Trade Diversification in the World of Disruption – How Australian Coal Survived China's Ban

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Mingwei Sun, Lecturer in Finance, Australian Institute of Business, **Kavita Goel,** Senior Lecturer in Finance, Australian Institute of Business, and **Christiana Osei Bonsu**, Lecturer in Finance, Australian Institute of Business

Trade Diversification

Diversification can be a key element of economic development in any country, without which the long-term growth of the country can be vulnerable to unpredictable external shocks. It is such a simple idea but goes a long way in this era of international trade with increasing uncertainty and unforeseen disruptions. In a recent article by Approved, it is argued that well-diversified supply chains could have alleviated three major disruptions that happened recently – China's power problems, the Shutdown of Vietnamese factories due to COVID-19, and the Suez Canal Blockage.

In layman's terms, diversification is the real-world application of the old saying, "Don't put all your eggs in one basket". Trade diversification helps to manage volatility and reduce vulnerability to adverse trade shocks, but it is not that easy when one country has an advantage in terms of geographical proximity as compared to other countries.

Here we define trade diversification as reducing the reliance on a single country, market, or product. The point is that, in case of any natural or human-induced disruption in that country, exports can be shifted to other countries easily.

The disruptions in the macro-environment over the last few years have highlighted the complexities of predicting the future. This has increased the attractiveness of the 'Diversification' strategy where businesses decide to export or import products from several different nations as opposed to one single nation, even though at any given point in time, one nation may seem to be significantly more attractive than the others.

In this article, we will evaluate how Australian coal has survived the import ban from China through trade partner diversification and discuss its implications for businesses in a disruptive time.

How Australian Coal Survived China's Ban

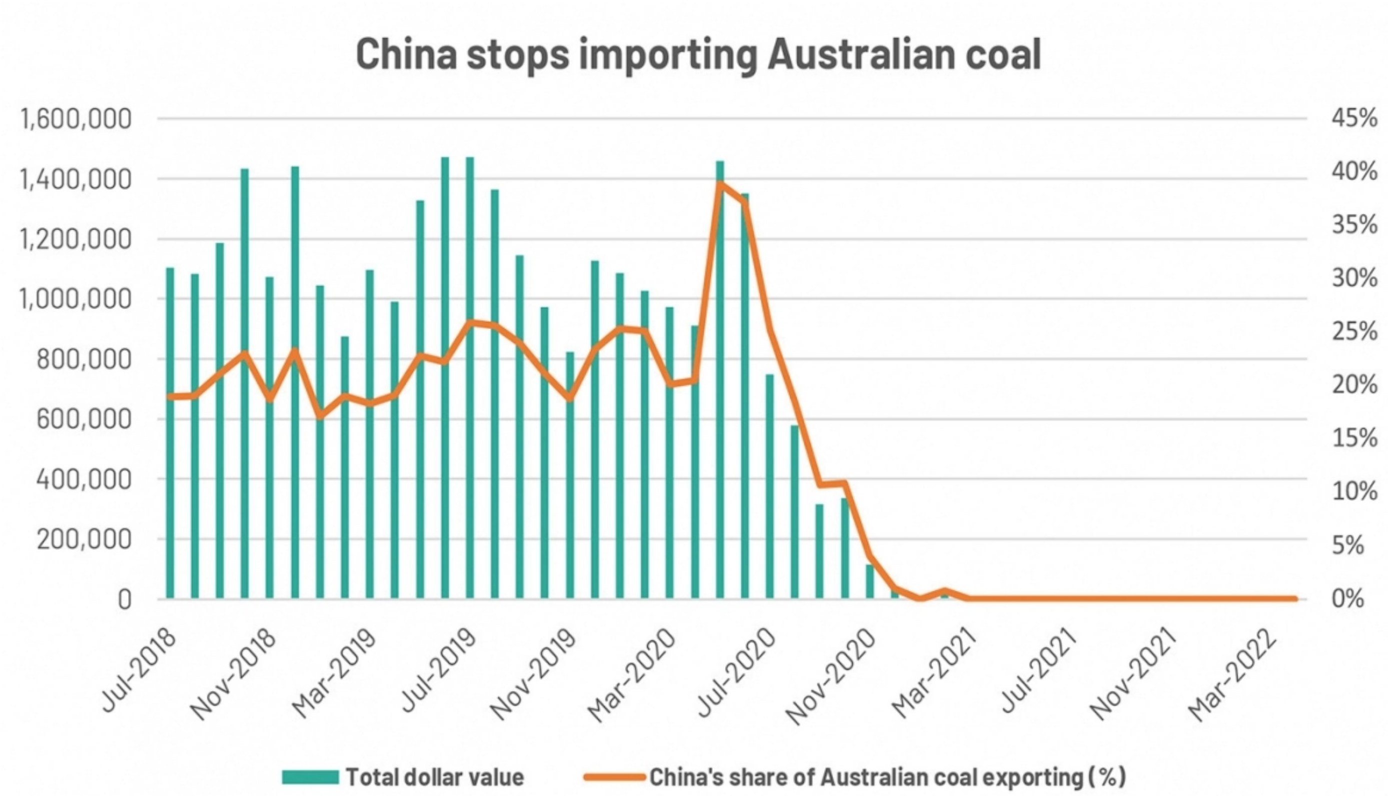
For decades China looked to be the optimal choice for international trade due to geographical proximity. China is Australia's biggest trading partner which imports 136,287 million dollars of Australian products, while Australia is China's fifth-biggest trading partner for importing (DFAT trade statistics).

