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Australia confronts Geoeconomics

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In June 2021, Australia's Trade Minister Dan Tehan, gave an address at a Konrad-Adenauer-Stiftung event at Parliament House. The Minister highlighted the importance of the new Australia-UK Free Trade Agreement (FTA) not only in terms of the bilateral economic relationship, but also on how Australia is seeking to diversify the breadth of its trade partnerships. Australia's next trade diplomacy objective – completing an FTA with the European Union – was outlined in similar terms. These FTAs complement a suite of trade diversification policies that the Australian Government has rapidly launched over the last twelve months.

Why is trade diversification suddenly such a high priority for an open economy like Australia, which has successfully built economic partnerships with fast-growing Asian economies in recent years? The Minister indicated that strategic, as much as economic, factors were at play, arguing "The economies of the Indo-Pacific will shape the strategic environment, which is why Australia is diversifying its trade partnerships". In drawing the connection between economic interdependence and the potential strategic effects, the Minister was referring to 'geoeconomics' – a phenomenon increasingly driving Australia's foreign economic policy and outlook.

Australia's geoeconomic challenge

In broad terms, geoeconomics can be defined as "the application of economic instruments to advance geopolitical ends"[1]. The concept argues that economic interdependence builds various connections between countries and these linkages have strategic implications that go beyond their purely economic effects. Moreover, these linkages can be deliberately manipulated by governments to project power and shape the international order towards their interests. Put simply, geoeconomics captures how economic policies can be used as a form of statecraft.

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1 Robert Blackwill and Jennifer Harris (2016), 'War by Other Means: Geoeconomics and Statecraft', p. 9.

Geoeconomics has become a prominent feature of international politics in the early 21st century. As rivalries have re-emerged between the world's major powers, governments have turned to economic tools as a way of advancing strategic agendas. This is especially true in the Indo-Pacific, a region home to many of the world's major powers. It has been driven by the US and Chinese governments, which have both deployed geoeconomic strategies to prosecute their great power rivalry. Trade warfare, infrastructure races, competing economic institutions and, most recently, 'vaccine diplomacy' have all become commonplace in the Indo-Pacific. Where economic interdependence was once a driver of cooperation in the region, it has recently become a domain of strategic competition.

The emergence of geoeconomic competition is a major challenge for a medium-sized and open economy like Australia. It has benefited immensely from the cooperative, rules-based and liberalising economic order that emerged in the post-war period. Australia has been an enthusiastic supporter – and major beneficiary – of the wave of economic liberalisation that spread throughout the Indo-Pacific in the last three decades. It allowed Australia to develop trade and investment relationships with the rapidly industrialising economies of Asia and drove a record-setting 29-year period without recession between 1991 and 2019.

But while this trajectory supported Australia's economic interests in the post-Cold War period, in an era of geoeconomics conflict Australia faces its most adverse external economic environment in several generations. The outbreak of coercive trade diplomacy has harmed the Australian economy and threatened the integrity of global economic institutions. As the commitment of major powers to multilateralism has waned, efforts at cooperative institution building have also been hampered. Australia has much to lose if it cannot adjust its policy settings to geoeconomic contestation.

