Coming to Terms with China: Managing Complications in the Sino-Australian Economic Relationship

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The ascent of China has irrevocably changed Australia's external strategic environment. While China became Australia's top trading partner during the mid-2000s, tensions in the bilateral economic relationship have posed a series of complications for Australian policymakers. In this article, we explore four areas where these complications have become salient: economic asymmetries, Chinese state capitalism, the so-called resource curse, and tensions with geopolitical imperatives. We argue these demonstrate that China's rise is not only a security challenge for Australia but also an economic one, which demands new strategies that are sensitive to the challenges and vulnerabilities of the Sino-Australian economic relationship.

The rise of China is transforming Australia's economic and strategic environment. This may not be a novel observation, but what is less commonly acknowledged is just how integrated the economic and geopolitical consequences of China's rise actually are. While it has become commonplace to highlight the difficulty of managing Australia's simultaneous economic and strategic reliance on competing great powers,[2] less attention has been paid to the politically transformative impact of China's growing material importance for Australia. The simple reality is that China is exerting an increasingly powerful influence on both the structure of the Australian economy and the options available to policymakers: even the most committed of American allies now have to think twice about gratuitously irritating the Chinese. Few doubt that in the event of conflict between the United States and China, Australia would side with the United States as it always has done. But in relatively peaceful times the question of how to deal productively with China is a more difficult, sensitive and important task than before.

In some ways Australia's economic relationship with China is a re-run of the Japan-sponsored resource boom of the 1970s.[3] The 'China boom' looks in

[1] This work was supported by the Australian Research Council Discovery project 'The political economy of Australia-China relations' (DP150100217).

[2] James Reilly, 'Counting on China? Australia's Strategic Response to Economic Interdependence', *The Chinese Journal of International Politics*, vol. 5, no. 4 (2012), pp. 369-94.

[3] John G. Crawford and Saburo Okita, *Australia, Japan and Western Pacific Economic Relations: A Report to the Governments of Australia and Japan* (Canberra: Australian Government Publishing Service, 1976). As one of the referees pointed out, there have been a series of other commodity booms in Australian history that display similar dynamics. See, I. W.

danger of ending in precisely the same sort of way that its predecessor did, with major potential implications for Australia's economic security.[4] There is of course one important difference between the Japanese and Chinese experiences: like Australia, Japan was a close ally of the United States, rather than a potential strategic rival. Moreover, even if the current trade relationship with China continues to expand, there are other aspects of Australia's relationship with China that will prove challenging for policymakers. The fact that China is a notionally communist country that practises a distinctive form of 'state capitalism' provides an additional layer of complexity, which exceeds even the notoriously opaque practices that were associated with Japan's economic relationship with Australia.[5] One thing the Chinese undoubtedly have in common with the Japanese, however, is a much more 'comprehensive' view of security issues and a lively appreciation of the interconnected nature of economic and strategic issues.[6] It is one Australian policymakers would do well to recognise—if not emulate—if they are to respond to the challenge presented by China's rise.

The starting point for this analysis is the observation that China and Australia are in some ways unlikely partners united primarily by brute economic realities. If Australian policymakers could freely choose with whom to have intimate economic relations, one suspects China—which carries the baggage of its emerging strategic rivalry with the United States—would not be top of the list. The logic of 'economic complementarity' between the two countries, and the unforgiving geographical reality of China's growing weight in the Asia-Pacific have compelled this unlikely union. The question is: What will come of it and who will benefit?

To begin to answer these questions, we explore the contours of the complications that Chinese economic ties are currently posing for Australian policymakers. Four such complications are explored: the challenges posed by asymmetries in Sino-Australian trade, difficulties associated with Chinese state capitalism, the impacts of the so-called 'resource curse', and the geopolitically charged nature of bilateral economic relations. We suggest that these complications—each of which is somewhat unique to the China relationship—are not only forcing a reappraisal of how Australia responds to

McLean, *Why Australia Prospered: The Shifting Sources of Economic Growth* (Princeton: Princeton University Press, 2013).

[4] Ross Garnaut, *Dog Days: Australia After the Boom* (Collingwood: Redback, 2013).

[5] Mark Beeson, *Competing Capitalisms: Australia, Japan and Economic Competition in the Asia Pacific* (London: Macmillan, 1999); Jeffrey D. Wilson, *Governing Global Production: Resource Networks in the Asia-Pacific Steel Industry* (Basingstoke: Palgrave Macmillan, 2013), Chapters 4-6.

[6] Muthiah Alagappa, 'Asian Practice of Security: Key Features and Explanations', in M. Alagappa (ed.), *Asian Security Practice: Material and Ideational Influences* (Stanford: Stanford University Press, 1998); Helen E. Nesadurai, 'Introduction: Economic Security, Globalisation and Governance', *The Pacific Review*, vol. 17, no. 4 (2004), pp. 459-84.

its external strategic environment, but are also reconfiguring internal considerations bearing upon economic policy choices. They also mean that Australia's process of 'coming to terms' with China will prove more challenging than its previous economic integration with Japan. The Sino-Australian relationship consequently provides a convenient window through which to examine the likely trajectory of the next phase in Australia's political and economic turn towards the Asian region.

Contextualising and Theorising Australia's Asian Trade Links

To understand the significance of Sino-Australian trade ties it is useful to provide some historical context. There has been a long run 'turn to Asia' as a consequence of the declining importance of Australia's imperial ties with Britain and the rapid industrialisation of Japan, Southeast Asia and China in the latter part of the twentieth century.[7] The simple, inescapable—and for some, unpalatable—reality has been that East Asia's growing economic importance left Australian policymakers with little alternative other than to come to terms with the region.[8] Crucially, a region that had previously been synonymous with strategic threat was now seen as a major economic opportunity and the basis for Australia's future prosperity.

