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GETTING THE AUSTRALIA–CHINA RELATIONSHIP RIGHT

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Key Messages

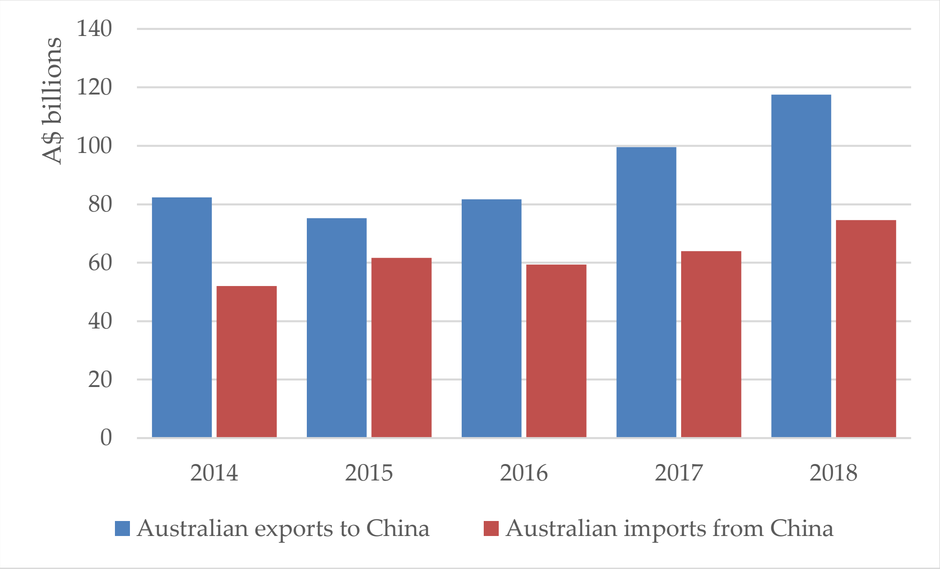
- Australia–China trade has continued to grow strongly over the past two years despite highly negative commentary about the two countries' bilateral relationship. Two-way goods trade expanded by 17.5 per cent in 2018, five times faster than global trade growth, topping A$192 billion. The success of the trade relationship is built on commitments to international market-based growth in Australia and China, the global trade rules under which the trade relationship has flourished, and both countries' putting in place bilateral arrangements such as the China–Australia Free Trade Agreement (ChAFTA) that deepen those commitments.
- Robust trade growth between the two countries belies the premises of the negative commentary on the Australia–China relationship. But there are important issues that both Australia and China must now address. That led to the proposal of the partnership for change in the 2016 Australia–China Joint Economic Report (ACJER) that embraces the achievements from investment in the relationship over the past 40 years, builds on shared interests in the region and the management of global affairs, and defines a new path towards productive engagement in the bilateral relationship.
- Both countries face big uncertainties in the global economy and threats to the multilateral trade and economic regime. The problems in China's economic relationship with the United States are one element in that uncertainty. These problems are a matter for resolution between China and the United States. Yet what those two countries choose to do is of systemic importance, affecting the whole international trading system. It is, therefore, a priority for Australia to work with China in multilateral frameworks such as the G20, the WTO and the IMF to ensure the multilateral regime is defended and strengthened to protect the interests of all countries whose welfare depends upon it. Countries in Asia and the Pacific, Australia and China included, are especially dependent on the multilateral system and its rules.
- Australia, China and their partners in Asia must give the highest priority to concluding the Regional Comprehensive Economic Partnership (RCEP). That will be an important statement about Asian priorities for open multilateral trade in the face of economic and political security uncertainties. RCEP is a critical vehicle for strengthening economic and political cooperation among economies in the region.
- Geopolitical anxieties about China's rise have economic consequences for China itself and partners such as Australia. Anxieties corrode trust in deepening economic integration, causing open trade and investment regimes to constrict. Both countries need to work to reduce these anxieties.
- China's Belt and Road Initiative (BRI) offers an opportunity for increasing connectivity and economic engagement in the region and around the world. China and regional partners including Australia must work together to commit to establish the principles and arrangements that will allow the potential of the BRI to be realised and reduce risks for all parties.
- Uncertainties in Australian foreign investment policies have coincided with reduced Chinese investment in Australia. These uncertainties can be mitigated within the framework of ChAFTA by working through the principles that might facilitate the growth of two-way direct investment.
- Australia and China need to elevate their engagement in a time of challenge. They need to build better understanding of the potential in their relationship as well as the areas where system differences limit it. Huge changes are taking place in Australia and China and in their relationships with other countries. Understanding these changes is necessary to provide a strong foundation for a big economic relationship and a political relationship that secures it. Australia has expanded funding for bilateral exchanges with the establishment of a new National Foundation for Australia–China Relations in Australia. The Foundation can be directed to deepening bilateral engagement. Both governments should jointly commit to exploring how to establish the Australia–China Commission recommended in the Australia–China Joint Economic Report. The Commission would be set up with the necessary standing to forge respectful understanding in both countries and to build on initiatives like the new Foundation.

New Circumstances

Since the Australia–China Joint Economic Report (ACJER) was released in 2016, the Australia–China trade relationship has continued to grow very strongly. Bilateral trade is expanding despite weak global trade growth and increased policy uncertainties around developments in the United States following the election of President Donald Trump and in Europe because of the crisis surrounding Brexit.

Australia–China goods trade topped A$192 billion in 2018 and grew more than five times as fast as the world average (see Figure 1).[1] This remarkable growth was largely due to strong Australian commodity exports and impressive trade diversification foreshadowed in the ACJER.[2]

Figure 1: Bilateral two-way goods trade, 2014 to 2018 (A$ billions)



Source: Australian Bureau of Statistics (ABS), *International Trade in Goods and Services, Australia*, cat. no. 5368.0, Jan 2019, Tables 14a and 14b.

Australia's share of total Chinese iron ore imports was 60 per cent in 2018 as total Chinese external procurement of iron ore rose to 90 per cent, up from 83 per cent in 2014. Australia's share of Chinese coal imports rose to a record 54 per cent in 2018, up from 48 per cent in 2014 (see Table 1). The value of China's coal imports from Australia grew by 9.8 per cent year-on-year,[3] despite China reportedly tightening import restrictions on coal from all countries in the last few months of 2018.[4]

[1] Australian Bureau of Statistics (ABS), *International Trade in Goods and Services, Australia*, cat. no. 5368.0, February 2019, <http://www.abs.gov.au/ausstats/abs@.nsf/mf/5368.0>; World Trade Organization, 'Global trade growth loses momentum as trade tensions persist', 2 April 2019, WTO Press Release 837, <https://www.wto.org/english/news_e/pres19_e/pr837_e.htm>.

[2] East Asian Bureau of Economic Research (EABER) and China Center for International Economic Exchanges (CCIEE), *Partnership for Change: The Australia–China Joint Economic Report*, Canberra: ANU Press, 2016, p. 72.

[3] Calculations based on UN Comtrade, <https://comtrade.un.org/data/>; General Administration of Customs, People's Republic of China, 'Customs statistics', <http://43.248.49.97/indexEn>; World Steel Association, November 2018, <https://www.worldsteel.org/steel-by-topic/statistics/steel-statistical-yearbook.html>; exchange rates from OECD National Accounts Statistics, <https://data.oecd.org/conversion/exchange-rates.htm>.

[4] Michael Smith and Peter Ker, 'China restricts coal imports to boost local miners', *The Australian Financial Review*, 26 September 2018, <https://www.afr.com/business/mining/coal/china-restricts-coal-imports-to-boost-local-miners-20180926-h15vh0>.

Table 1: Australia–China trade in coal and iron ore, 2014 to 2018 (A$ millions)

		2014	2015	2016	2017	2018
Iron ore	Chinese imports from Australia	60,179	47,592	47,978	60,683	60,916
	Total Australian exports	66,733	48,895	53,385	63,319	63,168
	Total Chinese imports	103,624	76,390	78,054	99,832	101,213
	Australian share of Chinese imports	58%	62%	61%	61%	60%
Coal	Chinese imports from Australia	9,977	7,061	7,510	12,883	14,142
	Total Australian exports	38,184	37,825	39,785	56,501	66,560
	Total Chinese imports	20,965	13,492	15,481	24,268	26,257
	Australian share of Chinese imports	48%	52%	49%	53%	54%

Sources: UN Comtrade, <https://comtrade.un.org/data>; Department of Foreign Affairs and Trade (DFAT), 'Trade statistical pivot tables', <https://dfat.gov.au/about-us/publications/pages/trade-statistical-pivot-tables.aspx>; and General Administration of Customs, People's Republic of China, 'Customs statistics', <http://43.248.49.97/indexEn>. Exchange rates from OECD National Accounts Statistics, <https://data.oecd.org/conversion/exchange-rates.htm>.

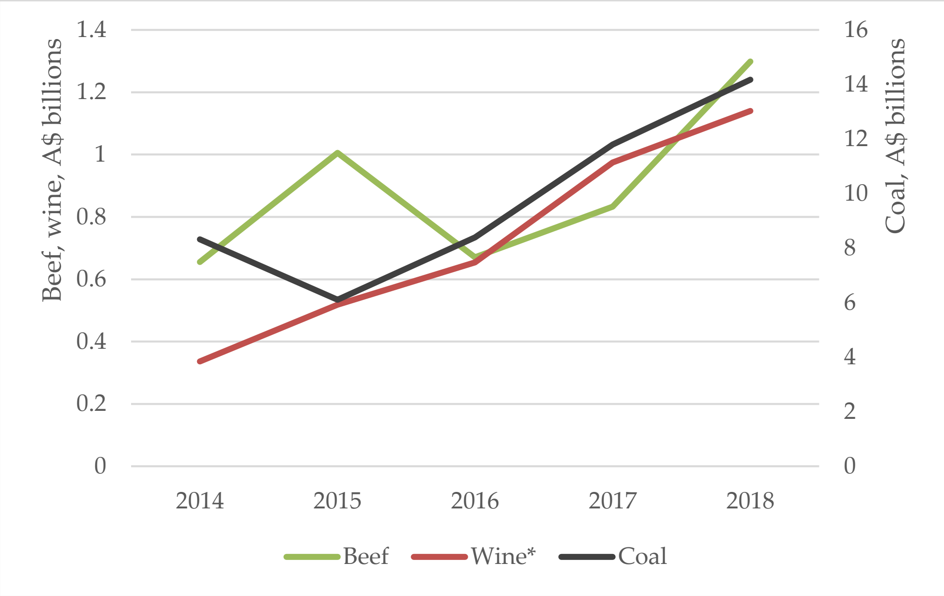
On the back of early-stage ChAFTA tariff reductions, Australian wine and dairy exports to China have seen strong growth. Despite reports in June 2018 of wine shipments being held up at Chinese ports,[5] Australia's wine exports to China grew 18 per cent in 2018 to A$1.1 billion (see Figure 2). By comparison, Australia's wine exports globally grew 10 per cent that year.[6] Australian dairy exports to China grew 34 per cent from 2016–17 to 2017–18, with Australia's market share expanding from 7.5 to 8.1 per cent. Australia is now China's fourth-largest source of dairy imports.[7]

[5] 'Australian wine shipments held up at Chinese ports amid political tensions: report', *The Sydney Morning Herald*, 15 June 2018, <https://www.smh.com.au/business/the-economy/australian-wine-shipments-held-up-at-chinese-ports-amid-political-tensions-report-20180615-p4zloj.html>.

