

**Submission to WA Legislative Assembly Economics and Industry Standing Committee**  
***Inquiry into challenges and opportunities for the WA economy***

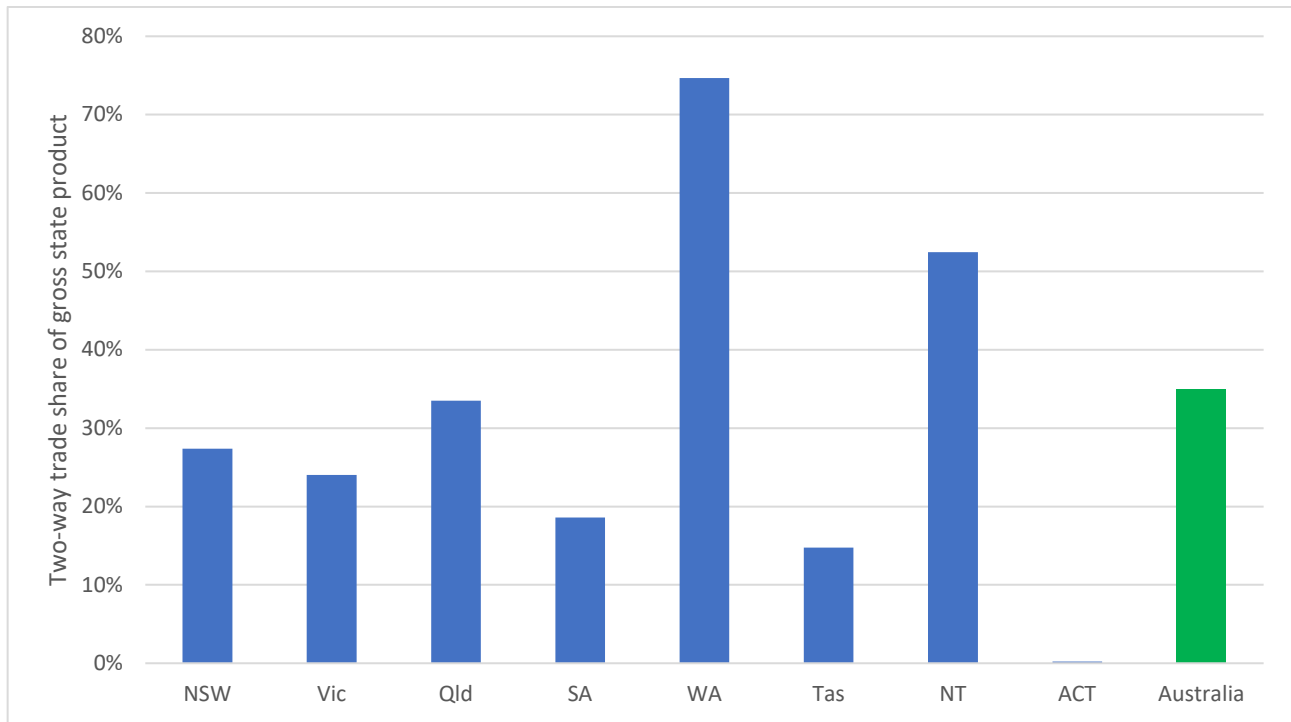
August 2021

**The prosperity and security of Western Australia fundamentally rests of its economic relationships with partners in the Indo-Pacific.** Since white settlement in the early 19<sup>th</sup> century, its growth and development has hinged on its proximity to, and complementarity with, markets in its region. Beginning with pastoral and natural resources, the one state's first major trading partners were the components of the British Empire in Asia – which are today the countries we recognise as being of the Indo-Pacific region. Following the Second World War, Western Australia developed large-scale mining and energy industries again oriented towards regional partners – first Japan in the 1960s, before diversifying to include Korea and Taiwan in the 1980s, and from the 2000s China and Southeast Asia. Without these regional economic partnerships, the state would be unable to develop and sustain the industries which underpin its prosperity and advancement.

