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ECONOMIC POWER AND VULNERABILITY IN SINO-AUSTRALIAN RELATIONS

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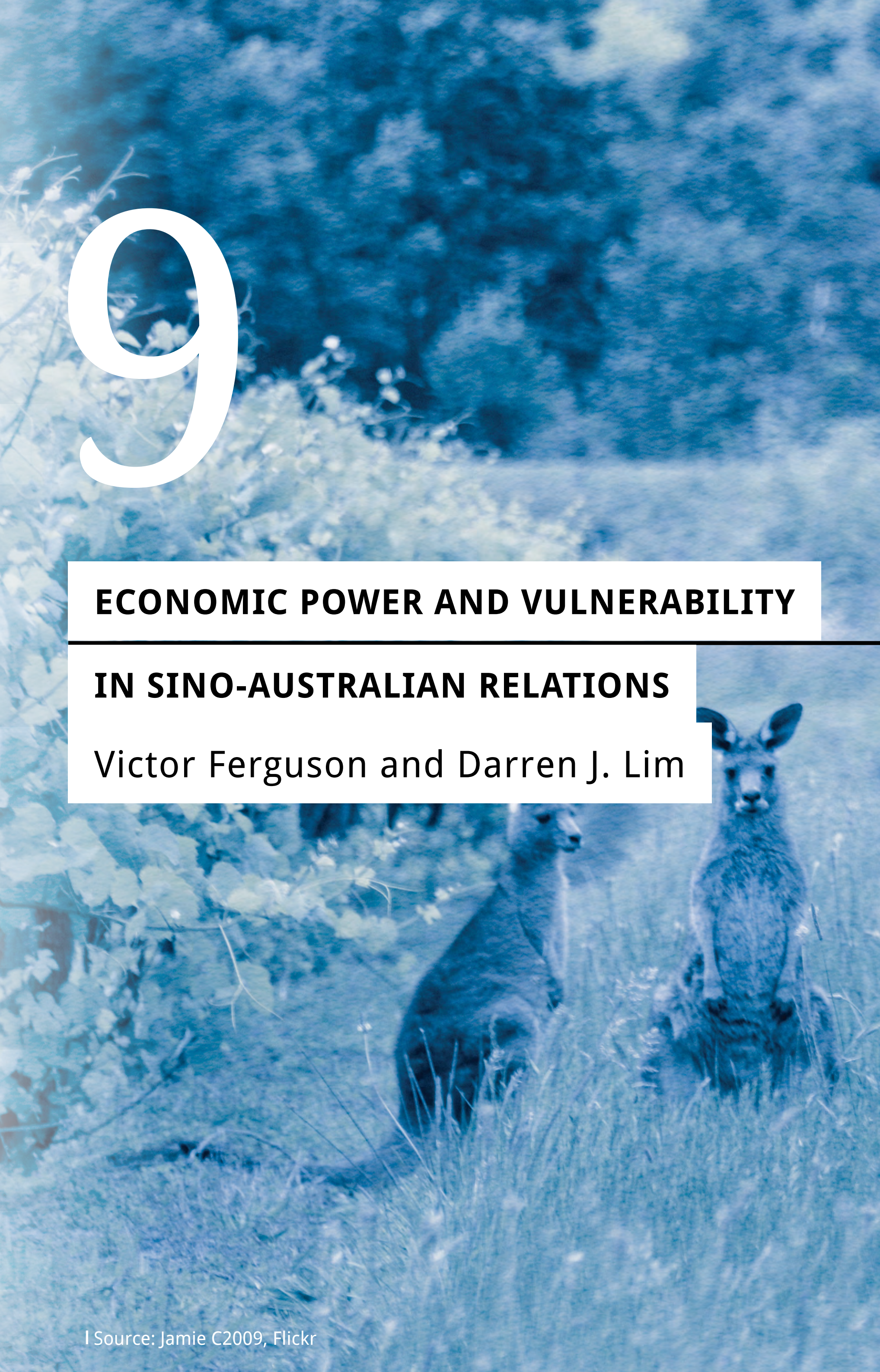

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FOR MORE THAN TWO DECADES, Australia's leaders have expressed the expectation, or perhaps the hope, that the country's mutually beneficial trading relationship with the People's Republic of China (PRC) would flourish regardless of occasional political disagreements between Canberra and Beijing. Despite different political systems, divergent values, and Australia's steadfast commitment to the US alliance, many inside the Australian government insisted that 'cold politics' would not extinguish 'hot economics'.

