

Session II Discussion Paper

How should Australia prepare for a changed trade and investment landscape?

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Australia will soon break the record set by the Netherlands for the longest period of uninterrupted economic growth in modern history. Two of the strongest factors behind this growth – aside from luck – have been the opening and reform of China’s economy, and the continued willingness of the United States to run a massive trade deficit. However, the trading system that allowed Australia to prosper from those conditions is under threat.

China’s trade and investment grew rapidly following its accession to the WTO in 2001, and since then its share of global trade has doubled. Australian merchandise exports to China are now ten times what they were at the time of China’s accession, and account for more than one-third of Australia’s total exports.

The relaxation of trade barriers under the WTO framework gave China more access to foreign capital and technology while helping its manufacturers integrate themselves into global supply chains. It gave countries like Australia the opportunity to supply the ravenous demand this created. However, the growth of China as a trading power is seen as a threat by some, who now seek to change the system that enabled China’s rise.

Since 2001, the US trade deficit with China has increased more than 300 per cent while its manufacturing sector shed more than five million jobs. The Trump Administration’s trade policy agenda promises a more aggressive approach using “all possible leverage” to open foreign markets, enforce US law, and negotiate new trade agreements that better serve US interests. It signals a shift towards bilateral rather than multilateral negotiations, and one of President Trump’s first executive orders after taking office was to withdraw the US from the multilateral Trans-Pacific Partnership (TPP).

This change is driven by a perception that global trade is a zero-sum game – a competition in which any US losses must be the result of a gain by someone else, with China being the culprit of choice. Competition is great when you’re winning, and the point at which rules and conduct are labelled unfair is often the same point at which the complainant ceases to have the upper hand.

Regardless of the motive, we are facing a likely shift in US trade policy towards selective protectionism and bilateral negotiations that allow it to leverage its power to greater effect.

Of key concern is whether China follows this approach and seeks to leverage its economic weight in pursuit of more overt self-interest. It wields a powerful stick by controlling access to the world’s largest market, while dangling a carrot in the form of Chinese cash and infrastructure through initiatives such as One Belt One Road (OBOR).

Alternatively, China may seek to differentiate itself as a defender (and reformer) of the multilateral rules-based system from which it has benefited so much.

So how does this affect Australia? We are a trading nation that depends on exports to maintain the prosperity to which we have become accustomed. Any move towards protectionism is a threat to those exports, and the flow of foreign capital on which we rely.

A web of bilateral FTAs may help hedge against the risk of a trade war between the US and China, allowing us to keep trading with our main partners if the multilateral system collapses. However, Australia has less bargaining power through bilateralism. Our market is small, and our economy is already relatively open. There aren't many barriers left to remove, so we have fewer economic concessions to offer in return for the benefits we seek.

Multilateral arrangements help reduce the asymmetry of power experienced by smaller nations, allowing them to band together in negotiating blocs based on shared interests. At a practical level, they also help reduce complexity by harmonising regional rules. Following the effective demise of the TPP, the most promising multilateral alternative is the Regional Comprehensive Economic Partnership (RCEP) being negotiated between ASEAN members and their six FTA partners – Australia, China, India, Japan, New Zealand and South Korea.

Japan pushed for Australia, New Zealand and India to be included in this group to help balance the negotiating power wielded by China. Our participation in these agreements will not always be based on economics. For many countries, opening their economies to Australia is seen as a threat due to the strength of our agricultural sector, and the potential for cheaper, high-quality Australian exports to displace domestic producers in areas that employ a large number of workers. However, the political benefits from Australian participation can sometimes be sufficient to override those concerns.

RCEP suffered from a lack of attention while the TPP remained our primary focus, so Australia's goals for the agreement remain unclear. China is pushing for the rapid conclusion of a deal focused on tariff reduction, whereas Japan wants a more comprehensive agreement that covers services and investment. Both versions have merit for Australia, but we cannot sit on the fence.

We need a clear understanding of what it is that we want to achieve, and the extent to which Australia is prepared to sacrifice business interests to achieve political objectives, or vice-versa. That requires a more sophisticated understanding of what our trading partners value most about Australia, and how we can leverage that value to greatest effect.

Questions

How might China seek to re-shape the regional trade agenda, and the way it is determined?

How should Australia mitigate the risk of China using its economic power over Australia to influence political outcomes? How can we enhance our leverage in bilateral deals?

Does China's 'One Belt One Road' initiative have substantive implications for Australia?



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