Nothing captured this change of mood—nor drove the subsequent policy shift that attempted to capitalise on it—more than Ross Garnaut's commissioned analysis of Australia's economic relations with Northeast Asia published in 1990.[9] Two points are especially noteworthy about this report. First, at that time it was still Japan rather than China that was the centre of attention. Second, Garnaut's analysis was informed by the assumptions of neoclassical economics, of which he was one of Australia's most influential and articulate advocates. As a former advisor of then Prime Minister Bob Hawke, Garnaut's views carried considerable weight, and his report provided a blueprint and rationale for Australia's economic engagement with the region. The guiding assumption was that Australian policymakers should liberalise and open up the economy and allow market forces to make the most of Australia's complementary relationship with Asia: Australia's comparative advantage in resource and commodity production would complement the demand from Asia's rapidly industrialising economies.

[7] Sandra Tweedie, *Trading Partners: Australia and Asia 1790-1993* (Sydney: UNSW Press, 1994).
[8] Ann Capling, 'Twenty Years of Australia's Engagement with Asia', *The Pacific Review*, vol. 21, no. 5 (2008), pp. 601-22.
[9] Ross Garnaut, *Australia and the Northeast Ascendancy* (Canberra: Australian Government Publishing Service, 1990).

Garnaut's views resonated and built on a more broadly based overhaul of Australia's domestic and foreign relations.[10] Many of these initiatives have become familiar components of neoliberal reform around the world: central bank independence, floating exchange rates, financial sector liberalisation, labour market reform and—most importantly for our purposes—trade liberalisation and tariff reduction, issues about which Garnaut's views were especially influential. Indeed, so enthusiastic did Australian policymakers become about the merits of trade liberalisation, they played a pivotal role in establishing Asia Pacific Economic Cooperation (APEC), a major new intergovernmental institution to promote similar reforms across the region.[11] The fact that Australia's reformist overtures were often met with studied indifference in a region that remained sceptical about neoliberalism should not blind us to the importance of economic liberalisation in Australia's overall policy orientation.[12]

In the last decade, China has replaced Japan as Australia's principal trade partner and most important regional economic relationship. However, the logic of complementarity between a resource-rich Australian economy and an industrialising Asian partner still applies. Sino-Australian ties therefore provide an important test of the reform period's efficacy, and of the merits of Australia's approach to trade relations with the region. While there may be much to be said for many of the reforms undertaken during the 1990s, Australia's economic relationship with China generates vulnerabilities and tensions that seem contrary to Australia's long-term economic—and perhaps political—interests. Why? Understanding the complications inherent in Sino-Australian trade relations can help illuminate the answer.

'Deep but Narrow' Economic Relations

Given the overwhelming contemporary significance of China to the Australian economy, it is easy to forget that bilateral economic relations are comparatively young. Prior to the Whitlam Government's diplomatic recognition of the People's Republic of China in December 1972, the two countries had practically no economic ties of which to speak. Indeed, economics would not come to the fore of the relationship for many years. Despite the signing of two major trade agreements in 1973 and 1981,[13]

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[10] Mark Beeson and Diane Stone, 'The Changing Fortunes of a Policy Entrepreneur: The Case of Ross Garnaut', *Australian Journal of Political Science,* vol. 48, no. 1 (2013), pp. 1-14.
[11] Nick Bisley, 'APEC: Asia-Pacific Economic Cooperation', in M. Beeson and R. Stubbs (eds), *Routledge Handbook of Asian Regionalism* (London: Routledge, 2012), pp. 350-63.
[12] Mark Beeson and Iyanatul Islam, 'Neo-liberalism and East Asia: Resisting the Washington Consensus', *Journal of Development Studies,* vol. 41, no. 2 (2005), pp. 197-219; Andrew Walter, *Governing Finance: East Asia's Adoption of International Standards* (Ithaca: Cornell University Press, 2008).
[13] 'Trade Agreement Between the Government of Australia and the Government of the People's Republic of China', *United Nations Treaty Series*, vol . 975, no. I-14127 (1973); 'Protocol on Economic Cooperation Between the Government of Australia and the Government of the People's Republic of China', *United Nations Treaty Series*, vol. 1368, no. I-23083 (1981).

economic considerations were subordinate to to Cold War security concerns for the majority of the 1970s and 1980s.[14] Australian aspirations to develop China as an economic partner were also constrained by diplomatic issues, particularly the 1989 Tiananmen incident and the 1996 Taiwan Strait crisis.[15] Complementarity between the two economies—with Australian well-endowed with natural resources, and China emerging as manufacturing powerhouse—was simply insufficient to overcome the inhibiting effects of geopolitics. As late as the year 2000, bilateral trade flows were worth $15 billion, equivalent to a paltry 6.6 per cent of Australia's total trade.[16]

