INDEPENDENT STRATEGIC ANALYSIS OF AUSTRALIA'S GLOBAL INTERESTS

Associate Paper

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# Too Many Eggs in the Dragon's Basket?
# Part One: Australia's Reliance on Exports to China

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**Key Points**

- China is manifestly Australia's principal two-way trading partner. Australian exports of goods and services to China were worth $153 billion, constituted 32.6 per cent of all exports and were growing at 9.5% per annum immediately pre-COVID-19.
- Exports are highly concentrated and resources predominate. Iron ore, coal and liquefied natural gas, together with tourism and education, account for over 70 per cent of the total.
- Over the past six months, the Chinese Government has either denied, or given indication of restricting, a range of Australian exports, including barley, meat, wine, cotton and services. Those sectors are significantly dependent on the Chinese market and total over $4 billion.
- Australian trade policy and practice avoids direct retaliation. Alternative or substitute markets either do not exist, or take time and market development to form. A strategic reappraisal of, and actions to diversify and transform, Australia's export base is required.

**Summary**

In the twenty years to 2019, Australia's exports of merchandise goods and services to China increased from $5 billion to over $153 billion, with China now accounting for 32.6% of all Australia's exports. Australia's exports to China over 2018-19 primarily comprised three commodities, iron ore ($63.1 billion) coal ($16.6 billion) and liquefied natural gas (LNG) ($14.1 billion) and one key services export, travel-related services, which includes education.

The latter was worth $16.6 billion in 2018-19, representing 36 per cent of all international students to Australia. Gold exports also enjoyed a surge. Chinese imports into Australia are more diverse, although again are first-ranking, accounting for 19.4% of all Australia's imports and worth $81.8 billion in 2018-19. China has rarely said much about a trade imbalance that is consistently in Australia's favour. Recent actions by the Chinese Government, however, to impede Australian exports now call into question the prudence of such reliance. They underscore the reality that geostrategic power can be effectively exerted to threaten vital trade, investment or commercial goodwill. The COVID-19 pandemic, too, is appearing to be markedly affecting the composition of Australian trade with China, which will be addressed in Part Two of this paper.

The depth of business relationships established with Chinese authorities and importers by Australia's leading volume-exporting companies, demonstrating their sophisticated marketing acumen, may be sufficient to sustain vital high-dollar-value commodities exports. The difficulties faced by exporters of barley, wine, meat or cotton to counter Chinese Government intervention, together with a lack of success (to date) from Australian Government trade diplomacy, leads, however, to the question, "what next"? A reported current instruction from the Chinese Government to several electric power producers to 'stop importing coal from Australia' may demonstrate that not even Australia's principal suppliers to China are immune to such political threats.

## Analysis

China has become the principal, practically indispensable, two-way trading partner of Australia. In 2018-19, merchandise exports totalled $134.7 billion, representing 36.1% of all exports. Services exports to China add a further $18.5bn, representing a similar 18.9% of Australia's total services exports, with the percentage of travel and education dominating that trade, at 90.2%. In total, Australian goods and services exports to China in 2018-19 represented 32.6% of all Australia's exports. Australia's merchandise exports to China have been growing, on a five-year average basis, at 9.5%, with services exports at an even greater rate of 18.4%. Trade and tourism constitutes just one aspect of an intricate foreign relationship, with developed people-to-people links including a large, disparate Chinese community in Australia which, with over 1.2 million residents, is now the predominant culture after Anglo-Irish heritage.

### *Casus Belli*

As is often the case with the belligerent actions of nation-states, the cause of China's seemingly deliberate actions over the past six months to impede or curtail significant Australian exports can be found in a sequence of political, diplomatic or even military miscues, each unremarkable at the time.

