Third National Meeting: Background Papers

Session I: Do China's regional ambitions threaten Australia's interests?

Richard Rigby

In the three years since Xi Jinping became China's top leader, he has not only concentrated power in his own hands, but has articulated an ambitious domestic and foreign policy agenda based on the notion of the realization of China's 'Great Rejuvenation'. His aim is to restore China to what he sees as its rightful position in the region and the world. In common with all Chinese leaders of whatever political stripe since the late 19th century, the bottom line is that China will never again be put in the disadvantageous position in which it found itself from the first Opium War onwards.

Within the broad context of the 'Chinese Dream', a series of more specific initiatives relevant to our region have been advanced, including One Belt One Road, a Community of Common Destiny, Peripheral State Diplomacy, and the Asian Infrastructure Investment Bank. Also of relevance to Australia is China's continued advocacy of the 'new model' of relations between big states, primarily but not exclusively focused on the United States. Xi has repeated these at times somewhat inchoate notions on numerous overseas visits, exhaustively covered in the Chinese media—reinforcing China's standing and his increasingly cultic position as a strong and globally respected leader.

Little of this should, *per se*, be problematic for Australia. Since the establishment of diplomatic relations with the PRC in 1972, Australian Governments have consistently welcomed China's re-emergence as a more wealthy and powerful country playing a role commensurate with its historic and actual position as a major regional and global state. Only last year DFAT Secretary Peter Varghese noted that China had 'every right' to seek greater strategic influence to match its economic power. In this sense, it is difficult to say that China's regional ambitions *directly* threaten Australia's interests.

At least two things, though, need to be acknowledged. The first is the largely unspoken but widely shared expectation that as China grew in economic power, so too would its governance evolve in a more open, just and even democratic fashion. However, this has not happened, and under Xi's leadership China has moved further away from, rather than towards, such a trajectory. While a country's international behaviour cannot invariably be judged by its domestic practices, concerns about the latter cause discomfort and wariness in assessing its future path. It is, moreover, of real concern in the context of 'common values' as a determinant of our own diplomacy.

Second, several Chinese activities continue to be problematical – notably in the East and South China Seas. Diaoyu/Senkaku remains a potentially dangerous issue despite a modest improvement in China-Japan ties. Since the last *China Matters* National Meeting

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in November 2015, tensions have increased in the South China Sea by, *inter alia*, China's placement of missiles on Woody Island and further US Navy Freedom Of Navigation patrols – while Australia is being encouraged by US sources to engage more in such patrolling. Should we decide to do this, we must expect a strongly negative Chinese reaction, which may not be quarantined from other aspects of the relationship.

From China's viewpoint, its activities in the South China Sea are purely defensive, and they are, like other claimants, convinced of the justice of their position. This only heightens the likelihood of greater tensions as a genuine security dilemma evolves, based around the shifting relative power between China and the US—thus inevitably involving Australia.

These activities are problematical not only intrinsically, but also for what they seem to imply about how China is likely to behave as its power grows, and the impact this will have on regional relationships.

Uncertainty in cross-Strait relations following the election of the independence-leaning DPP in Taiwan could lead to further problems in US-China relations. This, coupled with Australia's strong economic ties with Taiwan and our desire to see regional stability, could also become a more negative factor in Australia-China relations.

Notwithstanding the foregoing, it is still difficult to see China emerging as a *direct* threat to Australia. Arguably, we could opt to further deepen ties with China, optimizing our economic links, refraining from criticism of China's regional policies and activities, and eschewing participation in activities of other states aimed at constraining China's ambitions. In so doing, we would preserve both our security and prosperity for the foreseeable future. But as long as we see our economic and security interests best served by upholding the rules-based order to which we are committed, having a strong alliance with the US, and developing closer security relations with Japan and other regional powers, we will have to accept that this is not always going to be to China's liking, and that we will need to prepare seriously for more contentiousness in our relations with China than we have hitherto encountered.

Questions:

- What is the extent of Chinese ambition in the next 5 to 10 years and is it a threat to Australian interests?
- How most effectively can Canberra respond to Beijing's efforts to expand Chinese influence in the region and counterbalance Washington?
- What are the risks for Australia of closer security relations with Japan in the context of Australia-China relations?
- Should Australian business be concerned about these questions?

