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## **CHINA–AUSTRALIA ECONOMIC COOPERATION AND THE BELT AND ROAD INITIATIVE**

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# China-Australia Economic Cooperation and the Belt and Road Initiative (BRI)

## Background

This paper is the product of a study jointly undertaken by the East Asia Bureau of Economic Research (EABER) in the Crawford School of Public Policy in Canberra and the China Center for International Exchanges (CCIEE), in Beijing, as background to the visit of Premier Li Keqiang to Australia in March 2017.

## Summary

China's Belt and Road Initiative (BRI) relates to the overarching agenda for cooperation between Australia and China based on their shared interest in an open global economic system and reforms that promote the effectiveness of participation in the international market. These interests should guide the approach to regional and global cooperation. The BRI offers a framework for deepening cooperation through a process of open regionalism that promotes: policy cooperation on economic issues of importance to both countries; the exploration of priorities for investment to enhance connectivity; trade and direct investment; the deepening of financial links; and the expansion of people-to-people exchanges.

Both governments should invest in the deepening of the relationship within the framework of their Comprehensive Strategic Partnership by establishing an Australia-China (Ao-Zhong) Commission to promote high level policy research and scientific and cultural exchanges between the two countries. This will promote knowledge of developments in each country and facilitate cooperation on initiatives such as BRI.

It is time to follow through an ACJER recommendation that the Chinese and Australian governments upgrade cooperation on the BRI through establishing a dedicated high-level joint working group under the Comprehensive Strategic Partnership. A follow up study by officials and researchers might examine the role that BRI could play in the development of North Australia.

To promote trade and investment connectivity, the landmark ChAFTA agreement should be implemented and its investment chapter should be used to put in place a new bilateral investment agreement to benefit both countries. This will be a key to realise the opportunities from BRI.

Deepening financial integration will benefit from dialogues and work between the two governments to understand the challenges which China faces of opening its capital account to make its economy more flexible and resource allocation more efficient while managing associated financial risks to its domestic economy.

It is important to invest in people-to-people bonds and the social capital needed to support the development and management of a higher level relationship through the Australia-China Commission proposal. Deep mutual understanding and working closely together on policy developments through such exchanges will help manage risks and achieve the full potential in the relationship.

## **Introduction**

The Belt and Road Initiative (BRI) is a major Chinese initiative for achieving sustainable development through strengthening connectivity with partner countries and realising mutually beneficial economic relations. It offers a comprehensive framework for deepening international economic cooperation through a platform of open regionalism that promotes economic integration through deepening five types of links, namely: policy, infrastructure, trade and investment, financial and people-to-people exchanges.

Of these five types of links, a priority is put on infrastructure connectivity. This type of connectivity is about the building and financing of roads, rail, gas pipelines, oil pipelines, electricity and telecommunications connectivity between participating countries. It also includes building of major economic corridors and ports that facilitate the flows of goods, capital, technology, people, and information. Infrastructure connectivity is an important part of economic development, the deepening of which should significantly ease bottlenecks on growth and help deepen trade and investment and financial integration.

What are the principles and platforms that BRI promotes for the building of these different types of connectivity? Importantly it adopts the principles of open regionalism that welcome the participation of any countries around the world. Partners can take part in the cooperation at any level and in whatever area best suits their needs and priorities, domestic conditions and readiness for international cooperation. Through this open and inclusive platform, free trade and investment and financial integration can be promoted, ‘consult, jointly build, and share’ principles can be put into practice, ‘mutual learning and mutual benefit’ can be pursued, and joint development can be realised.

Upholding free trade principles and deepening economic integration are what the world now needs in the context of slow global growth and a rising tide of anti-globalisation. Australia can welcome commitment to these principles. It can recognise the upholding of these principles through the BRI as the demonstration of Chinese support for, and contribution to, the international public good and economic leadership that the region and the world needs for achieving more sustainable growth and development. Based on close consultation and cooperation, the BRI can be seen as an important opportunity for broadening and diversifying Australia’s and China’s bilateral, regional and global cooperation and strengthening their Comprehensive Strategic Partnership.

## **The foundations for Australia-China economic cooperation**

In his speech to a joint sitting of the Australian parliament on 17 November 2014, Chinese President Xi Jinping declared that Australasia was a ‘natural extension’ of the Maritime Silk Road, and he invited Australia to participate in the BRI. The state visit of Australia by Premier Li Keqiang on 22 March 2017 will frame the BRI as providing a new impetus to the development of Australia-China economic relationship.

