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**A Unique Asymmetrical Relationship  
between Australia and China**

A thesis presented

by

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to

Graduate Program in International Area Studies  
in Fulfillment of the Requirements  
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## Abstract

### A unique asymmetrical relationship between Australia and China

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*While the economic relationship between Australia and China is largely asymmetrical, Australia possesses a degree of leverage over China as 1) Australia is China's largest coal supplier and 2) China needs coal for her consistent domestic economic growth. Along with the 'coal' factor, the fact that Australia's economic dependence with China has not yet replaced her traditional economic partners, US and Japan, enables Australia to pursue her 'reciprocal accommodation model', where she separates her politics from the economy so as to strongly react against China's assertiveness. In fact, although Australia's economic dependence on China has deepened since 2000, China has only partially replaced the position of the US and Japan in the realm of merchandise trade, as its trade commodities lack in diversification. Moreover, China still has a long way to replace the role of US and Japan in the realm of service trade and investment, all of which come together to provide Australia with a larger diplomatic room to pursue her own and unique strategy towards China.*

**Keywords:** reciprocal accommodation strategy, middle power diplomacy, commercial liberalism, hedging strategy, trade peace theory

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## 1.0 Research Question and Argument

Has China replaced the United States and Japan to play a bigger role in the Australian economy? What are some of the characteristics of Australia-China trade? How does this shape the overall bilateral relationship and thus Australia's policy towards its new banker?

While the economic relationship between Australia and China is largely asymmetrical, Australia exercises a degree of leverage over China as the trade commodities between the two countries are largely concentrated in the mining sector, which is essential for China's consistent domestic economic growth. In addition, although Australia's economic dependence on China has deepened since 2000, China has replaced the position of the US and Japan in the realm of merchandise trade amount only. That is to say, China has not yet replaced the role of US and Japan in the merchandise trade items, and in the realm of service trade and investment. Hence, Australia's diplomatic room to pursue its 'reciprocal accommodation model', where it separates its politics from the economy and strongly react against China's "assertiveness", is assured, as the political spill over effect to the economy does exist, yet is kept at minimal.

Nonetheless, there is a possibility that Australia may lose its blatant economy/politics separation policy as its economic leverage over China may weaken over time. The fact that China is virtually the only major consumer of the material and the price of iron-ore is declining since 2013, may come

together to weaken Australia's leverage and consequently the driving force to pursue its reciprocal accommodation strategy. Australia is, thus, not likely to use its leverage as a practical pressure against China but is likely to keep it as a diplomatic card so as to maximise its strategic movement

## 2.0 Research

Australia, as a middle power state, adopts an ambiguous diplomatic stands towards the rising China. Its diplomatic policy is based on the principle of blatantly separating its economy from the politics. Whilst Australia enjoys economic pragmatism from its largest trading partner, China, it also strengthens its security cooperation with the US so as to check and balance China's growth in the international politics. In fact, the concept of middle power in Australia was apparent from the 1980s, when Australia supported to launch APEC and the ASEAN Regional Forum, and worked to effect the Cambodia settlement. The rhetoric has returned to Australia during the Rudd-Gillard governments, especially in relation to the Sino-American terrain where settled rules are absent (Cotton, 2013).

*He* argues that a middle power state, such as Australia, an adoption of an accommodation strategy becomes inevitable when there is a change of power relations in the international politics (He, 2012). However, He argues that Australia is adopting a 'reciprocal accommodation model' towards the rising

China (He, 2012). That is to say, should China take an assertive stance, the accommodation politics of Australia is to be redefined to express “*criticism, protest and hawkish reaction*” (HE, 2012). For instance, when China executed an outer space missile test in 2007, Australia expressed tougher reaction against China than its security partners, that is US and Japan, as it called Chinese ambassador in Australia to clarify China’s underlying intentions (He, 2012). Hence, Australia’s accommodation strategy on China is “*largely economy-induced rather than security-induced*” (He, 2012). Thus analysing Australia’s accommodation strategy, by analysing how much Australia’s economy is intertwined with China, the driving force behind Australia’s unique accommodation strategy may be derived and hence may come together to predict its behaviour in the upcoming years.

### 3.0 Australia’s China Policy

According to He, Australia’s China policy may be defined as a policy of *selective accommodation* (He, 2012). Australia implements policies and demonstrates behaviours to promote its cooperation with China, yet its policies and behaviors are nor subservient or unprincipled (He, 2012). Australia’s accommodation policy is rather *reciprocal*, where it demonstrates “*criticism, protest and hawkish reaction*” against China’s aggressive behaviors (He, 2012). For instance, as discussed above, when China has executed a missile test in the

outer space in 2007, Australia's accommodation politics has been redefined as it exposed even tougher reaction against China than US and Japan, where it called the Chinese ambassador in Australia to clarify China's intentions (He, 2012). The incident perhaps demonstrates Australia's capability of pursuing its reciprocal accommodation strategy. The fact that Australia is strengthening its security tie with the US, and its geographical remoteness, in combination with the fact that it does not have any territorial dispute with China, provides a room for Australia to blatantly separate its economy from its politics and security (He, 2012). He defines Australia's such accommodation strategy to be "*largely economy-induced rather than security-induced*" (He, 2012).

However, the domestic politics of Australia defines its energy reserve to be a security-induced matter. Thus, Australia considers its energy reserve as a strategic asset, which may function as an economic leverage over China. In fact, in 2008, there has been an incident where Australia attempted to regulate China's investment to its energy reserves (Hay, 2009). In an effort to regulate China's state owned enterprises' investment in Australia's iron-ore and coking-coal-related projects, Australia has made an alteration on its FDI law in 2008, making it difficult for China's investment on its strategic sector (Reilly, 2012; Refer to section 9.4.1).

The incident perhaps illustrates the growing concern within the Australian domestic politics on selling of its strategic asset to the non-allies states such as

China (Beeson, Soko, Yong, 2011). Perhaps Beeson, Soko and Yong best elucidates Australia's concern by stating:

*“What makes such debates more potent now is the fact that in recent years the resource sector has become an even more important part of Australia's overall economic profile, especially in respect of exports. The other complicating factor is that it is ‘communist China’ rather than the US or even Japan that is the principal economic partner driving policy responses, and this is heightening fears about the impact of foreign ownership of Australian assets”* (Beeson, Soko, Yong, 2011).

It is such concern on the potential consequences of extensive foreign ownership that has resulted Australia to regulate Chinese investment (Beeson, Soko, Yong, 2011). Such regulation may perhaps be interpreted as a manifestation of its reciprocal accommodation strategy, where the regulation functions to extend its economic leverage over China, as China desperately needs energy import from Australia to fulfill the domestic energy demand and thus to achieve consistent economic development.

### 3.1 Australia's China Policy in comparison with that of Korea's

Australia's blatant separation of politics and economics in its China strategy becomes vivid when it is compared to that of Korea. Korea exercises a similar level of influence in the international politics, as it has a similar size of economy- Korea with GDP of \$1.410 trillion in 2014; Australia with GDP of \$1.454 trillion in 2014 (World Bank, 2015)- and as they are both allies of the US, both countries have consolidated their position as strong middle power states in the international politics. Thus, comparing Australia's China strategy with that of Korea may provide an insight how blatant it is separating its economy from politics when compared to other middle power countries.

Since its diplomatic normalisation in 1992, Korea has developed a strong economic relationship with China and this is evident in its significant expansion of bilateral total trade (Kim, 2012). The bilateral trade between Korea and China from 1992 to 2014 has increased a staggering 36 times in size, from US\$6.38 million to US\$235.37 million, marking well above an annual growth rate of 20 percent (KOTIS, 2015). Since 1993, Korea has continuously enjoyed a substantial trade surplus with China, as Korea's China exports grew much faster than its China imports (Han, 2012; Kim, 2012). This, in combination with the fact that Korea's China trade grew faster than its overall foreign trade, China has become Korea's largest trade partner since 2003, replacing its traditional

economic partner, US, playing a pivotal role in the Korean economy (Kim, 2012). In fact, as of 2013, the total bilateral trade with China amounts US\$235.37 million (KOTIS, 2015). This becomes significant as the trade amount with US, the runner up trade partner, accounts \$US115.57 billion, which is less than half of China's share in the Korean economy (KOTIS, 2015). In this way, like Australia, China is considered as the most important economic partner of Korea which provides economic prosperity to the country (Han, 2008). In fact, Korea is China's largest single import source country, where it accounts 9.7 percent of China's total import, taking largest share of China's import in 2014 (Department of Foreign Affairs and Trade, 2015).

As commercial benefits from China has increased, Korea has altered its middle power diplomacy so as to sustain, or perhaps maximise its economic pragmatism (Han, 2008). Some scholars, such as Han, argues that China's economic viability has resulted Korea to swift its 'hedging' strategy to favour China, slightly moving away from the US, especially during President Roh's administration (Han, 2008). Han puts it as:

*“The fact that China has emerged as a more important partner than the United States in terms of economic contribution to South Korea was a major validation for the*

*Roh administration and his supporters to have emphasized China's value to South Korea's economic development, thus speeding up their policy of tilting toward China” (Han, 2008)*

Han's argument perhaps suggests that China's economic viability is considered as an important asset to Korea, perhaps as important as the security provided by US for the peninsula's prosperity and stability, which has ultimately influenced its middle power diplomacy so as to maintain its constructive relationship with China for years to come (Han, 2008).

In fact, Korea's such hedging strategy is less likely to change in the short term as Korea may further enjoy its economic advantage through its economic relationship with China through the Korea-China FTA, which is likely to come into an effect from January 2016. The Korea-China FTA is expected to provide a myriad of economic benefit to Korea (Choi, 2012). Korea-China FTA is expected to increase Korea's real GDP by about 0.95-1.25 percent in five years and 2.28-3.04 percent in ten years (Choi, 2012).

