

Trade war: Can the China relationship be salvaged?

by **Michael Wesley**

The Saturday Paper, 19 December 2020

Link: <https://www.thesaturdaypaper.com.au/news/politics/2020/12/19/trade-war-can-the-china-relationship-be-salvaged/160829640010911>

When the Covid-19 recession hit, Australia held the world record for the longest period of uninterrupted growth for a developed economy. Before this period of growth, ours had been an economy notorious for succumbing harder, faster and longer to global and regional recessions than other advanced nations. But since 1991, Australia has powered through three major regional and global downturns: the Asian financial crisis of 1997-98, the dotcom crash of 2000 and the global financial crisis of 2008-09.

The major reason for this is China.

For the past three decades, growing trade, investment and services links to the surging Chinese economy have been Australia's lifeline when economic turbulence has hit others hard. Even now, with relations between Beijing and Canberra at their nadir, China's demand for our iron ore has provided better than expected results in this week's midyear economic update. But the further deterioration of the relationship could mean that Australia will no longer be able to rely on our economic complementarity with China to save us from the next global or regional downturn.

Future generations will wonder what happened to so damage the natural complementarity of Australia's and China's economies. Close examination reveals that three factors have been at play.

First, Australia has allowed itself to be dragged into the polarising effects of a deepening rivalry between the United States and China. Whereas the government of John Howard successfully managed to decouple Australia's relations with the US and China, governments since have allowed Washington to make the nature and content of our relationship with China a test of alliance loyalty.

Dating from about the same time, Australia has become less willing to tolerate the more objectionable aspects of China's behaviour for the sake of economic gain. Let's be clear: China did not begin surveilling its own citizens, spying on other nations or acting aggressively in the South China Sea only after Xi Jinping came to power. Instead, somewhere along the way, Australia shifted from co-operating with China despite our differences to emphasising our differences despite our complementarities.

Canberra has also decided that responding to the threat China poses outweighs the benefits of a pragmatic relationship with Beijing. As with all threats, though, the appetite grows with the eating. All manner of linkages to China have been assessed as potentially providing leverage for Beijing if the relationship turns confrontational – and the very public process of doing so has turned the relationship confrontational.

At the same time, there has been a systematic delegitimisation of the economic interests and mutually beneficial relationships that have undergirded the relationship. Anyone in business speaking in defence of pragmatic relations is accused of craven self-interest, while many university partnerships are held up as evidence of a naive surrender to Chinese influence and intellectual property theft.

The Covid-19 crisis and stimulus funding have so far muted the domestic impacts of the shift in Australia's relations with China. But in time, the sudden interruption of resources, food and wine exports to their biggest and fastest-growing market will hit rural and regional communities disproportionately hard. The ripple effects through these communities will be devastating and go well beyond the effects of a normal recession – because despite efforts at market diversification, there is no alternative to the scale and dynamism of Chinese demand. This will affect our politics also: if ties between the National and Liberal parties are strained now, imagine the effects when rural communities start lobbying local members.

Political relations are now in deep freeze. Although Australia has decided this week to refer China to the World Trade Organization over barley tariffs, it is unlikely Canberra will impose its own trade boycotts in retaliation to China's trade provocations. And so the initiative lies with China to disrupt the Australian economy when it wishes.

Beijing has learnt, in the course of its trade war with the US, how to target particular communities and may already be applying these lessons to Australia. While trying to assert our independence, we've potentially entered a tutelage relationship with China, where it can reward or punish Australia according to its perceptions of how we've been acting.

The potential impact on Australia is not merely economic. There is the risk China will become a permanent antagonist. To know how that feels, ask Taiwan, which has faced a permanent diplomatic campaign to isolate it since 1972. Australia could become Beijing's target in a renewed "Asianist" campaign for a regional bloc free of Western members. Any new diplomatic initiative from Canberra could immediately face China's opposition, irrespective of its intent or content. Don't expect our friends in the region to rally to our side: we've very ably demonstrated the consequences of angering Beijing.

At this point, Australia faces some very stark choices. It is obvious those who have so strongly advocated a more antagonistic relationship with China have no idea what to do now. Nor are invocations to “turn down the volume” or “act more and say less” likely to have much material impact on bilateral relations.

Australia’s leaders face a difficult question: Will the China relationship eventually recover or has it already shifted to a new footing? It is clear Beijing sees little downside and considerable benefit in inflicting further punishment and insult. If, after clear-eyed analysis, it’s determined the relationship has shifted, Australia needs to think clearly how to structure bilateral ties to reflect the new realities.

The current frameworks for Australia–China relations – the Comprehensive Strategic Partnership and the China–Australia Free Trade Agreement – may no longer be appropriate. But if the ideas of a strategic partnership or free trade with China are no longer conceivable, what then should replace them? And perhaps most pressing: What would a new and stable Australia–China relationship look like?

Currently, Australia and China each heap the entire responsibility on the other for the deterioration in relations. To take any responsibility would be to accept the other’s accusations. But a situation in which both sides believe the other is solely to blame is a recipe for inertia, because each believes that improvement can only occur if the other admits responsibility and reforms its ways. Neither Canberra nor Beijing is going to do that. Being pragmatic does not require caving in to the 14 demands Beijing released through officials in Canberra; it does require developing and implementing a completely different approach to the relationship.

