Australian Citizens Party ABN: 96 864 903 379
National Office: 595 Sydney Rd Coburg VIC 3058 | **Postal address:** PO Box 376 Coburg VIC 3058
Phone: 03 9354 0544 | **Fax:** 03 9354 0166 | **Email:** info@citizensparty.com.au
Home Page: http://citizensparty.org.au

Friday, 31 July 2020

The Chairman
Joint Standing Committee on Trade and Investment Growth
PO Box 6021
Parliament House
CANBERRA
Canberra ACT 2600

Dear Chairman,

RE: Citizens Party submission to Inquiry into Diversifying Australia's Trade and Investment Profile

Thank you for conducting this inquiry, which is very important in the context of Australia's current economic challenges, amplified by the circumstances of the coronavirus pandemic.

This submission will address the terms of reference of this inquiry to underscore the Citizens Party's conviction that the only way to solve the current structural failings of the Australian economy, including its lack of diversity in trade and investment, is through the establishment of a national development bank.

We respectfully urge you to take the time to hold comprehensive public hearings on these issues, including the national development bank solution; the Citizens Party is willing to elaborate on this submission in a hearing of your committee.

Yours sincerely,

Craig Isherwood
National Secretary

Robert Barwick
Research Director

To diversify trade and investment, Australia needs a national development bank

The current circumstances of the COVID-19 pandemic demonstrates, in answer to the question posed in the terms of reference, that there *is* a need for Australia to diversify its trade markets and foreign investment profile. The pandemic has merely exposed structural vulnerabilities that already existed, however. Any number of serious crises, including a war or global financial crisis, would likewise have exposed the nation's dependence on imported manufactured goods, and the concentration of our export markets in resources, tourism and international students in one country. ABC 7.30 on 28 April reported on a confidential Defence Department study from 2019 that estimated a breakdown of global supply chains would lead to a breakdown of essential services in Australia in just three months.[1]

This lack of diversity and resulting vulnerability is entirely self-inflicted, the direct result of deliberate policies implemented by successive Labor and Liberal-National Coalition governments over decades, especially since 1983. Successive governments justified the shutdown of industry after industry—which reduced manufacturing from a high of almost 30 per cent of GDP in the late 1960s to 6 per cent today—with economic jargon the committee will recognise, including: "we must be internationally competitive"; "governments shouldn't be picking winners"; "we must stick to our comparative advantage"; and so on. In other words, the governments knew it was happening, but accepted it as a feature of their neoliberal economic dogma. Australia's obsession with free trade was such that in international trade negotiations Australia earned the moniker the "free trade Taliban".

Most seriously, Australia didn't simply manufacture less, we lost much of our *capacity* to manufacture. This is evidenced in Australia's plunge down the index recorded by Harvard University Growth Lab's ATLAS of Economic Complexity,[2] which assesses "the current state of a country's productive knowledge" based on "the diversity and complexity of their export basket". In 1995, the first year of the ATLAS rankings, Australia ranked 55th in economic complexity, behind Greece (54th) and ahead of Turkey (56th); China ranked 46th. In 2018, the most recent year of rankings, Australia ranked 87th, between Uganda (86th) and Burkina Faso (88th); by contrast, China had climbed to 18th. This is a dramatic representation of the different directions taken by the Australian and Chinese economies, China toward more, and more complex, manufactures, and Australia towards more raw materials exports.

One dramatic example of the consequence of this decline for Australia is that when the pandemic struck, Australia had only one company left that manufactured personal protective equipment (PPE), Med-Con in Shepparton, Victoria. The government was forced to deploy the army to scale up production at Med-Con from two million masks a year to two million per week. (It is a point of pride

[1] https://www.abc.net.au/7.30/confidential-report-predicted-how-long-it-would/12195072
[2] https://atlas.cid.harvard.edu/rankings

for the Citizens Party that this company was founded and had been kept going, despite decades of pressure to outsource, by a stalwart member of the Citizens Party, Joe Carmody, a firm believer in domestic manufacturing. Given the circumstances, Joe Carmody, now confined to a nursing home, deserves to be nominated for Australian of the Year.)

The good news is that because Australia's predicament is the consequence of government policy, it can be reversed through a change in government policy; specifically, through the government committing to support Australian industry. The Citizens Party has identified that the single most effective policy to boost Australian industry would be a national development bank. Australia's historical national bank, the Commonwealth Bank, and its subsidiary the Commonwealth Development Bank, were crucial to the extraordinary expansion of manufacturing during and after WWII from about 16 per cent of GDP to about 29 per cent at its peak in the 1960s. Similar institutions have been behind the economic success of such manufacturing powerhouses as China and Germany. A national development bank would both stimulate an expansion of manufacturing capacity in existing and new industries that would naturally find new export markets, which would diversify Australia's trade, and be able to harness the $3 trillion pool of Australian superannuation funds to invest in Australian economic development, reducing our dependence on costly foreign investment.

