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Getting China Right

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When China became its largest trading partner two years ago, Australia entered uncharted territory.

For the first time in our history, our most significant trading partner is not a member of our alliance system.

Our most important trading partner is our closest ally's strategic competitor.

And our most important trading partner is not a democracy.

With each passing month, the Sino-Australian relationship becomes more complex and difficult to manage, as the strands of that relationship become contradictory and tangled.

Canberra has a schizophrenic attitude to China's rise: happy at our windfall gains in the short term, but worried over the longer term China as a great power.

In this country, we have traditionally believed that three considerations should drive our foreign policy: our security, our prosperity, and our values.

With the growing centrality of China to our international affairs, each of the three underpinnings of our foreign policy points in different and contradictory directions.

While Canberra and Beijing agree that stability in our region is the best guarantee of security, they disagree on the methods.

We would prefer that the United States be the main guarantor of regional and global security – a preference with which the Chinese disagree.

When push comes to shove, our security preferences are going to be different from Beijing's.

Our prosperity, however, demands that we are attentive to China's economic wishes.

The customer is always right – right?

For the decades to come, the demand in China and other large developing countries for our resources, energy and education exports will provide a vital buoyancy for our economy.

But even our prosperity interests in relation to China are more complex on closer inspection. Beijing has a preference for acquiring equity stakes in resource producers in the interests of price stability and long-term supply security.

Many of the companies doing the buying are state-owned enterprises, and some Australians are uncomfortable about selling to interests linked to the Chinese state.

Our values are also likely to be challenged by China.

Beijing's neuralgia about travelling dissidents, from the Dalai Lama to Falun Gong, have shown it does not accept the validity of democratic freedoms in other countries when they are seen to cut across China's interests.

China has shown over time a willingness to manipulate bilateral relationships to discipline errant partners.

Australia can no longer muddle through its relationship with China.

The chill in Sino-Australian relations this year has drawn timely attention to the need to get Australia's relationship with China right.

This is important beyond the bilateral relationship; it is a test of whether Australia has the ability to look after its interests in the coming world – a world in which our international fortunes will not be solely determined by countries that are culturally-similar to us.

What is required is a fundamental re-examination of this country's vital interests, and a clear prioritization of the values that underpin our foreign policy.

We also need to develop a clear idea of how our international environment will evolve over the next decades, and where we can fit into this milieu.

Getting China right means Australia must make the effort to better understand China, to locate where its interests lie in the context of China's development, and to articulate its position clearly to Beijing, firmly but non-confrontationally.

My friend Clinton Dines, an Australian who has lived and worked in China for 30 years, calls this approach empathy.

Empathy lies at the mid-point between sympathy and cold self-interest.

An attitude of sympathy with China will lead to Australia being exploited.

An attitude of pure cold self-interest will harden gradually into mutual antagonism.

But an attitude of empathy brings a genuine determination to try to understand the situation of the other party.

With that understanding comes a clearer appreciation of how the other party's situation affects one's own.

With that understanding comes a more realistic appraisal of where one's own interests coincide or clash with those of the other side.

With that understanding comes a more nuanced calculation of what compromises, requests, demands and demarches are likely to work and not to work.

To repeat: empathy is an act of two movements.

The first is the act of understanding the other's situation.

The second is the process of discovering one's own interests, how they are affected by the other party, and deciding which can be compromised and which must be held onto firmly.

The bad news is that both of empathy's movements are really hard in relation to China.

Arguably, that's why we don't seem to have a clear, coherent policy in relation to China.

To start with, China defies easy understanding.

It is a country that evokes extremes of opinion.

People tend to make simple, sweeping judgements about China because it is huge, complex, and changing rapidly.

It is a country of confounding contradictions.

It is an authoritarian state in which no-one exercises clear, uncontested authority.

Power and resources in China are far more fragmented among competing authorities than in Australia and arguably even the United States.

Lucien Pye captured the two contradictory impulses that lie at the heart of Chinese politics: on the one hand the urge toward consensus and conformity, but on the other the search for security and advantage in particularistic, patronage relationships which produce an inherent factionalism in Chinese politics.

The only route to power, advantage, and authority in China lies through joining a policy clique – a group of people with a common interest in the welfare and influence of each other.

The fortunes of each member of a policy clique rise and fall together.