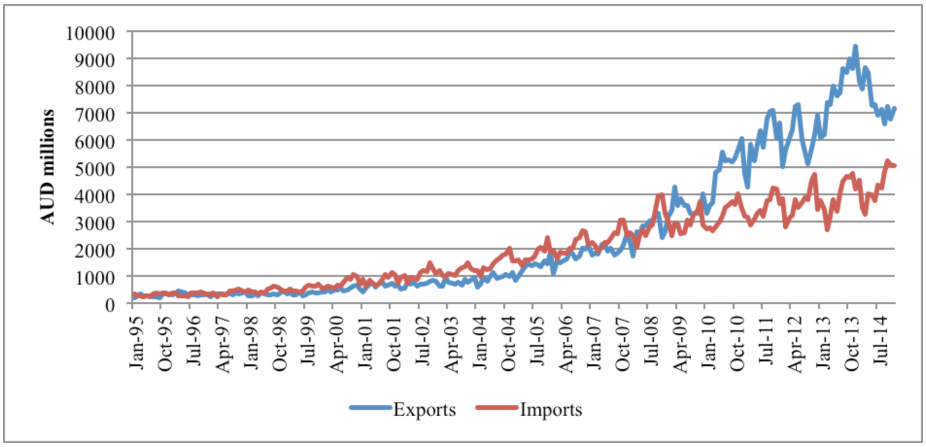
The catalyst for a rapid deepening of Sino-Australian economic ties was the 'global resources boom' of the mid-2000s. Owing to surging demand from a range of industrialising economies—including China, India, Brazil and Indonesia—global resource markets began a steady upward climb.[17] This demand side pressure saw the international price of most minerals and energy quadruple between 2005 and 2012.[18] At the same time, China was entering the 'heavy' stage of its industrialisation, driven by the steel, construction, machinery and automobile sectors. With only limited domestic reserves of minerals and energy to fuel its industrial sectors, China faced an emerging resource security crisis that threatened its overall economic development program.[19] Australia was ideally placed to take on the role of China's principal resource supplier, given its established and technologically advanced mining sector, and close geographic proximity to Chinese markets in comparison to competing African and Latin American producers. Iron ore—the principal raw material used in the production of steel—emerged as the major focus of this resource trade. By 2013 Australia was exporting some $55 billion worth of iron ore to China, accounting for 52 per cent of the country's import needs.[20]

The resource boom provided the underlying driver for a dramatic intensification in Sino-Australian trade ties. In the decade to 2014, bilateral trade flows quadrupled to $141 billion annually, with surging Australian resource exports flipping the trade balance from deficit to surplus from 2009 (see Figure 1). As China surged up the list of trade partners, the geographic

[14] Stuart Harris, 'Australia-China Political Relations: From Fear to Friendly Relations?', *Australian Journal of International Affairs,* vol. 49, no. 2 (1995), pp. 237-48.
[15] Frank Frost, *Directions in China's Foreign Relations—Implications for East Asia and Australia*, Parliamentary Library Research Brief, no. 9 (Canberra: Parliament of Australia, 2005)
[16] Australian Bureau of Statistics, *International Trade in Goods and Services Australia April 2015* (Cat No. 5368.0).
[17] Bernice Lee, Felix Preston, Jaakko Kooroshy, Rob Bailey and Glada Lahn, *Resources Futures* (London: Chatham House, 2012), Chapter 1.
[18] Jeffrey D. Wilson, 'Regionalising Resource Security in the Asia-Pacific: The Challenge of Economic Nationalism', *Australian Journal of International Affairs,* vol. 69, no. 2 (2015), pp. 224-45.
[19] Wilson, *Governing Global Production*, Chapter 7.
[20] United Nations Conference on Trade and Development, 'UNCTADstat Database', <unctadstat.unctad.org/EN/> [Accessed 8 June 2015].

structure of Australian trade underwent a similar shift. From an initially marginal position in the late 1990s, China became Australia's number one trade partner in 2007, and by 2014 accounted for approximately one-third of national exports (Figure 2). These shifts marked a dramatic reorientation in Australia's foreign economic relations, which had hitherto focused on 'traditional' partners such as the United States, EU, Japan and Korea. Expanding trade with China was also fortuitously timed for Australia, closely coinciding with the global financial crisis (GFC) of 2008-09. Indeed, many economists and the then-Treasurer Wayne Swan argued that the booming resource trade with China was critical in helping Australia escape the worst of the GFC, whose local effects were relatively mild in international comparison.[21]

Figure 1: Australian Trade with China, 1995-2014



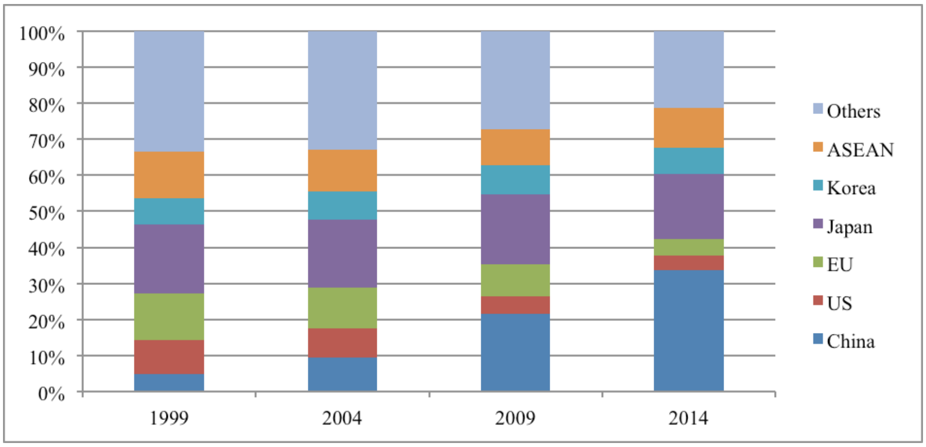
Source: Australian Bureau of Statistics, *International Trade in Goods and Services Australia April 2015* (Cat No. 5368.0).

