is Education services which is recorded as a component of Personal, cultural and recreational services. ITS Global has estimated around $150 million of this sector’s $208 million in export receipts is attributable to education services.

Other business services, which makes up 6.6 per cent of total services export to Asia-10 comprises mainly professional services such as legal, accounting and management consulting services, and technical, trade-related and other business services (including engineering, architectural and scientific services).

Trends in the types of services exported from Australia to Asia-10 economies over the past five years (see Figure 2.4) suggest growth and decline in a number of services sectors. Travel services were the fastest growing services category – not including Construction which is growing rapidly but from a low base – having increased by over 33 per cent between 2006 and 2010 (equivalent to a compound growth rate of 7.5 per cent per year). On the other hand, since 2006 exports of Transport services have contracted by 40 per cent.

Figure 2.4 Composition of Australian top 4 services exports to Asia-10, 2006-2010, $ billions (a)

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS Cat. 5368.0.55.004

Beyond the top services categories, Telecommunications, computer and information services remained steady at around $280 million until declining between 2009 and 2010 to $197 million. Financial services and Insurance and pension services have both increased by 19 per cent over the period to $161 million and $130 million in services exports respectively.

The story of the rise of China and India since 2000 to become major services markets for Australia is mirrored by the parallel decline in importance of Japan (see Figure 2.5). China has increased its consumption of Australian services exports from three per cent of all services exports in 2006 to six per cent in 2010 – in the region it consumes 28 per cent of Australia’s total services exports. For its part, India is now Australia’s second-ranked destination for
services exports in the region averaging services consumption growth rates of 15.5 per cent per year.

Figure 2.5 Australia’s major Asia-10 services export markets, 2006-2010, $ billions (a)

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS Cat. 5368.0.55.004

2.4.3 Selected services exports to Asia

Transport services

Transport services cover services provided by Australian residents to other economies that involve the carriage of passengers (including fares) and related supporting services, and the movement of freight. Postal & courier services are also included. Transport services make up 12.1 per cent of total Australian exports to the world.

Exports from this sector have averaged negative growth of 7.4 per cent per year since 2006. An overall 33 per cent drop from $9.7 billion in 2006 to $6.6 billion in 2010. This has been led primarily by passenger transport and freight, down 8.4 and 9.4 per cent over the 2006 to 2010 period respectively.

In Asia-10 where Australia’s Transport services make up 9.12 per cent of all services exports, the scenario is slightly worse. Exports to the region have averaged negative growth of 12 per cent per year since 2006, a 40 per cent drop over the period. And although exports spiked at $3.7 billion in 2008, this preceded a sharp decline out to 2010 shaving $1.7 billion off Australia’s Transport services export receipts.

This drop in Australia’s transport services export performance is attributable to the global downturn in 2008-09 compounded with the strength of the Australian dollar against other currencies resultant from robust mining sector exports.

Passenger travel (fares for foreigners travelling on Australia’s airlines) is the largest transport services sector and its performance hinges on tourist arrivals, a factor negatively correlated to some degree with the appreciating dollar (See discussion in section 2.5 on Australia’s trade weighted index for further details).
The economic downturn has also stripped value from the sector, as unlike geographically proximate markets in Europe and Asia which can substitute modes of transport between countries and benefit from increased inter-region competition, Australia’s Transport services are directly vulnerable to external economic conditions.

This is reflected in export receipts from key Asia-10 markets. Singapore, Australia’s largest Transport services market and the international hub for inward travel to Asia has declined considerably from $2 billion in 2008 to $650 million in 2010. Japan, Australia’s second largest export market dropped 26 per cent from $817 million in 2008 to $603 million in 2010 (see Figure 2.6).

**Figure 2.6 Australia’s major selected economy and Asia-10 Transport services export markets, 2006-2010, $ billions (a)**

![Graph showing export receipts from major markets](image)

**Notes:** (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS Cat. 5368.0.55.004

**Financial services exports**

Financial services exports cover financial intermediary and supporting services from Australian residents to those in foreign markets. These include: 13

- fees associated with letters and lines of credit,
- financial leasing and transactions involving foreign exchange,
- financial commissions
- fees related to transactions in securities,
- commissions on commodity trading,
- asset management services, and
- financial market and regulatory services fees.

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13 ABS, Trade in Services, 2010
Also included are Financial Intermediation Services Indirectly Measured (FISIM). FISIM estimates the services value provided by financial intermediaries and institutions for which no explicit charges are made.

Margins on buying and selling equities are, however, not included in the composition of Australia’s financial services export data due to research indicating that at present these transactions are insignificant to the Australian export context.

Australia’s financial services exports to the world remained buoyant at around $1.3 billion between 2006 to 2009 before dropping from $1.35 billion in 2009 to $998 million in 2010. This was led by a 28.4 per cent drop in FISIM services export receipts between the 2009 to 2010 period. The US and UK, which collectively account for 25 per cent of Australia Financial services, reduced their consumption over the 2009 to 2010 period by around four per cent.

The Asia-10 economies, which account for 16 per cent of Australia’s total Financial services exports, saw considerable growth albeit from a low base over the period. In 2006 Financial services exports totalled $135 million and grew 19 per cent out to $243 million in 2009. This was marred however by the economic downturn and its causal effect on credit conditions and financial services, stripping $82 million from Australia’s export receipts in real terms.

The growth and decline in Asia-10 were both led by Singapore and to a lesser extent Japan. Singapore is the largest consumer of Australian financial services in Asia-10 and the third largest market globally after the United States and the United Kingdom (see Figure 2.7).

**Figure 2.7 Australia’s major selected economy and Asia-10 Financial services export markets, 2006-2010, $ billions (a)**

![Graph showing financial services export markets](image)

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS Cat. 5368.0.55.004

**Education related travel services**

Since mid-2009, Education-related travel export receipts which make up 33.8 per cent of total services exports have declined. India, Australia’s second largest education-related services export market, led the decline dropping 18 per cent year-on-year from $3.4 billion in 2009 to $2.7 billion in 2010.
Weakening has occurred in other key Asia-10 export markets as well, namely the Rep. of Korea down ten per cent from $1.2 billion in 2009 to $1.08 billion in 2010; Japan down 13 per cent from $300 million to $268 million and Singapore down 2.3 per cent from $325 million to $318 million. Outside Asia-10 the UK was down 6.7 per cent from $190 million to $177 million and the US declined 3.2 per cent from $230 million to $222 million. However, these drops from a relatively low base should be considered marginal given other factors.

On the other hand education-related travel exports to China – our largest student market – grew from $4.4 billion in 2009 to $4.6 billion in 2010. Other key Asia-10 export markets have also seen growth. Vietnam was up 11.6 per cent from $767 million in 2009 to $856 million in 2010 and Indonesia grew slightly from $620 to $630 million (see Figure 2.8).

In aggregate terms, total world export receipts of Education related travel (the key component of our Australia’s Education exports) decreased over the 2009 to 2010 period, down 3.8 per cent – the sector has however seen 11 per cent growth over the 2006 to 2010 period. In Asia-10 total export receipts dropped 4.8 per cent over 2009 to 2010; however when not accounting for India the region saw marginal growth of 0.40 per cent, and over the 2006 to 2010 period, Education related travel exports to Asia-10 grew some 51 per cent.

Figure 2.8 Australia’s Education-related travel exports to key markets, 2009-2010, $ billions (a)

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS Cat. 5368.0.55.004

2.5 Determinants of Australia’s export performance

2.5.1 Strong economic growth in Asia

On the demand side, the major determinant of Australia’s export growth in the Asia-10 economies has been the growth in the level of their economic activity. Economic growth in newly industrializing economies increases the demand by their domestic industries for imported raw materials and intermediate inputs, while the income that is generated by the increased domestic activity adds to household demand for imported consumer goods and services.
In real terms the gross domestic product (GDP) of virtually all of the Asia-10 economies grew significantly faster than the World as a whole for every year of the five-year period to 2010 (see Table 2.8).

Given that trade tends to grow faster than GDP, especially for most of the 10 economies in question, Australia’s exposure to these 10 markets was the main reason why its exports of goods and services to them grew by more than 10 per cent a year over the same period.

In essence, Australia is a world-class exporter of industrial raw materials and most of these economies are rapidly industrializing at historically unprecedented rates, based on a strong orientation towards the export of manufactures. This makes for strong growth in their demand for the coal and ores needed to produce the base metals that are the foundation of a modern economy — such as iron and steel, copper, and aluminium.

Table 2.8 summarises the economic performance of each of the Asia-10 economies over this period as published by the IMF in its most recent World Economic Outlook. The Table highlights the fact that economic growth was rather uneven across the group of 10 during this period. China, India, Singapore and Taiwan all grew by more than double the five per cent rate achieved by the World as a whole in 2010, growth in Japan was less than that. The other five economies, nevertheless, each had growth rates that were significantly higher than the global average.

Table 2.8 Real GDP growth, Asia-10 economies, 2006-2010, % per annum

<table>
<thead>
<tr>
<th>Economy</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>12.7</td>
<td>14.2</td>
<td>9.6</td>
<td>9.2</td>
<td>10.3</td>
</tr>
<tr>
<td>India</td>
<td>9.7</td>
<td>9.9</td>
<td>6.2</td>
<td>6.8</td>
<td>10.4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5.5</td>
<td>6.3</td>
<td>6.0</td>
<td>4.6</td>
<td>6.1</td>
</tr>
<tr>
<td>Japan</td>
<td>2.0</td>
<td>2.4</td>
<td>-1.2</td>
<td>-6.3</td>
<td>3.9</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>5.2</td>
<td>5.1</td>
<td>2.3</td>
<td>0.2</td>
<td>6.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5.8</td>
<td>6.5</td>
<td>4.7</td>
<td>-1.7</td>
<td>7.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>8.7</td>
<td>8.8</td>
<td>1.5</td>
<td>-0.8</td>
<td>14.5</td>
</tr>
<tr>
<td>Taiwan</td>
<td>5.4</td>
<td>6.0</td>
<td>0.7</td>
<td>-1.9</td>
<td>10.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>5.1</td>
<td>5.0</td>
<td>2.5</td>
<td>-2.3</td>
<td>7.8</td>
</tr>
<tr>
<td>Vietnam</td>
<td>8.2</td>
<td>8.5</td>
<td>6.3</td>
<td>5.3</td>
<td>6.8</td>
</tr>
<tr>
<td>World</td>
<td>5.2</td>
<td>5.4</td>
<td>2.9</td>
<td>-0.5</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Source: IMF 2011b and ITS Global estimates

2.5.2 Changes in the composition of import demand in Asia

The high rates of economic growth that the Asia-10 economies are experiencing do not simply or automatically translate into equally high or even higher rates of growth in import demand across the board. The process of economic growth in a newly industrializing economy is
generally accompanied by structural change. Over time the process produces significant
changes in the composition of what these economies import and in what quantities.

Table 2.9 provides a snapshot of the import demand by China, Japan, Rep. of Korea and Vietnam
in a selection of two-digit HS codes in 2010 in which Australian manufacturing exporters have
an interest. The values are expressed in US dollars in current prices. The HS codes are the ones
that incorporate the four-digit HS codes that were previously examined in Section 2.3.2 above.

To give some idea of the structural changes that each of these economies has experienced, Table
2.10 has estimates of the compound rate of growth in import demand in each of the HS
categories in question over the period from 2006 to 2010. The original monetary values were
denominated in US dollars at current or outturn prices. This allows the exchange rate effects of
the Australia dollar to be isolated.

**Table 2.9 Import demand by Asia-10 economies, selected two-digit HS categories, US$ million, 2010**

<table>
<thead>
<tr>
<th>HS Category</th>
<th>PR of China</th>
<th>Japan</th>
<th>Rep. of Korea</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inorganic chemical (HS 28)</td>
<td>6,258</td>
<td>5,528</td>
<td>3,743</td>
<td>489</td>
</tr>
<tr>
<td>Pharmaceuticals (HS 30)</td>
<td>6,015</td>
<td>13,058</td>
<td>3,036</td>
<td>1,178</td>
</tr>
<tr>
<td>Aluminium (HS 76)</td>
<td>8,540</td>
<td>4,999</td>
<td>3,440</td>
<td>720</td>
</tr>
<tr>
<td>Non-electrical machinery (HS84)</td>
<td>124,000</td>
<td>46,059</td>
<td>34,407</td>
<td>9,983</td>
</tr>
<tr>
<td>Motor vehicles (HS 87)</td>
<td>28,363</td>
<td>10,927</td>
<td>5,516</td>
<td>2,524</td>
</tr>
<tr>
<td>Optical, precision, &amp; medical instruments &amp; apparatus (HS 90)</td>
<td>66,996</td>
<td>18,163</td>
<td>10,486</td>
<td>1,302</td>
</tr>
</tbody>
</table>

Source: UN COMTRADE and ITS Global estimates

**Table 2.10 Rate of growth of import demand, Asia-10 economies, selected two-digit HS categories, 2006-2010, % per annum**

<table>
<thead>
<tr>
<th>HS Category</th>
<th>PR of China</th>
<th>Japan</th>
<th>Rep. of Korea (a)</th>
<th>Vietnam (a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inorganic chemical (HS 28)</td>
<td>12.19</td>
<td>9.40</td>
<td>9.36</td>
<td>12.93</td>
</tr>
<tr>
<td>Pharmaceuticals (HS 30)</td>
<td>31.85</td>
<td>20.83</td>
<td>10.90</td>
<td>24.78</td>
</tr>
<tr>
<td>Aluminium (HS 76)</td>
<td>9.16</td>
<td>-4.09</td>
<td>-10.99</td>
<td>9.39</td>
</tr>
<tr>
<td>Non-electrical machinery (HS84)</td>
<td>12.08</td>
<td>0.55</td>
<td>2.17</td>
<td>19.96</td>
</tr>
<tr>
<td>Motor vehicles (HS 87)</td>
<td>30.53</td>
<td>0.53</td>
<td>1.71</td>
<td>34.23</td>
</tr>
<tr>
<td>Optical, precision, &amp; medical instruments &amp; apparatus (HS 90)</td>
<td>11.18</td>
<td>-0.52</td>
<td>-9.17</td>
<td>18.86</td>
</tr>
</tbody>
</table>

Notes: (a) growth rates are calculated for the 2006-09 period as no data were available for 2010.
Source: UN COMTRADE and ITS Global estimates

The notable message from this snapshot is the very large markets that exist for foreign
suppliers across the four economies in Non-electrical machinery (HS84) and Optical, precision,
& medical instruments & apparatus (HS 90), even more so than for Motor vehicles (HS 87). These two HS categories also offer strong growth prospects, although not as great as that for pharmaceuticals, which tops the bill in the growth stakes in all four of the economies.

Over the past five years China’s import demand in all the two-digit HS categories in question has generally grown rapidly in line with growth in GDP but some have grown much faster than others. China’s import demand for aluminium (HS 76) grew most slowly at nine per cent per year in nominal terms, while demand for pharmaceuticals (HS 30) grew fastest at nearly 32 per cent per year, just ahead of motor vehicles (HS 87) at 31 per cent per year. Of the other HS codes, import demand in inorganic chemicals (HS 28), non-electrical machinery (HS 84) and optical, precision and medical instruments and apparatus (HS 90) each grew at around 11 to 12 per cent per year.

There were strong similarities between China and Vietnam, which experienced double-digit growth in inorganic chemicals (HS 28) (13 per cent a year), pharmaceuticals (HS 30) (25 per cent a year), non-electrical machinery (HS 84) (20 per cent a year), motor vehicles (HS 87) (34 per cent a year), and optical, precision and medical instruments and apparatus (HS 90) (19 per cent a year). Even the growth in aluminium (HS76) was only a shade under double digits.

Despite its stagnant economic growth, Japan’s import demand for pharmaceuticals (HS 30) and inorganic chemicals (HS 28) were buoyant, increasing in nominal terms by 21 and nine per cent per annum respectively. Less surprisingly, Japan’s import demand for non-electrical machinery (HS 84), motor vehicles (HS 87), and optical, precision and medical instruments and apparatus (HS 90) barely expanded or slightly contracted in the case of the latter. Import demand in aluminium (HS 76) contracted by four per cent per year in nominal terms.

The picture in the Republic of Korea was broadly similar to that in Japan — strong growth in import demand for inorganic chemicals (HS 28) and pharmaceuticals (HS 30), anaemic growth in non-electrical machinery (HS 84) and motor vehicles (HS 87), with substantial contractions in demand in aluminium (HS 76) and optical, precision and medical instruments and apparatus (HS 90).

2.5.3 Sharp rises in world commodity prices

Once productive capacity becomes fully utilised, global economic growth tends to put upward pressure on output prices. This reflects the relatively long lead times that are involved in bringing new capacity on line, particularly to produce agricultural and mineral commodities.

Land has to be cleared and prepared in the case of farming and new mineral reserves have to be discovered – and their nature and extent proven – in the case of mining. In the meantime higher prices will increase the gross returns to the land, labour and capital that are employed in producing the output in question.

Figures 2.9 and 2.10 show how the monthly prices for a selection of internationally traded commodities have evolved since January 2000. The selected commodities are those that figure strongly in Australia’s global merchandise exports:

- aluminium, copper, and iron ore (metals);
- coal and natural gas (minerals);
- beef, lamb, sugar and wheat (food); and
- raw wool (fibre).

Over the same period the US implicit GDP deflator has risen by just over 26 per cent. As the prices of most internationally traded commodities are expressed in US dollars, this index gives
an indication of the change in purchasing power associated with the changes in commodity prices.

Figure 2.9 shows that the prices of metals and minerals began to climb strongly on world commodity markets in late 2004 and the price rises have continued to accelerate since that time. By August 2011 the nominal prices for coal, copper and natural gas were three and a half to five times higher than the levels that were recorded in the first half of the decade. In the case of iron ore its price is now an incredible fourteen times the level at the beginning of this period.

**Figure 2.9 Indexes of world prices for selected metal and mineral commodities, monthly, current prices, January 2000 to August 2011 (a)**

![Figure 2.9 Indexes of world prices for selected metal and mineral commodities, monthly, current prices, January 2000 to August 2011 (a)](image)

Notes: (a) January 2000 index value = 100
Source: IMF (2011d) and ITS Global estimates

**Figure 2.10: Indexes of world prices for selected agricultural commodities, by month, current prices, January 2000 to August 2011 (a)**

![Figure 2.10: Indexes of world prices for selected agricultural commodities, by month, current prices, January 2000 to August 2011 (a)](image)

Notes: (a) January 2000 index value = 100
Source: IMF (2011d) and ITS Global estimates
In contrast the nominal price of aluminium is only 40 per cent higher than it was in first half of the decade. This is equivalent to an increase of 14 per cent in the real price of aluminium metal, which, when combined with the appreciation of the Australian dollar, may help to explain the apparent loss of competitiveness of aluminium exports from Australia that was noted previously —since 2006 Australia’s global exports of unwrought aluminium have declined in real terms by an average of over ten per cent a year.

Figure 2.10 shows that the surge in agricultural prices started earlier in the decade but these prices have yet to reach the same heights that prices for metals and minerals have attained. As a consequence, the current nominal prices for agricultural commodities are only two to five times the levels of the early 2000s and, in the case of lamb, barely 20 per cent above the level of that time.

These two Figures dramatically illustrate just how strong the boom in commodity prices has been from Australia’s perspective. The real price rises in question have fed directly into substantially higher export returns for the aforementioned commodities which have in turn put strong upwards pressure on the exchange rate. This issue will be addressed in Section 2.5.5.

### 2.5.4 Changes to international competitiveness of export sectors

International competitiveness depends on many factors but most statistical indicators of competitiveness are based on relative prices. The real effective exchange rate (REER) is one such measure that is widely used.

Changes in the REER reflect the relative rates of change of productivity and prices in Australia compared to overseas. They can be decomposed into:

- movements in Australian wages relative to the wages in its trading partners;
- movements in Australian labour productivity — output per unit of labour input — relative to productivity in its trading partners; and
- changes in the exchange rate between the Australian dollar and the currencies of its trading partners, as measured by the trade weighted index (TWI).

The combination of the first two is a measure of unit labour costs in Australia. In the case of international competitiveness, it is the rate of wage growth compared to the rate of productivity growth that matters, rather than the growth in wages on its own.

The TWI measures the change in the value of the Australian dollar relative to the currencies of our major trading partners. Other things being equal, the export sectors become more competitive as the value of our dollar falls relative to the currencies of our competitors, and vice versa.

Since the Australian dollar was floated in December 1983, its exchange rate, as measured by the TWI, has been highly volatile but a number of longer term movements are evident in the historical data. Figure 2.11 illustrates the more recent of these.

By November 1984 the TWI had appreciated to a peak of 83.5 before beginning a trend decline and falling to a record low of 47.0 by September 2001. Subsequently the TWI began a long upswing, appreciating to 73.4, which it reached in June 2008. With the emergence of the Global Financial Crisis at that time, it fell relatively quickly to 53.2 in January 2009, at which point it began to strengthen equally quickly. It has since risen to its present level with only relatively minor perturbations on the way.
Figure 2.11 picks up the story in January 2000, just before the TWI began its gradual appreciation leading up to the advent of the GFC. At the end of 2006, when mineral commodity prices began to climb very rapidly, the TWI stood at 64.9 and had appreciated by 38 per cent from its record low in September 2001. Nevertheless, despite its most recent sharp rise, the TWI remained just above the level that it reached in July 2008. This is notwithstanding the fact that the headline exchange rate against the US dollar has recently peaked at over USD1.10.

