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Friend or Foe? Our China dilemma is our biggest test

Illustration: Eric Lobbecke

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Australia's ability to manage successfully its biggest postwar strategic challenge now hangs in a condition of uncertainty — and amid this confusion the intellectual elites of Australia and China have proposed an audacious agenda for much deeper intimacy.

The Partnership for Change joint economic report is an aspirational challenge for both countries and a wake-up jolt — the recommendations shatter the "business-as-usual" and delusional features of the Australia-China relationship. It is the most comprehensive review for several decades of Australia's most important economic partnership. There could not be a better time for its release. Beijing is militarising the South China Sea in defiance of global norms; Scott Morrison is imposing national security vetoes on the biggest proposed Chinese investment in Australia; and our foreign policy is an intellectual graveyard for any notion about how to manage these contradictions.

Australia has become a transactional nation. We are reactive, dealing with issues as they arise, trusting the consequences won't be too disastrous, sleepwalking into an unknown future and increasingly divorced from any grand strategy. There are two mutual hostile schools forming about China — the security school focused on the growing threat China's behaviour poses to the region and the economic school aware of the fantastic opportunities posed by the growth of China's middle class and luxuriating about increased trade and investment.

The upshot is obvious: the security problems will intensify with China's growing military power and economic links will intensify at the same time. Our debate seems clueless about how to balance these objectives. This is compounded by the rising tide of xenophobic resistance to foreign investment, a sentiment now concentrated on Chinese capital.

This report is illuminating and confronting, an unabashed work by elites at a time when experts are discredited as politics is dumbed down. It is a joint blueprint on how Australia should maximise its economic gains from the China relationship — and in the process it highlights something else, namely the alarming gulf between elite opinion and the nation's political stomach.

Recognising Australia-China ties are certain to become more important, the report has a 10-year aspiration to take relations "to a wholly new level". It seeks a comprehensive strategic partnership for change embodied in a series of initiatives that aspires to lift relations to a formal treaty status.

The treaty would be an umbrella arrangement that included all aspects of relations, notably open markets, resource and energy security, agriculture, food security and investment. The parallel with Japan is explicit. Given the 1976 Australia-Japan Basic Treaty of Friendship and Co-operation, sometimes called the Nara Treaty, the aim is to invest China ties with the same status long accorded to Japan.

The idealism of the goals is challenging for Australia as a society — the report says that if Australia and China are to maximise their potential then their ties must become "a model of how countries with different social systems and at different levels of economic development can collaborate". The report sees this project as transcending just bilateral ties and promoting beneficial outcomes for the region and world.

The document says realisation of its vision "requires a high level of trust" between the two governments. This is an understatement. The harmony and shared interest it assumes is profound. The unanswered burning question is: given the conflicting values and opposing models of governance that divide Australia and China is such trust possible between these countries and systems?

The report is a joint product of the East Asian Bureau of Economic Research at the ANU and the China Centre for International Economic Exchanges in Beijing. The key figure involved from the Australian side is Peter Drysdale, a policy veteran on trade and East Asia. The report has been workshopped through most of our policy elite, including former prime ministers and the major departments, Prime Minister and Cabinet, Foreign Affairs, Treasury and the Reserve Bank.

It was guided by experts from both countries, the Australian side including former PM&C head Ian Watt, former Productivity Commission head Gary Banks, former Office of National Assessments chief Allan Gyngell, former PM&C official and Communications Department head Heather Smith and new central bank governor Phil Lowe.

The proposed changes in investment are sweeping and a direct assault on the

Foreign Investment Review Board system, which is seen as an impediment to progress. Indeed, it assumes the existing arrangements are untenable in the long run, saying they risk "deterring beneficial Chinese capital by increasing the costs and the uncertainty of doing business in Australia". In short, if Australia makes Chinese investment too hard, then mobile capital will look elsewhere. The report wants more transparency — a point reinforced by many comments after Morrison's veto of Chinese capital bidding for NSW electricity assets.

Top of the proposals is ditching the "national interest" discretion vested in the Treasurer's hands and the case-by-case approval method. The backdrop, of course, is Australia has a global significance through its exposure to managing China as a creditor power. The report says Australia, post resources boom, has fallen back to be merely the second largest destination for China's direct investment after the US.

But relative to economic size, Australia remains China's most important investment destination — this is an opportunity but also a serious problem since 45 per cent of recent Chinese capital was bound for the real estate market.

The report advocates rapid movement to a regime contained in a new bilateral investment agreement that accords China equal status with other nations and more generous treatment of its state-owned enterprises. It says there is "no benefit" from Australia creating regulatory uncertainty. It recommends a market "that allows the free entry and exit of companies" in place of FIRB ad hoc screening. It recommends Australia identify the economic sectors where foreign investment can be open and those where national interest factors dictate a need for restrictions. Such areas should have their own independent regulators, not the Treasurer.

The report says that as more Chinese construction and utilities expand abroad the opportunity for infrastructure financing in Australia will be immense. It argues that because China's state-owned enterprises "are no longer mere instruments of the government" foreign investors should be judged under normal Australian law rather than upfront discretionary assessments.

The report was presented to Malcolm Turnbull on Monday. He thanked the lead authors and said the report came at a critical time when China's transition to "a consumption-led and services-based economy" offered Australia great opportunities. But Turnbull was strictly noncommittal.

This report is a watershed. It comes from the heights of our de facto policy establishment but located outside the executive arm. It is founded in two assumptions. First, that immense changes are necessary if Australia and China are to realise the sheer potential in their economic partnership; and second, that differences in security, values and systems are not insuperable obstacles to this realisation. The latter is a heroic assumption. The pivotal question posed (and that cannot be answered in a joint report) is whether this vision would make Australia more vulnerable to China's strategic leverage and whether this is the inevitable consequence of closer economic ties.