**The importance of Indo-Pacific partners to the state's economy is reflected in its trade orientation.** Western Australia is the most trade intensive (measured by share of trade in gross state product) jurisdiction in the Federation. Its trade intensity of 75 percent towers over that of any other state or territory, and is significantly higher than the national figure of 35 percent (**Figure 1**). Western Australia also generated \$187 billion of exports in 2020, which contributed a massive 51 percent of the national total (despite the state accounting for only a sixth of the Australian economy)<sup>1</sup>. The majority of the state's trade is with partners in the Indo-Pacific, which accounted for 78 percent of its two-way trade in 2020. While state-level data on foreign investment is not presently available, Western Australia also plays a leading role in attracting international capital to Australia, given the size and scale of its resource sector.

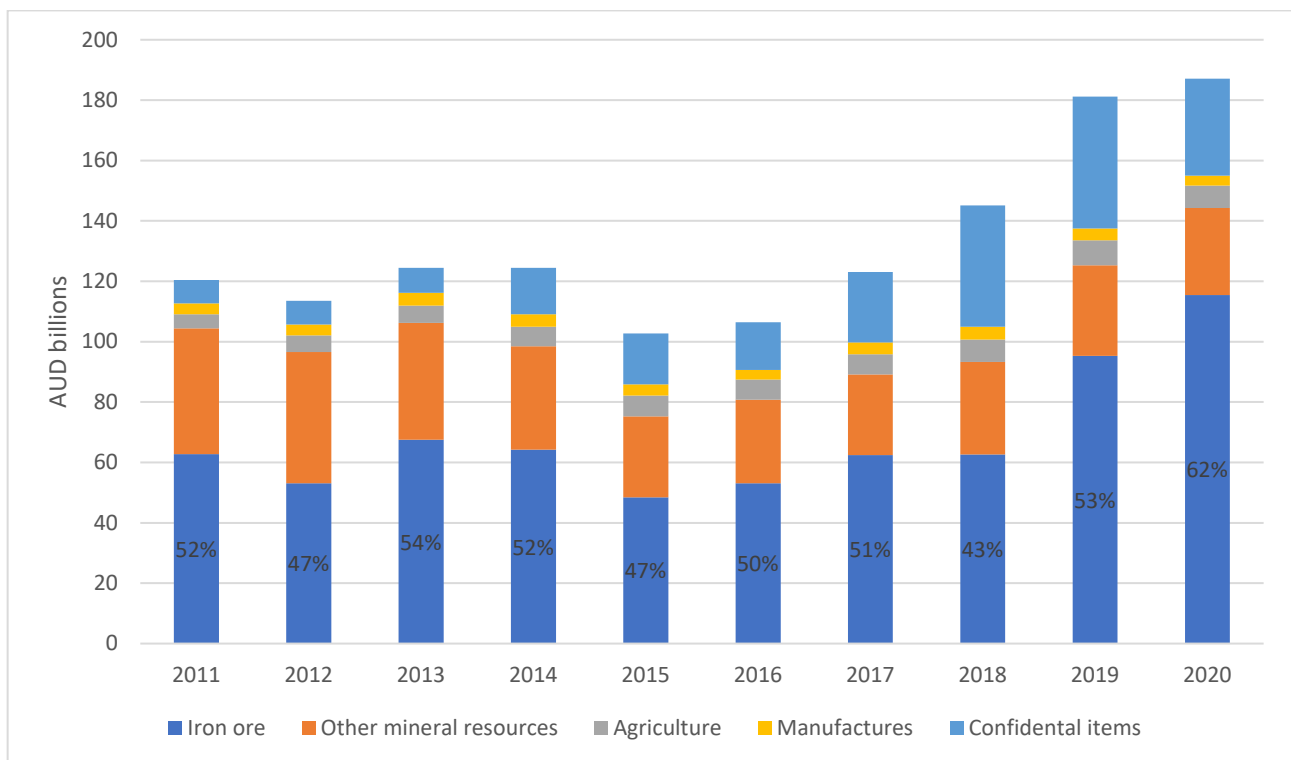
**However, Western Australia's trade relationships with the Indo-Pacific rely on a "deep but narrow" base.** In sectoral terms, its export basket depends heavily on natural resources, with minerals, natural gas and agriculture accounting for practically all of its exports (**Figure 2**). A single resource subsector – iron ore – is of extreme importance, accounting for more than all other export sectors combined. In fact, the state's export dependence on iron ore has increased over time, rising from 52 to 62 percent over the last decade. As a result, this small number of export-oriented resource sectors make an outsized contribution to the Western Australian economy. Mining presently accounts for 39 percent of gross state product<sup>2</sup>, is the single largest direct source of revenue for the state government (in the form of mineral royalties), as well as making a significant indirect contribution to the tax base for other state revenues sources (**Figure 3**).

