Political risks for the Australia-China agriculture trade

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The Perth USAsia Centre’s Indo-Pacific Analysis Briefs seek to provide perceptive and contemporary insights from across the region. The series features leading analysts from Asia, Australia and the US to deliver up-to-the-minute assessments on issues of national and regional importance. This series will shine a light on the issues that remain critically important to Australia and the Indo-Pacific at a time when global events may otherwise dominate the news cycle.

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In the last decade, China has emerged as Australia’s most important agricultural partner. It is Australia’s fastest growing market, and presently accounts for one-third of agricultural exports.

However, deteriorating political relations between the Chinese and Australian governments have cast a shadow over the bilateral trade. In recent months, China has applied punitive trade barriers to barley and beef exports, with the possibility that more sectors may be affected.

Developments in the US-China trade war compound these challenges. China has agreed to double imports of US farm goods under the “Phase One” trade deal, which will displace other suppliers such as Australia from the market.

As a result of these two political shocks, Australian agriculture now faces unprecedented headwinds its largest export market. The grains, beef, seafood, dairy, wine, horticulture and cotton trades with China are at greatest risk.

The Australian farm sector should diversify its trade by focusing market development on less risk-exposed markets in the Indo-Pacific. Vietnam, India and Indonesia (particularly in light of the IA-CEPA agreement) should be accorded immediate priority.
1. **Australia’s booming agricultural trade with China**

China has recently emerged as the most important trade partner for the Australian agricultural sector. China’s large and fast-growing domestic economy, efficient trade infrastructure, geographic proximity, and increasingly sophisticated consumer food market have driven a rapid increase in Australian agricultural exports. In the last decade, exports quadrupled to $16 billion per annum (Figure 1). Beef, wool, processed foods, meat, wine, cotton, horticulture and seafood have been the leading farm products to establish a strong presence in the Chinese market.

It is widely believed that the China-Australia Free Trade Agreement (ChAFTA) has been the principal factor behind export growth. ChAFTA contained significant agricultural market access provisions, including for beef, dairy, wine, seafood, and several horticultural and grains products. However, as Figure 1 illustrates, ChAFTA has not markedly changed the trajectory of the bilateral trade. This has maintained a consistent growth rate since 2009, with no discernible increase following ChAFTA’s entry-into-force in December 2015. Rather, the attractiveness of Australian products to Chinese buyers, growing Chinese consumer demand, and concerted marketing efforts from Australian agribusiness have driven increases in the trade.

This has seen a dramatic reorientation in Australian agriculture towards the Chinese market. In the decade to 2019, exports to China have grown at an annual average of 17 percent, considerably higher than the 2.5 percent annual growth for all other export markets. Nearly two-thirds of all agricultural export growth during this period has been due to the Chinese market. China has increased from 11 to 32 percent of national exports, displacing Japan as the largest market in 2011. It is now far more important than any other trade partner for the Australian farm sector, towering over Japan (12 percent), the US (9 percent), Korea (6 percent) and Indonesia (5 percent). For a decade now, the performance of Australia agricultural exports has been principally driven by dynamics in the Chinese market.

**Figure 1** Australian agricultural exports to China, 2006-19 and trend

Source: Author’s calculations, from DFAT. Note: Percentages indicate China share of Australian exports in 2009, 2014 and 2019.
As a result, the Australian farm sector now faces a very high level of exposure to China. However, the degree of exposure varies dramatically amongst agricultural subsectors (see Figure 2). In six products – wool, processed food, cotton, timber, seafood and barley – China accounts for over half of Australian exports, in some cases exceeding 80 percent. But in other major lines, including wheat, vegetables, oilseeds, sugar and animal feed, it is only a minor market. Even in beef, the single largest agricultural export to China at $2.7 billion in 2019, China market exposure is less than the sector-wide average at only 24 percent. This indicates that exposure to China is highly uneven, with some subsectors benefiting significantly while others have remained focused on traditional markets.

**Figure 2** Exposure to China in Australian top-20 agricultural exports, 2019

Source: Author’s calculations, from DFAT[^4]. Note: Numerical figures indicated value of Australian exports to China in AUD millions.
2. Political risks to Australia-China agricultural trade

As the Australian agriculture sector has reoriented to China, its risk exposure to economic and political developments in that market have dramatically increased. During the 2010s, very few such risks presented themselves. Australian agribusinesses were very successful in targeting their marketing to capture growing Chinese demand, while ChAFTA lowered the regulatory barriers required to do so. Relatively harmonious diplomatic relations also meant there were few political obstacles to bilateral agricultural trade.