[6] Wine Australia, '2018: An impressive year for Australian wine exports', 22 January 2019, Market Bulletin Issue 140, <https://www.wineaustralia.com/news/market-bulletin/issue-140>. Note: Wine Australia statistics for China include Macao and Hong Kong. Mainland China is the dominant component and has been the fastest growing in recent years. See Wine Australia, 'Market insights – China', <https://www.wineaustralia.com/market-insights/china>.

[7] Data from correspondence with Dairy Australia, 13 April 2019.

Figure 2: Value of select Australian exports to China, 2014 to 2018 (2014 = 100)



Sources: DFAT, 'Trade statistical pivot tables', <https://dfat.gov.au/about-us/publications/pages/trade-statistical-pivot-tables.aspx>; UN Comtrade, <https://comtrade.un.org/data>; Wine Australia, '2018: An impressive year for Australian wine exports', 22 January 2019, Market Bulletin Issue 140, <https://www.wineaustralia.com/news/market-bulletin/issue-140>.
* Wine includes Macao and Hong Kong (see note 6). Exchange rates from OECD National Accounts Statistics, <https://data.oecd.org/conversion/exchange-rates.htm>.

In services, Australian exports to China grew 17.2 per cent to A$16.9 billion in 2017–18 (see Figure 3), more than doubling the growth in Australia's total services exports over the same period. This included 16.7 per cent growth in the travel sector.[8] A record 1.43 million Chinese tourists visited Australia in 2018, overtaking New Zealand for the first time as Australia's largest source of short-term visitor arrivals.[9] The export of education also continues to grow. The number of Chinese students enrolling in Australian higher education institutions grew 14.3 per cent from 133,548 in 2017 to 152,712 in 2018. Another 13,662 enrolled in Australian schools and 22,341 in vocational education and training courses.[10] The total number of Chinese students in Australia stands at a record 205,000, according to remarks by Australia's top diplomat in April 2019.[11]

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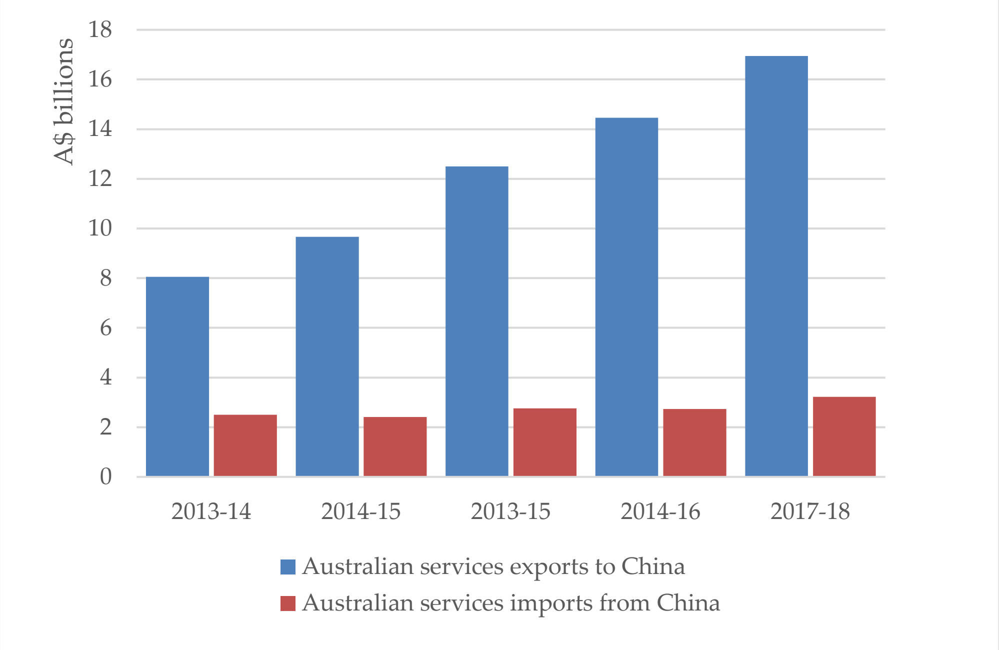
[8] ABS, *International Trade: Supplementary Information, Financial Year, 2017-18*, cat. no. 5368.0.55.003, November 2018, <https://www.abs.gov.au/ausstats/abs@.nsf/mf/5368.0.55.003>.
[9] ABS, *Overseas Arrivals and Departures, Australia, Dec 2018*, cat. no. 3401.0, <https://www.abs.gov.au/ausstats/abs@.nsf/products/961B6B53B87C130ACA2574030010BD05>.
[10] Australian Trade and Investment Commission, *Education Data*, pivot tables, <https://www.austrade.gov.au/ArticleDocuments/3510/2019_Basic_Pivot.zip.aspx>.
[11] Frances Adamson, 'Remarks at Australia–China Reception', 25 April 2019, Australian Embassy China, <https://china.embassy.gov.au/bjng/Speech190425.html>.

Figure 3: Bilateral two-way services trade, 2013–14 to 2017–18 (A$ billions)



Source: ABS, *International Trade: Supplementary Information, Financial Year, 2017-18*, cat. no. 5368.0.55.003, November 2018, Tables 5 and 6.

These developments represent clear evidence of the deep market-based and market-driven trade relationship between Australia and China, as well as ChAFTA's important role in improving the quality and breadth of the trade relationship. The health and resilience of the Australia–China trade relationship defies negative commentary about the relationship between Australia and China more generally and specific suggestions from some commentators that China was exerting coercive leverage on Australia through restrictions on these trades over political issues. The performance of the trade relationship over these years underscores the analysis of the structural forces driving it set out in the ACJER.

The bilateral investment relationship is a different story. In the 2016–17 financial year, despite the rejection of two high-profile Chinese investment bids, China was the largest source of foreign investment in Australia for the third consecutive year, with A$38.9 billion in proposals approved by Australia's Foreign Investment Review Board (FIRB). Between 2016 and 2017, however, the stock of Chinese direct investment in Australia fell slightly from A$38.7 billion to A$38.4 billion. China's total investment position in Australia, which includes direct, portfolio and other forms of investment, fell significantly, from A$85 billion in 2016 to A$64 billion in 2017, according to ABS data.[12]

In 2017–18, investment approvals fell by 39 per cent to A$23.7 billion, with the United States surpassing China for this measure for the first time since 2012–13.[13] What had been an increasingly strong Australian investment interest in China's growing services sector has also waned.[14] The Australian National University's new Chinese Investment in Australia (CHIIA) Database paints a

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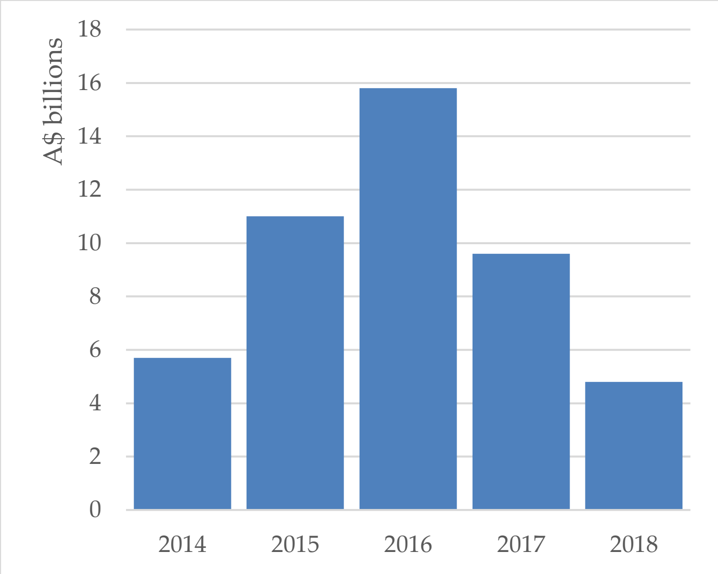
[12] ABS, *International Investment Position, Australia: Supplementary Statistics, 2017*, cat. no. 5352.0, May 2018, <https://www.abs.gov.au/ausstats/abs@.nsf/mf/5352.0>, Table 2.
[13] Australian Treasury, *Foreign Investment Review Board: Annual Report 2017–18,* February 2019, <https://cdn.tspace.gov.au/uploads/sites/79/2019/02/FIRB-2017-18-Annual-Report-final.pdf>, p. 47.
[14] Australia's total investment position in China fell from A$83 billion in 2016 to A$77.1 billion in 2017, while Australia's overall foreign investment position grew 4 per cent. Calculations based on ABS, *International Investment Position, Australia: Supplementary Statistics, 2017*, cat. no. 5352.0, May 2018, <https://www.abs.gov.au/ausstats/abs@.nsf/mf/5352.0>, Table 5.

starker picture with data released in May 2019 revealing a five-year low in Chinese investment flow into Australia at just A$4.8 billion (see Figure 4).

Figure 4: Total Chinese direct investment in Australia recorded by year (A$ billions)



Source: Chinese Investment in Australia (CHIIA) Database, <chiia.eaber.org>.

The sharp turnaround in bilateral investment activity is a sign both of a more cautious approach from Chinese investors to doing business in Australia and a more interventionist, defensive approach to Chinese investment activities by Australian foreign investment authorities. The more interventionist approach is unquestionably influenced by increased geopolitical anxieties about the rise of China and uncertainty about how to respond to it. The banning of Huawei and ZTE from Australia's 5G network is a sticking point in the relationship. There is every reason for the two countries to engage in dialogue on how the concerns and difficulties can be addressed over time by both countries.

Both countries face uncertainties in the global economy and worries about threats to the multilateral trade and economic regime. The problems China has in its trade and economic relationship with the United States are one element in that uncertainty. While these problems are a matter for resolution between China and the United States, what these two countries do is of systemic importance affecting how the whole international trading system works. It is therefore a priority for Australia to work with China in multilateral frameworks, such as the G20, the World Trade Organization (WTO) and the International Monetary Fund (IMF), to ensure that the multilateral regime is defended and strengthened to protect the interests of all countries whose welfare depends upon it. The countries in Asia and the Pacific are more reliant on that system than any other countries in the world.

Geopolitical anxieties about the rise of China are another important context in which the relationship must now be managed. These anxieties could have large economic consequences for both China and its partners. Anxieties corrode trust in deepening economic integration, most particularly through constricting trade and investment regimes and discouraging doing ordinary business in each other's countries. These anxieties are an element in considering the future of the relationship that both countries now need to acknowledge and deal with maturely and straightforwardly.

