UTS UNIVERSITY OF TECHNOLOGY SYDNEY

Professor James Laurenceson
Director
Australia-China Relations Institute
University of Technology Sydney
15 Broadway, Ultimo NSW 2007
[redacted]

PO Box 123
Broadway
NSW 2007 Australia
www.australiachinarelations.org

UTS CRICOS PROVIDER CODE 00099F

May 29 2020

Committee Secretariat, Joint Standing Committee on Trade and Investment Growth

PO Box 6021
Parliament House
CANBERRA
Canberra ACT 2600

Dear Committee Secretariat,

I appreciate the opportunity to make a submission to this inquiry and do so in my personal capacity as an academic at the University of Technology Sydney, specialising in the Australia-China economic relationship. The research institute of which I am the director does not take an institutional position on any issue. This submission focuses on the following terms of reference, discussing:

- whether Australia is too reliant on any one market for exports;
- the advantages and disadvantages, including in relation to the national interest and national economic risk, to an over reliance on any one market;
- The impact of global crises including trade disputes and political disputes on Australia's relationship with countries we are reliant upon for trade and investment purposes;
- whether Australia is too reliant on foreign investment and, if so, what factors are contributing to this dominance;
- industry and government preparations to diversify its trading partners and secure new markets for Australia's exports, including through further free trade agreements.
- industry and government preparations to ensure the Australian economy is not overly reliant on foreign investment.

Introduction

The stated purpose of this inquiry is to 'understand whether there is a need for Australia to diversify its trade markets and foreign investment profile'. However, on a website authorised by George Christensen MP – also the chair of this inquiry – it is referred to as the 'CHINA INQUIRY' (caps in the original). Visitors are invited to 'Have your say in a parliamentary inquiry into Communist China's economic infiltration of our nation'. Those wanting to take up the offer are provided with a pre-drafted letter. It seems reasonable, therefore, to conclude that the inquiry is preoccupied with the question of whether Australia needs to diversify its trade markets and foreign investment profile away from China.

Australia is not unique in having a large and growing economic exposure to China. This mostly reflects the global economic weight that China has achieved. In 2019, it accounted for 19.2 percent of global GDP (in purchasing power parity terms). This compared with 15.1 percent for the United

States (US).[1] China is also the world's leading trader of goods, accounting for 13 percent of total global exports and 11 percent of total imports in 2018.[2] Research by the Lowy Institute in Sydney last year showed that in 2001, 80 percent of countries traded more goods with America than China.[3] But by 2018, two-thirds of countries traded more with China.

To this inquiry, I offer the following observations.

1. There is scope under existing rules to prevent specific Chinese investment proposals on the grounds they may be contrary to Australia's national interest. But a more general claim that Australia 'needs' to diversify its foreign investment profile away from China does not make sense. Australia's foreign investment profile does indeed have a large single-country exposure. But this is to the US, not China.

According to new data from the Australian Bureau of Statistics (ABS), in 2019 the US accounted for 26 percent of the foreign investment stock in Australia. This was followed by the United Kingdom (UK) (18 percent), Belgium (9 percent), Japan (6 percent) and Singapore (3 percent). China's share was just 2 percent.[4] This fact has long been publicised by the US embassy in Canberra, as well as nearly every visiting senior American political leader.[5] The claim explicitly made by these sources is that because the US owns far more Australian assets than any other country it is 'Australia's most important economic partner'.[6]

Corroborating the above data, which are drawn from Australia's balance of payments statistics, is a survey of majority foreign-owned companies published by the ABS in 2018. Covering the period 2014-2015, the ABS identified 2,039 majority US-owned firms. In comparison, there were just 204 majority China-owned firms, placing China at 10 h on the list of Australia's most prevalent investors.[7]

According to the latest annual report of the Foreign Investment Review Board, approved investment from the US reached $58.2 billion in 2018-19.[8] This was followed by Canada, Singapore and Japan. China came in at fifth place with $13.1 billion. These data also likely understate the volume of US investment because, compared with the US, lower review thresholds apply to Chinese investors and those from most other countries.[9] For example, a privately-owned US entity can purchase Australian agricultural land or an agribusiness with a value of up to $1.2 billion without needing Australian