Session II: Has China's government lost control of core areas of the economy? What are the implications for Australian business? How should Australia respond?

Laurie Smith

In 2013 an ambitious reform agenda, in 2016 a sense of crisis

President Xi Jinping put his stamp on an ambitious economic reform agenda in November 2013. It was designed to unleash new sources of growth to replace China's investment-led but increasingly inefficient growth model. The plan highlighted the need to strengthen the role of markets, improve the investment environment, create more space for private firms, reform financial markets and prioritise innovation in manufacturing and the services sector.

Many analysts at the time were optimistic that Xi and his technocratic Premier, Li Keqiang, would move on these reforms with purpose and urgency.

Since then, growth has continued to slow. We saw a spectacular stock market crisis in mid-2015. Then a devaluation and adjustment to *renminbi* (RMB) trading rules that, together, spooked global markets. At the same time an ongoing anti-corruption campaign that is popular with the public has slowed decision-making in government and state-owned enterprises (SOE).

In Australia, the decline in commodity prices adds to uncertainty about the immediate and medium-term prospects of the Chinese economy as well as our own. The China-Australia FTA provides plenty of opportunities for Australian business at the macro level but firms are faced with lots of challenges to capture them in such an uncertain environment.

What does it all mean?

One view is that China's growth is slowing more dramatically than unreliable Chinese economic statistics suggest. Beijing re-states its goal of decreasing dependence on investment-led growth but every crisis is met by the same response – more infrastructure spending – as witnessed by Premier Li's announcement of a stimulus package at the March 2016 National People's Congress meeting in Beijing.

Recent setbacks might suggest that the quality of economic policy-making in Beijing is deteriorating. The primacy of Communist Party leadership has been re-emphasised. Space for debate on policy and social issues has contracted as independent voices are muted and more explicit loyalty to the party is demanded. According to this argument, the reform agenda of 2013 is badly compromised if not doomed.

But even a China that grows more slowly matters. Six percent growth in 2015 meant US$1.2 trillion in extra GDP, about the size of the Australian economy.

Overall growth figures for China mask dynamic change and ongoing reform in many sectors:

- In 2015, services grew faster than manufacturing and accounted for half of GDP; consumption growth remained strong with a 10% increase in retail sales;
- E-commerce sales surpassed US$600 billion in 2015; cross border transactions now exceed US$40 billion every year. Internet users increasingly buy packaged and even fresh food online.
- Regulators have committed to allow 100% foreign ownership of fund management firms in the Shanghai Free Trade Zone and issued new banking licenses to disruptive technology companies, Alibaba and Tencent.
- Foreign investment and know-how is warmly welcomed in health and aged care which have become top government priorities, while strong measures are being taken to cut capacity in heavy industry and increase energy efficiency.

For all of this progress, a new tension in policy making is evident. Politics could undermine the next wave of intended reforms in a way not seen for over two decades.

However, as Stephen FitzGerald recently commented, we do need to get past certain ways of looking at China: that economic problems mean the Chinese economy will crash, that an authoritarian one-party-state by definition can't understand a market economy and therefore can't know how to manage it (as we all do, of course), or finally, that the Chinese political system is headed for collapse.

Issues for Australia and Australian business

As the complexity of China grows, we need to invest at a national level to understand China's economic decision-making processes. At an industry or sectoral level, policy development in sectors of potential for Australia must be better understood.

Mechanisms are needed for firms to share insights across industry and with government. We need to understand the lessons of those who have built substantial businesses within China – say, *Bluescope* in manufacturing and *Seek/-Zhaopin* in services. We need to push back against the impulse to outsource China market development to Chinese-Australians because it is all too complicated and they 'get it' naturally. Companies need better insights into policy trends and risks to inform decisions about long-term China investments.

Questions:

- Are Beijing's decision-makers able to manage China's economic problems? Can the Communist Party manage an innovative consumer-led economy?
- If they can, (or: If they can not,) what are the implications for Australian business? If uncertainties grow, should Australian business spread risk away from China?
- How well does the Australian Government share its insights into policy trends in China with business? How could it do better?

Session III: Is there a problem with Chinese money?