Australia and China are major economic partners and have a shared strategic stake in regional and global peace and prosperity. They have a comprehensive relationship that leaders of both national governments have warmly acknowledged as a Comprehensive Strategic Partnership. Capturing the potential benefit of the relationship will require joint and concerted efforts from both the public and private sectors of the two countries in advancing the relationship.

The five types of connectivity promoted under the BRI provide a useful framework to think through how Australia and China can put effort into advancing their economic relationship for years to come.

### ***Political and policy commitment***

The Australia-China comprehensive partnership is anchored at the top leadership level through frequent visits and deep policy engagement that sends a clear message about the high level of political trust and goodwill in their relationship. This political commitment is critical to signal where the overall relationship currently stands and the breadth and depth of cooperation that the two governments aim to achieve bilaterally, in the region and in global affairs.

Going forward, political commitment and new institutional arrangements will be essential to support the deepening of the Australia-China partnership. The regular meetings between top political leaders that confirm this commitment will provide business and both communities with confidence in advancing their bilateral economic relations.

Strategic and policy engagement has played a key role in the development of the Australia-China relationship. The Chinese and Australian governments should continue to commit to invest in an institutional framework that seeks to deepen strategic engagement, promote trade and

investment opportunities as well as manage policy and political risks through regular high-level leadership dialogues.

To build the capacities necessary to elevate their engagement, Australia and China should commit to the establishment of a program of exchanges to promote high level policy research, scientific and cultural exchanges between the two countries. EABER and CCIEE suggest a Joint Task force be set up to develop recommendations for the implementation of this initiative, drawing on the expertise and work of the *Australia-China Joint Economic Report (ACJER)*.<sup>1</sup> It is timely to progress the establishment of a well-resourced bi-national Australia-China (Ao-Zhong) Commission. The Ao-Zhong Commission was a key recommendation made in the *ACJER* in 2016. It will nurture the capacities necessary to boost the level and range of policy, research, scientific, technology and cultural exchanges between the two countries and symbolise the unique importance of the relationship to both countries. The Commission will promote deeper and shared knowledge of developments in each country that support the Australia-China comprehensive strategic partnership, and facilitate cooperation on joint interests and initiatives, such as the connection between the BRI and North Australian development.

The economic relationship is the cornerstone of the overall Australia-China bilateral relationship. The *Australia-China Joint Economic Report (ACJER)*, the work of which the two governments have endorsed, recommends that the framework of economic collaboration should be built upon established partnerships between the two governments' departments and agencies. These partnerships include the Comprehensive Strategic Partnership, the Strategic Economic Dialogue and the Joint Ministerial Economic Commission at the leader and ministerial levels, as well as official agency partnerships such as that between the Australian Treasury and China's National Development and Reform Commission and the ties that are growing between the Reserve Bank of Australia and the People's Bank of China.

These arrangements can draw upon research and corporate expertise to inform in the development of official dialogues<sup>2</sup>. It is important to involve the state and provincial authorities and the research communities of both countries in developing initiatives in the relationship.

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<sup>1</sup> *Australia-China Joint Economic Report (ACJER)*, 2016, <http://press.anu.edu.au/publications/partnership-change/download>.

<sup>2</sup> For example, the Chinese Center for International Economic Exchanges and East Asian Bureau of Economic Research at ANU (who collaborated to produce the *Australia China Joint Economic Report* in 2016) may usefully be

## *The Belt and Road Initiative*

The BRI provides opportunity for deepening bilateral policy engagement between key economic agencies, between the national governments of the two countries in developing the appropriate 'policy match' between China's BRI and Australia's policy priorities. A critical part of the discussion includes the link between the BRI and Australia's infrastructure development needs, not only in relation to the development of North Australia but across all Australian jurisdictions, national, States and Territories.

Policy discussions should not be limited to bilateral or sub-national interests but include critical regional and global issues, encompassing how BRI may relate both countries' interest in the regional cooperation agenda, through RCEP and FTAAP, the development of which will have a great bearing on the international economic relations of both countries.

The time is right for Australia and China to pool their resources strategically and collaboratively to consider emerging and critical issues across a broad range of fields that affect their national development objectives, bilateral relationship and international interests.

