

# WebMemo



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## Australia–China Economic Relations: A Lesson for the U.S., Not a Threat

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China is rising in importance for Australia economically. What does this mean for security relations? Not what some people—including very influential, serious Australians—seem to think.<sup>1</sup> There is nothing about China's economic rise that gives it effective leverage over Australian foreign and defense policy or that necessarily supplants American leadership in the Asia–Pacific over the long term.

**Economic Benefits.** The growth and extent of Sino–Australian economic ties is impressive. From 2001 to 2010, according to Chinese data, the PRC's overall trade volume increased a dramatic 5.8 times. Sino–Australian trade volume surged 9.8 times. The bulk of the gain came from Australian exports to China, which skyrocketed from \$5.4 billion in 2001 to \$60.9 billion in 2010.<sup>2</sup> According to Australian data, the PRC is now Australia's largest trade partner by far, accounting for nearly one-fifth of goods trade.<sup>3</sup> Australia runs a sizable trade surplus with China.

Iron ore is the core. China spent almost \$80 billion on ore in 2010, and almost 40 percent of that came from Australia.<sup>4</sup> Iron ore comprised about half of Australia's total exports to China.

Investment numbers are less well known but also impressive. China's cumulative foreign direct investment in Australia is unremarkable. However, when equity investment is included, recent years have seen heavy Chinese concentration on Australia. The Heritage Foundation's China Global Investment Tracker puts Australia as the top Chinese non-bond investment destination at \$34 billion

from 2005 to 2010.<sup>5</sup> This is comparable to the total for Europe and considerably more than the U.S. received, despite Australia's far smaller population and comparatively small gross domestic product.

The most famous transaction is Chinalco's two-stage \$14.3 billion investment in Rio Tinto, which involved but was not limited to iron ore. Chinese acquisitions of stakes in Australian coal have exceeded \$5.5 billion since 2005. Other sectors have included natural gas and shipping.

Trade and investment enable Australia to share the wealth created by the PRC's rapid growth. Partly buoyed by Chinese demand—but also partly attributable to 25 years of Australian economic reform—Australia saw only one quarter of economic contraction during the financial crisis. It had no trough from which to recover. Growth in 2010 was a reasonable 2.7 percent, and unemployment was an enviable 5.1 percent. Using nominal exchange rates, Australia ranks as the world's sixth richest country. Correcting for purchasing power and excluding micro states, it ranks near the top 10 in average income.<sup>6</sup>

**Economic Risks.** It is underappreciated that economic ties with China bring risks. The obvious one

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for Australia is commodity dependence. Iron and coal are by far the country's biggest exports, the top 10 goods exports are commodities, and only education and tourism crack the top 10 when services are included. Iron dominates trade with China, and coal is about equal in value to all services exports to the PRC.

Chinese demand for fossil fuels will continue to rise, and demand for metals is hardly going to collapse. Rapid export gains for Australia, though, cannot last and may fade relatively soon. The PRC's steel sector suffers from gross overcapacity and must contract, hitting iron and coal.<sup>7</sup> Australia can supply China with a great deal of natural gas, but it faces considerable competition and has already lost a large gas deal with China.<sup>8</sup>

It is possible that Chinese demand for consumer goods will soar over the next decade. However, Australia is in a poor position to take advantage of this. The economy is now heavily skewed toward resources, and even if capital and labor could shift to finished goods, transport costs give China's market edge to Japan and Korea.

Another possibility seems to get little attention in Australia: The PRC's seemingly unstoppable climb

may end in a protracted stall. This is, of course, what happened to Australia's second largest trade partner, Japan.

There are multiple similarities between Japan in 1991 and China in 2011: size, export prowess, commodity needs, long-term growth threatened by sharply weakening demographics, and declining return to capital due to continued attempts at short-term stimulus. China also faces sharp environmental deterioration—the economic returns from labor, capital, and land all signal an end to the PRC's rapid growth.

**The Question of Leverage.** So Australia is making money hand over fist by selling natural resources to China—hats off. The relationship benefits tens of millions of individuals in both countries. Why does it follow in this mutually beneficial relationship that the seller must accommodate political pressure from the buyer? That certainly does not appear to be what has happened in global oil markets for the past 35 years.

China's double-digit increases in defense spending, its aggressiveness in seas to its east and south, and its thousand or so missiles trained on Taiwan should greatly concern Australia's policymakers.

