Submission to Joint Standing Committee on Foreign Affairs, Defence and Trade (JSCFADT)
*Inquiry into the implications of the COVID-19 pandemic for Australia’s foreign affairs, defence and trade*

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**Executive Summary**

- Australia’s economic success has and will depend on its international trade and investment relationships. However, Australia will face a number of external economic shocks in coming years.
- Interruptions to global value chains due to COVID-19 public health measures, recessions in key trade and investment partners, and a rising trend of protectionism, together pose the most adverse external economic environment Australia has faced in a generation.
- A lack of diversity in Australia’s economic ties will magnify the domestic effects of these shocks. A narrowly concentrated export basket, and dependence on a small number of trade and investment markets, increases Australia’s exposure to a deteriorating external environment.
- There is now a pressing need to increase Australia’s resilience to external economic shocks by diversifying the trade and investment profile.
- Policy efforts should focus on five objectives: fostering new export industries, diversifying our trade partnerships, developing new investment partnerships, better understanding value chain risks, and engaging in coalitional diplomacy to resist a turn towards protectionism.
- A suite of practical policy options are identified that the Australian Government can action in the immediate term, which would help add diversity and resilience to external economic ties.
Table of Contents

Executive Summary ......................................................................................................................................................... 1
1. Australia’s external economic ties: The relationship between diversity and shock-resilience ......................... 3
2. Diversity in Australia’s external economic relationships ......................................................................................... 4
3. COVID-19-related interruptions to global value chains ........................................................................................... 12
4. Recession in key trade and investment markets ....................................................................................................... 14
5. The global spread of protectionist trade policies ...................................................................................................... 17
6. Economic diversification and shock resilience ........................................................................................................... 21
About the Perth USAsia Centre .................................................................................................................................. 26
References ...................................................................................................................................................................... 27

List of Figures

Figure 1 Trade exposure of select economies, 2017 ................................................................................................. 4
Figure 2 Country composition of Australian merchandise exports, 2019 ................................................................. 5
Figure 3 Sectoral composition of Australian exports, 2018 .................................................................................... 6
Figure 4 Market concentration in Australia’s top-30 merchandise exports, 2019 ......................................................... 7
Figure 5 Market concentration in Australia’s top-30 imports, 2019 ........................................................................ 8
Figure 6 Australia’s two-way investment partners, 2019 ........................................................................................ 10
Figure 7 Sectoral composition of direct investment in Australia, 2019 .................................................................... 11
Figure 8 IMF growth forecasts for Australia’s main economic partners, 2020 ......................................................... 14
Figure 9 Trade interventions by governments by type, 2009-2019 ........................................................................ 17

List of Tables

Table 1 Real GDP growth forecasts for 2020 in Australia’s main trade partners .......................................................... 16
Table 2 US trade diplomacy under the Trump Administration ................................................................................ 18

List of Boxes

Box 1 Five objectives for Australia’s external economic diversification .................................................................. 22
1. Australia’s external economic ties: The relationship between diversity and shock-resilience

International economic linkages have been critical for Australia’s economic success. As a medium-sized and open economy, access to international markets for goods, services and capital enables Australia to exploit its comparative advantages on a larger scale than the local market allows. Many of its most important industries – across the resources, technology, education, agriculture and services domains – have been developed with foreign investment to serve exports markets.

Australia has enjoyed a highly favourable external economic environment for several decades. It is located within the Indo-Pacific, a region home to many of the world’s fastest-growing economies including China, India, Indonesia, and Vietnam. It has benefited from progressive economic liberalisation, which has lowered regulatory barriers to trade and facilitated the development of cross-border value chains. Relatively harmonious political relations between governments in the region ensured that diplomatic and strategic conflicts did not interrupt the steady growth of economic ties.

Unfortunately, in recent years this favourable external environment has deteriorated. Increasing geopolitical tensions in the Indo-Pacific have begun to spill over into the economic realm, particularly through trade wars. In early 2020 the COVID-19 pandemic immediately crimped international economic flows, as travel restrictions were imposed, transport connections interrupted, and shocks to demand and supply spread globally. In the near-term future, a post-COVID recession will (temporarily) end the high-speed growth that has driven regional economic dynamism. These shocks are posing Australia a more difficult external economic environment than it has experienced in several decades.

The diversity of Australia’s economic ties also magnifies the challenge posed by these shocks. Many of Australia’s current economic relationships are “deep but narrow” – large in gross size, but narrowly concentrated on a small range of countries and/or industrial sectors. When an external shock hits a trade or investment relationship that lacks diversity, the effects of that shock on Australia’s economy are magnified.

This submission provides an analysis of Australia’s exposure to economic shocks across the trade and investment domains. It identifies the key countries and sectors to which the economy is most prominently exposed, and the political and economic dynamics that are, or may soon, pose downside risks. It demonstrates that risks are most pronounced in areas where a lack of diversity will magnify the domestic effects of external shocks, in particular for the resources, tourism and education sectors, as well as the supply of foreign capital. It argues that government should adopt economic policies that encourage greater diversity in Australia’s international economic ties, in order to better insulate against the risks of external shocks.
2. Diversity in Australia’s external economic relationships

Trade is the most prominent mechanism connecting Australia to the global economy. In 2018, it engaged in $853 billion of two-way trade with foreign partners, equivalent to 46 percent of GDP\(^1\). This was composed of $662 billion of merchandise trade and $190 billion of services trade. Australia traditionally runs a relatively balanced trade account\(^2\) – across the five years to 2018, a trade deficit averaging $6 billion per annum – where a modest deficit on the services account is offset by a comparable surplus on the merchandise side. Many key industries are highly trade-oriented, including the resources, agriculture, education and tourism sectors.

