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Submission to Joint Standing Committee on Trade and Investment Growth (JSCTIG)
Inquiry into Diversifying Australia's Trade and Investment Profile

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Executive Summary

- Australia's economic success has and always will depend upon the strength of its international trade and investment relationships. However, the existing market and sector orientation of Australia's trade and investment relationships is unsustainable, and unlikely to underpin future prosperity.
- Australia is presently facing a number of external economic shocks, including COVID-19-induced interruptions to global value chains, and rising trade protectionism. Together, these shocks pose the most adverse external economic environment Australia has faced in generations.
- At the same time, Australia's trade and investment relationships are not currently reorienting and strengthening in line with the growth of the major emerging economies in the Indo-Pacific. Most stark is the underdevelopment of Australia's economic ties with India, Indonesia and Vietnam.
- Reputable economists also forecast the plateau of global demand for Australia's existing major export industries. In particular, demand for Australian iron ore is forecast to decline over coming decades, and gas and coal demand is likely to peak over coming decades.
- The lack of diversity in Australia's current economic relationships magnifies the domestic effects of these shocks. A narrowly concentrated industrial export base, and dependence on a small number of trade and investment markets, increases Australia's risk exposure in this deteriorating environment.
- Australia must therefore begin diversifying its trade and investment relationships as matter of national priority. A more diversified Australian economy will increase national resilience to near-term external economic shocks, and support Australia's long-term integration into the emerging corridors of global growth, trade and capital flows.
- Diversification efforts should focus on building new trade and investment relationships with key Indo-Pacific partners. A number of practical and immediate steps to begin this agenda are identified, with a particular focus on Indonesia, Vietnam and India.

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1. International economic relationships and the Australian economy

Trade and investment is critical to Australia's economic success. As a medium-sized and open economy, integration with international markets enables Australia to more productively and significantly exploit its comparative advantages. Australia's largest export industries – across the resources, technology, education, agriculture and services sectors – have been necessarily underpinned by foreign investment. One in five Australian jobs is directly trade-related, and one in ten Australian jobs relies on foreign investment[1].

Australia has benefited from a favourable external economic environment for decades. Australia resides in the Indo-Pacific region, home to many of the world's major advanced and major emerging economies, including China, India, Indonesia, Japan, Korea, the United States and Vietnam. Australia has benefited from decades of regional economic liberalisation initiatives, which have reduced barriers to trade and facilitated cross-border value chains. The nation has long benefited from being a secure and reliable supplier of minerals resources and energy commodities to industrialising and urbanising Northeast Asia.

A deteriorating regional economic environment poses immediate and long-term challenges to Australia. Geopolitical disputes are escalating the implementation of trade protectionist policies, and increasing the imposition of punitive trade measures. The contested regional strategic environment, a major driver of these measures, is the new normal. The COVID-19 pandemic and public health measures have also crimpled international flows of goods, services, capital and people - triggering a global recession. Fortunately, the underlying drivers of economic dynamism in the Indo-Pacific, such as youthful demographics in South and Southeast Asia, remain. This will in time help drive a return to post-COVID-19 regional growth.

The concentration in Australia's trade and investment relationships does not prepare Australia's economy well. The majority of Australia's current economic relationships are "deep but narrow" – large in gross size, yet narrowly concentrated in a small basket of countries and/or sectors. When an external shock hits a trade or investment relationship that lacks diversity, the deleterious effects on Australia's economy are magnified. Without developing new trade and investment relationships, the employment, incomes and growth Australia is accustomed to deriving from its existing trade and investment relationships, will not be sustained.

Australia needs to build more diversity – and hence resilience – into its international economic relationships. This submission provides analysis of the current concentration in Australia's trade and investment relationships, and the nation's exposure to immediate and long-term economic shocks. It demonstrates the need to building greater diversity into Australia's foreign economic relationships to improve their resilience, and outlines a series of practical and near-term steps which government can implement to this end.

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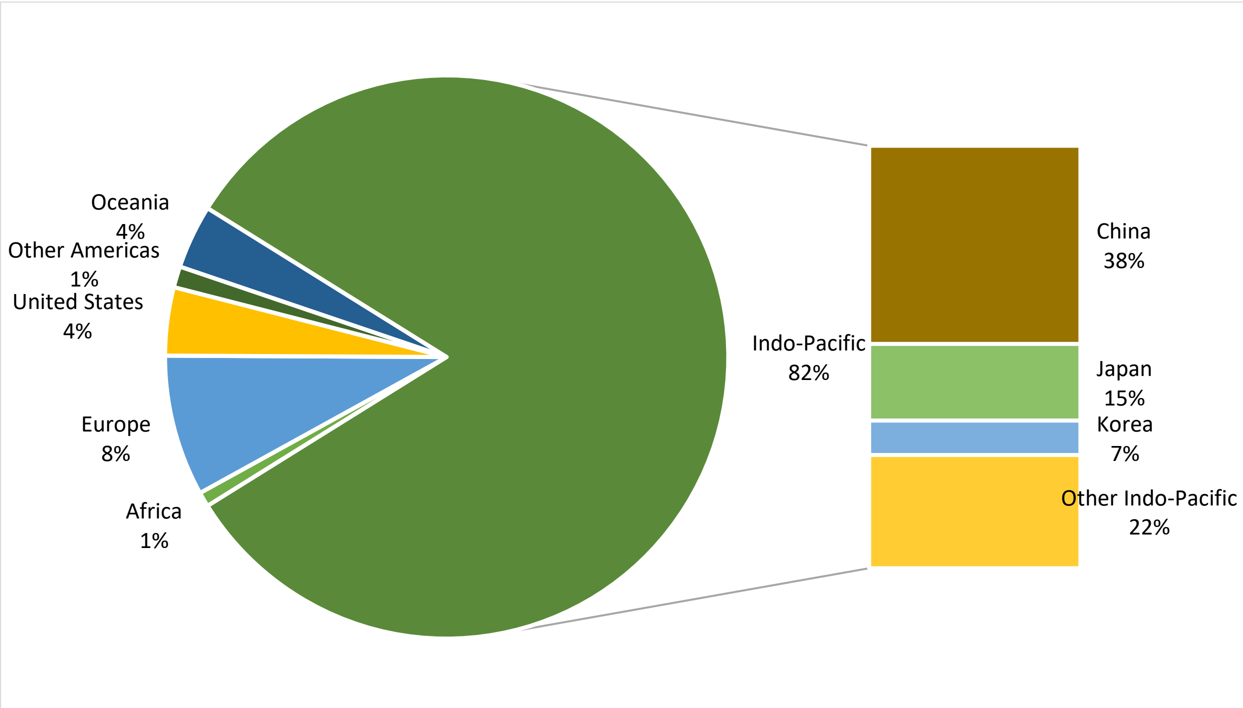
2. Diversity in Australia's international economic relationships

Trade is the most prominent mechanism connecting Australia to the global economy. In 2018, Australia conducted $853 billion of two-way trade with foreign partners, equivalent to 46 percent of GDP[2]. This was composed of $662 billion of merchandise trade and $190 billion of services trade. Australia traditionally runs a relatively balanced trade account[3] – across the five years to 2018, a trade deficit averaging $6 billion per annum – where a modest deficit on the services account is offset by a comparable surplus on the merchandise side. Many key industries are highly trade-oriented, including the resources, agriculture, education and tourism sectors.