**Figure 1 Trade intensity of Australian states and territories, 2019-20**



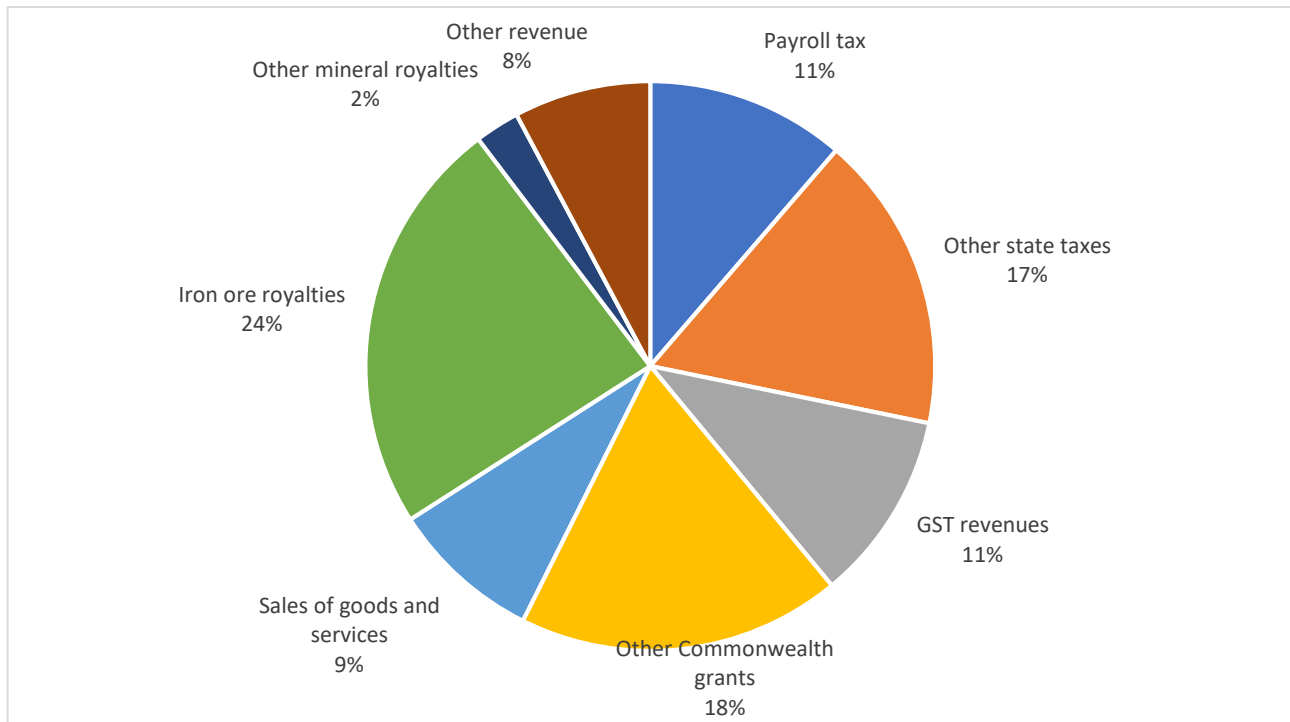
Source: Author's calculations, from DFAT Trade Statistical Pivot Tables and ABS Australian National Accounts: State Accounts (Cat No. 5220.0).