Nonetheless, several economic asymmetries mean the burgeoning China trade relationship may potentially face future challenges. Principal amongst these is the heavy dependence on a very narrow set of mineral resources. As Table 1 reveals, the rapid growth has largely been driven by iron ore (and to a lesser extent other minerals), which now collectively account for around 80 per cent of Australian merchandise exports to China. Non-mineral sectors have under-performed in comparison, to the point that the trade relationship might better be labelled an 'iron ore relationship'. This biased trade does not mirror the structure of the broader Australian economy (in

[21] Wayne Swan, 'Resources and Recovery—Speech to Minerals Week 2009, Canberra, 26 May 2009', <ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2009/012.htm&pageID=005&min=wms&Year=&DocType=> [Accessed 9 June 2015]; Dow Jones, 'Mining Sector Investment to Speed up Recovery from Slowdown', *The Australian*, 2 June 2010.

which mining accounts for only 9 per cent of gross domestic product).[22] This indicates that the 'China boom' has not impacted on most industrial sectors, and offered few opportunities for the broader Australian economy. Policymakers have had to manage the problems of a 'two-speed economy', where rapid (China-driven) growth in resource sectors must be balanced against more modest performance in other non-China oriented industries.[23] Iron ore trade with China also posed 'Dutch disease'-type problems for many other export-oriented sectors (particularly agriculture and tourism), whose international competitiveness were undermined by a rapid appreciation in the Australian dollar between 2008 and 2012.[24] While both the mining boom and currency have receded since 2013, the episode demonstrated the vulnerabilities that dependence on iron ore exports to China have posed.

Figure 2: Composition of Australian Trade by Partner, 1999-2014



Source: Australian Bureau of Statistics, *International Trade in Goods and Services Australia April 2015* (Cat No. 5368.0).

Second, there is a discernible pattern of asymmetry in the interdependence between the two economies. In macroeconomic terms, China now accounts for around a third of Australia's trade, and exports to China are alone equivalent to 5.7 per cent of GDP. A significant portion of the Australian economy—and the majority of its resource sector—now depends on access to what have been buoyant Chinese markets. But given the size disparities between the two countries, Australia's economic importance to China is far less pronounced. Australia is presently China's seventh largest trade partner, accounts for 3.2 per cent of its trade, and exports to Australia are

[22] Australian Bureau of Statistics, *Australian National Accounts: National Income Expenditure and Product March 2015* (Cat No. 5206.0).
[23] Harry Perlich, 'Economic Notes: Australia's Two-Speed Economy', *Journal of Australian Political Economy*, vol. 72, no. 1 (2013), pp. 106-26.
[24] W. Max Corden, 'Dutch Disease in Australia: Policy Options for a Three-Speed Economy', *Australian Economic Review*, vol. 45, no. 3 (2012), pp. 290-304.

equivalent to only 0.4 per cent of Chinese GDP.[25] While Australia is critically important as a supplier of iron ore to the Chinese steel sector,[26] in broader terms the bilateral economic relationship is of considerably less importance to China. This asymmetry means that Australian policymakers must place a greater emphasis on China than vice versa, which can frustrate economic diplomacy initiatives. An instructive example is provided by the negotiations for the China-Australia Free Trade Agreement (ChAFTA). Despite being a very high Australian trade policy priority, three federal governments took ten years and twenty-two rounds of negotiation to complete the agreement in 2015. Even then, Chinese unwillingness to meet Australian agricultural requests were only overcome by the Abbott Government making the difficult choice to exclude several farm sectors from the agreement.[27]

Table 1: Composition of Australian Merchandise Exports to China, 2000-13 (USD billions)

	2000	2005	2010	2013	% growth 2005-13
Iron ore	0.6	4.3	31.1	51.0	1174%
Coal	0.1	0.4	4.7	8.8	2167%
Other minerals	0.7	2.1	7.3	9.3	443%
Agriculture	0.5	0.5	1.3	3.7	716%
Others	1.6	4.9	8.0	14.6	299%
Total merchandise exports	**3.5**	**12.2**	**52.4**	**87.4**	714%
Minerals % total exports	*39.4%*	*56.0%*	*82.2%*	*79.1%*	

Source: United Nations Conference on Trade and Development, 'UNCTADStat Database', <http://unctadstat.unctad.org/EN/>.

A third—and often overlooked—problem is the fact that the development of investment ties has lagged well behind trade. Driven by interest in the mining sector, Chinese investment into Australia has grown rapidly in recent years, with foreign direct investment (FDI) stocks increasing four-fold to $65 billion in the five years to 2014. However, Chinese investors remain minor players (accounting for only 2.3 per cent of FDI stocks), and traditional partners such as the United States, UK and EU still provide the majority of Australia's foreign capital.[28] This investment is also narrowly concentrated, with the mining industry accounting for 75 per cent of approved Chinese

[25] Authors' calculations, from United Nations Conference on Trade and Development, 'UNCTADStat Database', <unctadstat.unctad.org/EN/> [Accessed 8 June 2015]; United Nations Statistical Division, 'UN Comtrade Database', <comtrade.un.org/> [Accessed 8 June 2015].
[26] Jeffrey D. Wilson, 'Chinese Resource Security Policies and the Restructuring of the Asia-Pacific Iron Ore Market', *Resource Policy*, vol. 37, no. 3 (2012), pp. 331-9.
[27] 'FTA Relies on Compromise', *The Land*, 13 September 2013; Jeffrey D. Wilson, 'China-Australia Trade Agreement a Compromised Victory', *The Conversation*, 18 June 2015.
[28] Australian Bureau of Statistics, *International Investment Position Australia: Supplementary Statistics 2014* (Cat. No. 5352.0).