Despite the strength of the economic relationship between Australia and China, problems in the broader relationship have emerged in the past few years, sharply and unexpectedly. Both countries need to understand the origins of these problems so that they can deal with them in a way that does not frustrate and disturb the pursuit of strong shared interests in their deeply complementary relationship and its potential to be a force for promoting regional and global prosperity and stability.

Improving the management of the Australia–China relationship is a top priority. The focus on poor diplomatic messaging or the lack of a good 'narrative' to describe the Australia–China relationship is misplaced. The narratives about political influence, 'silent invasion' and false 'choices' between economic and security interests and partners are a distraction from the substantial strategic interests that both countries share and now need to enunciate amid new circumstances.

The real problem is that messaging and narratives can only be settled upon once political leaders in both countries together have answered a set of more difficult questions. What kind of relationship does each country want with the other? And what are their jointly determined strategies for pursuing that relationship? These questions will be ongoing. They cannot be dealt with at a single point in time. The Comprehensive Strategic Partnership needs updating to guide the relationship in defining the answers to these questions and needs a built-in broad-based infrastructure of dialogue to engage on the evolving agenda of a partnership for change.

These perspectives on the bilateral economic relationship underline five important realities that Australia and China confront in managing the problems they face in the period immediately ahead.

Five Realities

The first is that the continued strength and the resilience of their bilateral trade relationship depends fundamentally on their commitment to the international market system and rules under which it has flourished. That includes the bilateral agreement, ChAFTA, which complements those multilateral arrangements.

The second is that the international system, which is the core of the economic and political security system in Asia, is under threat. Both China and Australia have strong shared interests in alleviating that threat through cooperation bilaterally, regionally and globally.

The third, which follows from the first and second, is that Australia and China have strong common cause with their partners in Asia in collective action regionally in pursuit of these same global objectives.

The fourth is that geopolitical anxieties must be acknowledged frankly and dealt with. This will require the extension and development of arrangements and strategies through bilateral, regional and global initiatives to avoid these anxieties corroding the foundations of economic and political security.

The fifth is that the bilateral agenda that these realities demand cannot be addressed without significant elevation of engagement and bi-national investment in new frameworks for engagement between Australia and China.

These five realities and the need to deal with them are the subject of the paper that follows.[15]

The WTO and Global Trade

President Trump's America First agenda is a dramatic departure from US leadership of a multilateral order that has been the guiding norm for over 70 years. That order defines the rules of trade and economic exchange between countries that have signed on to it through the World Trade Organization (WTO) and other international institutions, and have underpinned the growth in Asian economic relations and prosperity. These institutions are not perfect. They need updating. But they

[15] ABER, *Getting the Relationship with China Right*, Asian Bureau of Economic Research, Crawford School of Public Policy, The Australian National University, 31 May 2010 (forthcoming).

are the anchor for the global economic and political security upon which Australia, China and all the countries of Asia and the Pacific rely.

Economic relations between Japan and China, for example, have prospered hugely despite the ups and downs of their political relations because of both countries' adherence to the rules of the WTO.[16] Economic relations would unravel all over Asia if confidence in the WTO-led, rules-based order was undermined. Trade disputes, like that between Japan and China over rare earth metals in 2012, are settled appropriately and peacefully in the WTO without resort to retaliation, escalation or force. The WTO provides ballast and security in the conduct of trade relations between Australia and China and all their partners in the region.

US tariffs on steel and aluminium imports to protect American steel makers and, putatively, to reduce trade deficits, as well as other protectionist measures aimed at China, have not had a large, immediate economic effect but they pose a bigger and longer-term threat to the entire global rules-based system.

Many countries received exemptions from the steel tariffs and, in accepting those exemptions with quotas or voluntary export restraints, failed their obligations to the rules-based order. These choices have already become starker as the US continues down its chosen path of extra-WTO tariff action, and as other countries are pressured to retaliate. Security and trade are linked closer under this US administration and that makes decisions for other countries more complicated.

The United States and China — the world's two largest economies and traders — have dragged themselves into a tit-for-tat trade war that could spiral out of control. It is a high-risk game for which even the 'best' outcome is a bilateral settlement involving voluntary export restraints and other measures totally inconsistent with multilateral trade rules. This outcome is the most likely in the short term with both the US and Chinese governments favouring a deal. It would mean large negative spillovers to other countries, Australia included. The worst-case outcome is an all-out global trade war — possible under a number of scenarios with contagion from a bilateral fallout, for example — leading to global recession. That was not a plausible scenario three years ago, but it certainly is now.

The threat to the global trading system will only be met by a concerted response by other stakeholders in the global trade regime. Such a response needs coordination and strategic action that doubles down on the rules-based global system. As the world's largest trader and second-largest economy, China has more to lose than most, but also has the weight and interest to hold the line. China has clearly found it difficult to avoid retaliation against provocation acting alone, but China's banding together with the global community to hold the line on the escalation of protectionist measures may work better.

Defending the system

Japan, Indonesia, Australia and others will need to be part of a coalition of economies in that endeavour. The highest priority is to resolve the crisis around the WTO dispute settlement system. The WTO Appellate Body will be unable to hear new cases after 11 December — when the terms of two of the remaining three judges end — unless the stalemate on appointing new members is dealt with. The dispute settlement system is the crown jewel of the WTO and is one of the world's most successful dispute settlement systems that middle and small powers, as well as large powers, rely on to ensure that commitments under WTO rules are honoured. It is the backstop against full-scale protectionism and a credible mechanism that helps avoid a broader prisoners' dilemma outcome in global trade.

There are legitimate problems with the dispute settlement system that have been the subject of

[16] Shiro Armstrong, 'The politics of Japan-China trade and the role of the world trade system', *The World Economy* 35, no. 9 (2012).

discussion for decades. Criticisms include the sense that the appellate body has gone beyond its mandate: It does not report back within 90 days and has filled in gaps in international trade law that members have not agreed to through negotiation. The United States has picked the point in the WTO system where consensus is needed to continue its function — the appointment of appellate body judges — and has succeeded in applying pressure to bring the system to breaking point. This has at least succeeded in getting the attention of policymakers globally. While resolution is far from guaranteed, there is now an opportunity to address some of the more problematic aspects of how the system has evolved. Ideas have been proposed and negotiations remain feasible.

The United States has won as many critical cases in the WTO as it has lost and may return to being a more constructive player when it is winning disputes. If the United States can be satisfied with amendments to the current system, there may be a chance for resolution by December. If the US opposition is to the automatic nature of the system and the second-tier review mechanism, there may be no fix within the existing set of agreements and the entire dispute settlement system will require rewriting or rebuilding without the United States.

This assault on the WTO's dispute settlement arrangements is hardly consistent with respect for a rules-based global system but other countries may have to prepare for this contingency. If US concerns are addressed, there is a moral hazard problem and nothing that would stop other WTO members from similar behaviour. Members proposing alternative solutions in the event there is no resolution by December 2019 could threaten US membership in the system. The WTO and rules-based trading system will be at crisis point if the dispute settlement system ceases to function after December. The priority is to find a way forward in reforming the system to avoid its collapse while preparing alternative fall-back options — both require political will and leadership, including in the event of failure of reform by December, in standing up to the United States.

Reforming the system

Alongside protecting the trading system, its rules needs to be updated and made relevant for current day cross-border commerce. Reducing barriers to commerce must be informed by a new benchmark — the free-flow of data — building a consensus benchmark just like that of the free-flow of goods. A more open digital economy provides a platform to accelerate inclusive economic growth. Government policies aimed at regulating the digital economy remain underdeveloped and fragmented. There are significant country-to-country disparities in political philosophies, legal oversight, procedures for intervention, and the accommodation of data-flows and digital trade. These differences must be respected and multilateral principles designed that allow the free flow of data around the constraints that they impose.

Through a stocktake of supportive policies for a more open digital economy, however, the creation of new rules and disciplines for adoption by the WTO and other agreements might be progressed. Working from the benchmark of the free-flow of data, policymakers can aim to facilitate smoother data flows in data-intensive industries. Reform will be difficult. Governments need to be mindful of the costs to personal privacy and industrial as well as state security in a more open digital economy, despite the high value and attractiveness of data as a resource. Successfully reconciling privacy and sovereignty with economic efficiency will be critical to ensuring broad public support for a more open digital economy.

Facilitating a more open digital economy cannot be achieved without trade reform in services trade. Indeed, almost one third of global services trade is digitally-enabled and, in aggregate, trade in services accounts for a significant component of global trade at more than half of the exports from members of the G20. Despite this, significant roadblocks to services trade remain. Apprehensiveness among some policymakers for fear of fuelling further protectionism has held back advocacy for services trade reform in the WTO. Therefore, in reducing barriers to trade, G20 members should champion a liberalisation agenda for services in the WTO.

Plurilateral agreements will increasingly be where the liberalisation and rule-setting action will be in the WTO and the broader global trading system. Reform of the WTO rules is needed to facilitate plurilateral agreements that are most-favoured-nation-based and have open membership.

Can coalitions of like-minded nations foster a recommitment to multilateralism and reform of the WTO?

Japanese leadership, through its 2019 G20 presidency, will be essential to extend multilateral rulemaking across services and the digital economy — especially in the wake of emerging bilateralism and US disengagement from a leadership role in the system — and to deal with the crisis in the global trading system.

As G20 chair this year, Japan needs to play a leadership role as the world's third-largest economy. It demonstrated leadership in concluding the CPTPP and EU–Japan EPA in 2018. It is a US ally and major economic partner of China. But solidifying leadership will be difficult. The urgent task is system defence and preservation while creating and sustaining new rules through a multilateral approach. The WTO has underpinned the basic rules of trade and 98 per cent of global trade is conducted within the WTO framework.

Japan will not be able to set the strategic direction of multilateral trade reform alone. It will be constrained and distracted by the short timeline to the Osaka summit, its own bilateral negotiations with the United States, and running a successful G20 summit at a particularly difficult time of global uncertainty. US leadership has underwritten the multilateral rules-based order in the past but with US commitment to international institutions waning, the primary focus of Japanese leadership must be to advance a coalition of like-minded nations committed to upholding the mandate of the WTO.

Europe, Canada and economically open G20 members will be crucial to preservation and reform of the WTO, but a disproportionate responsibility will likely fall on Asia. Asia has been a major beneficiary of the open rules-based economic order and is, however wrongly, now seen as an over-privileged beneficiary of the system. Key countries that benefited from the rules-based trading system will need to do more.

Without regional agreements such as NAFTA or the EU, Asian value chains and Asian integration into the global economy have relied heavily on the multilateral trading system. The trade and economic growth that have disrupted many established markets have been primarily from Asia — centred on China but not on China alone. Other emerging markets are likely to cause disruption in the future.