By international comparison, the Australian economy has an unremarkable level of trade exposure. It is roughly the same as other major economies in the Indo-Pacific region, such as China, India and Japan (Figure 1). The US is the only major economy in the world with a significantly lower trade exposure. Indeed, Australia is somewhat below than the OECD and EU; and significantly lower than the highly trade-oriented economies of ASEAN, where trade accounts for a massive 119 percent of GDP. Nearly all economies display the same roughly 3-to-1 ratio of merchandise to services trade. From a macroeconomic perspective, Australia has a similar level and structure of trade exposure to that of its medium-sized, developed-economy peers.

*Figure 1 Trade exposure of select economies, 2017*

*Source: Author’s calculations, from UNCTADStat Database\(^3\)*
However, Australia’s trade relationships are noteworthy for their geographic bias. The overwhelming majority of merchandise exports – 82 percent in 2019 – are destined for Indo-Pacific markets (Figure 2). China accounts for around one-third of the total, with Japan and Korea a quarter, and others (predominantly ASEAN and India) a further quarter. By contrast, services have a more geographically balanced pattern: with regional markets accounting for only 48 percent of exports, while the EU (13 percent) and US (10 percent) have more prominent roles.4

*Figure 2 Country composition of Australian merchandise exports, 2019*

![Country composition of Australian merchandise exports, 2019](image)

*Source: Author’s calculations, from DFAT Trade Statistical Pivot Tables5*

**Australia also has a very highly concentrated sectoral bias to its export profile.** Resources account for approximately half of all exports, with three commodities – coal, iron ore and natural gas – dominant (Figure 3). Services come second at 22 percent, with ‘travel-related’ activities (education and personal and business travel) accounting for two-thirds of services exports. Significantly, the sectoral composition of exports is the inverse of Australia’s underlying industrial structure, as services account for two-thirds of the economy and mining only a tenth. This reflects the fact that Australia’s comparative advantage in international markets, not its domestic economic structure, determine patterns of export competitiveness.
**Figure 3 Sectoral composition of Australian exports, 2018**

![Pie chart showing sectoral composition of Australian exports, 2018.](image)

*Source: Author’s calculations, from DFAT, *Composition of Trade Australia 2018* and *Trade in Services Australia 2018*. Note: Presents figures for 2018 as services data for 2019 not available at time of writing.*

**Geographic and sectoral concentration leaves many export industries exposed to trade shocks.** Figure 4 presents the top-5 market share for Australia’s thirty largest merchandise exports, a group which accounts for 86 percent of the $336 billion of merchandise exports in 2019. By disaggregating trade exposure at the sub-sectoral level, this data identifies the export industries which are most exposed to particular markets:

- Most of Australia’s export industries rely on a single large market. Across the industries, the average market share (weighted) of the largest buyer is 49 percent.
- Only five industries – coal, beef, wheat, medical instruments and precious metals – have genuinely diverse markets without a clear dominant player.
- Several exporters face *monopsony* conditions\(^7\): where a single buyer accounts for the majority of sales. In thirteen industries, the top market is larger than the next four largest markets combined.
- Single market dependence is most pronounced in mining, particularly for iron ore, gold, bauxite, and nickel. By contrast, the agriculture and manufacturing sectors generally have more diversified markets, albeit with some sub-sector exceptions (such as aircraft parts, wool and cotton).
- China is the top market for fourteen of Australia’s leading export industries, far more than any other partner.
**Figure 4 Market concentration in Australia’s top-30 merchandise exports, 2019**

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**Source:** Author’s calculations, from data in DFAT *Trade Statistical Pivot Tables*. Excludes refined petroleum and two confidential items of trade, for which detailed partner data is not available. Labelled country identifies the largest export market.
**Figure 5 Market concentration in Australia’s top-30 imports, 2019**

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**Source:** Author’s calculations, from data in DFAT *Trade Statistical Pivot Tables*. Excludes confidential items of trade for which detailed partner data is not available. Labelled country identifies the largest import market.
Concentration problems also affect Australia’s imports, albeit to a lesser degree than exports. Figure 5 presents the top-5 market share for the thirty largest merchandise imports, which collectively account for 61 percent of the $307 billion of imports in 2019. This sub-sectoral data reveals the areas in which Australia is most exposed to import shocks:

- Many of Australia’s main imports also face single market concentration. Across the industries, the average market share (weighted) of the top supplier is 40 percent. This is lower, however, than seen for exports.
- Monopoly – where a single supplier accounts for most sales – is also a common feature. In fifteen industries, the top supplier accounts for more than the next four largest suppliers combined.
- High technology products, where barriers to entry prevent competition, tend to be the most concentrated. Computers, telecommunications equipment, electronics, aircraft parts and medical equipment all feature monopoly supply.
- China is again prominent, as the largest supplier of fourteen of the imports. However, there is a greater role for the US, which is the largest supplier of seven.

Foreign investment is also a critical – but often unappreciated – mechanism connecting Australia to the global economy. In 2018, there was $3.8 trillion of accumulated foreign investment in Australia, while Australian companies held $3.0 trillion of assets abroad. On a macroeconomic basis, foreign investment makes a smaller contribution to the Australian economy than trade. Two-way direct investment flows in 2019 were worth $60 billion, less than a tenth of the $853 billion of two-way trade. However, it still makes a material contribution to the Australian macroeconomy. In the decade to 2018, Australia had net capital inflows of $548 billion, equivalent to 16 percent of all private investment.

Beyond the supply of capital, there is an important qualitative linkage between trade and investment flows. Foreign investment offers the recipient businesses a combined package of capital, technology and marketing channels that support participation in world markets. Many of Australia’s successful exporters use foreign investment to support the development of globally-competitive export capabilities:

- In the resources sector, partnerships with foreign customers often bundle together investment relationships with ‘offtake’ agreements for the export of minerals and energy. These packages allow mining companies to develop projects by securing future export markets.
- In agriculture, foreign investors also provide recipient businesses support in accessing to their home-country marketing channels. This greatly eases the challenge of developing new markets in complex agro-food value chains.
In the technology sector, foreign investment can be bundled with technology licensing agreements, which provide Australian companies access to the underlying intellectual property required to commercialise new technology applications.