**Figure 2 Composition of WA exports, 2011-2020**



Source: Author's calculations, from DFAT Trade Statistical Pivot Tables. Note: Separate figures for natural gas exports are not available, which are included in the confidential items category.

**Figure 3 WA government revenue by source, 2019-20**



Source: Author's calculations, from WA Treasury, *Annual Report on State Finances 2019-20* and *Overview of State Taxes and Royalties 2019-20*.

**There is a an important, but often under-appreciated, intergenerational dimension to Western Australia's regional economic ties.** The resource sectors which currently underpin prosperity were not established recently, but many decades ago, and have subsequently matured into the internationally-engaged powerhouses the state benefits from today.

**The industrial history of the Western Australian iron ore industry provides an instructive example:**

- The development of an iron ore industry in the state's north was first proposed in the mid-1950s, in order to leverage recently-discovered mineral endowments to develop the region beyond what the existing pastoral industry could support.
- Initial attempts to replicate the "integrated" industrial model of the eastern states (co-located iron mining and steel production) were made. However, the infrastructural challenges of developing an integrated steel industry in the state's north proved uneconomic, and the state government pivoted to an "exports first" model for the iron ore industry.
- A regional partner was found in Japan, whose post-war industrialisation was driving rapid demand for natural resources in which Japan was poorly-endowed. Japanese steel mills sponsored the development of two large-scale export projects in the mid-1960s – Rio Tinto's Hamersley Iron and BHP's Mt Newman – by extending long-term sales contracts and equity investments.
- Within a decade, the "first iron ore boom" has seen the Pilbara became the world's only large-scale exporter of iron ore, establishing a seaborne trade in the commodity for the first time.

- In the 1980s and 1990s, the industrialisation of Korea, Taiwan and China also saw these countries develop trade relationships with the Western Australian iron ore industry. This diversified its customer base, eliminating its sole dependence on Japanese partners.
- In the early 21<sup>st</sup> century, China's shift to a 'heavy' stage of industrialisation saw its steel industry rapidly grow, to quickly become the world's largest. Given the low quality of its domestic reserves, it looked to Western Australia as an iron ore supplier, and became the state's largest export market in 2005.
- The burgeoning relationship with China triggered a "second iron ore boom" in the mid-2000s, of a similar form to the first Japan-sponsored boom of the 1960s. Chinese steel mills extended long-term contract and equity investments to new projects, greatly expanding production levels.
- Rio Tinto and BHP were able to greatly expand their local presence, while a third producer – Fortescue Metals – successfully joined the sector. Investment in new mines and infrastructure drove rapid inward migration and employment growth, and subsequent increases in output delivered significantly greater volumes of iron ore royalties to the state government.

**While occurring on a smaller scale, similar developmental models have characterised the growth of the state's natural gas, lithium and rare earths sectors.** Each of these sectors have emerged in response to the changing industrial needs of Indo-Pacific partners, have developed with partner support in the form of long-term sales contracts and investments, and within a decade have established Western Australia as a world's leading producer of the commodity in question.

**The developmental story of these resource sectors suggests three key insights for the future growth of Western Australian industries.**

**First, an orientation to Indo-Pacific markets provides the scale needed for success.** Given the small size of the state (2.6 million people), and national (25 million) markets, in industries where economies of scale are important projects with a local orientation will struggle to achieve international competitiveness. But Western Australia is fortunate to be located in the Indo-Pacific, a region that contains nearly half the world's population and is currently the epicentre of global growth. An export orientation to large and fast-growing Indo-Pacific markets – initially Japan, followed by other regional partners and then China – has allowed the state to develop industries at competitive scale.

