

The Australia-PRC economic relationship: greater distancing or closer mutual dependence?

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Key takeaways

- The COVID-19 pandemic has resulted in louder and more frequent calls for Australia to put greater economic distance between itself and the People's Republic of China (PRC). Accompanying such arguments is a narrative that says Australia should not be shy about distancing itself from the PRC because for some time Beijing has itself been decoupling its economy from the rest of the world.
- Yet data show the value of imports by the PRC and the value of foreign direct investment (FDI) it hosts continuing to grow. Lower tariffs and a loosening of inward investment restrictions have contributed to this outcome. After having overtaken Germany in fifth place, Australia is now on the cusp of displacing the United States as the PRC's fourth largest import source. Only five of the top 30 Australian exports to the PRC decreased in value between 2012 and 2019. Meanwhile, Australia's stock of FDI in China has nearly doubled.
- This year has seen a further deterioration in the political relationship between Australia and the PRC. This could lead to greater economic distancing in the future. But it would be a mistake for Australia to believe that the PRC was already making general moves in that direction. Closer mutual dependence, not greater economic distance, most accurately describes the bilateral economic relationship to date.

Introduction

The COVID-19 pandemic has resulted in louder and more frequent calls for Australia to put greater economic distance between itself and the PRC. In April, a program director at the Australian Strategic Policy Institute (ASPI), Michael Shoebridge, said that when the health crisis recedes 'we must discount' voices that would emerge 'advocating that we maintain or even increase our dependence on China', asserting that these voices reflect 'rusted-on self-interest'.¹

Accompanying such arguments is a narrative that says Australia should not be shy about distancing itself from the PRC because for some time Beijing has itself been decoupling its economy from the rest of the world. On September 4 2020, John Lee, a non-resident senior fellow at the United States Studies Centre (USSC) and at the Hudson Institute in Washington DC, wrote in *The Australian Financial Review (AFR)* that 'China had implemented a decoupling approach to the US long before Donald Trump assumed power'. He contended

¹ Michael Shoebridge, 'The Chinese state and Australia's economy: 'snapping back' must not mean business as usual', *The Strategist*, Australian Strategic Policy Institute, Canberra, April 27 2020 <<https://www.aspistrategist.org.au/the-chinese-state-and-australias-economy-snapping-back-must-not-mean-business-as-usual/>>.

that, 'The point matters because we need to be sure about what is causing economic globalisation to unravel, and who is significantly to blame'.² Lee cites Chinese government industrial upgrading initiatives like 'Made in China 2025' as 'evidence' that Beijing 'foresees control and dominance of entire manufacturing processes, supply chains, and services supporting a dozen advanced industry sectors'. The Belt and Road Initiative, which Beijing has presented as a means of improving global connectedness, is described as a 'Sino-centric model' aimed at ensuring 'roads, rail, ports, cables, digital networks and infrastructure begin and end in Chinese provinces'. Princeton University's Aaron Friedberg expresses the current Washington orthodoxy in describing the PRC's leaders as 'mercantilists' who 'see economic relations as yet another zero-sum struggle'.³

Leaving aside the question of whether matching each of the PRC's trade and investment barriers with ones of our own would serve the national interest, to what extent is the claim that the PRC is economically distancing itself from the rest of the world, including Australia, supported by data? This brief first overviews the global context before homing in on the PRC's economic engagement with Australia.

The global context

Context matters. And a key point of context missing in claims that the PRC is decoupling from the rest of the world and pursuing mercantilist objectives is that in 2019 its trade surplus (exports minus imports) as a percentage of gross domestic product (GDP) stood at just 1.2 percent.⁴ This saw it ranked an unremarkable 60th in the world and far behind US allies like Germany (5.8 percent) and South Korea (2.9 percent).

It is the case that the PRC's imports share of GDP has fallen from 28.4 percent in 2004 to 17.3 percent last year. However, another point of context is that this ratio remains 2.6 percentage points higher than the US.⁵ For a geographically large economy that is experiencing rapid industrialisation like the PRC's, it is inevitable that the import share of GDP will decline as its domestic market grows and its production sophistication allows more manufacturing inputs to be made at home. The heightened competition this implies might be unpleasant for overseas companies used to having a technological jump on their Chinese rivals, but of itself is not compelling evidence of decoupling or mercantilism.