**Similar to trade, Australia’s investment relations are highly reliant on a small number of foreign partners.** However, a different set of countries dominate investment ties. Two ‘traditional’ partners – the US and EU – account for the majority of Australia’s two-way investment stocks (Figure 6). This reflects longstanding corporate connections between Australia and the UK, which in the post-war period grew to include US and other European partners. By contrast, the Indo-Pacific economies which are important for trade have a much smaller role, collectively accounting for only 15 percent of the total. Significantly, China plays a comparatively negligible investment role, despite being Australia’s single most important export market and source of imports. While Australia has an Indo-Pacific-focused trade profile, its investment ties remain decidedly with Europe and the US.

**Figure 6 Australia’s two-way investment partners, 2019**

Investment flows into Australia are also concentrated in a limited range of sectors. The resource sector, with $360 billion of accumulated stocks, accounts for just under half of all foreign investment in Australia (Figure 7). This is approximately the same as its share of the national export basket, reflecting the link between inward investment and exports in resource projects. Manufacturing shows a similar pattern to resources, accounting
for 12 percent of both inward investment and exports. The wholesale/retail, finance and real estate sectors also attract significant levels of foreign investment, though none are major contributors to exports. This reflects foreign businesses seeking exposure to Australia’s buoyant domestic market. The sectoral outlier is agriculture, which accounts for 13 percent of exports but only 0.3% of all inward investment. Low foreign investment is in part due to investment rules regarding agribusinesses and agricultural land, which are stricter than for other industries

Figure 7 Sectoral composition of direct investment in Australia, 2019

Source: Author’s calculations from ABS International Investment Position, Australia: Supplementary Statistics. Unit: AUD Billions

The concentration of Australia’s international economic ties magnifies the domestic effects of external shocks. By their nature, all open economies are somewhat exposed to external shocks. However, a lack of diversity exacerbates this effect. When external economic ties are heavily dependent on a small number of countries and/or sectors, any shocks that occur in those markets have an outsized influence on the economy as a whole. This problem is evident in three external shocks presently affecting the Australian economy:

1. Interruptions to global value chains directly resulting from COVID-19-related shutdowns
2. Economic downturns in key markets associated with COVID-19 public health measures
3. Protectionist trade policies enacted by major trade and investment partners

The following sections examine the effects of these shocks in greater detail.
3. COVID-19-related interruptions to global value chains

In the short-term, the principle effect of COVID-19 on Australia’s international economic relationships has come via disruptions to global value chains. As government around the world have enacted public health measures to control the spread of COVID-19, these have dramatically interrupted normal economic activities. While the most conspicuous have been the temporary closure of retail businesses, they have also inhibited many of the activities necessary for international economic linkages.

COVID-related public health measures interrupt global value chains through one of four mechanisms:

1. Restrictions on domestic movement has constrained the supply of labour to businesses with non-essential classifications, particularly in the transport and manufacturing sectors
2. Restrictions on international movement have severely constrained – and in countries with ‘hard’ border closures, entirely suspended – business-, education- and tourism-related travel
3. Reduced international connections – particularly in terms of air transport – has lowered the availability and raised the cost of freight handling capacity
4. Enhanced customs and biosecurity procedures have slowed transit of goods through ports

The combination of these effects varies between countries, and depends on the specific timing and form of public health measures. By international comparison, Australia’s measures are unique. They have combined ‘hard’ border closures (seen in fewer countries) with comparatively lighter restrictions on the domestic movement of people. The classification of many key sectors – particularly the mining industry – as ‘essential’ has ensured a larger share of the economy has remained open than in countries with more stringent shutdowns. Successful Australian suppression of the disease during the April-June period is now enabling an early relaxation of these restrictions by international comparison.

However, many of Australia’s key export sectors have been affected by public health measures:

- The international tourism sector has been effectively shut-down by the closure of international borders to non-residents. International tourism contributed $38 billion to the national economy in 2018-19, accounting for 26 percent of the tourism sector by dollar value. The tourism industry is important as a key employer, particularly in regional areas, and pre-COVID-19 employed 5.2 percent of the Australian labour force.
- The international education sector is similarly affected by international border closures. While international students already in Australia have been able to continue studies, tertiary institutions have been unable to enrol new onshore international students. In 2018-19, international education generated $38 billion in services exports, of which $25 billion was in the university sector.
• The agriculture sector has been an unexpected casualty of border closures. Many high-value agricultural exports rely on air-freight in passenger aircraft. As international passenger flights have been greatly reduced, access to and prices of airfreight have increased dramatically. In April 2020, the Australian Government committed $110 million to support outbound freight services for affected seafood, meat, dairy, and perishable horticultural products.

Australia’s supply of needed imports has also been crimped by COVID-related public health measures in trade partners. Australia’s narrow industrial profile, particularly its limited manufacturing sector, means the country is dependent on imports for many products. And as value chains are interrupted by COVID-19 related developments, access to many essential goods will become constrained.

Import risks for medical supplies were the first to become apparent. Australia imported $18 billion of pharmaceuticals, medical instruments and medicaments in 2019. As global demand surges while production is constrained, supply of these products has become extremely tight. Like many other countries, Australia has already seen reported shortages of imported medical products, including in the early stages of the crisis for COVID-19 testing kits and personal protective equipment for hospital staff. While shortages of COVID-related equipment were quickly addressed by the procurement activities of government, there will remain future challenges in accessing new medical products. This will include drug, vaccine and treatment products – as these are developed by the global pharmaceutical and medical research sectors.

However, import risks will be felt economy-wide, not just in the health sector. Given the complexity of global value chains, Australia has faced many unexpected import supply shocks in the last three months alone:

• Some manufacturers and food processors have struggled to secure packaging materials from China and Southeast Asia.