Bilateral political issues would eventually present challenges. During the previous decade, a series of tensions had gathered between the Australian and Chinese governments. There was no single cause for the deterioration in the bilateral relationship, as a number of irritants were involved. These included disputes over Australia issuing visas for human rights activists, security risk surrounding Chinese investment in Australian critical infrastructure, allegations of ‘foreign interference’ within the Australian political system, China’s militarised island building in the South China Sea, and infrastructure competition in the Pacific Islands. While these issues did not interrupt the economic relationship – reaching a record $229 billion of two-way trade in 2019 – they did mark a falling level of political trust between the Australian and Chinese governments.

This downward trajectory escalated into outright political conflict in early 2020. The COVID-19 pandemic — arguably the most significant global crisis in at least a generation — was the catalyst. Internationally, a heated debate quickly emerged over the Chinese government’s approach: including its initial handling and reporting of the outbreak in Wuhan, then its subsequent diplomatic activities as the pandemic spread around the globe. The Australian Government’s decision in April 2020 to make calls for an ‘independent’ international enquiry into the origins of COVID-19 brought the dispute home. This move sparked a dramatic rebuke by the Chinese Government, which was quick to denounce Australia’s call as a political witch-hunt. Chinese state media accused the Australian Government of prosecuting an anti-China campaign on behalf of the US.

This political dispute quickly spilled over into the Australian-China trade relationship. On April 27, explosive remarks by the Chinese Ambassador Cheng Jingye were published in the Australian Financial Review. Ambassador Cheng intimated that Chinese consumer boycotts against four exports (beef, wine, education and tourism) were possible, due to Australia’s position on a COVID-19 inquiry. On May 17, it was revealed that China would apply massive retaliatory duties to Australian barley exports, as the result of a long-standing anti-dumping investigation. In subsequent weeks, similar coercive trade measures were applied to Australian beef, education and tourism exports to China (see Box 1). International media have also been briefed on a purported “hit list”, which threatens to extend such measures to wine, dairy, seafood, oatmeal and fruit exports if relations further deteriorate.
These Chinese measures are an example of using trade for ‘political sanctioning’. The Chinese government officially maintains that they are technical measures of a non-political nature, enacted consistently with relevant bilateral and international trade rules. Australian Government representations, and many independent analysts and Australian industry parties, contend these technical and countervailing measures are without legal or technical merit. Coming at a time of deteriorating relations between the governments, many have argued they are instead a disguised ‘economic sanction’ in retaliation to recent Australian foreign policy actions. Chinese state media have frequently described them in such terms.

Chinese trade sanctions have been deliberately targeted at the agriculture sector. As sanctions against education and tourism have largely symbolic effects while international travel is closed, it is agriculture that has borne the brunt. Barley was likely selected due to a pre-existing anti-dumping investigation that made the sanction deniable; while China has suspended export permits for Australian abattoirs in the past. Agriculture is a lower risk sanctioning option for
China than minerals – the mainstay of Australia-China trade – as minerals are essential for Chinese heavy industry. The existence of complex sanitary and phytosanitary (SPS) protocols also makes agriculture an attractive target: trade sanctions can be applied on political grounds, but publicly rationalised as a technical measure instead. Indeed, as all five products on the ‘hit list’ are agricultural, any further trade sanctions are also likely to fall upon the sector.

3. The US-China “Phase One” trade agreement

Australia’s agricultural exports to China are also threatened by recent developments in the US-China trade relationship. Since taking office in January 2017, the Trump Administration has frequently deployed coercive trade diplomacy as a foreign policy strategy. This has included US withdrawal from the Trans-Pacific Partnership (TPP) agreement; the renegotiation of several existing trade agreements under threat of tariff imposition; several bilateral trade disputes; and the veto of nominations to the WTO’s Appellate Body in an attempt to force governance reforms. Most of the world’s major economies – including China, Japan, Korea, the EU, Canada, Mexico, Turkey, India, Brazil and Argentina – have been subject to trade coercion, with Australia one of the few US trade partners to avoid sanction.