Australia's trade relationships are noteworthy for their market concentration. The overwhelming majority of merchandise exports – 82 percent in 2019 – are destined for Indo-Pacific markets (Figure 1). China accounts for around one-third of the total, with Japan and Korea a quarter, and others (predominantly ASEAN and India) a further quarter. By contrast, services have a more geographically balanced pattern: with regional markets accounting for only 48 percent of exports, while the EU (13 percent) and US (10 percent) have more prominent roles[4].

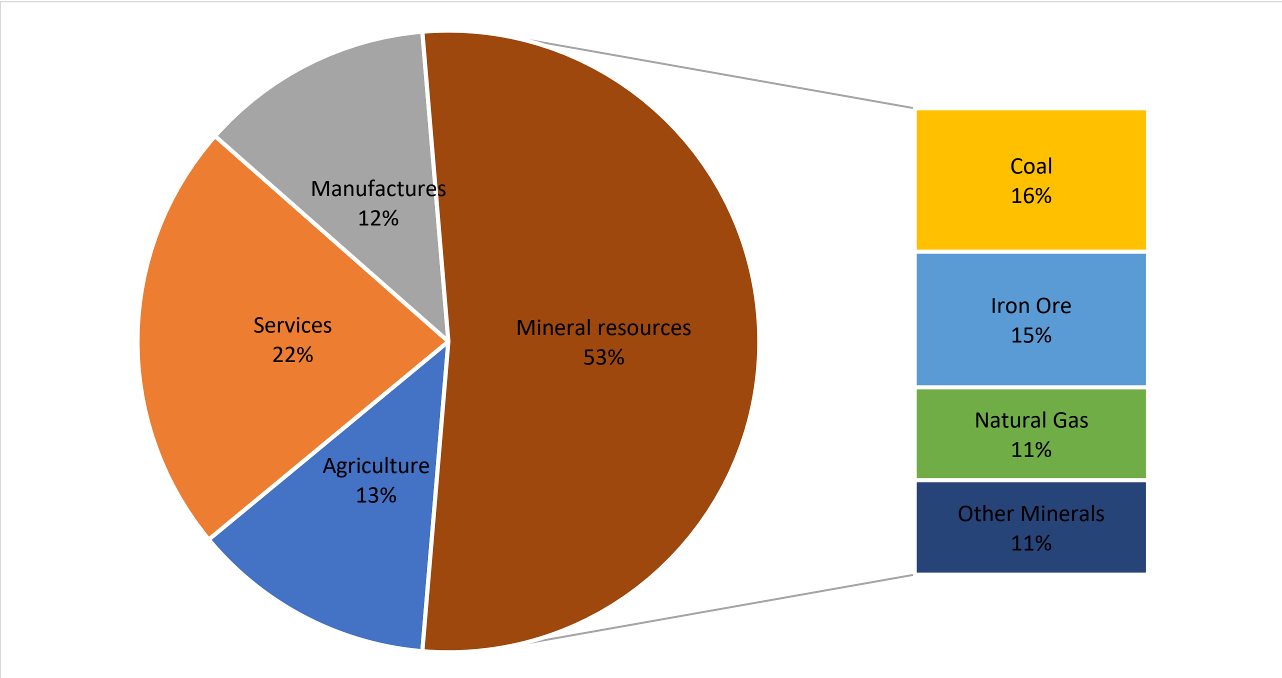
Figure 1 Country composition of Australian merchandise exports, 2019



Source: Authors' calculations, from DFAT *Trade Statistical Pivot Tables*[5]

Australia also has a very highly concentrated sectoral bias to its export profile. Resources account for approximately half of all exports, with three commodities – coal, iron ore and natural gas – dominant (Figure 2). Services come second at 22 percent, with 'travel-related' activities (education and personal and business travel) accounting for two-thirds of services exports. Significantly, the sectoral composition of exports is the inverse of Australia's underlying industrial structure, as services account for two-thirds of the economy and mining only a tenth. This reflects the fact that Australia's comparative advantage in international markets, not its domestic economic structure, determine patterns of export competitiveness.

Figure 2 Sectoral composition of Australian exports, 2018



Source: Authors' calculations, from DFAT, *Composition of Trade Australia 2018* and *Trade in Services Australia 2018*[6]. *Note:* Presents figures for 2018 as services data for 2019 not available at time of writing.