Throughout the Chinese system of government, preferment, power and succession are determined by complex bargaining among these factions.

The rigid division of bureaucratic authority and resources is fundamental to the Chinese system of government.

It is a governmental system that is constructed to produce competing interests which jealously guard their authority for specific responsibilities, and which compete ruthlessly for resources and authority.

A further division of power occurs between the national government in Beijing and the provinces.

The reform era has if anything significantly increased the resources and power of the provinces vis-à-vis Beijing.

Between Beijing and the provinces there is a constant struggle for authority, resources and the apportioning of blame for failures in governance.

Ultimately, national and provincial government each have resources and authority the other needs, and so are co-dependent – but this does not make the rivalry any less intense.

The reform era also threw powerful, entrepreneurial and cashed-up state-owned companies into the mix.

The Communist Party is supposed to provide the uniting force over these divided responsibilities – but the Party itself is deeply affected by the inherent factionalism of Chinese politics.

The glue that holds all of this together, and which keeps China moving in basically the same direction, is constant bargaining and consensus building.

No decision, no policy in China is possible without a protracted process of bargaining and consensus building, among jealous bureaucratic units and between centre, provinces and municipalities.

Gaining co-operation and marshalling sufficient resources can only be achieved through a constant process of negotiating and re-negotiating, of generating side-bargains and sweetheart deals, of satisfying or mollifying all relevant interests.

Ken Lieberthal and Michel Oksenberg capture Chinese politics nicely when they write:

China is held together by the formal structure of authority, by the networks of individuals bound by mutual obligations and loyalties who are embedded in the formal organizations, and by the total web of bargains among the hundreds of thousands of units which comprise the system.

So the simplistic understanding of Chinese politics – of an authoritarian centre imposing its absolute will by diktat and force – couldn't be further from the truth.

What is truly astounding is how such a factionalised and complex system of government has been able to hold 1.3 billion people together, and move them all in the same direction down a path of breath-taking reform.

But understanding the nature of Chinese politics, that policy outcomes are more often than not the result of prolonged haggling, compromises and power plays, is the first move we need to make in understanding China.

Another common belief is that China is no longer a Communist country.

The best apparent evidence of this came this year, when for the first time in history a Communist country was in a position to destroy global capitalism.

At the height of the global financial crisis, China could have sold its \$763 billion in US treasury bonds and finished off the global economy.

Instead, Beijing did everything in its power to stabilise the system, including buoying the value of the greenback.

While market reforms are fundamental to China's phenomenal success, to believe that China is on the road to capitalism is to misunderstand what's actually happening.

The state's control over exchange rates, the capital account, investment and infrastructure, energy pricing and development planning shows an economy that is a long way from being capitalist.

Neither are these temporary states of affairs soon to be abandoned along the inevitable road to capitalism.

In a recent careful study, Derek Scissors shows that the current administration of Hu Jintao and Wen Jiabao has reversed some of the pro-market reforms of the Jiang Zemin era.

And listening to the thinkers within the Communist Party is even more sobering.

They are in little doubt that history is on the side of socialism.

It was Marxist thinkers who first foresaw globalization; it is Marxist thinkers who are best able to see and exploit its contradictions.

The Party is in little doubt that China is constructing socialism; that history is on their side; and that Chinese socialism will eventually bury capitalism.

Probably the dominant popular perception of China is that of an economic superpower.

The factory of the world.

The holder of two trillion dollars of savings.

Almost every country's major trading partner.

With twenty years of near-ten percent economic growth rates, the dynamo of the world economy.

In reality, China's economy is about one-third of the size of California's.

The image of China as the coming economic juggernaut is an extraordinarily powerful one.

It is an image that China has become adept at using to its advantage.

No other country is so willing to use, and so successful at using, the terms of its bilateral relationships with other countries to exact what it sees as appropriate behaviour from them.

China seeks "friendly" relations with all countries.

But for Beijing, friendship entails clear obligations among its friends.

No formal relations with Taiwan. Recognition that Tibet and Xinjiang are part of China. Not speaking too loudly about human rights.

Otherwise friendship is not apparent, and access becomes difficult.

There are subtler shades to Beijing's shaping of its *guanxi* – its web of relationships with other countries.