However, the US-China trade war is the most significant of the Trump Administration’s trade policy actions. The dispute began in July 2018, when the US began applying protective tariffs in order to force the negotiation of a bilateral trade agreement. Over the following eighteen months, the dispute escalated through several cycles of tariff and counter-tariff actions, to eventually cover $735 billion of trade between the world’s two largest economies. Two concerns drive the US agenda in the dispute. The first is to negotiate a ‘trade balancing’ deal, which reduces the trade deficit with China by increasing US exports and lowering Chinese imports. The second is to demand reform to a number of Chinese trade practices considered adverse for US companies, including intellectual property protection, industrial subsidies and restrictive licensing procedures.

In late 2019, the US and China brokered a ‘ceasefire’ trade agreement. Negotiated in December 2019 and signed in January 2020, the deal involved a commitment to not escalate further tariffs while China agreed to greatly increase its imports of US products. It was referred to as a “Phase One” agreement, as it focused on the trade balancing dimension of the dispute; with regulatory and trade practice issues deferred for a “Phase Two” agreement for subsequent negotiation. The principal component was a Chinese commitment to purchase an additional USD 200 billion of US exports, above a (pre-dispute) 2017 baseline, across the 2020 and 2021 calendar years. With US exports totalling USD 129 billion in 2017, the agreement implied an average 77 percent annual increase in Chinese imports from the US.

The Phase One agreement included sector-specific Chinese purchasing commitments. Numerical targets were set for agriculture, manufacturing, energy and services for each year of the agreement. Given the political salience of the US farm sector, agriculture featured prominently in the schedule. China agreed to a base commitment of USD 80 billion of agricultural imports over 2020-21, with a further “strive” commitment of an additional USD 5 billion per year. As Figure 3 illustrates, this will require an almost immediate doubling of US agricultural exports to China on past trend.
To achieve this extraordinarily large increase, the Phase One agreement included a set of Chinese reforms to its agricultural trade regulations. These reforms were designed to loosen various behind-the-border trade measures, on a preferential basis for US exporters, in ten specific agricultural products (see Box 2). China has agreed to widen the scope of allowed imports for many product lines, agreed new or streamlined existing SPS protocols, automatically recognised several US registration systems, and reinstate the poultry trade that was suspended in 2014. The US Department of Agriculture has estimated expected export sales for each of the ten included products, though these subsectoral targets are indicative and not a binding component of the broader Phase One Agreement. These preferential measures will give US exporters an immediate advantage in market access vis-à-vis third country suppliers; and open some markets to US competition for the first time.

It is unlikely China will be able to meet these agricultural import commitments. Given the short-run inelasticity of agricultural output (due to climactic, labour and infrastructure constraints), it remains unclear whether US exporters will be able to ramp up production on the required timescale. The global recession created by the COVID-19 pandemic, which only emerged after these targets have been set in late 2019, has also placed a drag on Chinese demand. It is extremely likely that trade diversion – of US exports to third markets toward China, and of Chinese imports from third markets toward the US – will be required to meet the targets. This will therefore place significant pressure on the Chinese trade administration to preferentially direct market access to US exporters in coming years.

