The logic of China's economic coercion on Australian agriculture

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AT A GLANCE…

- In response to a wide-ranging suite of Australian policies, China has imposed a wide-ranging suite of economic sanctions on Australian exports in 2020, targeted especially at agricultural exports.
- In the fast-moving events, the framework of economic coercion helps understand the logic of China's trade barriers and helps Australia to formulate a response.
- China's economic coercion aims to impose high costs on targeted Australian industries, or encourage Australian industry interests and political opponents to lobby the Federal Government to change policy towards China. The Australian system has generally proved resilient.
- China has also selected trade barriers that reduce costs for China, or indeed bring long-term strategic benefits including the protection of local industry and import diversification.
- The coercion and protectionism stem from deep-rooted and ominous trends in China. Australia is not responding through retaliation (i.e. a trade war) but by appealing to law and through economic diversification.

IN 2020 China applied sanctions against 13 Australian industries including coal, education and tourism, but the agricultural sector has been especially targeted, with eight agricultural commodities subject to formal or informal trade barriers. It is widely accepted that the measures were taken in retaliation to Australia's policy posture towards China, expressed in a list of 14 grievances from the Chinese Government. China accounts for 32 per cent of Australian agricultural exports.

While the trade barriers are widely reported, they leave a series of unanswered questions. Why is China targeting particular industries with particular instruments? What are the costs of the barriers for Australia and China? What are the drivers from within China? How can Australia realistically respond?

The framework of economic coercion helps answer the questions. In a simplified version of the framework, a coercive State takes economic measures to change the behaviour of another State. The industries and instruments selected are designed to impose high costs on the target State, but only to the extent that this does not impose prohibitively high costs on the targeting State. The measures may even benefit the targeting State. The cases of wool, barley and wine illustrate the way these calculations have played out.

Xi Jinping's decision to 'dump' on Australian wine leaves a nasty taste on Morrison's palate. (IMAGE: ABC)

Maximising costs on Australia

In the first round of sanctions on Australian agriculture, China appeared to be seeking to impose high costs on Australia through substantive barriers on major agricultural export items. From May to August 2020, China imposed tariffs on Australian barley, opened an investigation on wine and suspended beef exports from five abattoirs (shaded in dark green Table 1).

The Chinese Government then selectively worked its way down the list with a series of shorter-term barriers (shaded medium green). In October, smaller Chinese cotton importers were verbally instructed that they may not be eligible for further quota allocations, while consignments of timber and lobsters were held up due to biosecurity concerns. That was followed by rumours of barriers to wheat exports and to seven other commodities including sugar (in light green). The State did not deny the rumours and indeed helped to spread them.

While the trade flows of affected items are worth billions of dollars, the actual costs of the barriers are considerably lower. Affected industries can offset costs through market substitution and product substitution. For example, barley previously exported to China is being diverted to other markets like Saudi Arabia albeit as lower-grade feed barley, while protocols have paved the way for more exports to India and Indonesia. The gaps from Australia's exit from the Chinese market will be filled by other suppliers (Ukraine, France, Canada) that in turn open opportunities in their markets. This re-alignment will still result in lower barley prices, but growers can respond by substituting from malting barley to feed barley or into other winter crops (wheat, pulses, oil crops). Current record grain harvests and cattle prices cushion the impact.

The substitution options vary by industry. The wine and cotton industries are less exposed to China and can sell into a greater range of other markets, but growers are not able to switch crops in the medium term due to high sunk costs in infrastructure and equipment.

Costs can also be reduced by circumventing barriers, for example by selling into Chinese special economic zones for re-export or selling through third countries. Conglomerates can divert cattle supply from suspended plants to other plants that still have access to the Chinese market. Wineries may be able to export in containers of more than two litres to circumvent the tariffs.

These complex dynamics mean that it is difficult for China to target measures with any precision to extract maximum cost. The measures are generally blunt and increasingly scatter-gun.

While the costs of coercion can be ameliorated, they should not be under-stated – they effect industries, communities and employment. Importantly, economic coercion does not necessarily require imposing prohibitive aggregate costs – it can have the desired effect in other ways. The coercion prompts industry groups to lobby government to change behaviour and creates opportunities for political rivals to criticise government policy. China may see political mileage in targeting the Australian agriculture sector. The sanctions also serve as a warning to other industries and other countries in a tactic known as "kill the chicken to scare the monkey".

Minimising costs for China – or bringing benefits

The other side of the equation for Chinese policy-makers is to select targets that minimise costs to China, or indeed bring benefits. That is, Chinese import barriers are also based on calculation of China's interests – both short-term commercial but mainly long-term strategic. Understanding the logic of that calculation requires an appreciation of Chinese agricultural structures and international markets.

TABLE 1: Average annual Australian agricultural exports to China, 2015-19.