China's deepest fear is that Washington will mobilise a coalition to isolate, contain, and economically strangle China.

In response, in a remarkably short time, China has been able to inculcate a generalised belief that the rest of the world cannot let China's economic miracle fail.

To let China fail would be to stall the global economy.

And there are variations on this theme. At the height of the tensions over the negotiation of an iron ore price, Chinese negotiators reportedly said to their Australian counterparts, "We're saving the world economy, and here you are trying to stiff us on an iron ore price?"

Even given its current size, most economists now concur that on current growth rates, China will have the world's largest economy by the mid-2020s.

But even as the world's largest economy, China will have a per capita wealth of X, around the same as that of Y and Z today.

In other words, along with India, China will be the poorest great power in history.

This has important implications for how it behaves in the world.

Beijing looks out at the world as having been stitched up by wealthy countries, which designed its institutions in their own interests, control the commanding heights of the

global economy, dominate the world's technological frontiers, and own all of the choice assets.

China's increasing flow of outbound investment is not just about economic imperatives and resources supply security.

It is about gaining a seat at the tables at which the big decisions on the global economy are taken.

It is about gaining a voice commensurate with China's role in the world economy.

But it's about more even than this – because for Beijing there's a principle at stake.

Encouraged by general and magnanimous calls for it to become a “responsible stakeholder” in global affairs, five years ago China embarked on a major phase of outward investment.

What it met with was not encouragement but carping.

China, it seems, was prepared to deal with unsavoury regimes in order to gain access to resource assets that hadn't already been stitched up.

These were accusations made by countries with not only commercial relationships, but alliances, with Saudi Arabia, Pakistan and Nigeria.

The real slap in the face came when China's oil company, CNOOC, made a very generous offer for a large stake in the American firm Unocal.

What we saw was an extraordinary fear campaign, orchestrated in part by competing commercial interests, over Chinese investment in an American icon.

CNOOC quietly withdrew its offer, but don't underestimate the impact of this episode in Beijing.

The rich boy's club doing everything in its power to protect its privileges.

The conclusion is that China has to play hardball. The global economy is not the free market depicted in economics textbooks.

Underpinning much of China's drive is a burning need for recognition.

The motive force is China's victimology, its national religion.

It is a heightened awareness that China, one of the world's great civilizations, faced a century and a half of humiliation at the hands of foreign colonialists.

I note in passing that elements of another of the world's great civilizations, Islam, are also reacting aggressively to perceived humiliation at the hands of the West.

In China's case, there is a powerful state that can articulate the demands of the civilization.

For the Chinese, the only atonement can be the world's full recognition of China's return to greatness.

But it is a mindset that makes Chinese nationalism so brittle.

It makes Chinese people react with great anger and hurt when others are seen to denigrate China. We saw this during the demonstrations over the Olympic torch last year.

It creates an exploitive cynicism in commercial dealings with foreigners.

Yet here again we confront another paradox.

A civilization so aware of its superiority, so determined to assert its rights, is terrified of leadership.

Confronted with an extraordinary proposition that it should form a "G2" with Washington to take the lead in solving the world's problems, Beijing couldn't have been less interested.

Instead, this authoritarian state has for decades been calling for the "democratization" of international affairs.

Meaning that no one state, or small group of states, should presume to dictate global affairs.

Beijing seems more intent on dismantling the concept of leadership in world affairs than in assuming a leadership position itself.

In a nutshell, what we face in a rising China is a phenomenon with which we are utterly unfamiliar.

We have no established templates for understanding what's happening here.

Our historical models for rising great powers aren't of much use to us.

This rising power is not conforming to the usual script of rising powers.

It is making no extravagant demands for leadership.

It is not raging against the established order.

Some say China is biding its time until it rises.

My question is, when will China decide it has risen?

I am no-one's excuse for a China expert, but I think taking a look beyond the clichés about China shows us three important things.

First, China's structure of government means its actions are rarely strategic or cunningly calculating.

Chinese policy is more often the result of chaotic competition or complex bargains and side payments among state agencies.

But this is not to say Chinese policy is naïve or self-harming all the time. Chinese policy makers also show an intuitive feel for tactical advantage in the situations they confront.

Second, China may be willing to play by the international rules, but it has no emotional or principled buy-in to those rules.