• The farm sector may face shortages of fertiliser and pesticides due to Chinese factory shutdowns, depending on the duration and severity of value chain interruptions.

• Construction companies import 60 percent of their materials from China, with non-deliveries already reported in products such as glass.

• Delivery of utility vehicles will be delayed due to factory shutdowns in Thailand.

• Global electronics value chains are also under strain, which Chinese shutdowns delaying supply by between five and nine weeks.

Given a lack of data on the industrial geography of many global value chains, it is not possible to evaluate where future import shocks to the Australia might originate. However, they should be expected to become more common in coming months, as the economic impacts of COVID-19 reveal hidden vulnerabilities.
4. Recession in key trade and investment markets

In the medium-term, the external economic impact of COVID-19 will be exacerbated by recession conditions in key partners. Australia has been fortunate to benefit from nearly four decades of high-speed growth, industrialisation and urbanisation in Indo-Pacific economies. This economic performance has driven steady increases in demand for Australian exports, particularly minerals, agriculture and education and tourism services. This growth will be temporarily interrupted by economic downturns induced by COVID-19 and its associated public health measures.

At this early stage in the crisis, it is very difficult to predict the size of COVID-19-related recessions. The IMF forecasts that global growth will collapse to -4.9 percent in 2020, with all economies badly affected (Figure 8). With major uncertainty regarding the effectiveness of current and future COVID-19 measures, forecasting beyond this timeframe is highly unreliable. Whether the global recovery is ‘V-‘ (fast snapback), ‘U-‘ (slow recovery), ‘W-‘ (repeated oscillations) or ‘L-shaped’ (long-term stagnation) remains debated by economists. What is clear is that Australia now faces the most unfavourable external economic conditions in a century.

Figure 8 IMF growth forecasts for Australia’s main economic partners, 2020

Source: IMF, World Economic Outlook Update June 2020
Global growth prospects hide significant geographic differences, however, with implications for Australia’s concentrated trade and investment ties.

A major, but unacknowledged risk is to Australia’s capacity to attract foreign investment. Australia’s main investment partners – the EU and US – will be hardest hit by COVID-19 related recessions. The IMF forecasts contractions of around 8 to 12 percent in these economies in 2020, over twice the global average. As their stock markets and financial institutions come under strain, the supply of capital from these economies will become extremely tight. As the US and EU account for nearly two-thirds of foreign investment ties, Australia is likely to suffer a significant reduction in both gross capital flows and net capital imports in the immediate future.

A downturn in foreign investment inflows will have serious implications for Australia’s economy. At the macroeconomic level, it will impose a further drag on the economy above and beyond to those produced by COVID-19 measures. As net capital imports are equivalent to approximately one-dollar-in-six of all private investment, a slowdown in foreign capital inflows will materially reduce domestic investment and job creation. These effects will be most pronounced in the sectors that attract the bulk of foreign investment:

- Despite accounting for half of Australia’ inward foreign investment, the effects on the resources sector will be moderate. As mine sites have been classified as an essential service, the operation of existing resource projects have only been mildly affected. The sector’s high trade exposure to the better-performing Chinese economy means it will be better placed to attract investment than others. However, the ability to develop new resource projects will be constrained by the tight supply of international capital. This will weigh on growing subsectors within the resource industry, such as natural gas, lithium, and critical minerals.
- By contrast, the effects on the real estate industry will be significant. As Australian foreign investment policy deliberately channels real estate investment into new dwelling construction, most foreign capital inflows support construction projects. With housing construction already under a cloud due to depressed domestic conditions, a reduction in foreign capital inflows will be a further drag on a sector that employs over a million people.
- The manufacturing sector faces mixed fortunes. On one hand, interruptions to global value chains has increased interest in developing Australian manufacturing capabilities, particularly for medical technologies and other high-value critical equipment. On the other however, the technological and financial resources required to develop these manufacturing capabilities are usually supplied through foreign investment packages. As US and EU manufacturing corporations face severe economic downturns at home, their ability to invest in projects in Australia will be significantly constrained.
Attracting investment will also become more challenging due to temporary changes to foreign investment rules. On 29 March the Treasurer announced temporary changes to this system, which now require all foreign investments – irrespective of their value or sector – to obtain review and approval. Given the administrative workload this would require, the timeframe for FIRB reviews was also extended from thirty days to six months. These changes are not designed as an ‘investment freeze’, but a measure to protect temporarily-distressed Australian companies from predatory takeovers.

However, these measures will add regulatory burdens for both foreign investors and their Australian partners. Many investments that previously only required FIRB notification – including those below $1.2 billion from FTA partners – must now complete a full assessment process. Extended processing times will also add uncertainty to the application process. There have been reports that firms in the agriculture, commercial real estate and finance sectors may struggle to secure investment due to added regulatory complexity.

The global economic outlook will impose a similar drag on exports. While economic performance in Australia’s investment partners will be the worst affected by COVID-19, its trade partners are expected to fare less poorly. The IMF forecasts positive growth in China in 2020, with comparatively mild contractions in Southeast Asia and Korea. Nonetheless, their performance will still be significantly dampened by COVID-19, given their previous trajectory of high-speed growth. COVID-19 should be expected to reduce economic growth in Australia’s trade partners by 5-7 percent in 2020 compared to past forecasts (Table 1).

