CapitalAnalyst Australia Edition - direct from Canberra

Here we go again, time makes a difference, timing is all that matters, a Swiss-Australian's view on the China Australia relationship, people come and go but Chiralia is likely to have many deaths yet survive. Like bushfires in Australia are lethal but part of the lifecycle.

China and the decline of the West

DEFENCE AND FOREIGN POLICY

Recently Australia's shadow foreign minister, Senator Penny Wong, departed from the bipartisan policy framework for dealing with China. She criticised the government for creating anxiety about relations with China for political purposes. The core take-out from both the government's

comments about China's more aggressive approach to international affairs and Labor's response, is that they reflect a naïve understanding about what is motivating China's international assertiveness.

In March, the South China Morning Post published an article that claimed: "'The East is rising while the West is declining' has become a common refrain for Chinese officials ahead of the Communist Party's centenary this summer".

This is not an isolated comment. Numerous senior Chinese academics have published essays about the decline of the West. Many of them have referred to German philosopher Oswald Spengler's book, 'The Decline of the West', which was published in 1918. Spengler has become something of a cult figure in China. Spengler correctly forecast the collapse of the Weimar Republic and the rise of Nazi Germany.

The Chinese government has taken particular pride in the orderly way it has handled the pandemic compared with the disorderly response in Europe and North America. A senior government official Zhang Chunxian described 2020 as a "watershed year" for China.

"Since no country could escape the major test of the pandemic last year, this trend that the East is rising while the West is declining has become very obvious," he said, according to a briefing summary.

"The phenomenon of China advancing, and the US retreating has also been conspicuous," he added.

Zhang, who was transport minister from 1998 to 2005, also quoted a French media report that said Chinese would soon overtake Americans with a higher average life expectancy, concluding that China's rise was unstoppable.

His remarks were echoed by Guo Shengkun, party secretary of the Central Political and Legal Affairs Commission.

"Chinese of all ethnic groups experienced the extraordinary accomplishments achieved by our party, the country and the public [last year]," Guo said. "This was especially seen in the striking contrast of the order in the East and chaos in the West, the rise of the East and decline of the West, and the ascendancy of China and fall of the US," he said.

There are a number of western commentators who agree with the Chinese analysis. They argue that the western socio-political structures are breaking down under the weight of grievances from special interest groups, a lack of consensus about the way forward, and a general lack of trust in the private sector's capacity to achieve wide ranging 'social justice' goals. In brief they think there is no unity of purpose in western democracies.

Based on this analysis commentators such as Martin Jaques argue that China will not only thrive in the 21st century but will do so at the expense of the United States. He says in his book, 'When China Rules the World' that:

"I would expect, and I think we're witnessing, the beginnings of the decline of America, America as the nation that exercises economic hegemony in the world. I think that part of the present crisis actually, the origins of it lie in the inability of the United States any longer to be able to sustain and underwrite the international economic system of which it is the architect and patron. That is a deep problem. The indebtedness means it cannot do it anymore - the multiple indebtedness."

This is grist to the mill of the Chinese leadership. It believes that China's dominance is now irresistible, and it will shortly become the pre-eminent world power as the superiority of its political and economic system is demonstrated.

It is also self-evident that the best response to Chinese assertiveness is for the West to get its act together in this post-Trump era.

Simmering discontent on the government backbench

THE ECONOMY

The government leadership group has been cock-a-hoop after their big spending re-election budget was generally well received. But there are rumbles of discontent emerging from the troops that may destabilise the government's rails run to the election, before winter is over.

On Sunday, it was reported that Liberal MPs Jason Falinski, Tim Wilson, Dave Sharma and Katy Allen were calling for borders to be opened earlier than the middle of next year. The prime minister has claimed that the date has been set by the medical experts. But two of those experts, Victorian chief medical officer Brett Sutton and former commonwealth deputy chief medical officer Nick Coatsworth have now called for early border opening.

The prime minister wants to keep the border closed so the voters will feel secure but there is a chance that the medical advisers will leave him high and dry.