Countries like Australia, China, Indonesia and South Korea can play an important role in coalition building alongside Japan, beginning within the G20. As the leading member of ASEAN, Indonesia plays a particularly important role and its government has been actively engaging other ASEAN members on WTO reform issues in the G20. Proactive support from other Asian countries can create space for Japanese leadership that might otherwise be significantly constrained by its dealings with the United States, alongside continued commitment to multilateralism from China.

Leadership in Asia will require opening up difficult issues and making commitments to continuing domestic reform. Increased transparency and monitoring, as well as starting discussions on the issue of developing country status (special and differentiated treatment), will help break deadlocks among G20 members. Collective action driven by Asia's strategic interest in the multilateral trading system will give the G20 process momentum in setting the trade reform agenda. Key players include Australia, China, Indonesia and Japan.

Reducing trade tensions

Advocating for reform of WTO rules that will help alleviate China–US trade tensions will restore confidence to the system. China and the United States may do a deal but if they do, whatever deal they do will not obviate the need to prioritise global trade system reform. It will, on the contrary, elevate its importance. Finding ways to advocate and use the multilateral system will also strengthen it. Countries should be using the system and encouraging the resolution to issues within the multilateral rules and norms, alongside setting the agenda for WTO reform that will address those issues currently not covered.

It will be important for policymakers to remember that the case for trade and openness is a domestic choice, but the domestic case can be reinforced by regional and global efforts. Domestic policy and trade policy are intertwined. Rebuilding a commitment to and advancing multilateralism must begin at home. Sharing the benefits of trade and technological change across society, strengthening social safety nets and getting domestic policies right are necessary to underscore public support for sustaining openness between economies. Reforms will be harder in a hostile external environment with international markets closing themselves off and uncertainty about the rules.

The challenge of Japan's G20 presidency in dealing with the threat to the global trading system, given all the impediments it carries, is large. But if this issue is shirked, the Osaka summit will be almost certainly judged a major failure. Australia and China need to actively support the WTO trade reform agenda at the G20 summit.

RCEP and Regional Leadership

Australia and China face new challenges in Asia and the Pacific as a result of the changing structure of regional and global economic power. Those challenges have become more acute and managing the adjustments to the structure of the global economy has become more difficult. Australia and China have long-shared interests in regional institution-building and cooperation but now there is urgency in holding the line regionally on trade openness in the face of a threat to the global rules-based trading system.

Asian coalition

Mobilising a coalition to take a clear stand against protectionism and to avoid descending into retaliatory beggar-thy-neighbour policies is the top priority. The Regional Comprehensive Economic Partnership (RCEP) — an agreement being negotiated by the 10 ASEAN members as well as Australia, China, India, Japan, New Zealand and South Korea — provides the membership and base to undertake that task.

The US-led liberal order took a hit on January 23 when President Donald Trump withdrew the United States from the Trans-Pacific Partnership (TPP), a 12-nation free trade agreement covering the Asia Pacific region.

After the confusion and uncertainty that Trump's move generated, the remaining 11 TPP members spent most of 2017 salvaging the agreement. These countries concluded a TPP-11, the rebranded Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), in March 2018.

The new agreement is the TPP in name only. The withdrawal of the United States, which accounted for 60 per cent of the TPP's collective GDP and around 40 per cent of trade activity within the grouping, has changed the character of the TPP.

The TPP meant different things to different members. For most it was an opportunity to keep the United States firmly locked into the Asia Pacific region. It was seen by the Obama administration as the economic arm of America's 'rebalance (or pivot) towards Asia'. It was also an opportunity for further liberalisation and reform, with access to US and Japanese markets the main prize.

The agreement aimed to set new standards and rules for commerce in the 21st century — an elusive aim at the global level because of the failure of the World Trade Organization's diverse membership to settle on common goals.

Conclusion of the TPP-11 or CPTPP does not deliver on the big strategic goal of keeping the United States entrenched in Asia. Instead, it sends to Mr Trump a strong message of the region's commitment to openness. Holding the line and pushing back against growing protectionist sentiment sustains pressure through market opening and reform on which US businesses and consumers miss out, and it keeps open the option of US re-entry down the track. It could also add momentum for broader liberalisation in Asia by facilitating the expansion of membership and by lifting ambition for RCEP.

TPP-11 is less important because of the American-sized hole in the middle, but it has become a better agreement given some of the changes that have been made to it. It has more of a chance of expanding its membership since it froze some of the more egregious provisions of the original TPP — especially the US-pushed intellectual property protections that were likely to benefit big business in the United States at the expense of consumers in the region. The scope of the investor–state dispute settlement provisions were narrowed, but still give foreign investors access to an international tribunal to resolve disputes with host governments.

The agreement still gives those inside TPP-11 veto power over new members, since accession requires agreement from all parties. Inclusion of larger countries like the United States, China or India will not be easy even if they meet membership criteria.

Australia almost single-handedly led the pushback against Trump's team on tearing up multilateralism as APEC's central tenet at the summit in Vietnam in 2018. With Australia having held the line in APEC and moving forward on the TPP, what is needed now is for the other powers in Asia to join in preserving and protecting the global system. The 2018 APEC summit in Port Moresby was unable to contain the protectionist demands of the United States and US—China tensions. The failure to produce a leaders' statement was a blow to the APEC process and a warning to the region.

The United States will not be party to the TPP for the foreseeable future, despite Mr Trump's vacillations over membership, as it deals with the domestic structural problems that were the political genesis of the Trump administration. Most of the 11 CPTPP members are also actively engaged in negotiating RCEP.

The most promising opportunity to strengthen Asia's rules-based economic order now lies with RCEP.

Regional cooperation agenda

Like the TPP, RCEP covers market access (in goods, investment, and services), rules, and trade facilitation. Yet RCEP differs from the TPP in being built around a cooperation agenda in which the developed countries are expected to join with less developed countries through capacity building and the harmonisation of standards, rules, and regulations. But it is likely to be much more than capacity building with an ongoing framework for cooperation on these and other issues. Of course, without a dominant country such as the United States to lead the negotiations and exert leverage, RCEP's commitments might be less ambitious. But TPP has set some benchmarks.

Thanks to China's economic weight and its growing political influence in the region, RCEP has often been described, including by former US president Barack Obama, as a China-led agreement. Yet as with other East Asian efforts at regional cooperation such as the ASEAN plus Three (China, Japan, and South Korea) dialogues on economic institution-building the real driver behind RCEP has not been China, but ASEAN. The proposed agreement is built on already existing free trade agreements between ASEAN and the six other RCEP parties. Negotiations were formally launched in 2012 at the ASEAN summit in Cambodia.

The structure of the negotiations means that China cannot dominate the negotiations and must show leadership by way of example. Indonesia, where RCEP's guiding principles were crafted, is the chair of the lead negotiating committee and every alternate negotiating round is held in an ASEAN country. Driven to unity and cooperation in dealing with its large neighbours, ASEAN favours slow, consensus-driven cooperation. Rivalry and political mistrust among Asia's major powers — China, India, and Japan — have made ASEAN the lynchpin of regional deal-making.

In addition to its economic benefits, the 16-country RCEP is an opportunity to salve the sometimes fractious political relations among the Asian powers. Just as the TPP provided cover for Japan to do a deal with the United States, RCEP provides cover for improved China–Japan, Japan–Korea and China–India economic relations, where political sensitivities might make negotiating bilateral deals too difficult. There is a further opportunity to enmesh rising economies in a rule-based system that would not only further regional economic integration but would also be an Asian contribution to keeping the global trading system open. This would reinforce geopolitical stability in East Asia, including through India's participation, at the same time as it underlines Asia's commitment to global openness.

Regional action with global objectives

RCEP provides a natural opportunity for building an Asian coalition in defence of free trade and economic cooperation. The group includes some of the largest and most dynamic economies in the world and is important enough to make a difference globally. An Australian Productivity Commission study estimates that even if tariffs were raised by 15 percentage points globally (similar to what happened in the Great Depression), RCEP countries could all continue their economic expansion if they abolished tariffs as a group.[17] The gains for RCEP countries would be even larger with behind-the-border reforms.

Any future agreement can incorporate certain aspects of the TPP such as the latter's rules on e-commerce and investor protections. But not all of the rules and standards in the TPP can or should be incorporated into RCEP. The TPP's rules on strengthened intellectual property rights and on higher labour and environmental standards, for example, reflected the expectations of an advanced economy and had largely been imposed by the United States. RCEP members such as China, India, and the developing economies of Southeast Asia may aspire to US standards on labour and the environment, but they cannot meet them immediately or leapfrog into advanced stages of development.

The RCEP agreement will be important for locking China and India into opening markets and pursuing reform, especially in a period of global uncertainty when protectionism is on the rise. That will not be easy until India comprehends its real strategic interest in economic integration with East Asia and until it ceases playing spoiler in international forums. It is important that RCEP secure commitments from countries that bind them to achieving higher standards, stronger rules, and more transparency over time. To be credible and deliver real reforms, there will have to be ambitious commitments to opening markets from day one of the agreement. Importantly, RCEP will need to be a living agreement that is able to evolve to meet new challenges over time. The economic cooperation agenda is central to RCEP's delivering on politically challenging behind-the-border reforms in the East Asian economy.

The economic cooperation agenda in RCEP has the potential to be the element in the RCEP agreement that delivers more for its economies over time. Economic and technical cooperation is often understood narrowly to mean capacity building for developing countries, but building off the experience in East Asia, it can create a framework to tackle behind the broader reforms in all countries, increase economic policy and political cooperation, and build mutual trust and confidence among RCEP members. This was the objective of the economic cooperation agenda in RCEP from its origins in ASEAN.

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[17] Productivity Commission, *Rising Protectionism: Challenges, threats and opportunities for Australia*, Commission Research Paper, Canberra, July 2017, <https://www.pc.gov.au/research/completed/rising-protectionism/rising-protectionism.pdf>, p. 81.

The guiding principles for RCEP include economic and technical cooperation as a core feature of a concluded agreement that 'will aim at narrowing development gaps among the parties and maximising mutual benefits from the implementation of the RCEP agreement'. Economic and technical cooperation in RCEP will build on existing economic cooperation agreements between ASEAN and its trading-partners.

East Asia has experience of building up economic cooperation through ASEAN, APEC and the AANZFTA agreement. These arrangements include mechanisms that allow officials, and to a lesser-extent businesses and other stakeholders, to interact routinely, build familiarity and understanding, and ultimately to build trust. The interactions go beyond agreements in FTAs to consult, which require one party to initiate consultation. It requires structured economic consultation and cooperation on a continuing and regular basis.

Routine and structured interaction around a common goal of implementing RCEP commitments and deepening economic integration can help build understanding of each country's trade and investment barriers, policy priorities, sensitivities, and preoccupations. It importantly helps to socialise useful ideas and policy strategies that are not otherwise familiar to partners. Policy strategy convergence can be achieved over time. For instance, members of APEC have built up a common understanding over time of the importance of openness and removing barriers to the flow of goods, services, capital, and skilled labour.