Such public optimism was maintained by Canberra over the past decade, despite growing evidence of China's willingness to use its geoeconomic power by leveraging trade relationships to resolve political disputes. In 2010, Norwegian salmon exports were suspended following the awarding of the Nobel Peace Prize to a Chinese dissident. In 2012, bananas from the Philippines rotted in Chinese ports following a maritime confrontation in the South China Sea. And in 2017, Chinese group tours to South Korea were banned during a dispute over a missile defence system. Other alleged cases of Chinese economic coercion have featured targets as diverse as Mongolia, Japan, and Canada.

Cheng Jingye, China's Ambassador to Australia, described Australia's push as 'dangerous' and 'irresponsible'
Source: Sophie Paris, CTBTO Photo

Until 2020, however, Australia had mostly managed to avoid such an experience.[1] Despite a recent downward spiral in political relations — strained by, among other things, Australia's 2017 foreign interference legislation, the 2018 exclusion of Huawei from the 5G network and criticism of Chinese actions in the South China Sea — bilateral trade had not experienced much, if any, obviously politically motivated disruption.[2] Then, on 19 April, the Morrison government called for an independent inquiry into the origins and spread of COVID-19.

The Chinese government swiftly denounced Canberra's proposal as a political attack. In a now infamous interview with the *Australian Financial Review*, Cheng Jingye 成竞业, China's Ambassador to Australia, described Australia's push as 'dangerous' and 'irresponsible', before speculating on how China might respond:

> The tourists may have second thoughts. Maybe the parents of the students would also think whether this place, which they find is not so friendly, even hostile, is the best place to send their kids to … And also, maybe the ordinary people will think why they should drink Australian wine or eat Australian beef?[3]

The comments stirred controversy and prompted Australian Foreign Minister Marise Payne to publicly denounce attempts at 'economic coercion'.[4] They also proved to be prescient: over the coming months, each of the industries the ambassador identified experienced some form of disruption in their trade with China.

Power and Sino-Australian Economic Interdependence

Successful economic coercion relies on an asymmetry in the costs of forgoing a trade relationship: the lost trade must be relatively less costly for the party doing the coercing. For most of the past twenty years, Australia's resource-heavy export mix underpinned a belief that, should China have any reason to coerce Australia, it would be constrained in so doing. Australian commodities such as iron ore and coal have been vital inputs into China's manufacturing and construction industries and are not easy to replace with alternatives. Australia's supposed invulnerability derived from the assumption that any benefits for China from disrupting this trade for coercive purposes would be outweighed by political problems arising from the damage to the Chinese economy.

By 2020, there were three significant challenges to the status quo. First, the rise of trade in services — particularly education and tourism — meant resources were no longer the only story in Australia's exports to China. In the 2018–2019 financial year, education ranked as Australia's fourth-largest export, while tourism ranked sixth.[5] China remained the

most important market for both sectors and major disruption to them could cause significant damage to the Australian economy, as the COVID-19 border closures illustrated.

Meanwhile, a maturing Chinese economy was changing the Chinese government's economic calculus. With export-led growth slowing, concerns about other interests, such as pollution, resource security, and the self-sufficiency of Chinese producers, served to lower the demand for various categories of foreign imports. The less essential an import category was to the domestic Chinese economy, the easier it was to justify disrupting it for coercive purposes.