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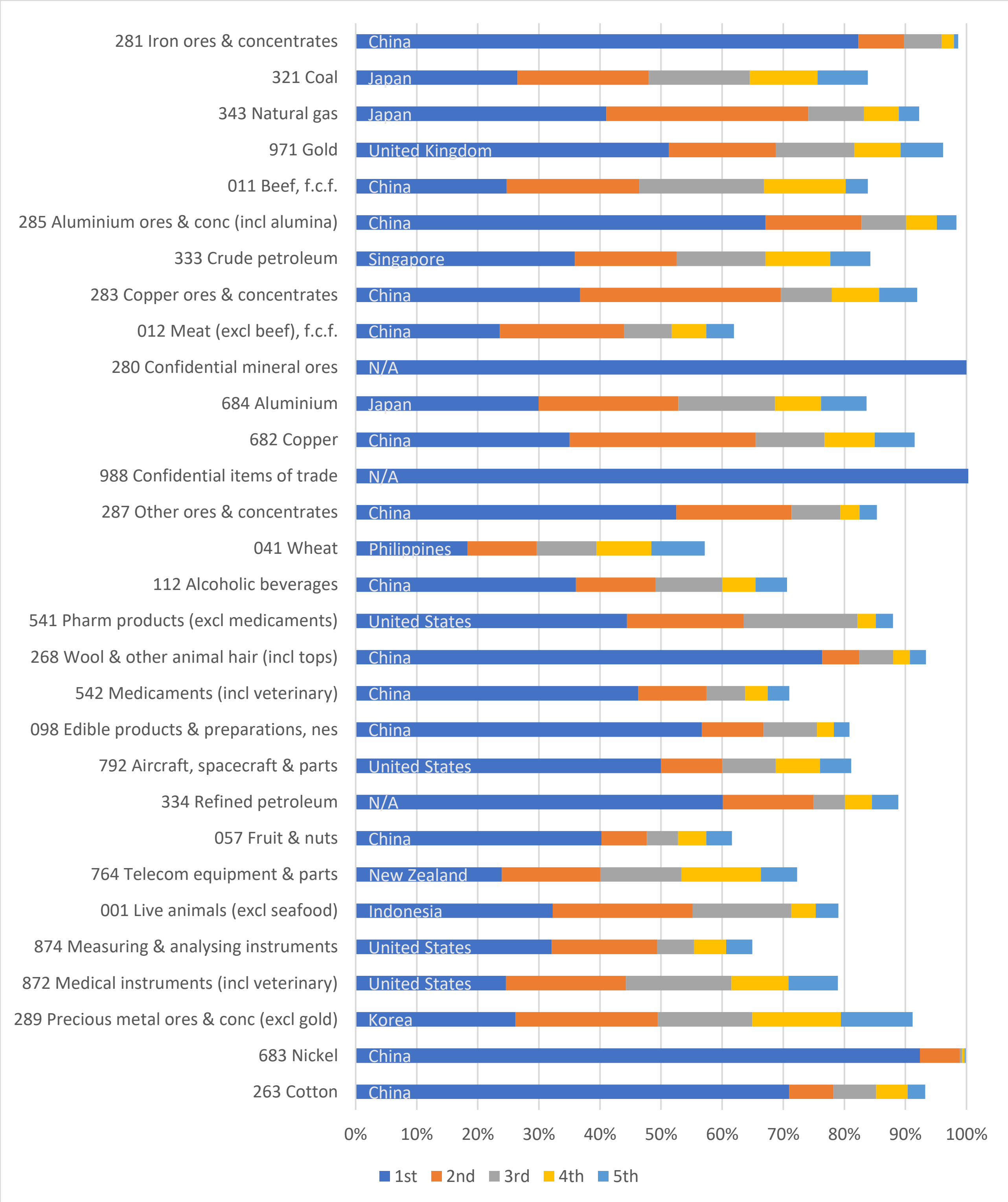
Figure 3 Market concentration in Australia's top-30 merchandise exports, 2019



Source: Authors' calculations, from data in DFAT *Trade Statistical Pivot Tables*[7]. Excludes refined petroleum and two confidential items of trade, for which detailed partner data is not available. Labelled country identifies the largest export market.

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Most of Australia's principal exports are heavily dependent on a single major market. Figure 3 presents the top-5 market share for Australia's thirty largest merchandise exports, a group accounting for 86 percent of the $336 billion of merchandise exports in 2019. By disaggregating trade exposure at the sub-sectoral level, this data identifies the export industries which are most exposed to particular markets:

- Most of Australia's export industries rely on a single large market. Across the industries, the average market share (weighted) of the largest buyer is 49 percent.
- China is the top market for fourteen of Australia's leading export industries, far more than any other partner.
- Several exporters face *monopsony* conditions[8]: where a single buyer accounts for the majority of sales. In thirteen industries, the top market is larger than the next four largest markets combined.
- Single market dependence is most pronounced in mining, particularly for iron ore, gold, bauxite, and nickel. By contrast, the agriculture and manufacturing sectors generally have more diversified markets, albeit with some sub-sector exceptions (such as aircraft parts, wool and cotton).
- Only five industries – coal, beef, wheat, medical instruments and precious metals – have genuinely diverse markets without a clear dominant player.

Foreign investment is also a critical – yet often unappreciated – mechanism connecting Australia to the global economy. In 2018, there was $3.8 trillion of accumulated foreign investment in Australia, while Australian companies held $3.0 trillion of assets abroad[9]. On a macroeconomic basis, foreign investment makes a smaller contribution to the Australian economy than trade. Two-way direct investment flows in 2019 were worth $60 billion, less than a tenth of the $853 billion of two-way trade. However, it still makes a material contribution to the Australian economy. In the decade to 2018, Australia had net capital inflows of $548 billion, equivalent to 16 percent of all private investment[10].

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

- In the resources sector, partnerships with foreign customers often bundle together investment relationships with 'offtake' agreements for the export of minerals and energy. These packages allow mining companies to develop projects by securing future export markets.
- In agriculture, foreign investors also provide recipient businesses support in accessing their home-country marketing channels. This greatly eases the challenge of developing new markets in complex agro-food value chains.

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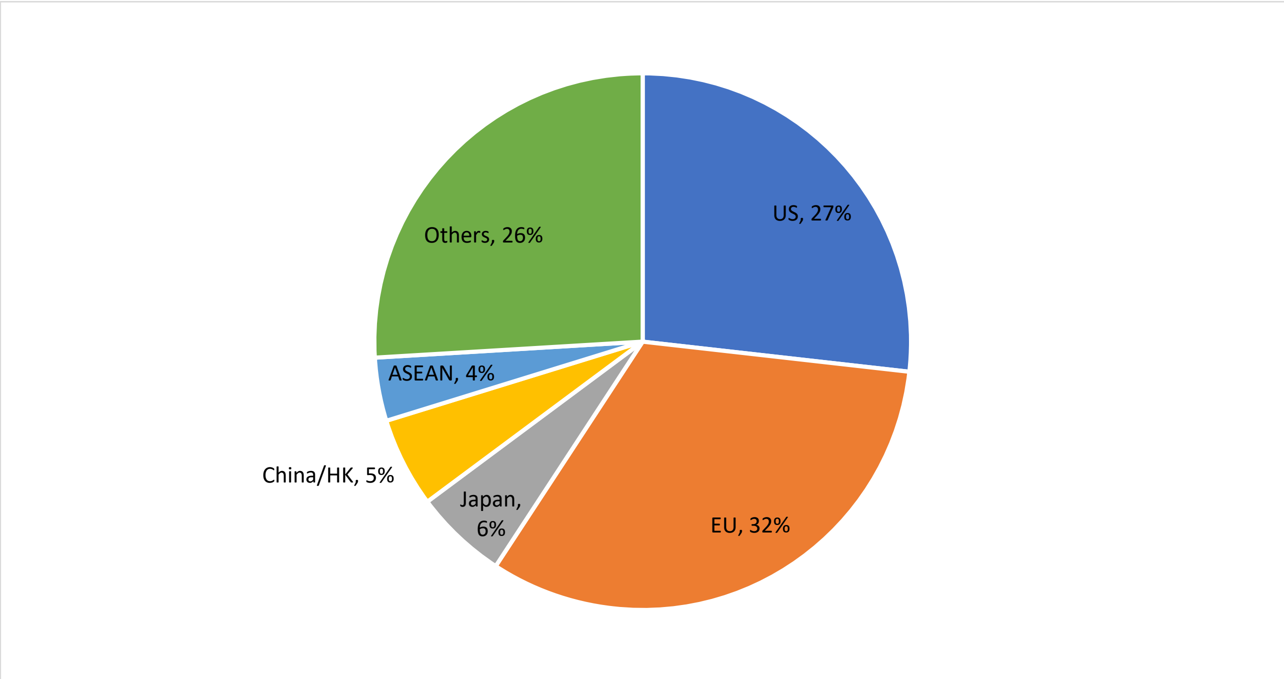
- In the technology sector, foreign investment can be bundled with technology licensing agreements, which provide Australian companies access to the underlying intellectual property required to commercialise new technology applications.