Between the end of 2006 — when mineral prices began their dramatic rise on world commodity markets — and August 2011, the TWI has appreciated by a further 17 per cent. Its progression through this second appreciation phase has, however, been particularly turbulent largely due to the Global Financial Crisis and its impact on international trade.

The appreciation of the Australian dollar against the currencies of its trading partners has had an adverse effect on the competitiveness of the export sectors of the Australian economy. This adverse impact has been partly offset by falling real unit labour costs. The index of real unit labour costs in the non-farm sectors that is published by the ABS has fallen more or less continuously since the March quarter of 2000 (see Figure 2.12). The index has dropped by over six per cent.

In the case of the mining and agricultural sectors, the loss of competitiveness due to currency appreciation has been more than offset by the rapid rise in commodity prices — which were discussed in Section 2.5.3. The manufacturing and services sectors, however, have both suffered a significant overall decline in international competitiveness, which has been a contributory factor in the loss of manufacturing and services exports since 2006.
Nevertheless the impact of these two factors on international competitiveness was not evenly felt across either sector. There is evidence of both gains and losses of market share in the Asia-10 economies in question to third country competitors over the five years to 2010. The details are set out in the Tables in Annex B.

The Tables in Annex B describe how manufacturing exporters made strong gains in market share over the five-year period. In ammonia (HS 2814), large gains were made in China (33 percentage points) and Rep. of Korea (19 percentage points), while in unwrought aluminium (HS 7601) the gains were more modest in Rep. of Korea (12 percentage points), Japan (four percentage points), and Vietnam (only three percentage points but a relative gain of 33 per cent).

In medicaments (HS 3004) there were large relative gains in Rep. of Korea (70 per cent increase), Japan (67 per cent increase) and China (23 per cent increase), admittedly from small market bases. Parts for lifting and earth moving machinery had a similar story, with market shares increasing 2.5 times in Vietnam, by 27 per cent in China, and by 29 per cent in Japan, again from small bases.

As would be expected there were also losses of market share including in unwrought aluminium (HS7601) in China, parts for lifting and earth moving machinery (HS 8431) in Rep. of Korea, and motor vehicle parts (HS 87041) in Vietnam. While most of the shifts do not appear to represent major changes, import values tell us nothing of the profitability of the trade and therefore its commercial sustainability.
3. Australia's investment with Asia: recent trends

3.1 Determinants of foreign investment

An analysis of Australia’s investment relationship with Asia should be viewed in the context of why the country needs inward and outward direct investment. The two directions of capital flow play different roles in Australia’s economy.

3.1.1 Resource- and asset-seeking inward direct investment

Inward direct investment provides access to the capital required to develop resources, build infrastructure and invest in productive means. Inward investment is often a means of producing raw materials or manufactures for export to the investing home country. Historically, in a less globalised world, Australia was also host to foreign direct investment which used Australia – a market which European and North American manufacturers understood – as a springboard into Asia.

Australia has a long history of using foreign direct investment to access greater funds than are available through domestic savings in order to invest and thereby increase growth, employment and living standards. FDI has also increased Australia’s international competitiveness by exposing local management to international business standards and best practice. It has provided access to advanced technologies and business innovations through the establishment of new businesses and the modernisation of existing ones. All have helped to raise productivity and living standards. Foreign investment is estimated to have contributed $25 billion to real national income between 1996 and 2006.

Australia has been built not just on the contribution of migrants, but on foreign investment. Every major phase of Australia’s industrial and economic development has been driven by foreign capital used to supplement savings by Australians. Chinese investment in mineral development is the latest chapter in this story.

The makeup of inward and outward investment is different. A large share of Australia’s inward investment goes to the mining sector (Figure 3.1). In 2010, the stock of FDI in mining accounted for almost one third (over $150 billion) of Australia’s total inward stock of direct investment (around $470 billion). This share was around 26 per cent in 2007 rising to almost 33 per cent in 2008, 2009 and 2010. Over the same period, direct investment in manufacturing remained steady accounting for between 17 and 19 per cent of Australia’s inward FDI stock. The next largest recipient sector of FDI in recent years is finance and insurance, which has accounted for around 14 per cent of the total inward stock since 2007.

15 The Australian Foreign Investment Review Board Annual Report states that “direct investment can be defined as capital invested in an enterprise by an investor in another country which gives the investor a ‘significant influence’ (either potentially or actually exercised) over the key policies of the enterprise. Ownership of ten per cent or more of the ordinary shares or voting stock of an enterprise is considered, under the ABS framework, to indicate significant influence by an investor.” FIRB (2010), Foreign Investment Review Board 2009-10 Annual Report, p. 52.
18 Values are in nominal AUD.
FDI in the domestic mining sector is a natural corollary of upstream producers — particularly in Japan and China — seeking to secure access to raw materials required by their domestic manufacturing sectors. The long time horizon and scale required for mining projects means acquisition of a controlling interest in existing mining operations is in many instances a sound commercial decision.

### 3.1.2 Market- and efficiency-seeking outward direct investment

For Australian businesses outward investment is not primarily about securing raw materials. It is more commonly a means of establishing new overseas markets through a commercial presence, or as a means of seeking greater efficiency in production through access to cheaper labour inputs. Australia’s outward direct investment is highest in the same sectors that dominate inward investment: mining, manufacturing, finance and insurance (see Figure 3.2).

ANZSIC services categories accounted for 52 per cent of outward FDI in 2007.19 Two-thirds of this was in finance and insurance. By comparison, mining made up 32 per cent of outward investment and 16 per cent was in manufacturing. By 2010, outward investment in services had declined as a share to 42 per cent, a 10 percentage point fall in three years. Mining investment had risen slightly to 41 per cent – an increase of nine percentage points – and outward investment in manufacturing remained at 16 per cent.

The relative decline in services-related outward investment may be explained by several factors. Services outward investment, particularly in finance and insurance, was affected by the global recession in 2008. Australian firms were not looking to expand their business offshore in the depressed economic environment. However, at the same time, the Australian mining sector withstood the downturn well thanks to a relatively buoyant Asian market and continued record demand for Australian resources.

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This pattern will not necessarily continue. Demand for commodities or the price of commodities might fall at some point and if this occurs mining M&A and offshore investment might be expected to slow. Australia’s outward FDI is discussed further below in the context of the share of Australian outward FDI hosted in Asian economies and the policy recommendations that flow from this.

**Figure 3.2 Level of outward direct investment by Australia, by select ANZSIC industry division, 2007-2010, $ billion (a)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Mining</th>
<th>Finance and insurance</th>
<th>Manufacturing</th>
<th>Construction</th>
<th>Property and business services</th>
<th>Transport &amp; Communication</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS, Cat. No. 53520, 2010

**3.1.3 Australia’s FDI outflows are comparable to inflows**

It is well known that Australia attracts relatively large inflows of direct investment. It is less commonly recognised that direct investment outflows have at times surpassed inflows. Figure 3.3 shows that in two years in the past decade – 2001 and 2003 – Australia’s foreign capital credits have exceeded liabilities. The anomaly in 2005 is explained by the change in News Limited headquarters from Australia to the United States in that year. This demonstrates the openness of the Australian economy and its reliance on having access to overseas markets, not just through trade but through holding a direct stake in offshore businesses.

**Figure 3.3 FDI inflows and outflows, Australia, 2001-2010, $ billions (a)**

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS, Cat. No. 5352.0, 2010
3.2 Australia’s investment relationship with Asia

Australia’s pattern of direct investment between 2006 and 2010 is described here based on inward and outward FDI. In most instances, data of FDI stocks is presented so as to allow for comparison with other countries in section 3.3 (FDI flows are only published at an aggregate level for Canada or Singapore). In several cases, ABS data on investment flows to and from Australia has also been drawn upon.

A general health warning about the nature of investment data is required. Caution should be exercised in drawing definitive conclusions from FDI statistics. For example, changes in the level (stock) of FDI do not necessarily mean companies have made new overseas investments. It represents the value of direct investments which change with exchange rates and prices. Direct investments by definition also include investments by sovereign wealth funds and Initial Public Offerings (IPOs).

3.2.1 Asian direct investment in Australia

Australia receives a significant amount of direct investment from Asia. In 2010, Asia-10 accounted for $92 billion, or 19 per cent, of the total inward stock of direct investment in Australia of $494 billion. This has increased from 10 per cent in 2006 (Table 3.1 and Figure 3.4). Around 95 per cent of Asian inward FDI originated in three countries: Japan, Singapore and China. This has been a consistent trend since 2006. In each of the last five years these countries have accounted for over 90 per cent of Asia-10 direct investment in Australia.

Table 3.1 Level of Asia-10 FDI in Australia, 2006-2010, $ billion (a)

<table>
<thead>
<tr>
<th>Country</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>0.7</td>
<td>-</td>
<td>4</td>
<td>9.9</td>
<td>13.3</td>
</tr>
<tr>
<td>India</td>
<td>-</td>
<td>-</td>
<td>0.1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Indonesia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>28.7</td>
<td>35.9</td>
<td>39.8</td>
<td>49.2</td>
<td>51.3</td>
</tr>
<tr>
<td>Malaysia</td>
<td>3.4</td>
<td>-</td>
<td>-</td>
<td>4.8</td>
<td>3.7</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>1</td>
<td>2.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>6.7</td>
<td>16.4</td>
<td>11.3</td>
<td>18</td>
<td>21</td>
</tr>
<tr>
<td>Taiwan</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.04</td>
<td>0.2</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Vietnam</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total (Asia-10)</td>
<td>39.6</td>
<td>52.5</td>
<td>56.2</td>
<td>83.6</td>
<td>92.2</td>
</tr>
<tr>
<td>Total (World)</td>
<td>406</td>
<td>458</td>
<td>430</td>
<td>482</td>
<td>494</td>
</tr>
</tbody>
</table>

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS, Cat. No. 53520

20 All values are expressed in 2011 Australian dollars.
Asia-10 direct investment in Australia is overshadowed by that of North America and Europe. Those countries with the largest amount of direct investment in Australia continue to be the large Anglo countries, the United States and the United Kingdom (Table 3.2). Table 3.2 shows two key messages: First is the continued importance of Anglo-European countries as a source of capital. The stock of investment from the United States fell in 2009 to under $100 billion, but...
rose again sharply by 20 per cent in 2010. Second is the prominence of the smaller Asian countries’ FDI. The fourth and fifth-ranked Asia-10 countries are ranked 17th and 18th out of all countries’ direct investment in Australia.

At an aggregate level, however, the share of total inward direct investment originating in Asia-10 has grown over the last five years. The level of total inward FDI peaked in 2007. Asia-10 accounted for around 10 per cent ($40 billion) of inward FDI in 2006 and 14 per cent ($60 billion) in 2008. Significantly, Asian direct investment increased by 50 per cent between 2006 and 2008, and then by almost 50 per cent between 2008 and 2010.

The fallout from the Global Financial Crisis offers some explanation for this pattern. In 2010, UNCTAD reported that global FDI inflows fell 37 per cent in 2009 from the previous year and were down 47 per cent from the 2007 peak. So, while UNCTAD reports that Australia’s share of global FDI inflows decreased to 2.0 per cent in 2009 (down from 2.6 per cent in 2008 and 2.2 per cent in 2007), European and North American countries fared worse. The EU’s share of global FDI inflows dropped from 44 per cent in 2007 to 32.5 per cent in 2009, and similarly the US’ fell from 18.3 per cent of inflows in 2008 to 11.7 per cent in 2009.

This decline in global inflows could be attributable to a decline in mergers and acquisitions (M&A) which contracted 34 per cent in 2009. Greenfield investment projects also fell 15 per cent.

Asia did not follow this downward pattern. Asia’s share of global FDI inflows rose from 16 per cent in 2007 to 21 per cent in 2008 and 27 per cent in 2009. In particular, China’s increased from 7.2 per cent in 2007 to 13.9 per cent in 2009.

3.2.2 Chinese direct investment in Australia

It is often assumed that China now holds the largest component of foreign capital productively invested in Australian businesses. This is not the case. As Figure 3.4 illustrates, China’s total level of direct investment in Australia has risen sharply in recent years, but now stands at $13 billion. Several other Asian countries continue to have a much larger stock of investment in Australia. Japan and Singapore accounted for $52 billion and $17 billion of direct investment in Australia in 2010 respectively.

Japanese direct investment rose from $29 billion in 2006, to $40 billion in 2008 and $52 billion in 2010. Singapore has gone from around $7 billion in 2006 to more than $11 billion in 2008 to $21 billion in 2010. The explanation for the sharp rise in Asia’s stock of investment in Australia is therefore attributable more to increases in the level of investment sourced from Japan and Singapore.

China’s FDI in Australia can also be placed in the context of overall Chinese outward direct investment. China’s total level or stock of outward direct investment has escalated quickly. In 1990 it was only US$4.5 billion, but by 2000 it had risen to US$28 billion. In 2007 it was US$98 billion and in 2010 China’s total outward direct investment had sky-rocketed to US$298 billion.

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22 UNCTAD, 2010.


China’s FDI outflows are also escalating quickly. In 2010 they were US$68 billion, up from US$57 billion in 2009 and US$52 billion in 2008. In 2005 China’s outward direct investment was US$12 billion.\textsuperscript{26} Nevertheless, China remains a relatively small outward investor.

China’s total outward investment of around US$300 billion is dwarfed by that of the US (US$4.8 trillion), the EU (US$9 trillion) and even Japan (US$830 billion) and Australia (US$402 billion).\textsuperscript{27} As shown by Table 3.2, China is now ranked tenth amongst countries that invest in Australia, with barely one tenth of the FDI stock of the United States.

Furthermore, in 2010, in the midst of a mining boom and with Australia attracting record levels of Chinese FDI, the inflow of Chinese investment ($2.5 billion) equated to only five per cent of inflows that year (Figure 3.5). This was around half that invested by Singapore. Japanese FDI inflows accounted for 13 per cent of the total. Canada and Switzerland also accounted for five per cent of FDI coming into Australia in 2010.

It has been reported in the media that Chinese investments in Australia have fallen sharply in 2011, with Chinese state-owned enterprises (SOEs) favouring investment in the mining sector in South America and Canada.\textsuperscript{28} ABS investment data and Foreign Investment Review Board approval data will not appear until 2012 so it is difficult to substantiate this suggestion.

**Figure 3.5 FDI inflows from select countries, Australia, 2010**

![Pie chart showing FDI inflows from different countries](image)

- **USA**: 36%
- **Japan**: 13%
- **Singapore**: 9%
- **Canada**: 5%
- **Switzerland**: 5%
- **Germany**: 2%
- **Hong Kong**: 2%
- **Malaysia**: 1%
- **New Zealand**: 2%
- **Other**: 20%

**Note:** Selected countries are not based on inflow rankings.
**Source:** ABS, Cat. No. 5352.0

### 3.2.3 Japanese direct investment in Australia

Japanese investment in Australia has grown over many decades. Japan began investing in the Australian resource and energy industries in the mid-1960s.\textsuperscript{29} Key characteristics of Australia’s

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\textsuperscript{26} Ibid.

\textsuperscript{27} Ibid.

\textsuperscript{28} J. Garnaut, 2011, ‘China warns of boycott’, *The Age*, Monday September 12, Business Age, p. 3.

economic relationship with Japan over the past half century include Japan's reliance on
Australian raw materials and the role Japanese investors in Australia have played in upstream
production and as consumers of raw material output. Over the past 50 years Japanese
companies have invested considerable amounts to develop Australian resources exports, acting
as shareholders and as customers.30

Japan remains a large investor in Australia: it is currently the country's third largest source
of FDI behind the United States and the United Kingdom.31

3.2.4 Other Asia-10 direct investment in Australia

Singapore has been a significant investor in Australia in recent years with acquisitions such as
SingTel's purchase of a controlling stake in Optus.

Malaysia can be categorised as a tier three investing country in Australia (it ranks 16th overall),
with a stock of around $4 billion. ABS data shows that Australia receives very little direct
investment from India, Taiwan and Thailand. The ABS does not have data for inward FDI from
Indonesia and Vietnam however these can also be expected to be insignificant.32

Insignificant levels of investment from a number of the Asia-10 countries do not necessarily
point to missed opportunities for the Australian economy. High levels of investment from other
countries suggest that regulatory barriers, such as the Foreign Investment Review Board, are
not a significant impediment to foreign investors. This is not to discount the stated concerns of
Chinese state-owned enterprises, nor does it imply that further relaxation of Australia's foreign
investment laws would not result in increased FDI – indeed liberalisation would most likely
result in further capital inflows.33

Some Asia-10 countries are not yet at a stage of economic development where local firms are
looking to expand through internationalisation. Other countries are pursuing growth through
outward direct investment, however their focus is on relocating production activities to lower
cost countries and to expand market opportunities. This is a familiar pattern in East Asia. Since
the mid-1980s Japanese firms lost competitiveness as the yen appreciated against the dollar and
were forced to move labour-intensive assembly operations off-shore.34 Australia's relatively
high labour costs together with its small domestic market would count against us attracting
high levels of efficiency-seeking, or indeed market-seeking, FDI.

A more accurate picture requires data on how much these countries invest in other countries in
the region and in other economies comparable to Australia. This is beyond the scope of the
research for this project.

31 China's role in developing Australian resources is more recent. It has been a significant investor in recent
years, however this is commonly overstated and the data suggests China's stock of investment and annual
inward flows of direct investment are smaller than imagined. These themes are discussed further in section 3.2.
32 ABS, Cat. No. 53520.
33 See for example, ITS Global (2008) Foreign Direct Investment in Australia – the increasing cost of regulation, at
http://www.itsglobal.net/sites/default/files/itsglobal/Research%20Report%20on%20Foreign%20Direct%20In
vestment%20and%20the%20Increasing%20Cost%20of%20Regulation%20in%20Australia%20%282008%29.pd
f
34 Thorbecke, W., and N. Salike (2011), Understanding Foreign Direct Investment in East Asia. ADBI Working Paper
paper/2011/06/23/4616.foreign.direct.investment.east.asia/
3.3 Australia’s outward direct investment

Direct investment from Australia to other countries is, as explained in sections 3.1 and 3.2.1, significant to the Australian economy, particularly as businesses use internationalisation as a strategy for gaining new markets. The Australian mining and manufacturing sectors are significant investors overseas, however services sectors account for half of all outward investment.

Figure 3.6 Australia’s stock of FDI in key Asia-10 countries, 2006-2010, $ billions (a)

Table 3.3 Outward FDI Stock, Australia, $ millions (a)

<table>
<thead>
<tr>
<th>Country</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>1,890</td>
<td>2,642</td>
<td>2,516</td>
<td>2,565</td>
<td>6,990</td>
</tr>
<tr>
<td>India</td>
<td>196</td>
<td>188</td>
<td>177</td>
<td>304</td>
<td>788</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,683</td>
<td>2,165</td>
<td>2,268</td>
<td>3,353</td>
<td>3,452</td>
</tr>
<tr>
<td>Japan</td>
<td>209</td>
<td>459</td>
<td>1,232</td>
<td>747</td>
<td>541</td>
</tr>
<tr>
<td>Malaysia</td>
<td>467</td>
<td>2,798</td>
<td>2,370</td>
<td>3,304</td>
<td>3,384</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>923</td>
<td>846</td>
<td>839</td>
<td>888</td>
<td>730</td>
</tr>
<tr>
<td>Singapore</td>
<td>6,072</td>
<td>10,367</td>
<td>7,120</td>
<td>7,885</td>
<td>6,527</td>
</tr>
<tr>
<td>Taiwan</td>
<td>75</td>
<td>62</td>
<td>59</td>
<td>49</td>
<td>49</td>
</tr>
<tr>
<td>Thailand</td>
<td>594</td>
<td>515</td>
<td>423</td>
<td>236</td>
<td>440</td>
</tr>
<tr>
<td>Vietnam</td>
<td>565</td>
<td>541</td>
<td>302</td>
<td>504</td>
<td>441</td>
</tr>
<tr>
<td>Total (Asia-10)</td>
<td>12,674</td>
<td>20,584</td>
<td>17,306</td>
<td>19,833</td>
<td>23,294</td>
</tr>
<tr>
<td>Total (World)</td>
<td>360,974</td>
<td>396,717</td>
<td>326,597</td>
<td>375,569</td>
<td>377,510</td>
</tr>
</tbody>
</table>

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: ABS, Cat. no. 5352.0
An analysis of recent outward FDI data to the world and, in particular, to Asia (Figure 3.6 and Table 3.3) reveals three key points: First, Australia’s stock of outward FDI to the world peaked at $397 billion in 2007 and contracted sharply in 2008 to around $327 billion with the onset of the GFC. In 2009 and 2010 it recovered but not to the levels of 2007 (Figure 3.6). This is consistent with the global trend (Table 3.3).

Second, Asia hosted only six per cent of Australia’s outward stock of FDI in 2010. This has risen slightly over the last five years from four per cent in 2006. By comparison, Australia drew almost 19 per cent of inward investment from Asia-10 in 2010. Given the relative parity between overall FDI inflows and outflows identified in Figure 3.3, there is a prima facie case that outflows to Asia-10 could increase.

Numerous reasons could explain why Australia’s investment in Asia is not greater. For example: Asian markets on the whole continue to be relatively closed to foreign investment, particularly in services sectors. Figure 3.2, above, shows that over the last five years between 40 and 50 per cent of Australia’s outward stock of FDI has been in services sectors.

Third, the value of Australia’s outward stock of FDI in China has doubled between 2009 and 2010 (Figure 3.6). Amongst Asia-10 countries, China has now overtaken Singapore as recipient of the largest amount of Australian direct investment. However the level is still relatively low in comparison with the $100 billion Australia has currently invested in the United States.