Building regional trust

Not all aspects of economic integration can or should be negotiated between countries. Many behind the border issues are deeply embedded in domestic institutions and regulatory structures and to build community support to change them requires longer time-frames, capacity, and an understanding of their interlinkage with other policies.

One example is the economic cooperation provision in AANZFTA which has had success in capacity building in the area of competition policy. APEC officials meet routinely to share reform experience, find common interests and find external support for domestic reform— in the form of peer pressure, a demonstration effect, or by undertaking reforms in concert. ASEAN was able to multilateralise its ASEAN FTA preferences over time through a process of deepening interactions, dialogue, and cooperation. That has helped ASEAN's integration with the global economy and the proliferation of value chains in East Asia. ASEAN sets non-binding targets for its member economies that though they may not often be met in some areas (such as services trade) have surpassed expectations with actual practice forging ahead of policy commitments.

The diversity in RCEP with economies at different stages of development and with different political and economic systems means that the gains from integration are larger. But that requires different treatment for less developed countries and the opportunity to build capacity to the benefit of the entire RCEP group and its integration into the global economy.

Many issues require urgent cooperation across East and South Asia. Most of them cannot be dealt with in a negotiating framework. Regional approaches to cross-border infrastructure investment, energy transition, and deep integration require deeper consultation and confidence building over time. Building thicker interaction at the policy level will build both economic and political cooperation.

Common issues such as competition policy, building a stronger social safety net, and undertaking difficult reforms can be promoted through sharing experience, capacity building, and sometimes the use of external pressure. The economic cooperation agenda in RCEP has the potential to bring large gains over time beyond the negotiated concessions, if the cooperation framework is right.

Many countries cannot easily identify or deal with non-tariff barriers (NTBs) in their own economies, and not all are barriers to integration, but doing so is an essential part of good governance. Some

NTBs can be dealt with in a negotiating framework but many NTBs will need to be dealt with in a purely domestic setting with domestically initiated reform packages. The economic cooperation agenda can help this process.

The economic cooperation agenda should not, and likely will not be able to, exclude interests of non-RCEP members given the global interests of RCEP economies. The core should focus on the ASEAN plus Six grouping but should not exclude the participation of others where relevant and where agreement can be forged.

This will not be easy, and all the sticking points are well known. Japan has not yet shown a willingness to open its agriculture and services markets to Asia, at least not to the extent it promised to open them to the United States in the TPP. China needs to commit to reforms that bring credibility to Xi Jinping's defence of globalisation at Davos in 2017 and doubles down on the opening up and reform commitments made at the Boao Forum in April 2018. India, despite pushing for the opening of service markets elsewhere, is still inclined to keep its own markets protected. On this count, India’s leadership will have to demonstrate credible commitment to opening up over time.

With TPP-11 signed and RCEP yet to be concluded, there is strong pressure to reach an RCEP deal in 2019. A low-ambition and low-quality deal would be a major lost opportunity. The core of a credible RCEP can be completed in 2019 but would need a clear framework for making ongoing progress through negotiation and economic cooperation. The multitrack and multispeed ASEAN approach has its advantages and can be extended to bring India along with it. But that should not exclude ambitious targets or reaching them quickly.

An ambitious RCEP announced in 2019 would require political leadership in countries that have so far been reluctant to lead. But this is no ordinary time in the global economic system. The rise of protectionism and nationalism around the world is driving home the point that business as usual for Asia will no longer suffice.

The BRI and Regional Infrastructure

Infrastructure needs in the Asia Pacific are immense and growing due to the rapid demographic and economic changes underway. The Global Infrastructure Hub forecasts that by 2040, half of global infrastructure needs will be in Asia and valued at over US$50 trillion in total.[18] Satisfying these needs is a priority for both countries’ future economic opportunities — and the BRI will play a central part in realising these opportunities.

Competition between investors can improve economic outcomes, through encouraging higher quality, more cost-effective or larger-scale projects. To secure these outcomes, however, recipient countries must be able to properly evaluate alternative project proposals, meet governance standards and know what the consequences will be if a project fails.

The degree to which Australia and China can collaborate productively on the BRI will depend on shared understanding across several dimensions, including project selection, governance, open procurement, multilateralisation and financial sustainability. For China, the best way to develop and sustain this shared understanding is to continue its positive efforts to multilateralise the BRI, including by engaging multilateral development banks and private-sector stakeholders. Australia benefits from encouraging and actively participating in these efforts.

[18] Chris Heathcote, ‘Forecasting infrastructure investment needs for 50 countries, 7 sectors through 2040’, *Infrastructure and Public–Private Partnerships Blog*, 10 August 2017, World Bank Group, <http://blogs.worldbank.org/ppps/forecasting-infrastructure-investment-needs-50-countries-7-sectors-through-2040>.

Getting the principles right

Infrastructure investment that adheres to transparent governance practices, including open procurement, will limit risks for recipient countries and improve outcomes for both investors and recipients. East Asian countries have the experience and architecture, including 'ASEAN plus' arrangements, APEC and the East Asia Summit, to take the lead on cooperation on effective infrastructure principles. Success in the Asia Pacific can pave the way for global cooperation through finding areas of consensus and building capacity, whether on project selection, evaluation or mediation in the case of failed projects.[19]

There are growing signs that China is stepping up its multilateral engagement on BRI issues. On the sidelines of the Second Belt and Road Forum in April 2019, People's Bank of China Governor Yi Gang pointed to some of the recent achievements. These included the IMF–China Capacity Development Center, set up in April 2018, which provides training courses in about 40 BRI countries on topics like macroeconomic governance and financial regulation.[20] Another promising initiative is the joint development of the BRI Green Investment Principles by China's Green Finance Committee and the City of London Corporation's Green Finance Initiative.[21]

President Xi Jinping's speech at the Second Belt and Road Forum underlined commitments to transparent governance and 'zero tolerance for corruption' in BRI projects.[22] The forum also saw Finance Minister Liu Kun launch a Debt Sustainability Framework for the BRI, heralded by IMF Director Christine Lagarde as a 'significant move in the right direction' and part of a 'BRI 2.0'.[23] The joint leaders' communique used the language of 'high-quality' infrastructure and emphasised the 'importance of economic, social, fiscal, financial and environmental sustainability of projects'.[24]

Much of the international wariness surrounding the BRI is about adherence to international standards — particularly regarding financial sustainability and transparency. The problem is that there is no clear consensus yet on what exactly the standards for infrastructure in the region should be. As a policy space, infrastructure governance is as important as it is crowded and fragmented. Countries like China, Japan and India have competing visions for the regional infrastructure of the future and offer different models for building it.[25]

Looking for consensus on regional and global principles for infrastructure investment is important for both China and Australia for several reasons. Multilaterally endorsed principles would reduce perceptions of uncertainty around BRI investment and make projects more attractive to third-country participants, donors and institutional partners. Better governance standards lead to better selection of projects, lower lifecycle costs and projects that are more likely to achieve their desired social and economic outcomes. G20 and APEC leaders should recognise the progress China has already made in this area, such as in the governance of the Asian Infrastructure Investment Bank

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[19] Shiro Armstrong, 'Japan joins to help China's Belt and Road', *East Asia Forum*, 28 October 2018, <https://www.eastasiaforum.org/2018/10/28/japan-joins-to-shape-chinas-belt-and-road/>.
[20] Yi Gang, 'Deepen investment and financing cooperation for quality development of the Belt and Road Initiative', Bank for International Settlements, 25 April 2019, <https://www.bis.org/review/r190502e.htm>.
[21] City of London, 'Green Belt and Road principles receive industry backing', 24 April 2019, <https://news.cityoflondon.gov.uk/green-belt-and-road-principles-receive-industry-backing/>.
[22] Xi Jinping, 'Highlights of Xi's speech at the Second Belt and Road Forum for International Cooperation', *People's Daily Online*, 26 April 2019, <http://en.people.cn/n3/2019/0426/c90000-9572819.html>.
[23] Christine Lagarde, 'BRI 2.0: Stronger Frameworks in the New Phase of Belt and Road', International Monetary Fund, 26 April 2019, <https://www.imf.org/en/News/Articles/2019/04/25/sp042619-stronger-frameworks-in-the-new-phase-of-belt-and-road>.
[24] Ministry of Foreign Affairs of the People's Republic of China, 'Joint Communique of the Leaders' Roundtable of the 2nd Belt and Road Forum for International Cooperation', 27 April 2019, <https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1658766.shtml>.
[25] Gordon de Brouwer, Adam Triggs, Shiro Armstrong & Matthew Goodman, *Delivering Prosperity in the Indo-Pacific*, December 2018, <http://eaber.org/node/26960>, p. 6.

(AIIB) and multilateralising the BRI through the Belt and Road Forum and third-country cooperation agreements.

Australian interest

Australia can contribute to BRI projects through capacity-building, knowledge-sharing, project evaluation and the development of financing mechanisms. But the potential gains from cooperation will not be fully realised without a deeper dialogue to explore the opportunities and engage on the requirements regionally. Australia and China should undertake a joint study identifying opportunities for cooperation on the BRI, including through third-country development cooperation for development in Southeast Asia and the South Pacific regions.

China's announced development project cooperation with Japan is an example of the value of multi-party international engagement on the BRI. On a state visit to China in October 2018, Prime Minister Shinzo Abe and President Xi Jinping announced 50 joint infrastructure projects. These joint projects help lay the foundation for dialogue on principles for difficult cross-border infrastructure projects in the region. China's economic partners in the Asia Pacific, including Australia, now need to engage in a broader conversation about how to best to mitigate infrastructure investment risks and find ways to adequately resolve problems where they arise. Forming consortia, as China and Japan have announced, is one way to diversify political risk and should be encouraged.[26]

The clearest way forward for Australia and China on infrastructure cooperation is through the G20 and APEC. At the 2016 Leaders' Summit in Hangzhou, G20 leaders recognised the importance of infrastructure in ensuring 'economic efficiency in view of life-cycle cost, safety, resilience against natural disaster, job creation, capacity building, and transfer of expertise and know-how on mutually agreed terms and conditions'.[27] These Hangzhou principles — already recognised by leaders in Australia, China and the United States — are a sound foundation for building regional infrastructure cooperation. Institutions such as APEC and the G20 enable the major players to build relationships based on regional or global infrastructure principles.

The comparative advantage of APEC is in allowing members to signal their reform objectives, make voluntary commitments and action plans, and trial new approaches through pathfinder initiatives. For issues as politically complex as regional infrastructure investment, APEC provides a valuable platform for identifying areas of potential consensus. Because of the strategic–competitive nature of infrastructure investment in the region, multilateral efforts must proceed in a way that is sensitive to other countries' priorities and values. If global governance on infrastructure becomes increasingly fragmented and politically fraught, coordination and cooperation on major projects will be too costly. The losers will be those in areas where cost-effective, well-managed infrastructure is needed most.

