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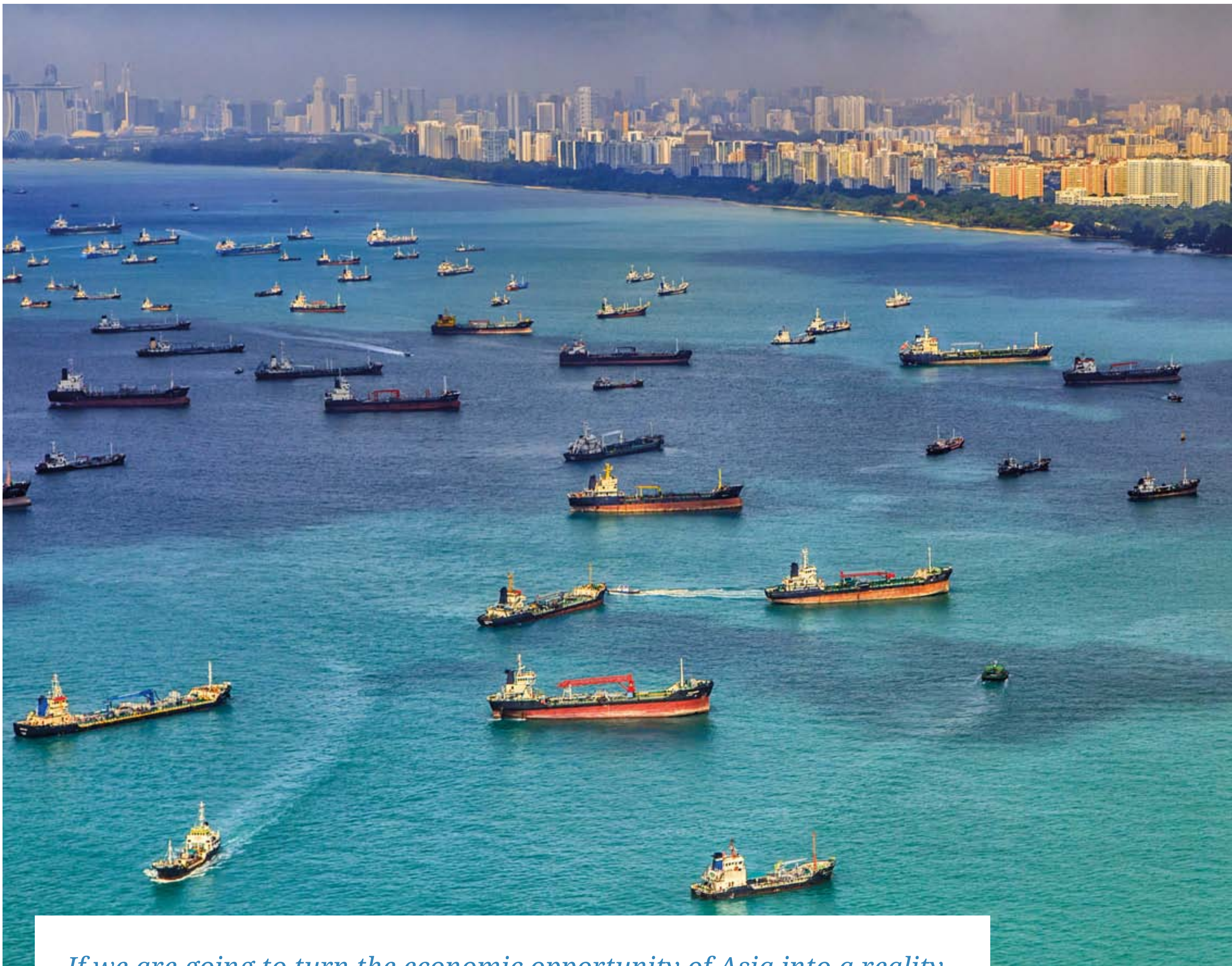
Making our own luck



If we are going to turn the economic opportunity of Asia into a reality, our strategic interests, both economic and security, desperately need to be understood in the context of a bi-partisan, long-term vision for our place in the region.

Australia has done tremendously well over the last 25 years exporting our commodities to Asia. Our agricultural products and mineral resources have benefitted from economic growth in the region and fed a rapidly growing middle class.

But how long will the good times last? When, exactly, will the “lucky country” run out of luck? Some say it started with the end of the resources investment boom; others believe it began when productivity growth started to slow in the early 2000s.

What's not in dispute is that the last quarter of a century of sustained economic growth cannot and will not continue indefinitely. If Australia wants its economic prosperity to endure, we need to start making our own luck.