China's BRI provides an opportunity for innovative cooperation that can strengthen open economic arrangements and promote investment in the infrastructure to support them. Through commitment to promote their mutual interests through the BRI, the two countries can work to strengthen bilateral investment arrangements; jointly study bilateral opportunities for cooperation; seek to promote economic cooperation through joint studies such as a study of the role that BRI might play in the development of North Australia or the maritime economy in the context of BRI..

Australia and China are maritime powers with common interests in seaborne supply routes and many other maritime issues. The Maritime Silk Road in the BRI provides an opportunity for collaboration in the development of the maritime economy. To facilitate such collaboration, Australia and China should establish a working group to discuss the implications of growing resource dependence for resource security; maritime resource development and protection;

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engaged to provide the vehicle for further study on deepening economic cooperation between Australia and China through the BRI.

maritime scientific and weather research; and Australian participation in the Maritime Silk Road initiative. .

### ***Infrastructure connectivity***

Infrastructure connectivity is a key area on which both countries could focus in developing their joint work plan in official dialogues at central or federal government and provincial or state government levels and the corporate level.

There is room to improve Australia's infrastructure significantly, as its international ranking on infrastructure has fallen, reflecting lower scores for road and air transport infrastructure. Further investments are needed in areas like transport networks to support growing urban populations in big cities such as Sydney, Melbourne and Brisbane.<sup>3</sup> Other regions in Australia that need infrastructure development include North Australia, a vast area with rich resources but a paucity of infrastructure that holds back development.

The Australian government has set up an A\$5 billion concessional loan mechanism, the Northern Australia Infrastructure Facility (NAIF), and businesses from any country are able to access these loans.<sup>4</sup> A possibility is that other countries might contribute to this funding mechanism. Australia does not have the domestic savings sufficient to build and upgrade ports, pipelines, logistics networks and transportation facilities. Overall expansion in infrastructure investment — whether in the North or anywhere else in Australia — will need to be supplemented by foreign savings.

The BRI can provide the opportunities to improve infrastructure connectivity in Australia. Financing for infrastructure development in Northern Australia is a particular interest, but Australia's national priorities and framework for infrastructure financing will be an overriding interest.<sup>5</sup>

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<sup>3</sup> Infrastructure Australia released an Australian Infrastructure Plan in February 2016 that outlines reforms for improving investment, deliverance and usage of Australia's infrastructure. *Infrastructure Australia* 2016, <http://infrastructureaustralia.gov.au/policy-publications/publications/Australian-Infrastructure-Plan.aspx>

<sup>4</sup> Government of Australia 2015b, *Our North, Our Future: White Paper on Developing Northern Australia*, 18 June, <https://www.cdu.edu.au/sites/default/files/the-northern-institute/docs/northern-australia-white-paper.pdf>

<sup>5</sup> Treasury 2015, *Foreign Investment Review Board Annual Report 2013-2014*. The 2015 round of the Australia–China Strategic Economic Dialogue focused on regional infrastructure investment, and formed working groups to explore

Australia and China can also explore opportunities of cooperation on infrastructure projects in third countries. A Chinese financial institution might provide the capital, a Chinese construction company provide materials and other inputs, and an Australian engineering consultancy might provide the project planning, financial forecasting, risk and talent management in cooperation on a major infrastructure project in a third country.<sup>6</sup> There are other forms of cooperation that can be explored. Cooperation from the G20 Infrastructure Hub in Sydney may assist in the development of a joint approach to regional infrastructure.

The *ACJER* recommends extending the work already being undertaken by the Strategic Economic Dialogue Investment Working Group that explores the practicalities of the two countries working together to enhance domestic and regional infrastructure investment.

### ***Trade and investment connectivity***

#### *Trade*

The China-Australia Free Trade Agreement (ChAFTA) signed between the two governments in December 2015 is the most open and liberalising such arrangement that China has entered into with any developed economy. It also goes much further than its trade liberalisation agreements with other partner countries that Australia has previously signed.

ChAFTA opens the door to expand bilateral trade in markets for high value goods and services, including offering China free access to Australia's services sector. It offers Australia the prospect of significant access in China's markets from dairy and health products to education and tourism — benefiting Chinese consumers. ChAFTA also opens the door to new opportunities in investment.