On April 19, 2020, the Australian government requested an international investigation of the COVID-19 outbreak that originated in China. This move was not well received by Beijing. In the subsequent weeks, the Chinese government then introduced a series of trade restrictions on Australian products, including barley, cotton, timber, beef, red wine, and coal, which is the focus of our analysis.

Date	Affected Australian Product
May 11, 2020	Banned imports from four Australian beef abattoirs
May 18, 2020	Imposed 80.5% tariff on barley
October 9, 2020	Verbally banned Australian Coal import
October 16, 2020	Discourage spinning mills using Australian cotton
October 31, 2020	Banned log timber import from Queensland
November 27, 2020	Doubled tariff on Australian red wine from 107% to 212.1%

Australia is the largest coal exporter in the world. The country's coal exports account for 55% (Metallurgical coal) and 21% of (Thermal coal) of the global import. In 2020, the top five importers of Australian coal were China, India, Japan, South Korea, European Union (Office of the Chief Economist).

Let us see how Australian coal has been affected by Chinese restrictions. Alongside the restrictions on several other products, the coal exported to China has plunged as early as August 2020 before bottoming out to a complete zero in January 2021 (see the Figure below).



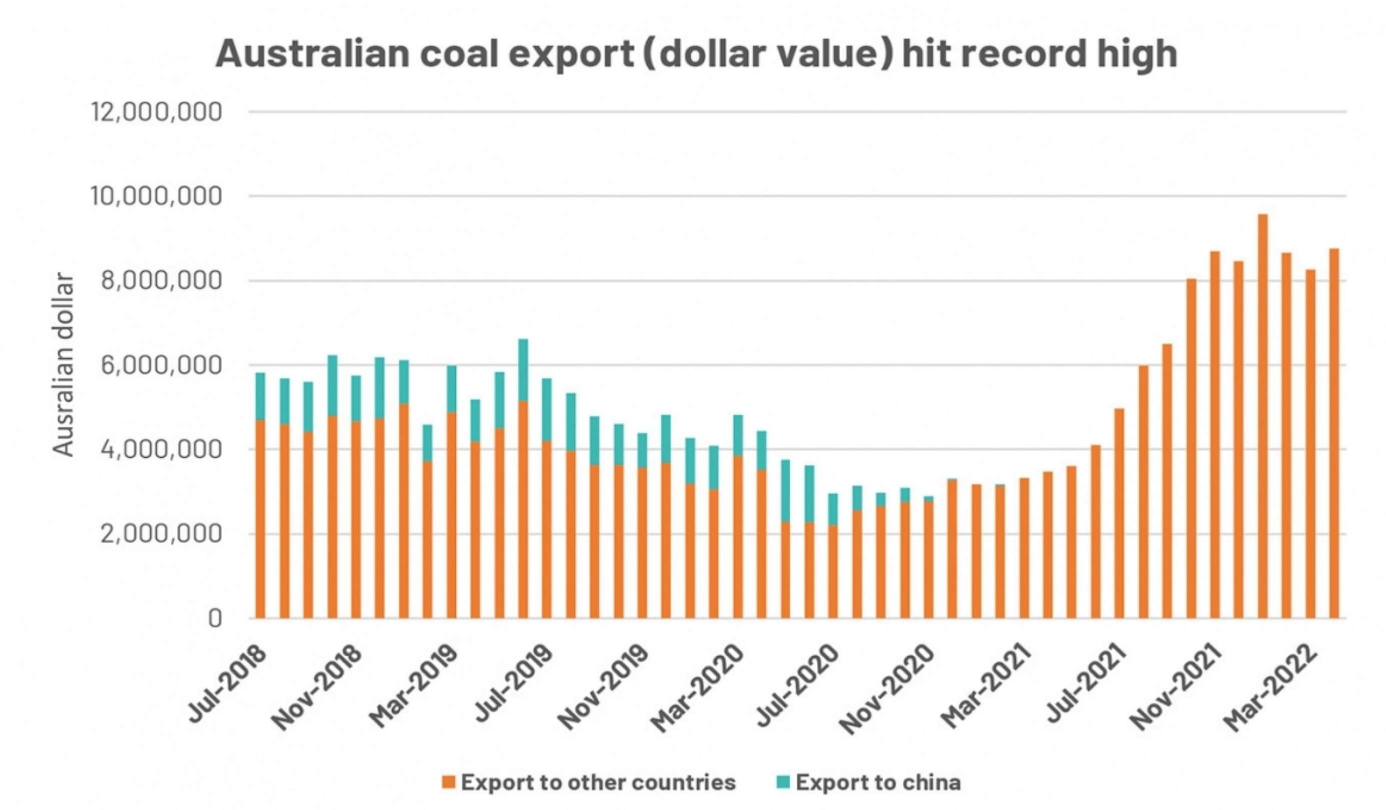
Source: Department of Foreign Affairs and Trade