To counter global questioning of China's management of the coronavirus outbreak, in early April 2020, the Chinese Embassy in Australia released a series of official media releases offering an account of their country's transparency, communication and co-operation on

COVID-19 (here, here and here). For some weeks prior, Prime Minister Scott Morrison had been discussing with a range of countries a call for an independent inquiry into the causes of the then-recently WHO-declared global pandemic. On 29 April, Morrison made a public statement at a press conference on the coronavirus pandemic stating, in part, '… [it would] seem entirely reasonable and sensible that the world would want to have an independent assessment of how this all occurred'. It remains unclear why the Australian Government appeared to be openly globally championing an inquiry, rather than employing more muted channels to seek outcomes at the-then forthcoming World Health Assembly meeting in May. Indeed, the Australian Government secured the support of the European Union at that Assembly and a motion was passed, with no mention of China. It was too late. The Australian Government's approach to the issue of the origin of the coronavirus incensed the Chinese Government, especially as announcements appeared to follow inflammatory public statements from leadership circles in the United States, with which China is engaged in a serious trade war. Tangential discord over Hong Kong, cyberattacks, Uighur human rights and the South China Sea did not help, and remain obstacles. Despite a sound history and the magnitude of bilateral co-operation, including Head of State visits and a free trade agreement signed in 2015, the China-Australia relationship has rapidly descended into what is probably its most fractured condition since Australia formally recognised the Peoples' Republic. Trade is the first observed casualty.

***Chinese Government Measures against Australian Exports***

**Barley:** On 19 May 2020, after an 18-month anti-dumping investigation, the Chinese Ministry of Commerce imposed a combined 80.5% tariff on Australian barley. Australian exports of barley to China averaged $1.3 billion per year between 2014-15 and 2018-19, representing over 50 per cent of all production. The Australian Government has yet to announce any appeal of the decision to the World Trade Organisation (WTO).

**Meat:** In May 2020, too, China suspended meat imports from four Australian production facilities representing some of the country's largest exporters, for reasons of technical labelling and biosecurity concerns. Beef exports to China have grown exponentially over recent years, to a value of $1.75 billion in 2018, representing some 24 per cent of total Australian beef exports. Alternative markets of a similar scale may be hard to find.

**Wine:** In August 2020, the Chinese Government announced the launch of an inquiry into claims that Australian bottled wine exports to China are subsidised, with a second, related investigation into suspicions of dumping launched the same month. Australian wine exports to China totalled $1.25 billion – a record – in the year to September 2019 and have been one of Australia's fastest-growing exports to China, enjoying a five-year growth of 45.5%. Gaining and sustaining national, varietal and maker brand loyalty among wine consumers often takes years to build. The Australian wine industry has been helping China in viticulture and management as well, so the loss of such a market would be devastating.

**Coal:** In mid-October 2020, reports emerged that at least four Chinese state-owned power generation companies (Huaneng, Datang, Huadian and Zhejiang), had been instructed 'to cease buying Australian (thermal) coal'. Chinese authorities to date have yet to confirm the action or give reason.

**Cotton:** Cotton mills in China have reportedly recently been advised that, if they import from Australia, they will have their domestic supply cut. Although Australia's cotton production fluctuates significantly depending on water availability (due to rainfall levels in the Gwydir, Namoi and Macquarie Valleys of north-western New South Wales and south-western Queensland), export values have, over a five-year average between 2013-14 and 2017-18, often exceeded $2 billion per year. Again, as with other commodities, China predominates as the export destination of choice, taking about 65 per cent of the crop. An added complication has been that the Chinese trade merchant company Weilin, which had committed to buy half the Australian crop in 2019-20, entered administration in July.

**Services (Education and Tourism):** In June 2020, the Chinese Ministry of Education urged students preparing to study abroad to 'do a risk assessment' and 'exercise caution' in choosing to go or return to Australia. Australia's closed international border, due to COVID-19, currently precludes study, but many Chinese people intending to travel to Australia as students (or tourists), will be likely to follow any similar alert warnings issued by China's Culture and Tourism Ministry in the future.

***Implications***

First, the measures taken by China appear to all fall within the technical bounds of allowed practice under the WTO, the 2015 China-Australia FTA or prevailing commercial contract.