The facts speak for themselves: our economy is slowing, our terms of trade are slipping, productivity growth is weak, our governments spend more than they raise from taxes and we are looking down the barrel of a national debt approaching $300 billion, or nearly 20 per cent of GDP. While low by international standards, our debt is greater than at any time in our history and double what it was in 2013.

On top of this, the global economic outlook is still sluggish, and demand for mineral commodities remains flat. Our once-reliable strategy of digging up iron ore and coal and shipping it to Asia simply won't cut it anymore.

So we face very real challenges as a nation to find new sources of growth that diversify our economic base, create more and better paid jobs for our children, and provide for an ageing population.

Missing an opportunity on our doorstep

So what's the alternative? Australian businesses say they are looking for new growth opportunities, yet they are largely ignoring the world's fastest growing region.

In the next 15 years, four of the world's five largest economies in purchasing power parity terms will be in Asia: China, India, Japan and Indonesia, with only the United States interrupting Asia's economic dominance. By 2030 two-thirds of the world's middle-class consumers – a staggering 3.2 billion, technologically enabled consumers – will live in the region.

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China alone, in the midst of a difficult period of transition itself, produces one-third of the world's growth in total economic output and in 2016 added over $US700 billion to its GDP. To put this into context, that's around two-thirds of an Australian economy. And let's not forget the ASEAN Economic Community (AEC). With a population of 620 million, nearly half under the age of 30, the AEC is, a $US2.6 trillion economy growing at around five per cent per annum.

The opportunities are extraordinary, but so far remain overlooked by most Australian businesses. In fact, Australian businesses have invested more in New Zealand ($60 billion in 2015) than they have in all ASEAN countries plus China, Japan, India and Korea combined ($59 billion).

Our economic relationships in the region are still built around our exports of bulk commodities: we are effectively still a quarry and a farm. We trade with Asia but we are not in Asia.

High-value goods and services: the new growth engine

As Asia's economies mature and consumption of products and services grow, there will be increased demand for the "other" things Australia is good at – clean and safe food and agriculture, tourism, education, and infrastructure.

Our quality education system means we also have strong capabilities in service industries like accounting, legal, healthcare, engineering, architecture and financial services, to name a few. These can be the drivers of a new wave of growth for Australia in Asia. If the last 25 years has been about shipping our bulk commodities to Asia, the next 25 will be a story of consumption and services.

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And to some extent, the shift is already taking place. In each of the past two years, the total value of exports to China has declined, largely a result of weaker commodity prices. But while the export of goods has fallen, the export of services has increased from $7.1 billion in 2013 to $9.8 billion in 2015. Our service exports to China now exceed the value of our iron ore exports to Korea and Japan combined.

International education and tourism are our third- and fifth-largest exports respectively. Together they generated export revenues of more than $35 billion across the region last year. These sectors employ more than 500,000 Australians.

China is expected to become Australia's largest source of tourist arrivals, eclipsing New Zealand in 2017-18. Already our largest market if measured by total expenditure, Chinese visitors in Australia will account for 43 per cent of the growth in arrivals and 60 per cent of the growth in visitor expenditure over the next decade, according to Austrade.

Trade in goods and our "export services" of education and tourism will remain important elements of the Australian economy and our relationship with Asia. The biggest opportunity though lays in tapping into the domestic markets in the region. To be part of those markets, Australian firms will have to be where the consumers are – and that is increasingly in Asia.

Of course, any projections of Asian success are not without risk. The region will require immense investment in infrastructure and improvements to political, economic, legal and social institutions. But as one of only a few developed economies in the region, Australia is well positioned to help others and ourselves with rapid advances in technology, innovative ideas, and our concentration of talented people.

If all this sounds too hard, we could, of course, accept the status quo, with economic growth expected to run in the 2-3 per cent range for the foreseeable future. While that's well below our long term trend rate of 3.3 per cent, we'll still do better than the major North American and European economies. The question is, are we happy with "okay"? Because if we are, it leaves us with a stark choice: accept a lower standard of living or leave our children with an even bigger debt burden.

One alternative is that we change the way we do business and take some calculated risks by stepping into Asia. To be sure, the operating environment is not straight-forward, and the opportunities are not risk-free. But then growth is never a risk-free proposition and the biggest risk may very well be in doing nothing at all.

Competition, capital and geopolitics can't be separated

Another factor we need to consider when thinking about the future of our economic relationship with Asia is capital. Because Australia's capital investment requirements exceed the funds made available from savings to finance those investments, we are a net importer of capital. This has been the case since Federation and is not a bad thing – it was Japanese capital that funded the development of our iron ore industry in the 1960s. Foreign capital supports investment, and investment drives innovation, productivity, growth and jobs.

