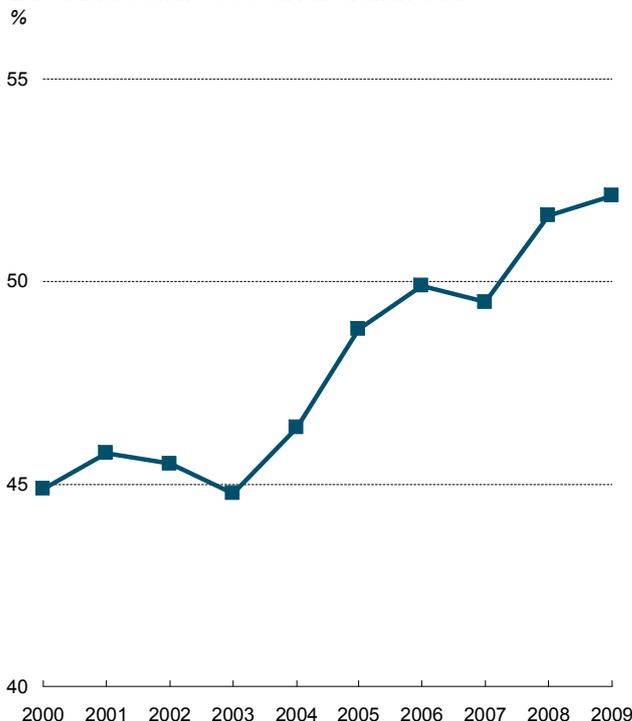


AUSTRALIA'S LOPSIDED EAST ASIAN INTEGRATION

Since the start of the millennium, Australia's trade integration with East Asia has deepened, while the investment relationship has lagged. That may now be changing.

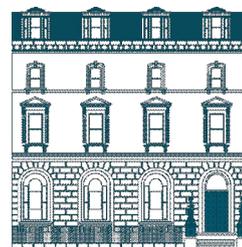
The modern story of Australian trade has largely been one of increasing integration with the economies of East Asia, as Australian resources have helped power the industrialisation and urbanisation of a series of rising regional powers.¹ Japan was the canonical case, and continues to be a major trading partner, while Australian resources have also played an important role in South Korea. China's economic take-off is the latest part of this multi-year story, and Chinese trade is now the key driver of Australia's rising trade integration with the region.

East Asia's share of total Australian trade



Source: Calculated from ABS data

Trade with East Asia was already about 45 per cent of total Australian goods and services trade at the turn of the millennium. By last year, East Asia's share of the total had risen to more than 52 per cent and was worth around A\$263.9 billion.² China has been the big driver of the latest rise in trade integration with East Asia, with the share of China in Australia's total trade increasing from less than six per cent in 2000 to almost 17 per cent in 2009.



Share of total Australian trade		
%	<u>2000</u>	<u>2009</u>
China	5.6	16.8
Japan	14.4	11.7
Korea	5.1	4.8
ASEAN	14.0	15.1
Other	5.8	3.7
Total East Asia	44.9	52.1

Source: Department of Foreign Affairs and Trade, *Australia's trade with East Asia: 2009*. (2010) and ABS

The pattern of two-way trade with East Asia is largely one that is dictated by the workings of simple comparative advantage: Australia exports raw materials – fuels and minerals – to the region, and receives imports of manufactured goods in return:

Composition of trade with East Asia (2009)		
%	<u>Exports to East Asia</u>	<u>Imports from East Asia</u>
Primary products	62.6	17.1
- Fuels	25.8	14.1
- Minerals	25.5	0.1
Manufactures	11.8	63.2
Other goods	11.8	6.6
Services	13.8	13.1

Source: Department of Foreign Affairs and Trade, *Australia's trade with East Asia: 2009*. (2010) and ABS. Note exports of 'other goods' includes confidential items, which in turn includes natural gas.

So while the trade relationship with East Asia is a deep and growing one, in some ways it's also a relatively narrow one, concentrated in resources and dominated by bilateral trade with China and Japan. For example, in 2009, of the A\$145.4 billion of exports to East Asia, just over half were accounted for by three products: some A\$29.9 billion of iron ores and concentrates (about 21 per cent of total exports to the region), A\$ 29.6 billion of coal (20 per cent), and A\$14.4 billion of travel exports (10 per cent), much of them education-related.

Indeed, exports to China of iron ore (A\$21.7 billion, or about 15 per cent of total exports to East Asia) and to Japan of coal (A\$15.9 billion or about 11 per cent) between them contributed to more than one quarter of the total value of exports.

