FINANCIAL REVIEW

Donald Trump is right, China cheats on trade

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When Xi Jinping strutted among the world's finance elite in Switzerland last month to champion China as the saviour of globalisation just as Donald Trump was abandoning a huge Pacific Rim trade accord, US business leaders and foreign affairs experts bristled with incredulity.

No sane US executive or diplomat believes Trump should execute his campaign threat to ignite a trade war with China by slapping a 45 per cent tariff on its goods. Yet there is widespread belief that some of Trump's loud complaints about Beijing cheating on trade have genuine merit.

Under the stridently nationalist leadership of Xi, China has regressed to deep mercantilism – propping up exports, suppressing imports and limiting foreign investment.

The Chinese industrial playbook consists of restricting market access for foreign technology, media and advanced manufacturing firms, intellectual property (IP) theft, cyber hacking of offshore competitors, buying foreign rivals in strategically important sectors and favouring state-owned enterprises.

US business has been the No.1 victim and has had a gutful of the unlevel playing field.

For all his overblown bluster about China destroying US manufacturing jobs – automation is a bigger factor – and outdated claims about artificial yuan devaluation, Beijing is now trying to strengthen the currency, Trump has tapped into legitimate misgivings.

Susan Shirk, a former senior US diplomat responsible for Asia policy in the Bill Clinton administration and now chair of the 21st Century China Centre at the UC San Diego School of Global Policy and Strategy, says America needs to show more "firmness" against Xi's protectionism.

"President Trump has actually identified some of the problems in US-China relations on unfair trade practices," she says.

"But what to do about it? Across the board tariffs or rejecting the One China policy would be very radical actions and a mistake."

Investors on edge

In a world where globalisation is on the nose and free trade is suddenly a dirty phrase, investors are on edge about the possibility of a trade clash between two jingoistic leaders of the world's largest economies.

Both have domestic audiences to gratify; Trump has working class voters in rustbelt manufacturing states to play to. Xi has to show strength to Communist Party members before the 19th National Congress of the party later this year, at which he needs to be re-elected leader for another five years.

Positively, Trump sent a letter to Xi this week, expressing hope for a constructive relationship, in a retreat from his hyperbolic rhetoric labelling China a currency manipulator.

Discontent in the US about China's economic nationalism may be news to many Australians.

Local business leaders fell over themselves swooning over Xi's preaching – but not practice of – international trade at the World Economic Forum in Davos, Switzerland.

Beijing and Canberra inked a free trade deal in 2015, which allowed Australian farmers and select service industries such as education and aged care to increase sales to China.

Perhaps blurring Australia's perspective, mining commodities, education and tourism make up the majority of its exports to China.

Fortuitously, China has insatiable demand for all three and it would be counterproductive for Beijing to impose trade barriers.

Australia's role

Expressing a glass half full view that contrasts with the US, a senior Australian government source says China is gradually opening up its economy.

In January, Beijing unveiled plans to attract foreign investment and improve market access in more than 20 industries. The proof will be in the scope and pace of delivery.

Trump, and his anti-China advisers, including Death by China author Peter Navarro, want more liberalisation by Beijing.

Australia, as a middle power with a strong interest in sound relations between the US and China, has a role to play, close observers say. The Turnbull government will need to lobby against Trump's blunt tariff instinct and channel it into targeted responses to China's trade problems.

Foreign Affairs Minister Julie Bishop and Trade Minister Steve Ciobo also need to prod China on the pace of economic reform to open up its economy and deliver sustainable growth.

"I think Australia and other countries dealing with China could encourage China to make good on President Xi's suggestions that China is going to be a leader," says Cato Institute senior trade fellow Dan Pearson, a former chairman of the US International Trade Commission.

The 16-country Regional Comprehensive Economic Partnership that China is promoting is a modest step. However, the tariff cuts and other reforms proposed under RCEP are relatively modest compared with the 12-country Trans-Pacific Partnership (TPP) that Trump withdrew from last month.

The Chinese-inspired Asian Infrastructure Investment Bank has also been welcomed outside the US as a sign Beijing is displaying global economic leadership.

Nevertheless, Xi's version of globalisation is vastly different to the US capitalist model that has dominated world economics for decades.

Closed economy

According to an Organisation for Economic Co-operation and Development report measuring foreign investment restrictiveness, China ranked as the second most closed economy out of 58 surveyed and is significantly behind other major emerging economies: Brazil, India, Mexico, and South Africa.