The following responses to specific terms of reference illustrate the effectiveness of the national development bank policy.

Consider if Australia is too reliant on any one market for exports. If so, what factors are contributing to this dominance?

It is not good that Australia is so dependent as it is on one country for trade, that being China. That said, Australia is extremely fortunate that it is China on which we are dependent. That is because China, while not without its economic problems such as a property bubble, invests more in real economic development than any other country in the world. This investment has been most dramatic since the 2008 global financial crisis, to which most Western countries responded by bailing out their banks and printing trillions of dollars, yen, euro and pounds to keep their banking systems on life support, whereas China embarked on the biggest infrastructure investment program in the history of the world. For instance, China completed its first high-speed rail line by the time of the Beijing Olympics in 2008; it has since completed 35,000 kilometres of high-speed rail, made from largely Australian iron ore and coal.

The growth in Australia's export dependence reflects China's economic development relative to most of the rest of the world. According to the Australian Bureau of Statistics, in the context of contracting global trade due to the pandemic, Australia is more dependent on China than ever. The 30 July *Australian Financial Review* reports: "China's share of Australia's goods exports has steadily risen from 35 per cent in February to 40 per cent in April and up to a record 46 per cent in June, according to the Australian Bureau of Statistics. The share is greater than Australia's entire goods exports to all its combined OECD trading partners and more than 3.5 times greater than our next most important trading partner, Japan, which has seen its share of Australia [*sic*] exports contract from 15 per cent in February to 13 per cent."

The way Australia should think through this growing dependence is to ask: What makes China such a huge consumer of our raw materials, and how could we emulate that? The answer is China's incredible level of investment, which is directed by its large state investment banks into infrastructure in China and around the world. With a national development bank Australia could direct proportionally similar levels of investment into infrastructure in Australia, built with a commitment to using Australian steel and cement, which would allow us to keep our trade relationship with China while increasing our domestic demand for our own resources. That way, while the trade relationship would remain significant, our overall economic dependence on it would reduce as our economy grows.

The advantages and disadvantages, including in relation to the national interest and national economic risk, to an over reliance on any one market.

While Australia is over-reliant on China, the advantages from our trade relationship have been obvious for at least a decade, and now more so than ever. As stated above, that is because we get to benefit from China's far-sighted investment decisions, which we should seek to emulate in our own economy. The risks from over-reliance are also obvious, however. It means Australia's economy is at the mercy of another country's decisions and experiences. While to date China's decisions have benefited Australia, it is now running into geopolitical trouble from the USA which has already cost Australia economically. For instance, China agreed to US demands that it import much greater quantities of goods from the USA, including agricultural goods such as barley and beef; not coincidentally, China agreeing to these demands coincided with Australian barley and beef producers experiencing trade difficulties from issues that previously China tended to overlook. These specific issues are small in comparison to the overall trade relationship, but they illustrate the risks.

Again, the solution is to grow our domestic economy and domestic demand for Australian goods, especially manufactures that value-add to our immense resources, while maintaining the trade relationship, which has been so beneficial, but on which we can become increasingly less dependent. Establishing a national development bank to invest in our own industries can make that happen.

To illustrate the benefits of domestic manufacturing that value-adds to our resources, consider the examples of bauxite and lithium.

In 1970, the John Gorton Coalition government approved National Party leader John "Black Jack" McEwen's proposal to establish a form of national investment bank, the Australian Industry Development Corporation, as a public credit institution to invest in aluminium smelting in Australia, on the basis of a Cabinet submission that showed the benefits of manufacturing that value-added to our raw materials. Then the biggest exporter of bauxite in the world, from the biggest bauxite mine in the world in Weipa in far north Queensland, the Cabinet submission showed the difference between exporting the raw material versus the processed product. In 1970-dollar terms, exporting one million tonnes:

- of bauxite earned $5 million;
- processed into alumina earned $27 million;
- processed into aluminium earned $120 million;
- processed into aluminium products earned $600 million.[3]

Lithium offers similar benefits. Australia is currently the biggest exporter of lithium in the world, for which we earn US$750 per tonne. Economist Dr Jim Stanford of the Australia Institute's Centre for Future Work explained to ABC on 23 July that manufactured into batteries, the same amount of lithium would be worth $US150,000 per tonne! Dr Stanford's team has ranked Australia as the lowest among the OECD developed countries for manufacturing self-sufficiency, which is not so much a measure of producing for ourselves, but a measure of capacity, meaning the amount of manufactured goods we produce is equal to 71.5 per cent of the manufactured goods we consume; the top 10 OECD countries are all above 110 per cent. ABC reported: "Dr Stanford estimates that increasing Australia's manufacturing self-sufficiency to 100 per cent could add another $180 billion a year in new manufacturing output, boost GDP by $50 billion a year and add more than 650,000 direct and indirect jobs."[4]

Consider if Australia is too reliant on foreign investment. If so, what factors are contributing to this dominance?