Similar to trade, Australia's investment relations are highly concentrated in a small number of foreign partners. However, a different set of countries dominate investment ties. Two 'traditional' partners – the US and EU – account for the majority of Australia's two-way investment stocks (Figure 4). This reflects longstanding corporate connections between Australia and the UK, which in the post-war period grew to include US and other European partners. By contrast, the Indo-Pacific economies significant for Australia's trade have a much smaller role, collectively accounting for only 15 percent of the total. Significantly, China plays a comparatively negligible investment role[11], despite being Australia's most valuable export market and import source. While Australia has an Indo-Pacific-focused trade profile, its investment ties remain decidedly with Europe and the US.

Figure 4 Australia's two-way investment partners, 2019



Source: Authors' calculations from ABS *International Investment Position, Australia: Supplementary Statistics*[12]

Investment flows into Australia are also concentrated in a limited range of sectors. The resource sector, with $360 billion of accumulated stocks, accounts for just under half of all foreign investment in Australia (Figure 5). This is approximately the same as its share of the national export basket, reflecting the link between inward investment and exports in resource projects. Manufacturing shows a similar pattern to resources, accounting

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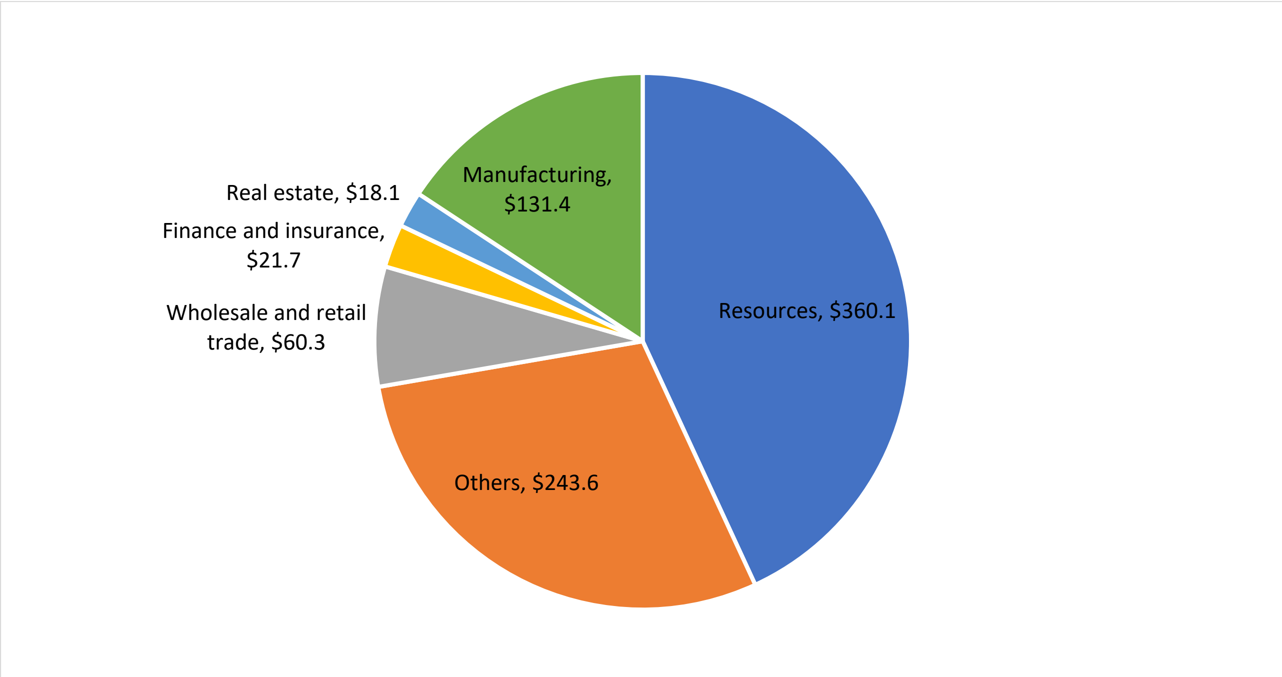
for 12 percent of both inward investment and exports. The wholesale/retail, finance and real estate sectors also attract significant levels of foreign investment, though none are major contributors to exports. This reflects foreign businesses seeking exposure to Australia's domestic market. The sectoral outlier is agriculture, which accounts for 13 percent of exports but only 0.3% of all inward investment. Low foreign investment is in part due to investment rules regarding agribusinesses and agricultural land, which are far stricter than other industries[13].

Figure 5 Sectoral composition of direct investment in Australia, 2019



Source: Authors' calculations from ABS *International Investment Position, Australia: Supplementary Statistics*[14]. *Unit:* AUD Billions

Australia's market and sector trade and investment concentration leaves not only export industries exposed to external shocks, but the Australian economy less adaptable to global industrial and geo-economic shifts. By their nature, all open economies are exposed to external shocks. However, a lack of diversity exacerbates this effect. When external economic ties are heavily dependent on a small number of countries and/or sectors, any immediate shocks that occur in those markets have an outsized influence on the economy as a whole.