---

[1] International Monetary Fund, *World Economic outlook, April 2020: The Great Lockdown*, Washington D.C., April 2020 <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>.
[2] World Trade Organization, *World Trade Statistical Review 2019*, July 29 2019 <https://www.wto.org/english/news_e/news19_e/publ_29jul19_e.htm>.
[3] Alyssa Leng, Roland Rajah, 'Chart of the week: global trade through a US-China lens', *The Interpreter*, Lowy Institute for Foreign Affairs, Sydney, December 18 2019 <https://www.lowyinstitute.org/the-interpreter/chart-week-global-trade-through-us-china-lens>.
[4] Australian Bureau of Statistics, '5252.0 – international investment position, Australia: supplementary statistics, 2019', May 7 2020 <https://www.abs.gov.au/ausstats/abs@.nsf/mf/5352.0>.
[5] James Laurenceson, 'In the US-AU-China love triangle, actions speak louder than words', *East Asia Forum*, October 1 2017 <https://www.eastasiaforum.org/2017/10/11/in-the-us-au-china-love-triangle-actions-speak-louder-than-words/>.
[6] Nathan Hondros, 'US ambassador issues reminder on Australia's 'most important economic partner'', *WAtoday*, March 29 2019 <https://www.watoday.com.au/politics/western-australia/us-ambassador-issues-reminder-on-australia-s-most-important-economic-partner-20190329-p518zo.html>.
[7] Australian Bureau of Statistics, '5494.0 – economic activity of foreign owned businesses in Australia, 2014-15', August 13 2018 <https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5494.0Main+Features12014-15?OpenDocument>.
[8] David Irvine, *Annual Report – 2018-19*, Australian Government Foreign Investment Review Board, May 4 2020 <https://firb.gov.au/sites/firb.gov.au/files/2020-05/FIRB-AR-2018-19.pdf>.
[9] On March 29 2020 new review thresholds set at zero dollars were introduced and apply to all foreign investment sources. But these measures are temporary and will only remain in place for the duration of the COVID-19 crisis.

government approval. This is 80 times greater than the threshold that applies to equivalent Chinese investors for agricultural land and 20 times greater for agribusinesses.[10]

One of the few foreign investment metrics where Chinese investors may appear prominent is with respect to the ownership of agricultural land. According to the Register of Foreign Ownership of Agricultural Land, administered by the Australian Tax Office, Chinese interests hold 9.2 million hectares, or 2.3 percent of total agricultural land. This follows only that held by UK interests with 10.2 million hectares, 2.6 percent of the total. Total foreign interests account for 13.4 percent.[11] But this headline figure drastically overstates the extent of Chinese land ownership for several reasons. First, 80 percent of agricultural land held by foreign interests are leasehold, meaning they do not own the underlying land asset. Second, the definition of a 'foreign interest' is a corporate entity with just 20 percent foreign ownership. By far the largest agricultural land holdings with 'Chinese interests' are those held by Australian Outback Beef Ltd, totalling 7.92 million hectares, or 86 percent of total Chinese agricultural land holdings.[12] But, in fact, Outback Beef only features a 33 percent Chinese ownership share. A 67 percent share is held by Gina Rinehart's Hancock Prospecting.

The committee may wish to consider whether currently Australia's foreign investment profile has 'too many eggs are in the US basket' but, in my assessment, this US investment supports Australia's national interest.

2. Diversifying Australia's export markets away from China means diversifying toward countries that are not willing to pay as high a price for the goods and services that Australian businesses produce, or that do not want to buy them at all. Meanwhile, any trade opportunities with China that are left on the table would quickly be snapped up by Australia's international competitors. The combined effect will cost Australians jobs and by weakening the economy will make Australia less, not more, secure.

Engaging with giant markets other than China would be wonderful – if only they existed.

In the real world, Australia does not get to choose where the demand for its goods and services comes from. That depends on which countries want and have the purchasing power to pay for them.

A China-AND diversification strategy where Australian businesses sell as much as they can to China, while at the same time trying to grow alternative markets, is one thing. But a China-OR diversification strategy, where government intervention drives businesses to leave China opportunities on the table, is a recipe for cratering Australia's national interest.

The often-heard claim that Australia must be 'less dependent' on China assumes that it can be 'more dependent' on, for example, India, or India and some combination of other countries. There is little evidence, however, that this assumption is true.

---

[10] Australian Government Foreign Investment Review Board, 'Monetary thresholds', March 2020 <https://firb.gov.au/exemptions-thresholds/monetary-thresholds>.
[11] Australian Government Foreign Investment Review Board, *Register of Foreign Ownership of Agricultural Land – Report of registrations as at 30 June 2018*, December 19 2018 <https://firb.gov.au/sites/firb.gov.au/files/2018/12/Register_of_Foreign_Ownership_of_Agr.pdf>.
[12] James Wagstaff, 'Who owns Australia's farms 2019', *The Weekly Times*, May 22 2019 <https://www.weeklytimesnow.com.au/agribusiness/agjournal/who-owns-australias-farms-2019/news-story/5dec51bc0b51fe113b48146b60093d61>.