Meanwhile, although China managed to import its coal from Indonesia, Russia, and other markets, the country suffered from unusual electricity outages in various provinces in 2021, which could be partially driven by a coal supply shortage as a side effect of the ban.

From the side of Australia, the Office of the Chief Economist in Australia points out that Australian coal exports have been "rapidly redirected to India and other Asian markets" after being restricted from China, which can be seen from the data below. China's ban has resulted in a reduction in total coal exports in 2021, but the export has increased to all the other major importers, including India, Japan, South Korea, and Taiwan, and the shift in exports, to a large extent, covered the hole left by China (see graph below).

Source: Department of Industry, Science, Energy and Resources

In the meantime, the coal price has steadily increased to a record high due to a surging coal price. If we consider the total value of Australian coal exports, it went to a record-high level (see graph below).



Lessons Learned

Overall, it can be seen that the Australian coal sector has been reasonably resilient against the trade ban from China, thanks to a diversified portfolio of trading partners. Indeed, as Professor Kramarz and his co-authors point out, exporters' volatility is lower when they have a more diversified portfolio of clients.

Diversification of markets, suppliers, and customers provides a variety of alternatives that help organizations face global disruptions, enhance resilience, and stay alive.

While "black swan" events, such as financial crisis, war, and COVID-19, are almost impossible to predict, some other changes are more predictable. For example, changes in Government policies can sometimes create trade tensions between two countries which can adversely affect exporters and importers. It is always important for businesses to continually scan for political and economic changes which can affect their supply chain choices.

From technology disruptions, pandemics, to geopolitical tensions, the way business is done is transforming every day. Although disruptions are nothing new, the recent five years have been a reality call for countries and companies alike. A well-considered diversification strategy provides a critical buffer for businesses in extreme events.

Dr. Mingwei Sun

Lecturer, Australian Institute of Business

Dr Mingwei Sun is a Lecturer in Finance who has a keen interest in investing and behavioural finance. He obtained his Ph.D. from the University of Adelaide.

Dr. Kavita Goel

Discipline Leader, Australian Institute of Business

Dr Kavita Goel is the Discipline Leader in Finance at the Australian Institute of Business. She is a passionate academic with extensive teaching experience across three continents – Australia, Asia and Africa. She is a qualified Cost and Management Accountant with Doctorate (PhD) in the Finance area.

Dr. Christiana Osei Bonsu

Lecturer, Australian Institute of Business

Christiana is a finance lecturer at the Australian Institute of Business. Her teaching and research interests are in the area of corporate finance and corporate governance. Christiana holds PhD in finance from the University of Adelaide.