investments between 2003-04 and 2012-13.[29] One major sticking point has been the screening of Chinese investment applications by the Foreign Investment Review Board (FIRB), which (rightly or wrongly) is perceived by Chinese investors as a form of regulatory discrimination by the Australian Government.[30] As a consequence, few Australian industries have developed meaningful investment ties with China. As these ties are an important element for accessing Chinese consumer markets—particularly in the services sector—this puts Australian firms at a relative disadvantage in developing new business opportunities.[31]

Sino-Australian economic relations might thus be summarised as *deep but narrow*—extensive in volume, but overwhelmingly dominated by a small number of resource commodities. This lack of diversity exposes Australia to several economic risks. A downturn in volatile global resource markets—such as the one that has hit the iron ore sector since 2014[32]—will rapidly decrease the value of Australian exports to China. The slowing pace of China's industrialisaton, associated with Xi Xinping's 'new normal' economic policy of 2014,[33] similarly threatens the buoyancy of Chinese resource markets on which the bilateral relationship is predicated. A lack of investment ties outside the mining sector also poses challenges for other Australian export industries—particularly the tourism, agriculture and technical services sectors—to penetrate Chinese markets subject to high levels of trade protection. Thus, while the Sino-Australian economic relationship has deepened significantly during the last decade, it remains characterised by a range of vulnerabilities that pose asymmetric risks for Australia.

Dealing with State Capitalists?

The Sino-Australian trade relationship is further complicated by political-economic differences in the way the two economies are constituted. Economic activity now is frequently disaggregated and dispersed across national boundaries by independent, footloose corporations that may have no obvious national allegiance or identity.[34] This is particularly true in the resource sectors at the heart of the relationship, which is dominated by two multinational mining firms BHP Billiton and Rio Tinto. BHP Billiton at one

[29] Authors' summary, from data in *Foreign Investment Review Board Annual Reports* (Canberra: Australian Government Publishing Service, various years).
[30] John Larum, *Chinese Perspectives on Investing in Australia* (Sydney: Lowy Institute for International Policy, 2011).
[31] First Murdoch Commission, *Western Australian and the Evolving Regional Order: Challenges and Opportunities* (Perth: Murdoch University, 2013), p. 49.
[32] 'The Latest Iron Ore Price Slump: Causes and Effects', *Forbes*, 14 March 2014.
[33] Angang Hu, 'Embracing China's "New Normal"', *Foreign Affairs,* vol. 94, no. 3 (2015), pp. 8-12.
[34] Peter Dicken, *Global Shift: Mapping the Changing Contours of the Global Economy*, 6th ed. (New York: Guilford Press, 2011).

time liked to style itself as 'the big Australian',[35] but now has a complex, multinational ownership structure that has overturned any simple identity between economic and political space. Whatever one may think of the merits of foreign versus local ownership, firms such as BHP and Rio Tinto that are overwhelmingly foreign owned at least have the merit of being familiar, profit-oriented, market-driven, independent commercial entities. No such assumptions can be made about the state-owned enterprises (SOEs) that are the principal partners with which resource Australian companies must trade.[36]

Despite the three decades of economic reform since the announcement of the 'Open Door' policy in 1978, the Chinese state continues to exert a profound influence over the course of economic development. While this is common in many Asian countries,[37] in China's case continuing state control over strategically important parts of the economy is essentially part of a distinct style of political rule known as 'state capitalism'. As Ian Bremmer points out, the ultimate motive of state capitalism

> is not economic (maximising growth) but *political* (maximising the state's power and the leadership's chances of survival). This is a form of capitalism but one in which the state acts as the dominant economic player and uses markets primarily for political gain.[38]

In the context of authoritarian China, in which the state's legitimacy and the authority of the Chinese Communist Party (CCP) is almost entirely dependent on its ability to deliver continuing economic growth,[39] this means that SOEs have assumed a critical role. Control of strategic economic activities through SOEs has assumed an existential importance, reflected in the Chinese state's 'Going Out' program and financial commitments to the internationalisation of state-owned resource companies and sovereign wealth funds.[40]

Far from abandoning state control, Chinese economic planners are actually attempting to develop 'national champions' in strategic sectors such as oil,

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[35] Alan Trengove, *'What's Good for Australia...!' The Story of BHP* (Stanmore: Cassell Australia, 1975).
[36] For example, the Chinese steel sector is dominated by a group of 'national champion' SOEs. In recent years, the Chinese Government has attempted to organise these SOEs into a 'buyer's cartel' that can exercise influence in iron ore price negotiations. See Wilson, 'Chinese Resource Security Policies', pp. 335-7.
[37] Richard Stubbs, 'What Ever Happened to the East Asian Developmental State? The Unfolding Debate', *The Pacific Review*, vol. 22, no. 1 (2009), pp. 1-22.
[38] Ian Bremmer, *The End of the Free Market: Who Wins the War Between States and Corporations?* (New York: Penguin, 2010), p. 5 (emphasis in original).
[39] Yuchao Zhu, '"Performance Legitimacy" and China's Political Adaptation Strategy', *Journal of Chinese Political Science*, vol. 16, no. 2 (2011), pp. 123-40.
[40] Nargiza Salidjanova, *Going Out: An Overview of China's Outward Foreign Direct Investment* (Washington, DC: US-China Economic and Security Review Commission, 2011).

mining, steel and banking.[41] Recent analysis by Szamosszegi and Kyle estimates that state-owned enterprises and their holding companies account for approximately 40 per cent of China's GDP.[42] More importantly, their exhaustive analysis of the SOE sector concluded that:

> SOE investments and actions also reflect the long-term vision of their controlling shareholder (the Chinese government), and thus short-term profits are not necessarily their highest priority … The top Chinese leadership has stated that SOEs will continue to be the main actors in China's going out policy, and that China will use its massive foreign exchange reserves to fuel this overseas expansion, especially targeting energy and natural resources.[43]