Laurenceson and Zhou (2020) examine this issue and show that over the past decade the annual value of Australia's total exports increased by a net $180 billion.[13] This injection of demand into the Australian economy is plainly in the national interest. But it has only been possible because one country provided 60 percent of the jump: China. Regularly touted alternatives to China, such as the US, Japan, India and Indonesia, hardly registered.

The Australia wool industry does not sell 80 percent of its output to China because it does not wish to engage other markets, or has not tried to do so. Rather, global wool processing capacity is concentrated in China, and, as China's middle class has burgeoned, it has been Chinese consumers willing to pay a premium for the high quality wool that Australia produces. The same applies to a raft of Australian industries from wine to education to iron ore.[14]

While this inquiry considers the need to diversify trade markets away from China, it should also be clear that other countries are striving to achieve the precise opposite, recognising that it is far better to be engaged with a large, high-growth market than one that is stagnant. The China-Australia Free Trade Agreement is widely envied and seen across the world as the gold standard for economic engagement with China. Even in the US, where talk of 'decoupling' is at fever pitch in the Washington beltway, what President Donald Trump appears more focused on delivering is a trade deal that increases American access to the Chinese market, not reduces it. On May 22 2020, the US Trade Representative touted progress on this front, noting that a 'Phase One deal' had cleared the way for increased US sales to China of barley, beef and more, potentially replacing Australian products in the process.[15]

COVID-19 does not change the outlook. This year the International Monetary Fund expects the Australian economy to shrink by 6.7 percent. In having 33 percent of exports going to China where the economy is forecast to grow by 1.2 percent, Australia is better placed than many peers. Consider the outlook for Canada, with 75 percent of its exports going to a US market that is expected to contract by 5.9 percent. Or the UK, with 45 percent of exports go to the European Union, with an economy forecast to go backwards by 7.5 percent.[16]

In the decade out to 2030, the Australian government's *2017 Foreign Policy White Paper* included a base case projection showing China's economy adding more new purchasing power than the US, Japan, India and Indonesia combined.[17]

3. Calls to cut imports from China rarely move beyond sound bites that depict such trade as menacing. They do not explain what policies should be implemented to replace imports from China, let alone consider how effective such policies might be in mitigating supply chain risk or account for the associated costs. They also fail to understand that Australia's supply chains are fed by global value chain (GVCs) over which the Australian government has negligible influence.

---

[13] James Laurenceson, Michael Zhou, COVID-19 and the Australia-China relationship's zombie economic idea, Australia-China Relations Institute, University of Technology Sydney, May 7 2020 <https://www.australiachinarelations.org/content/covid-19-and-australia-china-relationship%E2%80%99s-zombie-economic-idea>.

[14] Ibid.

[15] Robert Delaney, 'China approves more American imports, US trade office says', *South China Morning Post*, May 22 2020 <https://www.scmp.com/news/china/diplomacy/article/3085580/china-approves-more-american-imports-us-trade-office-says>.

[16] International Monetary Fund, *World Economic outlook, April 2020: The Great Lockdown*, Washington D.C., April 2020 <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>.

[17] Australian Government Department of Foreign Affairs and Trade. 2017. 2017 Foreign Policy White Paper, November 22 <https://www.dfat.gov.au/about-us/publications/Pages/2017-foreign-policy-white-paper>.

On March 31 2020 *Nine* political editor, Chris Uhlmann, wrote a commentary piece contending:[18]

> We should deliberately diversify our suppliers away from China. Every dollar spent building capacity in countries like Indonesia, Malaysia, Vietnam, Bangladesh and India is a dollar well spent.

But who does 'we' refer to? Media political commentators or Australian businesses and taxpayers? And what does 'deliberately' mean? Is Uhlmann advocating that the Australian government should put in place quotas that limit the ability of Australian businesses to import from China, forcing them to try to find higher cost and/or lower quality sources elsewhere? Or China-specific tariffs, with the Australian government abandoning its commitment to World Trade Organization rules in the process? Alternatively, government subsidies – funded by taxpayers – for imports from other countries? Next, suppliers of what? Certain critical goods or goods in general?

