Stocktake of the Sino-Australia relationship

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The dismal science of economics was found wanting in its failure to predict the timing of the global financial crisis (GFC) tipping point though some economists had foreshadowed the inevitability of adjustments arising from the tensions in the global economy which exploded and came home to roost with a vengeance through the early part of 2009. 2009 proved as resilient as the ox in Chinese astrology and global sentiment changed markedly through the year as unprecedented global cooperation amongst Governments of all persuasions seemingly averted the worst outcomes from the GFC. The GFC did, however, debunk the theoretical paradigm of "regional economic decoupling" and served to highlight global economic interdependence and the apparent failure of neo-liberalism along with its dated multilateral institutions such as the Group of 8 (G8). The G8 has been eclipsed by the G20 and an increasing focus on the rise of China and the end of the American Century and the possibility of a multi-polar world.

We enter the year of the Tiger riding a wave of massive stimulus, which, while averting a total economic meltdown, have given rise to unprecedented levels of public debt and saddled future generations in the process. As we navigate the sheet ice and contemplate the shape and sustainability of the immediate recovery, the global imbalances which remain sit like submerged icebergs and paint a worrisome picture of the voyage ahead and the economic future. How will sovereign risk be managed and public debt be paid off? Moreover, how will the global economy make the transition to a pluralistic world with the re-emergence of China, to a weaker US dollar, to a stronger more convertible yuan, to a less profligate US consumer, to a higher spending Chinese consumer and to higher levels of European unemployment arising from its structural malaise?

These considerations and the involvement of China seem a long way removed from the opening up of China in the early 1970s. It was in fact in February 1972 that Richard Nixon amazed the world by meeting Chairman Mao Zedong in his study in Beijing thus beginning the normalisation of Sino-American relations. The photograph, hanging in the Australian National Gallery, of Australian Prime Gough Whitlam sitting beside Chairman Mao in the same study in November 1973 serves to remind us how quickly Australia had acted to engage China after Nixon's visit. It is unquestionable that this early engagement and subsequent bipartisan support for the relationship through successive Australian Prime Ministers has served to positively differentiate Australia's diplomatic relationship with China and underpin cultural exchanges and trade/investment. It is noteworthy that former Australian Prime Minister Bob Hawke, a longstanding defender of the bilateral relationship, has made over 80 visits to China in various political, professional and personal capacities since the 1970s.

It is undeniable that similarities, differences and complementarities exist between the two countries, and that these define the contemporary bilateral Australia-China relationship. Australia and China are neighbours and have a vested interest in maintaining peace and delivering prosperity through mutually beneficial trade and investment across the region. The key differences relate to the socio-political systems and the prominent and unrivalled role of the State in maintaining the unity of Chinese civilisation throughout its long history, and the increasing scale of urbanisation in China. Any problem or opportunity in the Chinese context takes on impressive dimensions when multiplied by a population base of 1.3 billion. Hence, to take but one example the enormity of housing, feeding and employing so many people magnifies the scarcity of resources on a per capita basis and necessitates that collective considerations dominate individual ones.

Our respective endowments of human labour and natural resources define the complementary nature of our trade and investment relationship. As a country blessed with an abundance of natural resources, Australia exports its comparative advantage in agriculture, iron ore and energy (natural gas and increasingly uranium) commodities to China, which provides inputs for China's manufacturing base. As a rapidly urbanising country with a huge labour pool, China takes raw materials from Australia and exports its comparative advantage in labour-intensive manufacturing goods such as white goods, apparel and machinery, which provides Australia with cheaper goods for consumption. Recent research commissioned by the Australia China Business Council concluded that the out workings of this trade benefits Australian households by as much as $3,400 per annum. As renowned Princeton professor of economics William Baumol noted "free trade is not always and automatically benign", but given the differing comparative advantages enjoyed by each country and the differing levels of broad based development relative to one another trade between China and Australia has been undoubtedly beneficial to both countries.

As the Chinese Ambassador Zhang Junsai so insightfully observed the relationship between countries is multi-tiered. It operates across the personal, the professional and the political dimensions. 2009 saw significant development in each of these relational dimensions which when taken together describe the full extent of the bilateral relationship.

The personal and cultural links between the two countries continue to grow stronger. Some 700,000 people of Chinese descent live in Australia, in 2008 400,000 Chinese tourists visited Australia (and 600,000 Australians visited China) and 130,000 Chinese students were engaged in study across the country. Approximately one official Chinese government delegation arrives in Australia each day and there has been a significant increase of enrolments in Chinese language programs at universities. Moreover, Australian universities are expanding their collaboration and academic engagement with key Chinese universities. In addition to the obvious boost to the quality of academic exchange and research, these partnerships deliver key infrastructure to support Australian students and bolster their language proficiency through time spent in China.