Total foreign investment in Australia as of 2019 is $3,352.5 billion, or $3.3525 trillion, according to the latest figures from the Department of Foreign Affairs and Trade.[5] This compares to Australian GDP of around $1.9 trillion. While Australia is dependent on one country for trade, China, it is similarly dependent on just two countries for foreign investment, the United States and United Kingdom, which between them control 43.4 per cent of all foreign investment in Australia, worth $1.6698 trillion. (Ironically, for all the talk about Chinese investment, its share is tiny by comparison to the US and UK and to its relative economic size, just 2 per cent of the total at $78.2 billion).

While it is a myth that Australia needs foreign investment, it is true that from its days as a developing colonial economy Australia has always had a high level of foreign investment. There have been times when Australian governments have sought to reduce the level of foreign ownership of Australia, such as when the Whitlam government campaigned to "buy back the farm" to assert sovereign control over Australia's mineral resources. There have been other times, especially more recently, when neoliberal governments have effectively campaigned for more foreign investment, as if it were a proof of the competitiveness of the economy. After 40 years of such neoliberal economics, Australia has record levels of foreign investment and foreign debt.

There are definite risks associated with this level of foreign investment and foreign debt. One example materialised during the 2008 global financial crisis, when foreign creditors called in $50

[3] Hancock, Ian, *John Gorton: He Did It His Way*, 2002, Hodder Headline Australia, p. 267
[4] https://www.abc.net.au/news/2020-07-23/coronavirus-pandemic-leads-to-australian-manufacturing-revival/12481568
[5] https://www.dfat.gov.au/trade/resources/investment-statistics/Pages/statistics-on-who-invests-in-australia

billion of the more than $400 billion Australia's banks owed overseas on 90-day terms which they couldn't roll over due to the credit crunch. The banks were forced to plead with the Rudd government to guarantee their overseas borrowings, warning that without such guarantees they would be "insolvent sooner rather than later".[6] Despite that experience the banks owe similar amounts overseas on 90-day terms today; even worse, this debt does not correspond to productive domestic investment by the banks, but to speculative investment in the housing bubble which damages, rather than improves, the Australian economy.

Interestingly, the record levels of foreign investment and foreign debt have coincided with the adoption of the compulsory superannuation system which, in three decades, has achieved a superannuation savings pool of close to $3 trillion. When the Labor Party campaigned for the superannuation guarantee in the 1990 election, then-Prime Minister Bob Hawke promised: "Superannuation is building a massive bank of savings for investment in Australia's export and other productive industries—every dollar saved helps finance Australia's development without foreign debt."[7] Clearly it hasn't worked that way, and in fact we have a situation in which Australian superannuation funds send a significant portion of their members' savings to invest overseas, while overseas pension funds are becoming very big foreign investors in Australia. This reflects the fact that the superannuation system has been a boon to the financial services sector, and there's reason to suspect this was the intention all along. According to author David Love, then-Treasurer Paul Keating wanted to boost the growing deregulated finance sector in which new players such as Macquarie Bank were starting to star, and pushed compulsory superannuation to be a source of Australian foreign investment overseas because "unless the growth in savings—and therefore in financial capital—continued to accelerate, Macquarie and institutions like it could not manage to sustain the momentum of the growth in their overseas operations, and Keating wanted these as a new Australian industry."[8]

It would make far more sense for Australian superannuation to invest in Australia's economic development, rather than overseas. Superannuation funds should be encouraged to invest in government-guaranteed bonds in a national development bank, which could harness that investment for lending to Australian industries and for infrastructure.

The advantages and disadvantages, including in relation to the national interest and national economic risk, to an over reliance on foreign investment, especially foreign investment by state-owned enterprises.

There are few advantages of foreign investment in a developed economy like Australia that are not outweighed by the disadvantages of having to repatriate the returns from the investment overseas. There are exceptions, such as the car industry, which did make money for its foreign investors but also created a high-tech, high-skilled Australian manufacturing workforce.