Australia’s outflow of FDI to China in 2010 was a modest $165 million. This would suggest that other factors are at play to explain the steep rise in the value of Australia’s stock of FDI in China. Price and exchange rate movements are key determinants of changes to the value of FDI stock. However, the Australian dollar has appreciated against the Yuan pushing down the value of Australian-sourced capital. China is battling inflation, though price rises have not been sufficient to explain a doubling in value of Australian FDI over 12 months.

**3.3.1 Inhibitors to further outward direct investment to Asia-10**

Australia’s investment overseas depends on a combination of business conditions in Australia and foreign markets, together with regulatory barriers overseas. Regulatory inhibitors include those encountered at the border such as foreign investment laws, as well as so-called ‘behind-the-border’ barriers. These are sector-specific regulations that prevent foreign investment or impose significant compliance costs.

Whilst impediments to trade and investment are discussed in some detail in chapter 5, some mention of investment impediments is warranted here in assessing whether there may be opportunities available that are yet to be fully exploited by Australian businesses.

35 ABS, Cat. 53520; ITS Global estimates.
International organisations have looked in some detail at the extent to which economies restrict FDI. The OECD has produced an investment restrictiveness index since 2003, and OECD economies have been assessed on three occasions (2003, 2006 and 2010). The OECD has also assessed a number of non-OECD economies, including three Asia-10 economies not in the OECD (China, Indonesia and India). Japan and Rep. of Korea are OECD members. The index for a selection of 11 countries is shown in Figure 3.7.

The World Bank’s Ease of Doing Business project provides a proxy means of assessing the restrictiveness of investment policies for those Asia-10 countries not covered by the OECD index. The Doing Business index assesses performance across a range of topics relevant to running a business (for example, starting a business, registering property, paying taxes). “A high
ranking on the east of doing business index means the regulatory environment is more conducive to starting and running a local firm” (Figure 3.8).36

3.4 Assessing Australia's investment position

Australia's investment relationship with Asia-10 countries and the world as a whole can be compared with that of other countries. ITS Global has proposed Canada as a good comparator, and Singapore.

Canada is a suitable comparator from which to draw some – necessarily qualified – conclusions about Australia’s investment ‘performance’. It is a developed economy of similar size and resource endowment to Australia with a similar pattern of historical development. Its shared legal, linguistic, and institutional endowments and geographical location in relation to Asia also make it a good choice for comparison.

A caveat to this, however, is Canada’s special trade and investment relationship with the United States. As a consequence of sharing a geographic border with the world’s largest economy, Canada’s inward and outward investment activity is skewed towards the US. However, this bias is not so pronounced that Canada doesn’t also have strong investment relationships with other regions.

Annex Figure C.1 compares the restrictiveness of Canada's investment regime to that of Australia. This analysis suggests the two systems are broadly comparable. The regulatory framework of Australia and Canada should not be a causal factor as to why one country attracts more FDI than another. There is, nevertheless, some survey and anecdotal evidence that has shown Canada’s regime in a more favourable light.

Singapore is a very different economy; much smaller in size and different in economic specialisation with no resource endowment. However Singaporean businesses are significant investors and account for a sizeable number of M&A transactions.

For the purposes of this assessment, data for Australia, Canada and Singapore is presented. Comparisons are made between FDI to and from Asia-10, the World, China, Japan, Indonesia and Vietnam. Figures 3.9 –3.11 (and Annex D1 to D6) set out this information.

The key conclusions to be drawn from this comparison are as follows:

- Australia received almost 50 per cent less FDI than Canada from the world as a whole in 2009, yet receives almost twice as much FDI as Canada from Asia-10 countries. This is an important finding. It supports the broad conclusion of this study that Australia’s performance is quite satisfactory. Australia is riding the Asian rise.
- Australia invests about the same amount in Asia-10 as Canada. It has closed the gap on Canada since 2005.
- Singapore receives more FDI from the nine other Asia-10 economies than Australia receives from all ten (including Singapore, which is Australia’s second-largest investor). Unsurprisingly, it invests far more in the region than either Australia or Canada.
- Canada’s investment in Japan is greater than Australia by a factor of ten. An explanation for this may lie in Canada’s strong equity position in automotive sector companies that have investment links to Japanese automotive suppliers.

36 World Bank, see http://www.doingbusiness.org/rankings. “The index is compiled by averaging the country’s percentile rankings on 9 topics, made up of a variety of indicators, giving equal weight to each topic.”
Figure 3.9 Level of outward investment to World from Australia, Canada & Singapore, 2005-2009, $ billions (a)

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics

Figure 3.10 Level of outward investment to Asia from Australia, Canada, Singapore, 2005-2009, $ billions (a)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics
Figure 3.11 Level of outward investment to Japan from Australia, Canada, Singapore, 2005-2009, $ billions (a)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics
4. Near-term trade & investment opportunities in Asia

The Australian economy is in the midst of profound structural change. With commodity prices at historically unprecedented levels, at least in nominal terms, the economy is facing the biggest terms of trade stimulus it has ever experienced.\(^{37}\)

The strong terms of trade have pushed the Australian dollar to its highest exchange rate in real terms since it was floated in the 1980s. As a consequence, exporters or potential exporters that are not linked to the minerals economy either directly or indirectly are facing pressure from foreign competition.

The strength of the terms of trade is predominantly due to the rapid economic growth in the Asia-10 economies; most particularly China but also India. Although China and India have been growing rapidly for some time, they remain relatively undeveloped. From a similar starting point, Japan, the Rep. of Korea, Taiwan, and Singapore have all been able to sustain high rates of economic growth over several decades.

China and India have the potential to follow suit. Notwithstanding the favourable growth forecasts from key multilateral fora, however, the opacity of the Chinese economic and political institutions precludes confident predictions about the future course of economic development in China. These difficulties are compounded by the high apparent levels of formal and informal intervention by the different levels of government. Similar impediments exist in relation to India but they are not as severe; for this reason some believe that India has the potential to overtake China in terms of its economic size. However, India faces other impediments which may hamper rapid growth. These issues are taken up in Chapter 6.

The other critical consideration is by how much the global supply of minerals will expand in response to high commodity prices and over what time horizon that might occur. The high profitability associated with the mineral commodities is already bringing new productive capacity on stream. The immediate goal of the mining sector and all Australian governments should be to accelerate this process by shortening the planning and approval lead times involved with large resource projects and by reducing tax and regulatory uncertainty, particularly the uncertainty associated with sovereign risk.

Nevertheless relatively high prices for mineral commodities are likely to be sustained at least over the short to medium term. The immediate challenge for the non-minerals economy is therefore to take advantage of the opportunities that currently present themselves with a view to closing the 'productivity gap' with the mining sector. The immediate opportunities for Australian businesses are canvassed below.

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\(^{37}\) The terms of trade are the ratio of export to import prices.
Box 4.1: Global uncertainty in Q4, 2011

In light of growing global uncertainty in the fourth quarter of 2011 a caveat to the opportunities for increased trade and investment in Asian markets identified here is necessary.

The Eurozone debt crisis continues apace as fears of a Greek default loom large following a Greek government announcement that it would fail to meet its budget deficit reduction target for this year. The size of a second Greek bailout package will have to be increased. Germany leads the call for private creditors to make a bigger contribution by facing write-downs of up to 50 per cent on their debt.

If China experiences a downturn, much of East Asia can also be expected to slow.

Source: ITS Global

4.1 Merchandise trade

4.1.1 China

China is Australia’s fastest growing export market but, perhaps contrary to public perception, this growth is definitely not confined to mineral commodities. Of the Asia-10 economies, China represents Australia’s largest market for manufacturing exports and grew at a very respectable 4.1 per cent a year in real terms over the five years to 2010. This was the second fastest rate of growth in manufacturing exports in the group of 10.

Indeed, four of the four-digit HS categories that we examined in depth — ammonia (HS 2814), medicaments (HS 3004), parts for lifting and earth moving machinery (HS 8431), and medical, dental and veterinary apparatus (HS9019) — all had double-digit growth rates over the period, albeit from a very low base in many cases. Some grew faster than all exports to China over this period and therefore have increased their share of the Chinese market for Australian goods and services, which provides an indication of increasing competitiveness in that market.

These characteristics would seem to offer an opportunity to broaden the penetration of the Chinese market in these and related areas of manufacturing.

4.1.2 India

India represents another significant opportunity for similar reasons.

The size of the Indian market for Australian manufacturing exports is about 90 per cent that of the Chinese market but growing much faster at 6.4 per cent a year. However, this growth is somewhat more narrowly focussed than is the case in China.

India recorded double-digit growth in medicaments (HS 3004), unwrought aluminium (HS 7601), parts for lifting and earth moving machinery (HS 8431), car parts (HS 8708) and medical, dental and veterinary apparatus (HS9019) (see Table 4.1).

In most cases sales are considerably lower than in China so higher rates of growth are probably easier to achieve initially. On the other hand, India had more examples where the growth outstripped that for all exports and therefore had gains in their share of the Indian market for Australian exports of goods and services.
Table 4.1 Exports to India in selected products and annual growth, 2007-2010, $ billions (a)

<table>
<thead>
<tr>
<th>Export sector</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>%</td>
<td>Value</td>
<td>%</td>
<td>Value</td>
</tr>
<tr>
<td>3004 (Medicaments)</td>
<td>3</td>
<td>-67</td>
<td>8</td>
<td>144</td>
</tr>
<tr>
<td>7601 (Aluminium)</td>
<td>18</td>
<td>48</td>
<td>26</td>
<td>41</td>
</tr>
<tr>
<td>8431 (Machinery headings parts)</td>
<td>6</td>
<td>45</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>9019 (Med Apparatus)</td>
<td>0</td>
<td>119</td>
<td>1</td>
<td>221</td>
</tr>
<tr>
<td>Total exports</td>
<td>12,654</td>
<td>7</td>
<td>17,496</td>
<td>38</td>
</tr>
</tbody>
</table>

Notes: (a) real prices estimated using the implicit GDP deflator (IMF 2011)
Source: UNCOMTRADE, 2011

4.1.3 Other opportunities

Although Australia’s manufacturing exports to Rep. of Korea, Japan, Taiwan, Thailand, Indonesia, Malaysia, and Vietnam are all contracting in real terms; there appear to be strong opportunities for growth in selected areas.

In this regard both medicaments (HS 3004) and medical, dental and veterinary apparatus (HS9019) stand out. Exports in both of these HS categories have recorded double-digit real growth rates in virtually all of these economies over the last five years.

The same applies to Singapore, which has also proved to be a very buoyant market for exports of lifting and earth moving machinery from Australia, despite modest growth in manufacturing exports as a whole.

4.2 Services

The opportunities for exports of services to the Asia-10 economies are more promising than those for manufacturing exports, given that cross-border services recorded overall growth of 3.5 per cent a year over the last five years compared to the contraction in manufacturing exports.38

As with manufacturing, the services opportunities appear to be generally brighter in the Chinese market, which recorded double-digit real growth over the five years. On the face of it, the prospects for financial services would seem to be particularly attractive even if the current foothold in the market is modest and the regulatory and commercial hurdles to be negotiated are considerable.

38 Services also offer the prospect of expansion of exports through GATS modes 2, 3 and 4, which have been particularly promising for financial services, education and travel.
Much the same could be said for both services exports to India and the opportunities for expanding an even more modest position in financial services exports.

Malaysia, Indonesia and Vietnam offer some prospects for expansion of cross border services given the generally buoyant growth in overall services exports over the past five years. That said, the recent experience in exports of financial services has been very uneven over that time. In that respect Indonesia would also appear to represent important opportunities in financial services.

4.3 Investment

A feature of global M&A activity and greenfield investment projects is that it is mostly undertaken by companies investing within the same sector.\(^{39}\) Competitive advantage directs business to stick with what they know. Moreover, barriers to entry (specialist knowledge, technology, and cost) often make it less attractive for firms to jump into industries unless there is a clearly identifiable advantage to doing so. The challenge of moving into a new sector located across international borders makes this all the more risk-laden.

Consequently, opportunities for Australian businesses in Asia-10 are best assessed in terms of new markets where businesses could expand existing operations through acquisition or new projects.

There are limits to what can be discerned precisely from existing publically available data. For example, there is no sectoral data on Australia’s direct investment in individual countries. That is, it is not known what percentage of Australia’s outward investment in a given country is in the manufacturing sector, or finance and insurance. ITS Global has a broad understanding of which sectors are of the most importance however objectivity is prevented through sheer information gaps.

4.3.1 Republic of Korea

Rep. of Korea has very low levels of FDI from Australia and Canada. Australia’s direct investments are valued at around $750 million. Its restrictiveness and ease of doing business rankings however suggest it is, in theory, relatively open to foreign investment. On both measures, Rep. of Korea ranks about the same as Australia and Canada. This presents as a potential opportunity for Australian businesses. Whilst the OECD investment restrictiveness index may not be designed to adequately take account of any \emph{de facto} regulatory barriers to foreign investment, the Doing Business Index accounts for a wider and applied spread of regulatory barriers conducive to preventing enterprise development. Korea’s business environment is discussed further in Chapter 6.

In addition, Rep. of Korea and Australia are – at the time of writing – close to finalising a free trade agreement with investment provisions. This will offer investors greater assurance that investments will be afforded a certain standard of treatment under international law.

4.3.2 Japan

Canada has a substantially higher level of direct investment in Japan than Australia. The value of Canadian FDI in Japan has more than doubled over the last two years to $8 billion.\(^{40}\) As mentioned in chapter 3, this may reflect Canada’s equity position in automotive companies that

\(^{39}\) There are exceptions, particularly in the Asian model of capitalism. For example see Box 6.2 for an account of Korea’s conglomerates.

\(^{40}\) Canada Statistics, 2011
have invested in Japan’s car manufacturers. Australia’s FDI is valued at around $500 million (Figure 3.2). This presents a *prima facie* opportunity. However, Japan’s economy and the business environment have historically been challenging for foreign investment. Its rankings on the OECD and World Bank indices confirm that it is relatively difficult for foreign enterprises to invest and run a business in Japan.

4.3.3 Thailand

Australia’s level of FDI in Thailand is low ($440 million in 2010). Thailand is assessed favourably by the World Bank as a country in which to run a business. Under the country’s investment regime, sponsored investments are welcomed and are easier to have passed through the regulatory process. There are limitations and restrictions in a number of sectors where the *Foreign Business Act* dictates that Thailand is not yet ready to compete with foreign firms.41 The Australia-Thailand FTA, in force since 2005, means Australia has a close economic relationship with Thailand and the country offers sound prospects for greater Australian investment.

4.3.4 India

As was argued in Chapter 2, India’s growth and market size make it an important drawcard for Australian businesses. This is not yet reflected in the bilateral investment relationship. A major inhibitor is India’s regulatory regime which is assessed as not conducive to foreign investment and commercial presence operations. This is discussed further in section 6.2.3. This is a key area for policymakers given the size of India’s services sector and the importance Australian services firms assign to internationalising their operations in search of new markets.

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41 For example professional services (legal, accounting, architecture, engineering), construction, forestry and fishing, advertising, tourism services, food retailing. List 3, Foreign Business Act 1999, Thailand. Available at http://www.thailawforum.com/articles/foreignbusiness2.html
5. Outlook for Australia’s trade & investment with Asia

The outlook for Australia’s exports of goods and services to the Asia-10, and inward and outward foreign direct investment from those economies is expected to be relatively positive over the medium term.

This Chapter presents an assessment of the five-year outlook for Australia’s exports and foreign investment transactions, together with the opportunities that are expected to emerge over that time horizon in respect of:

- Cross-border exports of services and identified sub-sectors, either by delivery abroad or consumption by non-residents in Australia;
- Exports of merchandise trade in manufacturing, agriculture and mining and identified sub-sectors;
- Inward foreign direct investment credit receipts.

This assessment is based on an analysis of the most recent IMF projections of the key macroeconomic determinants of trade and foreign investment over the outlook period.

Projected foreign investment flows are however more difficult to assess due to the myriad of factors that affect global capital movements over the short and long run. As such a qualitative assessment of future investment opportunities has been made to further contextualise the FDI outlook.

5.1 Determinants of export & investment performance

Demand- and supply-side variables shape the outlook for Australia’s exports of goods and services and its foreign investment transactions. The demand-side variables include income and population growth rates in each of the Asia-10 export markets, the rate of liberalisation of regulation in these markets — which reduces transaction costs in international trade and investment and enhances foreign access to these markets — as well as business innovation, shifts in consumer preferences, and movements in real exchange rates.

On the supply-side, the factors that are important are the variables that affect domestic competition for primary resources and intermediate inputs as well as Australia’s ability to build and participate in competitive supply chains to exploit export opportunities. These include the contribution of government policy to facilitate these processes by improving the operation of factor and product markets, and reducing the impediments to export and investment posed by regulation.

It is also imperative to mention here the often vital role of inwards FDI as a determinant of export performance. The experience of a number of countries, in particular China and Singapore, suggests that inwards FDI contributes positively to the transformation of domestic industry and the composition of exports by supporting the development of export supply capacity. This thereby provides access to a higher value-added export portfolio.42

5.2 International macroeconomic outlook

The International Monetary Fund publishes diagnoses and prognoses of the global economy as part of its bi-annual World Economic Outlook (WEO). The reports include medium term

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macroeconomic forecasts for the world and for each of its member countries. The Fund’s most recent WEO was published in April 2011. It released an update of that outlook in June 2011.

While retaining the cautiously optimistic outlook that it outlined in its January 2011 and April 2011 editions, the IMF has expressed concern over the increasing risks to the macroeconomic outlook, in large part due to the continued volatility of sovereign finances and the fiscal challenges that are facing the peripheral members of the Euro zone. As a consequence, global financial markets are more volatile and this is adversely affecting investor certainty and confidence.

The risks identified by the IMF include resurgent market concern over the possibility that economic recovery in the US is stalling. The impact of such a slowdown would be severe, impairing funding conditions for public and private institutions in advanced economies and in turn undercutting capital flows to the developing world.

In large part, a return to recessory conditions thus far has been averted by fiscal consolidation in the advanced economies and an increase in private demand. Moreover, while concern has been raised about the outlook for commodity prices, which have remained volatile during 2011, the IMF summary findings indicate that some commodity prices (in particular food prices) are starting to soften beginning in early-2011.

The IMF expects the world economy to grow by 4.3 per cent during 2011 and 4.5 per cent in 2012. It expects this expansion to be led by higher growth in the emerging economies of 6.4 per cent in 2011. The advanced economies are forecast to grow at 2.2 per cent, which represents a downward revision of 0.3 percentage points to the Fund’s previous assessment.

Over the remainder of the time-horizon to 2016, the IMF sees global growth of just above 4.5 per cent a year.

The story in Asia remains positive due in part to strong private sector demand. Table 5.1 sets out IMF forecasts for real GDP growth to 2016 for each of the Asia-10 economies.

The Fund has forecast economic growth in the Asia-10 economies to return to more sustainable levels through to 2016, after a cyclically high 2010 period resulting mostly from domestic and foreign economy fiscal stimuli. Interruptions to East Asian production and supply networks as a result of supply constraints from the earthquake in Japan seem to be under control. However, the higher value-added elaborately transformed manufactures (ETMs), such as automobiles and electronics, could still experience setbacks.

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44 International Monetary Fund (b), 2011, World Economic Outlook, Mild Slowdown of the Economic Expansion and Increasing Risks, Washington, DC, June.
45 IMF 2011b, p.2
46 IMF 2011b, p.4
47 IMF 2011b, p.2
### Table 5.1 Growth in real GDP in Asia-10 economies, 2009-2016, % per year

<table>
<thead>
<tr>
<th>Economy</th>
<th>2009 (a)</th>
<th>2010 (a)</th>
<th>2011 (b)</th>
<th>2012 (b)</th>
<th>2013 (b)</th>
<th>2014 (b)</th>
<th>2015 (b)</th>
<th>2016 (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China, PR</td>
<td>9.2</td>
<td>10.3</td>
<td>9.6</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
</tr>
<tr>
<td>India</td>
<td>6.8</td>
<td>10.4</td>
<td>8.2</td>
<td>7.8</td>
<td>8.2</td>
<td>8.1</td>
<td>8.1</td>
<td>8.1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>4.6</td>
<td>6.1</td>
<td>6.2</td>
<td>6.5</td>
<td>6.7</td>
<td>7.0</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Japan</td>
<td>-6.3</td>
<td>4</td>
<td>-0.7</td>
<td>2.9</td>
<td>1.7</td>
<td>1.5</td>
<td>1.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-1.7</td>
<td>7.2</td>
<td>5.5</td>
<td>5.2</td>
<td>5.1</td>
<td>5.1</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>0.2</td>
<td>6.1</td>
<td>4.5</td>
<td>4.2</td>
<td>4.2</td>
<td>4.0</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>Singapore</td>
<td>-0.9</td>
<td>14.5</td>
<td>5.2</td>
<td>4.4</td>
<td>4.3</td>
<td>4.2</td>
<td>4.1</td>
<td>4.0</td>
</tr>
<tr>
<td>Taiwan</td>
<td>-1.9</td>
<td>10.8</td>
<td>5.4</td>
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<td>5.0</td>
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<td>Thailand</td>
<td>-2.3</td>
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<td>4.7</td>
<td>4.8</td>
<td>4.9</td>
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<td>Vietnam</td>
<td>5.3</td>
<td>6.8</td>
<td>6.3</td>
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**Memorandum Items**

<table>
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<tr>
<th></th>
<th>2009 (a)</th>
<th>2010 (a)</th>
<th>2011 (b)</th>
<th>2012 (b)</th>
<th>2013 (b)</th>
<th>2014 (b)</th>
<th>2015 (b)</th>
<th>2016 (b)</th>
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<tbody>
<tr>
<td>World</td>
<td>-0.5</td>
<td>5</td>
<td>4.3</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
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<tr>
<td>Australia</td>
<td>1.3</td>
<td>2.7</td>
<td>2.9</td>
<td>3.5</td>
<td>3.5</td>
<td>3.3</td>
<td>3.2</td>
<td>3.0</td>
</tr>
</tbody>
</table>

**Note:** (a) actual; (b) forecast

**Source:** IMF 2011b

In China, the IMF expects the rate of economic growth to reach 9.6 per cent in 2011 down on 10.3 per cent the previous year, and then to ease further to a strong 9.5 per cent over the rest of the forecast period. This is a robust growth forecast result of a shift from public to private demand, continued government policy efforts to raise household discretionary incomes and favourable labour market conditions.⁴⁸

India, another high growth economy, is expected to remain above trend at around 8.25 per cent in 2011 and remain buoyant at around 8 per cent over the period. Investment conditions are expected to improve with reduced capacity constraints and better access to liquidity ensuring the steady growth outlook.⁴⁹

While the Japanese economy experienced above trend growth in 2010 — due to heavy public investment and improved export receipts — the economy is expected to contract by 4.3 percentage basis points (which is a downward revision on the two basis points that the Fund estimated in April 2011) to negative growth of 0.7 per cent in 2011 as it continues to battle with the implications of the Tohuklu earthquake.⁵⁰ The outlook remains at around 1.5 to 1.7 per cent over the rest of the period.