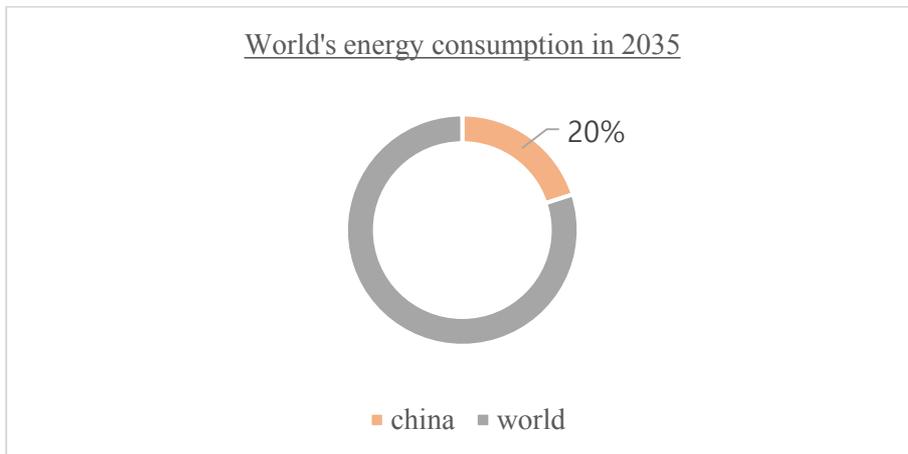
However, economic pragmatism is not the only reason that Korea redefined its hedging strategy. As opposed to the case of Australia, Korea not only needs economic pragmatism, but also political support from China, and thus cannot separate its economy from the politics. In other words, the diplomatic space is

smaller than that of Australia. Perhaps this is because Korea's diplomatic top priority lies in the reconciliation and reunification of the Korean peninsula (Han, 2008). In order to achieve this, Korea desperately needs China's assistance as China has the capacity to exercise leverage over its strategic ally, North Korea (Han, 2008). China's unique bilateral relationship with North Korea, as Han puts it as, "*a diplomatic patron, economic benefactor, and military sponsor*", gives China the capability to exercise a pivotal role in the survival of the North Korean regime and thus influence the politics of entire Korean peninsula (Han, 2008). In this way, for the fulfilment of Korea's national interests, reconciliation and reunification with the North, it needs China's political support and which makes Korea to accommodate China in politics to a certain degree (Han, 2008). As a result, Korea's diplomatic room is rather restricted than that of Australia (Han, 2008).

#### 4.0 China's Australia Policy

China's Australia policy comes in line with its 'Going Global' strategy (Beeson, Soko, Yong, 2011). Going Global strategy refers to the Chinese foreign policy that aims to secure resources for China's continuous economic performance (Beeson, Soko, Yong, 2011). The resource security is China's top priority in its foreign policies, as fulfilling the energy demand is closely related to the survival of the regime as the performance legitimacy underpins the regime's authority (Beeson, Soko, Yong, 2011). As securing the energy reserve

supply is essential for China's economic growth, China's resource import is a crucial factor that function to legitimize the Chinese Communist Party's (CCP) rule (Beeson, Soko, Yong, 2011).



cited: Beeson, Soko, Young, 2011

China's securing of energy reserve supply becomes even more significant when its domestic demand is projected to boost in the next few decades (Beeson, Soko, Yong, 2011). It is projected that China is to consume 20 percent of the world's total energy by 2035 (Beeson, Soko, Yong, 2011). Furthermore, the US Department of Energy projects that China's ratio of imported petroleum is to increase to 80 percent by 2020, which is greater than the projected US dependence rate of 70 percent (Beeson, Soko, Yong, 2011). Moreover, China Mining Industries Association claims that 19 of the 45 major minerals required in China is likely to be short in supply by 2020 (Beeson, Soko, Yong, 2011).



cited: Beeson, Soko, Young, 2011

Thus, China has implemented several domestic and foreign policies in an attempt to increase its accessibility to the energy resources, (Beeson, Soko, Yong, 2011). For instance, whilst it eliminated the domestic barriers for the investments abroad, it has also increased incentives for Chinese companies operating in overseas, all of which is believed to increase China's accessibility to the foreign resources, including that of Australia's (Beeson, Soko, Yong, 2011).

Perhaps the reason behind China's such boost of energy demand is due to its rapid economic growth which has portrayed a change in the country's energy economy (Adams and Shachmurove, 2007). Adams and Shachmurove argues that China is currently going through a state of "*energy transition*", where various changes are under process (Adams and Shachmurove, 2007). Some of these changes are:

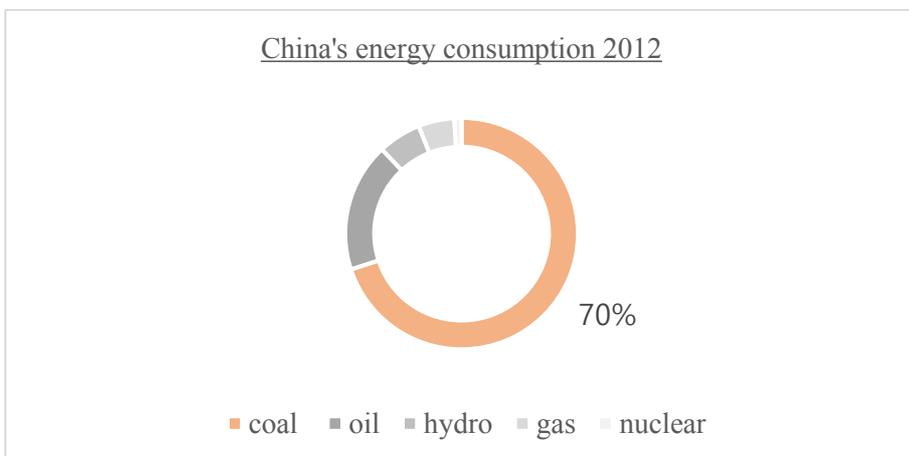
- *from a user of low efficiency solid fuels to higher efficiency gaseous and liquid fuel and electric power,*
- *from a predominantly agricultural economy to increasing urbanization and industrialization,*
- *from heavy industry to lighter and, increasingly, high technology industry,*
- *from a country with low motorization to rapid growth of the motor vehicle population,*
- *from a country that was largely energy self-sufficient to a significant petroleum importer*

(Adams and Shachmurove, 2007)

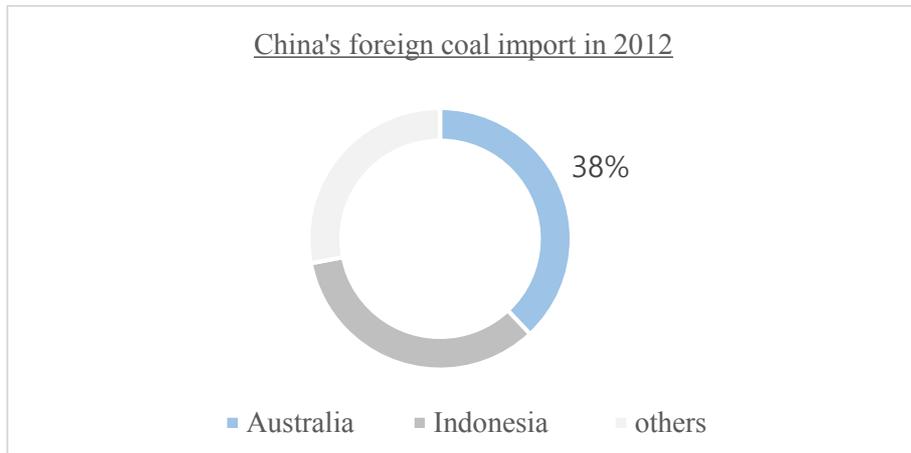
Adams and Shachmurove predicts that energy transition is likely to continue to take place in China for the next few decades, and as result, China's energy consumption and thus energy imports would is predicted to increase as well, especially that of coal, oil and natural gases (Adams and Shachmurove, 2007). The study highlights that China will depend on coal, oil and natural gases supply from the foreign imports and thus the import will grow both in absolute terms and in a fraction of the world supply (Adams and Shachmurove, 2007). This is due to the fact that China's domestic energy production rising slow when compared to its consumption (Adams and Shachmurove, 2007). Thus, the

imports of coal and crude oil will grow sharply over the period to 2020 (Adams and Shachmurove, 2007). Adam and Shachmuove estimates that amount of the increase as:

*“Crude oil imports increase roughly 3 times from 2002 to 2010 and again from 2010 to 2020. In terms of millions of barrels per day, these import quantities amount to approximately 3.8 million b/d in 2010 and 10 million b/d in 2020 (compared to 1.3 million b/d in 2002). Similar results are apparent for imports of coal. Chinese petroleum imports in 2020 are likely to amount to almost 12 million b/d, almost 20% of world imports at that time. Imports of coal in 2020 may amount to more than 50% of world trade in coal” (Adams and Shachmurove, 2007)*



cited: Beeson, Soko, Young, 2011; China Daily, 2012



cited: Beeson, Soko, Young, 2011; China Daily, 2012

Thus, China's Australia policy is aimed at securing its accessibility to coal, which is one of the three major energy resources that China needs for its domestic consistency (Adams and Shachmurove, 2007). In fact, Australia is the largest coal supplier to China, accounting 38 percent of China's total coal import in 2014 (Reuters, 2014). Furthermore, its importance is increasing as Australia has become the largest supplier of both thermal and coking coal, replacing Indonesia, which traditionally dominated China's thermal coal import (Tu, Johnson-Reiser, 2012). In 2012, Australian steam coal accounted 38 percent of China's total steam coal import, making Indonesia a second largest provider of steam coal, accounting 34 percent only (Du, China Daily, 2012). Thus, China's both heat and steel production, which needs thermal and coking coal, are related to Australia's coal supply, and hence Australia does exercise a

certain level of economic leverage over China.

Perhaps the aim of China's Australia policy lies upon the goal to secure consistent supply of resources, especially coal, while avoiding Australia's domestic politicization of the issue (Beeson, Soko, Yong, 2011). Beeson, Soko and Yong highlights that Chinese officials are well aware of the Australia's sensitivity on the Chinese investment, as well as the Australia's domestic concerns about strategic consequences of the Chinese control of the economic resources (Beeson, Soko, Yong, 2011). In addition, Chinese are well aware of their political system and the role of their state-owned enterprises are easily under the subject of politicization in Australia (Beeson, Soko, Yong, 2011). Beeson, Soko and Yong perhaps provide an adequate example.

*“the desire of Australia's former prime minister and now foreign minister, Kevin Rudd, to ‘stand up to’ China was especially disappointing given all the hopes that were invested in Australia's first Mandarin-speaking, China-savvy leader. To understand why relations with Australia remain problematic despite the potential benefits of Rudd's leadership and an increasingly sophisticated appreciation of the relationship on the Chinese side, it is important to see that relationship from an Australian perspective”* (Beeson, Soko,

Yong, 2011 )

Thus overcoming Australia's domestic negative perceptions, and consequently the perception of fear, on China's *expansion* is China's major priority in its implementation of Australia policy (Beeson, Soko, Yong, 2011). In this context, Australia provides an "*important testing ground for the efficacy of China's foreign policies towards states in very different economic and political circumstances*" (Beeson, Soko, Yong, 2011).

Thus, China's Australia policy is rather challenging, although the economic interdependence is largely asymmetrical, as Australia does not have the basic need for Chinese investment to its energy reserves, which makes the relationship asymmetrical but unique. (Beeson, Soko, Yong, 2011). Thus China's Australia policy is rather challenging, as China is aware of the fact that Australia's relative position against China, in terms of trade, is different from China's other trading partners (Beeson, Soko, Yong, 2011).