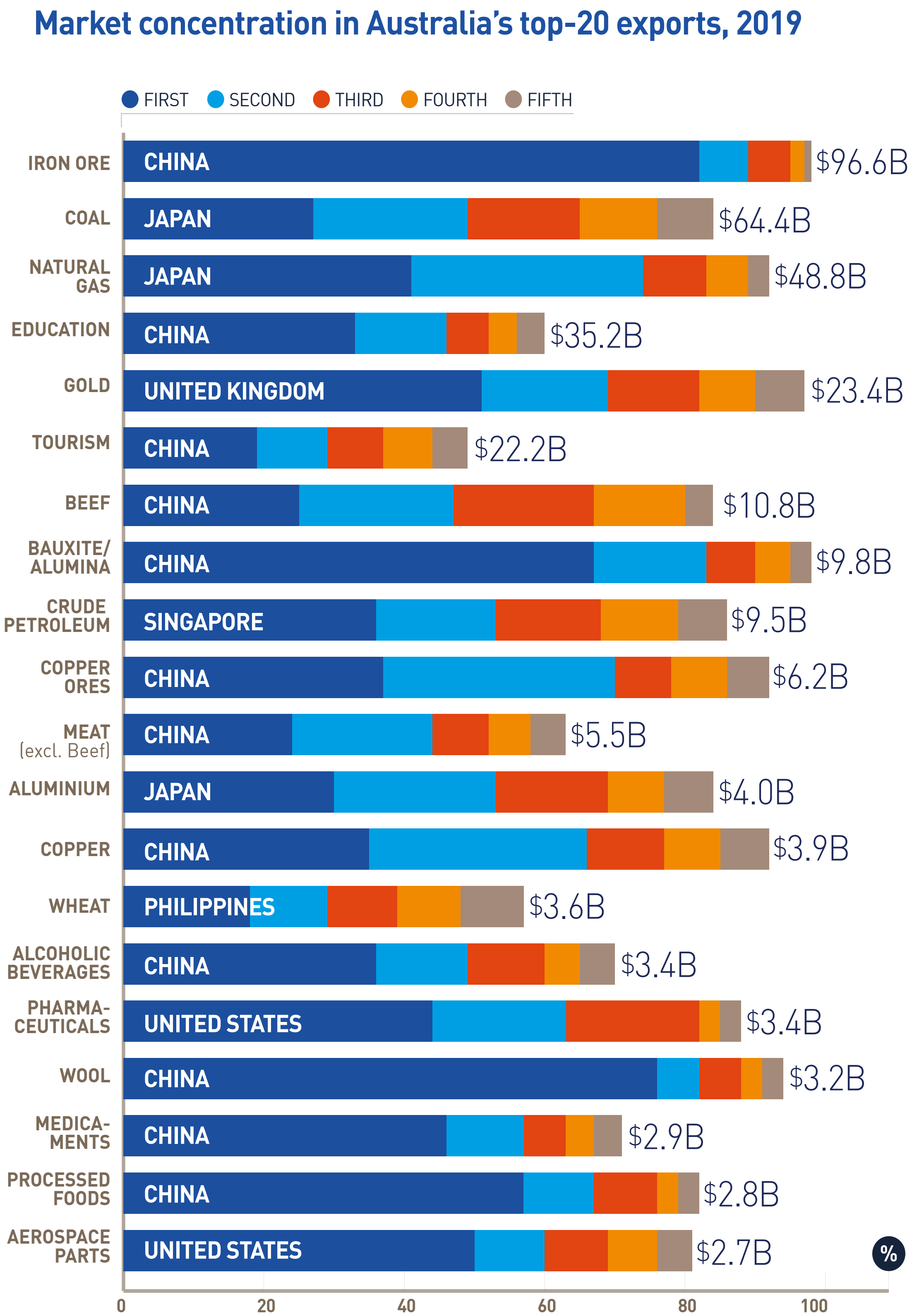
Australia's geoeconomic exposure

Australia's engagement with geoeconomics is shaped by its relative weight in the region. It is widely considered a 'middle power', as the world's fourteenth largest economy by nominal GDP and sixth in the Indo-Pacific[2] . When measured against major powers, Australia is comparatively small, at only one-thirteen the size of the US and one eighth of China. However, its small population (25 million) belies its status as one of the region's most-developed economies, where it ranks only second behind the US on GDP per capita terms. Australia is therefore large enough to respond autonomously to geoeconomic developments but must still compensate for its size differential with larger economic powers.

By their nature, all open economies are somewhat exposed to geoeconomics. However, Australia's lack of trade diversity exacerbates the challenge. Its trade profile is heavily concentrated on a small number of exports, principally natural resources and services, which are oriented to a handful of Indo-Pacific markets. As Figure 1 shows, most of Australia's main exports rely on a single large market and, in some cases, face monopsony conditions, where one buyer accounts for the majority of sales. Moreover, this single market dependence is particularly focused on China, which is the top market for twelve of the twenty export industries. Consequently, political shocks to one of these sectors or partners will have an outsized impact on Australia's economy.

2 Author Jeffrey Wilson's calculations, from UNCTADStat database

Figure 1 Market concentration in Australia's top-20 exports, 2019



Source: Wilson, 2021[3]

3 Jeffrey Wilson (2021), 'Adapting Australian to an era of geoeconomic competition', Figure 3. Available at: https://perthusasia.edu.au/our-work/geoeconomics-report

Australia's ability to confront geoeconomics is also constrained by its liberal policy settings. From the early 1980s, successive governments have engaged in a set of liberalising reforms designed to open the economy and improve its international competitiveness. From an economic standpoint, this liberal model allowed Australia to build trade and investment relationships with the growth economies of the Indo-Pacific. But from a strategic perspective, it also constrains its capacity to respond to geoeconomic risks. Many of the common tools of geoeconomics including strategic trade policy, negotiated investment ties and conditionalised aid programs, are not practiced in Australia due to its liberal policy principles. Thus, while liberal settings served Australia well during the era of cooperative economic relations, today they leave it exposed to risks emanating from the geoeconomic strategies of others.

Chinese trade coercion

In 2020, these geoeconomic risks became reality for Australia. Over the prior decade, political relations between Australia and China had been trending downwards. The Australian Government has expressed concerns regarding a number of Chinese behaviours including the militarisation of the South China Sea, repeated foreign interference and cyber-hacking, gross human rights abuses in Xinjiang, and the de facto legal annexure of Hong Kong. For its part, the Chinese government has viewed Australian advocacy on these issues as evidence of an "anti-China bias" and drawn offence at decisions such as the exclusion of Chinese company Huawei from Australia's telecommunications networks on national security grounds[4].

