China’s Dire Straits: No Brothers in Arms – Part One

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Key Points

- China’s economic and trade “free ride” is well and truly over.
- It is also encountering pushback from regional countries, and especially so by the United States.
- President Trump appears to wish to confront China at every stage and in every way.
- China needs its trade with the US, however. Without that trade, it would find itself with a very small trade surplus, which would derail its growth plans.

Summary

Having cast off the Deng-era policy of not taking the lead in world affairs and of biding its time, China under Chairman Xi Jinping has adopted instead one of seemingly deliberate aggressiveness. (It has been brought to the attention of this writer that there is no “president” in China; Mr Xi has three titles, one of those translating to “Chairman of the Country”. See here for more information.) That policy has now encountered pushback by countries in China’s immediate neighbourhood and much further away. While some of the countries in China’s immediate neighbourhood, such as those that are members of the Association of South-East Asian Nations, have chosen not to take an aggressive stance of their own against Beijing, they have made it evident that they will not be entirely cowed by its overwhelming economic and military might. Larger countries, such as India, have confronted Chinese actions on occasion, while other major players, such as the European Union, appear to have now decided to counter some of China’s aggression. It is the United
States under the Trump presidency that has, however, taken the most aggressive anti-China stance of all, deliberately working to contain China’s bid for worldwide influence by enhancing its own military and economic might.

Beijing has since realised that its “free ride”, as President Trump terms it, is more or less over. The American president has set in motion several efforts aimed at countering China’s bid for international influence. Previous US presidents acquiesced to various Chinese demands, its flouting and bending of international law and established rules and turned a blind eye to its aggressive policies in the hope that further engagement with a liberal international system would see China also become more liberal and less authoritarian. President Trump, however, has adopted a much harder stance against China. He has imposed tariffs on Chinese-sourced imports, terminated its strategy of using third countries to dump even more of its state-financed over-production to the US – thereby undercutting local manufacturers, putting them out of business and destroying employment opportunities in the US, thus weakening its overall economy – and, more recently, declared it a currency manipulator.

Although it is unlikely that these measures, by themselves, have had the effect of slowing China’s economic growth – estimates of its GDP growth in 2018 have ranged from the official 6.6%, which is unlikely, to less than half of that, a far cry from the double-digit growth figures of previous years – they remain a particularly nasty thorn in China’s side. That situation, coupled with President Trump’s efforts to re-invigorate the US military and his withdrawal from initiatives such as the Intermediate-range Nuclear Forces Treaty with Russia, which precluded the construction of nuclear-capable missiles with ranges of five hundred to 5,500 kilometres, worry Beijing, since the US can now counter its own missiles that fall within that bracket, an estimated 80 per cent of its missile force.

Chairman Xi is, in short, under tremendous economic, political and military pressure. Recognising that the US is playing to its strengths in causing that pressure, he has turned increasingly to Russia’s President Putin. That turn towards Russia has led many observers to assume that China and Russia will combine to counter the US and its allies in their efforts to hinder China’s rise and, simultaneously, give Russia the opportunity it seeks to once again become a superpower. That thinking is predicated on the understanding that the US is a common enemy that may only be contained, overthrown from its position as the global hegemon or even defeated by a combined Sino-Russian effort. That thinking is flawed, however, as this paper will demonstrate. It will show why a Sino-Russian relationship can only be, at best, a temporary marriage of convenience and why Vietnam is a key factor to blocking China’s efforts to bring Russia onside and to gain greater influence over the international system. This part of the paper will show why China is dependent on its trade with the US.

Analysis

Chairman Xi is beset by many problems. Arguably, the main one is a rapidly-slowing economy and the threat that President Trump poses to it. Even assuming that the state’s claim that GDP growth is around 6.6% over the previous year, Mr Xi’s goal to turn China into one of the world’s most advanced economies by 2049 increasingly appears to be more
aspirational than realistic. The trade war being waged on China by President Trump only adds to the issues that had already been buffeting the Chinese economy: record debt levels; rampant pollution; and an ageing population, the last thanks to the Communist Party’s misguided one-child policy. There is every possibility that the Chinese economy will stagnate before the country reaches the levels of development found in North America, Western Europe, Japan and South Korea.

