

PERSPECTIVES

**BUILDING ON STRONG FOUNDATIONS: THE
FUTURE OF THE CHINA-AUSTRALIA
RELATIONSHIP**

OUTCOMES REPORT

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The Lowy Institute for International Policy is an independent international policy think tank based in Sydney, Australia. Its mandate ranges across all the dimensions of international policy debate in Australia – economic, political and strategic – and it is not limited to a particular geographic region. Its two core tasks are to:

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**Building on strong foundations:
The future of the China-Australia relationship**

Outcomes report

Prepared by Dr Malcolm Cook

On 17-18 May, the Lowy Institute co-hosted with Chinese People's Institute of Foreign Affairs and the Tianda Institute a conference to mark the 35th anniversary of diplomatic relations between the two countries. The conference entitled *Building on strong foundations: the future of the China-Australia relationship* was held under the Chatham House rule of non-attribution and looked at how this burgeoning bilateral relationship will develop in the future. The Chinese side featured a 16-person strong delegation led by Zhao Qizheng, the Vice-Chairman of the Foreign Affairs Committee of the Chinese People's Political Consultative Conference, and Zha Peixin, the Executive Vice-President of the Chinese People's Institute of Foreign Affairs. The Australian speakers included Michael L'Estrange, Secretary of the Department of Foreign Affairs and Trade, and Senator Russell Trood among others.

The first half of the conference focused on the history of the past 35 years of relations and the economic and strategic position of the China-Australia relationship within East Asia. The second half of the seminar focused on two key issues in the bilateral economic relationship – energy security and the free trade negotiations.

Two common themes joined all the conference sessions together. First was how fast the bilateral relationship has grown and diversified on the back of very strong economic complementarity. One speaker noted that in 1972, the bilateral trade equaled roughly \$100 million while in 2006 it had reached \$33 billion. China is now, by most calculations, Australia's largest trading partner and second largest export market. Australia is China's ninth largest trading partner.

Second was how the deepening of the bilateral relationship and changes within China and East Asia as a whole are presenting a growing number of opportunities and challenges. The rise of China as a regional and global power and Australia's deepening relations with Japan and the United States mean that the Australia-China relationship cannot be viewed in isolation. The continued increase in Chinese regional and global influence and importance to Australia will only add to the relationship's regional and national significance.

Looking back

The first 35 years of official bilateral relations offered some useful signposts for evaluating their future. This period has largely been a very good story for both sides. The growing economic complementarity has meant that over the past two decades in particular, China has become much more important to Australia. Today, approximately 500,000 Australians claim Chinese heritage while up to 90,000 Chinese citizens study in Australia. (Only about 1,000 Australians are studying in China.)

Australia has become noticeably more important to China, especially as a secure supplier of raw materials and niche services. So far, the China-Australia economic relationship has not sparked concerns in Australia of economic dominance or a noticeable political backlash as we have seen in other developed economies with trade deficits with China.

Rather, the image of China in Australia has improved markedly over the last three decades from one of an ideological competitor and threat to a strategic economic partner. The beneficial mixing of economic complementarity and improving diplomatic relations was captured by the Prime Minister's invitation to Hu Jintao to address a special joint sitting of the Australian Parliament in October 2003.

Political differences between China and Australia though have occasionally become the central focus of the relationship and have had negative spillovers into commercial relations. In the 1960s, Australia became a major wheat exporter to China. However, when Canada recognized the People's Republic of China in advance of Australia, the Chinese government switched wheat purchases from Australia to Canada. More recently, in 1996, the Chinese government reacted harshly to Australia's strong support for the United States deployment of an aircraft carrier in the Taiwan Strait and the cutting of a major aid program in which China was a major beneficiary.

China as a paramount power¹

The Lowy Institute was particularly keen to co-host such a conference in Sydney because one of the biggest policy questions facing Australia is what kind of great power will China become and how will it be reintegrated into the regional and global system. For China, a big question is how will others interpret its rise and position themselves in respect to it.

In 1972, China's per capita income was roughly \$200 and it was a largely autarkic economy. Today, its per capita income is roughly \$2000 and the Chinese economy is significantly more integrated into the world trading system than Australia's which is more deeply integrated than the economies of the United States and Japan. The consensus view is that China's economic development is still in quite an early stage and China's already substantial global economic weight will only grow significantly larger. The

¹ This sub-heading originates from a Lowy Institute Paper by Milton Osborne entitled *The paramount power: China and the countries of Southeast Asia*.

question was posed whether Australia will become economically dependent on China over the next twenty years due to this process.

The regional, and increasingly global, corollary to this rapid increase in absolute and relative economic weight is the growing recognition of China as a regional and global great power. One of the speakers noted that Australia will have to learn to adjust to an East Asia where the United States is no longer the predominant power but one which it shares this mantle with China, with room also required for a diplomatically assertive Japan. While in the late 1980s and 1990s the question was how to engage China in the existing regional and global regimes (APEC, ARF, WTO etc), the question today is how will China reshape these organizations, particularly regional ones, to suit its interests better.

