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China’s relentless export machine

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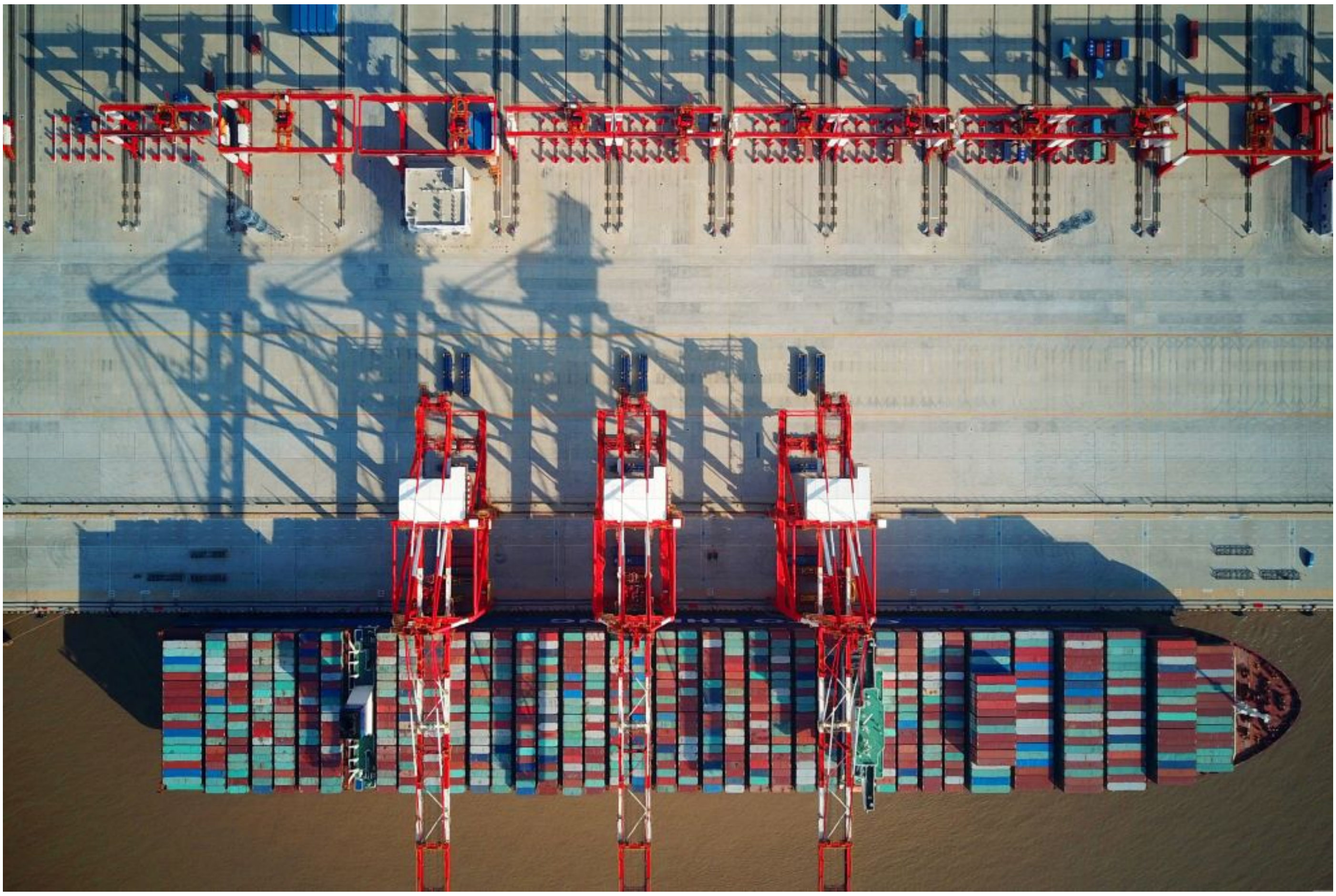

China’s trade surplus hit an extraordinary US$292 billion in the first five months of the year—more than double its pre-pandemic level—and its aggressive pursuit of export markets is likely to become a flashpoint in a slowing world economy.

The Chinese export surge includes Australia, despite Beijing’s continuing campaign of illegal trade sanctions against Australian exports.

China’s exports to Australia over the last reported five months were up 44% from a year ago, while Australia’s shipments in the other direction were down 5%, despite soaring commodity prices.

There is no hint of a concerted Western response to China’s mercantilist strategy, which treats trade surpluses as a manifestation of national power. The World Trade Organization’s rules place no restriction on either the preponderance of state-owned enterprises in the Chinese economy or the subsidies China extends to its private sector, which are fuelling its export boom.

Donald Trump’s administration concluded that the WTO was the problem, not the solution, and sabotaged its ability to adjudicate trade disputes. It unilaterally embarked on a trade war with China, successfully forcing China to sign an agreement in 2020 committing to lift purchases of US goods.