3. Immediate shocks and long-term challenges facing Australia

The immediate effect of COVID-19 on Australia's international economic relationships has come via disruptions to trading activity and global value chains. As government around the world have enacted public health measures to control the spread of COVID-19, restrictions on the movement on people and freight have dramatically interrupted economic activities. Many of Australia's key export sectors have been affected by public health measures:

- The international tourism sector has been effectively shut-down by the closure of international borders to non-residents. International tourism contributed $38 billion to the national economy in 2018-19, accounting for 26 percent of the tourism sector by dollar value[15]. The tourism industry is important as a key employer, particularly in regional areas, and pre-COVID-19 employed 5.2 percent of the Australian labour force[16].
- The international education sector is similarly affected by international border closures. While international students already in Australia have been able to continue studies, tertiary institutions have been unable to enrol new onshore international students. In 2018-19, international education generated $38 billion in services exports[17], of which $25 billion was in the university sector.
- In the agriculture sector, many high-value agricultural exports rely on air-freight in passenger aircraft. As international passenger flights have been greatly reduced, access to airfreight has been constrained. The Australian Government committed resources to support outbound freight services for affected seafood, meat, dairy, and perishable horticultural products[18].

Australia's supply of needed imports has also been challenged by COVID-related public health measures in trade partners. Australia's narrow industrial profile, particularly its limited manufacturing sector, means the country is dependent on imports for many products. And as value chains are interrupted by COVID-19 related developments, access to many essential goods have become constrained. Import risks have been felt economy-wide, and not just in the health sector. While there is presently a lack of data on the industrial geography of many global value chains,[19] Australia has faced many unexpected import supply shocks, including:

- Shortages of imported medical products, including testing kits[20] and personal protective equipment for hospital staff[21] in the early stages of the crisis.
- Some manufacturers and food processors have struggled to secure packaging materials from China and Southeast Asia[22].

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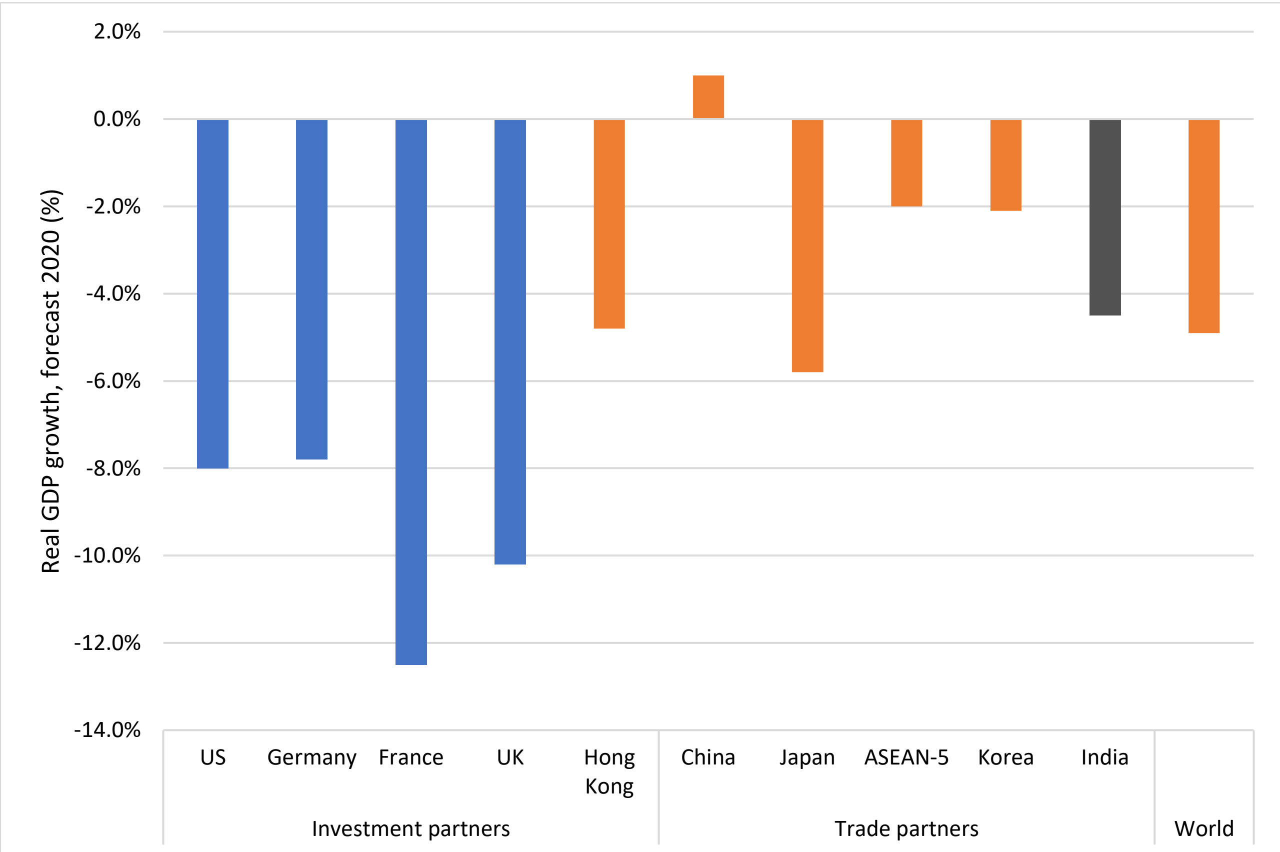
- Construction companies import 60 percent of their materials from China, with non-deliveries already reported in products such as glass[23].
- Delivery of utility vehicles will be delayed due to factory shutdowns in Thailand[24].
- Global electronics value chains are also under strain, with Chinese shutdowns delaying supply by between five and nine weeks[25].
- The farm sector may face shortages of fertiliser and pesticides due to Chinese factory shutdowns, depending on the duration and severity of value chain interruptions[26].

The external economic impact of COVID-19 will be exacerbated by recession conditions in Australia's key trade and investment partners. The IMF forecasts that global growth will collapse to -4.9 percent in 2020, with all economies badly affected (Figure 6). With major uncertainty regarding the effectiveness of current and future COVID-19 measures, forecasting is highly speculative.

Figure 6 IMF growth forecasts for Australia's main economic partners, 2020



Source: IMF, *World Economic Outlook Update June 2020*[27]

A major risk caused by COVID-19 related recessions will be Australia's capacity to attract foreign investment. Australia's main investment partners – the EU and US – are likely to be hardest hit by COVID-19 related

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recessions. The IMF forecasts contractions of around 8 to 12 percent in these economies in 2020, over twice the global average. As their stock markets and financial institutions come under strain, the supply of capital from these economies will become extremely tight. As the US and EU account for nearly two-thirds of foreign investment ties, Australia is likely to suffer a significant reduction in both gross capital flows and net capital imports. As net capital imports are equivalent to approximately one-dollar-in-six of all private investment[28], a slowdown in foreign capital inflows will materially reduce domestic investment and job creation.