The pattern of Australia's investment relationship with East Asia looks quite different. While East Asia is now by far Australia's most important trading partner, this is certainly not the case when it comes to either inward or outward investment. Last year, the stock of inward investment in Australia from the region was only about 12 per cent of the total and much smaller than the shares of the US (27 per cent) and UK (almost 26 per cent):

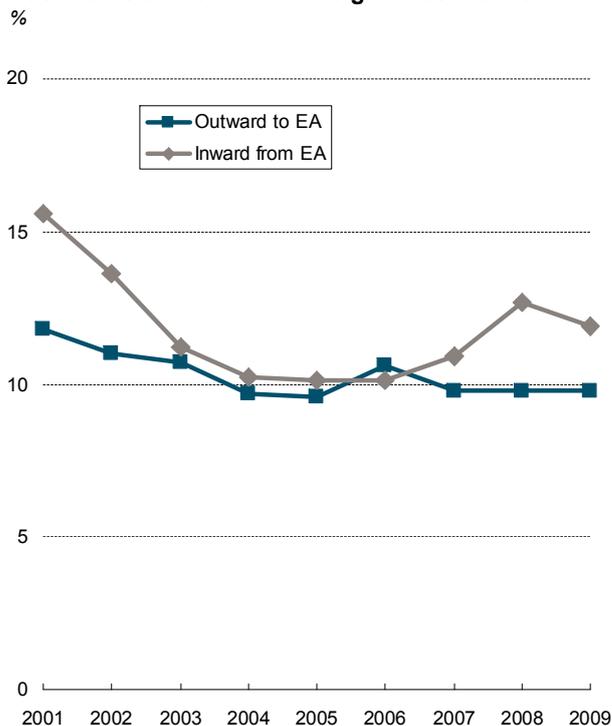


Outward and inward foreign investment (2009)		
% total	<u>Investment into Aus</u>	<u>Investment out from Aus</u>
China	0.9	0.6
Japan	5.4	2.8
HK	2.3	2.5
Other	0.6	0.9
ASEAN	2.7	3.2
- Singapore	2.1	1.9
East Asia	11.9	9.8
Memo: FDI only	18.5	8.7

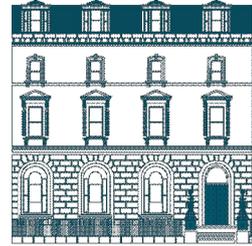
Source: Data from ABS Australian Bureau of Statistics, *International investment position, Australia: Supplementary statistics 2009 ABS Cat. No. 5352.0.* (2010)

It's a similar story with outward investment from Australia. Last year, East Asia accounted for less than 9 per cent of the stock of Australian outward investment, down from almost 12 per cent in 2001 and a fraction of investment in the US (almost 36 per cent) and the UK (almost 16 per cent). So, while the trade data show a clear picture of greater integration with East Asia, the investment data show nothing of the sort:

East Asia's share of total foreign investment stock



Source: Calculated from ABS data



The picture does look a bit different if the focus is shifted from total investment to inward foreign direct investment (FDI). For this category, East Asia is a relatively more important player, accounting for more than 18 per cent of the total stock, a figure which has been climbing since 2004. When it comes to outward FDI however, East Asia actually accounts for a smaller share than it does for total outward investment.

To some extent, this gap between Australia's trade and investment linkages with the region is not a surprise. While growth, size of market, and levels of barriers are important drivers of both trade and investment, and would both seem to point to greater East Asian integration for Australia, it's also the case that a range of other factors, typically involving significant behind-the-border issues, are more important in the case of investment flows and go some way to explaining some of the current gap.

It's also likely that the gap between the trade and investment relationship is set to narrow going forwards. The region is becoming an increasingly important source of outward investment, and with investment in the resource sector currently a preferred destination for funds, Australia is likely to see a greater inflow of regional money. Of course, this trend is already apparent, with the latest available Foreign Investment Review Board (FIRB) annual report providing some confirmation. Of the total deals given FIRB approval in 2008-09, China was in second place by value of deals (16 per cent) and Japan in third place (more than 13 per cent). In total, East Asian economies accounted for more than one third of FIRB approvals by value that year, making the region a significant player.³

Mark Thirlwell
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¹ East Asia defined here as Northeast Asia (Japan, China, South Korea, Hong Kong SAR and Taiwan) plus the ASEAN-10.

² Figures for 2009 are all from Department of Foreign Affairs and Trade, *Australia's trade with East Asia: 2009*. Canberra, Market information and research section, Department of Foreign Affairs and Trade, August, 2010.

³ See Table 2.14 in Foreign Investment Review Board, *Annual Report 2008-09*. Canberra, 2009.