Only five developing countries have succeeded in making the transition to advanced nation status since 1960, however, while maintaining a high level of economic growth. Chairman Xi has the added pressure of having to cope with the anti-China sentiment that is growing in the US, a sentiment that has led to the American president imposing severe penalties on Chinese exports to the US. The problem for China is that even if Mr Trump is not returned to office, the next president, whether Republican or Democrat, will almost certainly continue the current incumbent’s anti-China measures and possibly add to them. The International Monetary Fund’s annual Article IV report on the Chinese economy underlined Mr Xi’s dilemma, noting that if China did not reach a comprehensive trade agreement, it could lose access to markets and technology – a deliberate and not very subtle reference to China’s immediate and future economic priorities. The report also noted that the IMF projects China’s GDP growth to be 6.2% for 2019, six per cent for next year and 5.8% for 2021.

China’s industrial sector, the very backbone of its economic growth, now shows signs of withdrawing into deflation. Factory prices fell 0.3 per cent in July from a year earlier, making it a bigger decline than the median estimate of -0.1 per cent predicted by economists.
Added to those problems is President Trump’s announcement that he would impose a ten per cent tariff from 1 September on the US$300 billion ($442 billion) of China’s exports to the US on which he had not levied tariffs previously. If that were to occur, the US would effectively have placed tariffs on all Chinese exports to the US. Worse, he has also hinted that the figure of ten per cent could be raised much higher. When Beijing hit back at that announcement by halting its purchase of US agricultural products and allowing the yuan to fall to a rate of more than seven to the US dollar, the Trump Administration retaliated in a matter of hours, declaring China a currency manipulator. That extremely rapid rejoinder made one further point: it demonstrated that the US had anticipated just that move by China and was prepared to act against it.

China’s “Trump problems” do not, however, stop there. Rapidly-increasing tariffs and labelling China a currency manipulator are only two weapons in President Trump’s very large economic arsenal. He could increase tariffs to 25 per cent on all imports from China but, more dangerously for China, begin to implement a policy that he has only hinted at so far: to weaponise the US dollar, the world’s reserve currency. Despite having re-stated a long-standing compact not to engage in competitive currency devaluations, he has repeatedly called on the US Federal Reserve to cut rates, thus weakening the dollar and benefitting US exporters. The US economy, under President Trump, has seen a major revival from the doldrums into which it was cast by the failed economic policies of the previous president. The lowest US unemployment rates since 1969, the rise in real income levels and the easing of access to domestic energy sources that were previously restricted are just some of the factors that have combined to make the US dollar strong. Weakening it at this time, especially when China is experiencing multiple economic problems, could give the US an inordinate advantage over China.
A weaker dollar is not, again, the only economic weapon that the president possesses. The US Department of Commerce, acting upon the designation of China as a currency manipulator, has floated a proposal that would allow US companies to seek protection against Beijing’s exports by imposing specific retaliatory tariffs. If that proposal were to be implemented, it could see a flood of requests from US companies seeking that protection. It would also see a vast reduction in Chinese exports to the US, even more tariffs imposed on China-sourced goods or an increased flow of foreign companies out of China. That last outcome would add to the amount of capital already flowing out of China brought about by its devaluation of the yuan.

Two major pillars of Chairman Xi’s plan to make China the world’s leading power are pre-eminence in telecommunications technology and artificial intelligence. President Trump, who imposed restrictions on semiconductors and software to Huawei, China’s largest telecommunications company, later relented after his meeting with Chairman Xi in Osaka and allowed some US trade with that company. He could, nevertheless, revoke even that trade if he chooses to do so. The US’s issue with Huawei is not one of restricting its sales of telecommunications equipment or mobile phones; it is a bid to prevent that company from being in a position to dictate telecommunication protocols and frameworks according to which other non-Chinese companies would need to conform. If Huawei were to achieve that goal, it would be in a position that would enable it to dictate to the rest of the world the rules by which they would need to operate their telecommunications networks, which is anathema to the US. There could be little, if any, doubt that President Trump would work actively to prevent that situation from eventuating.

The same reasoning applies to the field of artificial intelligence. Despite lobbying by several US companies, which argue that placing restrictions on US exports of AI technology to China would restrict, in turn, their own development and see research funding dry up, the US Department of Commerce has worked to develop a list of broader export restrictions on
products from new and emerging industries, such as artificial intelligence and robotics, to China. Those companies would require special licences to export their products.