Second, typical of trading structures in China, the importers of Australian-produced commodities are predominately state-owned enterprises with procurement practices that are relatively easy to direct. Of possible relevance is that, on 17 March 2018, under sweeping institutional reform, China established the "State Administration for Market Regulation", to regulate all market competition and oversee most import and investment licensing. There may be associated administrative re-arrangements that are taking time to settle, but China's available central control, routinely repudiated by its authorities, helps to explain the relative ease with which China is able to exert trade pressure on importing countries.

Third, disregarding coal, the measures taken to date affect, at most, 3.4% of Australia's total exports to China. Beyond concerned producers, industry bodies and Federal/State authorities, a "denial of trade" of that magnitude is unlikely to create a crescendo of Australian public outcry. It is worth noting, however, that such export volumes equate to approximately all of Australia's trade in 2018-19 with Southern and Eastern Africa ($4.1bn), or South America ($4.8bn).

Fourth, the measures are not about pricing and would not appear to favour Chinese importers or consumers. On the contrary, as an example, modelling by the Australian Bureau of Agricultural Resource Economics and Sciences (ABARES), shows that, as a result of the barley tariff, the gross value of Chinese agricultural production falls by about $3.6 billion – around three times the average value of China's barley imports from Australia.

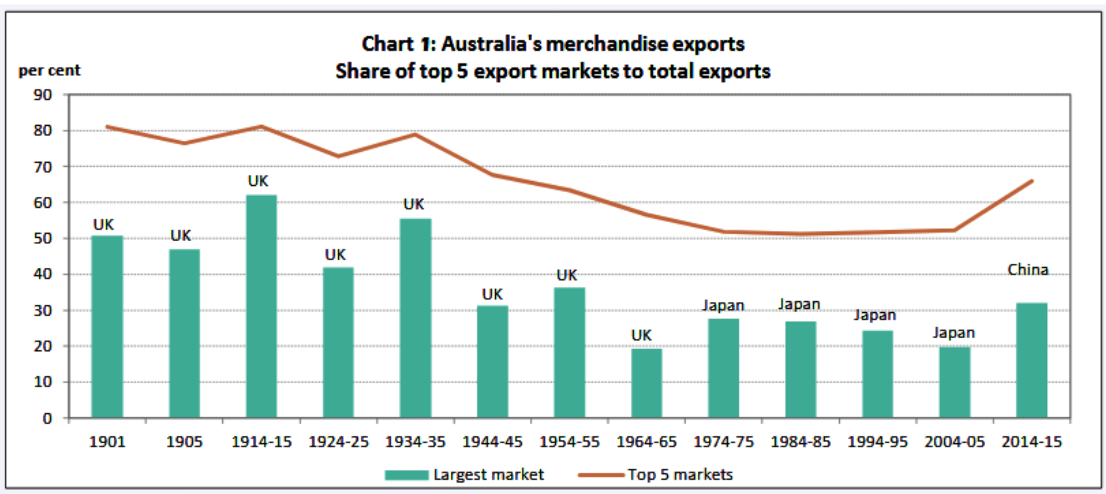
Last, even if trade protocols and commercial legalities were overridden by the Australian Government, the diverse composition of the Chinese goods and services imported into

Australia are such that only with refined petroleum could Australia possibly manage to deny trade and seek alternative sources. Any other measures, such as blanket tariffs, would hurt Australian consumers, as well as run counter to multilateral and bilateral trade policies that have been in place for decades. The Chinese authorities well know that.