More concerning for Scott Morrison, must be the dissatisfaction with his leadership among a number of backbenchers. There are two major complaints from the backbench: firstly, that the prime minister lacks conviction and is dragging the party too far to the left and secondly that the backbench is excluded from making any input into policy. As one backbencher told Capital Analyst, these days policy is made by interest groups and the budget was framed by focus groups.

Queensland backbenchers, in particular, are unhappy with the fact that the Prime Minister has shifted his ideological position. They say the Prime Minister sees the only purpose of government is to win elections. Unhappy backbenchers argue that the purpose of coalition governments should be to reform the economy and the legal system to enable greater choice for citizens and business. They argue that the prime minister should have used the pandemic to

reform the tax and transfer system, the federation and the national security strategy. They say openly that the PM lacks conviction.

As one Queensland backbencher told Capital Analyst, “Scott has lost the plot. He has crab-walked the executive to the left while the rest of the Coalition has stayed true to their values”.

The other significant grievance is that backbenchers were totally excluded from the framing of the budget or indeed any of the significant decisions that have been taken in relation to the pandemic. They argue that this deprives them of the opportunity to put their constituents’ interests forward in the framing of policy. They say this is particularly important in relation to responses to the virus where there are significant differences between regions.

The backbenchers complain that state premiers have more influence over policy than they do. They say that state Labor premiers are only interested in their urban voters because that’s where state elections are won and lost. This means a large number of regional electorates are treated badly or neglected.

There are no threats to Scott Morrison’s leadership at the moment because the executive is rock solid behind him. However the discontent is strong enough for some backbenchers to contemplate voting against the budget, especially if Labor agrees to support it. This would have major ramifications for the prime minister’s election campaign, as Labor will have a field day with the government disunity as it throws the criticism of the government back at them.

David Littleproud promotes carbon trading

ENERGY AND CLIMATE CHANGE - FOOD AND AGRICULTURE

At the beginning of March, the minister for agriculture, David Littleproud quietly announced the establishment of a $23.5 million Biodiversity Stewardship’s Carbon + Biodiversity Pilot. It didn’t waste any time getting the fund going; in early April it called for applications for funding. Under the scheme farmers will be eligible for a payment from the emission reduction scheme for carbon abatement, and a payment from business for a carbon credit and biodiversity. The scheme is still in a pilot phase and is being trialled in six areas.

The minister announced that the fund would reward farmers for mixed plantings of trees and would establish a mechanism for domestic and international trading of carbon credits. Implicit in this framework is the idea that business will be able to buy carbon credits from farmers, giving them an additional source of income.

The risk with the scheme, according to economists, is that the price of carbon credits will reach heights that will make it more profitable to use arable land for carbon farming rather than producing food.

At the moment the government is opposed to a mandated carbon price which it equates with a tax on emissions (a carbon tax). The proposed mechanism is voluntary with business having the opportunity to opt in and invest in the carbon credits that farmers are producing. The only compulsion to do this is pressure from their own shareholders.

At the moment there is growing pressure from major investors, such as superannuation funds, for big business to adopt the zero emissions by 2050 target. This means that there will probably be a thriving market in the farmers' carbon credits.

There are some starry-eyed assumptions built into the policy. The first is that farmers will only use unproductive land for carbon sinks. This really depends on the carbon price. The assumption is that in the absence of a mandated emissions reduction target, participation will be desultory, and the price will remain relatively low. However, as we have noted shareholder pressure is compelling big business to invest in carbon credits.

Current estimates put the carbon price necessary to achieve zero emissions by 2050 in the vicinity of $US280 a tonne. At this price, large pieces of arable land, particularly where there are problems with access to water, are likely to be devoted to carbon sinks. This has grave implications for future productivity and growth.

Another problem is the prospect of double counting. Many farmers have adopted policies of zero emissions by 2050 and have planted carbon sinks in order to offset their own carbon production. An accounting mechanism will need to be established that separates these credits from those that are tradeable on the market.

David Littleproud has been spruiking the fact that business is keen to participate in the scheme, however this proposition is still untested. Environmentalists are sceptical about business's willingness to participate.