The third and perhaps most important factor was the shift in Beijing's global political interests. The PRC is now a confident and assertive major power with an expanded set of interests that are increasingly coming into conflict with those of other countries, including Australia. Meanwhile, the authoritarian Chinese Community Party (CCP) under Xi Jinping 习近平 has faced growing criticism both at home and abroad. As a result, it has become increasingly focused on defending against threats to its political legitimacy.[6] Such threats can be perceived in international reproach of events and policies in Xinjiang and Hong Kong, or suggestions that Beijing is responsible for the COVID-19 pandemic. The stronger the CCP's political interests in an issue, the greater economic costs it will endure to protect them.

In the 2018–2019 financial year, tourism ranked as Australia's sixth-largest export
Source: Rambo2100, Flickr

These three gradual changes cumulatively created the conditions in which Australian vulnerability to economic coercion was greater than it had been in the past.

Barley

The first apparent instance of retaliation was China's imposition of anti-dumping and anti-subsidy tariffs on Australian barley. On 10 May, China's Ministry of Commerce (MOFCOM) announced a determination that Australian barley growers had received illegal subsidies and 'dumped' their produce in China at predatory prices, undermining local competitors. Tariffs of 80.5 percent were imposed on 18 May, to remain in place until 2025.

Some Australian commentators argued the tariffs were coercive sanctions.[7] MOFCOM denied this, calling them 'a normal trade remedy'. The Australian government distanced itself from arguments that the tariffs were political, though Trade Minister Simon Birmingham said he could 'understand why people draw those links'.

There is reason not to jump to conclusions. The Chinese investigation that led to the tariffs was launched in 2018, long before COVID-19. At that time, it appeared to be retaliation for Australia's own anti-dumping measures on Chinese products — an issue of trade, not politics.[8]

It just so happened that the eighteen-month investigation time limit coincided with the bilateral political row, and in the middle of the season for planting winter crops. Perhaps the tariffs would have been imposed regardless. Nevertheless, it is unlikely that Beijing failed to understand that they would be perceived as coercive, especially after the ambassador's comments and the expression of similar hypotheticals in Chinese state media editorials.[9]

The tariffs effectively cut off the barley industry's most important market. Since 2014–2015, China had purchased approximately 50 percent of Australia's barley exports for an average of AU$1.2 billion annually.

China's tariff on Australian barley sent shockwaves through grain industry
Source: Mark Seton, Flickr

The Australian Bureau of Agricultural and Resource Economics estimates that losing the China market will cost barley growers about AU$330 million a year, although some farmers claim that losses could amount to up to AU$1 billion a year.[10] Growers can offset some costs by shifting to alternative crops and diverting exports (albeit for lower prices). However, the tariffs are still a significant blow to the Australian agricultural sector. Subsequent reports of an 'informal ban' on Australian barley and the suspension of imports from two of Australia's largest grain exporters, CBH and Emerald Grain, suggest the market may remain inaccessible for some time regardless of the tariffs.[11]

Why was barley vulnerable? First, Australian barley is relatively substitutable, partly because barley can be sourced elsewhere (although not necessarily at the same price or volumes), and also because, as a livestock feed, it can be replaced with other grains. While there are some costs for Chinese importers, they are not so great as to disrupt the wider economy.[12] By contrast, it is harder for Australian growers to find alternative export markets. Second, by framing the tariffs as a remedy for Australian violations of international trade rules, China has 'plausible deniability': it can plausibly claim that they are not coercive sanctions.[13] Although China's legal arguments may not stand

up, the process of challenging them may take years and a finding in Australia's favour will not undo the interim economic damage. Finally, as University of Queensland agricultural economist Scott Waldron persuasively argues, ending imports of Australian barley may suit China's domestic agricultural policy objectives relating to food security and import diversification.[14]

Beef

On 12 May, between announcing and imposing the barley tariffs, China suspended imports from four Australian abattoirs, citing 'serious' and 'repeated' violations of Chinese customs and quarantine requirements. Once again, China denied the suspensions were coercive and the Australian Government downplayed the political angle, describing the measures as related to 'highly technical', isolated issues concerning labelling and health certificates.[15]

Nevertheless, the suspensions raised eyebrows. This was partly due to the timing and partly because of China's track record of using similar regulatory quibbles to disrupt trade during disputes with other countries. The suspensions, Perth USAsia Centre research director Jeffrey Wilson concluded, were 'unquestionably political retribution'.[16]