<table>
<thead>
<tr>
<th></th>
<th>April 2019 forecast for 2020</th>
<th>June 2020 forecast for 2020</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>5.8%</td>
<td>1.0%</td>
<td>-4.8%</td>
</tr>
<tr>
<td>Japan</td>
<td>0.8%</td>
<td>-5.8%</td>
<td>-6.6%</td>
</tr>
<tr>
<td>ASEAN-5</td>
<td>4.0%</td>
<td>-2.0%</td>
<td>-6.0%</td>
</tr>
<tr>
<td>Korea</td>
<td>2.8%</td>
<td>-2.1%</td>
<td>-4.9%</td>
</tr>
<tr>
<td>India</td>
<td>6.1%</td>
<td>-4.5%</td>
<td>-10.6%</td>
</tr>
<tr>
<td>World</td>
<td>3.0%</td>
<td>-4.9%</td>
<td>-7.9%</td>
</tr>
</tbody>
</table>

Source: IMF, World Economic Outlook April 2019 and June 2020

This economic downturn will be deleterious for Australia’s trade relations in the Indo-Pacific. In the decade to 2019, Australia exports to Japan grew by 51 percent, Korea by 66 percent, ASEAN by 110 percent and China by 252 percent. This growth was facilitated by the performance of the region which, with the exception of Japan, consistently delivered above-average economic growth. With that growth trajectory temporarily interrupted, Australia will be unable to enjoy consistently improving export performance with existing Indo-Pacific markets. This will undermine another driver of domestic private investment, which has played a key role in Australia’s world-leading economic performance during this period.
5. The global spread of protectionist trade policies

In the longer-term, the spread of protectionist trade policies will greatly hamper Australia’s external economic relationships. While Australia is an open economy with very low regulatory barriers to international trade and investment, most of its partners maintain comparatively more protectionist policy settings. Over the last three decades, Australia has benefited from a global trend toward economic liberalisation which saw such barriers progressively reduced. Its ability to successfully export to overseas markets, and engage in both outward and inward foreign investment, depends upon open economic policy regimes in key partners. It is likely that these regimes will become more protectionist in coming years.

The global trend towards rising trade protectionism predates the COVID-19 crisis. Beginning in the wake of the Global Financial Crisis (GFC) of 2008-09, many government responded to recession conditions by imposing restrictive trade measures designed to protect local industries. However, the trend towards rising protectionism has gathered pace in the years following post-GFC recovery (Figure 9). According to data compiled by Global Trade Alert, in the decade to 2019 governments have imposed 2751 measures restrictive of international trade, in comparison to 807 liberalising measures – a roughly three-to-one ratio. This trend is accelerating, with the number of restrictive measures exceeding 500 for the first time in 2019.

*Figure 9 Trade interventions by governments by type, 2009-2019*

![Figure 9 Trade interventions by governments by type, 2009-2019](image)

*Source: Global Trade Alert, GTA Database*
The use of trade restrictions by the Trump Administration in the US is a clear marker of this protectionist trend. Since taking office in January 2017, the Trump Administration has deployed coercive trade diplomacy against many major economies (Table 2). This includes 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. The most prominent of these is the US-China trade war, which over the course of two years escalated through several cycles of tariff and counter-tariff actions to cover $735 billion of trade between their economies. This use of coercive trade diplomacy is a worrying development, given the historical role of the US as the world’s most prominent advocate of trade liberalisation and leader within the WTO.

Table 2 US trade diplomacy under the Trump Administration

<table>
<thead>
<tr>
<th>Target</th>
<th>Year</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>TPP partners</td>
<td>January 2017</td>
<td>Withdrawal from Trans-Pacific Partnership, rendering entry-into-force numerically impossible</td>
</tr>
<tr>
<td>Canada and Mexico</td>
<td>August 2017 – September 2018</td>
<td>Renegotiation of North American Free Trade Agreement under threat of termination</td>
</tr>
<tr>
<td>Korea</td>
<td>January – September 2018</td>
<td>Renegotiation of Korea-US Free Trade Agreement under threat of termination</td>
</tr>
<tr>
<td>World</td>
<td>March 2018 - ongoing</td>
<td>Tariffs applied to solar panels, washing machines, steel and aluminium imports - on national security grounds Canada, China, the EU, India, Mexico, Turkey and Russia all impose retaliatory tariffs</td>
</tr>
<tr>
<td>China</td>
<td>July 2018 – ongoing</td>
<td>Escalating application of tariffs to demand a bilateral trade agreement, rising to cover $550 billion of imports from China. China repeatedly retaliates, with tariffs imposed on $185 billion of exports from US</td>
</tr>
<tr>
<td>Turkey</td>
<td>August 2018 - ongoing</td>
<td>Removal of Turkey from US Generalised System of Preferences (GSP) scheme; imposition of additional 25% tariff of Turkish steel (enacted August 2018, withdrawn May 2019, reimposed October 2019)</td>
</tr>
<tr>
<td>Japan</td>
<td>April 2019 – ongoing</td>
<td>Negotiation of a bilateral trade agreement favouring US agricultural exporters under threat of tariff imposition</td>
</tr>
<tr>
<td>European Union</td>
<td>May 2019 – ongoing</td>
<td>Imposition of retaliatory tariffs on $7.5 billion of EU exports in Airbus dispute Threatened imposition of 25% tariff on automobiles to force a trade-balancing bilateral agreement</td>
</tr>
<tr>
<td>India</td>
<td>June 2019 - ongoing</td>
<td>Removal of India from US Generalised System of Preferences (GSP) scheme</td>
</tr>
<tr>
<td>Brazil and Argentina</td>
<td>December 2019</td>
<td>Removal of exceptions from steel tariffs in retaliation for alleged currency manipulation</td>
</tr>
</tbody>
</table>

Source: See note 41
The Trump Administration’s use of coercive trade diplomacy is harmful to the Australian economy:

- Exports to the US have not been directly affected, due to Australia a securing national security exemption to steel/aluminium tariffs\(^\text{42}\).
- However, as Australia exports intermediate inputs to countries which then export final products to the US, they still carry indirect effects. As Chinese and Japanese steel output embodies Australian iron ore and coal, a *direct* US tariff against their steel exports is an *indirect* tariff against Australian minerals.
- It has undermined the effectiveness of Australian trade diplomacy. While US withdrawal from the TPP did not ultimately collapse the agreement (which was later resurrected as the ‘CP-TPP’ by the remaining eleven members), it has reduced its systemic impact. While the original TPP accounted for 38 percent of world GDP and 26 percent of world trade, US withdrawal reduced its size to only 14 percent of GDP and 15 percent of trade\(^\text{43}\).
- It has also weakened the resilience of the global trade regime. Due to US appointment vetoes, the WTO Appellate Body became inquorate (and unable to hear cases) on 10 December 2019. This has compromised the integrity of the WTO’s Dispute Settlement Mechanism, a key instrument by which Australia protects its trade interests in the global trading system.

