



## Session II Discussion Paper

### **How can the Australian economy be less dependent on the PRC?**

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A consistent feature of public debate about Australia-PRC relations has been the notion that Australia's policy-making space is limited by our economic dependence on the PRC. The fact that the PRC is our number one trading partner, a growing (though still small) source of foreign investment and a major player in international affairs means, so the argument goes, that Australia cannot criticise or respond to the PRC as freely as it might otherwise like. There is an element of truth to this. The PRC has imposed economic retaliation on countries when it deems their policies to be a serious enough risk to their interests.

The PRC's response to South Korea's decision to deploy the THAAD missile system is a case in point. Australia is particularly vulnerable to the possibility of retaliatory actions from Beijing in three areas: tourism, education and resources. In all three, the PRC dominates the market: tourism from China accounts for around 25% of total visitor expenditure; students from China are around one-third of all foreign student enrolments, and the PRC accounted for approximately 51.4% of our resources and energy exports in 2017-18.

I suggest there are three broad ways in which Australia could respond to these risks: diversification, promoting industries where demand from the PRC would be low, and adopting a policy that simply accepts the trade-offs of relying so heavily on the PRC.

Diversification is the most commonly called-for approach but also one of the trickier options as it involves state intervention in markets. Even if governments are willing and able to intervene, there are no clear policy choices as interventions usually force companies and universities to forgo higher profit margins and/or reliable buyers. Nonetheless, there are options that can nudge things in the right direction. Free trade agreements are the primary mechanism for promoting diversification as they can alter the value proposition by reducing costs and barriers that previously prevented companies from expanding their trade and investment in other countries. Another option is a program like the Economic Strategy recently presented by Peter Varghese in April 2018. The strategy aims to provide Australian businesses with a better understanding of the opportunities in India and how they can better take advantage of them.

Another option is to promote industries where demand from the PRC is likely to be low, thus removing the possibility of over-reliance. This would aim to reduce the relative reliance that the Australian economy has on the PRC while at the same time avoiding the political difficulties of state intervention in markets that are already heavily reliant on demand from the PRC. Defence industry is a logical example as it is unlikely we would sell military hardware to the PRC. We are already starting

to do this (though not with reliance on the PRC in mind) with Australia's new Defence Industry Capability Plan, which aims to have Australia as a top ten defence exporter by 2028. The more this approach is successful, the more ballast Australia has in its economy across the board, minimising the overall costs of potential retaliation from the PRC.

The third option is probably the least obvious but the easiest to implement: we could simply accept the possibility of greater costs in our relationship with the PRC. The underlying problem of economic dependence is that the potential costs of pursuing a course of action outweigh the expected benefit. The assessment of any potential costs, however, is often subjective as is the assessment of the extent to which any costs can be tolerated. In the case of the Australia-PRC relationship, the potential costs are confined to three industries and, while these would suffer quite severely in the short-term, the overall effect on the economy would be manageable. This is not to say that encouraging such retaliation would be wise, but rather that adopting a policy which shifts the threshold of what we find acceptable would give us greater freedom of action in policy-making.

None of these three options would be effective in isolation (except perhaps the third at its most extreme). Instead, they should be considered as inter-related levers that would require ongoing calibration in response to changing circumstances. Each of these policies are also difficult to implement in their own right. State intervention in the market, even if it is politically viable, is not guaranteed to be successful. All of these options also carry political risks for the government. Nonetheless, considering these options and how they might best be pursued could provide policy-makers with better options to ameliorate economic dependence in the Australia-PRC relationship.

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## Questions

- What policies could the Australian government implement to combat falls in demand for our resources?
- How can Australia diversify its exports towards other countries? Are there international examples we can learn from?
- What potential actions by the Australian government could cause the PRC to stop importing from Australia and does Australia have a strategy to prevent this from occurring?
- Should Australia pursue a Free Trade Agreement with Taiwan?