When Australia led international calls for an independent investigation into the origins of COVID-19 in early 2020, these political tensions boiled over into the bilateral trade relationship. In May 2020, China sought to sanction Australia by applying massive anti-dumping duties to barley exports, pricing the product out of its principal market. As political relations further deteriorated, coercive trade measures of some kind were progressively applied to another fifteen industries, ultimately covering all of Australia's major exports to China bar two: iron ore[5] and dairy products (Figure 2). A combination of formal (i.e. tariff and quota measures) and informal (e.g. arbitrary customs bans) were deployed to enact these sanctions. These measures are a clear example of China leveraging trade dependence to politically punish Australia.

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4 Jeffrey Wilson (2020), 'The Australia-China trade war: Vale the grand bargain', China Story. Available at: https://thechinastory.org/the-australia-china-trade-war-vale-the- grand-bargain/

5 Peter Ker (2020), 'Why China can't grow without Australian iron ore'. Available at: https://afr.com/companies/mining/why-china-can-t-grow-without-australian-iron-ore-20201204-p56knl

Figure 2 Coercive Chinese trade practices towards Australia

May 2020 – Barley: Imposition of an 80 percent tariff on Australian barley exports comprised of both anti-dumping and anti-subsidy components, which will price Australian barley out of the Chinese market. The Australia-China barley trade was worth $591 million in 2019.

May 2020 – Beef: Suspension of export licenses for four Queensland abattoirs, which collectively account for approximately one-third of beef exports to China. The Australia-China beef trade was worth $2.6 billion in 2019.

June 2020 – Tourism and education: The Chinese Ministry of Culture and Tourism issues an advisory warning against travel to Australia citing a "significant increase in racist attacks". Australia exported $12.1 billion of education services and $16.3 billion of travel services to China in 2018-19.

August 2020 – Wine: The Chinese Ministry of Commerce launches anti-dumping and subsidy investigations into Australian wine exports. Australia exported $1.2 billion of wine to China in 2019.

October 2020 – Coal: Several Chinese steel and electricity companies are instructed to cease buying Australian coal. The Australia-China coal trade was worth $13.8 billion in 2019.

October 2020 – Cotton: Chinese textile mills are instructed by the National Development and Reform Commission to cease buying Australian cotton under a WTO tariff rate quota of 1%. Australian cotton would instead by subject to a 40% duty. The Australia-China cotton trade was worth $1.1 billion in 2019.

November 2020 – Various products: Industry reports confirm that an additional eight commodities have been subject to "bans" by Chinese Customs. The commodities include wheat ($102m), wool ($2.4b), lobster ($707m), coal ($13.8b), sugar ($99m), copper ore ($2.3b), timber ($625m) and wine ($1.2b).

May 2021 – Table grapes: Chinese Customs imposes arbitrary delays on sanitary inspection of Australian table grape shipments, making supply chain management of exports unviable. The Australia-China table grape trade was worth approximately $250 million in 2019/20.

May 2021 – Liquefied Natural Gas: Industry reports confirm that two small Chinese gas importers (Shenzhen Gas and Beijing Gas) received "guidance" to stop making LNG purchases from Australia. The Australia-China gas trade was worth $16.1 billion in 2019.

Source: Wilson, 2021

The Chinese Government officially maintains it is pursuing technical measures of a non-political nature, enacted consistently with relevant bilateral and international trade rules. However, demands made by the Chinese Embassy in Canberra contradict this position. In November 2020, the Chinese Embassy provided Australian media with a list of 14 grievances against Australia. None of the grievances related to Australia's bilateral trade practices but rather, the government's political decisions, foreign interference laws, and positions on China's territorial disputes. Australian Government officials and many independent analysts and industry parties contend China's trade measures against Australia are without legal or technical merit. Coming at a time of deteriorating relations between the governments, many have argued they are instead a 'grey-zone' economic sanction in retaliation for recent Australian foreign policy actions[6]. Chinese state media and leaks from official sources have frequently described them as political sanctions for supposed Australian 'insults' to China[7].

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6 Darren Lim and Victor Ferguson (2020), 'In beef over barley, Chinese economic coercion cuts against the grain', Lowy Interpreter. Available at: https://lowyinstitute.org/the-interpreter/barney-over-beef-chinese-economic-coercion-cuts-against-grain; Ashley Townshend (2020), 'China's pandemic fuelled standoff with Australia', War On The Rocks. Available at: https://warontherocks.com/2020/05/chinas-pandemic- fueled-standoff-with-australia /; Jeffrey Wilson (2020), 'The Australia-China trade war: Vale the grand bargain', China Story. Available at: https://thechinastory.org/the-australia-china-trade-war-vale-the-grand-bargain/

7 Many incendiary examples abound but some of the most prominent include: Global Times (2020), 'Australia to pay heavy economic price, if acting as a US attack dog: experts'. Available at: https://globaltimes.cn/content/1188408.shtml; China Daily (2020), 'Yesman to one, liar to all', https://twitter.com/ChinaDaily/ status/1264677561264570373; Global Times (2020), 'Australia delusional in expecting normal trade amid tensions with China'. ABC News (2020), 'Australian officials respond angrily to fresh attacks from Chinese diplomat'.