Hans Hendrischke

Chinese money is flowing into Australia from unprecedented sources through unprecedented channels for unprecedented purposes, creating controversy at every turn. In 2015 the near $5 billion from students was dwarfed by $8 billion from tourists, which was in turn dwarfed by direct investment. All are predicted to continue rising.

Controversies abound. Has the money been acquired legally? Does it raise domestic prices? How many utilities (or ports) controlled by Chinese companies is too many? Do state-owned enterprises demand special consideration? What about private Chinese firms subject to political influence? How should – or could – Chinese investment be managed if bilateral relations deteriorated? Does Chinese investment alienate Australia from traditional allies? The last question is especially pertinent and has generated debate as to whether Australia's social and institutional frameworks can cope with the influx and effects of Chinese money.

Two recent investments – Kidman Holdings and the Port of Darwin – crystallized public opinion and prompted the government to review Australia's foreign investment framework, including the Foreign Investment Review Board (FIRB). The government is faced with a delicate balancing act: foreign investment is necessary and therefore to be encouraged while the public is to be assured that this is all in the national interest.

Chinese investment offers commercial and strategic opportunities (as does all foreign investment). For example, the *Developing Northern Australia White Paper* calls for agricultural development that demands substantial strategic investment from foreign investors. They will only invest if they have commercial and strategic stakes in those plans – as does, for example, China with its demand for Australian agricultural products.

All countries are entitled to regulate foreign investment. In Australia, FIRB (in consultation with other agencies) manages this case-by-case. Controversy arises when politicians or others use public concerns as a reason to question processes. It continues with insinuations that the government should be more restrictive of foreign investment.

One frequently touted means to allay public concern is greater public information and transparency. However, full transparency is difficult for two reasons.

First, FIRB's jurisdiction excludes numerous investment proposals valued below FIRB thresholds. Australia's bilateral trade agreements with China, Japan, Korea and the US set FIRB's threshold for private investment from those countries at A$1,094 million with lower thresholds reserved for special cases. These are A$252 million for 'sensitive businesses' and somewhat lower for agribusiness, agricultural, and residential land. Consequently, security oversight and public information dependent on FIRB is generally only available for major proposals.

Controversy over Chinese agricultural and residential property ownership recently prompted the establishment of registers for foreign holdings of Australian agricultural and residential land, substantially expanding public information. The most comprehensive information on new Chinese investments in Australia (including commercial investments over US$5 million) is available at a website sponsored by the Department of Foreign Affairs and Trade: www.demystifyingchina.com.au.

Second, FIRB's authority is limited to upfront assessments of investment proposals. It does not extend to investors' subsequent conduct. This steers public debate to FIRB's gatekeeping role, while the supervisory and compliance-enforcing roles of other agencies are rarely discussed. Consequently there is excessive demand for increasingly complex pre-entry scrutiny, which can easily become politicised. Meanwhile, agencies that supervise foreign investments over their whole lifespan are ignored, despite their roles potentially boosting public confidence in foreign investment. These include the Australian Securities and Investment Commission, Australian Taxation Office and Australian Competition and Consumer Commission.

The United Kingdom provides a case in point. The UK emphasises enforcement of subsequent regulatory compliance over upfront assessment. Subjecting foreign investors to the same supervision as domestic firms improves public confidence in foreign investment while limiting regulatory burdens at the proposal stage to security assessments.

Critical infrastructure also fits this framework. Australia's infrastructure needs (documented in the *Developing Northern Australia White Paper*) mean foreign investment is necessary for both critical and non-critical infrastructure. The Port of Darwin is an early example of corporatised critical infrastructure. Similar cases will emerge if infrastructure is to be built as planned, especially if Chinese investors remain competitive.

An inclusive approach to all foreign investment is therefore needed. Rigidly defining 'critical infrastructure' while only examining initial proposals (instead of lifespan supervision) creates commercial and security risk. Only ongoing government supervision and integration of foreign investments into domestic governance such as the critical infrastructure resilience strategy can mitigate that risk.

Questions:

- What genuine challenges does Chinese direct investment pose for Australia?
- What would we do without Chinese money?
- Are our current institutions sufficiently robust to manage Chinese investors' growing interest in Australia? If not, what needs to change?
- How can we have transparency and accountability without discouraging Chinese money?