For the other Asia-10 economies, the IMF sees real GDP growth across the board with growth reaching above seven per cent growth in Indonesia and Vietnam and a strong four to five per cent outlook for Malaysia, Singapore, Rep. of Korea, Taiwan and Thailand.

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⁴⁸ IMF 2011a, p73.
⁴⁹ IMF 2011a p.73.
⁵⁰ IMF 2011b, p.2.
The IMF also expects that the volume of imports of goods and services by Asia-10 to grow in 2011 and remain strong over the outlook to 2016 (see Table 5.2). This reflects the latent export demand available and underpins the relevance of GDP growth for export competing markets.

Of the Asia-10 economies, all exhibit strong import volume percentage increases over the period – with the exception of Malaysia in the current year and to a lesser extent Thailand and Vietnam. China is forecast to increase its import volume of goods and services by 15 per cent in 2011 and to grow to approximately 16 per cent in 2016. Similarly, Rep. of Korea while dropping from a cyclically high import volume growth rate of 17 in 2010 will stay strong at just under 12 per cent through the period.

Table 5.2 Growth in volume of imported goods and services by Asia-10, 2009-2016, % per year

<table>
<thead>
<tr>
<th>Country</th>
<th>2009 (a)</th>
<th>2010 (a)</th>
<th>2011 (b)</th>
<th>2012 (b)</th>
<th>2013 (b)</th>
<th>2014 (b)</th>
<th>2015 (b)</th>
<th>2016 (b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>3.7</td>
<td>17.7</td>
<td>15.0</td>
<td>15.0</td>
<td>14.9</td>
<td>15.1</td>
<td>15.6</td>
<td>15.9</td>
</tr>
<tr>
<td>India</td>
<td>8.3</td>
<td>11.5</td>
<td>11.1</td>
<td>9.1</td>
<td>9.4</td>
<td>9.6</td>
<td>9.9</td>
<td>10.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>-15.0</td>
<td>27.5</td>
<td>9.7</td>
<td>8.4</td>
<td>8.3</td>
<td>8.1</td>
<td>8.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Japan</td>
<td>-15.4</td>
<td>9.8</td>
<td>10.2</td>
<td>9.8</td>
<td>7.8</td>
<td>7.9</td>
<td>8.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-7.8</td>
<td>19.7</td>
<td>1.0</td>
<td>7.3</td>
<td>7.6</td>
<td>8.1</td>
<td>7.5</td>
<td>6.3</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>-8.2</td>
<td>17.3</td>
<td>11.6</td>
<td>11.8</td>
<td>11.7</td>
<td>11.8</td>
<td>11.8</td>
<td>11.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>-11.0</td>
<td>7.8</td>
<td>7.4</td>
<td>9.3</td>
<td>10.0</td>
<td>10.2</td>
<td>9.9</td>
<td>7.9</td>
</tr>
<tr>
<td>Taiwan</td>
<td>-12.8</td>
<td>28.3</td>
<td>6.3</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Thailand</td>
<td>-16.5</td>
<td>18.6</td>
<td>3.6</td>
<td>6.9</td>
<td>5.9</td>
<td>5.9</td>
<td>6.5</td>
<td>6.2</td>
</tr>
<tr>
<td>Vietnam</td>
<td>-1.5</td>
<td>2.5</td>
<td>4.9</td>
<td>7.4</td>
<td>11.3</td>
<td>11.1</td>
<td>11.0</td>
<td>9.4</td>
</tr>
</tbody>
</table>

Note: (a) actual; (b) forecast
Source: IMF 2011b
6. Impediments to trade & investment

6.1 Domestic impediments

Impediments to continued growth in trade and investment with Asia are primarily a function of those policies affecting Australia’s productivity; a key driver of international competitiveness. Australia’s productivity is running at only 1.5 per cent over the past decade, down from over three per cent in the 1990s.\(^{51}\) Removing impediments to productivity requires a range of measures: reducing the cost of regulation; increasing labour mobility; increasing workforce size and skills; and removing infrastructure bottlenecks.

Tariffs are low in Australia and most other countries, so a leading international strategy is to reduce the cost of trading, including the cost of time taken in moving goods through the supply chain. The impediment of trade transaction costs in Australia is explained in section 6.1.1, below. Other impediments on Australia’s competitiveness for which responsibility lies at home are outlined in section 6.1.2.

6.1.1 Trade transaction costs

Transaction costs are the resource costs – the land, labour, capital, and time – used to search out, negotiate, and complete an economic exchange. They should be distinguished from the costs of producing what is exchanged, which are sometimes referred to as ‘transformation costs’ to underline the distinction.

In international merchandise trade, transaction costs are incurred at every stage of the supply chain in each direction — export and import. In the export leg, such costs are incurred when:

- negotiating the sales contract;
- preparing the documentation required to obtain a clearance from customs and other border agencies — bill of lading, export declaration, certificate of origin, invoice, packing list, and any technical standard or health certificate;
- presenting the documentation to the border agencies and dealing with any queries;
- paying any fees or charges imposed on the transaction, e.g. export clearance fee;
- transporting the merchandise to the port — sometimes in stages to allow its consolidation with other freight; and
- loading the merchandise onto the vessel for shipment to its destination.

Equivalent costs are incurred in the import leg of the transaction. Only after both sets of costs have been incurred can the merchandise be delivered to the purchaser. Many of these costs are attributable to processes that have to be undertaken to comply with government regulation (red tape).

The World Bank Group (2010) collects indicators of business regulation and its impact on business for its Doing Business Index that is published annually as part of its Doing Business Report. For the Trading across Borders component of the Doing Business Index, the Bank collects

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data on the regulatory impediments to international trade from an annual survey of business people and government officials involved in international logistics.

ITS Global has used this data to estimate the trade transaction costs in APEC economies between 2006 and 2010 (PSU 2011). APEC commissioned this work as part of its Final Assessment of its Second Trade Facilitation Action Plan. Our work was based on the methodology and approach we had developed for the Interim Assessment of that Plan.

The Trading across Borders survey identifies every official procedure, along with the time taken to complete each stage in the logistics chain and the fees and charges that are incurred in the process.\(^52\) For this purpose the logistics chain in each trade direction is broken into four stages:

- Document preparation;
- Customs clearance and technical control;
- Ports and terminal handling; and
- Inland transport and handling.

We estimated that, between 2006 and 2010, trade transaction costs in APEC economies fell by five per cent in real terms. The fall represented an annual saving of US$58.7 billion, expressed in 2011 prices. The decline was made up of broadly similar reductions in the costs for imports (5.3 per cent) and for exports (4.6 per cent).

There was some variation in the components that made up the APEC result. Over the period in question, the real cost of the time taken declined by 6.2 per cent, although the drop was somewhat higher for imports (6.3 per cent) than for exports (6.0 per cent). In contrast, fees and charges rose by 4.8 per cent in real terms but with a significant divergence between the increase for exports (6.9 per cent) and that for imports (3 per cent).

Some two-thirds of APEC — 14 economies — experienced a real decline in their trade transaction costs over the period but the individual outcomes varied enormously. APEC economies registered an extremely broad range.

The estimates for Australia are summarised in Table 6.1. They show that trade transaction costs in both trade directions amounted to a total of US$35.9 billion in 2010. These costs were equivalent to an \textit{ad valorem} tax of 11.3 per cent on the value of Australia's imports and one of 13.7 per cent on the value of its exports.

Trade transaction costs in Australia have been reduced in real terms between 2006 and 2010 but only very marginally. Moreover, a total of 13 APEC economies had realised larger proportionate gains overall. While Australia's trade transaction costs had been reduced on imports by 1.2 per cent in real terms over the period, it is a matter of concern that its costs had increased by 0.9 per cent for exports.

Trade transaction costs in Australia, as elsewhere in APEC are dominated by the cost of the transit delays to merchandise caused by red tape. It is a matter of some considerable concern that no net reductions in the time taken to complete the red tape in international trade were realised in Australia over this period — the few gains in time in one part of the logistics chain were offset by losses in other parts. This was in sharp contrast to most other APEC economies; some of whom made very substantial gains in their processing times.

\(^{52}\) The World Bank explicitly excludes the cost of international shipping as well as any tariffs or duties that might be levied on the cargo.
### Table 6.1 Trade transaction costs, Australia, 2006 & 2009. US$ million (a)

<table>
<thead>
<tr>
<th>Direction of Trade &amp; Logistical Stage</th>
<th>2006 Fees</th>
<th>2006 Time</th>
<th>2006 Total</th>
<th>2010 Fees</th>
<th>2010 Time</th>
<th>2010 Total</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Imports</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Document preparation</td>
<td>587</td>
<td>5,424</td>
<td>6,011</td>
<td>702</td>
<td>6,126</td>
<td>19.5</td>
<td>0</td>
</tr>
<tr>
<td>Customs clearance and technical control</td>
<td>419</td>
<td>3,812</td>
<td>4,231</td>
<td>313</td>
<td>2,219</td>
<td>-25.4</td>
<td>-50</td>
</tr>
<tr>
<td>Ports and terminal handling cost</td>
<td>978</td>
<td>3,812</td>
<td>4,790</td>
<td>913</td>
<td>4,725</td>
<td>-6.7</td>
<td>0</td>
</tr>
<tr>
<td>Inland transportation and handling</td>
<td>1,146</td>
<td>1,906</td>
<td>3,052</td>
<td>991</td>
<td>4,803</td>
<td>-13.5</td>
<td>100</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td>3,131</td>
<td>14,954</td>
<td>18,085</td>
<td>2,918</td>
<td>17,873</td>
<td>-6.8</td>
<td>0</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Document preparation</td>
<td>82</td>
<td>8,467</td>
<td>8,549</td>
<td>726</td>
<td>9,193</td>
<td>786.4</td>
<td>0</td>
</tr>
<tr>
<td>Customs clearance and technical control</td>
<td>150</td>
<td>1,717</td>
<td>1,868</td>
<td>115</td>
<td>1,832</td>
<td>-23.7</td>
<td>0</td>
</tr>
<tr>
<td>Ports and terminal handling cost</td>
<td>955</td>
<td>1,717</td>
<td>2,673</td>
<td>891</td>
<td>2,609</td>
<td>-6.7</td>
<td>0</td>
</tr>
<tr>
<td>Inland transportation and handling</td>
<td>1,351</td>
<td>3,435</td>
<td>4,786</td>
<td>968</td>
<td>4,402</td>
<td>-28.4</td>
<td>0</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td>2,538</td>
<td>15,337</td>
<td>17,875</td>
<td>2,698</td>
<td>18,036</td>
<td>6.4</td>
<td>0</td>
</tr>
<tr>
<td><strong>All Trade</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Document preparation</td>
<td>669</td>
<td>13,891</td>
<td>14,560</td>
<td>1,427</td>
<td>13,891</td>
<td>15,319</td>
<td>0</td>
</tr>
<tr>
<td>Customs clearance and technical control</td>
<td>569</td>
<td>5,529</td>
<td>6,099</td>
<td>428</td>
<td>3,623</td>
<td>4,051</td>
<td>-24.9</td>
</tr>
<tr>
<td>Ports and terminal handling cost</td>
<td>1,933</td>
<td>5,529</td>
<td>7,463</td>
<td>1,804</td>
<td>5,529</td>
<td>7,333</td>
<td>-6.7</td>
</tr>
<tr>
<td>Inland transportation and handling</td>
<td>2,497</td>
<td>7,341</td>
<td>7,838</td>
<td>1,959</td>
<td>7,247</td>
<td>9,206</td>
<td>-21.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>5,668</td>
<td>30,291</td>
<td>35,960</td>
<td>5,618</td>
<td>30,291</td>
<td>35,909</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Note: Table 6.1 Trade transaction costs, Australia, 06 & 10, US$ million, 2011 real
Source: APEC PSU, 2011.
6.1.2 Regulatory impediments

The amount of government regulation Australian business must comply with has grown enormously in recent decades. In part, this is a consequence of the increasing complexity of Australian society and the global economy. It is also a consequence of pressure on government to regulate against all manner of risks. Whilst economic and social benefits have come from regulation, much government regulation represents a deadweight loss to the economy and poses a significant impediment on business resources; undermining the competitiveness of Australian business. The Productivity Commission has noted that the cost of regulation to business is not just about the extra paperwork and time this takes to complete, but it is also diverting management from the firm’s core business thereby stifling innovation and crowding out productive activity.\(^{53}\)

This impediment is not new. In Australia, the early focus of regulatory burden was on the removal of regulation that impeded competition. More recent efforts were sparked by the BCA’s important report in May 2005 highlighting the mounting concern from business at the “growth of regulation and its cumulative burdens”, particularly regulation of financial services, taxation, employment and the environment.\(^{54}\) The report documented “the regulatory blowout” at the Commonwealth and state levels and argued the case that benefits flow from deregulation, with Australia’s own experience a testament to this. The report set out a number of principles of better regulation.

The Howard Government heeded this call from business and established a taskforce on Reducing Regulatory Burdens on Business, headed by Productivity Commission chairman, Gary Banks. The taskforce was asked to recommend practical options for alleviating the compliance burden. Its findings included a number of options which have formed the basis of much of the work in this area since then:

- Reducing regulatory creep;
- Removing inter-jurisdictional overlaps and inconsistencies;
- Removing regulation that is redundant or not justified by policy intent;
- Reducing reporting and recording burdens;
- Aligning definitions and criteria.

This has led to an annual stocktake of regulation in key sectors. The stocktake, initiated in 2007 is carried out by the Productivity Commission.\(^{55}\) Australian state governments have also introduced red-tape reduction targets. For example, in Victoria, the Victorian Competition and Efficiency Commission (VCEC) is tasked with advising on business regulation reform. Through this large program of work at the federal and state levels Australia has put in place the mechanisms and institutions for ongoing review of the regulatory burden on business.

The task ahead is for the government to act on recommendations for revising regulations to reduce the burden on business and to remove regulation where duplication and overlap has been identified.\(^{56}\) Businesses need to see a reduction in the stock of regulation.

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Box 6.1 Drivers of over-regulation

In a submission to the government taskforce on Reducing Regulatory Burdens on Business, the BCA identified six drivers of high compliance costs:

1. the interaction between different laws, resulting in conflicting, overlapping or inconsistent regulation;
2. the constant changing of laws, making it difficult for companies to ensure they comply and adding considerably to their costs;
3. the inefficiencies and frustrations of multiple and uncoordinated licensing and approvals processes;
4. the lack of clear delineation between the roles of different regulators, their powers and their objectives;
5. the perverse consequences of a ‘zero tolerance’ attitude by regulators, driving excessive, unproductive and, at times, counter-productive compliance responses; and
6. the excessive and growing focus on personal liability of Directors and officers, causing companies to inflict higher than necessary compliance costs upon themselves.

Source: BCA Submission to the Taskforce on Reducing the Regulatory Burden on Business, 2005

6.1.3 Resource availability

There is considerable anecdotal evidence that the burden of red-tape that business must navigate through to secure access to land, mineral deposits and other natural resources is hampering economic growth in Australia. Red-tape, particularly licensing and permit requirements, is increasingly burdensome in the area of environmental regulation.

Regulation of mining has to be examined. Every state and territory, except the ACT and Victoria, have secured major gains in mineral exports in recent years. The common view is that Victoria is not naturally endowed with mineral resources. This is not the case. Last year the Fraser Institute, a Canadian economic research body, pointed to an ominous fact. In a global review it found regulatory constraints on mining in Victoria to be as unfriendly to investment as those in Venezuela and Zimbabwe. This has to be a priority for review.57

6.1.4 Labour market regulation

The Australian labour market is another over-regulated area of the economy. Labour market regulation is going through a period of significant change as a result of major amendments in the past five years, first through the Work Choices reforms implemented by the Coalition Government and then the Fair Work amendments of the subsequent Labor Government.

Removing regulatory impediments to workplace efficiency and reducing the costs to business associated with award requirements would increase labour demand and productivity. Reducing

the regulation over employer and employee relations gives the two parties greater freedom to negotiate employment terms and conditions.

The World Economic Forum’s Global Competitiveness Index has ranked aspects of Australia’s labour market efficiency poorly: Australia is judged as ranking 39th out of 142 countries on cooperation in labour employer relations, but only 97th on hiring and firing practices and 116th on the flexibility of wage determination.58

The BCA is currently completing further work on the impediments that are posed by labour market regulation.

6.1.5 Immigration

Australia faces a skills shortage that is impacting its international competitiveness. The mining boom has created a tight labour market and skilled workers are required to meet the demand for labour of a steadily expanding economy. The problem is well understood within business. Companies are reporting skills shortages for large-scale minerals and energy projects, in construction and in IT-related industries.59 Labour constraints turn on population, participation and productivity.60 The Business Council has been an active participant in the policy debate in each of these areas.

Australia’s population is naturally ageing. The size of the workforce is growing far more slowly as the baby boomers retire from the workforce. Indeed, 40 per cent of the workforce is nearing retirement. In the ten years from 1996-2006, those aged from 50 to 59 increased from 10 per cent to 13 per cent of the total population, or from around 1.8 to 2.6 million people.61 Trends in fertility, mortality and migration are therefore critical. Australia’s fertility and mortality rates are declining. Fertility has been below the replacement rate of 2.1 since 1976 and is now around 1.75. Australians are also progressively living longer. With fewer births and people living longer, the average age of the total population increases.

Public policy continues to target increasing participation in the workforce by people of working-age. Reducing welfare dependence and investing in education and training are core to this.

Skills Australia, an independent statutory body that advises the government, supports the notion that Australia needs more workers to address the country’s ageing population. It projects there will be almost 10 million new job openings over the next 15 years, almost half of which are to replace retiring workers.62

Increasing Australia’s workforce requires a coordinated response. It includes training and education measures to increase the skills of our existing workforce and the participation rate of the existing population. It must also include immigration measures targeting both permanent migration and temporary skilled migration.

Lifting participation through greater investment in education and training is critical, but is not sufficient to meet current and future demands for workers. Australia has always supplemented

62 Westacott, 2011.
demand for labour through migration and will continue to do so into the future. ITS Global supports an increased migrant intake, together with greater use of temporary skilled migration.

6.2 Impediments in key Asian markets

Global markets have opened significantly in the last 25 years. Governments across the industrialized and developing world have reduced or removed trade barriers – particularly import tariffs – unilaterally and as part of the WTO multilateral trading system, and domestic markets have opened to foreign competition. Australia has been a leading advocate and exponent of this process.

There are significant constraints for Australian companies to operate in the region, but these are not a reason for Australian businesses not to trade with and do business in Asian markets.

6.2.1 Barriers to services and investment

This section describes the types of barriers Australian businesses face when looking to invest in Asia-10 markets. Box 6.2 provides specific examples of impediments faced in Asia-10 economies who are members of the Association of South East Asian Nations (ASEAN), except Indonesia. Impediments are then considered in the broader economic and political context for four key Asia-10 markets (China, India, Japan and Rep. of Korea), and for Indonesia which, as our nearest Asian neighbour, is of special interest, though not one of our largest markets.

The largest impediments to business in Asia-10 countries are laws governing the establishment of a commercial presence and those restricting movement of labour – both skilled and unskilled. Commercial presence restrictions limit access to the services market, whilst labour restrictions tend to be discriminatory in that they favour national providers.

Investment laws typically apply at the border. For example, most Asia-10 countries impose foreign equity limits for certain sectors or activities. Use of a foreign equity limit varies significantly from country to country. In some countries, legal and administrative instruments require that foreign investors obtain government approval for almost all investments, even in non-sensitive sectors. In some instances it is the Constitution that presents a legal impediment by preventing foreign participation. The investment law or company law typically mandates a legal entity through which foreign investments are to be made.

Other investment laws are applied beyond-the-border, once an investor has approval to invest but before a local entity can operate. For example, licensing and authorization requirements and restrictions on employment of personnel may be included in laws that apply equally to local businesses, but which, by their nature, discriminate against a foreign business.