A business climate survey released in January by the American Chamber of Commerce in China, in partnership with Bain & Company, found that eight in 10 foreign companies feel less welcome than in the past, and more than 60 per cent have little or no confidence that China is committed to opening its markets further in the next three years.

David Dollar, a Brookings Institution senior fellow and former US Treasury emissary to China from 2009 to 2013, says Beijing is partially opening manufacturing, but car manufacturers such as Ford and General Motors have to operate through "awkward" 50-50 joint ventures with local partners.

"Most of the modern services sectors such as finance, telecommunications, media, and logistics are almost completely closed to foreign investment," Dollar says. The US needs to play "responsible hardball" against China.

Silicon Valley tech companies have spent billions of dollars trying to break into the lucrative Chinese consumer market. But many have been blocked, forced into joint ventures, faced censorship or ordered to transfer secret technology to China.

A Beijing court in June required Apple, perhaps the world's most innovative company, to stop selling two iPhone 6 models because they were too similar to a Chinese brand.

Technology giant IBM in 2015 succumbed to pressure to become the first foreign firm to hand over its confidential source code to China in a secure environment, according to The Wall Street Journal and Chinese state media.

Qualcomm, a US chip maker, was fined $US975 million in 2015 for violating China's anti-monopoly law. It was ordered to offer its licences for high-speed wireless data to smartphones at a steep discount to Chinese firms.

Social media

Facebook has been banned from the internet in China since 2009, despite Mark Zuckerberg's lobbying efforts (not to mention learning Mandarin), Twitter has also been firewalled. Meanwhile, China's social media platforms Weibo and WeChat have boomed.

At the same time, Chinese firms including Alibaba enjoy open access to the lucrative US market.

It gives Trump, who hosted Alibaba founder Jack Ma last month, a powerful and simple political argument that US companies are not allowed to do the same things as Chinese businesses.

It mirrors emotive arguments thrown up by One Nation leader Pauline Hanson and Nationals MPs who point out that China can buy up farms, mines and apartments Down Under but Australians can't reciprocate in China.

In financial services, US giants Visa and MasterCard have struggled to penetrate the Chinese market for yuan card transactions, facing regulatory hurdles against local monopoly China UnionPay.

Charlene Barshefsky, a former US Trade Representative for president Clinton and now senior international partner at law firm WilmerHale, says Xi has reverted to "highly aggressive mercantilist practices" that harm US companies and halt the necessary China domestic reform progress of past leaders.

"These policies especially target higher tech and strategic sectors like IT, biotech, artificial intelligence and advanced manufacturing," she says.

In December 2015 the Obama administration laid criminal charges against five Chinese military officers for allegedly hacking and stealing commercial secrets from aluminium producer Alcoa, Westinghouse Electric, US Steel, SolarWorld, Allegheny Technologies and the country's largest trade union, United Steelworkers.

In another case, SolarWorld rapidly lost market share to Chinese competitors after Chinese hackers stole cost, pricing and strategy information.

A report by the former director of the US National Intelligence under former president Barack Obama, Dennis Blair, and former ambassador to China, Jon Huntsman Junior, concluded in 2013 that China is the world's largest source of IP theft, accounting for 50-80 per cent of the problem, especially in technology and science.

"National industrial policy goals in China encourage IP theft, and an extraordinary number of Chinese in business and government entities are engaged in this practice," the report says.

Two weeks before Obama left the White House his science and technology council published a report warning that China's industrial policy posed a threat to the competitiveness of the US semiconductors – microchips that control all modern electronics.

Curious case

Motivated by economic and national-security goals, Xi is spending $US150 billion over a decade to build a semiconductor industry, including by buying offshore players in the US and Europe.

A detailed investigation by The New York Times published in September 2016 showed the curious case of German high-tech firm, Aixtron. Its Chinese customer, San'an Optoelectronics, belatedly cancelled a big order and Aixtron's stock price plunged. A few months later a Chinese investor, Fujian Grand Chip, agreed to buy Aixtron. According to the Times, San'an had financial links to Fujian.

An Asia Society taskforce report released in the US this week, which Barshefsky co-authored, makes recommendations for the Trump Administration to pursue with China on trade and investment.

First, enforce China's international trade commitments and strengthen US laws to counter unfair trade and investment practices.

Second, negotiate new agreements with China that help spur domestic economic reforms by Beijing.

In Australia, Prime Minister Malcolm Turnbull must try to convince China to do the right thing by the US on trade and he must stop Trump stooping to counterproductive tariffs against Australia's largest trading partner.