These effects will be most pronounced in the sectors that attract the bulk of foreign investment:

- The ability to develop new minerals resource and energy projects will be constrained by the tight supply of international capital. This will weigh on growing subsectors within the resource industry, such as natural gas, lithium, and critical minerals.
- The effects on the real estate industry will be significant. As Australian foreign investment policy deliberately channels real estate investment into new dwelling construction[29], most foreign capital inflows support construction projects. A reduction in foreign capital inflows will be a further drag on a sector that employs over a million people[30].
- The technological and financial resources required to develop domestic manufacturing capabilities are usually supplied through foreign investment packages. As US and EU manufacturing corporations face severe economic downturns at home, their ability to invest in projects in Australia will be significantly constrained.

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

Table 1 Real GDP growth forecasts for 2020 in Australia's main trade partners

	April 2019 forecast for 2020	June 2020 forecast for 2020	Difference
China	5.8%	1.0%	-4.8%
Japan	0.8%	-5.8%	-6.6%
ASEAN-5	4.0%	-2.0%	-6.0%
Korea	2.8%	-2.1%	-4.9%
India	6.1%	-4.5%	-10.6%
World	3.0%	-4.9%	-7.9%

Source: IMF, *World Economic Outlook* April 2019 and June 2020[31]

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This economic downturn will be deleterious for Australia's trade relations in the Indo-Pacific. In the decade to 2019, Australia exports to Japan grew by 51 percent, Korea by 66 percent, ASEAN by 110 percent and China by 252 percent[32]. This growth was facilitated by the performance of the region which, with the exception of Japan, consistently delivered above-average economic growth. With that growth trajectory temporarily interrupted, Australia will be unable to expect consistently improving export performance with Indo-Pacific markets.

Furthermore, the global trend of rising trade protectionism will hamper Australia's external economic relationships. While Australia is an open economy, the nation's ability to successfully export to overseas markets, and engage in both outward and inward foreign investment, depends upon open economic policy regimes in key partners. While Australia has benefited from a global trend over the last four decades toward economic liberalisation, it is likely international regimes will become more protectionist in coming years. This global trend of trade protectionism predates the COVID-19 crisis. According to data compiled by Global Trade Alert, in the decade to 2019 governments have imposed 2751 measures restrictive of international trade, in comparison to 807 liberalising measures – a roughly three-to-one ratio. This trend is accelerating, with the number of restrictive measures exceeding 500 for the first time in 2019. It is likely that the COVID-19 crisis will accelerate these global protectionist trends in coming years.

The use of trade restrictions by the Trump Administration in the US is a clear marker of this protectionist trend. Since taking office in January 2017, the Trump Administration has deployed coercive trade diplomacy against many major economies (Table 2). This includes withdrawal from the Trans-Pacific Partnership (TPP) agreement; the renegotiation of several existing trade agreements under threat of tariff imposition; several bilateral trade disputes; and the veto of nominations to the WTO's Appellate Body in an attempt to force governance reforms. The most prominent of these is the US-China trade war, which over the course of two years escalated through several cycles of tariff and counter-tariff actions to cover $735 billion of trade between their economies. This use of coercive trade diplomacy is a worrying development, given the historical role of the US as the world's most prominent advocate of trade liberalisation and leader within the WTO.

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Table 2 US trade diplomacy under the Trump Administration

Target	Year	Action
TPP partners	January 2017	Withdrawal from Trans-Pacific Partnership, rendering entry-into-force numerically impossible
WTO members	January 2017 – ongoing	Systematic veto of Appellate Body nominations to force US-requested governance reforms Appellate Body became non-functional on 10 December 2019
Canada and Mexico	August 2017 – September 2018	Renegotiation of North American Free Trade Agreement under threat of termination
Korea	January – September 2018	Renegotiation of Korea-US Free Trade Agreement under threat of termination
World	March 2018 - ongoing	Tariffs applied to solar panels, washing machines, steel and aluminium imports - on national security grounds Canada, China, the EU, India, Mexico, Turkey and Russia all impose retaliatory tariffs
China	July 2018 – ongoing	Escalating application of tariffs to demand a bilateral trade agreement, rising to cover $550 billion of imports from China. China repeatedly retaliates, with tariffs imposed on $185 billion of exports from US
Turkey	August 2018 - ongoing	Removal of Turkey from US Generalised System of Preferences (GSP) scheme; imposition of additional 25% tariff of Turkish steel (enacted August 2018, withdrawn May 2019, reimposed October 2019)
Japan	April 2019 – ongoing	Negotiation of a bilateral trade agreement favouring US agricultural exporters under threat of tariff imposition
European Union	May 2019 – ongoing	Imposition of retaliatory tariffs on $7.5 billion of EU exports in *Airbus* dispute Threatened imposition of 25% tariff on automobiles to force a trade-balancing bilateral agreement
India	June 2019 - ongoing	Removal of India from US Generalised System of Preferences (GSP) scheme
Brazil and Argentina	December 2019	Removal of exceptions from steel tariffs in retaliation for alleged currency manipulation

Source: See note 33

The Chinese Government's use of coercive trade policy is also harmful to the Australian economy. In the last year, the Chinese government has taken several trade policy actions which have constrained Australia's exports (see Box 1). Australian Government representations, and many independent analysts and Australian industry parties, contend these technical and countervailing measures are without legal merit. Many have argued they are instead a disguised 'economic sanction' in retaliation to recent Australian foreign policy actions[34].

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Box 1 Coercive Chinese trade practices towards Australia

February 2019 – Coal: Changed customs procedures for Australian coal at Dalian Port, which delayed the handling of export shipments. The Australia-China coal trade was worth $13.8 billion in 2019.

May 2020 – Barley: Imposition of an 80 percent tariff on Australian barley exports in May 2020 (comprised of both anti-dumping and anti-subsidy components), which will price Australian barley out of the Chinese market. The Australia-China barley trade was worth $591 million in 2019.

May 2020 – Beef: Suspension of export licenses for four Queensland abattoirs in May 2020, which collectively account for approximately one-third of beef exports to China. The Australia-China beef trade was worth $2.6 billion in 2019.

May 2020 – Various farm products (threatened): Briefings to international media indicate China is considering applying further restrictive measures to Australian wine, dairy, seafood, oatmeal and fruit, which will be applied if political relations deteriorate further.

June 2020 – Tourism and education: The Chinese Ministry of Culture and Tourism issues an advisory warning against travel to Australia, citing a "significant increase in racist attacks". Australia exported $12.1 billion of education services, and $16.3 billion of travel services, to China in 2018-19.