This state-led strategy has plainly been in evidence in Australia, where the investment efforts of Chinese SOEs have three inter-related goals. First, the Chinese Government hopes to use (state-subsidised) investment to increase the supply of minerals to China,[44] potentially lowering the world prices driving its soaring resource import costs. Second, it also intends to gain a strategic foothold in world resource markets, by developing 'captive mines' owned and controlled by Chinese corporations.[45] Third, it has also aimed to dilute the strength of the so-called 'Big-3' mining companies—BHP Billiton, Rio Tinto, and Brazil's Vale—which the Chinese Government has accused of being 'monopolists' that have artificially inflated global iron ore prices.[46] In other words, the arrival of Chinese SOEs in the Australian mining sector has not been driven purely by profitability motives, but also by the strategic economic objectives of the Chinese state.

The Australian Government is increasingly attentive to the possible impact of Chinese investment, and is more alert than its predecessors were about a similar Japanese strategy in the 1970s and 1980s.[47] The FIRB, which is charged with ensuring that investments are in the 'national interest', has recently become concerned about the possible strategic implications of Chinese resource investment. Former Treasurer Wayne Swan provided the FIRB with new guidelines for screening SOE investments in 2008,[48] which the head of the FIRB described as "a stricter policy aimed squarely at China's growing influence in Australia's resources sector".[49] While the current Abbott Government has attempted to position itself as 'open for

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[41] Yi-Chong Xu (ed.), *The Political Economy of State-owned Enterprises in China and India* (Basingstoke: Palgrave Macmillan, 2012).
[42] Andrew Szamosszegi and Cole Kyle, *An Analysis of State-owned Enterprises and State Capitalism in China* (Washington, DC: US-China Economic and Security Review Commission, 2011), p. 21.
[43] Ibid., p. 89.
[44] Junsai Zhang, 'China Seeks to Invest, not Dominate', *The Australian*, 2 April 2009.
[45] Wilson, 'Chinese Resource Security Policies', p. 334.
[46] 'Iron Ore Monopoly May End by 2015', *China Daily*, 25 March 2011.
[47] On the latter, see Wilson, *Governing Global Production*, Chapters 4-6.
[48] Department of Treasury (Australia)*, Summary of Australia's Foreign Investment Policy* (Canberra: Australian Government Publishing Service, 2008).
[49] Philip Dorling, 'Labor's Secret Curb on China', *Sydney Morning Herald*, 3 March 2011.

business', it has found itself coming under direct Chinese pressure to introduce a less intrusive, more even-handed policy regime as evidence of this approach.[50] FIRB screening was a key issue in negotiations for the ChAFTA agreement, whose investment chapter has subsequently and revealingly raised FIRB screening thresholds for *private*—but not *state-owned*—Chinese investors.[51]

Perhaps no incident better highlighted this tension than Chinese state-owned company Chinalco's abortive bid for a stake in Rio Tinto. Following its takeover of Canadian aluminum producer Alcan, a heavily-indebted Rio Tinto invited Chinalco to invest in the company in order to save it from a possible hostile takeover from BHP Billiton. Despite Chinalco's enthusiastic response, Rio Tinto withdrew from the deal in June 2009 in the face of considerable public consternation, regulatory hand-wringing, intense diplomatic lobbying and opposition from some Rio Tinto shareholders.[52] While the deal collapsed due to a combination of regulatory and investor concerns, Chinalco and Chinese observers more generally were convinced it had been killed off following the undisclosed intervention of the Australian Government and FIRB. As Jennifer Hewett points out, whatever the ultimate cause "the basic message [received in China] was that Australia was concerned about the prospect of China, a leading customer of its resources, having too much influence or control over those resources".[53] Nonetheless, the belief that national economic interests would be better served by a resource sector controlled by multinational mining firms would soon be shattered by the sector's response to proposed changes to fiscal policy.

Australia and the Resource Curse

It is usually assumed that the perils of the 'resource curse' are primarily associated with developing economies such as Sierra Leone or Middle Eastern authoritarian regimes such as Saudi Arabia.[54] In these and similar cases, the importance of a single commodity can distort economic development and consolidate the political position of any group that is able to control its production and the wealth it generates to consolidate its power. Through patronage and rent-seeking activities, privileged insiders and the politically powerful can use their access to resource-generated wealth to

[50] Anne Hyland, 'China Challenge for FIRB', *Australian Financial Review,* 10 June 2014.
[51] Department of Foreign Affairs and Trade (Australia), 'China-Australia Free Trade Agreement—Fact Sheet: Investment', <dfat.gov.au/trade/agreements/chafta/fact-sheets/Pages/fact-sheet-investment.aspx> [Accessed 11 June 2015].
[52] Richard Leaver and Carl Ungerer, *A Natural Power: Challenges for Australia's Resources Diplomacy in Asia* (Barton: Australian Strategic Policy Institute, 2010).
[53] Jennifer Hewett, 'Sorting Out the Miner Kerfuffle', *The Australian,* 21 February 2009.
[54] Richart M. Auty, 'The Political Economy of Resource-driven Growth', *European Economic Review,* vol. 45, no. 4-6 (2001), pp. 839-46.

entrench the position of what are invariably non-democratic, repressive regimes.[55]

For developed economies and democratic polities such as Australia, the resource curse might seem irrelevant. However, the structure of Australia's economy has been profoundly influenced by the growth of the resource sector. As in less developed economies, currency appreciation has had an adverse impact on other trade-exposed industries, especially manufacturing, agriculture and traded services (such as tourism).[56] While concerns about the negative impact of high resource prices and currency appreciation on Australian industry first emerged during the Japan-driven boom of the 1970s,[57] these had subsided in intervening years as mining fell from economic prominence. But as the Sino-Australian resource relationship gathered pace in the mid-2000s, these issues returned to the forefront of the national economic policy agenda. Indeed, Australia's trade profile shift towards mineral exports has made the economy as a whole much more vulnerable to commodity prices, which are notoriously volatile and now increasingly dependent on dynamics in the Chinese economy.