For the past century, most of our capital has come from Europe and the US because that's where the net surplus of savings has been. But in a post-GFC world, this is no longer the case, and we are increasingly relying on Asia, particularly Japan and China, to meet our capital requirements.

While much of the focus is on China, Japan has quietly overtaken the UK as Australia's second largest foreign direct investor with total investment surging by 21 per cent to $86 billion in 2015. And although China is only our fifth largest supplier of direct investment, the stock of $35 billion at the end of 2015 has largely been accumulated in the last decade. More critically, our two-way trade with China reached $155 billion in 2015, more than double that with the US which is our next largest partner at $70 billion.

Capital, ultimately, goes where it is wanted, and Australia cannot simply assume it will remain a preferred destination, or even entitled to a share when competing on a global stage, especially when we appear to be inconsistent in our views on foreign investment. And China, for example, has made this clear in a number of ways: while "friendship" has economic benefits, conversely, there are economic costs associated with actions seen as "unfriendly".

The business community – traditionally at arm's length from our strategic and security decision making – urgently needs to be heard making the economic case to the community.

Up to now, our economic relationships in the region have been largely separated from our security and geopolitical ones. Business gets on with doing business and our elected representatives and public servants deal with issues of national security and regional politics.

But tensions in the South China Sea, concerns about Chinese influence on Australian society and a recent string of decisions to block foreign – notably Chinese – investment suggests that business and politics are not so neatly separated. In the new world, our economic and our security interests go hand in hand. This should not necessarily be cause for alarm in Australia but we do need to pay attention. The business community – traditionally at arm's length from our strategic and security decision making – urgently needs to be heard making the economic case to the community. Our government and business leaders need to be engaged in these discussions together in a meaningful and informed way. The stakes are high and it will not be easy to get this right, but we need to – our economic future depends on it.

We need a national conversation about foreign investment

Despite reassurances behind closed doors, Chinese investors must be wondering how welcome they are in Australia. Almost every major transaction involving China in the past year – Ausgrid, Port of Darwin, S. Kidman & Co, Van Diemans Land – has ignited a slew of poorly informed and inflammatory commentary, and led to understandable confusion and disappointment among Chinese investors.

Nothing kills investment quicker than uncertainty or inconsistency. Wherever there's a cloud over the rules, we also leave ourselves wide open to accusations of xenophobia and populism, whether warranted or not. The lack of clarity and certainty around the way the rules are applied and the fact that deals are too often used as political footballs is not a sustainable state of affairs for a capital importing country.

There is nothing wrong with saying "no" to an investment that's not in our national interest. But we do have to be clear about what we want from foreign, particularly Chinese, investment. Today we are not there. It's time to take a step back and remind ourselves why we have foreign investment and the vital role it plays in ensuring the health of our economy.

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At the same time having more information about ownership, and developing some decision frameworks around critical infrastructure, agricultural land and residential real estate would go a long way to addressing the genuine concerns of both investors and the public.

None of this is to suggest that Australia should play down the priority of security in our national interest. But it's essential that economic decisions also factor prominently in our strategic deliberations around foreign investment.

We need a long-term economic and political vision

If we are going to turn the economic opportunity of Asia into a reality, our strategic interests, both economic and security, desperately need to be understood in the context of a bi-partisan, long-term vision for our place in the region.

Governments have a vital role to play in providing such a vision, but ultimately it must come from the Australian community and, in particular, business. In order to take the risks and make the necessary investments in Asia, we need a deeper partnership between business and government that will provide more certainty than a three-year election cycle.

This process is neither scary, nor new: we've had attempts going back to the 1970s. The most recent effort, the Asia Century white paper, placed Australia-Asia relations squarely into mainstream political and economic discussion in 2012. The paper wasn't perfect, but it did get us thinking again about the opportunities to our near north. It may well have formed – indeed, still could form – the basis of the vision we need. We should dust the paper off and revisit it and the proposed Foreign and Trade Policy White Paper is a golden opportunity to do just that.

We're running out of time to act

Our world is changing, and Australia needs to respond now if it wants to be a positive part of that change. The next 25 years could be spectacular for our country, but we can't take that for granted.

We need to ask ourselves: are we satisfied with the status quo; are we prepared to let this opportunity pass us by?

If not, then we need to act. First and foremost we need a long-term vision of our role in the region, informed by a meaningful and transparent national conversation, freed from day-to-day politics. This conversation should be led by the business community and supported constructively by governments. It also requires businesses to take some calculated risks: invest more in the region and make greater use of the talent at your fingertips.

We should be confident but we cannot afford to be complacent. The Asian Century is upon us, and it's not waiting for Australia.

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