China
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Session II Discussion Paper

What are Canberra's policy options if the PRC decides to punish Australia economically for being too supportive of the US?

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Three academics from the People's Republic of China (PRC) who were visiting Australia in September, courtesy of the PRC Embassy in Canberra, issued a dire warning: Australia could face retaliatory economic action if it adopted a pro-Washington stance on the PRC-US trade conflict.

Their warning followed Prime Minister Scott Morrison's speech to the Chicago Council on Global Affairs, in which he supported President Donald Trump's position that the PRC should cease to enjoy developing nation status in international trade. Instead, the PRC should be treated as a "newly developed nation". Should that transpire – something that in practice is easier said than done – Beijing would be bound by stricter trade obligations under rules of the World Trade Organisation.

This is yet another example of Australia being pressured to take sides in PRC-US competition. Canberra sometimes needs to make tough decisions which will annoy Beijing for national interest reasons, but it also does not need to support the United States on every economic issue, even if Washington pushes it to do so. Australia does not benefit from supporting Washington's trade conflict with Beijing. Australia's largest trade partner is the PRC. Most of the PRC's other major trade partners (and Australia's competitors) have eschewed taking sides.

Beijing has not been averse to dealing out economic punishments when it perceives its interests as being threatened. The PRC government has both halted and slowed imports from a target country to display its displeasure. Beijing has issued travel warnings or stopped travel agents from promoting tourism to destinations it deems unfavourable, such as Japan, Taiwan, The Philippines, South Korea and (most recently) the US.

Beijing has also effectively mobilised PRC consumers against countries in disfavour. Consumers in the PRC have now turned against the Houston Rockets' basketball team following a tweet by its general manager supporting Hong Kong protesters. Fearing a backlash from millions of fans in the PRC, the National Basketball Association called the general manager's tweet "regrettable".

Australia risks drawing Beijing's wrath in three ways. First, Beijing may decide to prevent or discourage its middle class from purchasing Australian goods and services. PRC middle classes make up the bulk of PRC tourists and university students coming to Australia, and comprise many of the consumers buying our infant formula, beef, berries and wine, for example.

Beijing could signal to consumers to not purchase Australian products through the issue of travel or phytosanitary warnings. It has already impeded Australian goods at the border, such as coal, chilled meat, wine, and barley. Australian agricultural goods and services enjoy a good reputation in the PRC, but they are replaceable by competitors from other countries, so the impact is potentially large.

The second risk is that the PRC hinders supplies of Australian iron ore which is our largest export. Conventional thinking decrees that Beijing's ability to switch to another supplier is limited due to issues of cost and reliability of supply. But suppose Beijing was prepared to "eat bitter fruit" for a period to teach Australia a lesson. Could it? What would be the impact for Australia of a short-term downturn in exports of iron ore? And how should we respond?

Finally, there is Beijing's drive to diversify sources of supply. One aim of the Belt and Road Initiative is to mitigate Beijing's economic risks by diversifying its sources of supply of key imports as well as growing its export markets. A January 2019 document jointly released by the Central Committee of the Communist Party of China and State Council called for "expanding import channels for agricultural products". To take the single example of barley, in the last year the PRC has permitted imports from Kazakhstan, Russia and Uruguay for the first time. It is boosting standards to protect human, animal and plant life and transport capacity in a number of countries while also investing in their agriculture sectors.

To mitigate the risks of PRC economic punishment, Canberra should encourage further investment from PRC companies into Australia's agriculture and agribusiness by easing the requirements for Foreign Investment Review Board approval. If PRC entities have "skin in the game" Beijing would be less likely to take retaliatory action that would impact these sectors. Other "at risk" sectors could gain protection from an initiative to attract PRC investment.

Tense political relations also prevent Australia from maximising the benefit of the China-Australia Free Trade Agreement. The FTA has an ongoing review mechanism which is meant to further lower trade barriers. That is not currently being implemented due to bilateral tensions. The PRC is currently in negotiation with other resource and agriculture intensive countries to lower tariff barriers.

The impact of the PRC's diversification efforts on Australia could be tempered by PRC market growth (if it occurs) and consumer preferences. But Australians should ask what are the long-term risks for Australia of PRC supply diversification and how do we mitigate those?

Standing with the US on matters of national security and human rights values is one thing; but should we draw a line in the sand and independently decide our stance on the PRC's international trading status or any other trade and investment decision which relates to our largest trading partner?

Session II questions:

- What immediate retaliatory measures would Beijing implement to punish Canberra?
- Longer term, will the PRC seek to reduce economic ties with Australia? Can it successfully do so?
- How should Australia respond to such threats and risks?

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