There remain a number of obstacles to deepening the Australia-China economic relationship. These obstacles are related to how commercial entities deal with behind-the-border trade and investment barriers, such as regulatory institutions. They are also related to how to build deeper

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opportunities in Northern Australia. China sent representatives to participate in the Northern Australia Investment Forum held in Darwin in November 2015. <https://firb.gov.au/files/2015/11/FIRB-AR-2013-14.pdf>

<sup>6</sup> Lumsden, A, Knight, L & Daveson, S 2015. "China's One Belt One Road — A new opportunity for Australian expertise", Corrs Chambers Westgarth, 20 July, <http://www.corrs.com.au/thinking/insights/chinas-one-belt-one-road-a-new-opportunity-for-australian-expertise/>

private bilateral business networks and associations to facilitate the growth of business between the two countries in each other's markets and those of third countries.

While services trade has driven the growth of the bilateral trade relationship in recent times, there is a lot more that can be done to expand the trade in services between China and Australia. In developing tourism, for example, each country needs to ensure that it remains an attractive travel destination so that visitor numbers continue to grow; visa-application processes are smooth and easy to navigate; airports and transport facilities are among the world's best; and the workforce grows its English language capacity in China and Chinese-language capability in Australia. Improving flight capacity and making flight connections more efficient are essential to the growth of the trade in tourism.

One form of cooperation that offers large potential gains is recognition of professional services qualifications from the other jurisdiction. Another field that could provide early gains is in Chinese medicine. Chinese medicine is still a nascent industry in Australia, but it has succeeded in attracting attention from government bodies and business. The range of recent advancements in regulation, collaboration and exchange can lead to greater opportunities for Australian research, development and export in the area of Chinese medicine in years to come.

### *Investment*

Arrangements to build confidence in undertaking foreign investment in each country are a priority if the opportunities of the BRI are to be realised. There remains confusion about the treatment of Australian and Chinese investors under each country's foreign investment regimes. Policies that enshrine no discrimination against the same class of foreign investment across foreign investment sources and entrench the national treatment principle need to be the anchors of each foreign investment regime. Making the national treatment principle robust in China is a subject for dialogue.

Australia's current foreign investment review regime risks deterring beneficial Chinese capital by increasing the costs and the uncertainty of doing business in Australia — especially as capital looking to invest in manufacturing, agriculture, tourism, infrastructure and services is far more mobile compared to that seeking resources investment. There is further work to be done in providing Chinese investors with similar screening thresholds to those accorded to Australia's

other FTA partners to remove the extra costs and risks to Chinese investments in agribusiness. To capitalise on the opportunities from Chinese capital and investment, Australia also needs to increase contestability in service and infrastructure markets to help attract Chinese and other foreign investment.

Foreign investment in China is in the early stages of liberalisation. China has started to approach foreign investment from the perspective of negative-listing and national treatment but that now needs to be an active agenda. China needs to reconsider sector-specific investment restrictions that apply to both domestic and foreign investors. Australia's aim is to provide a predictable and transparent investment review process. China's current investment regime is restrictive in areas of interest to Australia and provides inadequate institutional protections to Australian investors post-establishment. Australia should encourage China to continue to open its service sectors to foreign investment, based on China's own interest to develop a more internationally competitive service sector and achieve more balanced growth. China continues the effort to improve the negative list in governing foreign investment and make its foreign investment regime more open and transparent.

These are issues that need to be progressed through advancing the negotiation of the investment chapter under ChAFTA as recommended in the ACJER.

Given growing uncertainties in the international investment environment, it is timely that the the ChAFTA investment chapter be used actively to negotiate a new Australia–China Bilateral Investment Treaty (BIT) and adopt the principles of national treatment and a negative list on investment access<sup>7</sup>.

A lack of significant progress on improving the regulatory and policy frameworks for furthering the bilateral investment relationship will be a lost opportunity in its own right but also a major bottleneck for BRI cooperation between Australia and China.

### ***Financial integration***

Australia and China have taken many steps in recent years to develop closer financial linkages. This includes the realisation of convertibility between the Australian dollar and yuan in the inter-

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<sup>7</sup> ACJER, Chapter 4

bank market in China in November 2011; the signing of a bilateral local currency swap agreement between the Reserve Bank of Australia (RBA) and the People's Bank of China in March 2012; the achievement of direct trade between the two currencies in April 2013; the RBA beginning to hold yuan reserves and Chinese government debt; and the Australian Securities Exchange (ASX)- Bank of China RMB settlement service, which was instituted in February 2015 as a result the Chinese Government's announcement of Sydney as an official RMB Hub.