That the Chinese government is keen to promote industrial upgrading is also unremarkable: this is the only way to avoid the 'middle-income trap' and allow more Chinese citizens to enjoy high-income living standards as experienced in the US and Australia. Other countries are free to pursue industrial policies of their own and plenty do. Germany has its 'Industry 4.0' initiative, while New Delhi now touts its 'Make in India' strategy.⁶ The US and Australia have for several decades largely eschewed actively pursuing industrial policies. This was a sovereign choice that reflected an assessment that markets deliver better outcomes than government planners trying to 'pick winners'. As a sovereign choice, it is one that can also be revisited.

In any case, the fact that the PRC has a declining imports share of GDP does not automatically mean that other countries are worse off, for at least two reasons. First, the value of the PRC's imports can continue to rise even as they fall relative to the scale of the PRC's economy. Second, foreign countries can benefit from the PRC's expanding domestic market by investing into it.

Table 1 makes the first point. Since 2012 when Xi Jinping came to power, the compound annual growth rate (CAGR) on the value of the PRC's imports has been positive from all regions except for North America and Africa. Changing the base year to 2017 – immediately prior to the US beginning to impose tariffs on Chinese imports as part of the Trump administration's trade war – does not alter this picture with imports from Africa also now increasing.

Policy shifts by the PRC provide part of the explanation for these figures. The PRC applies a trade-weighted average tariff rate on imports of 3.4 percent, higher than the 1.6 percent and 0.9 percent recorded in the US

2 John Lee, 'China is decoupling the global train', *The Australian Financial Review*, September 4 2020 <<https://www.afr.com/world/asia/china-is-decoupling-the-global-train-20200904-p55sf2>>.

3 Aaron Friedberg, 'An answer to aggression: how to push back against Beijing', *Foreign Affairs*, September 2020 <<https://www.foreignaffairs.com/articles/china/2020-08-11/ccp-answer-aggression>>.

4 World Bank, 'External balance on goods and services (% of GDP)', 2020 <<https://data.worldbank.org/indicator/NE.RSB.GNFS.ZS>>.

5 World Bank, 'Imports of goods and services (% of GDP) - China', 2020 <<https://data.worldbank.org/indicator/NE.IMP.GNFS.ZS?locations=CN>>.

6 European Commission, 'Germany: Industrie 4.0', January 2017 <https://ec.europa.eu/growth/tools-databases/dem/monitor/sites/default/files/DTM_Industrie%204.0.pdf>; *Financial Express*, 'Two-decade wait set to end; Modi's 'Make in India' to get new industrial policy boost soon', January 22 2020 <<https://www.financialexpress.com/industry/two-decade-wait-set-to-end-modis-make-in-india-to-get-new-industrial-policy-boost-soon/1831309/>>.

Table 1. Compound annual growth rate (CAGR) of Chinese imports

Region	CAGR (percent)			
	2012-2019		2017-2019	
APEC	1.9	↑	3.7	↑
Asia	1.4	↑	5.4	↑
Europe	3.9	↑	7.2	↑
ASEAN	5.3	↑	9.2	↑
EU	3.8	↑	6.2	↑
Latin America	3.9	↑	14.1	↑
North America	-0.5	↓	-7.4	↓
Oceania	5.9	↑	12.8	↑
United States	-1.2	↓	-11.2	↓
Australia	5.1	↑	12.5	↑
Africa	-2.5	↓	12.3	↑

Note: Using CAGR smooths potentially large in movements in the value of imports on a year-to-year basis, instead illustrating the trend over a longer time frame.

Source: General Administration of Chinese Customs

and Australia, respectively.⁷ However, the PRC's rate has fallen from 6.0 percent in 2011, and it is lower again specifically for Australian goods because of the China-Australia Free Trade Agreement (ChAFTA) ratified in 2015.⁸ Despite the Australian government's best efforts, other trading partners like India have not been willing to negotiate a similar agreement. To be sure, the PRC also resorts to using non-tariff barriers (NTBs) with greater prevalence than either the United States or Australia.⁹ Data on the intensity with which these measures have been used by the PRC over time as de-facto trade barriers is, to the best of the authors' knowledge, unavailable.