While it is hard to quantify the net cost of these sanctions, estimates suggest they have cost the Australian economy close to $10 billion[8]. The Australian Government has formally sought consultations on the issue but China has refused to engage diplomatically. One Chinese government official has been quoted as saying that dialogue between the two nations would be "meaningless" while the "atmosphere is bad"[9] – the clear indication being, should Australia change its political stance on certain issues, then and only then could diplomatic talks to restart trade commence.

Spreading risk through economic diversification

As Australia's Trade Minister has argued, the most effective measure Australia can take to manage geoeconomic threats is economic diversification. At present, Australia's concentrated economic relationships magnify the effects of external shocks. In an era of geoeconomic conflict – and as recent experience with China reveals – outsized dependence on a single economic partner can become an 'exposure point' for strategic risk. Building more diversity into these relationships will spread risk, augment shock resilience, and reduce the impacts of political coercion if it occurs.

Importantly, diversification does not mean engaging less with existing partners. Trading less with China, or investing less with the US and Europe would simply make Australia poorer. Rather, it demands that future growth efforts are directed at building new or stronger ties with hitherto under-realised partners. Australia is well-positioned for this as the Indo-Pacific region is home to many of the world's fastest growing major economies including India, Indonesia and Vietnam. Realising the potential of these nascent relationships should be Australia's top foreign economic policy priority.

On the trade front, diversification efforts should focus on developing new export relationships for industries which are dependent on a single large market. Recent Australian trade initiatives – including Regional Comprehensive Economic Partnership, the bilateral trade agreement with Indonesia, and economic diplomacy with Vietnam – are steps in the right direction. As are a suite of Australian trade diversification policies announced in the last six months, designed to aid affected businesses in building new markets with greater breadth and resilience.

Working with international partners

As a middle power, Australia's most successful responses to global challenges – whether economic, security or diplomatic – have come via working through international coalitions. These are a force multiplier for Australia, pooling political and economic resources with others to deliver better results than acting alone. And, in an era where consensus behind economic openness is faltering, coalitional diplomacy will need to focus on partners that share Australia's commitment to liberal principles. This will necessitate a shift from multi- to minilateralism in economic diplomacy, where smaller groups of likeminded governments come together to advance cooperation in functional areas.

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8 Jon Daly, Daniel Mercer and Wing Kuang (2021), 'Is the dream over? Amid China's trade war, producers grapple with new world order. Available at: https://abc.net.au/news/rural/2021-05-17/after-12-months-of-the-trade-war-is-the-china-dream-over/100127874

9 Jonathan Kearsley, Eryk Bagshaw and Anthony Galloway (2020), ''If you make China the enemy, China will be the enemy': Beijing's fresh treat to Australia'. Available at: https://smh.com.au/world/asia/if-you-make-china-the-enemy-china-will-be-the-enemy-beijing-s-fresh-threat-to-australia-20201118-p56fqs.html if-you-make-china-the-enemy-china-will-be-the-enemy-beijing-s-fresh-threat-to-australia-20201118-p56fqs.html

Several efforts in this direction have already begun. Most notable was Australia's recent invitation as an observer to the G7 Summit in Cornwall, where the Prime Minister dedicated significant efforts to building a coalition in support of the rules-based trade system. Another is Australia's decision to refer two of China's sanctions – on barley and wine – to the World Trade Organisation's dispute settlement mechanism, where global level adjudication can be brought to bear on the issue. By 'multilateralising' these trade coercion issues, Australia is attempting to shift the playing field away from a bilateral mode, where size relativities vis-a-vis China dominate, to one where a coalition of likeminded partners can be brought to bear. This is an effective defensive strategy for a middle power seeking to preserve a rules-based approach to trade relations.

Importantly, Australia is not alone in its vulnerability to geoeconomic coercion. Most other open and liberal economies – across Europe, Asia and North America – face similar challenges. Major global shocks will continue to impact markets and the dynamic, grey-zone nature of geoeconomics means it is likely to form part of the geopolitical toolkit into the future. As such, all countries should seek to adapt to this reality through implementing protective counter-measures such as economic diversification and working with like-minded countries in minilateral frameworks. In this way, this is not only a path forward for Australia but also the path for other countries to adapt to an era of geoeconomic contestation.

About the Authors

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