Discussion Paper, Second National Meeting of China Matters, 20 November 2015

China's economic environment under Xi Jinping: what are the implications for Australian business?

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The Xi Jinping leadership assumed government with a 'new normal' economic policy and a structural reform agenda. Its main two features are reduced infrastructure investment and structural deregulation. This meant more reliance on domestic consumption, social spending and infrastructure spending focused on projects that increase productivity, such as urban transport. The result was a slow-down of GDP growth to a target range of 6 to 7 per cent and a decline in resources imports.

Does the new normal work? This depends on the ability to transfer control over allocation of assets to the market and enterprises through operating finance and equity markets and a growing private sector. Underlying reforms of public finance and business taxation, while out of the limelight, have enabled the growth of financial and equity markets. The state-owned banking sector is undergoing corporatisation and marketisation to shift its focus from serving the state-owned enterprise sector to serving the private sector and retail clients. The anti-corruption campaign, while seen as disruptive, is forcing out financial intermediation by local governments.

The private sector is expanding. The government has facilitated access to finance and markets (and decreased the red tape) enabling the growth of large national and global corporations, such as Alibaba, Wanda and Huawei. New large private enterprises are also emerging from the dismantling of large state-owned enterprise groups.

In this context, the 2015 stock market volatility was the result of the government's overconfidence in stock market development for corporate investors. The government's encouragement of small retail investors to cash in on growth damaged investor confidence in the stock market for investors. However, the role of equity markets, including the Stock Market, Private Equity, Venture Capital and Mass Finance, will continue to grow.

The new 13th Five Year Plan for 2016 to 2020 builds on these structural reforms. Its main elements are technical innovation, social consolidation and corporate globalisation. China aims to radically upgrade its manufacturing sector through phasing in a European inspired innovation program called China 2025 in order to avoid the 'middle income trap' of being stuck in labour intensive manufacturing. Agricultural innovation is driven by a closer integration of urban and rural areas which is supported by social measures such as the reform of residency restrictions.

The international consequences of structural reforms are new markets and new corporate actors. New markets are emerging in banking/finance, health, education and e-commerce. These are immature markets that will take experimentation to develop and are likely to be disruptive. These markets will be highly contested.

Other markets are opening up through China's regional economic expansion into Central Asia and Southeast Asia and the Asian Infrastructure Investment Bank.

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New corporate actors emerging from China's structural reforms are large-scale private enterprises that have the means to invest and operate globally and are more open to cooperation than traditional state-owned enterprises.

What are the implications for Australia? Australia has experienced a downturn in resources trade and resources investment. From 2013/14 to 2014/14 Australian merchandise exports to China declined by 18.6 per cent. Chinese direct investment into Australia declined from its peak in 2012 by close to ten per cent year on year in 2013 and 2014 driven by a steep decline in resources investment that was partially offset by an increase in other areas such as commercial real estate.

However, there is positive news as well as challenges. Past the resources boom, Australia's economy is well equipped to cater for China's growing consumer and producer markets under new normal policies and the 13th Five Year Plan. Australia has competitive advantages in the services industries, in particular finance and education, as well as in agriculture and agribusiness and continues to be a strong global player in resources and infrastructure. Australian economic dependence on China is likely to increase across major industries. As the ACBC's 2014 Australia China Trade Report noted, China is our main avenue to enter global value chains. In these globally contested markets Australian businesses can only depend on their agility and competitive advantages.

In this changing economic environment, the role of the Australian government will also undergo adjustment by moving from providing technical support for business towards promoting strategic opportunities.

Technical government support in reducing trade barriers through ChAFTA, TPP and other agreements is crucial for integration in global value chains. Government action will also be in demand to support foreign direct investment in China, where Australian firms are exposed to the same forms of institutional discrimination and competitive pressure as investors from other countries and where an on-going coordinated approach is called for.

In addition, Australian governments will have to take a pro-active strategic role when it comes to creating strategic commercial opportunities. This relates to at least three areas.

- Lobby for a commercial role for Australian companies in the new Asian Infrastructure Investment Bank (AIIB). Australia was invited as one of the original participants because of its commercial and institutional maturity. This could be commercialised in future third-country projects by AIIB, AIIB projects in Australia as well as Australian service provision for AIIB.
- A pro-active role in structuring Chinese direct investments in Australia as well as Australian investment in China. Currently, government focus is on pre-entry regulation of Chinese investment through FIRB. A stronger focus on post-entry integration by for example calling for more joint venture arrangements is likely to gain support from Australian and well as Chinese businesses.
- Australian governments could market Australian national infrastructure projects for joint international development as is currently happening in Northern Australia.

<u>Questions for the session to consider</u>:

- How do Australian businesses need to adjust given the changes that have taken place as part of China's economic rebalancing?

- How have the regulatory, political and strategic decisions made since Xi Jinping came to power, including the anti-corruption campaign, affected the business environment for Australians and for Chinese foreign investors?
- Are there concrete measures the Australian government should contemplate to manage possible increased risks, or should they be solely managed by business?