#### 5.0 A limited commercial liberalism

Cobden and Schumpeter states that trade has two major implications to a state (Cobden 1868, 1870; Schumpeter 1919/1951). First, it functions to increase the total income of a state's economy (Cobden 1868, 1870; Schumpeter 1919/1951). Second, it changes the domestic distribution of income (Cobden 1868, 1870;

Schumpeter 1919/1951). As such, international commerce is linked with the domestic distributional issues, which function to exert a level of economic pressures to a government to shape a state's foreign policy (Cobden 1868, 1870; Schumpeter 1919/1951). That is to say, the benefits of commerce make people within the society to receive income gains from trade and hence people are likely to lobby their government to enact a peaceful foreign policy in an attempt to maximize their economic goals (McDonald, 2004). In this way, the political influence of the beneficiaries of commerce and trade that was formed through the bilateral trade may expand so as to strengthen the bilateral relationship and hence promote peace (Domke 1988, 48).

Perhaps the theory of commercial liberalism may best be applied to elucidate the bilateral relationship between Australia and China. The growing economic interdependence of the two countries since 2000, fulfilled their commercial interests and hence have been directly influenced their foreign policies towards one another. Moravcsik defines commercial liberalism as international relations where it emphasises "*the interplay between aggregate incentives and distributional consequences*" (Moravcsik, 2010). That is to say, for there is a greater economic incentive, it is likely that a government to promote policies that further enhances such transactions (Moravcsik, 2010). Australia has enjoyed a gross profit of A\$44 billion from the trade with China in 2014, where China accounting 33.9 percent of Australia's total exports, making China as

Australia's largest export market with a total exports of A\$100 billion in 2014 (Department of Foreign Affairs and Trade, 2015; Refer to section 7.1). Moreover, Australia's total trade with China recorded A\$151.7 billion, making China as Australia's largest bilateral trade destination in 2014 (China Fact Sheet, 2015; Refer to Section 7.1). From Chinese perspective, China has sustained a steady domestic growth through the stable resource supply from Australia (Zheng, 2014; Refer to section 7.4.3). China largely depends its coal supply from Australia, accounting 38 percent of China's total coal import in 2014 (Watt, 2014; Reuters, 2014). Thus Australia also plays a pivotal role in ensuring China's energy security and thus economic stability. As such, the two countries has built a common ground through the trade, which fulfills their own economic interests and thus benefiting their domestic welfares, that has ultimately functioned to influence their foreign policies towards one another.

However, the bilateral economic relationship may not be fully be characterised by commercial liberalism. There has been few evidences where Australia is defining its energy reserves as a strategic asset, rather than that of economic, and thus regulating Chinese investment on energy reserves (Reilly, 2012; Refer to section 10.3). From a commercial liberals' perspective, Australia's energy policy must function to fulfil the energy security through the interdependence of the international energy market (Hay, 2009). Furthermore, commercial liberals define that the commercial interest and

the national interest are undistinguishable (Hay, 2009). Hence, for commercial liberalism to be applicable to explain Australia-China energy trade, the energy reserves is ought to be developed in relation to the market, which allows free competition among the domestic and international players of the energy consumers (Hay, 2009). Hence, the high level of bilateral interdependence may function to reduce possible conflict between the two countries.

However, in reality, Australia-China relationship may not fully be defined by the theory of commercial liberalism. The theory of commercial liberalism does not apply in explaining the Australia and China's energy reserve trade, as Australia has a tendency to implement nationalistic policies to regulate China's investment in its energy sector (Hay, 2009). Recently, Australian energy policy has moved away from the liberalism as its policies were affected by the nationalistic framework, demonstrating a characteristics of *economic nationalism* rather than commercial liberalism (Hay, 2009).

The paper focuses on the analysis of the bilateral economic relationship using that of US and Japan as comparing variables. Merchandise trade, service trade and investment sectors will be analysed so as to examine the applicability of the commercial liberalism theory to define the two countries' bilateral relationship. Moreover, the paper provides possible factors that may affect the bilateral economic relationship in the future.

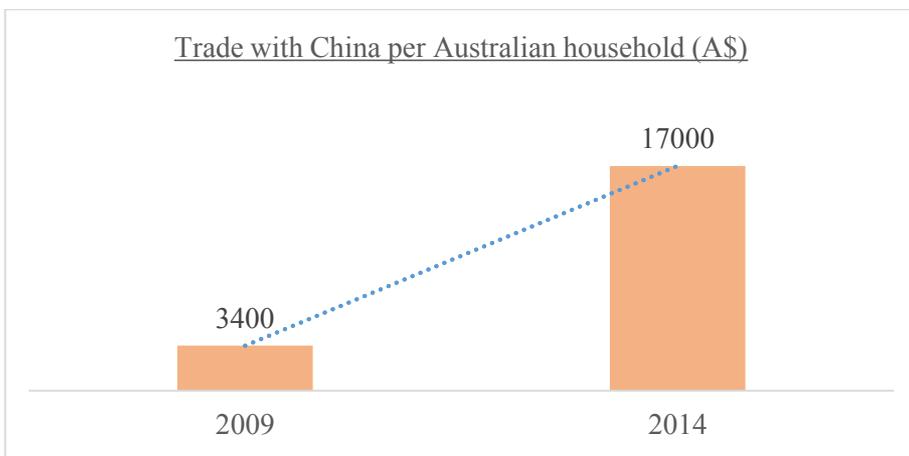
## 6.0 Economic interdependence with China

The following section analyses Australia's economic interdependence with China by analysing China's contribution to the Australian economy. The economic relationship between Australia and China is largely asymmetrical, yet Australia exercises a degree of leverage over China as the trade commodities between the two countries are largely concentrated in the mining sector, which is essential for China's consistent domestic economic growth.

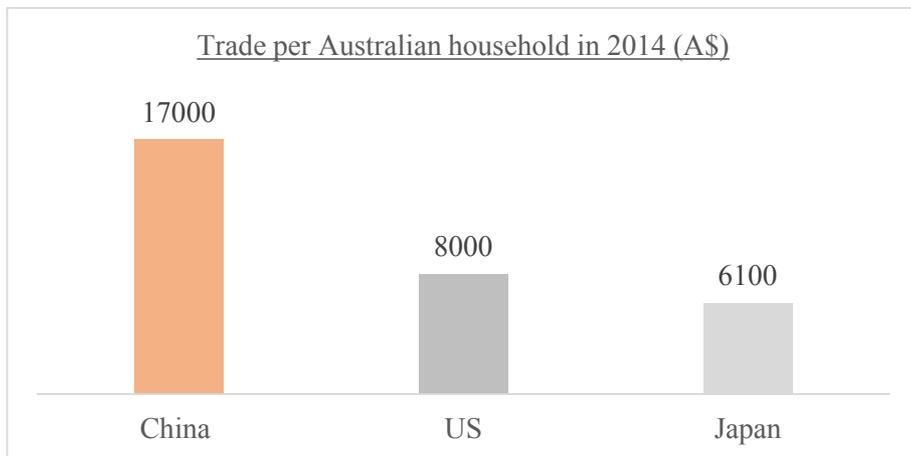
### 6.1 A unique relationship of asymmetrical interdependence

China has emerged as a major economic partner of Australia since 2000, which has now become the largest export market of Australia (Department of Foreign Affairs and Trade, 2015). In fact, China has become Australia's largest trading partner since 2009, replacing its traditional economic partner, Japan (Australian Bureau of Statistics, 2009). The importance of China within Australian economy is increasing, as the trade with China per household has amplified over the last five years (Australia China Business Council, 2015). Australia-China trade per household was at \$3,400 in 2009, however, the amount has tremendously amplified to be A\$16,985 in 2014, which is approximately five times that of 2009 (Australia China Business Council, 2015). The statistics becomes even more significant when it is compared with Australia's other major economic partners, US and Japan, where two-way trade per household is measured to be \$7,958 and \$6,149 respectively in 2014

(Australia China Business Council, 2015). China has benefited the Australian economy through the contribution to Gross Domestic Product (GDP) and employment (Australia China Business Council, 2015). The direct trade with China has taken 5.5 percent of Australia's GDP in 2014, which is double that of agriculture, forestry and fisheries put together (Australia China Business Council, 2015). Furthermore, one in fifty-eight Australian workplaces is involved in direct exports to China and nearly two hundred thousand Australian jobs are sustained by direct exports to China (Australia China Business Council, 2015).

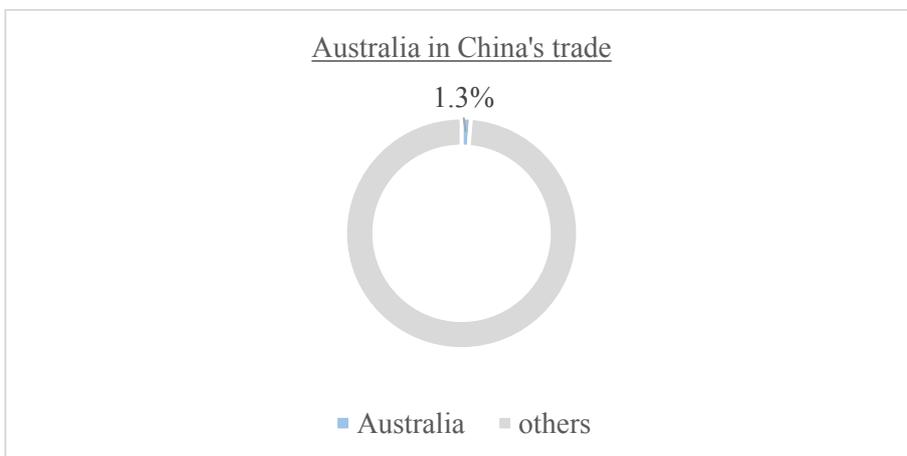


cited: Australia China Business Council, 2015; He, 2012



cited: Australia China Business Council, 2015; He, 2012

The economic relationship between Australia and China may be labelled as a relationship of *asymmetric interdependence* (Reilly, 2012). This is evident where whilst Australia took 1.7 percent of total China’s exports and provided 4.3 percent of China’s imports in 2010 (Reilly, 2012), China accounted 27.4 percent of the total merchandise trade of Australia in 2014, where exports to China accounted 33.9 percent and imports from China accounted 20.6 percent (Department of Foreign Affairs and Trade, 2015). The data may suggest that the economic relationship between the two countries is largely asymmetrical. Perhaps the situation is summarised by Hillary Clinton’s private comment to Kevin Rudd on 24 March 2009, where she stated “*How do you deal toughly with your banker?*” (Reilly, 2012).