July 2020 – Tourism and education: The Chinese Ministry of Foreign Affairs upgrades their warning against travel to Australia. It claims "the Australian media continue to incite anti-China and hatred of China sentiments", and that "law enforcement agencies have arbitrarily searched Chinese citizens and seized their articles".

Source: Authors' compilation, from endnote 35.

Any further Chinese trade measures against Australian exports have the potential to seriously harm the Australian economy. Australia's concentrated export portfolio makes it uniquely exposed to trade shocks emanating from China. China not only accounts for 38 percent ($150 billion) of its exports, but is also the top market for fourteen of its top-30 export products (Figure 3). Most of Australia's leading export sectors – including iron ore, coal, natural gas, base metals, education, tourism, beef, horticulture, seafood and cereals – rely heavily on the Chinese market.

A long-termer challenge facing the Australian economy is the economic unsustainability of overreliance on three bulk commodity minerals resources and energy exports. Chinese demand for Australian iron ore is expected to peak in the mid-2020s, as Chinese steel production plateaus and the Chinese economy transitions from investment-led to consumption-led growth.[36] BHP forecasts that China's iron ore demand peak is

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contemporaneous with the peak of the global iron ore industry, and forecasts the industry will then embark on a "multi-year decadal decline phase"[37]. Notwithstanding the impacts of COVID-19 in presently delaying major Australian LNG and other resources projects, the decades-long growth future of LNG as a transition fuel, and metallurgical coal for steel-making, is uncertain[38]. This is particularly the case as global industries transition to a low-carbon future, and new energy technologies become commercially viable.

This long-term industrial uncertainty is compounded by the likely plateau of foreign direct investment into Australia by the nation's traditional partners the US, the EU, and the UK. Over the last half-century, the leading sources of foreign investment into Australia have been from the US, the EU and the UK. It is likely that over coming decades the level of inbound investment from these long-term economic partners will plateau.[39] This will occur as these countries' share of the global economy and outbound capital investment reduces, and as investment flows are reconfigured towards the emerging drivers of global growth. This long-term plateau trajectory is likely to be accelerated by the COVID-19-induced recessions in the US, and across the EU and the UK. As a capital-importing and trade-reliant nation, Australia will need to find new sources of foreign investment to underpin and complement its trading relationships.

At the same time, Australia's trade and investment relationships with the major emerging Indo-Pacific economies – particularly, India, Indonesia and Vietnam - have not grown proportionately with the growth and dynamism of these economies. The economic dynamism of the last decade in the broader Indo-Pacific region has been most evident in the growth and development in South and Southeast Asia, most particularly in India, Indonesia and Vietnam. Reputable economists have forecast that by 2050, India will be the second largest economy in the world, Indonesia the fourth, and Vietnam in the top 20[40]. However, it is well recognised Australia's economic relationships with these three major emerging economies are underdeveloped. For example, whilst being neighbouring G20 economies, Indonesia is not yet a top ten Australian trading partner. Indonesia's long-term economic growth prospects far outweigh Australia's, and existing levels of bilateral economic engagement do not currently position Australia to economically benefit from this relationship in the long-term. Furthermore, the growth in Australia's merchandise trade with India has been negligible despite India's rapid economic growth[41]. Vietnam presently accounts for only 1.7 percent of Australia's two-way trade, with considerable room for growth.

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4. Economic diversification as a national priority

Australia presently faces the most adverse external economic environment in generations. Further to ill-equipping the nation to manage existing shocks, the unsustainable concentration in Australia's trade and investment relationships does not prepare the national economy for the geo-economic, geopolitical and global industrial transitions occurring – trends evident before COVID-19, yet accelerated by the pandemic.

Australia's trade diversification challenge has long been identified. Australia's overreliance on minerals and resources commodity exports to China is unsustainable, as is Australia's overreliance on foreign capital from the US and the EU. Australia's underdeveloped economic relationships with the major emerging economies in the Indo-Pacific has been identified for over a decade.

The external shocks presented by COVID-19 and the economic consequences of geopolitical tensions make Australia's diversification challenge harder, but all the more necessary. A more diversified Australian economy will increase national resilience to near-term external economic shocks, and support Australia's long-term integration into the emerging corridors of global growth, trade and capital flows. However, traditional market development and economic diplomacy initiatives are constrained due to COVID-19, and many growth sectors (such as international education and tourism) remain shut down.

Fortunately, the structural economic growth fundamentals in the major emerging Indo-Pacific markets remain. The drivers of economic dynamism in the major emerging Indo-Pacific economies are temporarily subdued, but not eliminated by the COVID-19 pandemic. This particularly includes the favourable demographics of India, Indonesia and Vietnam, whose large and young populations mean their nations' demand for goods, services and skills will not remain stagnant. These structural growth drivers have underpinned pre-COVID-19 forecasts of the increasing significance of these economies, and in the post-COVID-19 era these countries will return to growth.

Australia has diversified its trade and investment relationships before, it must do so again. Australia's current weight of trade and investment relations were developed both advisedly, and over decades. The nation's transition from being an agricultural producer and exporter to the UK, to being a trusted and reliable supplier of minerals resources and energy products to Northeast Asia, was the result of successive generations of Australian Commonwealth and State Governments and Australian business and Industry developing these world-class minerals and energy resources industries. Achieving this was seen as a national priority. Australia's record 29 years of economic growth is a testament to the success of these efforts.

Fortunately, the Australian Government already has policy efforts in train to strengthen existing and develop new trade and investment relationships. Prior to the COVID-19 crisis, these efforts were a routine

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and longstanding component of Australia's foreign and economic diplomacy. However, as immediate external shocks bring into sharp focus the economic risks associated with concentrated trade and investment relationships, diversification policies should now be accorded a much higher priority. As the preceding analysis shows, diversification is not simply desirable, but essential for Australia to both weather existing external economic shocks, and build trade and investment relationships for sustained longer-term prosperity.