Most agreed that the standard dichotomy between China as a status quo power versus China as a revisionist power was inadequate as the rapidity and scale of China's rise meant that it would change the nature of the regional and global inter-state system. Rather, the question was rephrased as to whether China is/will be a satisfied, confident power or a dissatisfied wary one. A similar dichotomy could be used in relation to the countries in East Asia. Are they satisfied and confident about the rise of China or dissatisfied and wary? It is quite clear that Australia sees the rise of China in largely positive and confident terms.

The regional context

The regional context of the China-Australia relationship and its interaction with Australia's relations with the United States and Japan was the focus of the most intense discussion during the day. The recent Japan-Australia joint declaration on security cooperation and the centrality of the ANZUS alliance to Australian security policy were raised as issues that might complicate or retard China-Australia relations. One Chinese presenter noted that Australia and China should move beyond a focus on complimentary interests to common, shared interests which for them included a more active One-China policy from Australia focused on containing Taiwan.

Another Chinese presenter called for China and Australia to establish a "comprehensive security partnership" similar to that signed by China and the United Kingdom in 2004.² This could include closer cooperation in military training and technological development. On this issue of balancing Australia security relations with China and those with Japan and the United States, one of the Australian presenters suggested that the trilateral strategic dialogue (no longer termed the trilateral security dialogue) between the United States, Japan and Australia be expanded to include China. Prime Minister Abe, Vice-President Cheney and others are also talking about a quadrilateral dialogue but one that includes India not China. Some participants also felt it was too early in the bilateral relationship for such a significant increase in security cooperation between Australia and China.

² For the text of this agreement, please visit http://www.uk.cn/bj/index.asp?menu_id=272&artid=466

Another important element to the regional context of bilateral relations is whether China's interests in East Asian regional architecture are congruent with Australia's. This is particularly important given the strong belief that China will continue to gain influence in (and maybe over) East Asian regional organizations. As Australia is in some regional organizations (APEC, EAS) and not others (ASEAN+3) while China is in all of them, which one China sees as the most useful and whether Australia is in it or not is important for Australia.

China-Australia relations also have a growing multilateral context often with a regional focus. Australia and China were both active in addressing the fallout in Southeast Asia of the Asian financial crisis and both played an active role in the response to the Boxing Day tsunami. China was one of the first governments to recognize the independent state of Timor Leste. China, like Australia, is an active contributor to United Nations peacekeeping activities and one presenter thought this could be an area of greater cooperation between the two countries.

Energy security

The growth of Australian energy exports to China (LNG, coal and uranium) is the major pillar of the bilateral economic relationship. It brings issues of energy security and climate change into the bilateral relationship. With Australia holding the largest known reserves of uranium in the world and very well placed to be a regional supplier of first choice for LNG for the foreseeable future, this energy pillar will only grow stronger. Coal is the major source of energy both in Australia and China.

Australia and China are already cooperating on climate change issues and there is a strong commitment by both sides to deepen this cooperation. Both are members of the AP6 coalition seeking technological solutions to climate change and Australia sees that China would be a great market and strategic partner in the development of clean coal technology.

How China's demand for imported sources of energy is satisfied is one of Beijing's primary foreign policy foci while at the same time being an issue of great global concern. China is expected to become the single largest emitter of greenhouse gases next year (while still a small emitter in per capita terms) while its growing demand for energy means that it adds the equivalent of two coal-fired power stations every week to its energy grid. No country faces a greater task than China in addressing the twin challenges identified in the latest IEA World Outlook: the lack of secure supplies at affordable prices and the environmental harm caused by energy consumption.

China's approach to dealing with the first challenge has led to Chinese interest in gaining greater access to Australian energy reserves through strategic equity stakes and participation in exploration and development consortiums. However, state-owned energy firms often have different interests from the private firms that are the major players in Australia, making cooperation between the two in

consortiums tricky. Energy security from an importer's point of view can often be reduced to the choice between open market transactions and pursuing energy self-reliance through gaining control of overseas reserves. Japan's past costly and largely unsuccessful bid to achieve energy self-reliance through overseas purchases should act as a cautionary tale.

Free trade negotiations

The session on the state of the free trade negotiations between Australia and China was the most specific session of the day but also brought together many of the issues above. Energy security is a key driver in China's trade diplomacy as is developing closer relations with countries in the region. Australia is negotiating a free trade deal with China at the same time that it has started free trade talks with Japan.

The free trade negotiations also bring out another very important dimension of China. It is a developing country that is still in the early stages of development and is very sensitive about the potential short-term costs of market liberalization. While Australia is pushing for a comprehensive agreement covering all sectors, China is reluctant to discuss significant new openings in agriculture and services. One of the Chinese presenters argued for the idea of a partial agreement with the potential to revisit the deal in the future once China had developed more. However, the Australian negotiating position is that any deal must be comprehensive with all issues put on the table or no deal at all.

A representative from Australian industry supported this comprehensive approach and also argued that no deal was preferable to a partial one. The representative also noted that for many Australian businesses competing with China, their largest concern was not tariffs but the Australian dollar-Chinese yuan exchange rate. The differences in approach to free trade negotiations explain why the negotiations are moving very slowly with no end in sight.

Both in the area of security and diplomacy and commercial relations, the foundations of rapid growth and complementary interests are strong, yet finding ways of strengthening these through detailed agreements like a free trade deal or a "comprehensive strategic dialogue" are proving more difficult. As the China-Australia relationship grows, the incentives for such new agreements will increase as will their national and regional complexities.

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