cited: Department of Foreign Affairs and Trade, 2015



cited: Department of Foreign Affairs and Trade, 2015

The Department of Foreign Affairs and Trade highlights the importance of China in Australian economy as:

*“China is Australia’s largest export market and accounted for one quarter of Australia’s total exports to the world in 2011. Exports to China have grown from \$8.8 billion in 2001 to*

*\$77.1 billion in 2011, representing average annual growth of 25.6 per cent. This was well above Australia's average export growth rate of 8.4 per cent per annum to the world. In volume terms, Australia's exports to China rose by an average annual growth of 17.3 per cent compared to Australia's export volume growth rate of just 2.7 per cent to the world. Resource and energy commodity exports dominated exports, accounting for 80.9 per cent of Australia's total exports to China in 2011, up from 44.5 percent in 2001"* (Department of Foreign Affairs and Trade, 2015)

Nonetheless, although China tops in the rank of the Australia's merchandise trading, the economic relationship between the two countries may not solely be characterised by traditional relationship of asymmetric interdependence. That is to say, Australian commodity exports are also important to China as its major export commodities lie in the mining sector, which is crucial for China's domestic growth and sustainability (Reilly, 2012; Department of Foreign Affairs and Trade, 2015). As Zheng highlights "*China has become heavily dependent on Australia for resource supply as a result of her rapid economic growth over the 2000s*" (Zheng, 2014; Refer to 6.4.3). It is China that wants to shape a consistent and credible resource partnership with Australia (Zheng,

2014). Hence, the economic relationship of the two countries may be defined to be a *unique* relationship of asymmetrical interdependence. In fact, Australia's economic relationship with China has expanded faster than China's other bilateral economic relations. The total bilateral trade volume of Australia and China has increased 9.8 times from 2001 to 2010, which is a double the growth of China's overall trade volume (Department of Foreign Affairs and Trade, 2011; Reilly, 2012). This may be an indication that the trade relationship with Australia is also important to China. The mining sector of Australia plays an integral role in the Chinese domestic economy (Refer to section 7.4.3).

## 7.0 Trade

The following section investigates Australia-China trade using that with US and Japan as comparing variables. It is discovered that whilst the merchandise trade with China has exceeded that with US and Japan put together in the recent years, yet it has not replaced US in the service trade and is not likely for many years to come.

### 7.1 Australia-China Trade

In 2009, China has surpassed Japan to become Australia's largest export market, with total merchandise exports to China valued at A\$42.4 billion, with

an increase of 31.2 percent over the previous year (Australian embassy China, 2015). China has become the largest two-way trading partner of Australia in goods and services, accounting approximately A\$160 billion in 2013-14 (Department of Foreign Affairs and Trade, 2015). In addition, China has become Australia's the largest goods export destination, accounting A\$100 billion in 2013-14, and the largest source of merchandise imports, accounting A\$50 billion in 2013-14 (Department of Foreign Affairs and Trade, 2015). In 2014, Australia's total trade with China recorded A\$151.7 billion, making China as Australia's largest bilateral trade destination (China Fact Sheet, 2015). In fact, China was Australia's the largest export market with a total merchandise exports of A\$142.1 billion in 2014 (China Fact Sheet, 2015). The major export included iron ore and concentrates, coal, gold and copper, which contributed A\$50.6 billion, A\$8.1 billion, A\$7.0 billion, A\$2.1 billion to Australian economy respectively (China Fact Sheet, 2015). The major service export accounted a total of A\$9.5 billion in 2014, which included A\$4.1 billion worth of education related travel and A\$2.0 billion worth of personal travel excluding education (China Fact Sheet, 2015). In addition, China was Australia's largest source of imports in 2014, with a total import (goods and services) of A\$54.1 billion (China Fact Sheet, 2015). The major imports from China included telecom equipment and parts, clothing, computers and furniture, mattresses and cushions, which were worth of A\$5.6 billion, A\$5.0

billion, A\$4.9 billion, \$2.3 billion respectively (China Fact Sheet, 2015). The major service import included A\$0.8 billion of personal travel excluding education and A\$0.5 billion of transport (China Fact Sheet, 2015). The trade with China has made the Australian economy to be stable and reliable (He, 2012). It is argued that China's massive purchase of raw material functioned as a driver of Australia's economic boom (He, 2012). In fact, China's purchase has led Australia to cut its tax cuts in 2006 (He, 2012). Furthermore, Australian iron ore of US\$50 billion contract liquefied natural gas was made during the Global Financial Crisis, biggest trade deal in Australia's history (He, 2012). However, it must also be acknowledged that the bilateral trade between the two countries may be defined to be weak as they lack diversification. That is to say the trade between the two countries are selective, and is concentrated in the mining and thus the 'strong' bilateral trade may be seen as superficial.

So as to further enhance the bilateral economic engagement and diversify the trade commodities, the two countries have commenced a direct trading between the Australian dollar and the Chinese renminbi since April 2013 and started Australia-China FTA is under negotiation (Department of Foreign Affairs and Trade, 2015). Such practice may function to enhance and strengthen the trading activities as it would *"help to lower currency conversion costs, facilitate the currencies' use in bilateral trade and investment, and promote financial cooperation"* between the two countries (Department of

Foreign Affairs and Trade, 2015).

## 7.2 Australia-US Trade

In 2014, US was Australia's third largest two-way trading partner in goods and services, after China and Japan, at \$60.2 billion (US Fact Sheet, 2015). Moreover, in 2014, US provided the fourth largest export market to Australia after China, Japan and South Korea with an export of A\$18.3 billion (Department of Foreign Investment and Trade, 2015). Australia's major merchandise exports to US included beef at A\$2.4 billion, aircraft, spacecraft and parts at A\$0.8 billion, meat excluding beef at A\$0.7 billion and alcoholic beverages at \$0.4 billion (US Fact Sheet, 2015). The major service export included professional technology and other business services and personal travel excluding education at A\$2.3 billion, A\$1.0 billion respectively (US Fact Sheet, 2015). In addition, US was Australia's second largest source of imports after China in 2014, with a total import (goods and services) of A\$42.0 billion (US Sheet, 2015). The major merchandise imports from US includes passenger motor vehicles at A\$2.2 billion, measuring and analysing instruments at A\$1.1 billion, telecom equipment and parts A\$1 billion, and medicaments A\$0.9 billion (US Fact Sheet, 2015). The major service import included personal travel excluding education and professional technology and other business services at A\$4.1 billion and A\$3.1 billion, respectively.

### 7.3 Australia-Japan Trade

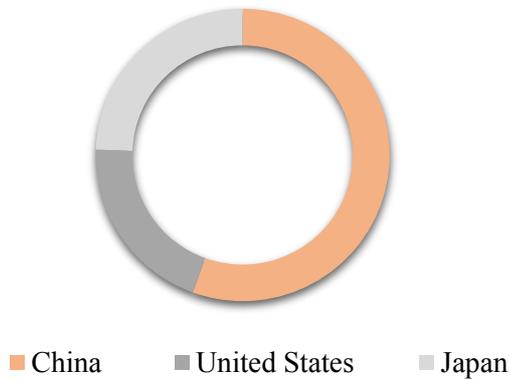
In 2014, Japan was Australia's second largest export market after China with a total two-way trade of A\$72.2 billion (Japan Fact Sheet, 2015). The total export to Japan was worth of A\$51.0 billion, and the major exports included liquefied natural gas, LNG, at A\$17.1 billion, coal at A\$13.1 billion, iron ore and concentrates at A\$9.6 billion, beef at A\$1.4 billion and copper ores and concentrates at A\$0.97 billion (Japan Fact Sheet, 2015). In fact, the Department of Foreign Affairs and trade highlights the importance of Japan in trading by stating “*Japan was Australia's largest export market for beef, fish, fruit and vegetable juices, animal feed, coal, liquefied propane and butane, aluminium, transmission shafts, dairy products and natural gas*” (Department of Foreign Affairs and Trade, 2015). The 2014 merchandise export included Coal at A\$13.2 billion, iron ores and concentrates at A\$9.7 billion, beef at A\$1.4 billion, copper ores and concentrates A\$1.3 billion (Department of Foreign Affairs and Trade, 2015). In addition, Japan was Australia's third-largest source of imports, after China and US in 2014, with a total import of A\$21.1 billion (Japan Fact Sheet, 2015). The major imports from Japan includes passenger vehicles at A\$6.1 billion, refined petroleum at A\$3.4 billion, goods vehicles at A\$1.2 billion and tubes, pipeline of iron or steel at \$0.7 billion (Japan Fact Sheet, 2015).

## 7.4 Comparison

The following section compares Australia's total merchandise trade, and also its composition, with China, US and Japan. It was discovered that coal fuel energy resources, which is Australia's second largest export commodity to China, dominates China's coal import, that is 38 percent of China's total coal import in 2014, and which provides a room for Australia to exert a degree of leverage over China as the resource supply from Australia has become a matter of national economic security for China. However, simultaneously, the section argues that it would be a fallacy to believe that Australia would exercise a strong degree of its resource leverage as the export itself is also one of the necessities to the Australian economy and Australia do not wish to lose its leverage over China for a strategic purpose. A Sino-Russian case will be used as an example.

### 7.4.1 Total Merchandise trade in 2013-2014

### Total Merchandise Trade



(A\$m):	China	United States	Japan
Total merchandise trade	142,139	40,621	67,466
Exports	90,061	11,881	49,024
Imports	52,078	28,739	18,442

cited: Department of Foreign Affairs and Trade, 2015

In the area of merchandise trade, China has replaced the position of US and Japan. It is evident in the data that the total merchandise trading with China is more than three times of that with the US, double that with Japan. The importance of China in the Australian economy becomes more vivid by comparing total export to China, which is eight times larger than that of US and double that of Japan. Perhaps the fact that China has replaced US and has become a number one merchandise trader in the world in 2013 may have contributed to such phenomenon (China Council for the Promotion of International Trade, 2014). China Council for the Promotion of International

Trade illuminates that “According to the preliminary statistics of the World Trade Organization Secretariat, China was the leading merchandise trader in 2013. China's merchandise trade totalled US\$4.16 trillion in 2013 with exports reaching US\$2.21 trillion and imports of US\$1.95 trillion,” (China Council for the Promotion of International Trade, 2014). Thus, whilst the growing Chinese influence in the Australian economy does indicate the two countries’ deepening economic interdependence, the emergence of China as a major economic partner of Australia comes in line with the global phenomenon.