It is worth emphasising the importance of terms of trade. Australian exporters or traders of commodities have little influence on markets, mostly being "price takers", denominated in US dollars. Global commodity prices fluctuate, but the relative value of the Australian dollar to the US dollar influences the profitability of companies, affecting the return to the Australian economy through royalties and taxes. To illustrate, a useful example is the impact of the royalties received as revenue ($7.7bn in 2019-20) by the Western Australian Government, overwhelmingly drawn (85 per cent), from the export of iron ore. To quote the WA Government Budget Papers, 'Movements in the $US/$A exchange rate and the iron ore price represent the largest risks (both upside and downside) to general government revenue'. Imagine managing a State Government budget, with relatively fixed expenditures and eternal wrangling for GST supplementation revenue from the Commonwealth, in which a single source was worth 21 per cent of all revenue but anticipating a downward price movement of nearly 35 per cent into 2021-22, compounded by unpredictable movement in the USD/AUD exchange rate.

***Alternatives for Australia***

It is perhaps an unfair description but it could be said that as a country, Australia is a narrow and opportunistic trader. Since Federation, Australia has relied on efficiently and effectively producing and marketing wool, wheat, coal, iron ore, LNG, tourism and academic study as "exports of choice" to the highest bidder. Until around 1970, the top five exports constituted over 50 per cent of total exports, especially wool, with that commodity comprising between 30 per cent and 40 per cent of all exports for some seventy years following Federation. Since 2014, iron ore is finding a similar place (over 20 per cent), despite what is now a far more globalised, product-differentiated world. The same concentration has occurred with export destinations. Until the Second World War and immediately following it, the UK took around 50 per cent of all Australian exports, essentially wool, wheat and gold.




*Australia's Trade Since Federation*, Statistics Section, Office of Economic Analysis, Department of Foreign Affairs and Trade, June 2016.

From the early 1970s, for around 30 years, Japan bought more than 25 per cent of all Australian exports; initially primary products but then resources, especially coal and iron ore. As mentioned above, from around 2000, up to 30 per cent of exports have gone to China. Australia's trading history would, therefore, suggest that the concentration of exports into China is not unique. Action that Australia may be able to take to retain the existing trade with China, to restore blocked goods and services, or to seek out new markets, is addressed in Part Two.

***Commodities Exports: A Not-So Secure Future?***

The total of barley, meat, wine and cotton exports to China was $3.94bn in 2018-19. In the same reporting year, coal exports (combined thermal and coking) were worth $14.1bn and wool, exports of which may too become threatened, worth $2.8bn. The sum to date is not inconsiderable, but with all Australian exports totalling $692.8 billion, resident economists and trade officials could argue that the economy is resilient and adaptable enough to prevail. A number, it would seem, are more concerned.

The future for Australian commodities exports to China may not be so secure, however, even if trade and political relations improve. With Chinese energy producers inexorably shifting away from coal and towards domestically-generated renewable energy; possessing a (fickle) degree of ownership of a potentially globally-transformative iron ore resource at Simandou, in the West African country of Guinea; having the opportunity to purchase cheaper LNG at spot prices; enjoying viable alternative global sources of copper, aluminium ores, wine, meat and education; and with commodities such as wood, lithium, gold and uranium domestically extracted already, Australian exports to China demand prudential care. Interested parties can only trust that the Australian Government has discretely assembled a "China Trade Task Force" in Canberra that is urgently, ardently and quietly working with industry and the States and Territories to resolve the growing problem.

Part Two of this paper will examine the feasibility of reducing Australia's trade reliance on China and where Australia could look to diversify or create new markets.

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**About the Author:** Greg Hull graduated into the Australian Army from the Royal Military College and served in a range of command and staff appointments, including counter-terrorism, strategic intelligence and scenario planning. He held overseas exchange appointments with the British and US Armies. Greg changed careers into the Australian Trade Commission (Austrade) as National Industry Manager, Defence and Aerospace, before serving as Senior Trade Commissioner for Mexico/Central America and Mid-West USA (as Consul-General in Houston), then Papua New Guinea/South-West Pacific, Middle East (Iraq/Jordan/Syria/Lebanon) and Africa (Johannesburg). On leaving Austrade, Greg consulted in Africa and for the Australian Department of Foreign Affairs and Trade in Thailand. Greg holds a BA, Grad Dip Fin Mn and Dip AICD.

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