Movement of labour impediments may be applied at the border – e.g. in an investment law – or beyond the border. These can take the form of laws imposing nationality and residency requirements, economic needs tests, and licensing and qualification requirements.
### Box 6.2 ASEAN: Select services & investment impediments

Key impediments to services commercial presence and mining, manufacturing and agriculture investment in ASEAN members of the Asia-10 group (note, Indonesia is addressed in section 6.2.6) include the following:

**Malaysia**  
**Services:** Domestic laws in telecoms and transport restrict commercial presence. For example, the Communications and Multimedia Act, Multimedia Commission Act, Merchant Shipping Ordinance, Merchant Shipping Amendment Act.

**Investment:** Domestic laws on investment in manufacturing and mining and quarrying (eg. Foreign Investment Guidelines, Industrial Coordination Act, 1975).

**Singapore**  
**Services:** Restrictions on commercial presence in telecommunications services are contained in the Telecommunications Act and Legal and Accounting services are restricted by the Legal Profession Rules, Legal Profession Act, Accountants Act.

**Investment:** Foreign equity participation in local banks is limited to 40% in total, and 5% per for single or related foreign shareholders. Foreign bank head offices must have minimum capital of S$200 million and must satisfy Bank for International Settlements (BIS) capital adequacy requirements.

**Thailand**  
**Services:** The Foreign Business Act, Telecommunications Business Act and Revised Telecoms Business Act, Vessels Act, Transport Act, Land Transport Act, Legal Profession Act, Accounting Profession Act, Architect Act, Engineering Act, Medical Profession Act).

**Investment:** Foreign investors require separate approval in writing to be accorded investment protection rights under Thailand’s investment treaties. The Foreign Business Act restricts and prohibits foreign participation in: List 2 (group 3) and List 3 activities.

**Vietnam**  
**Investment:** Certain industries are closed to foreign investors but open to domestic investors (see Law on Investment; Government Decree 108/2006-ND-CP). Restrictions on equity participation, type of legal entity, performance requirements for admission, and use of foreign senior management are contained in, for example, Decree 34/2008/ND-CP. Foreigners do not receive national treatment for the use and ownership of commercial land (Law on Land, 2003; Decree 181/ND-CP).

Source: ITS Global

### 6.2.2 China

Prior to 1979 China had a centrally planned economy. All means of production were owned and directed by government and all levels of government were under the monopoly control of the Chinese Communist Party.

The economic reforms initiated by Deng Xiaoping in 1979 replaced Soviet-style central planning, where government determined what and how much was produced, by a system that progressively let State-Owned Enterprises (SOEs) make their own business decisions, allowed a degree of private ownership, partially privatized assets owned by central and provincial government and local communes, and reduced barriers to foreign trade and investment. Officially the reforms are known as the ‘socialist market economy’ or ‘socialism with Chinese characteristics’.  

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63 The need to develop a Socialist Market Economy was formally recognized by the 14th National Congress of the Chinese Communist Party in 1992 (OECD 2009).
By 2001 China had joined the World Trade Organization and its product and factor markets had become much more competitive. Market forces are now generally the main, but not the sole, determinant of prices and economic behaviour, although this is more the case in product markets than in factor markets for land, labour and capital.  

A legal framework has been established for the conduct of private commercial activity, including providing for incorporation and corporate governance, control of monopolies, and the definition and protection of intellectual and other property rights. Reforms have enhanced the capacity of the central government to oversee a market economy, and regulation has become less focussed on ad hoc treatment of individual cases and more on establishing a transparent framework based on the rule of law. In the context of the global economic crisis, however, industry policy in the form of sectoral plans is being stepped up.

Notwithstanding the significance of these reforms, formal and informal intervention by government remains pervasive, both in absolute and relative terms. SOEs dominate most economic sectors, particularly large-scale manufacturing, telecommunications, transport, banking and financial services, while maintaining close ties to and the backing of government, especially local government. The national government is involved in the appointment and removal of chief executives of SOEs, industry associations and the judiciary. It also maintains Party units within the SOEs and private businesses. The ability of the private sector to enforce property rights and contractual obligations through the courts is uncertain.

China’s domestic capital markets remain underdeveloped, while financial intermediation is limited. Private access to finance is strictly regulated. This results in high levels of saving by private companies, which have to retain a high proportion of their earnings to finance investment, and by households, which have no social safety net to help to finance their health or aged care needs.

Private savings are mostly held by State-Owned Commercial Banks (SOCBs). They provide most commercial lending and most of that flows to the SOEs. The central bank manages the foreign exchange rate and capital controls prevent foreign currency inflows. The government acquires all foreign currency inflows and most foreign exchange reserves are invested in dollar securities held by sovereign wealth funds.

Capital market discipline of listed companies is limited by the predominance of SOE shareholdings, a ban on sales of state shareholdings, and the absence of a corporate bond market. It is unclear whether the Party will eventually allow SOEs to sell their controlling stakes to private investors, let alone foreign ones.

**a. Specific impediments to international trade & foreign investment**

China has cut its average applied MFN tariff rate from around 50 per cent in the early 1980s to 9.5 per cent in 2009. While bound tariff rates are close to applied rates, the tariff schedule is complex — for example, the applied MFN tariff has 60 different ad valorem rates.

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65 OECD, 2010.
Box 6.3 China: Select trade & investment impediments

**Investment:**
- Catalogue Guiding Foreign Investment in Industry lists restricted, prohibited and permitted industries; the catalogue is used to target high-value added manufacturing sectors.
- National Development Reform Commission verification of projects is required for those greater than US$50 million for restricted categories and US$300 million for encouraged categories.

**Services:**
China imposes restrictions in a number of services sectors that prevent or discourage foreign suppliers from gaining or further expanding market access. For example:
- Insurance: Foreign life insurance companies can only be established as joint ventures, with foreign equity capped at 50%.
- Banking: regulations require that only foreign-funded banks with a representative office in China for two years and total assets exceeding $10 billion can apply to incorporate in China.
- Legal: foreign firms cannot practice Chinese law; there are also restrictions on cooperation with Chinese law firms.
- Retailing: domestic retailers appear to receive more favorable treatment than foreign companies over zoning and urban development requirements. Foreign retailers also face informal minimum capital requirements.
- Telecommunications: Foreign participation is limited to 49% in basic services and 50% for value-added telecommunications services. Investment approval procedures are non-transparent.

**Goods:**
- Import licensing and tariff rate quotas are applied to certain agricultural commodities (rice, rice flour, and wheat flour) and chemical fertilizers.
- Certain imports are prohibited (chemicals, used machinery, used electronics, and used transport equipment).

Source: WTO (2010); USTR (2011)

China also extensively uses non-tariff border measures, such as import and export licensing or state trading to ‘guide’ the allocation of resources. Imports of commodities are subject to import licensing, tariff rate quotas (TRQs) are applied to certain agricultural commodities and chemical fertilisers, and prohibitions apply to imports of certain commodities, chemicals, used machinery, used electronics, and used transport equipment.69

In aggregate, China’s import barriers have been estimated to be equivalent to an *ad valorem* tax of 10.0 per cent on the value of all merchandise imports by China, as measured by the Trade Restrictiveness Index (TRI) developed by the World Bank.70 Based on the World Bank’s TRI estimates, the *ad valorem* tax on Chinese imports is in line with the average for all APEC economies, which we have estimated at 9.9 per cent.71

China has recently relaxed some of its restrictions on foreign direct investment in services, notably in telecommunications and tourism.72 The Central Government is in the process of delegating to local government the authority to licence operations of ‘encouraged’ foreign-invested enterprises (FIEs) and certain selected sectors, as well as certain types of FIEs such as

71 APEC Policy Support Unit, forthcoming.
72 WTO, 2010.
foreign invested joint-stock companies. Nonetheless, there are still significant restrictions including foreign participation limits on inwards foreign investment in some sectors and in private-sector activities. 73

In banking, stringent qualification requirements remain. They include high minimum asset requirements on sole or controlling shareholders, high minimum paid-up capital amounts, restrictions on the supply of credit-card services, and restrictions on the business scope of foreign banks branches. 74

The stock market in China has continued to develop and the process of converting shares of SOEs to be traded in the market has progressed.75 Bond markets, however, are still completely closed.76

b. Transparency of institutions & policy

While the WTO recently reported that China has continued to take steps to improve the transparency of its trade policy regime, it has also pointed out that aspects of the regime remain complex and opaque. 77

In 2009 China was ranked 38th out of 48 countries that were assessed on the Milken Institute’s Opacity Index.78 This Index was developed to assess the effectiveness of a country’s economic and financial institutions, and therefore the risk the country represents to trade, investment and other commercial activity. Unlike other country risk assessments, the Opacity Index is based entirely on empirical measurements, so as to facilitate international comparisons.

The five components of the Opacity Index measure:

- a country’s level of corruption;
- the inadequacies of its legal system;
- its enforcement of creditor and property rights;
- its application of international accounting standards and corporate governance; and
- its regulation.

While the domestic banking system in China it is well-insulated from external shocks, the effective centralisation of credit decision-making within the Party and the barriers to entry in the banking sector make it systematically vulnerable to destabilising shocks. The opacity of politics, government and the system of justice in China, however, means that it is very difficult to assess the precise extent of this vulnerability.

73 WTO, 2010.
74 WTO, 2010.
75 WTO, 2010.
c. Fragility & adaptability of institutions & policy

State owned commercial banks (SOCBs) play a key role within the Chinese economy. Given the
difficulties the SOCBs have had in the past in recovering bad loans to SOEs,79 such spending
could be expected to lead to a sharp rise in non-performing loans in the banking system and
thereby impair its ability to fund economically worthwhile investment.

At present the level of public debt, broadly defined, has been estimated to be about 80 per cent
of GDP. Of the total, 28 percentage points represents borrowings by local government, while
some 15 percentage points is accounted for by non-performing loans that are held by state
owned financial institutions, most of which were made prior to the onset of the Global Financial
Crisis.80 If this is estimate is even close to the mark, the current level of public debt in China
would greatly constrain any attempt by the Central Government either to expand public
investment itself or to recapitalise the banking system so as to allow the SOCBs to fund
investment by the SOEs, or the private sector for that matter.

6.2.3 India

India’s economy rebounded from the global economic crisis with growth over 10 per cent in
2010 and over eight per cent in 2011 as it continues the program of structural reform and trade
liberalization begun in the early 1990s. Growth is forecast to remain above eight per cent in the
medium term, led by services and manufacturing with agriculture growing more slowly. India’s
forecast high growth taken together with ITS Global’s more sanguine assessment of China and
the modest economic engagement between Australia and India mean India is, prima facie, a
promising business prospect. We are, nevertheless, reluctant to herald India as the “new China”
due to weaknesses and underlying problems present in India’s economic model leaving
capitalism “skewed towards the state and [family-controlled conglomerates].”81

a. Specific impediments to international trade & foreign investment

India is the world’s largest parliamentary democracy with decentralised control through the
constitutional separation of powers and three independent branches: the executive, the
legislative and the judiciary. It has a federal structure with legislative power divided by the
Constitution between the federal parliament and elected state governments, a largely
independent press, an activist Supreme Court, and a large and growing middle class. Despite
this, religion and caste play a major role. In the period since independence India’s embrace of
non-Leninist socialism (in its Constitution and through government policy) also influenced its
economic structure and capitalist model for many decades. From 1991, the new government
introduced economic liberalisation with the support of the finance minister, Manmohan Singh,
now prime minister.

India suffers high rates of rural and urban poverty, corruption, caste-related violence and has
unresolved border disputes. However, reforms and economic growth over the past two decades
have seen improvements in poverty reduction measures. GDP per capita increased 40 per cent
in the three years to 2009-10. Infant mortality declined from 68 per 1,000 in the mid 1990s to
52 per 1,000 in 2008. And literacy levels increased from 49 per cent in 1990 to 66 per cent in
2008.82 It is reasonable to expect such improvements to continue.

Wiley & Sons, Singapore.
80 Walter and Howie, 2011
The government continues to run large public sector budget deficits, though fiscal consolidation is again underway after an expansionary phase during the global economic crisis. Whilst urban and rural infrastructure has improved, deficiencies in this area are a major constraint on India's economic development. India is an under-developed country outside the middle-class services-oriented communities. Significant improvements are required in electricity, roads, railways, ports, airports, telecommunications, water and sanitation.83

This is beyond the capacity of the fiscally constrained federal and state governments. India will not be able to achieve the same success in this area as the centrally controlled Chinese government. Indian states are not compliant in the way Chinese provincial governments are. Further private infrastructure investment, including foreign investment, is required.

The services sector accounts for 56 per cent of GDP and is the main driver of economic growth. Services grew at an average of 10 per cent between 2006-07 and 2009-10. India's call centre facilities and IT and back-office support staff are world renowned. This is, in part, attributable to India's success in offering businesses around the world an educated and English-speaking outsourced workforce. Those services sectors exhibiting strongest growth are financial services, trade services, hotels, transport and communications. Foreign direct investment is limited in financial services but not for most other services activities. The OECD recommends India relax constraints on the financial sector.

Manufacturing's share of GDP was 15.5 per cent in 2009-10 and agriculture accounted for 16.6 per cent. Agriculture, however, employs 52 per cent of the Indian workforce. This has meant the government continues a protectionist agricultural policy. Average tariffs in this sector (around 33 per cent) are far higher than in manufacturing (8.9 per cent). Agriculture also receives government support through a variety of other programs.

India is gradually allowing more FDI and has recently improved the transparency and predictability of its investment regime for investors. Investors generally receive national treatment. Nevertheless, foreign investors are faced with a complex system of rules and institutions governing investment, and India does discriminate against investors from certain countries (particularly Pakistan and Bangladesh). This complexity is exacerbated by the fact that changes to foreign investment rules can be proposed by any ministry of the Indian government, though the proposal must be considered and approved by Cabinet.

**Box 6.4 India: Select trade & investment impediments**

<table>
<thead>
<tr>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Investment: In most sectors investment is subject to an equity limit and specific conditions. These are set out in the Consolidated FDI Policy circular and are subject to periodic revision.</td>
</tr>
<tr>
<td>- Stringent and nontransparent regulations and procedures governing local shareholding inhibit inward FDI and increase risk to new entrants. Foreigners can in principle acquire 100% ownership of a locally traded company, but regulatory hurdles make this impossible at present.</td>
</tr>
<tr>
<td>- Price control regulations undermine the incentive for foreign investors to increase equity holdings in India.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Insurance services: foreign equity is currently limited to 26% of paid-up capital. Government ownership has a strong presence in the industry.</td>
</tr>
<tr>
<td>- Banking services: foreign banks are required to submit their internal branch expansion plans on an annual basis, but expansion is limited by nontransparent quotas on branches. Foreign banks are not authorized to own more than 5% of on-balance sheet assets of an Indian private bank without</td>
</tr>
</tbody>
</table>

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Investment in most sectors is subject to an equity limit and specific conditions. These are spelled out in the Consolidated FDI Policy circular, periodically updated. Sectors not listed are assumed to be fully open. FDI is prohibited in relatively few sectors (e.g. retail trading, some agriculture, and sectors reserved for the public sector, to name a few) though the range of sectors/activities where foreigners are not allowed has increased in recent years. An illustration of the problem faced by investors is even where 100 per cent foreign ownership is allowed, fulfilling necessary conditions and obtaining permits means that – de facto – the sector is more restricted to foreign investors than where an explicit equity cap applies.

The impediment foreign businesses face negotiating investment approval belies one of the major impediments to doing business in India. India’s business environment is ranked poorly by the World Bank’s Ease of Doing Business index. Ranked 134 overall, India fares even worse in one other category: starting up a business and obtaining construction permits. The World Bank assesses that it is more difficult to set up and run a business in India than in any other leading newly industrializing economy (for example Brazil, Indonesia, China or Vietnam – see Figure 3.8).

b. Transparency of institutions & policy

Reform is required to increase the transparency of trade and investment policies and simplify India’s import regime, especially its licensing and permit system. India’s institutions by and large operate in an open fashion. This underlying factor distinguishes India from China. However in India, governments do not succeed or fail on economic policy alone. The reason for this has been explained by India’s history. Unlike many industrialized democracies, India was economically poor when its people became enfranchised.

Transparency is, nevertheless, hindered in two ways. First, corruption is widely regarded as being significant, especially in government procurement of telecommunications, power and defence contracts. This is an impediment to foreign investment. Transparency international ranks India 84 out of the 180 countries in its Corruption Perceptions Index. Second, India’s

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84 WTO (India), 2011, p. 32.
85 India ranks 165 for starting a business and 177 for obtaining construction permits in 2010. (It can take 200 days to obtain a construction permit.) See http://www.doingbusiness.org/rankings
87 Heritage Foundation, 2011. See http://www.heritage.org/index/Country/India#freedom-from-corruption
burdensome regulatory environment is difficult to navigate and India is an excessively bureaucratic place to do business.

c. Fragility & adaptability of institutions & policy

India’s burgeoning middle class and rapid economic development mean it is often seen as the “next China”. Whilst ITS Global is of the view that India offers significant prospects for Australian businesses – particularly in light of the down-side risks associated with China’s continued economic growth – there are caveats to future trade and investment success with India.

India’s past links to socialism, though now abandoned by the government, are deeply rooted. India shares features of post-Soviet capitalism with oligarchs wielding enormous power and influence. The economy is dominated by state-backed firms and conglomerates usually run by powerful families. These are major impediments for foreign businesses wanting to operate in India. Influence and corruption also make it difficult to predict export success since purchasing decisions in India are often not transparent, nor are they necessarily dictated by cost or quality. Despite these drawbacks, there are positive signs of a grassroots private sector.

ITS Global is inclined to concur with Stratfor’s assessment that India will not be able to match China’s growth in the short to medium term. Democratic India has struggled to coordinate infrastructure investment in the way the Chinese Communist Party has managed this process. China began economic reform in 1979 and has carried this out under the command of an authoritarian regime. India, by contrast, is a huge and diverse democracy and the federal government is hampered by the need to get state government on board with the reform agenda. The states are renowned from ignoring the central policy agenda and pursuing their own populist agendas. Government bureaucracies in India are bloated and corrupt.

Reform and rapid industrialisation is nevertheless forecast to continue. However, the likely pace of this change is unlikely to compare to China’s growth over the last decade. India’s strength is its underlying democratic tradition and the durability of the country’s continued development now that it is well entrenched.

6.2.4 Japan

Japan’s story of recovery and industrialization in the post World War II period is one of the great economic success stories of the twentieth century. From 1960, Japan experienced three decades of rapid economic growth averaging 10 per cent in the 1960s, five per cent in the 1970s and four per cent in the 1980s. It was the world’s second largest economy from the late 1960s until 2010. Japan suffered an asset price bubble in the second half of the 1980s leading to a crash in the early 1990s. Growth remained low through the 1990s and recovered slightly through export-led initiatives over the past decade until the global financial crisis.

Since the 1960s, Japan has been an important trade and investment partner for Australia. The two economies are largely complementary with Japan lacking natural resources for its technology-based manufacturing sector and land for agriculture. Australian commodities fed Japan’s economic miracle from the 1960s. In the 1970s and 80s Japan sought to secure supply by investing in the Australian mining sector. Australia also benefited from the boom in Japanese tourism in the 1980s. As Chapter 3 has noted, Japan remains a major foreign investor in Australia.

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a. Specific impediments to international trade & foreign investment

Japan is a highly industrialised market economy with a liberal democratic parliamentary government. Parliament functions as a bicameral legislature, and decision making power resides with the appointed Prime Minister and publically elected politicians.

In recent years Japan’s trade-related structural reform agenda has stalled due to nationalist intervention and regulatory impediments remain. Privatization of Japan Post and its financial subsidiaries has stalled, and the Enterprise Turnaround Initiative Corporation (ETIC) has, since 2009, supported domestic entities facing increased competition and financial pressures.90

Japanese agriculture remains highly protected. The average MFN applied tariff for agriculture is 14.7 per cent. This is compared to 3.4 per cent for mineral and manufacturing imports and an average 5.8 per cent overall.91 OECD Producer Support Estimates highlight the degree of intervention in agriculture. In 2008, total transfers to agricultural producers arising from government policies were estimated at 48 per cent of production value. The OECD average was just 21 per cent.92 This issue has been taken up by Australian policy makers in the context of bilateral FTA negotiations, though to date little headway has been made.

Domestic measures affecting the competitiveness of agricultural imports include price support schemes (in the case of beef and pork), subsidies and direct income producer payments and concessions. Non-tariff import measures are also prevalent, consisting mainly of administrative and market access requirements. For example, the government operates a wheat import monopoly which re sells imported wheat to domestic producers at prices above the import price ceiling. This discourages local wheat consumption by increasing the cost of wheat based foods.93 While rice imports are affected by tariff-rate quotas and imported almost exclusively for government stocks, preventing direct access to retailer and consumer markets.94 Import safeguards on beef also impede the free flow of goods.

Japanese manufacturing typically receives little government support though the ETIC program outlined above however the ETIC has support seven major manufacturers on grounds of indebtedness.95

Japan imposes discriminatory measures inconsistent with WTO principles. For example, Japan’s importation and distribution system for rice limits meaningful access by foreign suppliers.96 Japan also retains a tariff-rate quota on leather footwear, set in a non-transparent manner that limits foreign market access. The United States continues to contest both these measures.