#### 7.4.2 Merchandise trade (imports and exports) & Service Trade (imports and exports) in 2013-2014

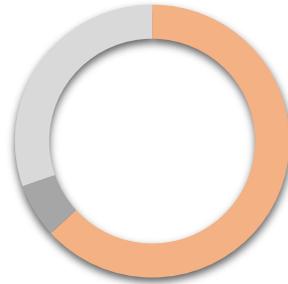
(A\$m):	China	United States	Japan
Merchandise Exports	90,061	11,881	49,024
Merchandise Imports	52,078	28,739	18,442
Service Export	7,487	6,399	2,005
Service Import	2,050	13,200	2,702

cited: Department of Foreign Affairs and Trade, 2015

Australia’s merchandise export to China doubles that to Japan and is nearly ten times larger than that to US. Moreover, China takes the lead in the areas of merchandise import, service export. However, as is evident in the data,

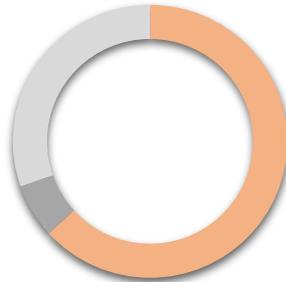
China has not replaced US or Japan in the areas of service import. The following section goes to investigate what this means to the Australian economy.

### Merchandise Exports



■ China ■ United States ■ Japan

### Merchandise Exports



■ China ■ United States ■ Japan

cited: Department of Foreign Affairs and Trade, 2015

#### 7.4.3 Composition of Merchandise trade with China

It is evident in the data that Australia's eight out of ten top merchandise commodities are concentrated in the mining sector (Department of Foreign

Affairs and Trade, 2015). In fact, Reilly elucidates that China has made Australia to be the world's No.1 producer of bauxite, coal, No.2 producer of gold, iron ore, lead, uranium, zinc, No.3 producer of silver, nickel, No.4 producer of manganese, No.5 producer of aluminium, copper (Reilly, 2012). The growth of the industry may be highly important to Australian economy, as stated by the Minerals Council of Australia, resources take approximately fifteen to twenty percent of the economy and sixty per cent of entire exports (ABC, 2014). Moreover, because the export is concentrated in the area of mining concentrates, Australia may exert a degree of leverage over China to the certain extent.

**TABLE 39: AUSTRALIA'S MERCHANDISE TRADE WITH CHINA (a) (b)**  
(A\$ million)

Rank	SITC	Commodity	2011	2012	2013	% growth	
						2012 to 2013	5 year trend
<b>Top 20 merchandise exports</b>							
1	281	Iron ores & concentrates	43,960	38,440	52,653	37.0	23.3
2	321	Coal	4,543	6,783	9,082	33.9	52.8
3	971	Gold	1,284	5,529	8,074	46.0	749.4
4	682	Copper	1,211	938	2,069	120.5	24.8
5	287	Other ores & concentrates (c)	1,845	1,549	2,007	29.5	5.0
6	268	Wool & other animal hair (incl tops)	2,022	1,877	1,944	-3.6	7.8
7	283	Copper ores & concentrates	1,500	1,364	1,896	39.0	9.4
8	263	Cotton	1,470	1,788	1,733	-3.0	79.9
9	333	Crude petroleum (d)	2,902	2,448	946	..	..
10	284	Nickel ores & concentrates	553	921	846	-8.2	14.3
11	211	Hides & skins, raw (excl furskins)	649	635	842	32.6	13.7
12	011	Beef, f.c.f.	59	149	722	383.7	96.4
13	222	Oil-seeds & oleaginous fruits, soft	113	109	676	517.5	256.4
14	043	Barley	367	551	548	-0.5	17.1
15	285	Aluminium ores & conc (incl alumina)	236	270	520	92.5	33.6
16	542	Medicaments (incl veterinary)	432	748	515	-31.2	33.3
17	012	Meat (excl beef), f.c.f.	166	247	510	106.8	41.3
18	288	Non-ferrous waste & scrap	398	402	481	19.7	10.4
19	686	Zinc	243	267	302	12.9	18.4
20	041	Wheat (e)	215	570	283	-50.3	195.1
<b>Total merchandise exports</b>			<b>71,451</b>	<b>72,973</b>	<b>94,655</b>	<b>29.7</b>	<b>22.8</b>

cited: Department of Foreign Affairs and Trade, 2015

Australia accounts 38 percent of China's total coal import (Reuter, 2014).

To China, for domestic stability, the resource supply from Australia has become a matter of China's national economic security (Zheng, 2014). China would need a constant resource supply from Australia as China's energy consumption under a constant, yet fast, growth which would ultimately be double that of U.S. by 2040 (Watt, 2014). Moreover, it is coal fuel energy resources, Australia's second largest export commodity to China, that dominate China's energy consumption (Watt, 2014). This is evident where coal fuel accounted 68 percent of China's total energy consumption in 2012 (Watt, 2014).

The consumption of energy in China and China's demand for coal, are closely related and thus affect the amount of Australian coal export to China. The increase of coal consumption has increased the amount of Australia's coal export to China, with a total export of \$9 billion in 2013, which demonstrates a 52.8 percent growth from 2008 (Department of Foreign Affairs and Trade, 2013). Such phenomenon may provide Australia a certain extent of leverage over China as when the relation between the two countries are not in its best shape, the coal supply from Australia may possibly be decreased and this may negatively affect China's domestic economic growth. In fact, there had been an incident where the systemic impact of China's rise has resulted in a deterioration in the strategic dimension of China-Australia relations and hence negatively affected its economic relations (Zheng, 2014).

This has in turn created considerable constraints and uncertainties in China's resource cooperation with Australia. Zheng highlights the situation as:

*“China remains the more vulnerable party in the uneven resource interdependence with Australia. The Chinese have sought to improve their power position vis-à-vis the Australians; but domestic economic constraints and internal fragmentation have considerably undermined Chinese efforts to gain the upper hand in the bilateral resource politics”*  
(Zheng, 2014)

Hence, despite the fact Australian economy is heavily dependent on its banker- as Hilary Clinton puts it- Australia exercise a degree of leverage over China as it possess the commodity that China need for its consistent domestic economic growth. Thus, it may be argued although the economic relationship between the two countries are highly asymmetrical, Australia may exercise a level of leverage over China. However, simultaneously, it would be a fallacy to believe that Australia would exercise a strong degree of its resource leverage. This is not only because the export itself is also one of the necessities to the Australian economy, but also Australia may want to keep the leverage over China for a strategic purpose. That is to say, a hasty attempt

to use its leverage over China may result in losing its strategic influence as China may attempt to find another stable, persistent provider of the coal supply.

Perhaps China's attempt to move away from the Russian influence proves the argument to be relevant. While China needed petroleum and natural gas from Russia for its domestic growth, Russia was passive in opening its resources to China due to its strategic concern over China (Swanstorm, 2014). As a result, so as to find alternative suppliers of the resources, China has actively developed energy plants in Latin America, Middle-east and Africa, in an attempt to weaken the Russian leverage and fulfill the domestic demands and consequently its economic growth (Swanstorm, 2014). Similarly, should there be a movement of Australia to exercise its leverage over China, it is likely that China would strengthen its resource trade with other resource-rich countries such as Indonesia, Kazakhstan, or even possibly India, although resource trade with India is least likely as India itself is a major consumer of energy for the domestic growth as well. Thus, Australia is not likely to use its resource as a practical pressure against China but is likely to keep it as a diplomatic card so as to maximise its strategic movement.

中	美	日
<b>Major Australian exports, 2014 (A\$m):</b>	<b>Major Australian exports, 2014* (A\$m):</b>	<b>Major Australian exports, 2014* (A\$m):</b>
Iron ores & concentrates	Beef	Coal
50,579	2,428	11,868
Coal	Aircraft, spacecraft & parts	Iron ores & concentrates
8,326	830	8,408
Gold	Meat (excl beef)	Beef
7,023	690	1,646
Copper	Alcoholic beverages	Copper ores & concentrates
2,077	448	1,555
	<i>*Includes \$1.7bn of confidential items &amp; special transactions, mainly uranium, nickel &amp; alumina. 15% of total exports.</i>	<i>*Includes \$18.0b confidential items of trade, mainly LNG. 37% of total exports</i>
<b>Major Australian imports, 2014 (A\$m):</b>	<b>Major Australian imports, 2014* (A\$m) (e):</b>	<b>Major Australian imports, 2014 (A\$m):</b>
Telecom equipment & parts	Passenger motor vehicles	Passenger motor vehicles
5,624	2,219	5,894
Clothing	Measuring & analysing instruments	Refined petroleum
4,996	1,136	2,636
Computers	Telecom equipment & parts	Goods vehicles
4,948	999	1,285
Furniture, mattresses & cushions	Medicaments (incl veterinary)	Tubes & pipes of iron or steel
2,295	900	861
	<i>* Includes \$2.8b of confidential items. 10% of total imports.</i>	

cited: Department of Foreign Affairs and Trade, 2015

#### 7.4.4 Total Service Trade in 2013-2014

Total service trade



■ China ■ United States ■ Japan

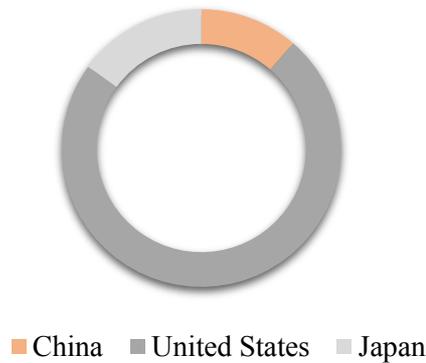
(A\$m):	China	United States	Japan
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Total service trade	9,537	19,599	4,707
Service Export	7,487	6,399	2,005
Service Import	2,050	13,200	2,702

cited: Department of Foreign Affairs and Trade, 2015

In the area of service trade, China has replaced Japan, accounting double the total service trade of Japan (Department of Foreign Affairs and Trade, US Fact sheet, 2015). However, it has not replaced US, as it has nosedived to account half of US's total service trade to Australia (Department of Foreign Affairs and Trade, US Fact sheet, 2015). This is not because US remains to be largest service export market, but due to Australia's heavy service import from the US. In fact, it is evident in the data that service export to China is slightly larger than that to the US, but service import from the US is 6.4 times larger than that from China (Department of Foreign Affairs and Trade, US Fact sheet, 2015). It is professional technology that takes a substantial portion of its service import from the US, making the US as number one service trading partner (Department of Foreign Affairs and Trade, US Fact sheet, 2015). Bisley elucidates that access of technology is one of the crucial reasons that Australia needs US (Bisley, 2013). As Australia depend on US for its technology, Bisley argues that it is a fallacy to believe that Australia is likely to move away from Washington (Bisley, 2013).