Australia and China should stand ready to respond positively and rapidly to ASEAN initiatives to engage through regional frameworks such as APEC or ASEAN plus Six and the multilateral banks (ADB, ASIIB, World Bank) in ministerial level dialogue on these issues. RCEP may later provide an important platform for regional infrastructure cooperation.

As today's emerging markets grow, they will continue to have more capacity and willingness to shape international rules and norms on infrastructure. Developed nations should recognise this and advance a positive, not an exclusive, vision for infrastructure investment in the region through cooperation at a business and government level. Engaging and recognising the importance of the BRI will be crucial for future economic cooperation that will benefit all parties.

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[26] Shiro Armstrong, 'Japan joins to help China's Belt and Road', *East Asia Forum*, 28 October 2018, <https://www.eastasiaforum.org/2018/10/28/japan-joins-to-shape-chinas-belt-and-road/>.

[27] 'G20 Leaders' Communique', *European Union External Action*, 4–5 September 2016, <https://eeas.europa.eu/sites/eeas/files/20160906_01_en.pdf>.

Bilateral Trade and Investment under ChAFTA

ChAFTA remains the best platform for the two countries to deepen their trade and investment relationship while complementing and catalysing multilateral efforts to defend the open trade regime and facilitate investment.

Trade in Goods and Services

International trade is central to Australian and Chinese economic prosperity, amounting to 45 and 34 per cent of GDP respectively in 2018.[28] In Australia, about one in five jobs are in an international trade-related activity.[29] Australia is China's 14th-largest export destination and seventh-largest source of imports. China procures a quarter of its externally sourced raw materials from Australia, including over 60 per cent of iron ore and over 50 per cent of coal (Table 1). China is Australia's most important trading partner globally, both in goods trade and as a destination for services such as education and tourism.

The bilateral trade relationship has grown rapidly since ChAFTA entered into force. Growth in Australian exports to China has been particularly strong in sectors that benefited from ChAFTA tariff cuts, such as coal, dairy and wine. Preliminary analysis indicates ChAFTA has already had a significant positive impact on bilateral trade in its first two years. For Australia, resource and energy-based exports have benefited most from the agreement. For China, a range of manufacturing sectors, including petrochemical products and motor and transport equipment, were among those with the biggest early gains from ChAFTA.[30]

The structure of Australia–China trade will continue to change in coming decades. Australian resource and energy-based exports will become relatively less important components of the bilateral trade mix. For China, a bigger role will be played by high value-added manufacturing exports and electronic equipment. For Australia, services exports will be much more important, particularly education, tourism, healthcare and finance. Projections undertaken for ACJER show the share of transport, travel and tourism services in Australian exports to China rise from 8 per cent in 2014 to 19.6 per cent in 2025 (see Appendix). The share of financial, insurance and business services more than doubles, from 0.5 per cent in 2014 to 1.1 per cent in 2025, while the relative importance of the mining and extraction sector falls from 70.6 to 58.7 per cent.[31] In 2017–18, Australian services exports to China grew 17.2 per cent, while goods exports to China grew 11.3 per cent.[32] These forecasts, undertaken for more bullish and more bearish economic outlooks, all suggest the same direction if not the same pace of structural change.

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[28] Calculations based on National Bureau of Statistics of China, 'National Economic Performance Maintained within an Appropriate Range in 2018 with Main Development Goals Achieved', 21 January 2019, <http://www.stats.gov.cn/english/PressRelease/201901/t20190121_1645832.html>; ABS, *Australian National Accounts: National Income, Expenditure and Product*, cat. no. 5206.0, December 2018, <https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5206.0Dec%202018>, Table 1; ABS, *International Trade in Goods and Services, Australia*, cat. no. 5368.0, December 2018, <https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5368.0Feb%202019>, Table 2.

[29] The Centre for International Economics, *Australian trade liberalisation: Analysis of the economic impacts,* October 2017, report prepared for DFAT, <https://dfat.gov.au/about-us/publications/trade-investment/Documents/cie-report-trade-liberalisation.pdf>.

[30] Ligang Song & Son Ngoc Chu, 'Trade Impact of China-Australia Free Trade Agreement', forthcoming.

[31] EABER & CCIEE, *Partnership for Change*, p. 89.

[32] ABS, *International Trade in Goods and Services, Australia*, cat. no. 5368.0, February 2019, <http://www.abs.gov.au/ausstats/abs@.nsf/mf/5368.0>; ABS, *International Trade: Supplementary Information, Financial Year, 2017-18*, cat. no. 5368.0.55.003, November 2018, <https://www.abs.gov.au/ausstats/abs@.nsf/mf/5368.0.55.003>.

ChAFTA should be thought of as a living document that can facilitate the next wave of bilateral trade cooperation, taking advantage of and preparing for ongoing structural changes in the trade mix.[33] The agreement made significant advances in services trade across a wide range of sectors, notably through the promotion of Australian higher education providers, market access commitments in telecommunications and health care, and removing restrictions on international legal services. It also contains a built-in review agenda. The ChAFTA Committee on Trade in Services had their first meeting in October 2017 in Canberra, with further meetings to be held every two years to review implementation and explore liberalisation opportunities in other areas.

This review process, now underway but in need of serious acceleration, offers scope for both countries to cement progress on behind-the-border issues identified in the ACJER. A key area of opportunity for further reform is in the recognition of professional services qualifications from each country. The Australian and Chinese governments need to effectively support the Committee on Trade in Services in exploring reviews of qualifications recognition. This support can involve coordinating engagement between regulatory bodies that provide accreditation in sectors like accounting, legal services, engineering and traditional Chinese medicine. E-commerce plays an increasingly important role in bilateral trade and is another area where regulatory harmonisation — particularly around food and healthcare products — offers significant gains and urgently needs engagement. To boost tourism, both countries need to explore lifting restrictions on domestic air travel services that make international routes to Australia less commercially appealing.[34]

A strength of ChAFTA is in its potential to complement regional arrangements, further lowering barriers to developing each countries' industries of the future. Extending ChAFTA's tariff reductions to RCEP negotiations would allow China and Australia to make the most from regional manufacturing supply chains. Lowering barriers regionally will help China continue to move into higher value-added manufacturing exports.[35]

Building investment confidence

In addition to progress already made in liberalising screening thresholds for Chinese foreign direct investment in Australia, ChAFTA's investment chapter includes a program for further negotiations on investment and a commitment to review. This review process commenced in March 2017 and is ongoing but effectively inactive. The Memorandum of Understanding on an Investment Facilitation Arrangement (the MoU), a side document to ChAFTA, provides a basis for further work in this area. Work through ChAFTA on investment facilitation complements the new WTO Dialogue on Investment Facilitation.

Since ChAFTA's entry into force, the foreign investment climate in both countries has changed. In Australia, foreign investment — particularly in agriculture, residential real estate and critical infrastructure — has long been a politically sensitive issue. But in recent years, heightened geopolitical competition and rapid technological change have imbued the foreign investment policy climate with new anxieties and urgency. On the other hand, China's new Foreign Investment Law has recently been reworked to provide more certainty to foreign investors, although there remain big problems that need to be addressed. Responding to these circumstances requires extending and developing arrangements and strategies to effectively alleviate the risks of foreign investment in both China and Australia by elevating policy engagement under the ChAFTA framework.

Foreign investment authorities everywhere face the challenge of reconciling economic opportunities with the management of political, security and other risks. The growing complexity of these risks, coupled with anxieties about China's expanding presence in the region, have led Australian policymakers to respond to the challenge with a more defensive and interventionist approach than

[33] EABER & CCIEE, *Partnership for Change*, p. 72.
[34] *Ibid*, pp. 73, 98–99.
[35] *Ibid*, p. 72.

in the past. In January 2019, for example, a senior FIRB official told the media that China's National Intelligence Law had 'done away with the distinction between [China's] private and state-owned companies' when it comes to foreign investment.

While policy change is the prerogative of political leaders, not officials, if this stance reflects Australian government policy it is a significant shift from the approach to private Chinese investment embodied in ChAFTA.[36] This issue needs clarification. The shift may be in part a response to developments in the political security environment in Australia and outside China, but it is also a response to policy developments in China, including the National Intelligence Law passed in June 2017.[37] But it is not clear that it is justified or sensible, nor that both countries cannot resolve the uncertainties satisfactorily and beneficially.

Changes in Australia's foreign investment policy environment have been felt in a range of sectors. New requirements for agricultural land investment were introduced in early 2018. Land must be marketed widely to Australian bidders for a minimum of 30 days before being considered for approval. This is a significant departure from the well-established 'negative test' approach to national interest testing. In residential real estate, screening and compliance responsibility moved from FIRB to the Australian Tax Office in December 2015 and harsher penalties have been introduced for more serious breaches. Most Chinese investors are compliant and do not face greater risks from these changes.[38]

Foreign investment regimes

Most significantly, there have been several developments affecting investment in critical infrastructure. From March 2016, FIRB has been required to review all state and territory sales of critical infrastructure to foreign investors. Previously, this had been required only where the investor was a state-owned enterprise.[39] In January 2017, the Australian government established a Critical Infrastructure Centre (CIC) to advise FIRB and the Australian Treasurer to help owners and operators better manage risks. The CIC now manages a Register of Critical Infrastructure Assets, set up through the *Security of Critical Infrastructure Act 2018*.

The implications of the CIC and the Register for the Australia–China economic relationship are mixed. An effective CIC could complement FIRB by streamlining or replacing existing processes. Through listing critical assets, undertaking risk assessments and determining asset-specific safeguards, the CIC can contribute more comprehensive advice to decision makers where there may be complex economic–security trade-offs from foreign investment. Unpredictable decision-making around high-profile cases, notably the 2016 Ausgrid bid, has highlighted the need for a more transparent institutional environment in Australia.

Yet while the CIC introduces another bureaucratic layer, the issue of defining critical infrastructure remains unresolved. The CIC definition comprises eight sectors, including food and grocery, and banking and finance.[40] The Register includes critical assets in electricity, ports, water and gas, but

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36 Angus Grigg, 'No such thing as a private company in China: FIRB', *The Australian Financial Review*, 16 January 2019, <https://www.afr.com/news/policy/foreign-investment/no-such-thing-as-a-private-company-in-china-firb-20190116-h1a4ut>.

37 See Samantha Hoffman & Elsa Kania, 'Huawei and the ambiguity of China's intelligence and counter-espionage laws', *The Strategist*, 13 September 2018, Australian Strategic Policy Institute, <https://www.aspistrategist.org.au/huawei-and-the-ambiguity-of-chinas-intelligence-and-counter-espionage-laws/>.

38 Australian Treasury, *Foreign Investment Review Board: Annual Report 2017–18*, February 2019, <https://cdn.tspace.gov.au/uploads/sites/79/2019/02/FIRB-2017-18-Annual-Report-final.pdf>, p. 47.

