Adapting Australian policy for the geoeconomic era

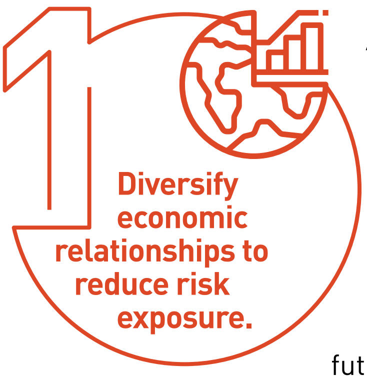
The rise of geoeconomic contestation is a new and major challenge for Australian foreign policy. As open and cooperative global economic system are under threat, economic interdependence has become a domain of conflict. And as a medium-sized and open economy, Australia is highly exposed to risks from the geoeconomic strategies of major powers. Compounding matters, its liberal policy settings are poorly configured to respond to geoeconomics, as governments seek to manipulate economic relationships for strategic purposes. The era of cooperative and rules-based economic order in the Indo-Pacific – from which Australia has benefited immensely over the last three decades – has unfortunately come to an end.

Australia's foreign economic policy needs an update for the era of geoeconomic contestation.

However, adapting to geoeconomics does not imply abandoning liberal policy. The simplistic response would be to start strategically manipulating economic relationships as well. However, this 'if you can't beat them, join them' approach would carry serious costs. Economically, it would mean erecting barriers to the trade and investment flows that have been critical to Australia's economic success for its entire modern history. Nor, given Australia's medium size, can it realistically expect to 'win' trade wars or investment races against larger players. Politically, it would pose risks of being drawn deeper into the strategic rivalries that presently divide the Indo-Pacific. An Australia that naively abandons liberalism would be poorer, more exposed to risk, and potentially at the whim of the region's major powers.

Instead, Australia will need to strike a new balance between openness and security. Maintaining open and liberal policy settings will be essential for Australia's future prosperity and integration with the Indo-Pacific. But introducing a greater degree of strategic considerations is necessary to minimise its exposure to the rising tide of geoeconomic contests in the region. This is a balancing act that requires complex trade-offs. Too little of the strategic imperative and Australia will be exposed to economic risks and political coercion. Too little openness and Australia will harm the economic relationships on which its prosperity depends. Policy settings will need to be continuously reappraised in light of the changing mix of opportunities and risks.

Five key policy objectives that should inform how Australia adapts its foreign economic policy for the geoeconomic era:



Australia's concentrated economic relationships magnify the effects of external shocks. In an era of geoeconomic conflict, any trade and investment link that is dependent on a single partner becomes an 'exposure point' for risk. Building more diversity into these relationships will spread risk, augment shock resilience, and reduce the impacts of political coercion.

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 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 trade initiatives – including RCEP, the bilateral trade agreement with Indonesia, and economic diplomacy with Vietnam – are steps in the right direction. On the investment front, Australia should aim to build deeper relationships with the Indo-Pacific to broaden the geographic base of capital inflows and outflows. This will require Australian economic diplomacy to place equal emphasis on investment alongside trade. In both cases, business must also be provided assistance to take advantage of opportunities created by new government-to-government platforms.

Australia has been repeatedly affected by geoeconomic risks in recent years, and will face more in the future. Its previous defensive strategy – of relying on multilateral institutions such as the WTO – is no longer effective, as consensus behind these institutions breaks downs. Australia needs to put new policy instruments in place to effectively and quickly respond to geoeconomic risks when they occurs.

Recent reforms to the foreign investment regime are an instructive example of what is required. They have allowed Australia to manage new risks surrounding state-owned investors and critical infrastructure while maintaining the overall openness needed to attract investment. However, many other economic policy frameworks will need to be similarly reformed. One immediate example is international value chains for 'critical' commodities such as essential technology, resource and medical products. New policies are needed to build greater resilience into these important sectors.

With coercive trade diplomacy rising, Australia must also develop new ways to respond to trade disputes. Diversification is part of the solution, as it reduces economic exposure. Australia will also need to much more actively litigate trade disputes than in the past: using both the WTO's interim MPIA mechanism, as well as provisions in its fifteen FTAs. And in cases where these mechanisms fail, the Australian Government will need to offer countervailing support to industries affected by political actions that fall outside normal business risks.

Historically, Australia has deployed its economic diplomacy primarily for economic ends. However, in an era when many governments are adopting geoeconomic strategies, Australia will be at a disadvantage if it does not do the same. Australia's medium size prevents it from mounting strategies on the scale seen by major powers. But Australia has many geoeconomic policy levers which can nonetheless be pulled.

The recently announced Pacific Step Up is a first move in this direction, as it recognises the more prominent role strategic considerations will need to play in the aid program. But more of these type of programs will be required in coming years, and will involve more than just aid program spending.

Trade diplomacy will need to change its orientation, to place higher priority on 'rule making' efforts rather than simply pursuing market access (i.e. export) gains. This is evident in the mega-regional FTAs (the TPP and RCEP), whose principal utility for Australia is as rule-making agreements. Rule-making should also play a larger role in bilateral economic diplomacy, particularly with non-FTA partners such as India and Vietnam.

Australia could also leverage its outbound investment – which averages $34 billion per annum[118] – to build links with key partners. While government cannot 'direct' the investment activities of private firms, it can certainly shape them through supportive action. Commercial diplomacy programs (delivered through Austrade and other sectorally-focused agencies) provide government an opportunity to promote outbound investment in domains where it is strategically beneficial.

Australia's most successful responses to geoeconomics 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 mini-lateralism in economic diplomacy, where smaller groups of likeminded governments come together to advance cooperation in functional areas.

These coalitions will also be critical to sustaining formal (i.e. treaty-based) economic institutions. Coalitions can nimbly deploy informal instruments not available to formal bodies, such as dialogue processes, coordination mechanisms and non-binding agreements. These informal instruments lower accession costs for governments, and focus attention on building consensus around norms and principles. Moreover, informal instruments can help sustain formal institutions during period of conflict, as has occurred recently at the WTO..

Foreign economic policy has historically been the preserve of a limited number of Australian government agencies: principally DFAT, the Treasury and groups within relevant line agencies. However, as geoeconomics requires a greater sensitivity to strategic considerations, a broader range of government agencies need to become involved in the policymaking process. And, as the recent debate over the risk sub-national economic agreements illustrates, it also should incorporate state governments as well.

Expanding the network of involved agencies necessitates new and better mechanisms for intra-governmental policy coordination. The technical and specialist nature of many issues will also demand that expertise is shared more broadly across government, rather than being sequestered in departmental silos. The Critical Infrastructure Centre, established in 2018 to advise across the government and corporate sectors on critical infrastructure issues, provides an example of an appropriate model.

Finally, government will need to more closely incorporate business into strategy and policy-making discussions. Businesses are the front line troops of geoeconomics, as it is they – and not government itself – that 'do' trade and investment. Geoeconomic risks fall directly upon businesses; and many national responses (such as trade diversification) require business to take the lead. Much closer and responsive government-business relations will be required for Australia to successfully adapt its foreign economic policy to the geoeconomic era.