### Service imports



cited: Department of Foreign Affairs and Trade, 2015

中		美	
Major Australian service imports, 2014 (A\$m):		Major Australian service imports, 2013-14 (A\$m):	
Personal travel excl education	747	Personal travel excl education	4,133
Transport	513	Prof, tech & other business services	3,127

cited: Department of Foreign Affairs and Trade, 2015

## 8.0 Investment

The following section investigates the two-way investment between Australia and China by using that with US and Japan as comparing variables. The paper has exposed that whilst the investments from US and Japan predominates within the Australian economy, China's investment remains to play a pivotal role as the investment has a tendency to be consistent regardless of influences of external factors and this is evident during the global financial crisis, where global investment to Australia has diminished, yet it was China's investment that contributed cash inflow to the Australian economy, which ultimately functioned to stabilise the domestic economy.

## 8.1 China's Investment in Australia

In 2014, China was Australia's second largest investment provider, after US, with a total investment of A\$64.5 billion to Australia, with \$30.0 billion in the form of foreign direct investment (China Fact Sheet, 2015). In addition, Australia's investment in China amounts a total of A\$57.9 billion in 2014, with 12.1 billion in the form of foreign direct investment. Although China's investment do not take major part within Australian economy, China's investment plays an essential role within the economy as the investment has a tendency to be consistent regardless of influences of external factors (Refer to 7.4). Moreover, the amount of investment is increasing fast. As an example, China's investment in Australia in 2013 is at \$31.9 billion with net investment inflows of \$8.8 billion, which is more than fourteen times the level it was in 2005 (Department of Foreign Affairs and Trade, 2015). Thus in an attempt to further attract China's investment, the Australian government is promoting an open investment regime and Foreign Investment Review Board process (Department of Foreign Affairs and Trade, 2015). Moreover, the Minister for Trade and Investment, the Hon. Andrew Robb and the Minister for Immigration and Border Protection, the Hon. Scott Morrison, have announced that Australian government will *"increase flexibility of Chinese investors by offering a new three-year multiple entry visitor visa Chinese business visitors"*,

in an attempt to attract bigger China's investments (Department of Foreign Affairs and Trade, 2015).

## 8.2 US investment in Australia

The United States places itself as Australia's largest two-way investment partner, with the two-way investment stock reaching over \$1.1 trillion in December 2013. In 2014, US was Australia's the largest investment provider once again with a total investment of A\$758.1 billion to Australia, with \$163.4 billion in the form of foreign direct investment (US Fact Sheet, 2015). Australia's investment in US amounts a total of A\$575.5 billion in 2014, with 136.2 billion in the form of foreign direct investment.

The driving force behind US's protuberant investment to Australia is due to none restrictions on moving capital in or out of US (Department of Foreign Affairs, 2015). In fact, it was the protocol amending the double taxation convention for Australia and US that entered into force on July 2003, which has functioned to enhance the bilateral investments of the two countries (Department of Foreign Affairs, 2015). It is projected US will remain its position as the largest investment provider to Australia as the agreement to improve International Tax Compliance and to implement the Foreign Account Tax Compliance Act (FATCA) were into force since 30 June 2014, which may further enhance the bilateral investments of the two countries (Department of Foreign Affairs, 2015).

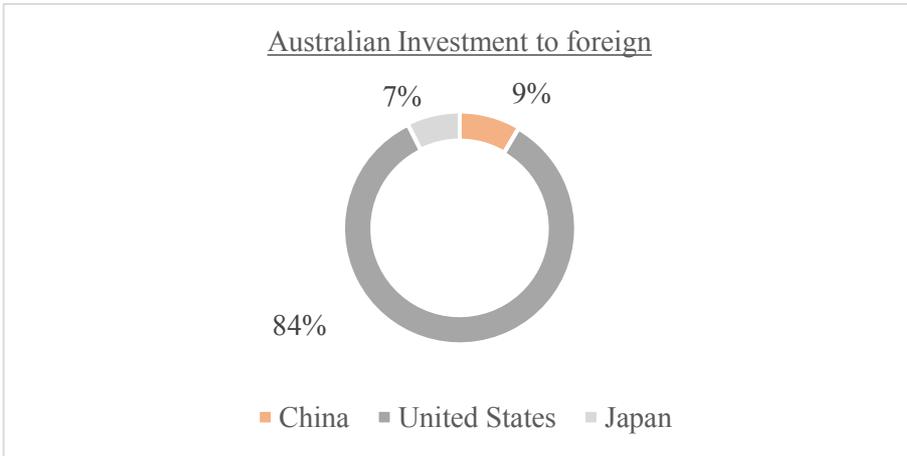
### 8.3 Japan's investment in Australia

In 2014, Japan was Australia's the third largest investor with a total investment of A\$131.0 billion to Australia, with \$63.4 billion in the form of foreign direct investment (Japan Fact Sheet, 2015). Australia's investment in Japan amounts a total of A\$50.2 billion in 2014, with 0.5 billion in the form of foreign direct investment. It is apparent throughout the data that nearly half of Japan's total investment in Australia is in the form of foreign direct investment (Department of Foreign Affairs and Trade, 2015). This means Japan's investment directly targeted specific industries, which soothed the cash flow and ultimately resulted the industries to boost. The Department of Foreign Affairs and Trade highlights such phenomenon by stating: "*Japanese direct investment has been essential in the development of many of the export industries that have driven Australia's growth, including in large-scale projects to meet Japanese demand for resources such as iron ore, coal and motor vehicles*" (Department of Foreign Affairs and Trade, 2015). Moreover, Japan's investment has contributed the fast growth of Australia's LNG capacity, which is predicted to make Australia to become the world's largest producer by 2017 (Department of Foreign Affairs and Trade, 2015). In addition, a Japanese company, INPEX, is starting a \$34 billion worth of a project near Darwin and is scheduled to initiate its production in 2016 (INPEX,

2015). The project becomes significant as this will be the first Japanese-operated LNG project anywhere in the world (Department of Foreign Affairs and Trade, 2015). It may be anticipated that the Japan's investment would further increase in next few years as Japan's major trading houses continue to make multi-billion dollar investments in Australian resources (Department of Foreign Affairs and Trade, 2015). In fact, Japan's investment to Australia has stretched outside the traditional regions of natural resources to "*diverse sectors such as financial services, infrastructure, information and communications technology, property, food and agribusiness*" (Department of Foreign Affairs and Trade, 2015). Moreover, the Japan-Australia Economic Partnership Agreement, which has been entered into force from 15 January 2015, may function to further lift Japan's investment to Australia, which may generate Australia's employment growth (Department of Foreign Affairs and Trade, 2015).

#### 8.4 Comparison in investment in 2014

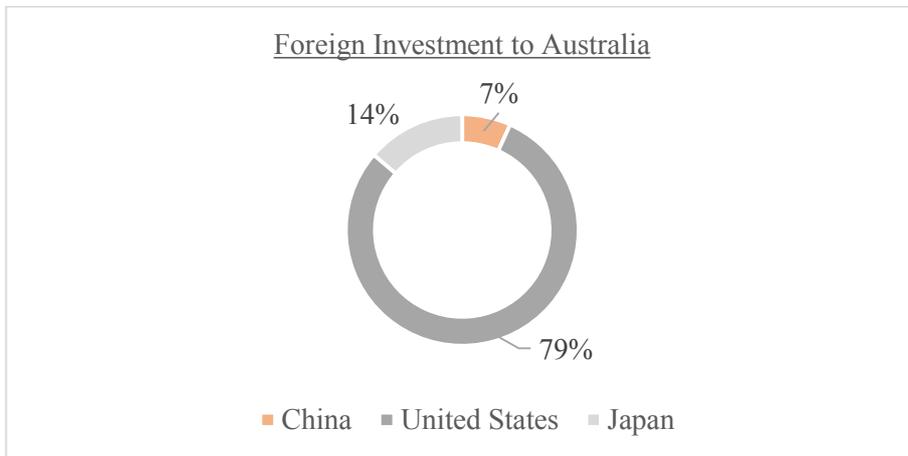
Australia's investment to foreign country:



(A\$m):	China	United States	Japan
Total investment	57,884	575,514	50,225
FDI	12,074	136,248	477

cited: Department of Foreign Affairs and Trade, 2015

Foreign Investment to Australia:

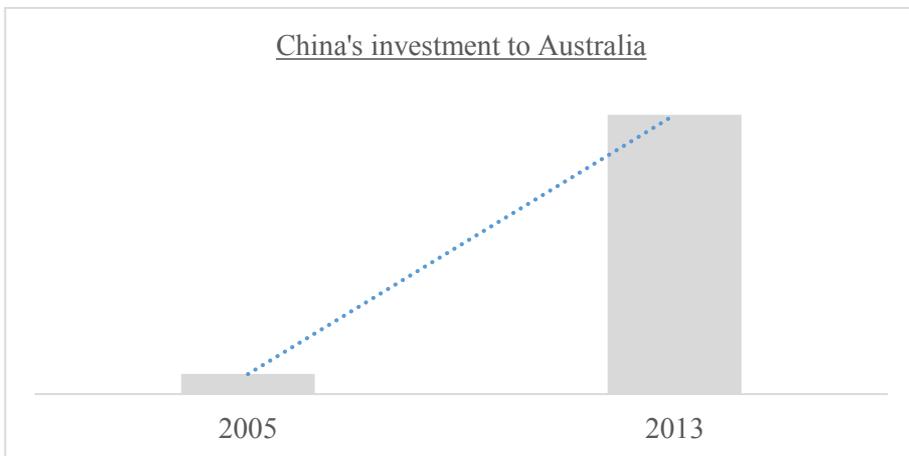


(A\$m):	China	United States	Japan
Total investment	64,525	758,153	130,982

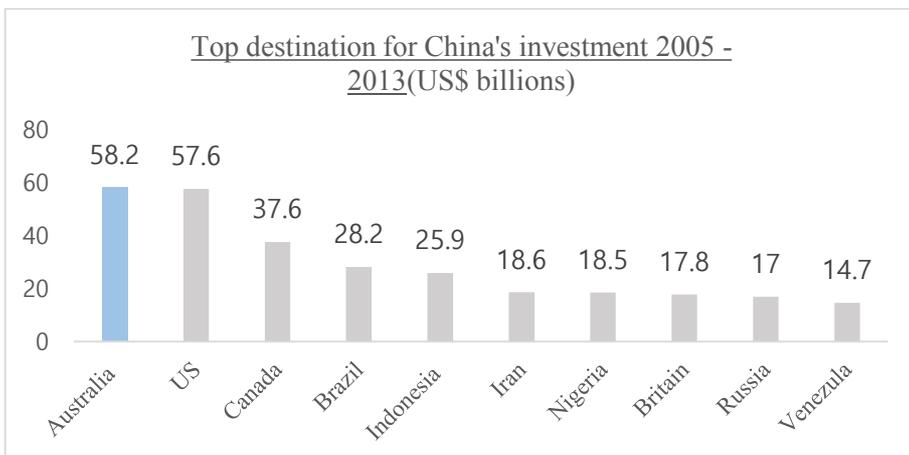
FDI	29,970	163,410	63,257
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cited: Department of Foreign Affairs and Trade, 2015