Turning to the second point, as with tariffs and NTBs, the PRC places more restrictions on FDI than does the US or Australia. The Organisation for Economic Co-operation and Development's (OECD) FDI Regulatory Restrictiveness Index for the PRC stood at 0.244 in 2019, compared with 0.089 and 0.149 recorded in the US and Australia, respectively. However, since 2012 the PRC's score has fallen from 0.431.¹⁰ Once again, policy shifts have resulted in less economic distance between the PRC and the rest of the world, not more.

With a much larger domestic economy as well as falling restrictions on foreign investment, data show the total stock of foreign direct investment in the PRC expanding from \$US586.9 billion in 2010 to \$US1.8 trillion in 2019.¹¹ US government data point to the assets of American multinational companies with majority-owned affiliates in the PRC growing from \$US371.6 billion in 2012 to \$US466.0 billion in 2018.¹² During the same

7 World Bank, 'Tariff rate, applied, weighted mean, all products (%)', TCdata360, 2020 <https://tcdata360.worldbank.org/indicators/TM.TAX.MRCH.WM.AR.ZS?country=CHN&indicator=1909&countries=USA&viz=line_chart&years=2010,2018>.

8 Australian Government Department of Foreign Affairs and Trade, 'China-Australia Free Trade Agreement', 2020 <<https://www.dfat.gov.au/trade/agreements/in-force/chafta/Pages/australia-china-fta>>.

9 United Nations Conference on Trade and Development, 'Data on non-tariff measures', 2020 <<https://unctad.org/en/Pages/DITC/Trade-Analysis/Non-Tariff-Measures.aspx>>.

10 Organisation for Economic Co-operation and Development, 'OECD FDI Regulatory Restrictiveness Index', OECD.stat, 2020 <<https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX>>.

11 United Nations Conference on Trade and Development, 'Country fact sheets 2020', 2020 <<https://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Country-Fact-Sheets.aspx>>.

12 Sarah Scott, 'Activities of US multinational enterprises in 2013', Bureau of Economic Analysis, US Government Department of Commerce, August 2015 <https://apps.bea.gov/scb/pdf/2015/08%20August/0815_activities_of_multinational_enterprises.pdf>; Bureau of Economic Analysis, 'News release - activities of US multinationals 2018', US Government Department of Commerce, August 21 2020 <<https://www.bea.gov/news/2020/activities-us-multinational-enterprises-2018>>.

period, their sales in the PRC rose from \$US233.8 billion to \$US392.7 billion. Australia's stock of FDI in the PRC has nearly doubled from \$A8.6 billion in 2012 to \$A15.5 billion last year.¹³

The PRC's economic distance from Australia

An agricultural economist at the University of Queensland, Scott Waldron, argues that the PRC's approach to managing its trading relationships is to 'actively diversif[y] import sources (多元化) for reasons of national interest and security. This is especially the case in food, and possibly energy and minerals'.¹⁴ Such instincts around food security are not unique to the PRC and they are also blended with a recognition of economic reality and a broad appreciation that international trade and investment is a positive-sum exchange. In 2018 former Australian ambassador to Beijing Geoff Raby observed that the PRC's leaders had allowed the country to become 'utterly dependent on world markets to keep supplying it with all the resources it needs for its economic survival'.¹⁵ Or as Tim Harcourt, a trade economist from the University of New South Wales, put it on July 23 2020 in *The Australian*, '[G]iven China's enormous needs for energy security, food security, high-quality professional services and infrastructure, and a need for excellent education for its younger generations, China needs Australia too'.¹⁶

Table 2 shows that in 2012, Australia was the PRC's sixth largest import source by value at \$US84.6 billion. By 2019 Australia had leapfrogged Germany to become the fifth largest source with \$US121.4 billion, and just a fraction behind the US in fourth at \$US122.7 billion. Australia's share of the PRC's goods imports rose from 4.7 percent in 2012 to 5.8 percent in 2019.¹⁷ It is the case, however, that Australia has been moving closer to the PRC at an even faster rate, meaning that Australia now has a much larger aggregate exposure to the PRC than the reverse. In 2012 the PRC bought 27.2 percent of Australia's good exports and this had risen to 38.2 percent by last year.¹⁸ Nonetheless, the trade relationship between the PRC and Australia is most accurately described as one of closer mutual dependence, not greater economic distance.