Rank	Commodity	Trade value ($bn)	China in total exports (%)
	Grand total	**13.4**	**26**
1	Wool & other animal hair (incl tops)	2.5	100*
2	Edible products & preparations	1.3	52
3	Beef	1.3	15
4	Barley	1.2	70
5	Cotton	0.8	47
6	Alcoholic beverages	0.8	28
7	Wood in chips or particles	0.7	59
8	Hides & skins, raw	0.7	85
9	Meat (excl beef)	0.6	14
10	Wood, rough	0.5	93
11	Fruit & nuts	0.5	24
12	Crustaceans	0.4	37
13	Milk, cream, whey & yoghurt	0.4	28
14	Wheat	0.3	7
15	Live animals (excl seafood)	0.2	12
16	Other cereals	0.2	89
17	Animal feed	0.1	100
18	Oil-seeds & oleaginous fruits, soft	0.1	9
19	Pulp & waste paper	0.1	48
20	Sugars, molasses & honey	0.1	6

Source: ABS. Five year averages are used to smooth annual fluctuations. The second category is miscellaneous, but includes milk powder. * Over-stated.

If the main aim of Chinese coercion is to maximise costs and leverage on Australia, it would target wool. Around 80 per cent of Australian wool and wool tops are exported to China, with limited alternative markets. A substantive barrier would cripple the Australian industry. But such barriers would also cripple Chinese worsted mills that depend on Australian fine wool to make higher-value apparel like suits. Unlike barley, there are no alternative suppliers of fine wool, and China has finally come to terms with limits to domestic fine wool production. An additional factor is that barriers on the Australia-China wool trade would also irreparably damage the already minor niche position of wool in the global textiles markets where it competes with other fibres. The costs of imposing barriers on Australian wool are, for the time being, too high. Australian iron ore may be in a similar position, although unlike wool, China depends on it.

This is not to say that China is not prepared to bear the commercial costs of coercion. Its barley tariffs also cost its brewers and livestock industries a hefty $3.3 billion according to the ABARES modelling. The China Alcohol and Drinks Association (CADA) made a submission against the tariffs, which the government over-rode due to longer-term strategic considerations. The Ministry of Agriculture and Rural Affairs is concerned about the decline in national barley production and the incomes of small-holders including in low-income areas

WTO Entrance Geneva – perhaps soon not to be the only one walking out the door. (IMAGE: WTO)

of China (Gansu, Inner Mongolia, Xinjiang and Qinghai). Even though the decline has been occurring for four decades, this was attributed to a rapid increase in barley imports over the past five years, which now account for 70-80 per cent of China's total barley supply. This contravenes Chinese policy settings on food security. Furthermore, Australia accounted for 70-80 per cent of all barley imports, which contravenes policy settings on import diversification. The over-reliance on a single source of imports is exacerbated if the source is seen as "anti-China".

This is disappointing for the Australian barley industry which has for years oriented barley breeding, production and grading systems to meet Chinese demands. Industry even created a new grade of barley (fair average quality) so that Chinese brewers could comply with Chinese laws against the use of (cheaper) feed-type barleys in brewing. Thus, in some ways, Australian agricultural industries like barley have been too successful. As a result, China has resorted to protectionism with a spurious case that is likely to be ruled illegal if Australia appealed to the World Trade Organization (WTO). Unlike wool, barley can be sourced in large volumes from other countries (Canada, Ukraine, France) albeit with less favourable price-grade alignments.

Similar drivers are at play in the Chinese tariffs on Australian wine. China has had an industry policy over the past decade to increase wine production through large-scale wineries, including from grapes grown in lower-income areas of Xinjiang and the Loess Plateau (Ningxia, Gansu, Shaanxi). China's wine production halved over the past five years, but according to statistics (that require interpretation). The representatives of the big wineries – again CADA – states that the burgeoning Chinese wine market was being robbed by imports, which have surged, especially from Australia, partly due to the elimination of tariffs under the China-Australia Free Trade Agreement (ChAFTA) and declining average prices since 2015. CADA applied for an investigation into subsidies and dumping of Australian wine, which the Ministry of Commerce ruled on in November 2020 with tariffs of up to 212 per cent, in what appears to be another case of protectionism.

Beef exports to China have been dented by suspensions of the five Australian abattoirs: four due to mislabelling and non-conforming certificates; and one for residues (of cat and dog eye ointment). Another two remain suspended due to stated risks of importing COVID-19 through beef products. While some of the barriers may be legitimate, these technical barriers to trade are used to manage the beef trade, along with plant certification and disease protocols. Although China has the fourth largest cattle herd in the world, production cannot keep up sky-rocketing beef consumption. Faced with price inflation for beef, massive volumes of smuggled beef, and over-reliance on Australia for formal imports, China has diversified beef imports over the past five years, especially from Brazil, Argentina and Uruguay. Fortunately, the Australian beef industry is diversified across more than 100 international markets with modest exposure to China. The Chinese barriers to Australian beef can also be seen as a mirror to increasing access of US beef to China associated with the Phase 1 trade deal.

Policy responses

The simplified coercion framework presented in this article outlines the logic of the trade barriers and effects to both Australia and China. For the major exports of barley, wine and beef that have substantive barriers, China appears to be both imposing costs on Australia and also pursuing its own strategic objectives, or killing two birds with one stone. The equations may vary for other agricultural products subject to more informal, shorter-term or rumoured barriers on cotton, lobsters, timber, sugar and wheat.