Then, why is 'every dollar spent' in these other countries 'a dollar well spent'? For Australia's supply-chain stability how relevant is it that a producer might be located in a country with a political system more similar to Australia's if at the same time its logistics network is less reliable? World Bank data shows that China ranks 26th out of 160 countries globally for the strength of its logistics environment. In comparison, India and Indonesia rank 44th and 46th, respectively.[19] And in what other countries are found the confluence of factors that afford China its production comparative advantage – infrastructure and scale, as well as clustering and network economies – which gives international buyers access to a sometimes unrivalled combination of speed, cost and quality? Or why wouldn't a dollar be better spent on investment in Australia, or on local health, education or defence?

In avoiding these basic questions, which Australian businesses and government policy-makers cannot, such commentary moots an idea that appeals at first glance but actually offers little that is constructive for advancing the national interest.

The other key point such commentary misses is that Australia's supply chains are fed by global value chains (GVCs), which see inputs and stages of production spread across multiple countries, including China but also countries that the Australian government's *2017 Foreign Policy White Paper* identifies as strategic priorities such as Japan, India and Indonesia. For example, an Apple iPhone is recorded in Australia's trade statistics entirely as an import from China but research shows that what China is responsible for is mostly only the final stage of production, consisting of assembly and packaging. This accounts for less than four percent of its cost. Far more of its value is supplied by the US (29 percent), Japan (29 percent), Taiwan (20 percent) and Korea (7 percent).[20] What GVCs mean is that simply importing fewer final goods from China would not see China removed from Australia's supply chains but it would add to costs for Australian consumers and businesses. Further complicating matters is that locational decisions in GVCs are made by multinational companies, most of which are headquartered overseas and beyond the direct reach of Australian policy-makers. This means that imagining the Departments of Industry or Defence in Canberra have the ability to determine, or even significantly influence, locational choices is mostly deluded.

---

[18] Chris Uhlmann, 'It's certain COVID-19 will change everything but this needs to change most of all', *The Sydney Morning Herald*, March 31 2020 <https://www.smh.com.au/national/it-s-certain-covid-19-will-change-everything-but-this-needs-to-change-most-of-all-20200331-p54fk3.html>.

[19] World Bank, 'Logistics Performance Index – global rankings 2018', 2018 <https://lpi.worldbank.org/international/global?sort=asc&order=LPI%20Rank#datatable>.

[20] Jason Dedrick, Greg Linden, Kenneth Kraemer, 'We estimate China only makes $8.46 from an iPhone – and that's why Trump's trade war is futile', *The Conversation*, July 7 2018 <https://theconversation.com/we-estimate-china-only-makes-8-46-from-an-iphone-and-thats-why-trumps-trade-war-is-futile-99258>.

4. The facts and evidence around Australia's economic relationship with China matter for advancing the national interest. Unfortunately, misinformation abounds.

Australia's economic engagement with China presents genuine risks. For example, these include the knock-on effects if China's economy were to experience a hand economic landing, or the possibility that Australian companies could find themselves the targets of economic coercion orchestrated by the Chinese government in retaliation for political disagreements with the Australian government.

But responding effectively to such risks requires assessments based on facts and evidence. A report by Laurenceson and Zhou (2019) showed that the scale of these risks is frequently overblown.[21] And as a more recent report by Laurenceson and Zhou (2020) notes, there are likely to be more effective ways of managing them and at a lower cost than forcing a diversification in economic ties away from China.[22]

On April 18 2020, Peter Jennings, Executive Director of the Australian Strategic Policy Institute (ASPI) wrote in *The Australian* that 'COVID-19 will force Australia to redesign its approach to supply-chain security' and that '[a] stronger national security perspective must be brought to how we manage fuel security, food, medical supplies, information technology and critical infrastructure'. The reference to food is puzzling.[23] A new study by the Australian Bureau of Agricultural and Resource Economics and Sciences concludes that 'Australia does not have a food security problem'. In fact, it said that, 'Australia is one of the most food secure nations in the world'. Imports only account for 11 percent of food consumed in Australia, while 70 percent of agricultural production is surplus to domestic needs and sold overseas.[24]

On April 19 2020, former foreign minister Alexander Downer said that Australia should reduce its dependence on Chinese pharmaceuticals.[25] But trade data from the ABS reveal that only two percent of Australia's medicament and pharmaceutical imports come from China (SITC codes 541 and 542), compared with 47 percent from the European Union and 21 percent from the United States.[26] China may be involved in manufacturing inputs like active pharmaceutical ingredients, but European and American pharmaceutical giants like Pfizer and Roche mostly control the GVCs that

---

[21] James Laurenceson, Michael Zhou, *Small grey rhinos: understanding Australia's economic dependence on China*, Australia-China Relations Institute, University of Technology Sydney, May 22 2019 <https://www.australiachinarelations.org/content/small-grey-rhinos-understanding-australia%E2%80%99s-economic-dependence-china>.