Joe Biden’s administration has been unable to articulate a coherent strategy for managing the Trump legacy in its dealings with China. Although China has increased some US imports, it has fallen far short of its commitments, while China’s exports to the US have surged.

US exports (https://www.census.gov/foreign-trade/balance/c5700.html) to China in the first four months of this year were US$16 billion higher than they were two years ago as the Trump deal took effect, while China’s exports to the US were US$73 billion higher.

The Trump deal provided for a punitive escalation of US tariffs on Chinese goods if Beijing failed to fulfil its commitments. The Biden administration toyed with enforcement. Trade representative Katherine Tai (https://ustr.gov/about-us/policy-offices/press-office/speeches-and-remarks/2021/october/remarks-prepared-delivery-ambassador-katherine-tai-outlining-biden-harris-administrations-new) said last October that not only would China be required to meet its commitments, but it would also have to reduce its ‘state-centred and non-market trade practices’ which had not been addressed by Trump.

However, the sharp rise of inflation this year has led the Biden administration to foreshadow the removal of tariffs on Chinese goods, some of which are scheduled to expire in July. There have been media suggestions of differences between Tai, who favours retaining tariffs, and Treasury Secretary Janet Yellen, whose over-riding concern with inflation is pressing for their removal. Tai’s promises of enforcement and action on Chinese state subsidies have come to naught.

Political pressure on the Biden administration to do something about Chinese inroads in the US economy will continue to mount. His electoral success in 2020 was founded in winning back the support from manufacturing workers in states like Pennsylvania and Wisconsin who had voted for Trump in 2016. If a slowing US economy over coming months results in rising unemployment and if Trump declares he will run again in 2024, those votes will switch back.

The European Union’s deficit with China has also risen by 50% over the past two years with trade figures for the first four months of this year showing a further blowout. The EU has a number of trade remedies at its fingertips: it is instituting a ‘climate border adjustment’, which allows it to impose taxes on energy-intensive imports that haven’t paid for their carbon emissions and is introducing a scheme to counter the use of trade for economic coercion. The latter would enable the EU to impose retaliatory barriers to trade and investment. Although these measures wouldn’t be legal under the WTO rules, the EU argues that the economic coercion is itself illegal and hence justifies going outside the WTO. There are also moves to strengthen the EU’s human rights restrictions on trade and investment.

Australia is in an invidious position: as a mid-sized nation, it lacks the power of the US or EU to retaliate against Chinese coercion and sees the WTO as its best bet. Canberra is counting on the WTO to find in its favour on the disputes it has lodged over Chinese tariffs on Australian barley and wine. Both Australia and China are signatories to an alternative interim dispute mechanism for the WTO.

At last week’s WTO meeting of trade ministers in Geneva, Tai agreed to a motion requiring members to come up with a reform proposal for the WTO, including its ability to resolve disputes, by the time of the next ministerial meeting, which is likely to be held late next year.

However, the US is yet to present any package of reforms it would find acceptable and there are some significant hurdles. China will never agree to any proposal that allows the subsidies at the heart of its industry policy to be challenged.

A new study by the Center for Strategic and International Studies (https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/220523_DiPippo_Red_Ink.pdf?LH8ILLKWz4o.bjrwNS7csuX_C04FyEre) highlights the massive dimensions of the industrial subsidies that are supporting China's export machine. It estimates that the Chinese government is spending 1.7% of GDP on industry support, mainly through cheap credit to state enterprises and more general direct subsidies. That is more than it spends on defence and is equivalent to over US$400 billion at purchasing power exchange rates. It is more than twice as much in dollar terms as the US devotes to industry support and more than twice as much as a share of GDP as the next most aggressive industrial nation, South Korea.

The trade policy that the Australian Labor Party took to the election emphasises the importance of diversifying markets for Australian exports but is silent on China's fast-rising share of Australian imports, which is heading for 30%, up from a quarter before the pandemic.

The Labor policy emphasises strengthening trade relations in the region, with early ministerial visits to India, Indonesia, Japan, South Korea, Malaysia and Vietnam. India and Indonesia will receive particular focus.

Japan has been a valuable trade partner; its share of Australia's exports, which had dropped below 10% in late 2020, recently reached 18%, its highest since 2015, helping to compensate for the Chinese trade bans.

The risk for Australia is that, as China's trade surpluses with the US and the EU become politically toxic, deals are struck that, like Trump's 2020 deal with China's Xi Jinping, inflict collateral damage on Australia. The Trump deal saw the US take Chinese markets from Australia in beef, barley and cotton.

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David Uren is a senior fellow at ASPI. Image: AFP (https://www.gettyimages.com.au/detail/news-photo/this-photo-taken-on-december-6-2017-shows-a-loaded-cargo-news-photo/888029700)/Getty Images.