The professional dimension of the relationship is fundamentally captured by the activity in trade and investment. The value of Australia-China trade has grown rapidly from the time of the Whitlam-Mao meeting in the early 1970s to now exceed $76 billion per annum. The arrangements surrounding many of the resource off-take contracts contributing to this trade are long-term (i.e. 20 plus years) relational contracts describing strategically dependent partnerships. It was in fact the announcement of various transactions through the latter part of 2009, including the multi-billion dollar Exxon-Mobil Gorgon LNG sale to PetroChina, that helped put in context the differences of interest that had been straining diplomatic relationships at that time.

When viewed alongside these trade figures bilateral investment is still relatively modest but has been increasing to cause much angst and public debate in Australia. The inescapable truth is that Australia has always run a current account deficit and drawn on international funds to promote faster economic growth, and support jobs and a standard of living that would not be allowed for by domestic savings alone. In the past the UK, US and Japan have provided these funds but given the depressed state of these economies following the GFC, the diversification and growth in foreign investment from China is good on a portfolio basis.

From the turn of the century Chinese foreign direct investment (FDI) has increased at a compound rate of 60 per cent per annum to reach some $US 56 billion in 2008. This investment growth is driven by China's policy of "going out" to acquire strategic resources, new markets, organisational capability and global brands, and is made possible by the huge current account surpluses created by its export led economy which results in banks being encouraged to lend money to State Owned Enterprises (SOEs) for foreign acquisitions.

It is the State's ownership of these enterprises that cuts to the core of the public debate on Chinese inbound investment. State ownership runs contrary to the prevailing Western paradigm, informed by the Washington consensus, which advocates for an economy run by private interests in which the State's role is confined to within purely legislative boundaries. On this issue the public has been subject to myopic television advertising, and a process of politicisation which fails to provide an informed review of the wider contextual framework and simply seeks to engender an emotional (and often xenophobic) response from certain elements of the community.

There are three observations that should be made in connection with the above. Firstly, the West's decision to engage China was made back in the early 1970s and to be successful that engagement must be comprehensive and non-discriminatory across all aspects of the relationship, and must accept that our different socio-political systems will continue to evolve through engagement with one another. Through globalisation the world will be a different place in 2050! Secondly, the last thirty years of experience in dealing with inbound investment has given us an enviable regulatory system, which successfully balances the immense value of FDI to the economy with wider national interest considerations. Finally, appropriately structured investments can use our established domestic laws (whether they be competition, fiscal or corporations' law) to ensure commercial outcomes from asset management irrespective of ownership.

Clearly, Chinese companies from the beginning of the 21st century have been learning through the process of making applications and prosecuting deals, and in a sense setting precedents and testing the boundaries of what is possible in Australia. Australia's Foreign Investment Review Board (FIRB) has in turn sought to clarify how legislation is applied and manage some applicants' propensity to turn "policy argument into legal debate" whilst balancing the legitimate discretion required by the State to protect national interests and the full-transparency desired by investors. Guidelines issued in February 2008, and qualified by the FIRB's mantra of "case-by-case", stipulated that good corporate governance, regulatory compliance, government royalties, company operations, industry competition and national security should not be adversely affected. In 2009 these guidelines were further clarified by Treasury officials' views on preferred equity levels, and notification that arrangements in which the product off-taker is also a project investor will be closely scrutinised to ensure that product pricing conflicts are managed and to ensure that Australia remains a fair and secure source of supply for all its trading partners.

A number of high profile deals including FMG and Hunan Valin, Oz Minerals and Minmetals and Yan Coal and Fellix Resources, have been configured to comply with specific FIRB's qualifications and successfully consummated. The size and sophistication of the deals continue to increase and the $3.5 billion Yan Coal transaction including the specification of a hybrid entity with Australian directors and the requirement to list on the ASX was complex when assessed against any measure.

Given recent announcements that China's State owned foreign exchange reserves have topped $2.6 trillion, and that any future liberalisation of its capital account (providing for the unfettered movement of money in and out of the country) could potentially open up a further $6 trillion in private and corporate savings China's outward bound investment can be expected to continue unabated. With the right checks and balances Australia is ideally placed to benefit from these investments but should not take its position for granted as China actively diversifies and courts other suppliers throughout Africa and Latin America, and the link between growth and resources decreases with increasing sophistication in the composition of the Chinese economy.

The Australia China Business Council (ACBC) has been calling for bilateral investment to be reciprocal and balanced both ways. Apart from a few notable exceptions such as BlueScope Steel, SinoGold (recently acquired by Canadian Eldorado), ANZ, the Commonwealth Bank and Telstra, Australian investment into China has been languishing at around $6 billion for some time. Given the current Chinese focus on increasing domestic consumption from 30 per cent of GDP (the global average is around 60 per cent of GDP) it's even more important that the huge potential afforded by a Chinese domestic market increasingly focused on the quality (i.e., energy efficiency, pollution reduction and broad based service provision) dimension of growth is accessible to Australian firms.