Impediments to foreign services providers and investment in Japan include limits on foreign investment, incorporation requirements, and controls on the type of services supplied. Restrictions also extend to business providers looking to deliver services across borders in the form of limits on the number or value of services supplied, and visa and immigration restrictions on business providers delivering services temporarily or as a resident. Some examples are set out in Box 6.5.

91 WTO, 2011
94 USTR, p.195.
96 USTR, p.195
Box 6.5 Japan: Select trade & investment impediments

**Investment**
- Japan has the lowest inward FDI as a proportion of total output of any major OECD country.
- FDI is restricted on national security, public order and public safety grounds in aviation, maritime transport, telecommunication, broadcasting, manufacturing, and utilities.
- Limitations also exist in sectors of ‘domestic importance’ (agriculture, forestry and fishing, air and maritime transport) and where foreign investments are judged to adversely affect the smooth management of the Japanese economy.

**Services**
- Transport: Foreign suppliers are limited in the provision of domestic air services to domestically incorporated companies. Foreign shareholders in a domestic airline carrier are also restricted to having no more than one third of votes.
- Financial services: local subsidiaries of foreign insurance corporations must have a minimum initial capital of ¥1 billion (roughly A$14 million); local branches of foreign insurance companies must have a minimum local deposit of ¥200 million (A$27,000). Foreign companies wishing to sell insurance in Japan must establish a local commercial presence unless special approval is granted.

**Goods**
The MFN applied tariff for agriculture is 14.7% compared to 3.4% for mineral and manufacturing imports. Agricultural barriers include:
- Domestic agricultural protection includes price support schemes on beef and pork, subsidies and direct income producer payments and concessions.
- Japan operates a wheat import monopoly which resells imported wheat to domestic producers at prices above the import price ceiling.
- Tariff-rate quotas affect rice imports and are imported for government stocks.

Source: WTO (2011); USTR (2011); APEC (2008); DFAT (2005)

b. Transparency of institutions & policy

Japan has long been a *de facto* one-party democracy, though the 2010 election brought the long-time opposition Democratic Party of Japan to power. This brings into question the quality of parliamentary process, political disclosure and institutions and accessible procedures for independent parties to express non-partisan views in an otherwise democratic system. Poor transparency impedes foreign competition and investment, drains domestic resources and administrative capacity and reduces the government’s ability to make a meaningful contribution to and secure the rewards of increased international integration.

Japan has however sought to develop regulation in a means conducive to improving transparency and the reliability of public institutions. This is highlighted in its relatively low World Bank Doing Business index of 19, which is ahead of Germany at 21 and its regional neighbours China, Taiwan and Vietnam 78, 34 and 88 respectively.

Measures in support of increased transparency have included improvements to accounting standards, such as registration requirements and the clarification industry techniques. More recently, as a response to the global financial crisis Japan promulgated the Act for the Amendment of the Financial Instruments and Exchange to improve the transparency of financial institutions.

c. Fragility & adaptability of institutions & policy

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98 World Bank Doing Business Index, accessed: http://www.doingbusiness.org/rankings
According to the World Trade Organization, to increase adaptability the Japanese government needs to undergo structural reform of the labour market and taxation, and further trade liberalization of export sectors in large part to improve productivity in services and agriculture and to increase domestic demand. Productivity improvements in export sectors would also reduce the impact of an appreciating Yen against the USD, which has hampered Japan’s international competitiveness in recent times.\textsuperscript{100}

The fragility of the Japanese political and economic system has been compounded by the ramifications and recovery process underway since the Tohoku-Chihou Earthquake. While the north-eastern coastal region is less developed than its industrial centres, the outcome of government efforts to manage the impact of this disaster – and its impact on investor and business confidence and the national psyche – is still to be fully realised.

6.2.5 Republic of Korea

The Republic of Korea has undergone substantial reform since the Korean War in the 1950s and is now the world’s thirteenth largest economy, just behind Australia. Despite long periods of autocratic rule and relative political chaos – including uprisings and political assassinations – through to the late 1990s, significant economic reforms were instituted. In the 1960s, a focus on industrial expansion through labour intensive light industries and currency reform saw Korea’s growth outstrip its Asian neighbours. In the 1970s, there was further fiscal stimulus in heavy industry. In the 1990s, Korea was able to recover from the Asian Financial Crisis with major financial reforms and a re-orientation toward a market-based economy. Much of this growth has been export sales driven.\textsuperscript{101}

The Republic of Korea is a democratic republic with power distributed between the executive, legislative and judiciary, but with power historically more concentrated with the President.\textsuperscript{102} The three most recent elections (1997, 2002 and 2007) consolidated democracy in Korea.\textsuperscript{103} The structure of Korea’s economy is consistent with the pattern of industrialized economies. Services accounted for 58.2 per cent of GDP in 2010, manufacturing comprised 39.3 per cent and Korea’s agricultural sector accounted for only 2.6 per cent of GDP in 2010. Labour in Korea is predominantly in the services sector: 68.4 per cent of the labour force work in services compared to 24.3 per cent in the manufacturing sector and 7.3 per cent in agriculture.

a. Specific impediments to international trade & foreign investment

The Republic of Korea continues to maintain high tariffs across agriculture and fishery products – such as dairy (35%), nuts (30%) and tea (754%) – and has reduced tariffs to zero on paper, steel, furniture, agricultural equipment, construction equipment and information technology equipment. All of these sectors could be considered key inputs into Korea’s major industries.

Korea has further reduced tariffs to bilateral and regional partners through preferential trade agreements (FTAs). The European Union and United States are amongst those parties who have concluded FTA negotiations recently with Rep. of Korea. The EU-Korea FTA has entered into force in 2011, whilst, at the time of writing, the US-Korea FTA (KORUS) has only just been through the US Congressional process having been renegotiated by the Obama Administration in 2010. Australia is also nearing conclusion of an FTA with Korea.

\textsuperscript{100}WTO (Japan), 2011; between September 2008 and November 2010 the Yen appreciated from ¥109 per $US to ¥81.

\textsuperscript{101}http://www.state.gov/r/pa/ei/bgn/2800.htm

\textsuperscript{102}The Rep. of Korea is currently governed by the Grand National Party. President Lee Myung-Bak, elected in 2007.

\textsuperscript{103}http://www.state.gov/r/pa/ei/bgn/2800.htm
Heavy subsidisation of the production of certain important goods such as semiconductors has resulted in countervailing duties being imposed by the United States and Japan. The current Administration has plans to privatise many of the banks which had been used as vehicles for subsidies in the past.

Rep. of Korea does not have a foreign investment screening process, but requires either pre or post notification for investment. Prior notification is required for newly-issued stocks, acquiring existing stocks. Ex post facto notification is required for the acquisition of stocks through mergers, transfers of stock or equity, decrease in stocks and applications for registration of foreign firms – all within 30 days.

**Box 6.6 Rep. of Korea: Select trade & investment impediments**

**Investment:**
- Meat wholesaling to 50%
- Transportation sector to 49%.
- Telecommunications sector to 49%, cable broadcasting to 49%, satellite broadcasting to 33%, news provision to 25%

**Services**
- Banking: A minimum capital requirement of 100 billion won applies for establishment of a nationwide commercial bank and 25 billion won for a regional bank.

**Goods:**
- High tariffs across agriculture and fishery products – such as dairy (35%), nuts (30%) and certain teas (754%).

Source: USTR (2011); WTO (2008)

**Box 6.7 Korea’s industrial conglomerates**

The Republic of Korea’s path to industrialisation has focused on creating industrial giants and conglomerates (chaebol) with close links to government and domestic banks pressured to providing them with cheap credit. Through this model Rep. of Korea has specialised in heavy industry such as automotives and shipbuilding making Daewoo and Hyundai household names.

Samsung is another example. It began as a noodle business in 1938 and now boasts a conglomerate network of 83 companies responsible for 13 per cent of Rep. of Korea’s exports. The successful strategy employed by Samsung has been to identify new markets and invest heavily into winning these markets. Samsung Electronics is now the world’s biggest technology firm, measured by sales. It is the largest television manufacturer and second only to Nokia in manufacturing handsets.

Source: The Economist, 1 October, 2011, p. 15.

Prior permission is required for the acquisition of shares by any company in the defence industry, through the Minister for Commerce, Industry and Energy. FDI is completely prohibited in the Nuclear Power industry, Radio Broadcasting and Over-the-Air Broadcasting.
Foreign equity is limited in the Telecommunications sector to 49 per cent, Cable Broadcasting to 49 per cent, Satellite broadcasting to 33 per cent and news provision to 25 per cent. In the transportation sector investment is limited to 49 per cent.

Foreign financial service providers seeking entry to the Korean banking sector require regulatory approval from the Financial Services Commission (FSC) in accordance with the Banking Act. The following restrictions apply:

- A minimum capital requirement of 100 billion won applies for establishment of a nationwide commercial bank and 25 billion won for a regional bank;
- A foreign bank branch is required to have core operational funds of W3 billion at the time of establishment;
- No single person or business entity may as a general rule own or control more than 10 per cent of equity interests in a nationwide commercial bank (15 per cent for a regional bank);
- Under special circumstances, domestic individuals or business entities may be exempted from the 10 per cent rule and acquire up to 100 per cent with approval from the FSC.

These are significant barriers given Korea is the second largest insurance market in Asia and the seventh largest in the world.

b. Transparency

Although Rep. of Korea has seen a decrease in Government involvement and an increase in financial freedom, the Heritage Foundation’s Index of Economic Freedom reveals a decrease in freedom from corruption and labour freedom.104 This is echoed by the Fraser Institutes Economic Freedom of the World Index, which shows high levels of labour market regulation, low degrees of judicial independence and high costs for bureaucracy.105 Korea is however ranked highly (16th) in the World Bank Group’s Ease of Doing Business report.106

Concerns have also been raised regarding transparency in the financial services industry, in particular regarding “administrative guidance” – unofficial regulation made by public officials – which is not often available publicly. This form of guidance has been known to influence pricing policy of companies and other anti-competitive market behaviour, as well as being in conflict with written regulations.107 The FTA with the United States sought to remedy this by ensuring that all administrative guidance is written and made available.108

Rep. of Korea also administers Tariff-Rate Quotas which are allocated by Korean domestic Industry groups. It has been claimed that these are often allocated favourably to significant members of the groups.

c. Fragility & adaptability of institutions & policy

108 http://www.koreauspartnership.org/facts/financial-services.htm
Korea’s economic fragility stems from having a low population growth rate and, as a result, an ageing population.\textsuperscript{109} It also suffers high levels of income inequality despite lowering unemployment.\textsuperscript{110}

Foreign investment is very low in Korea and the country struggles to attract investors due to both economic and demographic factors.\textsuperscript{111} Korea has seen a gradual decline in labour productivity in the services sector. This has been attributed to the country's focus on developing a high-tech sector instead, which has seen increased productivity.\textsuperscript{112} This is compounded by rising costs due to an appreciating currency and increased regulation\textsuperscript{113} that have reduced incentives for foreign businesses to invest.\textsuperscript{114}

Despite maintaining positive growth, Korea’s markets are highly dependent on global trade, with over 90 per cent of GDP generated by total trade in goods and non-factor services.\textsuperscript{115} As a result, any fluctuations in the global economy have a significant impact on Korea’s GDP. This was seen during the 2008-09 crisis where the rate of GDP growth in Korea which had been trending around eight-nine per cent dropped to just 0.2 per cent. The rebound in global growth saw Korea’s GDP growth rate rise again to over six per cent.\textsuperscript{116} In the final assessment, this picture of fragility must, however, be balanced with the enormous economic success Rep. of Korea has had over many decades in its path to industrialization and the global presence many Korean companies have carved out.

6.2.6 Indonesia

Indonesia grew at more than six per cent in 2010 but continues to be dogged by high unemployment of around 11 per cent as the economy tries to absorb between 2 and 2.5 million new entrants to the workforce each year.

Manufacturing accounts for 28 per cent of GDP, but is responsible for 64 per cent of the country’s exports.\textsuperscript{117} Indonesia’s exports include abundant natural resources such as natural gas and timber, and manufactures including electrical appliances and textiles. Agriculture contributes only 15 per cent of GDP but accounts for over 40 per cent of employment.\textsuperscript{118}

Australia’s exports to Indonesia hinge on wheat, live animals and aluminium. Exports to Indonesia comprised 1.8 per cent of Australia’s total exports in 2010 (see Table 2.5). Given Indonesia’s geographic proximity and the political importance accorded to bilateral relations, it is perhaps surprising two-way trade is not more significant. Key impediments in Indonesia’s regulatory framework are outlined in what follows.

\textsuperscript{112}WTO (Korea), 2008, p vii.
\textsuperscript{113}http://www.state.gov/r/pa/ei/bgn/2800.htm
\textsuperscript{114}WTO (Korea), 2008, p vii.
\textsuperscript{115}WTO (Korea), 2008, p vii.
\textsuperscript{117}WTO, 2011, \textit{Trade Policy Review: Report by the Secretariat, Indonesia}.
\textsuperscript{118}US Department of State, 2011, \textit{Background Note, Indonesia}, accessed at http://www.state.gov/r/pa/ei/bgn/2748.htm
Despite significant increases in Government expenditure on welfare and poverty initiatives, the percentage of the population living below the poverty line increased from 16 to 17.8 per cent from 2005 to 06.\(^{119}\)

### a. Specific impediments to international trade & foreign investment

Labour market rigidity is an important impediment to domestic employment in Indonesia and consequently to economic growth. Indonesia places restrictions on foreign workers, including in professional services such as legal and accounting firms – all lawyers practising Indonesian law, for example, must be Indonesian residents. Indonesia is ranked last in the region in terms of labour market flexibility.\(^{120}\)

Indonesia restricts foreign ownership in many sectors. For example, foreign equity is limited to 49 per cent in many transport services and is restricted in some banking services (Presidential Regulation No. 111/2007). Foreigners are also prevented from owning land in Indonesia (Law No. 5/1960). Preferences are also given to domestic companies in mining and energy sectors. For example, companies bidding for oil and gas licenses must have 35 per cent local content, and local authorities are required to give preference to local subcontractors.\(^{121}\)

Indonesia dictates that foreign firms wishing to invest do so through joint ventures with Indonesian firms in the form of a limited liability company (Law No. 25/2007). Many sectors are also reserved for small, medium and micro enterprises and cooperatives such as travel agencies, courier services and rural bus transportation (Presidential Regulation No. 111/2007).

Services impediments include limits to the number of telecommunication network suppliers and requirements for telecommunication suppliers to be in the form of a state owned enterprise, regional state enterprise, private company or cooperation (Law No.36/1999). Other examples are set out in Box 6.8.

**Box 6.8 Indonesia: Select trade & investment impediments**

<table>
<thead>
<tr>
<th><strong>Investment</strong></th>
</tr>
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<tbody>
<tr>
<td>• Laws impeding foreign investment in various activities and sectors, for example Law No. 25 on Investments 2007, Presidential Regulation No. 111, 2007.</td>
</tr>
<tr>
<td>• Foreign firms must enter joint ventures with local firms (Law No. 25/2007).</td>
</tr>
<tr>
<td>• Foreigners are not allowed to own land in Indonesia (Law No. 5/1960 and Presidential Decree No. 34/1993).</td>
</tr>
<tr>
<td>• Certain sectors are reserved for SMEs eg. travel agencies, couriers services (Law No. 20 of 2008 concerning Micro, Small and Medium Enterprises).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Services</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Restrictions on skilled labor, including discriminatory restrictions in professional services (eg. Law No 23 on Advocate Indonesia 2003)</td>
</tr>
<tr>
<td>• Domestic laws in telecoms and transport restrict foreign commercial presence. For example, Law No. 36 on Telecommunications 1999 and No 52 on Telecommunications Management 2000;</td>
</tr>
<tr>
<td>• Tourism services: equity restrictions for commercial presence based on geographical location, licensing requirements for travel agencies and tour operators, nationality restrictions on employment.</td>
</tr>
</tbody>
</table>

\(^{119}\)WTO (Indonesia), 2011, section 1. Indonesia also suffers from relatively low literacy rates, low urbanisation at 47 per cent and is ranked 108th on the UN Human Development Index.

\(^{120}\)WTO (Indonesia), 2011, section 1.

Assessing Australia's Trade and Investment with Asia

Law No 25 on Investments 2007, Presidential Regulation No 111 2007

**Goods:**
- Non-tariff measures in the form of import controls apply to animal and vegetable products, wood, machinery, vehicles and transport and equipment. For example:
- Rice import controls and a single channel for imports (Decree of Ministry of Industry and Trade No 9/MPP/Kep/I/2004; MIT:141/MPP/Kep/3/2002: Import licensing (Nomor Pengenal Importir Khusus);
- Seasonal bans on sugar imports (Decree Ministry of Industry and Trade Number 643/MPP/Kep/9/2002).

Source: ITS Global

Reflecting the extent of these impediments across the economy, Indonesia is ranked 135 out of 175 countries in the World Bank’s Ease of Doing Business index.

Impediments to importing goods in Indonesia are particularly burdensome in agriculture. Indonesia continues to apply tariffs of over 40 per cent on more than 1,300 agricultural products. Bound tariff rates – that present a ceiling – are far higher than applied rates, leaving exporters to Indonesia uncertain whether tariffs on their products may be increased. For example tariffs on corn and soybeans rose in 2005 – from the applied rate of 0 to five and ten per cent respectively.

High applied tariffs on imported chemicals, fabricated metal products and motor vehicles restrict the capacity for the manufacturing sector to grow. This is compounded with restrictive import licensing requirements across the textile, alcohol and cigarette sectors.

**b. Transparency of institutions & policy**

Corruption continues to be the most significant issue facing Indonesia in its quest for increased investment and international recognition. Anti-corruption legislation was passed in the early 2000s with enforcement beginning to take effect in 2005 with the establishment of the Anti-Corruption Commission, the Anti-Corruption Court and similar enforcement arms such as the Corruption Eradication Team. Consequently, Indonesia has slowly risen from the 11th lowest to the 33rd lowest on Transparency International’s Corruption index.

**c. Fragility & adaptability of institutions & policy**

Indonesia faces a range of challenges to business stability. In addition to corruption perceptions, the archipelago’s geography means the country faces regular natural disasters, such as 2004 earthquake and tsunami in Aceh Province, as well as the earthquake in 2006. Indonesia has also had to contend with Islamic extremists, most notably the Bali and Jakarta terrorist attacks in 2002 and 2003. These factors add to Indonesia’s reputation as an uncertain place for investing.

Whilst decentralisation by localising legislative power and incentivising competition between regions for investment was a key reform following the Asian financial crisis, it too has proved problematic. Localised control created additional uncertainty for investors and increased barriers to trade. Businesses face additional document processing and problems with administrative transparency. Decentralisation has also led to increased minimum wages – the growth of which has outstripped increases in productivity across the nation.122

Indonesia’s parliament has also been known to implement protectionist measures which have harmed rather than benefited the economy. For example, in 2006 a temporary ban on rice imports – which comprise up to 25 per cent of the expenditure of the poorest Indonesians – led to price hikes and contributed to inflation of 12 per cent in 2008. Although the Government

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122 WTO (Indonesia), 2011, Section 1.
removed the ban, the hit to inflation had repercussions in the economy stifling consumer spending.
7. Trade & investment opportunities over the medium term

As we saw in Chapter 5, the medium term for Australia's trade and investment engagement with the Asia-10 economies is generally very favourable from the perspective of Australian business. Economic growth is expected to remain relatively strong in these economies, especially when compared to the outlook for the rest of the world. Moreover, this growth should continue to be largely based on manufacturing exports to the rest of the world.

Australian exporters are well placed, particularly those selling industrial raw materials, pharmaceuticals, non-electrical machinery, and optical, precision and medical instruments and apparatus. The demand for both cross-border and locally consumed services, particularly the income sensitive services such as higher education, transport and communications, will grow strongly with rising household incomes in Asia.

The outlook for two-way investment is also positive. Growing industrial output and household incomes in Asian economies will mean expanding domestic markets in banking and financial services, telecommunications, professional services, and retail services that can only be effectively delivered through a local commercial presence in the economy in question. Asian investors will also be increasingly interested in investing in Australia, particularly to secure supplies of key industrial raw materials from an internationally competitive source.

There are, nonetheless, significant risks in the macroeconomic outlook, as the IMF has noted in its latest World Economic Outlook. Not the least of these is the fragility of many large-scale financial institutions around the world, the overhang of public debt in the developed economies, particularly in the US and the EU, as well as the substantial fiscal and current account imbalances that beset the global economy.

These risks, of course, are outside Australia's control and largely outside its influence. For our purpose they are best treated as a given. That said, they cannot and should not be ignored, as they would significantly modify the expected outcomes should they come to pass.

Putting these macroeconomic risks to one side, the ability of Australian businesses to take advantage of the opportunities that can be expected to emerge from this medium term outlook in the Asia-10 economies depends, to a very significant degree, upon the policy barriers and impediments that exist, both in Australia and in each of the Asian economies in question. These impediments were described in Chapter 6.

In broad terms the impediments to merchandise trade are mostly in the form of trade policy barriers. In the Asia-10 economies, these barriers are concentrated in agricultural commodities and in elaborately transformed manufactures; unsurprisingly they are generally low in mineral commodities such as those produced in Australia. Domestically, impediments for Australian business include the substantial 'red tape' burden in time and expenses that border controls place on trade in both directions.

In the case of services and investment the impediments are a combination of regulatory barriers to domestic entry and the movement of labour; both skilled and unskilled, as well as a variety of restrictions on foreign investment. This combination is to be found in virtually all of the Asia-10 economies. The extent of these barriers tends to vary by service sector.