[22] James Laurenceson, Michael Zhou, *COVID-19 and the Australia-China relationship's zombie economic idea*, Australia-China Relations Institute, University of Technology Sydney, May 7 2020 <https://www.australiachinarelations.org/content/covid-19-and-australia-china-relationship%E2%80%99s-zombie-economic-idea>.

[23] Peter Jennings, 'Coronavirus: China wants to be saviour of the world', *The Australian*, April 18 2020 <https://www.theaustralian.com.au/inquirer/coronavirus-china-wants-to-be-saviour-of-the-world/news-story/c6e0353a845cde1c4ce935f16119906e>.

[24] Australian Bureau of Agricultural and Resource Economics and Sciences, 'Australian food security and the COVID-19 pandemic', *ABARES Insights*, Australian Government Department of Agriculture, Water and the Environment, April 17 2020 <https://www.agriculture.gov.au/abares/publications/insights/australian-food-security-and-COVID-19>.

[25] Alexander Downer, 'China must be held to account for unleashing a global catastrophe', *The Australian Financial Review*, April 19 2020 <https://www.afr.com/policy/foreign-affairs/china-must-be-held-to-account-for-unleashing-a-global-catastrophe-20200419-p54l3o>.

[26] Australian Government Department of Foreign Affairs and Trade, 'Trade statistical pivot tables', March 2020 <https://www.dfat.gov.au/about-us/publications/Pages/trade-statistical-pivot-tables>.

absorb these.[27] With the world's second largest pharmaceutical market, it is hardly surprising that China should have significant production capabilities.[28]

Conclusion

The current pattern of Australia's trade markets and foreign investment profile stems from decisions made by hundreds of thousands of businesses spread right across the economy – agriculture, manufacturing and services – evaluating and weighing the opportunities and risks they face. Businesses are incentivised to carefully judge these opportunities and risks because it is their money, time and good-will on the line. This market-driven, outward-looking engagement overwhelmingly serves the national interest, and indeed, is the very reason why despite Australia having a modest domestic market and a population of just 25 million, living standards are amongst the world's highest.

Of course, Australia's national interest is broader than just business interests. But in providing prosperity to the Australian economy, business interests are not in contradiction to the national interest.

Just as in their dealings elsewhere, Australian businesses leveraged to the Chinese market must understand that the Australian government cannot be expected to bail them out in the event this market is disrupted. And because the Australian government's assessment of the national interest is broader, encompassing national security and the strategic outlook, sometimes the government may need to take decisions to protect Australia's sovereignty that China regards as being contrary to its interests. This means that Australian businesses must recognise the possibility that their business model could suffer if China applied coercive economic pressure in retaliation. In short, businesses cannot expect the government to do the 'de-risking' for them.

But to argue more fundamentally that the pattern of Australia's trade and foreign investment profile 'needs' to change requires demonstrating that businesses have been irresponsible and gotten the risk/return equation wrong. And that the government is better motivated, informed and resourced to make such decisions.

To the extent that the Australian government may have access to information sources that businesses do not, a business accounting of the risks they face can be enhanced through regular and frank dialogues with, amongst other arms of government, national security agencies.

Market-driven outcomes also do not rule out the possibility of there being niche areas where government intervention could pass some sensible cost-benefit test. For example, questions have previously been raised around the resilience of supply chains for rare earth metals. In such cases the Productivity Commission could undertake an investigation and invite national security analysts to detail their concerns. If a problem is revealed, the Commission could then recommend appropriate government action.

While facts and evidence are needed to advance Australia's national interest, too often what is seen are vague policy propositions accompanied by warnings that appear intended to scare.

Best regards,

---

[27] Eric Sagonowsky, 'The top 20 pharma companies by 2019 revenue', *FiercePharma*, April 20 2020 <https://www.fiercepharma.com/special-report/top-20-pharma-companies-by-2019-revenue>.
[28] China Daily, 'China's pharma market to gain 30 percent global share', *China.org.cn*, December 20 2019 <http://www.china.org.cn/business/2019-12/20/content_75532721.htm>.

Professor James Laurenceson