Whilst China attracts more FDI than any other country apart from the US it maintains restrictions on investment in areas such as mining, agriculture, banking and financial services, telecommunications and media – all of which are of potential interest to Australian firms. Apart from these explicit restrictions various other factors related to bureaucracy, transparency and complexity can also serve to deter or frustrate investment. The ACBC supports the view that a bilateral investment framework could be usefully included in a FTA, and that the effectiveness of investments should be monitored over time, to guard against frustration and assure efficacy, through the process of government/industry supported strategic dialogue.

On both commercial and political levels, Australia's relationship with China is entering the new year on very positive terms. Observers of the relationship could be forgiven if for the briefest of moments, they were to forget what was otherwise been a difficult year. With the recent arrival of Wang Wang and Funi working miracles for the South Australian tourism market, coupled with a sense of real political will in Canberra and Beijing to resume FTA negotiations and the resumption of high level visits, many of the niggling issues including the defence policy paper and names like Rebiya Kadeer feel like distant memories.

Yet as observers come to their senses, they are perhaps pondering the sustainability of the current mood and reading the green tea leaves left from the turbulent events of 2009. With fundamental differences in our respective political systems and overarching socioeconomic architecture, it seems inevitable that China and Australia will again clash over ideology and skirmish over trade and investment issues in the future. As China expands its role within the region and its international economic bargaining power, some argue that Australia will be forced to end its century old procrastination over its troubled identity as a lone defender of Western values in the Asian region, or as a member of a new multilateral political and economic order.

However, these arguably inevitable differences should not cause undue concern or alarm: the US China relationship for example has come to typify a model of maturity in that both sides readily accommodate differences yet remain committed to ongoing cooperation and engagement. Beijing is accustomed to the Washington electoral cycle and has come to begrudgingly accept that criticism on issues such as human rights and Tibet might flare up in the midst of congressional elections and rhetoric in presidential campaigns, business as usual returns in non-election years.

The US-China Strategic and Economic Dialogue serves as a striking example of meaningful bilateral dialogue and as a template for engagement between China and major economies. It is in this spirit that on the eve of Chinese Vice-Premier Li Keqiang's visit to Australia, Foreign Minister Stephen Smith should be congratulated for announcing the Australian Government's broad intentions to establish a 1.5 track dialogue with China. The government is in the process of addressing a significant gap in the relationship and the proposal's warm reception in Beijing is testament to the underlying strength of the relationship and the importance of institutionalising such a forum.

As we review the year that was one can't help but reflect on the worries of China's prescient Premier Wen Jiabao in 2007 when he said that something was "unbalanced, unstable, uncoordinated and unsustainable". He was of course talking about China but he could equally have been talking about the state of the global economy. As it turns out China has faired much better than most countries, the unchecked neoliberal system has been discredited through the damaging financial crisis and a new world order beckons.

The rise of China is inevitable and will continue to occupy the public's imagination in Australia and elsewhere. There is perhaps no single individual, enterprise or country that has not already felt the centripetal pull or centrifugal push of China. China defies a simple characterisation because it's both developed and developing, it's capitalistic but with Chinese characteristics, it's a country with geographic borders but has been better described as a civilisation with tributaries reaching every part of the world and is just so big and dynamic that new superlatives are created daily.

It remains to be seen whether there is a role for Australia in the vital interaction between Beijing and Washington. As both a middle power and a developed economy with multifaceted commercial engagement with China and a comprehensive alliance with the US, Australia is perhaps well placed to serve as a practical example of how a country can sustain a contemporaneous and close relationship with each one of the G2. Those that would argue for Australia to provide a bridge which facilitates cooperation between the two behemoths are naïve in assuming that Australia is needed, or indeed would be welcomed, in this role as clearly the G2 talk directly and frankly across a broad range of issues without the need for interpreters and bridge builders. Australia is, however, ideally positioned to manage the relationship with each of its two friends to demonstrate the possibility of pluralism.

What is clear is that China is a country driven by the imperative of large numbers and its proximity to Australia means that the bilateral relationship between Australia and China is important to both countries. To this end the renewed energy and political will around a potential free trade agreement is welcome. Australia's push to complete the Doha round of negotiations along with consummating bilateral trade agreements with key trading partners like China is both aspirational and pragmatic. Not to consummate bilateral (and multilateral) agreements as others are doing would simply disadvantage Australian industry and risk our key competitive advantages. Whilst there is a hard economic benefit that flows to China and Australia from completing a fully comprehensive free trade and investment agreement, which opens up trading markets and relaxes investment restrictions, there is also an important reputational and symbolic dimension associated with its delivery.

Given our broad based and long standing relationships and our unquestionable complementarity there is every reason to feel optimistic about the long-term bilateral relationship.

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