Box 7.1: Australia's diversified export market

Australia's economic strength over the past two decades has been aided by the country's diversified export markets. Whilst Asia has been the predominant recipient of Australian merchandise exports, Australia also
has key markets in north America and Europe. Australia’s trade with New Zealand is also commonly overlooked. This diversity is unusual for exporting countries and is an advantage to Australia. A downturn in the economic cycle does not typically affect all of these regions concurrently.

This is illustrated through the following three charts.

**Australia’s exports of goods and services, 1980-2010 (billions)**

**Australia’s merchandise trade, key countries, 1990 to 2010**
7.1 Opportunities for merchandise exports

The medium term macroeconomic outlook that was described in Chapter 5 for the Asia-10 economies and the rest of the world means that there will be opportunities for Australian businesses to expand their merchandise exports to the region. This section will outline those possibilities and address the circumstances in which they can best be exploited.

Over the medium term it is expected that world prices for mineral commodities will remain high and economic growth in the Asia-10 economies will remain buoyant. Accordingly, there will be ample opportunities for Australia to expand the volumes of its mineral exports to these economies, both over this time horizon and possibly well beyond it.

In previous episodes of high commodity prices, Australia has struggled to take advantage of such opportunities by expanding its mineral production capacity; the economic benefit of the terms of trade boost has therefore been largely transitory and has generally ended in rising real unit labour costs and a loss of international competitiveness. The challenge for policy makers is to avoid a Groundhog Day experience and watch idly as economic history repeats itself. This will require a much more disciplined approach to policy at a time when the political temptation is to take the diametrically opposite course.

This policy discipline should focus on removing the domestic impediments to investment in the mining sector and should remove them as quickly as possible since time is of the essence. The process of removal should target the impediments to both new and existing mineral developments and the policy priorities in this regards are as follows:

- Mineral exploration: Other things being equal high mineral prices will increase the rate of exploration for new mineral discoveries but only if exploration rights are easily and quickly obtained and exploited for all areas of interest. These rights are issued and regulated by State and Territory Governments. The more restrictive the regulation of
these rights, the areas that they cover, and how the rights may be exploited, the less attractive they are to prospective explorers and the less likely they are to find an economically worthwhile discovery. Locking up large areas of the nation from exploration makes little or no sense from an economic perspective.

- Mineral developments: These developments are extensively regulated by Commonwealth, State and Territory Governments. Much of this regulation is to protect the environment. Many of the regulatory measures used are highly detailed and prescriptive controls over production inputs and processes, rather than environmental outcomes, and as such are relatively ineffective but impose a heavy compliance burden. Of even greater concern, however, is the long time it takes for projects to be approved by Commonwealth and State authorities.

- Labour market regulation: The ability of the minerals sector to exploit its expansion opportunities successfully will greatly depend upon the productivity of its labour, including the flexibility of wages and conditions and how well it utilises its workforce, both in the construction and operational phases of a capacity expansion. The recent legislative changes by the Commonwealth to restrict the scope of individual and enterprise agreement are backward steps in this regard.

- Workforce skills: The new mineral developments and expansions of existing mines that appear to be in prospect will place a heavy demand upon the availability of the workforce skills that will be required in their construction phases, particularly in the technically skilled trades. It is almost certain that demand will outstrip the available supply in at least some skills and it makes little sense to simply let wages rates rise temporarily in those areas to ration the excess demand, when temporary skilled migration to augment supply is a better alternative.

- Country risk. The Commonwealth Government’s attempts to introduce a carbon tax and a tax on mineral resource rents have greatly added to the policy uncertainty surrounding mineral investment in Australia. In each case the policy development process was fundamentally unsound and ignored the well-established protocols for handling complex and contentious policy issues. Given the long lead times and large scale of most mineral investment this uncertainty has undoubtedly added to perceptions of increased country risk for mineral investment in Australia at the very moment when such investment is highly desirable from a community-wide perspective.

The buoyant outlook for economic growth in the Asia-10 economies should also provide opportunities for Australian manufacturers, notwithstanding the sector’s recent loss of some of its international competitiveness due to appreciation of the real exchange rate in the wake of rising commodity prices. These opportunities are, however, likely to be selective both as to products and export markets.

As we saw in Chapter 4 there are very large markets for foreign suppliers in non-electrical machinery and optical, precision and medical instruments and apparatus in China, Japan, the Republic of Korea and Vietnam. These product categories enjoy generally strong growth prospects in demand in these economies, although not as great as that for pharmaceuticals. Innovative Australian manufacturers of high-value niche products in these categories have been able to share in that growth.

The growth prospects in the export markets for these products are also not equally distributed across the Asia-10 economies. Some of these economies are expected to grow much faster than others. The extremes are best exemplified by Japan whose GDP growth is expected to be just
over one per cent per year over the medium term, while China is expected to grow at nearly 10 per cent per year over the same period.

These characteristics mean that successful exploitation of these opportunities by Australian manufacturers will put a premium on their abilities to innovate and adapt in an environment that is as conducive as possible to export. The policy process should therefore target the removal of impediments in both areas:

- **Labour market regulation:** The productivity and cost of labour is critical to the international competitiveness of manufacturing. As has already been noted, the recent legislative changes to restrict the scope of individual and enterprise agreements are considered by business to be an issue that needs to be addressed.

- **Workforce skills:** The new mineral developments and expansions of existing mines that appear to be in prospect will place a heavy demand upon the availability of the workforce skills that will be required in their construction phases, particularly in the technically skilled trades. It is almost certain that demand will outstrip the available supply in at least some skills and therefore a responsive skilled migration program is needed to augment skills requirements.

- **Fiscal consolidation:** The sharp appreciation of the Australian dollar in real terms has significantly eroded the ability of non-mineral exporters to compete with the non-traded sector for labour and capital in the domestic economy. Progressive reductions in the budget deficit of the Federal Government would help to reduce the extent of this competition and reduce the upward pressure on the exchange rate.

- **Reduction in red tape burden:** The regulation of domestic business activity places substantial compliance burden on business, and often for little economic gain. This includes much environmental regulation of business. Much the same is true for the regulation of international trade flows. Both add to business costs and undermine the international competitiveness of manufacturing exporters.

### 7.2 Opportunities for investment & services trade

Opportunities for Australian businesses in Asia-10 are most promising in markets where businesses can expand existing operations through acquisition or new projects. The possibilities are difficult to discern in any detail due to the paucity of the relevant information.

The major impediments in these areas relate to the policy restrictions imposed by the destination economies. In all cases there is some scope for Australia to promote positive policy changes.
8. Conclusions & recommendations to remove or reduce impediments

8.1 Conclusions

Measured in terms of the aggregate value of bilateral trade flows and stocks of foreign direct investment, Australian businesses are generally well engaged with each of Asia-10 economies that are the focus of this report. Nevertheless greater economic engagement with the region is both feasible and desirable from the perspective of the economic welfare of the Australian community as a whole.

In 2010 Australian exports of goods and services to the Asia-10 economies were valued at $175 billion — expressed in mid-2011 prices. That year, the stock of Asia-10 investment in Australia was valued at $92 billion and the stock of Australian investment in the Asia-10 economies stood at $23 billion.

Over the past five years the extent of Australia’s economic engagement with Asia has grown rapidly. In 2006 the Asia-10 economies took around one-half of Australia’s exports of goods and services. By 2010 it was nearly two-thirds. Over the same period the stock of Asia-10 investment in Australia has more than doubled, while Australia’s stock of investment in the Asia-10 economies has nearly doubled.

Although Australia’s trade and investment relationships with Asia-10 economies have generally grown more slowly than their rates of economic growth, there are good reasons why this is not unreasonable. Most of these economies are at an earlier stage of economic development. The process of ‘catching up’ to industrialised countries, such as Australia, in terms of productivity levels is much easier than breaking new ground. Moreover, there are significant policy impediments in those economies to their greater economic integration with the rest of the world. In addition, there is growing competition within markets in Asia.

As these factors are beyond Australia’s control, the appropriate test of how well Australia has engaged with Asia, or indeed with the rest of the world, is how much it has done to reduce its domestic impediments to that engagement. Reduced to their essential these impediments relate to the productivity of the sectors of the economy and their exposure to foreign competition.

Over the past five years the Asia-10 economies have accounted for a rapidly rising share of Australia’s global exports of goods and services but most of this growth has occurred in China, India and the Republic of Korea, so much so that China is now Australia’s largest export market. Indeed the shares of some of the economies in question have fallen, notably Indonesia, Japan, and Singapore.

The growth in Australia’s exports to the Asia-10 over this period has been completely dominated by massive increases in mineral exports, particularly exports of iron ore and coal to China, India, and the Republic of Korea. All other industry sectors in Australia have lost export market share, both in the Asia-10 as well as the rest of the world.

Notwithstanding the loss of export share by the manufacturing sector, exports of certain ETMs continued to grow in real terms over the five years to 2010. In some cases the growth was very rapid, even if it was measured from a relatively modest base. For example, at the four-digit level of the Harmonized System of product classification, exports of Medical dental and veterinary apparatus (HS 9019) grew fastest, at more than 31 per cent per year over this period. They were followed by Parts for lifting and earthmoving machinery (HS 8431) — at 8.5 per cent per year — and Medicaments (HS 3004) — at 8.3 per cent per year.
In addition, there are a significant number of Australian manufacturers and businesses in the services sector that, having invested in Asian markets, deliver their products and services in those markets. These businesses are an important component of Australia’s overall trade and investment with Asia which are not fully captured by export data.

As a consequence of recent external developments, even those aside from the Global Financial Crisis, there are profound structural changes that are working their way through the Australian economy.

The rapidly industrializing economies have driven minerals prices to record levels and encourage mining operations in Australia to expand production of resources for export by attracting domestic labour and capital from other sectors of the economy. The consequences of these external developments for the real rate of exchange for the Australian dollar have also placed strong downward pressure on the Australian dollar returns from non-mineral exports. At a sectoral level, domestic manufacturing has been hit hardest by the pincer effect of these two structural changes.

As this report makes clear, there continue to be major opportunities for Australian industry from the exporting of commodities into Asia. At the same time, there is a risk that a rapid change in external economic circumstances could reduce the price or demand for Australian commodities in Asia. Australia’s policy settings need to take account of the ability of the Australian economy, including the resources and the non-resources sectors, to adapt to such a change.

At the same time, China is the largest exporter to Australia of consumer goods. Costs in China are rising and are likely to increase costs in Australia.

Any domestic policy impediments to increasing productivity, particularly in the non-mineral sectors of the economy, can only exacerbate the structural adjustment problem. Unfortunately there are many such impediments, both domestically and externally. The impediments include:

- regulation of trade and international movement of merchandise;
- business regulation and taxation generally;
- the inflexibility of labour market regulation;
- restrictions on entry of foreign skilled labour and access to local natural resources; and
- entry barriers in foreign markets to both domestic and foreign businesses — Table 8.1 has a synthesis of key impediments.

In recent years the most valuable category of cross-border services exports to the Asia-10 economies has been the travel services consumed by students from those economies who undertake secondary and tertiary studies in Australian schools and universities. These exports have been significantly affected by recent swings in the value of the Australian dollar on foreign exchange markets and in the terms on which visas are issued to foreign students for tertiary education in Australia.
Table 8.1 Examples of impediments in key Asia-10 economies

<table>
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<tr>
<th>Country</th>
<th>Impediment</th>
</tr>
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<tbody>
<tr>
<td>China</td>
<td>• Investment: Catalogue Guiding Foreign Investment in Industry lists restricted, prohibited and permitted industries; the catalogue is used to target high-value added manufacturing sectors.</td>
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<tr>
<td></td>
<td>• Investment: National Development Reform Commission verification of projects is required for those greater than US$50 million for restricted categories and US$300 million for encouraged categories.</td>
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<td></td>
<td>• Insurance services: Foreign life insurance companies can only be established as joint ventures, with foreign equity capped at 50%.</td>
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<td></td>
<td>• Banking: regulations require that only foreign-funded banks with a representative office in China for two years and total assets exceeding $10 billion can apply to incorporate in China.</td>
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<tr>
<td></td>
<td>• Legal services: foreign firms cannot practice Chinese law; there are also restrictions on cooperation with Chinese law firms.</td>
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<tr>
<td>India</td>
<td>• Investment: FDI subject to equity limits and specific conditions in most sectors: Consolidated FDI Policy circular, periodically revised.</td>
</tr>
<tr>
<td></td>
<td>• Insurance: foreign equity is currently limited to 26% of paid-up capital. Government has strong ownership presence in the sector.</td>
</tr>
<tr>
<td></td>
<td>• Banking: foreign banks are required to submit their internal branch expansion plans on an annual basis, but expansion is limited by non-transparent quotas on branches.</td>
</tr>
<tr>
<td></td>
<td>• Legal services: Foreign law firms are not authorized to open offices in India.</td>
</tr>
<tr>
<td></td>
<td>• Retail services: FDI in multi-brand retail outlets is prohibited.</td>
</tr>
<tr>
<td>Japan</td>
<td>• Investment: FDI is restricted on national security, public order and safety grounds in aviation, maritime transport, telecommunication, broadcasting, manufacturing, and utilities. And in sectors of ‘domestic importance’ (agriculture, fishing, air and maritime transport).</td>
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<tr>
<td></td>
<td>• Transport services: Foreign suppliers are limited in the provision of domestic air services to domestically incorporated companies. Foreign shareholders in a domestic airline carrier are also restricted to having no more than one third of votes.</td>
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<td></td>
<td>• Financial services: local subsidiaries of foreign insurance corporations must have a minimum initial capital of ¥1 billion (roughly A$14 million) and local branches of foreign insurance companies must have a minimum local deposit of ¥200 million (A$27,000).</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>• Investment: Despite relaxation of investment restrictions in recent years, foreign equity limits in sectors including meat wholesaling (50%) and transportation (49%) apply.</td>
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<tr>
<td></td>
<td>• Banking services: Minimum capital requirement of W100 billion to establish a nationwide commercial bank and W25 billion won for a regional bank.</td>
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Source: Chapter 6.2.
Australia’s cross-border exports of financial services to the Asia-10 economies were recorded as being worth $161 million in 2010. The official data are, however, likely to understate the full extent of overseas sales by Australian services businesses.

An important avenue for such sales involves Australian services firms establishing a commercial presence in a foreign market rather than servicing that market from its Australian base. Overseas sales of services by the foreign affiliates of Australian-based businesses are more significant than is generally recognised. ITS Global has previously estimated that such sales could be worth $100 billion per year.123

Establishing a commercial presence in a foreign country generally requires the business in question to make investments there. The stock of foreign direct investment (FDI) by Australian businesses in the Asia-10 economies has traditionally been less than the equivalent stock levels in either Europe or North America. In large part, this reflects the fact that the services markets in Europe and North America are generally much larger and more open than those of the Asia-10 economies.

Nonetheless, compared to its industrialised country peers Australia has performed well in terms of both inward and outward FDI in connection with the Asia-10 economies collectively. For example, Australia has received almost twice as much FDI from Asia-10 investors as Canada despite receiving around 50 per cent less FDI from all sources than Canada.

Japan is the largest of the Asia-10 investors in Australia, with an FDI stock valued at $52 billion in 2010. Singapore is the second largest Asia-10 investor with an FDI stock of $17 billion in that year. Although China’s stock of FDI in Australia has risen rapidly over the last five years, it was still only valued at $13 billion in 2010.

To put these numbers into overall perspective, however, the stock of FDI in Australia held by United States investors in 2010 accounted for more than $120 billion.

The stock of Australia’s outward FDI in the Asia-10 economies is relatively modest when compared to its stock in the rest of the world, particularly North America, Europe and New Zealand. The regulatory impediments to foreign investment in the Asia-10 economies are significantly higher than those in the rest of the world. This limits the scope for foreign investors to establishing a commercial presence in those economies or expanding existing business activities there.

In light of our analysis, ITS Global has concluded that Australian Governments need to adopt a two-pronged strategy to reducing and removing policy impediments to Australia’s further economic engagement with Asia, and indeed with the rest of the world. One element of the strategy requires addressing the domestic impediments to such engagement, while the other should target the external impediments.

Success on both fronts will be important to the overall result. Given, however, that the external impediments are outside Australia’s jurisdiction, the scope for substantive reform in the external realm is considerably less than it is in the domestic one. An additional consideration is that domestic policy reform in China and Japan, our two largest export markets, has apparently lost considerable momentum, albeit for quite different reasons, and it is hard to see a reversal occurring in the foreseeable future. The prospects for trade and investment liberalisation are therefore likely to be limited and

Australia will need to pursue an opportunistic strategy in terms of how best it might facilitate and encourage domestic liberalisation efforts.

That said, investment is generally becoming more important than trade to international economic engagement. From an economic perspective, foreign investment is more of a complement to cross-border trade in goods and services than a substitute for it.

Global trade in goods is dominated by intra-industry and intra-company trade, driven by increasing vertical specialization. The fragmentation of production processes across national borders that such specialization involves is associated with foreign investment. Global trade in services is ultimately dependent on services providers having a commercial presence across national borders, which also requires foreign investment.

As the Asia-10 economies mature their consumption of services will grow rapidly and services will eventually come to dominate their household budgets. The efficiency of local delivery of services in those markets will become an increasingly important consideration in their domestic policy formation and will increasingly require relaxation of the policy barriers to domestic entry and foreign participation into their services markets.

The terms of reference for this assignment did not require Australia's approach to engaging with Asia to be compared to the policy approaches that have been or are being adopted by its existing and prospective competitors in the export of minerals and energy.

The current global outlook for minerals and energy represents an historic economic opportunity for Australia to realize a step-change in its share of the global trade in those commodities. As the opportunity also exists for any other mineral exporter or prospective mineral exporter, time is of the essence and the opportunity will progressively disappear as global production capacity expands and world prices of mineral commodities come off their historic highs.

While we have examined the domestic impediments to the expansion of productive capacity in the mining sector in Australia, we see merit in the BCA commissioning an examination of the policies and priorities of emerging economies to ascertain whether or not their mining sectors can be expected to gain a competitive advantage over the Australian industry as a consequence of any policy changes that they have made or are in the process of making.

8.2 Policy Recommendations

In the light of the conclusions that have been outlined above, ITS Global proposes the following recommendations to address the major policy issues that they raise. These recommendations represent a distillation of the broad directions for reform rather than a design of the precise nature of solutions.

ITS Global proposes that the following six recommendations be addressed in parallel, though greater benefit may be expected from according priority to domestic reforms (recommendations 1-4). We have listed sub-points in order of priority where feasible, namely, in the case of recommendations 3, 4, 5 and 6.
1. **Reduce the transaction costs that regulation and government red tape impose on Australia’s international merchandise trade.**

In particular these reforms should focus on reducing the time that it takes

- exporters and importers (or their agents) to prepare and submit the information required to obtain a clearance from the government agencies responsible for border control;
- border control agencies to clear goods for export or import;
- to move the goods in question between the business premise of the exporter or importer and the port;
- to load or unload the goods in question at the port.

In doing so the process should identify and address any infrastructure bottlenecks in the land transport, freight terminal and port stages of the international logistics chain. It should also benchmark the time taken at each of the stages of the logistics chain through each of Australia’s major container ports against international best practice — for example Singapore.

2. **Reduce the burden of regulation and government red tape that Commonwealth, State and Local Governments impose on domestic businesses.**

The reform priorities should include the following:124:

- streamlining the operation of the Commonwealth *Environmental Protection and Biodiversity Act* — including by finalising bilateral agreements with each of the States and Territories on environmental impact assessment and on the processes for granting environmental approvals and licenses;
- streamlining the operation of the Commonwealth *Native Title Act* and considering alternative mechanisms for settling claims made under the Act;
- an assessment of alternative approaches to the regulation of native vegetation management by landowners;
- operational implementation of the recommendations of the Beale review of quarantine and biosecurity arrangements;
- streamlining the implementation and operation of corporate law and financial services reforms;
- streamlining the administration of business taxation and taxes that affect business — such as corporate income tax, GST, fringe benefits tax, State and Territory payroll taxes, PAYG withholding tax, the superannuation guarantee levy; and the associated business activity statement requirements.

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124 These recommendations are based on recent policy and regulatory reviews, in particular the work of the Taskforce on Reducing Regulatory Burdens on Business (2005), the subsequent annual reviews that have been undertaken by the Productivity Commission (2007-2011), and the Beale Review (2008).
In addition, all governments should review the data collection and regulatory reporting obligations they impose on regulated entities to ensure the information obtained is essential to the regulatory purpose and are not duplicated. For its part, the Commonwealth should also develop and implement a business reporting standard and should consult with the States and Territories for its extension to each of their jurisdictions.

3. **Reduce the burden of taxation that Australian governments impose on business and its ability to create jobs.**

The reform priorities should include:

- progressively reducing the headline corporate tax rate to a level where it is comparable to the rates that are imposed by our major trading partners;
- streamlining State and Territory payroll and land tax regimes by eliminating or reducing the tax-free thresholds and reducing marginal tax rates;
- eliminating the most economically inefficient taxes that are currently imposed by the States and Territories — such as stamp duties and other transaction-based taxes.

4. **Improve the operation of the labour market**

There is a need for comprehensive reform that addresses the regulation of the labour market, the acquisition of human capital by members of the workforce, and the ability for businesses to access external sources of labour to relieve shortages of particular workforce skills from time to time. They should include changes that:

- increase the flexibility of labour market regulation so as to allow greater use of workplace agreements with individual employees and/or with groups of employees at a workplace, while placing less reliance on award terms and conditions;
- implement mutual recognition of occupational licensing of para-professionals and professionals;
- align the vocational education and training systems of the States and Territories with their occupational licensing and registration requirements;
- further relax the entry restrictions on foreign students who are eligible to enrol at Australian universities and tertiary educational institutes;
- further relax the restrictions on the temporary entry of foreign workers with skills that are in short supply in the domestic market.