Table 2. The PRC's top importers by value (\$US billions)

Rank (2012)	Rank (2019)		Economy	Import value (2012)	Import value (2019)
2	1	↑	Korea	168.7	173.6
3	2	↑	Taiwan	142.9	173.0
1	3	↓	Japan	177.8	171.8
4	4	—	US	133.8	122.7
6	5	↑	Australia	84.6	121.4
5	6	↓	Germany	91.9	105.1
9	7	↑	Brazil	52.3	79.8
7	8	↓	Malaysia	58.3	71.8
26	9	↑	Vietnam	16.2	64.1
11	10	↑	Russia	44.1	61.1

Source: General Administration of Chinese Customs; UN Comtrade

¹³ Australian Bureau of Statistics, 'International investment position, Australia', May 7 2020 <<https://www.abs.gov.au/statistics/economy/international-trade/international-investment-position-australia-supplementary-statistics/latest-release#data-download>>

¹⁴ Scott Waldron, 'The exposure of Australian agriculture to risks from China: the cases of barley and beef', *Asian Cattle and Beef Trade Working Papers No. 4*, University of Queensland, June 2020 <<http://www.asiabeefnetwork.com/wp-content/uploads/2020/06/200610-China-barley-beef.docx.pdf>>.

¹⁵ Geoff Raby, 'Prometheus bound: how China's power is constrained', *The Australian Financial Review*, September 12 2018 <<https://www.afr.com/policy/foreign-affairs/prometheus-bound-how-chinas-power-is-constrained-20180912-h159py>>.

¹⁶ Tim Harcourt, 'We need China, China needs us', *The Australian*, July 23 2020 <<https://www.theaustralian.com.au/commentary/we-need-china-china-needs-us/news-story/7cf1c3a0fd6b1baf108551e5bd45edae>>.

¹⁷ United Nations Statistics Division, 'UN Comtrade', 2020 <<https://comtrade.un.org/data>>.

¹⁸ Australian Government Department of Foreign Affairs and Trade, 'Trade time series data', March 2020 <<https://www.dfat.gov.au/trade/resources/trade-statistics/Pages/trade-time-series-data>>.

To consider whether Australia's overall market share in the PRC is being driven by dominant single commodities like iron ore, Table 3 presents the top 30 Chinese imports of Australian goods by value (classified at the HS-4 level), along with their market shares. Talk of the PRC wanting to buy more iron ore from Brazil and developing mines in Guinea is not new.¹⁹ Yet Australia's share of the PRC's iron ore imports expanded by 14 percentage points since 2012 to reach 61 percent last year. This is not, of course, to dismiss the possibility that such developments might still occur.²⁰ The increase in Australia's market share for iron ore was not unusual: 19 of the 30 categories of goods recorded an increase between 2012 and 2019.

Table 3. The PRC's top Australian imports as of 2019

Rank	Commodity	Market share (2019)		Commodity	Rank		
1	Iron ores and concentrates	↑	61.1	22.9	↑	Cotton	16
2	Petroleum gases and other gaseous hydrocarbons	↑	26.2	33.4	↑	Fuel wood	17
3	Coal	↑	49.3	41.7	↑	Meat of sheep or goats; fresh, chilled or frozen	18
4	Gold	↑	17.1	22.1	↑	Food preparations not elsewhere included	19
5	Wool	↑	74.2	42.4	↓	Barley	20
6	Copper ores and concentrates	↓	4.9	23.9	↑	Nickel; unwrought	21
7	Aluminium ores and concentrates	↑	31.0	6.2	↑	Wood in the rough	22
8	Meat of bovine animals; frozen	↓	19.5	7.8	↑	Crustaceans	23
9	Manganese ores and concentrates	↓	21.1	41.2	↓	Niobium, tantalum, vanadium or zirconium ores and concentrates	24
10	Petroleum oils	↓	0.5	20.5	↑	Nuts; fresh or dried	25
11	Mineral substances not elsewhere specified or included	↑	80.9	21.6	↓	Zinc; unwrought	26
12	Zinc ores and concentrates	↓	36.3	11.2	↑	Milk and cream	27
13	Medicaments	↑	4.1	47.5	↓	Aluminium oxide; aluminium hydrozide	28
14	Copper; refined and copper alloys, unwrought	↑	3.9	8.5	↓	Precious metal ores and concentrates	29
15	Wine	↑	35.4	15.4	↑	Lead ores and concentrates	30

Note: Arrows denote whether Australia's market share has increased or decreased compared with 2012.