No country understands better how supposedly impartial rules can be used as weapons than the country that was excluded from its seat at the United Nations for twenty years.

We should be careful not to overestimate how far China can be socialised into our system of rules as a responsible stakeholder.

And we should not underestimate the extent to which this view of international order provides justification for treating those rules instrumentally if there is advantage to be had by doing so.

Third, we will wait a very long time if we think China is about to assume a formal leadership role in international affairs in partnership with other great powers.

Beijing is comfortable with some of the trappings of leadership, but is highly averse to being isolated on international issues.

It has not been able to articulate a vision for international order beyond its general assertions of states' rights.

As I said earlier, empathy is an act of two movements.

The second movement is a process of discovering one's own interests, how they are affected by the other party, and prioritizing which can be moderated and which must be held to firmly.

So what are Australia's interests, and how are they affected by China's rise?

In general terms, we tend to parcel our interests into three bundles: our security, our prosperity, and our values as a society.

At the moment, our security and values seem to want to pull the relationship in a different direction from our prosperity interests.

A simple answer to this conundrum would be that if we want to prioritise our prosperity, we should be prepared to compromise on both our security relationship with the United States and some of our democratic values, about who we allow into this country and what we allow them to say.

Or that we should not compromise our alliance with America or our democratic values at any cost, and so therefore should be prepared to accept a lower level of economic growth and prosperity, and a basically confrontational relationship with China.

To some extent, it is these two positions that have begun to define what passes for public debate on China in Australia.

The old “Panda hugger” versus “China basher” debate.

Like so many other polarised debates, it makes for good media controversy but very poor policy.

And if allowed to start to shape public attitudes, it could shape and constrain government policy making on China to our national detriment.

Smarter policy must come from a first-principles understanding of our interests and how they are affected by China’s rise.

Beyond this, our policy must be clearly articulated and presented to the public, to help shape public discussion of China, and avoid the temptations of fear-mongering.

So, back to our interests, starting with our security.

Australia has never been able to defend itself on its own, and likely will never be able to.

It is usual to say that we have therefore looked to “great and powerful” allies for our defence.

Not so.

If we were forced to rely just on an alliance we would be in a very precarious position.

Our allies are global in their interests: always distracted, always stretched, often with interests and interpretations different from our own.

Australia’s defence rests not on a specific alliance commitment, but on the structure of the international system built by its powerful allies in ways congenial to our security.

We have always fought to uphold that order, and we expect that others will be eventually assimilated to this order.

China’s rise is pushing against this international order.

Beijing does not view the international order as benignly as we do.

An order underpinned by a network of United States allies ranged around China’s coastline.

An order which means it must transport the energy and resources it depends on over seas patrolled by the navy of the United States, a country that has repeatedly proved itself willing to cut off others’ fuel supplies in order to pressure them to do what it wants.

An order that asserts the rights to speak of those who challenge the rule of the Communist Party of China.

China will push against this order, though it is unlikely to challenge it directly.

Those who predict an imminent shift from an American-dominated region to a Chinese-dominated region predict too much.

Too many countries in this region prefer a strong American presence, and few have shown a willingness to align decisively with Beijing.

Our interests are clear.

Our commitment to the current regional security order is non-negotiable.

But our interests in maintaining the integrity of that order must stretch to accommodate the region's changing power equation.

If it is inflexible, it will be brittle, prone to miscalculations and mistakes.

We should be working with Washington and its allies in the region to ensure that regional security arrangements evolve to allay China's legitimate concerns as much as possible.

The system of bilateral US alliances in the Pacific is 50 years old, and the original reason for its existence vanished 20 years ago.

It needs to be re-articulated with a clear mission for the 21st century: as a network of mutual security commitments to maintain order and stability as the states of the region become richer and more powerful.

Joint naval responsibilities for maintaining maritime security; a common vision and approach to the integrity and security of energy supplies.

For its part, China will have to come to the party too.

Beijing must be encouraged to remove the incentive for its neighbours to flock to Washington's skirt hems.

It must as a start be convinced to abandon its cartographic aggression in the South China Sea.

These are basic issues that must be addressed. If they are not, no amount of regional negotiation will paper over the basic tensions.

Let's move on to our prosperity interests.

Australia was built by trade and will always depend on being able to trade with the rest of the world.