A fifth abattoir was delisted in August after Chinese customs allegedly detected residues of a banned antibiotic in a consignment of beef. That announcement came one day after Prime Minister Scott Morrison announced new legislation enabling the federal government to terminate agreements made between Australian states and foreign governments that are deemed by the Foreign Minister to be inconsistent with national foreign policy; Victoria's Belt and Road Initiative (BRI) deal with Beijing could be subject to such a review. While Australian Agriculture Minister

David Littleproud stated that China's concerns about the beef were 'quite legitimate', industry insiders noted that the antibiotic in question had not been detected in Australian beef for a decade.[17]

The affected abattoirs together supply approximately one-third of Australia's AU$1 billion annual beef exports to China. Exports for the first three quarters of 2020 were down 22 percent compared with the same period in 2019, and China slipped from Australia's first to fourth-largest export market for beef in July.[18] Yet other contributing factors to the fall included decreasing demand in China, Chinese regulations requiring COVID-19 testing of imported meat products, and the application of safeguard tariffs to Australian beef in early July.[19] By expanding the list of approved suppliers from other countries, Beijing has also encouraged importers to shift to alternative markets. This may create future issues for Australian exporters. As one Chinese market analyst noted: 'It will be hard for Australian beef suppliers to regain the market share once Chinese consumers get used to the beef from other countries.'[20]

If the motivations were political, the logic of targeting beef is that it is relatively easy for China to substitute Australian imports and — like other agricultural goods — trade can be easily disrupted by opaque applications of technical regulatory rules. However, it is impossible to be certain. That some of the abattoirs had previously been suspended for label violations and that one of the implicated factories is wholly Chinese-owned support the case that there was a genuine issue. Alternatively, these same facts offer the cover of plausible deniability for a coercive measure undertaken at a time of high tension.

Tourism and Education

In June, citing media reports about increased attacks and discrimination targeted towards 'Chinese and Asian people' in Australia, the Chinese Ministry of Culture and Tourism alerted citizens against travel to

Australia. The following week, China's Ministry of Education cited the same 'discriminatory events', warning Chinese students to be 'cautious' about choosing Australia as a study destination. In July, in what appeared to be direct retaliation for Australian government warnings about the risk of 'arbitrary detention' in mainland China, the Chinese government upgraded its travel advice to warn that 'Australian law-enforcement institutions arbitrarily search Chinese citizens and seize their assets'.[21]

Were these warnings given out of genuine care about the welfare of Chinese travellers or were they a message to Canberra? The case for the latter turns on the timing, the fact that ambassador Cheng had publicly singled out the sectors and China's history of using travel warnings and other policy instruments to deter Chinese citizens from travelling to specific countries during political disputes.[22]

In 2019, China was Australia's top source of short-term visitors — about 15 percent of the total. Chinese travellers were also the highest spenders, contributing about 27 percent of the AU$45 billion spent by foreign tourists.[23] This is partly due to the large number of Chinese nationals studying in Australia, who continue to make up the largest cohort of international students at Australian universities (approximately 38 percent),[24] and were responsible for AU$12.1 billion of the total AU$37.6 billion international education exports in 2018–2019.

It is difficult to measure the impact of the warnings given that Chinese citizens were unable to travel to Australia due to the pandemic. Study visa lodgements by prospective Chinese students decreased by 20 percent in the 2019–2020 financial year. Due to the general uncertainty stemming from COVID-19 and border closures, however, visa applications from other countries were also down — some by greater percentages, including India at 47 percent and Nepal at 61 percent.[25] While there is some evidence that Chinese students and tourists take travel warnings seriously, with borders still closed, it is too early to identify the impact on travel or enrolment numbers.[26]

What is the logic of disrupting travel to a country that had already closed its borders? Reports of increased racist behaviour in Australia gave Beijing scope to plausibly deny that the warnings were sanctions in disguise.[27] They caused Beijing no pain to issue, either. While their practical impact may have been limited, the warnings signalled Chinese displeasure, put pressure on the Australian government and stirred debate about the vulnerability of the tourism and education sectors to coercion.