Coercive trade diplomacy by China has also imposed harm on the Australian economy. In the last year, the Chinese government has taken several trade policy actions which have constrained Australia’s exports:

- Changed customs procedures at Dalian Port in February 2019, which delayed the handling of Australian coal shipments\(^\text{44}\). The Australia-China coal trade was worth $13.8 billion in 2019.
- Imposition of an 80 percent tariff on Australian barley exports in May 2020 (comprised of both anti-dumping and anti-subsidy components), which will price Australian barley out of the Chinese market\(^\text{45}\). The Australia-China barley trade was worth $591 million in 2019.
- Suspension of export licenses for four Queensland abattoirs in May 2020, which collectively account for approximately one-third of beef exports to China\(^\text{46}\). The Australia-China beef trade was worth $2.6 billion in 2019.
- A range of sanitary and phytosanitary (SPS) bans applied on an ad hoc basis to shipments of Australian horticulture products in 2019, including oats, milk powder and almonds\(^\text{47}\).

These Chinese measures are an example of using trade for ‘political sanctioning’. The Chinese government officially maintains they are technical measures, enacted consistently with relevant bilateral and international trade rules. Australian Government representations, any many independent analysts and Australian industry parties, contend these technical and countervailing measures are without legal merit. Coming at a time of
deteriorating relations between the Australian and Chinese governments, many have argued they are instead a disguised ‘economic sanction’ in retaliation to recent Australian foreign policy actions.

**Chinese trade measures against Australian exports have the potential to seriously harm the Australian economy.** Australia’s concentrated export portfolio makes it uniquely exposed to trade shocks emanating from China. China not only accounts for 38 percent ($150 billion) of its exports, but is also the top market for fourteen of its top-30 export products (Figure 4). Most of Australia’s leading export sectors – including iron ore, coal, natural gas, base metals, education, tourism, beef, horticulture, seafood and cereals – rely heavily on the Chinese market. If such trade measures were extended to a wider range of sectors, the effects on Australian exporters could be potentially catastrophic.

**It is likely that the COVID-19 crisis will accelerate these protectionist trends in coming years.** As economic dislocation and political tensions caused by the pandemic intensify, governments will come under increasing pressure to respond with protectionist and/or coercive trade and investment policy measures. There is already evidence this has begun. Data collated by Global Trade Alert indicates governments have enacted 411 restrictive trade measures in the first five months of 2020 alone, a dramatic acceleration on even recent trends. Many of these restrictions have focused on the pharmaceutical sector, with 89 governments restricting the export of medical products required for the treatment of COVID-19. As global value chains come under increasing strain, it is possible this tendency will spill over into a range of other sectors as well, particularly for ‘critical’ commodities such as agriculture and high technology products.

**Australia has limited capabilities to use international law to defend against such protectionist measures.** The standard response is to raise a dispute through the WTO’s Dispute Settlement Mechanism (DSM), which can address whether trade measures comply with commitments under the various WTO legal instruments. However, WTO DSM cases routinely take multiple years to proceed to result, and require significant investment of resources by both the affected industry and the Department of Foreign Affairs and Trade. In most instances, a resolution only comes years after a key trade relationship has been interrupted. Realistically, only the most significant trade interruptions can be litigated through WTO mechanisms. Moreover, the fact that the WTO Appellate Body is presently inquorate (and thus unable to hear cases) raises doubts over the future reliability of the DSM process. While Australia should continue to use WTO dispute settlement to protect its trade interests, it will not provide a reliable defence against the range of protectionist measures that are likely to come in future years.
6. Economic diversification and shock resilience

Australia presently faces the most adverse external economic environment in over a century. Public health measures to address the COVID-19 crisis have immediately crimped important import and export relationships. The global recession that will follow will threaten Australia’s ability to grow export markets and attract foreign capital. A rising trend towards protectionism will further harm the long-term prospects for economic ties with foreign partners. There is little that Australian governments or businesses can do to prevent these global trends.

However, the lack of diversity in Australia’s external economic relations will magnify the effects of these shocks. Its trade profile is heavily concentrated toward primary industry exports to Asia, with China the dominant buyer across most leading sectors. Its investment relationships depend upon the supply of capital from US and European markets. As a consequence, an economic shock facing a particular sector or country will have an outsized impact on the domestic economy. In an era in which external economic shocks are intensifying in frequency and magnitude, this lack of diversity poses dire risks to Australia’s future prosperity.

While Australia cannot prevent external shocks, it can take steps to manage risk by diversifying its economic relationships. Australia’s current pattern of economic ties did not originate by accident. They were built due to the deliberate acts of successive generations of governments and businesses: to support the development of world-class export industries in the primary and services sectors, and pioneer trade and investment relationships with partners in Asia. Its world-record run of 29 years recession free (1991-2019) is a testament to the success of these efforts. However, it also shows that Australian governments and businesses can make decisions regarding the form of their foreign economic ties. Deliberate steps toward external economic diversification are now an essential risk management strategy for Australia’s economic future.