We have a vital interest in the integrity of a rules-based global trade and investment order.

At the moment we seem to be blessed in having a lot of the things that are in increasingly urgent demand in global markets: resources, energy, food and services.

But we need to look beyond the current boom.

China, and other powerful countries, are in the uncomfortable position of having to import increasing amounts of the things they need to maintain their development progress.

In times of rising concern about the supply of strategic resources and energy, Australia needs to start to recognise that these are not purely commercial matters.

What may look like clever business from our perspective can be strategically alarming to those relying on imports of vital supplies.

What look like expedient, one-off decisions from our point of view can be interpreted as part of a larger, worrying policy position to others.

Australia needs to form a clear sense of the global significance of its resources, energy and food assets in an era of tightening global supply.

We need to accept that some of our customers will want to invest in the production of these commodities in Australia.

Above all, it is fundamentally our interest to ensure that the current open trading system in resources, energy and food is maintained at all costs.

The danger is that the emerging trend towards national control of strategic materials production will extend to trade and distribution.

Nothing will trigger destructive conflict faster than powerful countries competing over stitching up resources and energy supply deals.

In such a conflict Australia is a prime target.

As a major producer, Australia can be a prime force in upholding the integrity of global resources, energy and food markets.

Indeed, we should be making common cause with some of the other major producers to advance this goal.

At home, Australia needs to articulate clear rules about what types of investment are welcome, and what types are not.

On the one hand we should be skeptical about simplistic claims that by allowing Chinese investment we are permitting the Chinese state to buy up our resources.

Previous waves of investment, from Britain, America and Japan, have not resulted in the wholesale exploitation of Australia.

On the other hand, we need to be mindful of the potential vulnerability of private companies to demands for access to Board seats – when the objective is to gain access to commercial intelligence that can be used to bargain down prices.

Our prosperity interests lie in articulating clear foreign investment and merger rules that apply to all comers, while at the same time helping Chinese companies understand the logic and limits of the markets they're playing into.

Finally, our values – the principles which define us as a society and underpin our way of life.

Our values, I think, can be thought of as a series of concentric circles.

The innermost circle contains those principles that determine how we choose to live.

The next circle out includes those principles – which are part of how we choose to live – that we are concerned about people in other countries having.

The outermost circle is a system of global principles, of general norms of human rights embodied in a plethora of Charters, Declarations and Resolutions.

Ultimately each level is important to allowing us to live our lives as we wish to.

Of course, striving for a completely consistent set of values is a pointless task.

Security and prosperity are, of course, also values.

We have found as a nation that the high priority we place on security and prosperity at times require a compromise over some of our other values.

Ultimately the challenge is to make sure that the priorities we assign, and the compromises we make, do not compromise the general principles that define us and the way we wish to live.

China's success challenges our values from the outside-in.

It is adamant that neither the system of global human rights norms nor the concerns of liberal democracies for the rights of people outside their borders impinges on the authority of its rule within its borders.

Less frequently, when our domestic actions are seen to challenge China's integrity, it challenges the innermost circle of our values.

It demands that we deny its exiles visas and the freedom to speak publicly in Australia.

Our interests here must be to defend our values most vigorously in this inner circle.

At no point, and for no stakes, can we compromise the basic democratic freedoms of Australia.

We should send this signal consistently to Beijing – firmly but not confrontationally.

At the same time, we must recognise how important global human rights norms are to our own system of values.

The consistency and applicability of these norms must be upheld as much as possible.

And the middle circle – our concern for the rights and conditions of those who are not our fellow citizens – is important in that it makes our values not just about *us*, and *our* wellbeing, and how *we* live.

But we must also recognise that while China wants to lower its execution rates, reform its legal system, and reduce its incarceration numbers, it is not likely, any time soon, to transform into a liberal democracy like us.

We need to confront this reality directly.

We need to realise that, like us, China also has these three concentric circles of values.

Like us, China has certain red lines that it will not compromise on, particularly relating to its inner circle of values.

The challenge for Australia-China relations in the future is to find areas of values conflict and work on these.

Once again, we need to exercise empathy, recognizing China's genuine desire to reduce execution and incarceration rates and improve its judicial processes.

But acknowledging also Beijing's deepest fears of social chaos.

Its fundamentally different attitude towards dissent.

There is room for much more exchange here.