The high price of feeding the hungry dragon
Mark Thirlwell
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Resource-rich economies around the globe have been busy counting their swelling foreign exchange receipts as their leaders consider how best to blow their rocketing tax revenues. The Middle East is awash in petrodollars, government coffers in Latin America and the Caribbean have been swollen by bumper earnings from oil, coffee and copper exports and sub-Saharan African producers are experiencing a welcome boost. Australia, meanwhile, is enjoying a resource bonanza that has lifted its stock market to record levels.

Soaring world prices for oil, gas, base metals and agricultural products have prompted speculation about a commodity supercycle that could last two decades, and this latest resource boom is bringing with it all the usual benefits and pitfalls. But it is also presenting policymakers in commodity exporting countries with a new challenge, one that relates to a key driver of the current cycle. While factors such as low real interest rates and concerns about security of supply have helped drive up prices, demand from China has probably played the most important role.

Take the case of metals and minerals. Last year, China accounted for almost half of the world's consumption of metallurgical coal, over 40 per cent of thermal coal and iron ore consumption, and more than 20 per cent of steel, aluminium, copper and zinc consumption. The demand triggered by its industrialisation and urbanisation projects turned China into a big influence on commodity prices.

It is now widely recognised that China's expanding economic weight is exerting a gravitational pull on countries in its neighbourhood, reshaping regional trade flows and institutions. One consequence of its immense appetite for commodities is that China is also pulling economies from further afield into its economic and political orbit. Bilateral economic relations with resource exporters worldwide are blossoming: Chinese companies are investing in Sudan, Angola and Nigeria; and China is now a big export market for Chile, Peru, Argentina and Brazil.

While feeding the hungry dragon is an economically rewarding experience, it adds a new diplomatic and strategic element to the macroeconomic policy issues involved in managing a resource boom. Australia's experience as a significant commodity exporter and a close ally of the US provides a particularly interesting example both of the benefits involved in a deepening bilateral economic relationship with Beijing and the challenges that come with it.

The positive side of the balance sheet is impressive. China is now Australia's second largest trading partner, and the complementarity between the two economies means that China's rise has represented a huge economic windfall for Australia. Export prices have surged on the back of resource demand, even as Chinese production has helped hold down the price of manufactured imports. The Reserve Bank of Australia's nominal commodity price index is at its highest ever level, and Australians are enjoying the biggest cumulative rise in the terms of trade since the early 1970s. The income boost has helped underwrite a record 15-year long expansion, a stock market boom and an unemployment rate currently at a 30-year low. That same complementarity, however, means that national prosperity is increasingly dependent on the growing power to the north. True, this is not the first time the "lucky country" has surfed its way to prosperity on a regional development wave. Economic take-off in Japan and South Korea were earlier east Asian boosts to Australian growth. But the relationship with Beijing injects a strategic element that was much more muted in the relationships with Tokyo and Seoul. Japan and South Korea were, like

Australia, US allies, and neither had realistic ambitions to superpower status. China is different in both respects and Beijing has not been shy in linking economic ties with broader strategic objectives.

One example came last month, when China started to play hardball in negotiations over the contract price of iron ore. At one stage China reportedly threatened to impose a price cap on imports, prompting Australian protests. While that threat has now receded, the recent visit by Premier Wen Jiabao provided China with another opportunity to remind Canberra politely of the broader point: while Australians might think resource contracts are a matter for businesses, that is not a view shared by Beijing.

China is seeking to leverage its growing weight as a consumer to secure a more favourable price and Beijing is applying the same principle – using its economic power to win a better deal – in bilateral relations more generally. Canberra has learnt to play the game. Australia granted China market economy status as a precursor to free trade agreement negotiations and has pleased Beijing by announcing a deal to sell China uranium. Australia's foreign policy stance is being influenced. Canberra has indicated that it will no longer automatically take its US ally's side on issues where Washington and Beijing differ, from exchange rate policy to Taiwan. Even public analysis of last month's visit by Condoleezza Rice, US secretary of state, focused in part on whether the security dialogue it entailed might unduly offend Beijing.

China's economic rise has been good news for the world's commodity exporters. But as Australia's experience demonstrates, they should not make the mistake of thinking that the resulting bilateral relationship will be confined to taking Beijing's money and shipping product. China has great power aspirations and superpowers, even prospective ones, tend to view their relationships with suppliers in a much broader perspective than in purely commercial terms. Just ask Washington about its dealings with Middle East oil suppliers.

The writer is director of the international economy programme at the Lowy Institute for International Policy