

Associate Paper

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Federalism and the Belt and Road Initiative: Managing Tensions between Australian Governments

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Key Points

- Canberra's opposition to China's Belt and Road Initiative (BRI) sets the stage for possible conflict with State and Territory Governments, which favour closer economic ties with China but do not typically consider strategic issues.
- The BRI could create new opportunities for Australian exports, including access to minerals and supply chain management services, yet such opportunities will not be easily accessed.
- Increased Chinese investment in Australia and the linking of programmes, such as Developing Northern Australia, to the BRI have become more controversial, given the willingness Beijing has displayed elsewhere to take control of strategic assets.
- Canberra may need a more comprehensive strategy for addressing both the scant attention paid to strategic concerns by the States and Territories and its own lack of consideration of the implications that Chinese economic custom and plans such as the BRI have for sub-national jurisdictions.

Summary

The Australian Government opposes China's massive Belt and Road Initiative (BRI), largely on the grounds that it may help to end the United States-led order in the Indo-Pacific region and beyond. While that is a grave concern, it does not discount the fact that the many economic opportunities produced by the BRI may still be enticing to other actors, principally

Australia's State and Territory Governments. The Northern Territory's controversial lease of the strategically-important Port of Darwin to a Chinese company with People's Liberation Army links, highlights the type of tensions that might increase between the Federal Government and the States and Territories over the BRI and China's plans in Australia more generally.

Analysis

It is by now abundantly clear that the Australian Government has serious misgivings about Beijing's massive Belt and Road Initiative (BRI), which aims to fund an enormously improved network of regional and global economic interconnectivity, with China at the centre.

Though formally invited to sign on, Canberra has only agreed to a memorandum of understanding, designed to facilitate access to opportunities in BRI countries for Australian companies. It has rejected a Chinese suggestion that the plan might be tied to the Developing Northern Australian economic agenda or [other national strategies](#).

More recently, there have been signs that Australia is helping to mount an active opposition to China's plans. In February 2018, a Department of Foreign Affairs and Trade official said that Canberra was talking to Washington, Tokyo and New Delhi about a BRI alternative.¹ In March, Canberra announced the ASEAN-Australia Infrastructure Co-operation Initiative, which observers could not help but [see as an alternative](#) to Beijing's plans.

Canberra's position might appear prudent given that, as well as aiming to ensure the continued evolution of China's domestic and global economic environment, the BRI is a manifestation of the "march west" strategy through which Beijing hopes to build a new [sphere of influence](#) across the Eurasian continent, while counteracting suspected American containment attempts to the east. It is, thus, a concern for countries, such as Australia, which have vested interests in maintaining the status quo in the Indo-Pacific region.

Opposing the BRI is risky, however. President Xi Jinping is becoming increasingly powerful and committed to [pursuing that agenda](#) and, with Beijing estimated to be rolling out US\$1 trillion in [funding](#) over the next decade, Canberra's actions may be fateful for ties with its largest trading partner for many years to come.

Domestically, Canberra's emerging BRI position also establishes possible causes for conflict with other actors. That includes the State and Territory Governments, many of which are accustomed to ever-increasing Chinese patronage of their economic development. Those governments are not often charged with, or even particularly concerned with, the wider strategic dimensions of the bilateral relationship.

The personification of that oppositional stance may be former Western Australian Premier Colin Barnett, who, in a 2012 speech, [boasted](#) that Australia's China relationship 'is very much a China-Western Australia relationship'. Referring to the Foreign Investment Review

¹ Coorey, P., 'Australia Mulls Rival to China's "Belt and Road" with US, Japan, India', *Australian Financial Review*, 18 February 2018.

Board [FIRB] process and its application to Beijing's ambitions, he also claimed – quite erroneously, as can now be observed – that 'a lot of the political tension from China over that seems to have now largely evaporated'.

As James Laurenceson of the Australia-China Relations Institute (ACRI) notes, State and Territory political forces have often had success in [changing Federal opinions](#):

In 2015, when Federal Labor party leader Bill Shorten was resisting the enactment of the China-Australia Free Trade Agreement, he was left appearing isolated as Labor leaders in New South Wales, Victoria and South Australia all came out in strong support.

The key question now for the States and Territories is whether the economic appeal of the BRI is so great that it is worth fighting Canberra over it.