The data illustrates that it is US investment that predominates the Australian economy. The total investment from the US to Australia is 11.7 times larger than that from China, whilst investment from Japan is double that of China. However, China's investment plays an essential role in the Australian economy as the investment is concentrated in mining sector (Department of Foreign Affairs and Trade, US Fact sheet, 2015). Moreover, China's investment exerted a consistent inflow to the Australian economy even during the times of global financial crisis, which ultimately stabilised the economy (Reilly, 2012). For instance, whilst global FDI fell twenty percent in 2008, Chinese outflow was doubled to be \$41billion (Reilly, 2012). In addition, while the number of total Federal Investment Review Board (FIRB) approved projects fell from 8,354 in 2007-2008 to 604 in 2008-2009, China's approved investment increased more than \$A16 billion between 2009 and 2010 (Reilly, 2012). Moreover, Australia has become a single largest destination of China's direct investment (Reilly, 2012).



cited: Department of Foreign Affairs and Trade, 2015



cited: Heritage Foundation, 2013

#### 8.4.1 Domestic concern as a barrier for further investment

China's investment confronted Australia's domestic concern due to the fear that Australia's strategic sector, such as mining, is excessively exposed to an investment by the non-allies (Reilly, 2012). That is to say, Australian government had to encounter a difficult decision where limiting the investment may undercut Australia's economic growth, whilst encouraging it

may escalate China's strategic leverage over Australia (Reilly, 2012). From 2002 to 2010, 36 of 49 China's investment in foreign iron-ore and coking-coal-related projects were made to Australia, with a total value of A\$27 billion (Reilly, 2012). Among which, six of the projects were invested by state owned enterprises and financed by state owned banks (Reilly, 2012). Such concern and fear has ultimately led Australia to vary its FDI law to regulate China's investment in 2008 (Reilly, 2012). In fact, Reilly argues that it is the 2008 incident that has made Australia's domestic concern to be surged. He highlights "*In January 2008, Chinalco, a Chinese state-owned mining conglomerate, attempted to prevent the takeover of Rio Tinto by BHP Billiton through a massive A\$15.5 billion 'dawn raid' on Rio Tinto shares in the London stock market*" (Reilly, 2012). As a result, 17 days after the incident, Australian government has issued an updated set of FDI review guidelines through its Treasury Department (Reilly, 2012).

The revised law states that:

- *The investor is subject to and adheres to the law, and observes common standards of business behaviour*
- *The investment hinders competition, or leads to undue concentration or control in an industry*
- *The investment impacts on Australian government*

*revenue or other policies*

- *The investment impacts on national security*
- *The investment impacts on the operation or direction of an Australian business, including its contribution to the economy and wider community (Wilson, 2011)*

The variation is the first variation made in Australian FDI mining policy since 1992 and the law, in combination with its growing domestic concern, may act as a barrier of China's future investment in Australia. However, despite Australia's growing concern, China will continue to invest in Australia's mining sector for years to come (Zha, 2013). The driving force behind the China's investment may be explained by the four principles of the diamond model. First, strategically and structurally China needs Australia's mining export. Beijing pursues a strategic approach to investing abroad, particularly in the resources sector and domestically in China, the iron ore industry faces a number of structural challenges (Zha, 2013). China's iron ore is low-grade, expensive to process, and its mines are being depleted (Zha, 2013). Second, factor condition makes China to rely its import from Australia. It is the absence of residual security issues between the two countries is also an important factor, as it contributes to low concerns over sovereign risk (Zha, 2013). The China's rapid growth of domestic economy functions as a factor

for the country urgent need for the material. Third, related supporting industries may also be taken into an account. The success in the Australian market can help a Chinese company enhance its credentials in becoming a truly global multinational corporation (Zha, 2013). Fourth, the demand condition may also be taken into the consideration. In fact, the growing Chinese demand of resources and energy for the domestic economic growth (Zha, 2013). However, it must be noted that it may be Australia's variation of its FDI law that may work as a barrier of China's will to invest into Australia.

#### 8.4.2 Australian dilemma on the Chinese investment

There is a concern that Australian mining industry's heavy reliance on China may cause a negative effect to the Australian economy. The Economist has called Australia to be an '*unlucky country*', stating that "*The country suffers from plummeting iron-ore prices as China's economic growth slows*" (GARNAUT, 2015). China's economic slowdown and the accompanying plunge in iron-ore prices may put the Australian economy in the stagnations (Economist, 2015). The World Bank have stated in 2015 that the implication of China's economic slowdown to Australia would be relatively large for countries like Australia, whose economies are major links in the region's supply chains (Economist, 2015). Hockey predicts that that the iron-ore price would drop to \$35 per tonne for the next fiscal year's budget-revenue

calculations, which is a quarter of its price in September 2013 (Economist, 2015). In fact, there is a tendency that the price of iron-ore would continue to decline as the price fell to \$95 per tonne when the government passed its first budget in May 2014, and then the price has halved since then in 2015 (Economist, 2015). The problem becomes even more significant for Australia as regardless of the price decline, Australia must continue its export so as some cash is better than no cash to save the falling industry and thus sustain its economic sustainability (Economist, 2015). Thus, it leaves Australia not many options but to rely on China so as to sustain its economic suitability (Economist, 2015).

## 9.0 Possible Game Changer

The following section investigates the Australia's possible internal and external factors that may act to reduce Australia's reliance on China. The section argues that China will continue to be Australia's largest and the most important merchandise trader. Despite the Australia-Japan Bilateral and regional trade agreements, it is less likely for Japan to take its position back as Australia's largest trade partner and this is evident in the case of AUSFTA. In addition, the China-Australia Free Trade Agreement may function to *diversify* the trade commodities and hence strengthen the two countries' merchandise trade relationship. However, as mentioned in section 7.0 and 8.0, the effect is

to be limited within the merchandise trade area only. Moreover, the section argues that Australia's energy nationalism may function as an internal factor that may work as a barrier for China's further investment, which may possibly affect the overall economic relationship.

### 9.1 Australia-Japan Bilateral and regional trade agreements (JAEPA)

Some may argue that the Australia-Japan Bilateral and regional trade agreement, which has been signed on 8 July 2014 may function to increase that merchandise trade between the two country and Japan may take back its position as Australia's largest merchandise export destination (Department of Foreign Affairs and Trade, 2015). In fact, Australian government projects that the agreement will portray the two economies closer, as it will deliver benefits to *"Australian farmers, manufacturers, exporters, service providers and consumers"* (Department of Foreign Affairs and Trade, 2015). The government predicts that the agreement will function to enhance the two countries' trade by stating: *"More than 97 percent of Australia's exports to Japan will receive preferential access or enter duty-free when JAEPA is fully implemented. To date, JAEPA is by far the most liberalising trade agreement Japan has ever concluded"* (Department of Foreign Affairs and Trade, 2015). However, the effect of JAEPA would not be large enough to put China behind Japan in trading and this is evident in the case of Australia-United

States Free Trade Agreement (AUSFTA). The AUSFTA has entered into force on 1 January 2005. AUSFTA has made more than 97 percent of Australia's non-agricultural exports to US to be duty free and two-thirds of agricultural tariff lines went to zero, strengthening the economic tie between the two countries (Department of Foreign Affairs and Trade, 2015). The Department of Foreign Affairs and Trade emphasises outcome of AUSFTA as:

*“Under AUSFTA, for the first time, Australian companies have access to the federal government procurement market in the United States and the government procurement markets of 31 US states. Since AUSFTA entered into force, bilateral trade has grown by around one third”* (Department of Foreign Affairs and Trade, 2015)

However, it must be noted that while AUSFTA *did* function to increase the total trade between Australian and US, but the effect was not big enough for Australian to put China behind US in trading. This is evident where China became the largest trading partner of Australia regardless of AUSFTA in 2007, and when the total trade of China is almost ten times larger than that of US in 2014 (Australian Bureau of Statistics, 2007; China Fact Sheet, US Fact Sheet, 2015).

9.2 The China-Australia Free Trade Agreement (ChAFTA) entering into a force

The ChAFTA was signed on 17 June 2015 and this would furthermore surge economic partnership between Australia and China, consolidating China's position as the country's largest trading partner in many years to come (Department of Foreign Affairs and Trade, 2015). Australian government believe that the Agreement will enhance the growing trade and investment relationship as the economies of the two counties are highly complementary (Department of Foreign Affairs and Trade, 2015). The government projects that the agreement will *“ensure the competitiveness of Australia's agricultural and manufacturing industries, protect and ensure the competitiveness of our services providers and attract greater investment in Australia”* (Department of Foreign Affairs and Trade, 2015). In fact, over 85 percent of the value of Australia's goods exports to China will enter duty free upon entry into force, *“rising to 93 percent after four years and 95 percent when ChAFTA is fully implemented, which will furthermore increase Australia's economic dependence on China”* (Department of Foreign Affairs and Trade, 2015). The agreement may further enhance Australian services providers to China as they are likely to benefit from new access to China's significant and growing services sector. Moreover, it may function to diversify the trade commodities and hence strengthen the two countries' trade relationship. Nevertheless, the

effect of ChAFTA is likely to be limited within the area of merchandise trade as China may not be Australia's major provider of the professional technology (Bisley, 2013). The spill over effect to the area of service trade is still projected to be limited.

### 9.3 RCEP and TPP

Australia is one of the seven countries who formally expressed interest in joining both Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP). Many assume that signing one the two mega regional trade may influence Australia's middle power diplomacy, as TPP and RCEP are considered as a proxy for competition between US and China for the regional influence (Wilson, 2015). However, the paper argues that none of the two mega-regional trade agreements will influence Australia's current diplomatic stance as their economic impact is rather limited.

Firstly, the paper argues that RCEP doesn't do much to the Australian economy. Wilson highlights that the major players of RECP- that is China, Japan, Korea and India- demonstrate rather protectionist behaviors in defending their agricultural industries (Wilson, 2015). Thus, Australia, a major agricultural exporter, is not likely to benefit from the RCEP agreement as there is a little chance for Australia to achieve a significant progress in the agricultural market

access (Wilson, 2015). In other words, Australia's overall economic benefits under RCEP are likely to be limited, unless substantial compensations are present in the services sector (Capling and Ravenhill, 2015).