What is also becoming apparent is that the mining sector's power is not confined to its economic influence. Increasingly, the mining sector is exerting a *political* influence that reminds us that the possible consequences of the resource curse are not confined to the developing world. An underlying structural reality is the fact that the 'Australian' resource sector is overwhelmingly foreign owned. Decisions about investment and production are generally made by multinational corporations driven by a global organisational logic that may be at odds with the ostensible 'national interest'. The growing economic and political significance of the resource sector has in large part been driven by the fact it drives the burgeoning Sino-Australian trade relationship, which has enabled it to influence government policy in ways that reflect corporate interests. This possibility was dramatically highlighted in the intense political struggle that emerged over tax policy during the administration of Kevin Rudd.

The mining lobby collectively underwrote a highly effective campaign to oppose the Rudd Government's proposed Resource Super Profits Tax (RSPT). The tax proved extremely controversial, was stridently opposed by the mining sector and the then-opposition Liberal-National coalition, and led to an 'advertising war' between the federal Labor Government and industry. Following Kevin Rudd's removal from the prime ministership in June 2010, the Gillard Government reformed the proposal as the newly named Minerals Rent Resource Tax (MRRT). However, even this watered-down package

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[55] Michael L. Ross, 'Does Oil Hinder Democracy?', *World Politics*, vol. 53, no. 3 (2001), pp. 325-61.
[56] Corden, 'Dutch Disease in Australia'.
[57] Robert H. Gregory, 'Some Implications of the Growth of the Mineral Sector', *The Australian Journal of Agricultural Economics*, vol. 20, no. 2 (1976), pp. 70-91.

remained contested, and became one of the key issues contributing to the success of the Coalition in the September 2013 federal election. The MRRT also proved very short lived, only taking effect in the 2012-13 financial year before being repealed by the Abbott Government in September 2014. By investing $22 million in a high profile advertising blitz, the mining sector was able to save an estimated $60 billion in taxation revenues that the RSPT would have raised over ten years.[58] As Paul Cleary points out,

> The success of multinational miners in securing these concessions, and in beating voters to the punch, reveals the perverse world order in which we live: an advanced country can possess enormous riches but lack the capacity to do what is clearly in its own long-term interest.[59]

The inability of a democratically elected government to compete with the financial firepower and political skills of a powerful set of vested interests is revealing and troubling. But of even greater concern was the fact that the mining lobby's highly successful campaign was instrumental in bringing about the downfall of Australia's then prime minister. True, Kevin Rudd had famously alienated many within in his own party, and was highly dependent on his public popularity to maintain authority within a notoriously faction-ridden, tribal and brutal party machine.[60] However, the mining industry had clearly emerged as an exceptionally powerful lobby group, capable of exercising considerable—and ultimately decisive—discursive influence over national policy debates.[61] The fact that this industry was overwhelmingly foreign-owned, and its political centrality was a consequence of growing (but asymmetric) trade ties with China, only adds to the perception that Australia's political and economic independence have become somewhat compromised.

The Geopolitics of Trade

If these economic and political issues in Sino-Australian relations were not enough, geopolitics has further complicated policymaking. This should not surprise us. One of the big lessons of the entire East Asian developmental experience, of which China is now such an important part, is that politics, economics and security are intimately entwined. It is simply not possible to understand the course of the post-war economic 'miracle' in East Asia, for example, without considering the wider geopolitical context within which it occurred.[62] Moreover, for many East Asian states, economic development

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58 Jessica Irvine, 'A $60b Riddle: How Miners Took Taxpayers to the Cleaners', *The Age,* 18 February 2011.

59 Paul Cleary, *Too Much Luck: The Mining Boom and Australia's Future* (Melbourne: Black Inc. Books, 2011), p. 79.

60 Maxine McKew, *Tales from the Political Trenches* (Melbourne: Melbourne University Press, 2012).

61 Stephen Bell and Andrew Hindmoor, 'The Structural Power of Business and the Power of Ideas: The Strange Case of the Australian Mining Tax', *New Political Economy*, vol. 19, no. 3 (2013), pp. 470-86.

62 Richard Stubbs, *Rethinking Asia's Economic Miracle* (Basingstoke: Palgrave, 2005).

remains the core of a more encompassing view of national security.[63] This has major implications not just for the way many Asian states organise their economies and political relations, but for their trading partners, too. Unless such differences are recognised and understood, Australian policy will be incapable of grasping opportunities or responding to potential threats, especially to economic rather than more traditional forms of security.

Trade relations and economic interdependence cannot be understood in isolation. Australia's trade with China occurs within a complex strategic overlay and, as many commentators have noted, Australia's largest economic partner and principal strategic ally are geopolitical rivals.[64] At least when Japan was Australia's largest trade partner, they were both in the same ideological and strategic camp. Now Australian policymakers need to manage two pivotally important relationships at a time of rapid change in their own relative standing. The simple material reality is that no matter how much cultural and historical affinity may exist between Australian and American people, China's economy is exerting an irresistible gravitational pull that is reshaping the Australian economy and making the calculation of the national interest increasingly problematic. Choices currently facing Australian trade policy perfectly illustrate this dilemma.