Wine

In August, MOFCOM announced new investigations into allegations that Australian wine exporters had been receiving illegal subsidies and 'dumping' their wares in the Chinese market at predatory prices. A spokesperson from China's Ministry of Foreign Affairs described the investigations as 'normal' and advised Australians not to draw 'unnecessary associations'. Within twenty-four hours of the first investigation being launched, however, the Australian government declared the allegations 'baseless', while winemakers and analysts derided the probe as a politically motivated sanction.

Again, there are reasons to believe China has plausible legal complaints.[28] However, the timing of the probes — coming amid unprecedented tensions in the bilateral relationship — suggests they are political. Chinese state media had been hinting for months that wine could be targeted, especially after Australia joined the US in denouncing China's legal claim to most of the South China Sea in July.[29] Wine also featured in ambassador Cheng's April comments.

Investigations do not directly disrupt trade, but they flag the possibility of future restrictions. Such signalling can impose costs on a target country's markets. The share price of Australia's largest winemaker, Treasury Wine Estates, collapsed more than 28 percent over the week following Ministry of Commerce's announcement. Concerns were also raised that Chinese

Chinese students decreased by 20 percent in the 2019–2020 financial year
Source: ANU Image Library, Flickr

importers might pre-emptively shift to alternative suppliers to hedge against the risk of a proposed 202 percent tariff should investigations conclude there had been trade violations. Australian winemakers could see their largest export market, worth AU$1.2 billion in 2019, shrink regardless of whether tariffs are ultimately imposed. Meanwhile, there is little the Australian government can do beyond consult with the industry, file formal responses, and prepare for a possible World Trade Organization (WTO) challenge.

The impacts on Australian wine suppliers illustrate how investigations can be used as coercive sanctions while guaranteeing China plausible deniability.[30] They are a relatively low-cost tool for China to ratchet pressure on Australia up or down: if political relations improve, they might opt to withdraw the investigations; if relations continue to deteriorate, they can escalate by imposing tariffs.

Wine is highly substitutable, with ready alternatives to Australian wines, including from France, Chile, and South Africa. The possibility of tariffs might upset enthusiasts of Penfolds Grange and adversely affect

those Chinese citizens who have invested millions in Australian wine businesses,[31] but it will hardly disrupt the Chinese economy or lead to civil unrest.

Lessons on Economic Power and Vulnerability

In the final months of 2020, after this chapter had been written, Australia's export industries experienced a new series of disruptions. In mid-October reports emerged that Beijing had issued verbal instructions for traders to cease importing Australian cotton and coal.[32] Two weeks later, as exporters of those products began to see orders cancelled, the disruption spread. Chinese customs officers seized tonnes of Australian lobster for testing, citing concerns about metal content levels, and halted imports of Australian timber after allegedly discovering pests.[33] At the same time, the *South China Morning Post* reported that traders had received new informal instructions about a forthcoming import ban on seven Australian products: timber, lobster, copper ore and concentrate, sugar, wheat, barley, and red wine.[34] The full consequences of these new measures remain

Australian wine sold in a liquor store
Source: Maxim75, Wikimedia

unclear, however, they and the cases described above lend themselves to several conclusions about the nature of power and vulnerability in the Sino-Australian economic relationship.

The first regards the changing composition of Sino-Australian trade. As Australian exports continue to diversify away from natural resources into services and consumer products, they will inevitably become more substitutable and thus more vulnerable to coercion. This will not render Australia helpless — among other things, less dispensable resource commodities will continue to make up a large share of exports to China — but it does underscore the need for broader recognition that we no longer live in an era when the inherent qualities of Australian exports insulate them from any disruption.