39 The Australian Senate, Foreign investment review framework, Economics References Committee, April 2016, <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Foreign_Investment_Review/Report>, p. 11.

40 Critical Infrastructure Centre (CIC), CIC Compliance Strategy, <https://cicentre.gov.au/document/P10S011>.

also any other asset declared critical by the relevant minister.[41] Other recent policies, like the state and territory reforms described above, have used different definitions.

These policy developments have coincided with a decline in levels of Chinese investment in Australia. FIRB approvals of Chinese investment fell in number by 30 per cent and in value by 39 per cent in 2017–18.[42] Recent CHIIA data indicate that realised Chinese investment in Australia in 2018 was 37.6 per cent lower than in 2017 and the lowest since 2010.[43] For global context: data from China's Ministry of Commerce indicate that total Chinese outbound FDI increased by 4.2 per cent in 2018 year-on-year.[44] By industry, realised Chinese investment in Australia was up in 2018 in the manufacturing (mainly healthcare products), renewable energy, and oil and gas sectors, but fell in infrastructure, real estate, mining, and food and agribusiness.[45]

Shoring up the Australia–China investment relationship requires acknowledging the changes that have occurred in the policy environment and addressing the most important issues that create uncertainty.

Australia's foreign investment regime should draw a clear line between sectors where foreign investment is welcome and those in which the government retains discretion. Truly critical infrastructure, such as army bases, should never leave government hands. Other investments, such as direct investments in ports or telecommunications infrastructure, require proper weighing of opportunities against the risks. There are opportunities for dialogue between the CIC, FIRB and investors to improve understanding of risks in sectors deemed critical. Foreign firms looking to invest in Australia currently have little certainty when it comes to what infrastructure is considered critical, how different risks are weighed, and what they might be able to do to mitigate those risks pre-emptively. Where critical assets are identified, policymakers should be equipped with a comprehensive framework for assessing long-term costs and benefits of investments across economic, security and foreign policy objectives, while having a framework for assessing and recommending risk mitigation measures.

ACJER underlined the importance of a predictable and transparent foreign investment review process centred on ongoing risk management rather than the pre-approval process. Australia's foreign investment review regime risks deterring beneficial Chinese (and other) capital by raising uncertainty and transaction costs. There is evidence now to suggest this deterrence effect is already being felt. It will likely be particularly costly as the structure of the trade and investment relationship changes — capital invested in manufacturing, agriculture and services is more mobile than that in resources and extraction.[46] An open, transparent investment regime maximises the inflow of beneficial capital — particularly important for countries like Australia where investment demand exceeds domestic savings. Instead of turning away from the opportunities foreign investment offers, the most efficient approach is to welcome investment in non-critical sectors and use a portion of the economic gains to properly manage risks.

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[41] Security of Critical Infrastructure Act 2018 (Cth), sections 9 and 51, <https://www.legislation.gov.au/Details/C2018A00029>.

[42] Australian Treasury, *Foreign Investment Review Board: Annual Report 2017–18*, February 2019, <https://cdn.tspace.gov.au/uploads/sites/79/2019/02/FIRB-2017-18-Annual-Report-final.pdf>, p. 45.

[43] KPMG & The University of Sydney, *Demystifying Chinese Investment in Australia*, April 2019, <https://assets.kpmg/content/dam/kpmg/au/pdf/2019/demystifying-chinese-investment-in-australia-april-2019.pdf>, p. 10.

[44] Ministry of Commerce, People's Republic of China, 'MOFCOM Department of Outward Investment and Economic Cooperation Comments on China's Outward Investment and Cooperation in 2018', 17 January 2019, <english.mofcom.gov.cn/article/newsrelease/policyreleasing/201901/20190102829745.shtml>.

[45] KPMG & The University of Sydney, *Demystifying Chinese Investment in Australia*, p. 13.

[46] EABER & CCIEE, *Partnership for Change*, pp. 110–11, 118–19.

China's move to a 'negative-listing' approach to foreign investment and to base further liberalisation on the principle of national treatment will provide more certainty to Australian and other foreign investors in China. The NDRC and MOFCOM provide sector-based guidance on foreign investment. The agencies' latest foreign investment negative list, released in July 2018, places restrictions in foreign investment in 48 sectors. This is a reduction from 63 sectors in the previous year's list.[47] But the most significant barriers are behind the border. Businesses seeking to invest in China face a complex regulatory environment, with three separate laws governing the creation of foreign enterprises, plus hundreds of subsidiary and local rules affecting foreign investors.[48] Investment facilitation efforts to simplify the regulatory environment for foreign investors should be a priority — in China this includes the WTO agenda on investment facilitation and complementary bilateral efforts.

Consortia in largescale infrastructure investment

Investors need to explore the use of consortia or partnerships to mitigate or hedge political risk. Partnering with local firms brings the benefits of in-country networks and experience while making it clear that domestic firms have had the opportunity to gain from the investment. The consortia approach to investment can be used to diversify economic and political risks for investor and investment recipient alike, mitigating concerns regarding competition or security in highly concentrated or critical sectors. Several large Australian investments in recent years have been won by consortia of Australian and Chinese partners, including the Port of Melbourne in September 2016.

Both countries should continue working together to harness the liberalising and investment facilitation opportunities presented in ChAFTA. The investment chapter's forward work program outlines several priority areas for further negotiation: expropriation, transfers, investment-specific state-to-state dispute settlement and China scheduling its investment commitments on a negative-list basis. The other major opportunity ChAFTA offers is in investment facilitation.

Investment facilitation aims to make it easier for investors to both establish investments and conduct day-to-day business. Effective regulatory institutions and accessibility of information are central to this. ChAFTA has promoted investment facilitation through improving the transparency of foreign investment policies and the efficiency of processes in both countries, but more remains to be done. The MoU accompanying ChAFTA — though its provisions are highly project-specific — provides a precedent for building on the agreement further. The UNCTAD Action Menu for Investment Facilitation offers several pathways to build on ChAFTA's investment facilitation framework. Its recommendations include designating a lead agency or focal point for investment facilitation and establishing investment facilitation monitoring and review mechanisms.[49] Potential candidates for these roles in both countries are Austrade and the China International Investment Promotion Agency.

Investment facilitation is emerging as a prominent issue in multilateral economic policy. It featured heavily in the Guiding Principles for Global Investment Policymaking agreed at the 2016 G20 Leaders' Summit as well as the 2017 BRICS Trade Ministers Statement. In December 2017, 70 WTO members, including China and Australia, signed a Joint Ministerial Statement on Investment Facilitation for Development. Exploring investment facilitation on a bilateral level through ChAFTA will help China and Australia contribute effectively to these multilateral and regional processes, not only in the WTO but through forging RCEP cooperation on investment.

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[47] Baker McKenzie, 'China further liberalizes restrictions on foreign investment', July 2018, Client Alert, <https://f.datasrvr.com/fr1/718/43991/2018-237.pdf>.

[48] EABER & CCIEE, *Partnership for Change*, p. 124.

[49] United Nations Conference on Trade and Development, *Investment Facilitation: A Review of Policy Practices*, Geneva: UNCTAD, 2017, p. 8.

Bilateral Engagement

Recent problems in the Australia–China relationship have exposed thinness of engagement. They demonstrate the need for a more responsive and resilient bilateral relationship to mitigate uncertainty and geopolitical anxieties. Active investment in the bilateral relationship from both governments will provide a platform for both countries to protect the integrity of each other's sovereign interests and the international system upon which sustained regional and global prosperity depend. Elevated bilateral engagement will help foster understanding of the potential in the bilateral relationship as well as the areas where system differences limit it.

Problems in the relationship

Despite the strength of the economic relationship between Australia and China, problems in the relationship over the past few years emerged sharply and unexpectedly. Both countries need to understand the origins of these problems so that they can deal with them in a way that does not frustrate and disturb the pursuit of strong shared interests in their deeply complementary relationship — and its potential to promote regional and global prosperity and stability.

Improving the management of the Australia–China relationship is a top priority. The focus on poor diplomatic messaging or the lack of a good 'narrative' to describe the Australia–China relationship is not the real problem. The narratives about political influence and 'silent invasion' or false 'choices' between economic and security interests and partners are a distraction from the substantial strategic interests that both countries share and need to enunciate in the new circumstances that now surround it.

The real problem is that these narratives can only be settled upon once political leaders in both countries together have answered a set of more difficult questions. What kind of relationship does each country want with the other? And what are their jointly determined strategies for pursuing that relationship? These questions will be ongoing. They cannot be dealt with at this single point in time. The Comprehensive Strategic Partnership needs updating to guide the relationship and needs a built-in broad-based infrastructure of dialogue to engage on the evolving agenda of a partnership for change.

ACJER and this report on the deep shared interests in the Australia–China relationship has sought to identify key elements in this task and the issues that a joint economic agenda needs to focus on in the new geopolitical context of the relationship. The failure to jointly address these questions has allowed a vacuum in which all manner of other voices have come to dominate the debate about the relationship, and the national interests of both Australia and China in the relationship has become captive to third-order issues. Both countries need to upscale national and bilateral investment in framing their bilateral agenda.

What's at stake for Australia and China

Stale frameworks blind us to the reality of why China is so important to Australia's future and Australia is important to China.

The relationship is important not because both countries will agree on every issue — they will not — nor simply because of the weight of the bilateral economic relationship, though that cannot be ignored. Australia's importance to China lies its strategic raw materials partnership and the deep and complementary interdependence in the bilateral partnership. Australia is not only economically enmeshed with East Asia, giving it a high stake in China's success. It also has strong economic, cultural and strategic links to the United States, and therefore a compelling interest in a positive relationship between the United States and China. Australia's geopolitical position and multicultural society are thus key assets in China's shaping relationships with the West.

Both countries have a compelling interest in the successful adaptation of the multilateral institutions for global governance to the economic and security challenges of the 21st century. That includes the challenges to the trade system, management of the economic opportunities and security challenges of the digital economy, and the impact of China's increased provision of global public goods (through the established multilateral institutions under the UN, the IMF and World Bank as well as the AIIB and BRI). China's importance to Australia lies in the fact that it will have the greatest impact in the region and across the world on every major policy issue facing Australia in the decades to come, whether it be the global economy, climate change, regional security, migration or technology.

Both countries have to navigate these policy issues. But this is a task that will test both capacities and diplomatic skills, partly because of the two countries' very different political systems and histories, and partly because the responses to these policy issues are becoming increasingly shaped by wider global contest between the United States and China. Both countries will sensibly set their responses to the pressing policy issues of the day within a wider focus on the Asia Pacific region. Working together with regional states to forge new rules and norms on cyber security, regional trade and investment, or freedom of navigation will help establish the bona fides on China's 'global shared community' goals and ameliorate the bipolarisation of regional affairs.

Bi-national response

The Australian Government recently announced substantially increased spending on exchanges between Australia and China. It has allocated A$44 million over the next five years to expand these exchanges, transforming the Australia-Council, which has successfully promoted two-way exchanges between the two countries over the past 40 years, into a new Australia–China Foundation with more resources and status.