1. See Hugh White, "Power Shift: Australia's Future Between Washington and Beijing," *Quarterly Essay*, No. 39, September 2010, at <http://www.quarterlyessay.com/issue/power-shift-australia%E2%80%99s-future-between-washington-and-beijing> (March 9, 2011).
2. National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 12, 2001, to Vol. 1, 2011.
3. Australian Government, Department of Foreign Affairs and Trade, "Trade at a Glance 2010," at [http://www.dfat.gov.au/publications/trade/trade\\_at\\_a\\_glance\\_2010.pdf](http://www.dfat.gov.au/publications/trade/trade_at_a_glance_2010.pdf) (March 9, 2011).
4. Xinhua, "China's Iron Ore Imports Drop Last Year as Production Costs Rise," February 24, 2011, at [http://news.xinhuanet.com/english2010/china/2011-02/24/c\\_13747703.htm](http://news.xinhuanet.com/english2010/china/2011-02/24/c_13747703.htm); Australian Government, Department of Foreign Affairs and Trade, "Composition of Trade: 2009," at <http://www.dfat.gov.au/publications/stats-pubs/cot-cy-2009.pdf> (March 9, 2011).
5. Derek Scissors, "China Global Investment Tracker: 2011," The Heritage Foundation, January 10, 2011, at <http://www.heritage.org/research/reports/2011/01/china-global-investment-tracker-2011>.
6. Australian Bureau of Statistics, "Key National Indicators, 2007," at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/1345.0?opendocument?opendocument> (March 9, 2011); U.S. Central Intelligence Agency, "The World Factbook: Australia," March 1, 2011, at <https://www.cia.gov/library/publications/the-world-factbook/geos/as.html> (March 9, 2011).
7. Derek Scissors, "The 'Beijing Consensus' in Energy and the Environment," Heritage Foundation *WebMemo* No. 2970, July 26, 2010, at <http://www.heritage.org/Research/Reports/2010/07/The-Beijing-Consensus-in-Energy-and-the-Environment>; David Stanway, "China Steel Has Last Chance to Restructure—Angang," Reuters, March 5, 2011, at <http://af.reuters.com/article/metalsNews/idAFTOE72400B20110305> (March 9, 2011).
8. Reuters, "Factbox: China's Liquefied Natural Gas Import Deals," February 24, 2011, at <http://www.reuters.com/article/2011/02/25/china-lng-deals-idUSTOE71003020110225> (March 9, 2011); Peter Smith, "China–Australia \$40bn Gas Deal Expires," *Financial Times*, January 4, 2010, at <http://www.ft.com/cms/s/0/112f80bc-f903-11de-80dc-00144feab49a.html#axzz1FxpZiOA> (March 9, 2011).

There is no reason why Australia cannot speak its mind on these issues and others, including human rights, for fear of economic repercussions. China's economic growth provides no objective reason to lose faith in American leadership.

China's economic rise is an opportunity for Australia, not a threat. Neither is it a threat to the U.S. The China threat is political/military in nature, and it is growing as much from American hesitance as from Chinese action. The U.S. should make the most of its economic relationship with China, even as it pushes back on the political/security side of the relationship.

#### **What the U.S. Should Do:**

***Play the International Economic Game.*** China's economic development has caused serious dislocation, but it has also brought huge benefits to many, perhaps led by Australians. Some of the gains for Australia have been and continue to be available to the U.S. For example, the U.S. has more natural gas and far more coal than Australia, yet Chinese investment in American resources was nonexistent until just a few months ago. The American investment review process should be simplified, learning from Australia's Foreign Investment Review Board.

***Get Back in the Asia-Pacific Trade Game.*** The problem with the U.S. economic position in Asia is not China's ties to Australia and others but America's own sclerotic trade policy. Conclusion of the U.S.–Korea Free Trade Agreement after three years of lost opportunity is welcome. Now the Administration should see it through to final passage and not leave the U.S. trade position in Asia hostage to protectionism aimed at Colombia and Panama.

The Administration also needs to show fruit from its negotiations on the nine-nation Trans-Pacific Partnership (TPP), which includes Australia. TPP currently appears unlikely to make a November completion deadline. Anything less than an agreement on the eve of an election year will be correctly perceived as empty.

***Stay Fully in the Security Game.*** Investments should be made in America's military that are indicative of a long-term presence in the Pacific. The U.S. Navy is currently running at least 30 fewer ships than it says it needs and is heading lower. This must be addressed.

In addition, the American commitment to Taiwan's security should be kept in deed as well as word. There can be only one reason the Obama Administration refuses to sell Taiwan the arms it requested to address the imbalance across the Taiwan Strait: It fears China's reaction. It is understandable if friends and allies such as Australia believe they see in this the coming eclipse of America's power.

***Nothing to Fear.*** Australian Prime Minister Julia Gillard, as evidenced by the tributes to the U.S.–Australia alliance that she is paying in Washington this week, seems to understand that there is nothing inconsistent in supporting an American-led order in the Asia-Pacific and close economic relations with China. This is a point that American policymakers should better understand.

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