[6] Garnaut, Ross; Llewellyn-Smith, David; *The Great Crash of 2008*; Melbourne University Press, 2009
[7] https://youtu.be/NBii_ahfEIk
[8] Love, David; *Unfinished Business: Paul Keating's Interrupted Revolution*; Scribe Publications, 2009

Just as the pandemic has exposed Australia's trade and investment vulnerabilities today, in both world wars of the 20th century Australia found itself having to be more self-sufficient in finding capital for investment. In both wars, especially WWII, Australia did very well in this regard thanks to the Commonwealth Bank.

In WWI the Commonwealth Bank raised war loans from the public to spend on the war effort, for a fraction of the brokerage fee that the London banks which usually raised Australia's loans would have charged. It also invested directly in an Australian shipping line, various commodity pools to keep farmers producing, and infrastructure.

In WWII the Commonwealth Bank under John Curtin and Ben Chifley was a much more powerful institution. It again raised war loans from the public, but it also directly created credit through the monetisation of Treasury bills to the tune of hundreds of millions of dollars, which financed enormous government investment in the wartime economic mobilisation that transformed Australia's economy into a manufacturing powerhouse. While gross Australian Government debt increased from around 40 per cent of GDP in 1939 to around 120 per cent of GDP in 1945, that was almost exclusively funded domestically.[9] The proportion of government debt owed overseas fell from close to 40 per cent at the beginning of the war, to less than 10 per cent by war's end—Australia underwent its most dramatic economic transformation without foreign investment, thanks to the Commonwealth Bank! If we could do it under the extreme circumstances of WWII, we could do it again today.

Analysis of industry and government preparations to diversify its trading partners and secure new markets for Australia's exports, including through further free trade agreements; and analysis of industry and government preparations to ensure the Australian economy is not overly reliant on foreign investment.

The government met the coronavirus pandemic with a distinct shift in economic rhetoric. Industry Minister Karen Andrews emphasised the need to revive Australian manufacturing, and went so far as to foreshadow a possible shift in government procurement policy to favour domestic suppliers. While there have been some positive signs in the support for the emergency manufacturing of medical and protective supplies, so far most of the rhetoric has been just that—rhetoric. Treasurer Josh Frydenberg soon reverted to the jargon of "comparative advantage", and Finance Minister Mathias Corman has indicated procurement policy is unlikely to change.

If Australia is serious about addressing the vulnerabilities exposed by the pandemic and the issues being examined by this committee, we must establish as soon as possible a national development bank. Such a bank would:

- support Australia's existing industries, which currently suffer from their reliance on credit from the private banks that are more interested in lending for over-inflated housing than in serving the special needs of farmers and independent manufacturers;

[9] "A history of public debt in Australia" by Katrina Di Marco, Mitchell Pirie and Wilson Au-Yeung, Australian Treasury

- foster new industries through being available for innovators and entrepreneurs to approach for financial and marketing support for their ideas, which too often are lost to Australia because the innovators can't get any backing here but are picked up overseas (one high-tech CNC-aided engineer explained the potential of this sector to the Citizens Party by saying that if the government divided $5 billion among 1,000 small Australian engineering firms to advance their ideas to production, some would fail, many would succeed, but 10 would become bigger than BHP!);
- lend to local, state and federal agencies for infrastructure projects that would create massive demand for Australian steel and cement and machinery, boosting industries that value-add to Australia's resources.

At the outset of the pandemic, the Citizens Party proposed converting the Clean Energy Finance Corporation into an emergency national development bank, because it already existed and could be converted with minimal legislation. That proposal was made in view of the initial suspension of Parliament, but when Parliament resumed a normal schedule the Citizens Party drafted proper legislation for a dedicated national development bank, modelled on relevant aspects of the Commonwealth Bank, the Commonwealth Development Bank, and the legislation introduced into the US Congress on 31 March for a National Infrastructure Bank.[10] The draft legislation provides for a bank with $100 billion in capital to be provided from the Treasury and by selling guaranteed bonds to superannuation funds, which at a conservative lending ratio of 10 to 1 would be the basis of up to $1 trillion in loans to industry and for infrastructure.

It would be national suicide for Australia to "decouple" from China as certain political figures in the USA, UK and Australia are encouraging; rather, Australia should value its trade relationship but grow our domestic industries so we become increasingly less dependent on raw materials exports, tourism and international students. The Committee should dedicate time to a detailed examination of how a national development bank could help to achieve this.

[10] https://www.congress.gov/bill/116th-congress/house-bill/6422/text?r=5&s=1