Despite the recent Federal reluctance to sing its praises, the BRI continues to be seen as a potential opportunity by many of Australia's sub-national jurisdictions. In a recent speech, Western Australian Mines and Petroleum and Asian Engagement Minister Bill Johnston noted that it could potentially spur more infrastructure investment in Asia and, consequently, support demand for new mineral exports.² That view is supported by a [BHP estimate](#) that the current growth rate in steel consumption in BRI countries could double in the next ten years.

In a follow-up telephone conversation, Johnston also highlighted opportunities to export his State's excellence in supply chain management. That record of achievement is most notable in the integrated and highly-automated systems developed for the export of Western Australian iron ore.

The promotion of such specialist strengths may help to overcome a potential limiting factor of BRI participation: the fact that Chinese loans for projects often require construction and other contracts to be [awarded to Chinese companies](#). As a report from [Baker McKenzie](#) notes, Chinese enterprises nonetheless struggle to enter markets where environmental standards and/or demand for advanced technologies are high, which opens a doorway for Australia.

State and Territory Governments hoping to see their firms and industries benefit from the BRI will still need to be aware of other obstacles. These include the fact that, while the BRI seeks to facilitate greater Chinese access to energy, the China National Petroleum Corporation predicts that BRI countries connected to China by land-based pipelines will supply a large percentage of its petroleum needs, which could make it more difficult for Australian producers to satisfy new demand.³

² Bill Johnston, Transcript of Speech to Committee for Economic Development of Australia, 27 February 2018.

³ Quoted in Nadège Rolland, 'China's Eurasian Century? Political and Strategic Implications of the Belt and Road Initiative', *National Bureau of Asian Research*, 2017.

Investment Risk

In Beijing's eyes, the other major potential area of interest of the BRI for Australia is the direct connection of the plan with state and national investment priorities. It is unsurprising that the idea raises concerns in Canberra, given China's willingness to take control of strategic assets through the BRI. One example is the worrying case of Sri Lanka, which, in December 2017, handed over control of the port of [Hambanota](#) to a Chinese state-owned enterprise, in return for relief of US\$1.1 billion in debt.

With Australia's more financially robust companies and stronger institutional safeguards, Canberra may not fear that the States and Territories will be tricked out of such assets, so much as the possibility that those jurisdictions will voluntarily invite Chinese interest.

Victorian Premier Daniel Andrews, for example, has expressed an openness to [linking the BRI](#) with his State's infrastructure development projects. He has said that Victoria 'very much welcomes international partners and direct foreign investment to get the job done'.

Turning to the Developing Northern Australia plan, while Western Australia's Bill Johnston gave no indication of seeking to lobby Canberra, his State is less critically involved in the 20-year vision. Calls for BRI-linked Chinese finance to underpin development could certainly arise elsewhere; public frustrations at the slow pace of rolling out commitments were [already evident](#) at a Cairns conference a year after the launch of the funding mechanism, the Northern Australia Infrastructure Fund.

There is, moreover, a certain logic to calls for connecting the BRI with Developing Northern Australia, which may prove less avoidable as matters progress. It includes alignment of many of the priorities of the latter – support for a northern trade and investment gateway, development of world-class infrastructure and industry diversification among them – with those of the former. The Federal Government has also been quite active in pursuing integration of its [northern plans](#) with external partners other than China, such as ASEAN and APEC.

Should Australia not formally accede to the BRI, or even continue opposing it, there are certainly signs that the Chinese investment already occurring in the north and elsewhere may fall. A more strategic focus in 2017 saw China's outbound direct investment [fall 30 per cent](#), while BRI investment remained unchanged and [increased its share](#) of ODI by 3.5 per cent to 12 per cent.

While China's \$41.9 billion in new investment in Australia [in 2016](#) paled in comparison to the \$195 billion that came from the US, it was, significantly, 15.7% higher than the total for 2015. That total has, in fact, been climbing for years.

Chinese involvement has also recently contributed to the development of some critical and long-discussed pieces of State and Territory infrastructure. These include the \$800 million Northern Gas Pipeline from Tennant Creek in the Northern Territory to Mount Isa in Queensland, which is expected to be completed in 2018. It is being built by Jemena, which will later own and operate the pipeline. Jemena is [dually-owned](#) by the State Grid Corporation of China and Singapore Power.

On the other side of that coin, China's recent investment in Australia has encountered more than its fair share of financial and other difficulties, as in the case of Western Australia's magnetite iron ore sector. That has seen many Chinese-backed projects struggle with profitability, particularly in the Mid-West region.