On the other hand, TPP offers more pragmatic economic gains to Australia, when compared with RCEP, as it may function to further liberalise the agricultural markets of the participant countries (Capling and Ravenhill, 2015). In fact, the TPP agreement, which had been finalized on 5 October 2015, included agreement to reduce tariffs on beef, dairy, wine, sugar, rice, horticulture and seafood- Australia's major export commodities (Chang, 2015). This would function to eliminate 98 percent of tariffs on Australian agricultural exports, adding A\$3.67 billion to its budget (Chang, 2015). Perhaps it is Australian sugar industries that would benefit by large from the TPP agreement as Australia's current sugar export quantity of 107,000 tonnes per year is projected to increase to be 400,000 tonnes per year in the next two or three years as a result of reduced tariffs among the TPP participants (Chang, 2015). As TPP is structured as a set of coordinated bilateral trade agreements, which provide the *same* market access provisions among its participants, Australia's agricultural industry may maximise its profit through the extended market access (Capling and Ravenhill, 2015).

However, Capling and Ravenhill elucidates that the effect of all mega-regional

trade agreements, including TPP , Australia’s entry to the Asian market is rather limited as FTA utilization rate is rather low in some Asian markets. Capling and Ravenhill argues that:

*“The conclusions from the Productivity Commission’s detailed study of Australian PTAs that the benefits of PTAs for Australia have been ‘oversold’ are supported by evidence from elsewhere. A major review conducted by an Asian Development Bank officer found that ‘Overall, Asian FTAs are not widely used and FTA utilisation rates are very low among Asia countries largely because Asia’s trade is already dominated by zero MFN trade’. A recent review by the Economist Intelligence Unit found that only 19 percent of Australia’s exporters made use of its PTAs” (Capling and Ravenhill, 2015) PTA= preferential trade agreements*

Moreover, Australia’s projected gain in the agricultural area through the TPP agreement, A\$3.67 billion, is not likely to significantly supersede its loss in the intellectual property rights. This is evident where Australia, as a primary consumer of intellectual property, has made A\$3.5 billion loss from the WTO’s

Trade in Intellectual Property Rights agreement (Capling and Ravenhill, 2015). Thus, it is difficult to argue that the welfare gain through mega-regional trade agreement will significantly outweigh the loss. In fact, it was never Australia's interest to include intellectual property provisions to mega-regional trade agreement negotiations as voices of intellectual property importers are seldom heard within the mega-regional trade agreement negotiations (Capling and Ravenhill, 2015).

Thus, whilst it is widely accepted that TPP will bring Australia some economic benefits, its effect to the Australian economy is rather limited. Hence, it would be logical to argue that the TPP agreement will not have a substantial effect to the Australian economy to influence its middle power diplomacy to lean back more towards the US in economy. In addition, from Australian perspective, joining mega-regional trade agreements, whether it be TPP or RCEP, is not only due to economic benefit, but is rather a result of various considerations such as; *“security linkages, the desire to gain campaign contributions and votes from particular constituencies, bureaucratic interests and perceptions/ideas”* (Capling and Ravenhill, 2015). Thus, as Australia is already heavily leaning towards the US in politics, TPP is not likely to influence Australian politics to change its US, or perhaps China strategy.

#### 9.4 Australia's energy nationalism

Australia's energy nationalism may further function as a barrier for future Chinese investment in Australia. prior to 1983, Australia had implemented nationalistic energy policies, where the government had actively interfered the resource market so as to maximise its 'national interest' (Hay, 2009). Nonetheless, since 1983, as there had been a nationwide deregulation throughout Australian economy, energy policies had also been liberalised and the development of its energy reserves were dictated by the market. (Hay, 2009). However, the Australia's latest energy policies illustrate a retreat from the liberalisation agenda that had once dominated Australia's politics (Hay, 2009). Hay identifies the three evidences where Australian energy policies has been influenced by a nationalist framework (Hay, 2009). Hay highlights that:

*“(1) the domestic gas reservation policy in Western Australia; (2) Australian government efforts to promote a ‘value adding’ nuclear processing industry and (3) Australian Labor Party policy giving preferential financial incentives for gas to liquids projects. The re-emergence of nationalism in Australia is occurring either because policy makers now favour it as a path to energy security or in some cases because they believe that appeals to nationalism will generate political support”* (Hay, 2009)

Australia's implementation of such policies are in fact a worldwide phenomenon as since 2000, the "new wave of resources nationalism" took place throughout the world (Hay, 2009). Bolivia's nationalisation of gas fields and Russia's attempt to take the government control over Russian energy assets via the state owned enterprises, and Venezuela's oil contract renegotiations by the Chaves government proves this to be true (Hay, 2009).

Along with implementation of policies, Australia has also revised FDI review guidelines in 2008, in an attempt to regulate China's investment on its energy reserves (Reilly, 2012; Refer to section 9.4.1). Such resource nationalism has emerged due to the psychology of insecurity that has overtaken rational policy debate (Bochkarev and Austin, 2007). As a result, there has been a wide perception that the country's energy reserves are a "*constituent element of its own national security*" (Bochkarev and Austin, 2007). That is to say, there may has been a fear within the Australia's domestic politics where its strategic sector is being exposed to an investment of a non-ally, China (Reilly, 2012). In fact, there has been a negative perception on China's energy diplomacy among the western society where it views the investment as a strong neo-mercantalist approach where it "*aims at acquiring direct control over overseas oil and gas reserves*" and so as to "*ensure that the output of oilfields under Beijing's control is exported directly to China and not sold on the world markets the output of most multinationals is.*" (Kreft, 2006). Such fear has

aroused a nationalistic response towards China's direct foreign investments in a liberal democratic state, such as Australia, where there is a perception that views the Chinese "neo-mercantilist" strategy is directly targeting Australia's energy reserves in an attempt to take control over Australia's strategic assets (Hay, 2009). It is this fear mentality that has resulted in the increase of Australia's resources nationalism which works as a challenge the commitment to commercial liberalism that has dominated Australia's policy making after 1983 (Hay, 2009).

Perhaps Australia's implementation of such nationalistic approach may be of Australia's will to pursue its reciprocal accommodation towards China. The policies may be seen as an illustration that Australia has placed its commercial interest subservient to the objective of its political and strategic purpose (Hay, 2009). As Hay highlights:

*"For a country such as Australia, which has considerable energy reserves, there are two objectives which policy seeks to meet. The first objective is to ensure the continuing availability of energy to satisfy domestic demand at reasonably stable prices... The second objective is the development of the nation's energy reserves in a manner which maximises the 'national interest'. What constitutes the national interest is*

*subjective. For some it may be defined purely in economic terms (e.g. maximising gross domestic product) for others it may include industrial, military or political independence”*  
(Hay, 2009)

Perhaps the policies has enabled Australia to use its energy reserves as a strategic tool, extending its economic leverage and thus its strategic influence towards China. In this way, Australia-China relations may be defined as subordinate variable under Australia-US relationship. Thus, it may also be argued that Australia’s nationalistic stance in its energy policy may be a manifestation of the Australia’s security tie among US and Japan, so as to check and balance China (Hay, 2009; Bisley, 2013). In addition, Australia’s such approach may function as a factor to negatively impact the bilateral relationship in future. There is a possibility that the decrease in China’s accessibility of the energy reserves may compromise China’s interest, weakening the bilateral relationship between the two countries.

## 10.0 Conclusion

The paper has analysed that Australia’s economic dependence on China has become more important than that of the US and Japan but the effect is limited in the merchandise trade only. In the service trade and investment, Australia’s

traditional economic partners, especially US, plays a bigger role in the Australian economy and hence exerts more influence to the economy. Hence, the paper argues that the room Australia may pursue its 'reciprocal accommodation model' is assured, as the political spill over effect to the economy is kept at minimal. It is also projected that such phenomenon is not likely to change for many years to come, as the service trade with US, especially service import, lies in the area of professional technology, which is not likely to be replaced by China. Moreover, although Australia does have some degree of leverage in its asymmetrical economic relations with China, there is a possibility that Australia may lose such leverage over time as China is virtually the only major consumer of the material, and the price of iron-ore is declining since 2013, which may come together to weaken its leverage over China.

The paper advises that so as to keep its strategic leverage over China, Australia should rather actively make China to further engage and thus rely on the Australia's mining industry for its domestic economic growth. Should there be a revision of Australia's FDI law, which is currently working as a barrier for China's investment to the Australian mining industry, China's reliance on the Australia may further be wired and thus the leverage over China may be assured. This would come together to provide a bigger room for the Australian diplomacy, which would enable the continuation of its reciprocal accommodation strategy.

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## 국문초록

호주와 중국의 경제 관계는 비대칭적이지만 호주에게 일정 수준의 레버리지 존재하는 독특한 형태를 보인다. 중견국인 호주가 대국(大國)인 중국을 상대로 여느 중견국들과 달리 넓은 외교적 운신의 폭을 보이는 것이다. 1)호주는 중국의 가장 큰 석탄 수입국이라는 점, 2)중국은 평화롭고 지속적인 국내발전을 위해 석탄을 필요로 한다는 점이 이를 가능하게 한다. 중국의 호주 정책을 살펴보면 논문의 주장은 더욱 설득력을 얻는다. 중국의 호주정책은 ‘走出去战略’로 설명할 수 있으며 자원 안보 확보를 우선 과제로 삼고 있음을 알 수 있다. 향후 중국의 에너지 수요 중 석탄, 석유, 천연 가스의 수요가 폭발적으로 증가 할 것이라는 점이 때문에 이 수요를 충족하기 위해 호주로부터의 자원 수입이 반드시 필요한 것이다.

호주의 경제가 중국에 종속되지 않았다는 점도 호주가 정치와 경제를 철저히 분리해 자국의 이익을 극대화 하는 ‘대응적 수용전략’ 구사 할 수 있게 한다. 호주의 대중국 경제의존의 수준은 전통적인 경제파트너인 미국과 일본을 대체하지 못했다. 논문은 교역의 세 가지 대표분야인 상품 무역, 서비스무역, 투자부분을 살펴본다. 1)상품무역에서 호주-중국의 상품 교역 총량은 미국, 일본과의 교역량을 압도하지만 그 구성은 다양하지 않다. 2)호주의 대중국 서비스 수출은 미국/일본을 앞서지만 전체 서비스 교역 총량에서 미국의 절반밖에 미치지 못한다. 또한 호주는 전문 기술에 대한 접근성을 높이기 위해 서비스 분야에서 미국을 필요로 한다. 3)투자 분야에서 중국의 對호주 투자 규모는 미국의 11분의 1, 일본의 2분의 1 수준에 불과하며 호주는 국내 정치를 위해 중국의 투자 규모를 제한하고 있다. 따라서 논문은 중국이 호주경제에서 행사하는 영향력은 제한적이라고 주장한다. 이러한 요소들은 호주의 중견국 외교 전략인 ‘대응적 수용전략’의 원동력으로 작용하고 있다.

주요어: 호주의 대응적 수용전략, 중견국 외교, 상업자유주의, 헤징 전략, 무역평화론

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