Another issue raised by environmentalists is the regulatory framework that will govern the assessment of carbon credits. They argue that there is no way of assessing that the designated vegetation will actually deliver the amount of emission reduction that business has paid for.

These are issues that arose with the carbon trading schemes that were established in places like Europe earlier this century. Audits found that local authorities were certifying carbon credits that were vastly in excess of the actual carbon abated.

Nevertheless, Mr Littleproud said if 16 per cent of Australia's farmland was revegetated, the carbon captured in plant growth could offset all agricultural emissions.

"With farmers rejuvenating their unproductive landscape, we (the farm sector) could be net zero," he said.

He is bullish about the prospects of a carbon trading scheme and says that it will enable farmers to stabilise their incomes as they move towards the target of $100 billion worth of exports by 2030.

Josh Frydenberg's high risk economic strategy

THE ECONOMY

It is hard not to think that if Mathias Cormann was still the finance minister, the budget would have looked a lot different. More Peter Costello and less Anastacia Palaszczuk. Former Senator

Cormann had a couple of hard rules which the current expenditure review committee of cabinet has chosen to ignore: expenditure should not increase by more than 2% in real terms and the budget should balance over the cycle.

Josh Frydenberg has chosen to adopt a Keynesian approach to economy recovery. His sole focus is the reduction in unemployment and his aim is to get the rate down to 4.5% within the four-year budget framework. He has adopted an approach which involves massive increases above the long-term trend in expenditure, the deficit and $1 trillion in debt.

The big risk is that a large proportion of this investment represents structural changes that are baked in over the long term. Increased expenditure on aged care, childcare and the NDIS will go on indefinitely, which is inconsistent with Keynesian policy theory. This says that governments should spend when there is latent capacity in the economy but should withdraw expenditure and engage in fiscal consolidation when the economy is at full capacity, otherwise there is a risk of high inflation.

The other risk in the Frydenberg strategy is that the big expenditure on social policy measures will overhang the private sector and have a negative impact on business investment. Expenditure on aged care, childcare and the NDIS has a minimal impact on productivity growth. This puts an increased onus on the private sector to increase productivity in order to fund the increased demand for essential services.

Neo-classical economics says that increased growth and productivity is the result of increased investment in capital, labour and technology. In Australia this investment is captured in the business investment number. In the 1960's business investment was 25% of GDP; in 1980 the figure was 20%, as it was in 2013. However, in the last year business investment was down to less than 10% of GDP.

The government is relying on tax concessions to stimulate business investment. There are wide ranging income tax cuts, which it is hoped will stimulate consumer demand and in turn provide an incentive for more business investment. There are also business tax cuts that are geared to providing deductions for business investment. However, at the moment there is no sense that business will take up the incentive to undertake substantial structural reform.

The other growth drivers identified in contemporary economies are knowledge and skills. Knowledge can be divided into two types: general knowledge and specialist knowledge. The Gillard government made a big investment in specialist knowledge by creating uncapped university places. This was meant to lead to more business investment and real wage growth. Unfortunately, this didn't happen, and many graduates were forced into the gig economy.

The current government is putting the emphasis on skills training and short courses at university. It remains to be seen if these courses provide an incentive for business to upgrade the skills of their workforce in order to invest in technology-intensive production techniques.

The budget has deficits stretching out to 2031-32. It is relying on natural growth at very low levels to reduce the debt to GDP levels. This looks very much like a policy of keeping fingers and toes crossed and hoping for a miracle.

The environmental cost of a target of zero emissions by 2050

ENERGY AND CLIMATE CHANGE - THE ECONOMY

The OECD'S International Energy Agency (IEA) has been looking at the environmental cost of achieving zero emissions by 2050. The analysis reveals that the target, which has been adopted by governments around the world, may need to be reconsidered because the environmental cost of implementing it is too high.

The key piece of analysis is a report entitled, "The Role of Critical Minerals in Clean Energy Transitions". This research looks at the minerals that are essential to build the wind, solar and battery assets that make up the current renewables catalogue. The first conclusion that it draws, is that there are not enough mines in production to provide the required 'energy transition minerals (ETM's) needed to even produce the renewables necessary to get us to 50% reduction in emissions by 2030'.