In ACJER a number of steps were suggested to strengthen the relationship in the face of its growing scale and the changing circumstances in which it has to be managed. While the architecture of the relationship has evolved substantially, it needs strengthening to manage the fractures in trust that have arisen in the past few years and will inevitably occur from time to time — partly, but not only, in consequence of system differences.

A starting point will be to entrench the core principles and rules of engagement in an upgrade of the Strategic and Comprehensive Partnership between the two countries into a new Strategic and Comprehensive Partnership for Change. The new partnership must acknowledge the starting points in the relationship and its international setting but premise the conduct of the relationship on respectfully working through the huge changes that confront them both over the coming decades.

The Comprehensive Strategic Partnership agreed in 2014 was put in place to guarantee high-level attention to the relationship through an annual leaders' meeting, a Strategic Economic Dialogue and a Foreign and Security Dialogue. Australia and China also have ChAFTA, which has already delivered significant trade liberalisation and opens the door in both countries to widened access to investment and services markets. With its embedded forward negotiating agenda, ChAFTA can serve as a key instrument for transforming the commercial relationship of the coming decades and a model for deeper integration with China across the region and globally.

These bilateral structures can be deployed to advance both countries common regional and global agendas. Working regionally with partners to conclude RCEP and globally to defend and extend the WTO trading system are two priorities. But dialogue on China's lead in the provision of international public goods, such as AIIB and the implementation of the BRI, is also a priority. Opening a dialogue on maritime security issues is another.

The setting of strategic bilateral objectives in a forward agenda requires a sub-structure of official and non-official arrangements that are still only partially in place. It will only be possible if there is investment in national capacities to engage in the structure of official arrangements and through private sector and community exchanges. That will depend on investing in new frameworks for institutionalising active collaboration on policy development and change across the large and challenging range of issues identified above.

The initiative by Australia to set up a new Australia–China Foundation is an important step in this direction, depending on how the activity is structured. If a key principle of its organisation and activities is to foster collaboration on issues of shared priority in the relationship, it will fill an important gap. But a solely Australian-driven effort to fill this gap is bound to fail. That is why a complementary China-side commitment with elevated and matching funding is important to establishing the deep exchange and engagement now needed to manage the scale and nature of the Australia–China relationship.

That is why the ACJER Report (2016) recommended that both governments needed to set up an Australia–China Commission (hereafter Commission) to elevate bilateral engagement and help to achieve its potential. The Commission was designed to be an independent bi-national organisation and a significant channel for government, political, academic, business, community, and cultural exchanges between Australia and China. The Commission would be established through a bilateral treaty or agreement, with core funding from the Australian and Chinese governments. On the Australian side the Commission could be built from the Australia–China Foundation. The Commission would also invite academic institutions, businesses, community foundations, prominent individuals, and sub-national governments to sponsor specific bilateral programs under its aegis. This is would be an effective mechanism for dealing with the influence issue in funding community-based efforts directed at strengthening the relationship and its role internationally.

Australia–China Commission

The model that is precedent in some respects for the Commission is the Australian–American Fulbright Commission (AAFC), but the Australia–China Commission would aim to be broader and deeper. The Commission will foster investment in human capital, activities, and institutions across the spectrum of government, industry, and research. The Commission will place specific emphasis on developing the highest-level competencies and networks that will be relevant to the future relationship between Australia and China. The Commission was originally proposed in the ACJER in 2016, and has since been developed in more detail in a series of research articles based on bi-lateral stakeholder engagement.[50]

The Commission would increase the depth and sophistication of bilateral engagement within a lasting institutional infrastructure. A number of actors, activities, and institutions are already involved in active bilateral exchanges. Despite considerable effort and goodwill from actors on both sides, investment in these exchanges remains disparate and unstructured. The Australia–China Foundation is a potentially complementary effort in the making, but its objectives and operational structure are yet to be defined. What is needed is a bi-national, independent institution capable of encouraging multiple interests across the continuum of the bilateral relationship to create joint programs that serve the public interests of both countries.

The risks and frictions associated with system differences between Australia and China need to be carefully managed and negotiated by both government and non-government actors. It is important to recognise frankly that engagement does not necessarily require complete agreement or coincidence of views on every issue. Hence, both governments have the responsibility to ensure that the bilateral relationship is sufficiently endowed with the people, capacities, networks, and institutions that will allow for deep and sophisticated exchange in managing their relations.

The Commission would activate three important mechanisms for the bilateral relationship: joint political leadership and commitment from both governments, transformation of private interests into public projects of mutual benefit, and the generation of high-level exchanges to build the

[50] Peter Drysdale & Zhang Xiaoqiang, 'The Australia–China Commission: a Preliminary Proposal', August 2016, EABER Working Paper Series, no. 123, <http://eaber.org/node/25749>.

capabilities and knowledge necessary to manage the large and changing bilateral relationship in its international context. This initiative would be an extremely significant statement of political intention by both countries towards their bilateral relationship and the development of trust and respect in their dealings. Only a truly bi-national and comprehensive organisation will be capable of activating all three mechanisms. Together, these mechanisms will help establish a more robust and sure-footed bilateral relationship. The Commission would help maximise the opportunities and mitigate the problems and risks associated with the differences between the two economies and societies.

The Commission's activities would be structured around four cross-cutting themes: policy, education, innovation and culture.

A key element of the policy stream will be sponsoring exchanges between future political and government leaders in both countries through secondments, fellowships and joint training programs. As well as encouraging long-lasting working relationships and expanded networks, these exchanges will increase familiarity and understanding of the other country's political systems and policymaking processes. These would be usefully complemented by business and economic exchange programs targeted to assist Australian and Chinese economic reform priorities.

In the education stream, the Commission would act as a centre for managing, overseeing and kick-starting academic exchange programs. The innovation stream would be focused on expanding bilateral cooperation on scientific research, technological development and research commercialisation. It would achieve this partly through funding fellowships and joint research programs on bilateral priority areas such as the environment and energy. The culture stream would aim to improve linguistic capabilities and cultural understanding through managing exchanges between educational, arts, media and community organisations. The Commission would be set up with the necessary standing to forge respectful understanding in both countries and to build on initiatives like Australia's new National Foundation and thinking about China's BRI. In the case of the BRI, the Commission would provide support to work together on the principles and arrangements that will allow the BRI's potential to be realised and reduce risks for all parties. Ultimately, the Commission could also help to work on the foundations for a Basic Treaty of Cooperation between Australia and China.

Appendix: Bilateral Trade Structure Projections to 2025

The structure of Australia–China trade was projected using the GTAP database for three scenarios: ‘business as usual’; reform, where China’s institutional quality converges upwards; and stagnation, where it converges downwards. IMF growth forecasts were used up to 2020 and the different scenarios were modelled for 2020 to 2025.[51]

Table A1: Actual and projected shares of exports by sector (%)

	2014				2025 Business as usual			
	Aus to China	Aus total	China to Aus	China total	Aus to China	Aus total	China to Aus	China total
Grains and crops	2.5	4.5	0.4	1.4	3.0	4.8	0.3	0.9
Livestock and meat products	4.8	6.0	0.5	0.7	6.4	6.9	0.5	0.6
Mining and extraction	70.6	46.6	2.3	2.1	58.7	36.0	1.5	0.9
Processed food	0.6	1.9	1.2	0.9	0.8	2.5	1.1	0.7
Textiles and clothing	0.0	0.2	21.7	16.3	0.0	0.2	20.0	15.0
Leather, wood and paper products	0.6	0.9	4.5	3.1	0.5	0.7	4.7	3.4
Petroleum and chemical products	8.2	8.7	14.1	12.1	6.3	8.5	10.7	8.6
Metal products	2.9	4.4	9.0	7.2	2.2	3.2	7.8	6.1
Motor vehicles and transport equipment	0.1	1.6	4.8	4.1	0.1	1.8	5.3	4.5
Electronic equipment	0.2	0.9	14.1	22.2	0.1	0.2	15.1	26.0
Other machinery and equipment	0.7	2.9	19.6	18.4	0.5	3.3	27.9	25.7
Other manufacturing	0.0	2.9	19.6	18.4	0.5	3.3	27.9	25.7
Utilities and construction services	0.1	0.4	0.1	0.6	0.1	0.5	0.1	0.6
Transport, travel and tourism	8.0	12.9	3.7	3.7	19.6	19.7	2.2	2.0
Financial, insurance and business	0.5	1.8	0.4	1.1	1.1	2.5	0.2	0.7
Other services	0.3	3.3	0.6	3.6	0.6	5.2	0.5	2.6
Bilateral trade share (% of trade with world)	28.5		1.6		27.1		1.4	

[51] Yu Sheng, ‘Economic growth in China and its potential impact on Australia-China bilateral trade’, July 2016, EABER Working Paper Series, no. 122, <http://www.eaber.org/node/25672>, pp. 12–18; EABER & CCIEE, *Partnership for Change*, pp. 88–90.

Table A2: Actual and projected shares of exports by sector (%) in alternative scenarios

	2025 Reform				2025 Stagnation			
	Aus to China	Aus total	China to Aus	China total	Aus to China	Aus total	China to Aus	China total
Grains and crops	3.4	4.8	0.1	0.3	2.8	4.6	0.3	0.9
Livestock and meat products	10.3	8.0	0.0	0.0	6.2	6.5	0.5	0.5
Mining and extraction	62.2	41.5	0.4	0.2	59.1	39.1	1.2	0.6
Processed food	0.7	2.3	0.8	0.5	0.8	2.4	1.1	0.8
Textiles and clothing	0.0	0.2	16.5	10.7	0.0	0.2	21.1	15.5
Leather, wood and paper products	0.5	0.9	2.5	1.7	0.5	0.8	4.7	3.4
Petroleum and chemical products	3.2	7.3	12.9	9.5	6.6	8.1	10.2	8.2
Metal products	1.5	2.7	8.3	5.9	2.5	3.3	7.4	5.8
Motor vehicles and transport equipment	0.1	1.7	2.1	1.7	0.1	1.7	5.0	4.3
Electronic equipment	0.1	0.3	14.2	21.6	0.1	0.3	16.5	27.4
Other machinery and equipment	0.2	2.4	34.8	28.9	0.7	3.4	27.1	25.1
Other manufacturing	0.1	4.0	0.8	0.6	0.1	3.8	1.9	1.6
Utilities and construction services	0.1	0.4	0.1	0.6	0.1	0.4	0.1	0.6
Transport, travel and tourism	16.8	17.3	3.1	2.5	18.8	18.3	2.1	2.0
Financial, insurance and business	0.9	2.2	0.3	0.8	1.1	2.3	0.2	0.7
Other services	0.1	4.0	3.1	14.5	0.6	4.8	0.5	2.6
Bilateral trade share (% of trade with world)	31.1		1.3		24.1		1.4	