Diversification will be a complex, long-term endeavour for Australia’s foreign economic policy. It is not about building any particular product or country market, nor indeed reducing existing trade and investment relationships that have performed well. Rather, it involves a set of inter-linked activities by government to foster a broader foundation for Australia’s future economic engagement with the world. Given current patterns of external trade and investment exposure, there are five key objectives that need to underpin diversification efforts:
OBJECTIVE 1: Product diversification of the export basket by fostering new export industries. Australia’s export performance presently depends on just four sectors: agriculture, mining, tourism and education. While these have successfully developed over the last three decades, their growth prospects will diminish due to external shocks in coming years. There is a pressing need for a broader industrial base to provide resilience against expected shocks in these established export sectors. Industries in areas of existing strength – such as technology-intensive services and advanced manufactures – should receive policy support to become more export-oriented, to complement the existing export profile.

OBJECTIVE 2: Country diversification of the export basket by promoting new markets. Most of Australia’s leading export lines rely on a single market for the bulk of their sales. This leads to a very high exposure to external shocks – both natural and political – originating in these markets. As these shocks become more common, there is a need for greater diversity in the markets with which Australia’s export industries trade. Policy support should be given to existing and new export sectors to build relationships with new markets, with a focus on higher-growth economies in the Indo-Pacific.

OBJECTIVE 3: Country diversification of foreign investment relationships. The Australian economy currently depends on net capital inflows from traditional markets in the US and Europe, which in the short term are unlikely to supply investment at the levels previously experienced. There is also a clear missed opportunity to develop investment ties – both inward and outward – with higher-growth economies in the Indo-Pacific. Investment policy efforts should focus on establishing investment relationships with economies in the Indo-Pacific where trade relationships have already been successfully built.

OBJECTIVE 4: Assessment of import concentration and potential value chain risks. Many of Australia’s most important imports rely on a single supplier. As the COVID-19 crisis has shown, interruptions to global value chains can expose Australia to shortages of critical inputs. Given the complexity of these value chains, there is very little data on where such risks could originate in future. The Australian Government should undertake or commission research to better understand the geography of value chains for critical inputs, identify potential risks, and develop policy to build resilience in areas where identified risks are found to be significant.

OBJECTIVE 5:Coalitional international diplomacy in response to spreading protectionism. As an open economy, the protectionist trend sweeping the global economy will seriously harm Australia’s trade interests. And as a medium-sized country, Australia is unlikely to be able to defend itself against this global trend acting alone. But by working through international coalitions with likeminded partners, Australia can contribute to collective efforts to resist the turn towards protectionism. Coalition-building for free trade should become a leading focus of Australia’s global and regional diplomacy.
Fortunately, the Australian Government already has many policy efforts in train to develop new trade and investment relationships. Prior to the COVID-19 crisis, these efforts were a routine and longstanding component of Australia’s foreign economic diplomacy. But as the crisis has brought into sharp relief the risks associated with concentrated economic relationships, they should now be accorded as much higher priority than in previous times. As the preceding analysis shows, diversification is not simply desirable but essential if the Australian economy is to successfully weather the external economic shocks that the COVID-19 crisis has created. The Australian Government should, in the first instance, expand and accelerate its existing policy programs designed to achieve the aforementioned diversification objectives.

It is beyond the scope of this submission to provide a comprehensive and economy-wide analysis of all available policy options for external economic diversification. However, and building upon existing and emerging Australian policy initiatives, several possible steps which warrant immediate and high priority include the following:

1. **Promoting commercial opportunities unlocked under IA-CEPA with Indonesia.** The Indonesia-Australia Comprehensive Economic Partnership Agreement enters into force on 5 July 2020. IA-CEPA is more than a trade agreement, and combines conventional economic liberalisation provisions (in the trade and investment domains) with institutional mechanisms to enhance bilateral economic cooperation. It unlocks major new opportunities for trade relationships in the agriculture and services sectors, as well as a regulatory foundation for promoting bilateral investment. However, many of the provision in IA-CEPA – including those based on regulatory cooperation – will require additional bilateral diplomacy to be implemented. Once COVID-19 restrictions have sufficiently eased, the Australian Government should prioritise IA-CEPA implementation efforts.

2. **Increased focus on economic diplomacy with Vietnam.** Vietnam is an ideal economic partner for Australia. It has complementary economic needs, a stable business environment, and a high growing economy driven by youthful demographics and rapid urbanisation and industrialisation. However, Vietnam presently accounts for only 1.7 percent of Australia’s two-way trade, indicating there is considerable room for growth. Fortunately, there are already two platforms for trade and investment: their joint membership in the Australia-NZ-ASEAN free trade agreement (AANZFTA) of 2009, and the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) of 2018. More focused commercial diplomacy with Vietnam, particularly targeting opportunities opened by the CPTPP, would help build new trade and investment ties with a complementary partner.

3. **Developing new sectoral cooperation platforms with India.** Like Indonesia and Vietnam, India is an economic partner of great potential for Australia. However, the bilateral economic relationship has
suffered from a lack of supporting instruments beyond joint membership in the WTO. In June 2020, the governments agreed to relaunch negotiations for the India-Australia Comprehensive Economic Cooperation Agreement (IA-CECA), which had been on hiatus since 2015. Negotiating a bilateral FTA with India is an important medium-term priority, as India is the only major Indo-Pacific country with which Australia lacks a trade agreement. But as FTAs routinely take several years to negotiate, ratify and implement, Australia should also pursue sectoral cooperation with India as an ‘early harvest’ initiative. The recently-concluded bilateral MoUs on critical minerals, cyber technologies, defence science and vocational training provide a foundation on which such sectoral efforts can be built.

4. **Supporting international partnerships in the critical minerals and battery sectors with Japan and Korea.** Critical minerals – such as lithium, rare earths and cobalt – are a major new economic opportunity for Australia. These minerals are essential for the digital, clean energy, battery and defence sectors, but value chains currently face several security and sustainability challenges. Australia’s strong geological endowment and trusted investment environment make it an ideal new supplier across many critical mineral subsectors. Its technological capabilities also offer opportunities for developing ‘mid-stream’ processing industries in the fast-growing battery sector. Japan and Korea are ideal partners for these efforts, given their position as major world producers of technology products containing critical minerals. Australia’s longstanding and trusted economic partnerships with Japan and Korea provide a political and institutional foundation to jointly develop these new industries.