Conceptualising the costs of the trade barriers is important in formulating a response. It is important not to over-state the real costs of the barriers, which would lead to over-reach in policy response. Market substitution, product substitution and other measures reduce the costs of coercion. The coercion has not yet reached as far as critical commodities like wool and iron ore, which would signal decoupling. Even if the measures were to spill over into substantive barriers on commodities like coal, the net effects for the average Australian household are modest.

But neither should the significance of the barriers be under-stated. The affected industries, companies and producers have suffered considerable losses in revenues and resources forging trade links and relationships. The barriers also reveal ominous directions in Chinese policy settings.

The cases reveal the extent to which China is prepared to use economic coercion to pursue geo-political objectives. These are not isolated events, but a product of more structural forces. They add to a list of 152 cases of Chinese coercion worldwide, the vast majority of which occurred in 2018–20 associated with the rise of "wolf-warrior" diplomacy and prompted by Xi Jinping's assertive speech at the 19th Party Congress. The structural risk of coercion has to be factored into the decision making of Australian business.

As do economic development strategies in China including industry policy, protectionism, mercantilism, import diversification and import replacement. Continuation or escalation could be expected in China's current inward-turning economic policy articulated in recent months in the Dual Circulation programme, the Fifth Party Plenum and the proposed 14th Five Year Plan. As shown in the cases of barley, wine and beef, the current bilateral dispute can be seen as a "vent" for the application of these economic strategies. While the US and EU also protect agriculture and distort trade, subsidies are far higher and trending upward in China, and Australia is more exposed.

China's trade barriers also demonstrate its cavalier approach to international trade laws it has benefited from and signed up to. The measures are against the letter and spirit of agreements including the WTO and ChAFTA. While China records relatively few trade remedy cases for agriculture, it has been argued to be a fast learner and barley and wine add to the list.

These deep-rooted forces cannot simply be "fixed" through more refined diplomacy or a special envoy. Calls to "fix" the relationship are rarely backed by tangible recommendations on how to do so. The commercial costs imposed on Chinese industry by the trade barriers show that disputes will not be resolved simply because of underlying economic complementarities or because of the "quality and price" of Australian products.

Relationship-building programmes also have limits. Australia has for decades conducted hundreds of small and large collaborative agricultural programmes with China to build relations – through industry and government bodies including ACACA, ACIAR and DFAT – that do not seem to have helped in 2020.

China would perhaps be satisfied for the time being with an apology or change in policy on an issue like Huawei, foreign interference, Xinjiang, Hong Kong, or the South China Sea. This is not likely from the Australian Government, which indeed has bipartisan, public and international support. Agricultural industry groups – not known to be backward in coming forward – have generally respected the division between their commercial interests and foreign policy. That is, the Australian political economy has proven resilient to the coercion, which may help to deter more coercion in the future.

The Australian Government response to the trade barriers has been measured. Australia has not entered into tit-for-tat economic retaliation of the sort seen in the US-China trade war, which would not work well for Australia. The Chinese Government list of 14 grievances of Australia's policies towards China does not include the anti-dumping cases Australia has lodged against China (which may be legitimate). Barriers on Chinese investments have not been taken due to "national security" as widely reported, but for the Foreign Investment Review Board to manage distressed sales from the COVID-19 outbreak.

Rather than engage in retaliation, Australian Government and industry bodies have usually echoed Chinese Government statements, and then gone about addressing the technical concerns and compiling evidence on the anti-dumping and anti-subsidy cases. Having been rejected by the Chinese Government, the Australian Government has indicated that it will appeal China's barley tariffs with the WTO. Australian agriculture relies on international trade rules being upheld and baulking in fear of further retaliation would set a dangerous precedent. Proposals to counter Chinese coercion through international alliances are promising but ambitious.

Australian agricultural industries and agencies are increasingly aware of the exposure and structural risks posed by China. For example, in submissions made to the 2020 Parliamentary Inquiry into Diversifying Australia's Trade and Investment Profile, 11 of the 12 submissions from agricultural industry groups encourage government to facilitate diversification. These industry submissions were made before escalation of trade barriers in July.

Diversification is therefore clearly not a "zombie idea". It is a long-term process that occurs not just through corporate and farmer decisions, but a large apparatus of federal and state trade representatives, industry bodies, biosecurity and standards agencies and collaborative research and development projects. Government and industry bodies are reassessing the ways these scarce public resources are deployed. New trade agreements and technical and market access agreements are being negotiated with countries including Indonesia, Vietnam, Japan and India.

Of course, these markets will not immediately "replace" China and there may be costs, but as part of normal business practice – and indeed government policy – this is the trade-off for reduced risk. As shown in this paper, the risks from China appear structural. In this case, diversification is best undertaken sooner rather than later before the costs of coercion escalate.

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Scott has conducted 15 agricultural development projects in China since 1997 funded by Australian government and industry bodies. He has collaborated with 20 Chinese research and government organisations; conducted fieldwork at country level and below for at least 30 months; and provided technical assistance in trade negotiations on beef and wool. He has written eight books on China, two have been translated into Chinese and he has published in The China Journal and China Quarterly. Scott is fluent in Chinese.

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