While Australian and Chinese financial institutions will continue to play a role in delivering financial services directly to local consumers, they have more of a role to play in lowering the costs of trade between Australian and Chinese companies. This includes supporting settlement or trade directly between the Chinese renminbi and the Australian dollar, providing products to hedge currency risk (particularly as China's foreign exchange regime becomes more flexible), and fostering integration with Chinese payment systems. This has occurred in the context of the RMB internationalisation process that uses the RMB to settle cross-border trades and services. Given China's position as the world's largest trading nation, that has helped fuel the demand for the currency.

China's continuing financial reform and capital account opening will be crucial to facilitating future financial integration. China's financial opening will increase the size and range of Chinese assets held by Australian institutions and corporations, as well as the portfolio of Australian assets held by Chinese institutions and enterprises. It will see China's currency used more extensively in international transactions and borrowing. Chinese households and institutions will increase the portfolio of assets they hold in Australia and elsewhere.

The management of financial risks should also be part and parcel of deepening financial integration between the two economies. China faces the challenges of opening its capital account to make its economy more flexible and resources allocation more efficient while managing associated financial risks to its domestic economy. This issue should be an important part of the agenda in official policy dialogue between the governments and policy communities in Australia and China. Over time the exchanges that are developed through the Australia-China Commission will be important to building capacity for these dialogues.

### ***People-to-people bonds***

People-to-people bonds are the fifth component of connectivity that the BRI promotes. They are critical in underpinning the success of initiatives for international cooperation. The BRI will not bring mutual benefit to both countries nor help the realisation of potential in the relationship unless a true partnership can be developed between the two societies and their peoples. This is a long term project but requires immediate action as we have argued above and in our *Australia-China Joint Economic Report*<sup>8</sup>.

There are short-term practical implications. Australia and China are now aiming to realise the potential for trade in higher value-added goods and more sophisticated services. That requires Australia and China to go beyond transactional relationships of the kind that are more common in resources and manufactured goods trade, toward a partnership that supports long-term two-way investment and the exchange of ideas and talent in building innovative and more productive economies.

This requires long-term investment. Strong people to people bonds build mutual trust, entrench friendship and foster a deeper understanding of how the other country works. This is the social capital on which a stronger relationship will be built. This capital takes years, if not generations, to nurture and grow. Australia and China have very different social traditions, systems of government and business cultures and investment in this social capital is essential to development and management of the relationship.

As a first step, Australia and China should develop in-depth knowledge of the political, economic, social and cultural circumstances of one another and help develop understanding and reduce misreading of the intentions of the other side. This will require significant investment in education by the governments, organisations and individuals to improve the language skills and cultural awareness of other countries.

The bi-national Australia-China Commission that we have recommended can help boost the level and range of scientific, official, research, business and community exchanges between the two countries dramatically and drive the accumulation of human capital and networks needed to take the Australia-China relationship to the next level. It will promote the building of ‘literacy’, multi-level scholarly exchange, bureaucratic network-building, political interactions and sustained

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<sup>8</sup> *ACJER*, Executive Summary and Chapter 6

high-level business dialogue, and develop a forward work agenda for improving economic policymaking coordination.

Tourism and cultural exchange can also play an important part. Both sides would benefit from clear frameworks for cooperation on the bilateral movement of people and ideas. A bilateral working party consisting of official, business, tourism and education representatives should be convened to review the adequacy of visa arrangements on both sides. Existing initiatives, such as Australia's Significant Investor Visa program, could be more widely advertised to promote uptake. Both countries should consider making it easier for each other's citizens to live and work in either country.

The Chinese community in Australia has a special role to play in bridging the bilateral relationship. Migration from China to Australia helps meet Australian demand for human capital in fast-growing areas. Chinese accountants, advertising and marketing professionals, IT specialists and educators do not just bring technical skills, but also possess up-to-date knowledge of consumer preferences, business practices and market opportunities in China. Through their local knowledge and network, they can also bring opportunities for Chinese businesses. With the help of entrepreneurs who were Chinese-born, or raised, in Australia with an in-depth understanding of Chinese and Australian culture and sensibilities, Australia and China can develop better goods and services that the other side needs, and make investment decisions tailored to local demands.