**Second, Indo-Pacific economic ties must be partnership-based, rather than purely transactional.** The state's trade with relationships with Japan and China did not simply involve exporting iron ore at arm's length. Rather, partners were integral to the development of projects from the outset. The industry was developed in response to an emerging need of the partner, and its establishment pioneered the development of a new global market (seaborne iron ore trade between WA and Northeast Asia) that did not exist prior. Customers were involved from the beginning as full partners, and supported industrial development through long-term sales contracts and investments that created durable ties between the state and the region.

**Third, the time horizon of major industrial initiatives is measured in generations, not years.** While iron ore is the backbone of the state's economy in 2021, the groundwork for the industry was laid four generations ago in its post-war developmental efforts. Young Western Australians are today reaping a harvest sowed by their

great-grandparents. Indeed, the industry has been transformative for the state on two separate occasions, first with Japan in the 1960s and then with China in the 2000s. As economic currents in the Indo-Pacific have changed over time, new opportunities are presented which could not have been conceived by those who initiated these industries.

**These insights raise an important question for contemporary policymakers: What initiatives to economically engage the Indo-Pacific today will lay the groundwork for the prosperity of future West Australians?** There are both normative and practical dimensions to this question. Normatively, if the prosperity of the current generation is in part bequeathed by the efforts of several generations past, it is arguably incumbent on the current generation to do the same for those in the future. While the economic opportunities in the Indo-Pacific of the future remain uncertain, a failure to attempt to anticipate and position for them fails the test of intergenerational equity. In this way, the need to take a very long term view of Western Australia's economic relationship with the Indo-Pacific involves similar ethical considerations to climate change.

**But practically, there are also considerations around the medium-term future of the state's prosperity.** Rapid development and technological change in the Indo-Pacific means the structure of demand for the state's products will change over the next decade. As global steel intensity (the amount of steel required for each unit of GDP) is nearing its peak, it has been forecast that demand for iron ore will peak sometime in the mid-2020s, before plateauing<sup>3</sup>. As climate change adaptation gathers pace, renewables will gradually displace hydrocarbons such as gas in the global energy mix. While the state's current industries will remain important, they will not drive growth in its regional economic relationship as they have for the last two decades.

**Fortunately, Western Australia is well-positioned to create new industries and relationships aligned to the Indo-Pacific of 2041.** Many of the industries that will drive the next phase of global development are those in which the state has competitive advantages, and will be led by economies in the Indo-Pacific. But given the long time horizons involved in regional economic engagement projects, it is essential the state commence efforts to build these industries and relationships today. It is beyond the scope of this short submission to make a full accounting and prioritisation of where the state's next generation of economic opportunities lie. However, in its recent research work, the Perth USAsia Centre has identified a number of areas that hold promise for replicating the state's past success at economic engagement with the Indo-Pacific.

**Six future opportunities for Western Australia's regional economic engagement are identified (Table 1).** At the sectoral level, three new industries – critical minerals, batteries and hydrogen – provide the state an opportunity to re-align its mining sector to the clean energy transition. Demand for all three products will soar as new energy technologies penetrate the industrial ecosystem, and the state is well-endowed with the natural and human capital required to become the region's leading supplier. At the relationship level, three countries – Indonesia, Vietnam and India – will prove critical for the state's regional engagement. These three economies have emerged as the driver of the next phase of Indo-Pacific economic growth, and developing economic ties with them today will complementing the state's existing relationships with Japan, Korea and China.