Further to long-term strategic diversification objectives, there are a number of immediate practical policy initiatives the Australian Government could further advance. These include:

1. **Promoting commercial opportunities unlocked under IA-CEPA with Indonesia.** The Indonesia-Australia Comprehensive Economic Partnership Agreement entered into force on 5 July 2020. IA-CEPA combines conventional economic liberalisation provisions (in the trade and investment domains) with institutional mechanisms to enhance bilateral economic cooperation. It unlocks major new opportunities for trade relationships in the agriculture and services sectors, as well as a regulatory foundation for promoting bilateral investment. Many of the provision in IA-CEPA – including those based on regulatory cooperation – will require additional bilateral diplomacy to be implemented. Once COVID-19 restrictions have sufficiently eased, the Australian Government should prioritise IA-CEPA implementation efforts[42].
2. **Increased focus on economic diplomacy with Vietnam.** Vietnam is an ideal economic partner for Australia. It has complementary economic needs, a stable business environment, and a high growing economy driven by a large population, youthful demographics, and rapid urbanisation and industrialisation[43]. However, Vietnam presently accounts for only 1.7 percent of Australia's two-way trade, indicating there is considerable room for growth. Fortunately, there are already two platforms for trade and investment: the joint membership in the Australia-NZ-ASEAN free trade agreement (AANZFTA) of 2009, and the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) of 2018. More focused economic diplomacy with Vietnam, particularly targeting opportunities opened by the CPTPP, would help build new trade and investment ties with a complementary partner.
3. **Implementing the India Economic Strategy and India's Australia Economic Strategy.** The Australian Government's India Economic Strategy, commissioned in 2018 and endorsed upon release in 2019, outlines a comprehensive vision for Australia to triple its exports to India and to increase tenfold the level of outbound Australian investment to India by 2035.[44] The Strategy identifies ten principal sectors of opportunity for strengthening the Australia-India bilateral relationship. Highlighting the urgency of enhanced whole-of-nation engagement with India, the Strategy outlines 90 headline

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recommendations, including ten priority 'recommendations to implement now'. There are numerous recommendations in the India Economic Strategy which are yet to be implemented by the Australian Government. These should be implemented as a priority. In response to the India Economic Strategy, the Indian Government commissioned an equivalent Australia Economic Strategy, which is scheduled for near-term release following a COVID-19-related revision. This includes in the critical minerals and energy technologies sectors, in healthcare and agribusiness.[45] Further to activating economic opportunities created in recently concluded and relevant Australia-India MoUs[46], the Australian Government should work closely with Indian and Australian State Governments, and Australian and Indian industry to jointly implement the recommendations in the two Strategies.

4. **Supporting international partnerships in the critical minerals and battery sectors with the United States, Japan and Korea.** Critical minerals – such as lithium, rare earths and cobalt – are a major new economic opportunity for Australia. These minerals are essential for the digital, clean energy, battery and defence sectors, but value chains currently face several security and sustainability challenges. Australia's strong geological endowment and trusted investment environment make it an ideal new supplier across many critical mineral subsectors[47]. Its technological capabilities also offer opportunities for developing 'mid-stream' processing industries in the fast-growing battery sector[48]. The United States, Japan and Korea are ideal partners for these efforts, given their position as major world producers of technology products containing critical minerals. Australia's longstanding and trusted economic partnerships with all three provide a political and institutional foundation to jointly develop these new industries.
5. **Promoting opportunities created by RCEP.** The Regional Comprehensive Economic Partnership (RCEP) is a landmark addition to the global trade architecture. Comprising ASEAN and five partner economies (Australia, China, Japan, Korea and New Zealand), its members account for 29 percent of world GDP in 2018[49]. Most negotiations have now been completed, with a target for signing by the end of 2020. While RCEP offer some new market access for Australia in Southeast Asian markets, its principal benefit is as a platform of regulatory harmonisation amongst the fifteen country bloc. It will provide a single, streamlined set of rules across many trade, services and investment domains, opening new opportunities for the development of regionally-integrated cross border value chains[50]. When RCEP is completed, the Australian Government should look to support Australian businesses to participate in these new value chains.
6. **Expansion of the CPTPP agreement, with a focus on Thailand, Korea and Indonesia.** The CPTPP is one of the highest-standard free trade agreements ever completed, combining a range of tariff reductions with rules for '21st century' trade issues such as investment, intellectual property and services.

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Importantly, the CPTPP also includes 'accession' provisions that enable additional countries to join the eleven-member bloc. As the CPTPP is an important bulwark against the spread of protectionism, and reflects Australia's trade interests as a service- and knowledge-intensive economy, Australia should lead diplomatic efforts to bring new members into the agreement[51]. The Korean and Thai governments have formally considered CPTPP accession, while Indonesia may also look to join the agreement as it attempts to recover from the effects of a COVID-related recession. In the longer term, there may well be potential for diplomatic efforts to encourage the United States to enter the Agreement.

7. **Supporting India's integration into the regional architecture through APEC membership.** For several decades, India has been an outsider to the regional economic architecture promoting the economic integration of the Asia Pacific, and more recently, the Indo-Pacific. This presents barriers to India's voice in regional discussions on issues of economic importance, and Australian attempts to build an India economic relationship beyond bilateral areas of interest. Indian membership of APEC would provide a practical first-step in closing this gap. APEC is an established and trusted economic dialogue platform for the region; and its voluntary and non-binding constitution lowers barriers to entry in comparison to treaty-based organisations and mechanisms. There is also appetite for Indian accession amongst several current APEC members[52]. The Australian Government should engage India and regional partners to explore options for Indian accession to APEC in the near future.

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The Perth USAsia Centre located at the University of Western Australia is a non-partisan, not-for-profit institution strengthening relationships and strategic thinking between Australia, the Indo-Pacific and the USA. The Centre is a leading think tank focusing on geopolitical issues, policy development and building a strategic affairs community across government, business and academia. Since the Centre's inception in 2013, we have collaborated with over forty partners to convene more than four hundred programs across sixteen cities in eight countries, engaging a world-class community of over 10,000 strategic thinkers and policy leaders.

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[3] An exception to this occurred during the global resources boom of 2005-2014, where surging mineral exports saw Australia run consistently large trade surpluses.
[4] Authors' calculations, from ABS (2019) *International Trade: Supplementary Information, Calendar Year, 2018*, Cat No. 5368.0.55.004
[5] DFAT (2019), *Trade Statistical Pivot Tables*, https://www.dfat.gov.au/about-us/publications/Pages/trade-statistical-pivot-tables
[6] DFAT (2019), *Composition of Australian Trade 2018* and *Trade in Services Australia 2018*.
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[8] Monopsony refers to a situation where a single dominant buyer accounts for the majority of a defined market, and is able to suppress competition in that industry. It is the inverse of the better-known concept of monopoly, which refers to markets with a single dominant seller.
[9] Authors' calculations from ABS (2020), *International Investment Position, Australia: Supplementary Statistics*, Cat No. 5352.0, Table 5.13.
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[11] For investment accounting purposes, the PRC ('mainland China') and Hong Kong should be treated as a single entity. This is due to Hong Kong's role as a financial intermediary between the PRC and global capital markets, where investments to and from the mainland are routed through corporate entities domiciled in Hong Kong.
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