Those measures aside, the Trump Administration could blacklist and sanction Chinese companies that are complicit in China’s violations of human rights domestically, sanction individuals for the same reason and also sanction other non-Chinese organisations that conduct business with those Chinese companies or individuals. The US could restrict joint US-China research and has already restricted the number of Chinese students who wish to study science, engineering, mathematics and technology in the US. The objective of those restrictions is to curtail China’s ability to innovate, which would slow, if not halt altogether, any meaningful technological advancement, thus putting at risk Chairman Xi’s plan to rejuvenate China.

The US notwithstanding, the greatest threats to Chairman Xi’s dream of creating an innovative nation derive from domestic sources. Unrest is growing in China; the demonstrations in Hong Kong, which are on the verge of turning into a revolt against the Chinese Communist Party, are only the most visible of those. Technological advances go hand in hand with corruption and unacceptably poor implementation in China. The crash of a high-speed “bullet train”, which was caused by flaws in its design, was made all the worse by the cover-up that followed. One source asked the pointed question, is China the world leader in biomedical fraud? It noted in unequivocal terms that:

A 1998 study found that Chinese scientists almost never reported negative results – a scientific impossibility. Little seems to have changed since then. Null results remain extremely uncommon in traditional Chinese medicine papers according to a 2016 study. Today, China also leads the world in retractions due to fraudulent peer review, while a survey by Chinese regulators found that about 80 per cent of clinical trial data was fabricated.

Another noted that ‘many of the country’s scientific journals are filled with incremental work, read by virtually no one and riddled with plagiarism.’ Even infants, China’s most vulnerable citizens, are not spared by corrupt practices, as the tainted milk formula scandal showed.

China needs access to the US market if it is to achieve its goal of becoming a wealthy country. As Sinosider observes:

Its total surplus in goods trade in 2017 was US$419.32 billion ($618 billion). Of that amount, US$275.81 ($407 billion) derived from its trade with the US. Absent that trade with the US, China’s trade would have earned it US$143.5 billion ($211 billion). Between January and June (inclusive) of 2018, however, the surplus it derived from its trade in goods was US$138.576 billion ($204 billion). Of that amount, US$133.57 billion ($197 billion) derived from its trade with the US. Its goods trade with other countries amounted to a mere US$5 billion ($7.4 billion), a twelve-
fold decrease from the previous year. If China were to lose the US market, it would indeed be in dire straits.

China faces other problems, which pose, arguably, an even greater threat to its economy than the US does. Its debt now stands at roughly 300 per cent of its GDP, despite the Communist Party’s efforts to wean Chinese businesses off credit stimuli. A real estate bubble threatens to burst at any time, which would cause fiscal distress across the country. Three banks have so far been nationalised because they were on the verge of collapsing. On the political front, the US, again, is exacerbating the situation by using Taiwan as a way of upsetting Beijing. Washington has agreed to sell Taipei anti-tank missiles, main battle tanks and other weapons. The Trump Administration has been accused, additionally, of delaying the sale of the latest iteration of the F-16 fighter aircraft, a sale that could be worth around US$10 billion ($14.7 billion), probably to coerce China into acquiescing to its trade demands. In any case, whatever its reasons may be, there are growing calls in the US to view China as a hostile and revolutionary power. The demonstrations in Hong Kong pose yet another major challenge to the Communist Party’s rule. The demonstrations that began as a protest against extradition laws appear to have evolved into a revolution (or something close to it) and a call for true democracy. While Beijing has amassed its troops on the border with Hong Kong, any attempt to use force against the demonstrators will give the lie to its claims of political harmony in China and could, moreover, bring back memories of the Tiananmen Square massacre of 1989. Were that to happen, there could be little doubt that the US and EU would severely reduce their trade with China, if not terminate it altogether, even if only for a limited time. In any case, Beijing will have lost the moral high ground, assuming that it held it in the first instance.

Beijing’s troubles do not end there, however. As the second part of this paper will demonstrate, China has angered other countries, too, forcing it to turn to Russia for support. Any incipient alliance between them, however, would be little more than a marriage of convenience and prone to mutual suspicion. It is in that context, that Vietnam, aided by the EU and possibly the US, could be the key factor in upsetting China’s turn to Russia.

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