**Table 1 New sectors and relationships for WA's future economic engagement with Indo-Pacific partners**

Sectors	Critical minerals	Critical minerals – such as lithium, cobalt and rare earths – are the lifeblood of modern technologies. But the global value chains which presently supply these essential goods are neither secure nor sustainable. With its significant geologic endowments, and technological capabilities for processing, WA is ideally positioned to become the world's preferred supplier for critical minerals. Read more at <a href="https://perthusasia.edu.au/our-work/in-the-zone-2019-issues">https://perthusasia.edu.au/our-work/in-the-zone-2019-issues</a>
	Batteries	Batteries are essential for the global transition towards renewable energy. With demand forecast to increase ten-fold by 2030, there is need to bring new players into the global battery industry. WA is already a leading player, supplying half of the world's primary lithium, and can leverage its resources and technology to move 'along the value chain' into mid-stream battery processing. Read more at <a href="https://perthusasia.edu.au/our-work/the-governance-of-battery-value-chains">https://perthusasia.edu.au/our-work/the-governance-of-battery-value-chains</a>
	Hydrogen	To achieve their 'net-zero' carbon targets, governments around the world will need to incorporate 'green hydrogen' into their energy systems. But while demand for this new energy is growing, supply remains constrained. WA's renewable energy and infrastructure gives it the opportunity to become the principal hydrogen supplier to the Indo-Pacific region, and support global efforts to adapt to climate change. Read more at <a href="https://perthusasia.edu.au/our-work/fuelling-cooperation-the-indo-pacific-hydrogen-tr">https://perthusasia.edu.au/our-work/fuelling-cooperation-the-indo-pacific-hydrogen-tr</a>
Relationships	Indonesia	Despite our proximity, WA's trade and investment ties with Indonesia have lagged those of other regional partners. But the recently-completed Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) provides an opportunity to kick-start the economic relationship. Complementarities in agriculture, services and infrastructure can provide a foundation for economic engagement. Read more at <a href="https://perthusasia.edu.au/Our-Work/A-New-Platform-for-Deepening-Economic-Ties-The-In">https://perthusasia.edu.au/Our-Work/A-New-Platform-for-Deepening-Economic-Ties-The-In</a>
	Vietnam	Vietnam has emerged as one of the most dynamic economies in Southeast Asia. With youthful demographics, rapid industrialisation, and a longstanding commitment to economic openness, it is poised to become the growth engine of Southeast Asia. WA's sister state relationship with Ba Ria-Vung Tau province, an emerging industrial cluster, provides a platform for building WA-Vietnam economic ties. Read more at <a href="https://perthusasia.edu.au/our-work/australia-and-vietnam-an-agenda-for-economic-coop">https://perthusasia.edu.au/our-work/australia-and-vietnam-an-agenda-for-economic-coop</a>
	India	The WA-India economic relationship has much room for growth. The 2020 WA government Parliamentary Inquiry into India created a roadmap to recover and grow the relationship. Priority should be given to building investment, technical partnerships, and sector specific engagement in critical minerals, METS and services. Read more at <a href="https://perthusasia.edu.au/our-work/the-australia-india-economic-relationship-new-str">https://perthusasia.edu.au/our-work/the-australia-india-economic-relationship-new-str</a>

## About the Perth USAsia Centre

The Perth USAsia Centre located at The University of Western Australia is a non-partisan, not-for-profit institution strengthening relationships and strategic thinking between Australia, the Indo-Pacific and the USA. The Centre is a leading think tank focusing on geo-political issues, policy development and building a strategic affairs community across government, business and academia. Since the Centre's inception in 2013, we have collaborated with over thirty partners to convene more than four hundred events across sixteen cities in eight countries, engaging a world class community network of more than 10,000 strategic thinkers and leaders.

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<sup>1</sup> Author's calculations, from DFAT, *Trade Statistical Pivot Tables*.

<sup>2</sup> Author's calculations, from ABS, *Australian National Accounts: State Accounts* (Cat No. 5220.0).

<sup>3</sup> Accenture (2017), *Steel Demand Beyond 2030: Forecast Scenarios*, [https://www.oecd.org/industry/ind/Item\\_4b\\_Accenture\\_Timothy\\_van\\_Audenaerde.pdf](https://www.oecd.org/industry/ind/Item_4b_Accenture_Timothy_van_Audenaerde.pdf)