![Figure 3 US agricultural exports to China – Actual and “Phase One” agreement commitments](image-url)
<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Export Potential</th>
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<tbody>
<tr>
<td><strong>BEEF</strong></td>
<td>Expand scope of allowed imports; eliminate age restrictions on slaughtered cattle; eliminate ‘unnecessary’ traceability requirement; establish maximum residue rules for hormones. Export potential of $1 billion p.a.</td>
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<tr>
<td><strong>PORK</strong></td>
<td>Expand list of eligible products to include processed products; risk-assessment for veterinary drugs. Export potential of $1.7 billion p.a.</td>
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<td><strong>POULTRY</strong></td>
<td>Partial reversal of 2014 export ban; reinstatement of technical procedures and exporter registrations. Export potential of $1 billion p.a.</td>
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<tr>
<td><strong>PROCESSED MEAT</strong></td>
<td>Recognise USDA oversight of US meat facilities, eliminating unique registration requirements and allowing import based on USDA certificates alone. Export potential of $10-25 million p.a.</td>
<td></td>
</tr>
<tr>
<td><strong>LIVE CATTLE FOR BREEDING</strong></td>
<td>Commence technical discussions for imports. Export potential of $25-50 million p.a.</td>
<td></td>
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<tr>
<td><strong>DAIRY AND INFANT FORMULA</strong></td>
<td>Streamline timelines and procedures for registering US facilities, and provide regulatory stability for registration. Export potential of $250-300 million p.a.</td>
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<tr>
<td><strong>PET FOOD</strong></td>
<td>Immediately resume trade in products containing poultry; and lift ban on products containing ruminant ingredients. Export potential of $300 million p.a.</td>
<td>$300 million p.a.</td>
</tr>
<tr>
<td><strong>RICE</strong></td>
<td>Commitment to authorise imports within 20 days of USDA providing SPS approval. Export potential of $300 million p.a.</td>
<td>$300 million p.a.</td>
</tr>
<tr>
<td><strong>SEAFOOD</strong></td>
<td>Approval of import of twenty-six new aquatic species; streamline procedures for registering US seafood processing facilities. Export potential of $400 million p.a.</td>
<td>$400 million p.a.</td>
</tr>
<tr>
<td><strong>HORTICULTURE AND FEED PRODUCTS</strong></td>
<td>Finalise SPS protocols for US avocados, blueberries, potatoes, nectarines, barley, alfalfa and almond meal. Feed product export potential of $700 million p.a.; horticulture potential of $150 million p.a.</td>
<td>$700 million p.a.; $150 million p.a.</td>
</tr>
<tr>
<td><strong>SANITARY AND PHYTOSANITARY MEASURES</strong></td>
<td>Implement USDA’s Public Health Information System (PHIS), which allows USDA to issue health certificates electronically ahead of shipments. Agreement not to implement new SPS regulations which are not “science-and risk-based”.</td>
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Source: Author’s compilation, from USDA\textsuperscript{14}
4. Emerging China trade risks for Australian agriculture

These political developments now expose Australian agricultural exporters to unprecedented levels of risk in the China market. Deteriorating Australia-China political relations have already led to trade sanctions in barley and beef, with the possibility that more products could be affected. The US-China Phase One agreement will also force China to divert a significant volume of its agricultural imports to the US, potentially displacing Australian market share. The global recession engendered by the COVID-19 crisis will also dampen growth in the Chinese economy, further exacerbating the effect of these political shocks. At no time in recent history has the Australian agriculture sector faced such an adverse outlook in its principal export market.

However, the impact of these political shocks will vary across agricultural subsectors. The likelihood of reduced Australian exports depends not only on political developments, but also the short-run ability of Chinese buyers to switch to alternatives. Political diversions to trade are impractical to execute if alternate suppliers are unable to quickly fill demand. Therefore, the degree of competition for Australia in specific Chinese agricultural markets will ultimately determine the extent of trade substitution. Figure 4 outlines the degree of competition in ten of Australia’s main exports, showing Australia’s share in the Chinese import market alongside that of its principal competitors.

**Figure 4**  Competition for Australian agricultural exports in the Chinese market, 2018

Source: Author’s calculations, from UN Comtrade. Note: ○ denotes products with preferential provisions in US-China Phase One trade agreement (see Box 2).
As Figure 4 reveals, distinctive forms of risk are likely to affect different Australian farm sectors. Four specific market risks can be identified:

**Box 3 New China market risks facing Australian agribusiness**

1. **Trade diversion due to an established US presence.** Given the size of its Phase One commitments, Chinese trade administrators face strong incentives to divert imports towards the US wherever possible. Australia’s cotton, dairy, seafood and wheat exports to China all currently face strong competition from US alternatives.

2. **Reduced Australian competitiveness due to new US preferences:** Products where China has offered the US preferential behind-the-border treatment will see greater competition from US exporters. Australia’s barley, live cattle, dairy, seafood and beef exports will each be affected by new US trade preferences.

3. **Substitution by third-country suppliers:** Consumer boycotts (potentially encouraged by government signalling) are most likely to occur in products where there are established alternate suppliers. Barley, cotton, dairy, seafood, sheep meat and wheat all currently face third-country competition in China, particularly from Canada, New Zealand and Vietnam.

4. **Risks of future Chinese trade sanctions.** If Australia-China political relations continue to deteriorate, ‘non-technical’ SPS or anti-dumping measures may be applied to a wider range of Australian exports. Reports suggest that wine, dairy, seafood, oats and horticulture could be affected; however a lack of established competitors may make sanctions against oats impractical.