5. **Improve the domestic environment for business investment, particularly in the traded goods sector**

The reform priorities should include the following:
• progressive reductions in total government spending and the structural deficit to minimize ‘crowding out’ of private investment;

• reducing the significant country risk associated with excessive policy uncertainty and the application of inadequate processes to develop policy measures that have community-wide and far-reaching economic consequences — such as the processes that were used to develop the Australian Government’s proposals for a carbon tax and a tax on mineral resource rents;

• extend to private investors in all countries the monetary thresholds for FIRB review that are applied to US investors — $1,005 million in the case of non-sensitive sectors and $231 million for sensitive sectors such as media, telecommunications, transport, and uranium mining.\(^{125}\)

6. **Improve the international environment for Australian business**

The key reform priorities should include the Australian Government taking action to:

• restore a high priority to economic engagement with the economies with the Asia Pacific region through APEC — APEC is the most effective vehicle through which to facilitate that engagement but, at present, is being overshadowed by the priority that is being given to the G-20;

• push for the conclusion of a plurilateral agreement on the liberalisation of services — the key components for such an agreement have already been progressed as part of the WTO Doha Round negotiations, albeit as part of the WTO’s ‘single undertaking’ negotiation, so a more ambitious services-only agreement may be feasible;

• increase government efforts devoted to continuing efforts to reduce and remove key trade and investment impediments, including those highlighted in Table 8.1, above;

• refrain from negotiating Free Trade Agreements (FTA) that are essentially ‘political showpieces’ and do not deliver significant liberalisation of trade in goods and services, and of investment;

• actively explore the opportunity for closer economic relations with Taiwan; and

• press for a comprehensive FTA with India on the basis of a preparedness by Australia to relax restrictions on the export of uranium ore to India.

\(^{125}\) It has been agreed that these thresholds will also be extended to New Zealand investors. Relevant legislation is yet to take effect.
Annex A: Data & information sources

The assignment involves preparation of a written research report on the strategic opportunities and risks inherent in Australia's trade and investment relationships with its key Asian economic partners. To undertake this activity select data and information inputs were required to build a recent, current and forward looking picture of the regions trade and investment, and political economic environment.

Data and information sources were assessed for the Asia-10 economies of interest, across the period 2006 to 2010. Aggregate sectors identified for analysis include: agriculture, manufacturing, mining and services. In addition several sub-sectors were identified.

The time-horizon and sectoral detail was determined appropriate given a combination of the preferences of the BCA, the requirements of ITS Global's proposed analytical methods and outputs, and the nature of the available data.

A.1 Information sources

The strategic design and direction of the assignment leverages principally the subject matter expertise of ITS Global Principal and Senior Consultants. This includes staff with former high-level experience in key multi-lateral organisations (i.e. OECD, UNCTAD) and executive levels of government in Australia.

Secondary sources have also been assessed. Key research includes the Asian Development Bank Initiative publications, as well as UNCTAD, OECD, IMF and the World Bank analyses of trade and investment trends in the region. Industry and academic research has been analysed and adapted where necessary to both build and add weight to the direction of the assignment.

A.2 Data sources

Primary analysis has identified developments in trade in goods and services, and inward and outward investment using separate sources to allow for a clear and encompassing picture of Australia's interaction with Asia. This will also provide the detail necessary to obtain an appreciation of the more critical interplay that exist between each aggregate sector.

Data on merchandise trade was sourced from the United Nations COMTRADE database under the Harmonized System Code (HS Code) series. Whilst the Australian Bureau of Statistics (ABS) publishes Australian export data, using the COMTRADE HS Code series ensures consistency when Australia's export performance is compared with that of other countries. COMTRADE data also allows for an analysis of the import contribution to Australia's trade, accounted for in Section 3.

Trade in services data was collected from two ABS catalogues: International Trade in Goods and Services (Cat 5368.0) and Balance of Payments and International Investment Positions (Cat 5302). The ABS records balance of payments data (BoP) for eleven major service categories. Of the eleven Financial services and Transport services were identified for further analysis.

Estimates of the foreign merchandise content of exports and of the services contribution to manufacturing (both in Section 3) used the 2001-02 Input-Output Table published by
the ABS (the latest available). This is estimated for each of the 109 ANZSIC industries (four-digit codes) that make up the Table.

Investment stock and flow data makes use of publically available sources through the ABS catalogue International Investment Position, Australia 2010 (Cat. 53520); Canadian investment stock data published by Canada Statistics and their foreign affairs bureau; and Singapore Statistics international investment data for the period ending 2009 due to data limitations.

National Statistics bureaus of the ten Asian economies were reviewed as necessary to supplement data sources available.

Index data of trade and investment restrictiveness, as well those to assess the Australian domestic environment as it affects Australia’s international competitive position were also identified.
Annex B: Determinants of Australia’s export performance

The following tables serve as additional inputs to section 2.5 on Australia’s competitiveness with export competing economies.

*Table B.1: Australia’s share of imports by the Peoples’ Republic of China, selected HS categories, %*

<table>
<thead>
<tr>
<th>HS Category</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Change 2006-10 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inorganic chemical (HS 28)</td>
<td>27.33</td>
<td>26.69</td>
<td>17.06</td>
<td>19.17</td>
<td>15.13</td>
<td>-12.21</td>
</tr>
<tr>
<td>Ammonia (HS 2814)</td>
<td>16.67</td>
<td>49.50</td>
<td>30.93</td>
<td>25.54</td>
<td>50.13</td>
<td>33.46</td>
</tr>
<tr>
<td>Pharmaceuticals (HS 30)</td>
<td>1.41</td>
<td>1.14</td>
<td>1.11</td>
<td>1.70</td>
<td>1.57</td>
<td>0.16</td>
</tr>
<tr>
<td>Medicaments (HS 3004)</td>
<td>1.63</td>
<td>1.38</td>
<td>1.33</td>
<td>2.13</td>
<td>2.01</td>
<td>0.38</td>
</tr>
<tr>
<td>Aluminium (HS 76)</td>
<td>9.40</td>
<td>6.76</td>
<td>6.39</td>
<td>9.55</td>
<td>8.13</td>
<td>-1.27</td>
</tr>
<tr>
<td>Unwrought aluminium (HS 7601)</td>
<td>20.47</td>
<td>18.61</td>
<td>13.84</td>
<td>13.86</td>
<td>14.08</td>
<td>-6.39</td>
</tr>
<tr>
<td>Non-electrical machinery (HS84)</td>
<td>0.29</td>
<td>0.35</td>
<td>0.24</td>
<td>0.29</td>
<td>0.25</td>
<td>-0.03</td>
</tr>
<tr>
<td>Parts for lifting &amp; earth-moving machinery (HS 8431)</td>
<td>0.41</td>
<td>0.46</td>
<td>0.25</td>
<td>0.58</td>
<td>0.59</td>
<td>0.19</td>
</tr>
<tr>
<td>Motor vehicles (HS 87)</td>
<td>0.05</td>
<td>0.12</td>
<td>0.06</td>
<td>0.05</td>
<td>0.05</td>
<td>0</td>
</tr>
<tr>
<td>Motor vehicle parts (HS8704)</td>
<td>0.05</td>
<td>0.17</td>
<td>0.09</td>
<td>0.08</td>
<td>0.09</td>
<td>0.04</td>
</tr>
<tr>
<td>Optical, precision, &amp; medical instruments &amp; apparatus (HS 90)</td>
<td>0.10</td>
<td>0.11</td>
<td>0.13</td>
<td>0.16</td>
<td>0.14</td>
<td>0.04</td>
</tr>
<tr>
<td>Medical, dental &amp; veterinary apparatus (HS 9019)</td>
<td>2.32</td>
<td>1.83</td>
<td>2.84</td>
<td>3.29</td>
<td>3.07</td>
<td>0.75</td>
</tr>
</tbody>
</table>

Source: UN COMTRADE and ITS Global estimates
### Table B.2: Australia’s share of imports by Japan, selected HS categories, %

<table>
<thead>
<tr>
<th>HS Category</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Change 2006-10 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inorganic chemical (HS 28)</td>
<td>0.012</td>
<td>0.010</td>
<td>0.011</td>
<td>0.011</td>
<td>0.015</td>
<td>0.002</td>
</tr>
<tr>
<td>Ammonia (HS 2814)</td>
<td>0</td>
<td>0</td>
<td>1.971</td>
<td>0</td>
<td>2.611</td>
<td>2.611</td>
</tr>
<tr>
<td>Pharmaceuticals (HS 30)</td>
<td>0.006</td>
<td>0.005</td>
<td>0.008</td>
<td>0.007</td>
<td>0.009</td>
<td>0.002</td>
</tr>
<tr>
<td>Medicaments (HS 3004)</td>
<td>0.676</td>
<td>0.561</td>
<td>0.977</td>
<td>0.891</td>
<td>1.132</td>
<td>0.456</td>
</tr>
<tr>
<td>Aluminium (HS 76)</td>
<td>0.156</td>
<td>0.169</td>
<td>0.169</td>
<td>0.145</td>
<td>0.182</td>
<td>0.026</td>
</tr>
<tr>
<td>Non-electrical machinery (HS84)</td>
<td>0.001</td>
<td>0.001</td>
<td>0.001</td>
<td>0.001</td>
<td>0.001</td>
<td>0.000</td>
</tr>
<tr>
<td>Parts for lifting &amp; earth-moving machinery (HS 8431)</td>
<td>0.170</td>
<td>0.087</td>
<td>0.146</td>
<td>0.412</td>
<td>0.190</td>
<td>0.020</td>
</tr>
<tr>
<td>Motor vehicles (HS 87)</td>
<td>0.002</td>
<td>0.003</td>
<td>0.003</td>
<td>0.002</td>
<td>0.003</td>
<td>0.001</td>
</tr>
<tr>
<td>Motor vehicle parts (HS8704)</td>
<td>0.679</td>
<td>0.811</td>
<td>0.765</td>
<td>0.582</td>
<td>0.801</td>
<td>0.122</td>
</tr>
<tr>
<td>Optical, precision, &amp; medical instruments &amp; apparatus (HS 90)</td>
<td>0.003</td>
<td>0.004</td>
<td>0.005</td>
<td>0.005</td>
<td>0.006</td>
<td>0.003</td>
</tr>
<tr>
<td>Medical, dental &amp; veterinary apparatus (HS 9019)</td>
<td>4.442</td>
<td>5.963</td>
<td>7.989</td>
<td>8.004</td>
<td>8.289</td>
<td>3.847</td>
</tr>
</tbody>
</table>

Source: UN COMTRADE and ITS Global estimates
Table B.3: Australia’s share of imports by the Republic of Korea, selected HS categories, 2006-2009(a), %

<table>
<thead>
<tr>
<th>HS Category</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Change 2006-09 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inorganic chemical (HS 28)</td>
<td>0.044</td>
<td>0.060</td>
<td>0.025</td>
<td>0.047</td>
<td>0.003</td>
</tr>
<tr>
<td>Ammonia (HS 2814)</td>
<td>10.879</td>
<td>36.317</td>
<td>17.991</td>
<td>29.514</td>
<td>18.634</td>
</tr>
<tr>
<td>Pharmaceuticals (HS 30)</td>
<td>0.033</td>
<td>0.035</td>
<td>0.036</td>
<td>0.051</td>
<td>0.018</td>
</tr>
<tr>
<td>Medicaments (HS 3004)</td>
<td>4.329</td>
<td>4.968</td>
<td>4.789</td>
<td>7.346</td>
<td>3.017</td>
</tr>
<tr>
<td>Aluminium (HS 76)</td>
<td>0.137</td>
<td>0.137</td>
<td>0.118</td>
<td>0.190</td>
<td>0.053</td>
</tr>
<tr>
<td>Non-electrical machinery (HS84)</td>
<td>0.008</td>
<td>0.008</td>
<td>0.007</td>
<td>0.004</td>
<td>-0.005</td>
</tr>
<tr>
<td>Parts for lifting &amp; earth-moving machinery (HS 8431)</td>
<td>0.151</td>
<td>0.228</td>
<td>0.079</td>
<td>0.037</td>
<td>-0.114</td>
</tr>
<tr>
<td>Motor vehicles (HS 87)</td>
<td>0.010</td>
<td>0.011</td>
<td>0.016</td>
<td>0.011</td>
<td>0.001</td>
</tr>
<tr>
<td>Motor vehicle parts (HS704)</td>
<td>2.133</td>
<td>2.419</td>
<td>2.187</td>
<td>1.213</td>
<td>-0.921</td>
</tr>
<tr>
<td>Optical, precision, &amp; medical instruments &amp; apparatus (HS 90)</td>
<td>0.003</td>
<td>0.004</td>
<td>0.004</td>
<td>0.004</td>
<td>0.000</td>
</tr>
<tr>
<td>Medical, dental &amp; veterinary apparatus (HS 9019)</td>
<td>1.564</td>
<td>3.941</td>
<td>3.646</td>
<td>4.790</td>
<td>3.226</td>
</tr>
</tbody>
</table>

Notes: (a) no data were available for 2010
Source: UN COMTRADE and ITS Global estimates
Table B.4: Australia’s share of imports by Vietnam, selected HS categories, 2006-2009 (a), %

<table>
<thead>
<tr>
<th>HS Category</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Change 2006-09 (% point)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inorganic chemical (HS 28)</td>
<td>0.019</td>
<td>0.016</td>
<td>0.017</td>
<td>0.011</td>
<td>-0.008</td>
</tr>
<tr>
<td>Ammonia (HS 2814)</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Pharmaceuticals (HS 30)</td>
<td>0.034</td>
<td>0.033</td>
<td>0.027</td>
<td>0.029</td>
<td>-0.005</td>
</tr>
<tr>
<td>Medicaments (HS 3004)</td>
<td>3.541</td>
<td>3.433</td>
<td>3.023</td>
<td>2.934</td>
<td>-0.607</td>
</tr>
<tr>
<td>Aluminium (HS 76)</td>
<td>0.104</td>
<td>0.107</td>
<td>0.105</td>
<td>0.110</td>
<td>0.006</td>
</tr>
<tr>
<td>Unwrought aluminium (HS 7601)</td>
<td>9.034</td>
<td>10.358</td>
<td>9.946</td>
<td>12.376</td>
<td>3.342</td>
</tr>
<tr>
<td>Non-electrical machinery (HS84)</td>
<td>0.004</td>
<td>0.002</td>
<td>0.003</td>
<td>0.003</td>
<td>-0.001</td>
</tr>
<tr>
<td>Parts for lifting &amp; earth-moving machinery (HS 8431)</td>
<td>0.517</td>
<td>0.365</td>
<td>1.279</td>
<td>1.855</td>
<td>1.339</td>
</tr>
<tr>
<td>Motor vehicles (HS 87)</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>Motor vehicle parts (HS8704)</td>
<td>0.005</td>
<td>0.002</td>
<td>0.005</td>
<td>0.003</td>
<td>-0.002</td>
</tr>
<tr>
<td>Optical, precision, &amp; medical instruments &amp; apparatus (HS 90)</td>
<td>0.006</td>
<td>0.004</td>
<td>0.006</td>
<td>0.004</td>
<td>-0.002</td>
</tr>
<tr>
<td>Medical, dental &amp; veterinary apparatus (HS 9019)</td>
<td>0.000</td>
<td>0.082</td>
<td>0.508</td>
<td>0.395</td>
<td>0.395</td>
</tr>
</tbody>
</table>

Notes: (a) no data were available for 2010 or for imports of HS 2814 from Australia in any year
Source: UN COMTRADE and ITS Global estimates
Annex C: Comparing foreign investment performance by Canada & Australia

Canada distinguishes between WTO and non-WTO members for investment review thresholds. A threshold (below which no review, only notification is required) of $312m applies to WTO member states and $5m for non-WTO members in 2011. Investments in culturally sensitive sectors or areas that concern national security can be made subject to a review irrespective of value. Indirect acquisitions are non-reviewable but subject to notification requirements.

Where required corporations or individuals submit applications to the Minister of Industry or, where cultural matters are concerned, the Minister of Canadian Heritage. Reviewed investments are then subject to a net-benefit test, which considers the effect of the investment on economic activity, employment, resource processing; participation of Canadian individuals or businesses; effect on productivity, technological development and innovation; effect on local competition; compliance with Canadian Industry policy aims and the investments contribution to Canada’s global competitiveness.

Investment limitations exist in the following sectors: fishing (49 per cent); uranium (49 per cent); air transport (25 per cent); book, periodical and film publishing/producing and distribution (subject to review and net-benefit test, and limitations on activities permitted exist); broadcasting (20 per cent) and telecommunications (46.7 per cent).

Australia and Canada’s investment regimes differ according to the exceptions that apply in notification, the scope of the sensitive sectors, and the bodies that grant approval. In Canada, all approvals (except for Cultural approvals) are granted by the Minister of Industry, whilst in Australia approvals are granted by the Treasurer, with recommendations made by a separate committee – the Foreign Investment Review Board (FIRB) which comprises independent experts.

In Australia, investments requiring prior approval include acquisitions of interests in Australian businesses worth over $231m (or $231m for US companies in sensitive sectors, $1004m otherwise); Portfolio investments in Media over 5 per cent, and all direct investments by foreign Governments (regardless of size). Proposals by private investors to establish new businesses do not require prior approval.

Canada has higher thresholds for investment ($312m) compared to Australia’s $231m. However, Australia applies much higher thresholds for US investment ($1004m). Both countries have additional requirements and equity restrictions for media, telecommunications, transport, national security and uranium industries. However,

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127 This concept is not defined in the regulations but is decided on consultation between the Minister of Industry and the Minister of Public Safety and Emergency Preparedness (WTO TPR s 19)
128 Doing Business in Canada (2011)
130 WTO TPR s 16
131 For example, establishing a film distribution company is only permitted for importation and distribution, takeovers of distribution businesses in Canada are only permitted if the investor reinvests a percentage of earnings in Canada (http://www.state.gov/e/eeb/rls/othr/ics/2011/157253.htm)
132 http://www.state.gov/e/eeb/rls/othr/ics/2011/157253.htm
133 WTO TPR s 24
Australia has more broad sweeping exceptions related to transport (includes ports, rail and shipping whereas Canada only includes air transport). Furthermore, Canada’s concept of “national security” is not defined, whereas Australia’s requirements are more specific. 135 Australia also has requirements for notification prior to the purchase of real estate (and lower thresholds apply).

Australia additionally requires all foreign governments and state owned enterprises to notify the FIRB before being granted approval; whereas Canada does not make this distinction. Most importantly, Australia’s test of what is in the “national interest” is approached on a case-by-case basis and is therefore discretionary, whereas Canada has listed parameters for what should be considered.

C.1 OECD investment restrictiveness index

The OECD investment restrictiveness index is discussed in Chapter 3. It offers a means of comparing different countries over the question of openness to foreign investment.

The overall downward trend for both countries is to reduce regulatory barriers to foreign investment.

Australia and Canada have had quite similar index results in the surveyed years. In 2003, Australia was assessed as being slightly more open to foreign investment with an index value of 0.27 compared to Canada’s 0.35. By 2006, Australia was judged to be less open than Canada (0.28 compared whilst Canada’s 0.23. In 2010, Canada was again slightly less open than Australia (0.15 compared to Australia’s 0.13).

Figure C.1 Comparing OECD investment restrictiveness, Australia & Canada

135 “National security” areas include the supply of training or human resources, or the manufacture or supply of military goods or equipment or technology, to the Australian Defence Force or other defence forces; the manufacture or supply of goods, equipment or technology able to be used for a military purpose; and the development, manufacture or supply of, or the provision of services relating to, encryption and security technologies and communications systems.
Annex D: Inward & outward FDI

The following charts are additional material relating to Chapter 3.3. Key messages from these figures have been included in the text of that section.

Figure D.2 Level of inward foreign direct investment from the Rest of the World to Australia, Canada, Singapore, 2005-2009, $ billion (a)

![Graph showing inward FDI levels from the Rest of the World to Australia, Canada, Singapore, 2005-2009.](image)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.

Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics

Figure D.3 Level of inward foreign direct investment from Asia-10 to Australia, Canada & Singapore, 2005-2009, $ billions (a)

![Graph showing inward FDI levels from Asia-10 to Australia, Canada, Singapore, 2005-2009.](image)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.

Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics
Figure D.4 Level of outward foreign direct investment to China from Australia, Canada & Singapore, 2005-2009, $ billions (a)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics

Figure D.5 Level of outward foreign direct investment to India from Australia, Canada & Singapore, 2005-2009, $ billions (a)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics
Figure D.6 Level of outward foreign direct investment to Indonesia from Australia, Canada & Singapore, 2005-2009, $ billions (a)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics

Figure D.7 Level of outward foreign direct investment to Vietnam from Australia, Canada & Singapore, 2005-2009, $ billions (a)

Note: (a) real prices estimated using the implicit GDP deflator (IMF 2011); Singapore data only available to 2009, so five year series from 2005-09 is presented. Singapore data is calculated based on investment from and to the remaining 9 Asian-10 countries.
Source: ABS Cat. No. 5352.0; Statistics Canada; Singapore Statistics
References


Joel Kurtzman and Glenn Yago, 2009, 2009 Opacity Index: Measuring Global Risks, Milken Institute, Santa Monica, CA, April