Second, while the range of vulnerable industries may be broadening, those that are actually targeted are not random. One signpost is Chinese domestic policy goals, which often guide the selection of targets. Barley is a good example of this. Chinese agricultural policy promotes food security through import diversification and increased domestic production — a goal at odds with high levels of Australian barley imports.[35] A similar logic also appeared to underpin the disruption experienced by South Korean electric vehicle battery makers in 2017–2018, whose competitiveness in the Chinese market was at odds with Beijing's efforts to support domestic firms like Contemporary Amperex Technology (CATL).[36] It might also be relevant to the two 'unofficial' bans on Australian coal and cotton exports that were reported in October. Beijing's apparent instructions to steel mills and energy providers to cease importing Australian thermal and coking coal are consistent with new Chinese plans to significantly slash coal consumption and carbon emissions. Likewise, China may be concerned about protecting domestic cotton producers confronted with low demand for textiles and a glut of foreign supply in 2020.[37]

Third, even where Beijing does wish to disrupt trade, it is constrained by its unwillingness to acknowledge formally that disruption is related to politics. This helps avoid legal liability and provides flexibility to wind

down the disruption without admitting 'defeat' once the other issues are resolved or tensions decrease. To maintain plausible deniability, Beijing requires both an alternative explanation — such as alleged breaches of customs requirements (as for beef) or international trade rules (as for barley and wine) — and regulatory tools such as the anti-dumping framework or discreet mechanisms such as travel warnings. Yet the plausible deniability constraint may be fading; the breadth of the bans apparently instituted towards the end of 2020, combined with the 'fourteen points' document released to the Australian media in late November apparently listing Beijing's political demands, make continued denial of economic retaliation extraordinarily difficult to sustain.[38] This might suggest Beijing's approach to the dispute has moved into a new phase, where it values the benefits of plausible deniability less than the scope to disrupt a broader range of Australian trade. Time will tell.

Finally, economic coercion is unlikely to involve China fundamentally upending the bilateral trading relationship in the short to medium term. Beijing's approach to geoeconomics has not involved applying 'maximum pressure' on a target economy in the style of the United States' comprehensive sanctions on Iran or North Korea. Instead, Chinese sanctions are more selective, designed to strike a careful balance between signalling displeasure and creating meaningful political pressure on their target while being (mostly) deniable, minimising the cost to China and facilitating domestic policy objectives. Nevertheless, the fog created by Chinese denials and the fact that booming iron ore exports saw overall trade actually increase in 2020 should not cloud the ongoing risk faced by Australian exporters. Moreover, longer-term Chinese planning, such as the "dual circulation" concept sitting at the heart of Beijing's latest five-year plan, suggest that Beijing's own efforts to diversify its import sources and achieve greater self-sufficiency may affect its trading relationships regardless of bilateral tensions.[39] (See Chapter 4, 'The Chinese Economy: Crisis, Control, Recovery, Refocus', pp.103–116.)

Head office of the Department of Foreign Affairs and Trade, Canberra, Australia
Photo: Adam Carr, Wikimedia

There is a clear need to deepen understanding of the nature of political risk in the economic relationship with China. Consideration of the kinds of factors discussed here, including relative substitutability and the relationship between disruption and domestic policy goals, could assist the government in identifying vulnerable industries and even individual companies in advance. Advance consultation with exporters could allow them to anticipate potential forms of disruption and take steps to minimise their exposure to political risk in the Chinese market.

The reality is that some industries will remain vulnerable even with flawless customs paperwork or impeccable sanitation standards. Reports that both Australia's domestic intelligence agency, the Australian Security Intelligence Organisation (ASIO), and the Department of Foreign Affairs and Trade are actively engaging with the private sector to ensure they are mindful of these risks are reassuring.[40] Some industry actors also appear to have a growing understanding of how economic coercion works — in

'Squeeze a piglet, make it squeal and the big sow will come running ... [T]he industry is getting better at not responding because that's what China wants'
Source: laughingmonk, Flickr

particular, that it often relies on economic disruption prompting firms to lobby their governments to change policies to accommodate the concerns of the coercing state. In the words of the chief executive of the Western Australian Farmers Federation: 'Squeeze a piglet, make it squeal and the big sow will come running … [T]he industry is getting better at not responding because that's what China wants.'[41]

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