The IEA is clear in its conclusion that the mining industries and infrastructure do not exist at the moment. This is often overlooked by climate activists, who blandly claim that the technology to achieve zero emissions currently exists and is ubiquitous. The IEA finds that with a global energy transition like the one President Biden envisions, demand for key minerals such as lithium, graphite, nickel and rare-earth metals would explode, rising by 4,200%, 2,500%, 1,900% and 700% respectively, by 2040.

The IEA says that at the present time there is no investment going into exploration for energy transition minerals, development of new mines and the construction of associated infrastructure. If the private sector is not prepared to make the necessary investment, despite the sanctimonious statements in support of the zero emissions target, then there is no way that the target will be achieved.

The IEA stipulates that green technology requires a lot more ETM's than conventional technology. An electric vehicle requires six times as many minerals as a conventional vehicle and an onshore wind turbine power plant requires nine times the minerals of a gas fired power plant.

The IEA points out that the mining required to meet the demand for ETM's will lead to substantial degradation of environmentally sensitive areas. This is likely to lead to push-back from the public and demands for alternative solutions. At the moment the obvious answer seems to be a combination of nuclear energy and hydrogen.

What climate activists decline to acknowledge is what the IEA describes as a shift from a fuel intensive energy system to a minerals intensive energy system and the consequences of that for the environment. It will be interesting to see the reaction of environmentalists and conservationists, when authorities are asked to approve a large-scale mining project in an environmentally or culturally sensitive area.

Will they countenance approvals being rubber stamped on the basis that the project is essential for action on climate change or will they demand that governments find alternative low emission technologies even if it takes a little longer to meet the mandated zero emission target.

UK farmers sound the alarm over the UK/Australia free trade agreement

THE ECONOMY - FOOD AND AGRICULTURE

A few weeks ago, trade minister Dan Tehan was announcing that signature of the UK/Australia free trade agreement was imminent. Now we are told from British sources including the BBC that Boris Johnson's cabinet is split over the deal and the National Farmers Union is claiming that UK beef and sheep farmers will be wiped out by the deal.

British farmers have just twigged to the fact that beef farmers with herds of forty cows will not be able to compete with Gina Reinhart, who has 40,000 cattle in a feedlot waiting for export at any time. They are calling for quotas on imports of Australian beef and sheep meat.

On the other hand, the UK government is keen to do trade deals in a post-Brexit world and has now indicated that farmers may have to prepare for the lowering of tariffs on agricultural imports. UK farmers have been hit with a double whammy. When Britain withdrew from the European Union, they lost the subvention payments which the European Commission pays to small European farmers to enable them to survive. At the same time, they are being subjected to competition from more efficient foreign producers.

Not that we should feel sorry for them. These are not poor farmers struggling to survive on the land. Many of them are investment bankers who are in it for the tax breaks. Others are tenant farmers who work for large agri-businesses such as the Duchy of Cornwall, which is owned by Prince Charles and his two sons.

According to the BBC the UK Department of International Trade is more interested in the bigger picture than it is in the future of the farmers. It told the BBC a deal would be "an important stepping-stone" to joining the Trans-Pacific Partnership, a sprawling trade group that includes New Zealand, Chile, Japan and Vietnam, as well as Australia.

A deal would "allow UK farmers even greater access to growing consumer markets in Asia", the DIT said, adding that it would not allow importers to undercut the farming industry or food standards.

NFU president Minette Batters said: "We know that if we're to open up the opportunities of new markets overseas for UK farmers, we will have to offer greater access to our own markets in return.

"However, this trade-off needs to be balanced, and we need to make sure concessions to our hugely valuable home market are not given away lightly.

"There is a very real risk that, if we get it wrong, UK farming will suffer irreversible damage rather than flourish in the way we all desire, to the detriment of our environment, our food security and our rural communities."

Farmers' concerns are reportedly shared by some members of the Cabinet.

The Financial Times reported that environment secretary George Eustice and cabinet office minister Michael Gove are at loggerheads with international trade secretary Liz Truss and Brexit minister Lord Frost over granting tariff-free access to Australian, and possibly New Zealand, farmers.

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