**This analysis suggests that nearly all of Australia’s agriculture exports to China face new levels of market risk.** Of Australia’s main export lines, only one product – wool – is not subject to any of these risks. The seafood ($952 million, 65 percent exposure) and dairy ($644 million, 26 percent exposure) export industries potentially face all four. The beef sector ($2.6 billion, 25 percent exposure) will also now confront serious US competition in the Chinese market for the first time, due to new rules loosening requirements for traceability, slaughter age and the use of veterinary hormones.

**Australian agriculture must now prepare for a significant change in its trade outlook.** For a decade, China has been the fastest growing and single most important of all its regional export markets. Focused and effective marketing efforts have consistently delivered double-digit export growth. However, with political risks to the China trade mounting, and COVID-19 clouding the broader economic outlook, this trajectory is highly unlikely to continue in coming years. These risks will affect almost all subsectors within Australian agriculture, requiring an industry-wide reappraisal of export strategies.
5. Options for export diversification

There is now a pressing imperative for the Australian farm sector to diversify its trade relationships. While China has been a reliable growth market for the last decade, political risks mean this pattern is unlikely to continue in the future. This diversification imperative is especially pronounced for subsectors with a high degree of China market exposure (such as barley, cotton and seafood), and those subject to explicit trade threats (beef, dairy, wine and horticulture).

Diversification is a complex and long-term endeavour for the agribusiness sector. Many of Australia’s high quality food products are not sold on a ‘commodity’ basis, but require long-term relationships with foreign partners. These relationships take time and effort to negotiate, which is especially hard in the context of COVID-19 restrictions. However, beginning market development efforts now will lay the groundwork required to manage future risks in the China market.

Fortunately, there are several credible diversification options that Australia can pursue in the near- to medium-term. The Indo-Pacific region is home to many of the world’s fast-growing developing economies, where urbanisation and industrialisation are driving an increase in food imports. In a context of constrained capacity for market development, Australian efforts should be focused on markets which provide the best prospects for medium-term gains. Three particular partners in the region provide attractive opportunities:

- **Indonesia**: Indonesia is already Australia’s fifth largest agricultural export market ($2.4 billion in 2019), with established trades in live cattle, beef, wheat and sugar. The Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), which entered into force on 5 July, establishes Australia as Indonesia’s preferred agricultural trade partner. Liberalising tariff rate quotas (TRQs) will secure market access for live cattle, animal feed and several horticulture products; while reduced tariffs for dairy and beef will preferentially lower barriers to Australian exports

- **Vietnam**: Vietnam offers a high-growth and demographically-favourable market for Australian agriculture, which is similar to that of China a decade ago. Australia also benefits from shared membership with Vietnam in two existing trade agreements: the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) and the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP). AANZFTA provides preferential access to the Vietnamese market for cotton, wheat, fruit, beef, dairy and barley. The CPTPP provides preferential access for wine, beer, sugar and seafood.

- **India**: India is a potentially significant agriculture market, particularly in premium products where Australia aligns with growing middle-class demand (including dairy, meat and horticulture). However, India’s very high rates of agricultural protection – with tariffs routinely between 30 and 50 percent – have historically constrained trade. In June 2020, the Australian and Indian governments agreed to resume negotiations for a bilateral trade agreement, which had commenced in 2011 but been suspended in 2015. Australian agribusiness would benefit from beginning marketing efforts now, to capitalise on opportunities that will be created by a future FTA.
Endnotes


3 Author’s calculations, from (DFAT), **Trade Statistical Pivot Tables**.

4 (DFAT), **Trade Statistical Pivot Tables**.


10 For an overview, see Table 2 of Perth USAsia Centre (2020), Submission to Joint Standing Committee on Foreign Affairs, Defence and Trade (USCFTADT) Inquiry into the implications of the COVID-19 pandemic for Australia’s foreign affairs, defence and trade, [https://www.aph.gov.au/DocumentStore.ashx?id=6781e646-290e-4b08-896c-8e3ce0c4a887&subId=685451](https://www.aph.gov.au/DocumentStore.ashx?id=6781e646-290e-4b08-896c-8e3ce0c4a887&subId=685451).


13 *Economic and Trade Agreement Between the Government of the United States of America and the Government of the People’s Republic of China*, [https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf](https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf).


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