The place to start in reconceptualising our relationship with China is by admitting our strategy so far has failed. As China’s growth, foreign policy assertiveness and domestic authoritarianism began to alarm Australian and US leaders, Canberra and Washington began to search for levers that would limit China’s disruptive aspirations. The objective was to return China to the international posture developed by former leader Deng Xiaoping, by demonstrating to Beijing the self-harming consequences of departing from Deng’s playbook of non-disruptive foreign policy.

There was a view, in Canberra and in Washington, that China’s assertiveness – whether in the South China Sea, or through boycotts and cyber attacks, or in unveiling plans to dominate high-tech sectors of the global economy – would increasingly alarm its neighbours and the world, threatening to isolate China and damage its vital international economic interests. Meanwhile, the US and Australia began directly competing against China’s foreign policy initiatives: warning that the Belt and Road Initiative was a strategy of “debt-trap diplomacy”, while proposing their own infrastructure schemes to woo South-East Asian and Pacific countries away from China’s investment.

As China faced the prospect of rising opposition to its actions and initiatives, it was hoped that Beijing would moderate its disruptive behaviour and ambitions. This was why Australia and the US spoke loudly and frequently in favour of the arbitration ruling against China's claims and island-building in the South China Sea, warned others of the dangers of economic dependence on China, and flamboyantly trumpeted their moves against foreign interference and bans on Chinese companies building communications infrastructure.

After nearly a decade, it is clear this strategy has failed. It has not moderated Beijing's international ambitions or claims, alarmed its neighbours enough to materially change their relations with China or damaged China's international economic interests. In the Pacific, countries have willingly accepted increased Australian and American assistance, while at the same time gratefully accepting assistance from China. With typical frankness, Pacific leaders have said they have no interest in being dragged into a new Cold War between Washington and Beijing. Privately, leaders in South-East Asia say the same thing.

American trade policy has caused a decisive shift in China's economic strategy. In May 2020, China's leaders began promoting a new "dual circulation" strategy that will guide the country's international economic activities into the future. While still vague on detail, the strategy prioritises greater emphasis on the domestic economy through indigenous innovation and greater public consumption. International trade, investment and economic development co-operation will be structured to promote priorities in China's domestic economy. The dual circulation strategy is a big bet – predicated on the presumption that China's own innovation economy has sufficient size, scale and momentum to be self-sustaining; and that Belt and Road deals are sufficient to supply long-term markets and resource and energy supplies.

Even with Donald Trump due to vacate the White House, it is clear the basis of the global economy has shifted in ways that US president-elect Joe Biden will not be able to reverse. The technological decoupling of China from the US and its allies in Europe and the Pacific now has an unstoppable momentum. The Covid-19 crisis has raised concerns about supply chains and overdependence on certain markets and suppliers, and these concerns will persist for at least a generation. The fear of competitors gaining an advantage has swamped benign support for economic integration that made all involved better off. The era of globalisation is dying and being replaced by an era of autarky and trust-based trade, investment and innovation.

The consequences for Australia–China relations are profound. These new international economic imperatives mean that quality and cost – the two fundamental trade advantages for Australia's major exports – risk being displaced by strategic considerations in Beijing's selection of suppliers. If the dual circulation strategy is

implemented, and bilateral relations worsen further, Beijing will likely seek to replace Australian suppliers with alternatives from countries with which China has more positive relationships.

These de-globalising trends and the deterioration in the Canberra–Beijing relationship require Australia to face up to the realisation there is now a vanishingly small prospect relations will recover to the status quo ante. The relationship has transitioned from a basically trustful one – where each side believes its own interests coincide with those of the other – to a basically distrustful one, where each side believes the other’s interests are opposed to its own. The imperative in a trustful relationship is to build trust and the interactions that underpin it; the imperative in a distrustful relationship is to build resilience against the undermining of one’s own interests and values.

Australia has entered a world in which it must maintain a relationship with a powerful country it deeply distrusts, and which deeply distrusts it. This is a new experience for a country that’s used to all good things going together: strategic alignment, trade and investment and positive political ties. The good news is that we are not alone. Vietnam has a fundamentally distrustful relationship with China; Poland has similar feelings about Russia. There is much we can learn from nations outside our traditional partnerships.

Looking at other distrustful relationships, there are clear pointers for our future China strategy. Tacit agreements that underpin pragmatic relationships can be built from a clear recognition of distrust, plus an understanding that geography means a basic level of comity needs to be preserved. Such agreements rely on mutual understandings that deep and intimate collaboration is impossible, but that pragmatic, interests-based accommodation can be contemplated. Further, there needs to be an understanding that while basic interests may be opposed, there will be limits to that opposition. Both sides will need to withdraw from actively undermining each other’s interests and be able to reassure each other that this has happened.

Reaching this state of Sino–Australian relations will be hard work and require political discipline. Preserving some of our mutually beneficial trade, investment and research relationships will require stopping subjecting them to pervasive suspicion, while acting – quietly and deliberately – to build the resilience of our own activities and systems. And it will require clear signalling to the US, in word and deed, that Australia has its own interests in relation to China and will not tolerate these being judged as tests of alliance loyalty.

Michael Wesley is professor of political science and deputy vice-chancellor International at the University of Melbourne. He is also a board member at China Matters.