5. **Promoting opportunities created by the RCEP trade agreement.** The Regional Comprehensive Economic Partnership will be a landmark addition to the global trade architecture. Comprising ASEAN and five partner economies (Australia, China, Japan, Korea and New Zealand), its members account for 29 percent of world GDP in 2018. Most negotiations have now been completed, with a target for signing by the end of 2020. While RCEP offer some new market access for Australia in Southeast Asian markets, its principal benefit is as a platform of regulatory harmonisation amongst the fifteen country bloc. It will provide a single, streamlined set of rules across many trade, services and investment domains, opening new opportunities for the development of regionally-integrated cross border value chains. When RCEP is completed, the Australian Government should look to support Australian businesses to participate in these new value chains.

6. **Expansion of the CPTPP agreement, with a focus on Thailand, Korea and Indonesia.** The CPTPP is one of the highest-standard free trade agreements ever completed, combining a range of tariff reductions with rules for ‘21st century’ trade issues such as investment, intellectual property and services. Importantly, the CPTPP also includes ‘accession’ provisions that enable additional countries to join the
eleven-member bloc. As the CPTPP is an important bulwark against the spread of protectionism, and reflects Australia’s trade interests as a service- and knowledge-intensive economy, Australia should lead diplomatic efforts to bring new members into the agreement. The Korean and Thai governments have formally considered CPTPP accession, while Indonesia may also look to join the agreement as it attempts to recover from the effects of a COVID-related recession.

7. Supporting India’s integration into the regional architecture through APEC membership. For several decades, India has been an outsider to the international architecture promoting the economic integration of the Indo-Pacific. This imposes barriers to India having a voice in regional discussions on issues of economic importance, and Australian attempts to build an India economic relationship beyond bilateral areas of interest. Indian membership of APEC would provide a practical first-step in closing this gap. APEC is an established and trusted economic dialogue platform for the region; and its voluntary and non-binding constitution lowers barriers to entry in comparison to treaty-based organisations and mechanisms. There is also appetite for Indian accession amongst several current APEC members. The Australian Government should engage India and regional partners to explore options for Indian accession to APEC in the near future.

8. Coalitional diplomacy to sustain a rules-based global trade architecture. As a medium-sized and open economy, Australia depends on a rules-based global trading system to safeguard its external relationships. With protectionism rising around the world, and both the US and China deploying coercive trade diplomacy, the need to re-invest in a rules-based trading system is higher than ever. There are two global initiatives presently underway to which Australia is a party, including:

   a. WTO negotiations on e-commerce, launched in January 2019 by a coalition of 75 WTO members accounting for 90 percent of global trade. These negotiations intend to create baseline rules for digital-based trade, an important gap in the existing WTO legal architecture. They will also help open new markets for Australian digital-based service exports.

   b. WTO Multi-party interim appeal arbitration arrangement (MPIA). With the WTO Appellate Body becoming inquorate in December 2019, 18 WTO members and the EU formed an interim mechanism for the resolution of trade disputes in April 2020. Expanding this arrangement would help safeguard existing WTO mechanisms while Appellate Body reform is conducted. While these initiatives cannot address the challenges posed by rising protectionism, their success and growth would be a powerful marker of commitment to rules-based trading arrangements amongst a broad coalition of economies. In keeping with its tradition of middle power diplomacy, Australia should prioritise these multilateral initiatives within its trade diplomacy in the near-term.
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The Perth USAsia Centre located at the University of Western Australia is a non-partisan, not-for-profit institution strengthening relationships and strategic thinking between Australia, the Indo-Pacific and the USA. The Centre is a leading think tank focusing on geopolitical issues, policy development and building a strategic affairs community across government, business and academia. Since the Centre’s inception in 2013, we have collaborated with over forty partners to convene more than four hundred programs across sixteen cities in eight countries, engaging a world-class community of over 10,000 strategic thinkers and policy leaders.

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2. An exception to this occurred during the global resources boom of 2005-2014, where surging mineral exports saw Australia run consistently large trade surpluses.
4. Author’s calculations, from ABS (2019) International Trade: Supplementary Information, Calendar Year, 2018, Cat No. 5368.0.55.004
7. Monopsony refers to a situation where a single dominant buyer accounts for the majority of a defined market, and is able to suppress competition in that industry. It is the inverse of the better-known concept of monopoly, which refers to markets with a single dominant seller.
8. DFAT (2019), Trade Statistical Pivot Tables
9. DFAT (2019), Trade Statistical Pivot Tables
10. Author’s calculations from ABS (2020), International Investment Position, Australia: Supplementary Statistics, Cat No. 5352.0, Table 5.13.
11. Author’s calculations, from ABS Cat Nos. 5352.0 and 5206.0
12. For investment accounting purposes, the PRC (‘mainland China’) and Hong Kong should be treated as a single entity. This is due to Hong Kong’s role as a financial intermediary between the PRC and global capital markets, where investments to and from the mainland are routed through corporate entities domiciled in Hong Kong.
13. ABS Cat No. 5352.0.
15. ABS Cat No. 5352.0.
16. ABS (2019), Australian National Accounts: Tourism Satellite Account, 2018-19, Cat No. 5249.0, Table 9. Note that while “non-education personal travel” generated $22 billion of exports in 2018, the higher figure reported ($38 billion) here reflects the total GDP contribution of this activity.
17. ABS Cat No. 5249.0, Table 13.
18. ABS (2019), International Trade: Supplementary Information, Financial Year, Cat No. 5368.0.55.003, Table 9.1.
20. Author’s calculations, from DFAT (2019) Trade Statistical Pivot Tables. Comprises commodity codes 541 (pharmaceutical products), 542 (medicaments), 774 (medical diagnostic apparatus) and 872 (medical instruments).


Supra note 11.


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Supra note 40.


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