Source: General Administration of Chinese Customs; UN Comtrade

For another six categories of goods, Australia's market share fell but the dollar value of the PRC's imports from Australia still rose. For example, Australia's share of the PRC's imports of 'Meat of bovine animals; frozen' fell by 29.3 percentage points to stand at 19.5 percent in 2019. But the value of the PRC's imports of this category from Australia rose by \$US1.4 billion. This implies that even if this is an instance of where the PRC has actively diversified away from Australia, it is one in which Australian producers have still benefited rather than suffered.

¹⁹ Frik Els, 'Chinese buy world's largest mining project', *MINING.COM*, October 28 2016 <<https://www.mining.com/chinese-buy-worlds-largest-mining-project/>>.

²⁰ Lauren Johnston, 'Steel pipe dreams: A China-Guinea and China-Africa lens on prospects for Simandou's iron ore', *The Extractive Industries and Society*, 4(2), April 2017 <<https://doi.org/10.1016/j.exis.2016.08.004>>.

There are only five of 30 categories of goods that have seen the PRC importing less value from Australia. In three of these, the PRC has been importing less value globally, meaning that even if, at worst, China was replacing imports with domestic production, Australia's declining sales are not unique. This leaves just two categories in which, while the PRC's total import value has increased, both Australia's market share and value has been falling. One is 'Petroleum oils', a category in which Australia does not have a comparative advantage, according to United Nations data.²¹ The other is 'Zinc; unwrought'.

The outlook

In contrast to the closer mutual dependence of recent years, it remains an open question whether the further deterioration in Australia-PRC political relations in 2020 will lead to greater economic distancing in the future. These tensions may see the PRC make more extensive use of trade as a tool of coercion or strive more intently to diversify away from Australia if it is now regarded as an unreliable supplier. Actions such as those taken by Beijing in May when it imposed an 80.5 percent tariff on Australian barley, allegedly for anti-dumping and anti-subsidy purposes and which brought the trade to a halt, and its sudden announcements in August of anti-dumping and countervailing-duties investigations into Australian wine, do not bode well.²² Yet the PRC could also ask questions about Australia's intent. The August decision by Treasurer Josh Frydenberg to block the sale of Lion Dairy and Drinks from a Japanese owner to a Chinese one, despite it having been ticked off on by the Foreign Investment Review Board and the Australian Competition and Consumer Commission, is one that left many local as well as Chinese commentators grappling for answers.²³

Amidst this year's political tensions and the economic shock wrought by the COVID-19 outbreak, the bilateral trade data for 2020 to date has proven resilient overall. In the first eight months of the year the value of Australia's exports to the PRC declined by 2.3 percent compared with the same period last year. This compared with a fall of 11.2 percent to all other countries.²⁴

As this brief has shown, US-PRC trade is falling as both countries erect trade barriers in their bilateral dispute. In contrast, the PRC's trade data point to reduced economic distance with the rest of the world, including Australia. This has been assisted by past policy decisions in both Canberra and Beijing as exemplified by ChAFTA. Such findings illustrate why it is problematic to view the Australia-PRC economic relationship through a Washington lens. Striving to diversify Australia's trading partners cognizant of the risk that results from a large, single-country exposure is one thing, and a sensible strategy in itself. However, it would be a mistake for Australia to actively distance itself from the PRC driven by a belief that Beijing was already making general moves in that direction.

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²¹ United Nations Conference on Trade and Development, 'Revealed comparative advantage index, annual', 2020 <<https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=157975>>.
²² James Laurenceson, Thomas Pantle, Michael Zhou, 'PRC economic coercion: the recent Australian experience', Australia-China Relations Institute, University of Technology Sydney, September 14 2020 <<https://www.australiachinarelations.org/content/prc-economic-coercion-recent-australian-experience>>.
²³ Kath Sullivan, Stephen Dziedzic, 'Plan for China's Mengniu to buy Lion Dairy ditched after Josh Frydenberg labels sale 'contrary to national interest'', *ABC News*, August 25 2020 <<https://www.abc.net.au/news/2020-08-25/lion-dairy-china-mengniu-deal-off/12592534>>.
²⁴ Australian Bureau of Statistics, 'International merchandise trade, preliminary, Australia', September 25 2020 <<https://www.abs.gov.au/statistics/economy/international-trade/international-trade-goods-and-services-australia/latest-release#data-download>>.