Such problems have not stopped Duncan Calder, a former president of the Western Australian chapter of the Australia China Business Council, calling for the resuscitation, via a BRI-linked development, of the [Oakajee port and rail project](#), which fell over in 2009 following a drop in iron ore prices. In referencing the BRI, Calder said that 'there is nothing more important to Australia and, in particular, Western Australia, than the trajectory of China. We need to make sure we do not waste this historic opportunity'.

While there is no indication that such views might sway state or national opinion, it is important to remember in assessing Chinese investment proposals for big-picture projects, that the final business case (let alone the wider strategic arguments) often matters less than a somewhat abstract appeal to a state- or nation-building rationale.

Such a view might alarm market fundamentalists, yet it becomes less controversial when we consider that job creation, as well as business opportunities for companies such as equipment and technology providers, is [typically higher](#) during the construction-heavy cycles of key Australian industries, for example mining and petroleum development, than during the operational stages.

Lessons from Darwin

Discordances between market and political, and State and Federal, forces were certainly evident in the Northern Territory's 99-year lease of the Port of Darwin to the Chinese-owned Landbridge company. The arrangement is particularly instructive in the complexities of Chinese investment in a federal system of government, such as that of Australia.

In [defending the deal](#), a senior Northern Territory Government official said it was about 'getting off the teat of Canberra, becoming less and less reliant on money from Canberra'. That was after the Territory Government had reportedly been rejected 14 times on applications for Federal funding to upgrade the facilities.

The government of then Chief Minister Adam Giles also continued to defend the deal as it came under increasing criticism from members of Australia's strategic community, and even US President [Barack Obama](#), as a result of Landbridge's links to the People's Liberation Army and Darwin's role as a staging ground for American troops.

Despite there being no formal Australian connection to the BRI at the time, Giles was bold enough to claim that the [port deal](#) would 'position Darwin as a natural gateway into Australia as part of China's Maritime Silk Road'.

There were suggestions last year that the Port of Darwin might be included in the BRI by stealth, when Landbridge sought a \$500 million loan from the Export-Import Bank of China – a key funder of BRI activities – as it struggled to make interest payments on the purchase.⁴

Such fears were, however, challenged by the Executive Director of the Australian Strategic Policy Institute, Peter Jennings, who noted that it was common in China ‘to build links with the [Chinese Communist] Party that would then open up preferred funding from the state’.⁵ A spokesperson for Treasurer Scott Morrison also said that a clause in the Port of Darwin lease agreement allowed the Northern Territory Government to terminate the lease in the event of a loan default, meaning that the ‘Darwin Port will not come under the effective control of a Chinese bank’.⁶

Nonetheless, the Port of Darwin case remains the best example of the potential for a divergence of opinions on the BRI between Canberra and the States and Territories.

The Federal actions taken in response, including FIRB approval [of any sale](#) of critical State or Territory infrastructure valued at more than \$250 million, seem to alleviate some of the risks. Yet, they also pose the question of what other State and Territory back doors might remain open to potentially unwanted outcomes as a result of BRI- or other Chinese-backed activity.

While Canberra may need to continue to adopt a reactive approach to addressing such potential problems, it might ultimately require a more comprehensive strategy. That strategy would need to overcome the scant attention paid to strategic concerns by the States and Territories, as well as its own lack of consideration for the unique implications that Chinese investment and plans, such as the BRI, have for sub-national jurisdictions.

While there are certainly challenges for the States and Territories in accessing the benefits of the BRI, Canberra cannot discount an increased push for closer integration from the other governments as a means of overcoming obstacles in their way. Such an eventuality becomes more likely should the Federal Government’s increasingly oppositional approach to the BRI produce some combination of reduced monetary support from Beijing for the economies of Australia’s States and Territories, while failing to produce an alternative pipeline of opportunities for new trade and investment.

⁴ Grigg, A., ‘Chinese Buyer of Darwin Port Struggles to Pay Interest and Heavily in Debt’, *Australian Financial Review*, 5 July 2017.

⁵ Grigg, A., ‘How Landbridge’s Purchase of the Darwin Port Killed Perceived Wisdom on China’, *Australian Financial Review*, 7 July 2017.

⁶ Grigg, A., ‘Chinese Buyer of Darwin Port’.

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