Two new 'mega-regional' trade agreements are presently under negotiation in the Asia-Pacific: the US-led Trans-Pacific Partnership (TPP) and the ASEAN-led but China-backed Regional Comprehensive Economic Partnership (RCEP) agreement. The agreements are competing proposals, differentiated by membership and level of ambition for trade liberalisation. Their competition is also a proxy for US-China rivalry, with the United States a member of the TPP but not the RCEP (and China vice versa). Australia is presently one of a handful of countries that is a party to both negotiations, and must decide how (finite) political capital and diplomatic resources are divided between the initiatives.[65] While trade policy interests might normally be expected to be at the forefront of such decisions, it is impossible to disentangle these from geopolitical concerns. For the United States, the TPP constitutes the economic wing of its recently announced 'Pivot to Asia' strategy; while some voices in China have argued it is an attempt to economically 'contain' China by dictating the terms of regional trade liberalisation.[66] For Australia—and indeed, the other six countries party to

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[63] Mark Beeson, 'Security in Asia What's Different, What's Not?', *Journal of Asian Security and International Affairs*, vol. 1, no. 1 (2014), pp. 1-23.
[64] James Manicom and Andrew O'Neil, 'Accommodation, Realignment, or Business as Usual? Australia's Response to a Rising China', *The Pacific Review,* vol. 23, no. 1 (2010), pp. 23-44; Hugh White, 'Power Shift: Australia's Future Between Washington and Beijing', *Quarterly Essay*, vol. 39 (2010), pp. 1-74.
[65] Jeffrey D. Wilson, 'Mega-Regional Trade Deals in the Asia-Pacific: Choosing Between the TPP and RCEP?', *Journal of Contemporary Asia*, vol. 45, no. 2 (2015), pp. 345-53.
[66] John Kehoe, 'Pacific Trade Pact is all about Containing China', *Australian Financial Review*, 26 January 2015; Shannon Tiezzi, 'Will China Join the Trans-Pacific Partnership?', *The Diplomat*, 10 October 2014.

both TPP and RCEP negotiations—the risk exists that privileging one trade agreement over the other will implicitly (and perhaps unintentionally) signal geopolitical choices between the United States and China.

Given this backdrop, the decision to name China as a strategic threat in the Rudd Government's 2009 Defence White Paper, and the more recent commitment to establish a continuing American military presence in Darwin, assume even greater significance. Both of these decisions were plainly intended to send a powerful message about Australia's strategic priorities and its concern about how the 'rise of China' is viewed in Australia.[67] Whatever the merits of this strategic calculus, there is an implicit judgement that this is a call Australians can and ought to make without incurring major costs. And yet such a position ignores the growing asymmetries and biases in Australia's relationship with China, and China's increased ability to push back. True, China needs Australian resources, but the Australian economy is now structurally dependent on narrow economic ties with China that are extremely vulnerable to exogenous shocks. Moreover, it would hardly be surprising if Australia's recent security policy moves accelerate Chinese efforts to enhance their own economic security and independence, and to capitalise on its existing primacy in the bilateral economic relationship.[68]

Conclusion

What does this array of economic complications mean for Australia's relations with China, and indeed the Asian region more broadly, in coming years? Two major implications stand out. First, they demonstrate that Sino-Australian economic relations themselves contain problematic tendencies. Narrow trade ties are posing new vulnerabilities for the Australian economy, while the complications of Chinese state capitalism make the relationship hard to broaden and diversify. Moreover, the reconfiguration of political-economic forces in Australia is changing the policymaking calculus within the country, while asymmetries in Sino-Australian trade ties have intensified Chinese influence from without. Coming to terms with China consequently means more than simply prudently navigating security tensions to ensure mutually beneficial economic integration can proceed smoothly. Problems within the economic relationship will require their own management strategies, and with China now Australia's number one trade partner the stakes have never been higher. Australian policymakers will be committing a dangerous error if they assume that economic relations with China are unproblematically positive on their own terms, or do not pose difficult choices.

[67] Christopher Joye, 'We're all the Way with USA', *Australian Financial Review,* 25 January 2014.
[68] John Kerin, 'Dangerous Liaisons: Australia's Alliances Leave China Cold', *Australian Financial Review,* 7 July 2014.

Second, these economic complications mean that Australian policymakers will need to think creatively about how economic and security issues are balanced on the foreign policy agenda. The continuing primacy attached to more traditional forms of security by Australian policymakers is striking, but entirely in keeping with long-established tradition. Australian policymakers have always looked to 'great and powerful friends' to underwrite their security and recent events confirm that they still do. The question is whether, in an age of greater interdependence, when the likelihood of conventional inter-state war has declined, and when Australia has no real capacity to influence the outcome of such conflicts even if they were to occur, such high profile strategic initiatives are either necessary or productive. We think not. On the contrary, we think that if Australia is to play the sort of constructive 'middle power' role that recent governments have rhetorically championed, which suggests that Australia ought to play a more prominent, independent role as a broker of new ideas and policies, it could do so more effectively as an exemplar of a successful 'trading state'.[69] This would involve a shift in policy priorities that more accurately reflected Australia's weaknesses as well as its possible strengths. A more realistic understanding of the nature of its principal trading relationship and its impact on domestic economic and politics might be a good place to start. This is, after all, an arena in which Australian policymakers might realistically and legitimately expect to exert influence, and where their efforts might be more usefully directed.

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[69] Mark Beeson and Richard Higgott, 'The Changing Architecture of Politics in the Asia-Pacific: Australia's Middle Power Moment?', *International Relations of the Asia-Pacific*, vol. 14, no. 2 (2014), pp. 215-37.