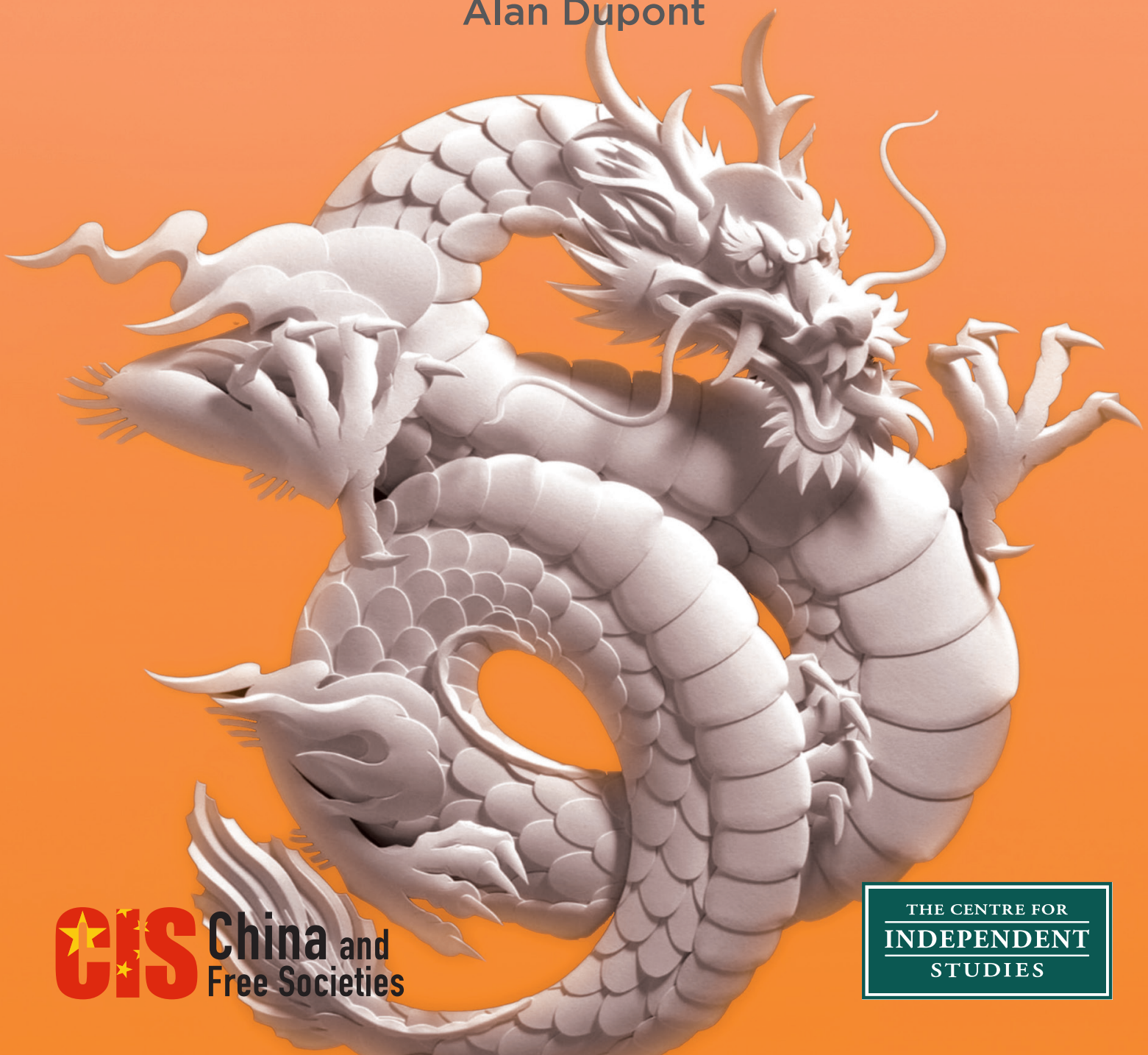


RESISTING CHINA'S ECONOMIC COERCION: WHY AMERICA SHOULD SUPPORT AUSTRALIA

Alan Dupont





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POLICY Paper 38

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Executive Summary

China's recent trade actions against Australia offer a case study in economic coercion for geopolitical purposes. Capitulation to coercion would embed its malign use in a new China-dominated authoritarian world order, in which smaller states risk being reduced to vassals.

Conversely, US support for Australia would send a powerful signal to friends and competitors alike that Washington is prepared to resume a global leadership role after the chauvinism of Donald Trump's America First approach. It could also stimulate the emergence of a more formal alignment of democracies, strengthening their collective ability to stand against China's coercive practices and by extension the

authoritarian, state-dominated model that China promotes.

Countering China's coercive diplomacy and power trading is a necessary defensive measure to protect the prosperity and security of every nation that values its sovereignty and an open trading system. Canberra has shown the way forward, but needs Washington's support. If Australia fails to maintain its independence in the face of China's mounting pressure, other countries may well conclude that appeasement is the only feasible alternative. That would signal the end of American pre-eminence and the rules-based global order the US created and led for more than seven decades.

Resisting economic coercion

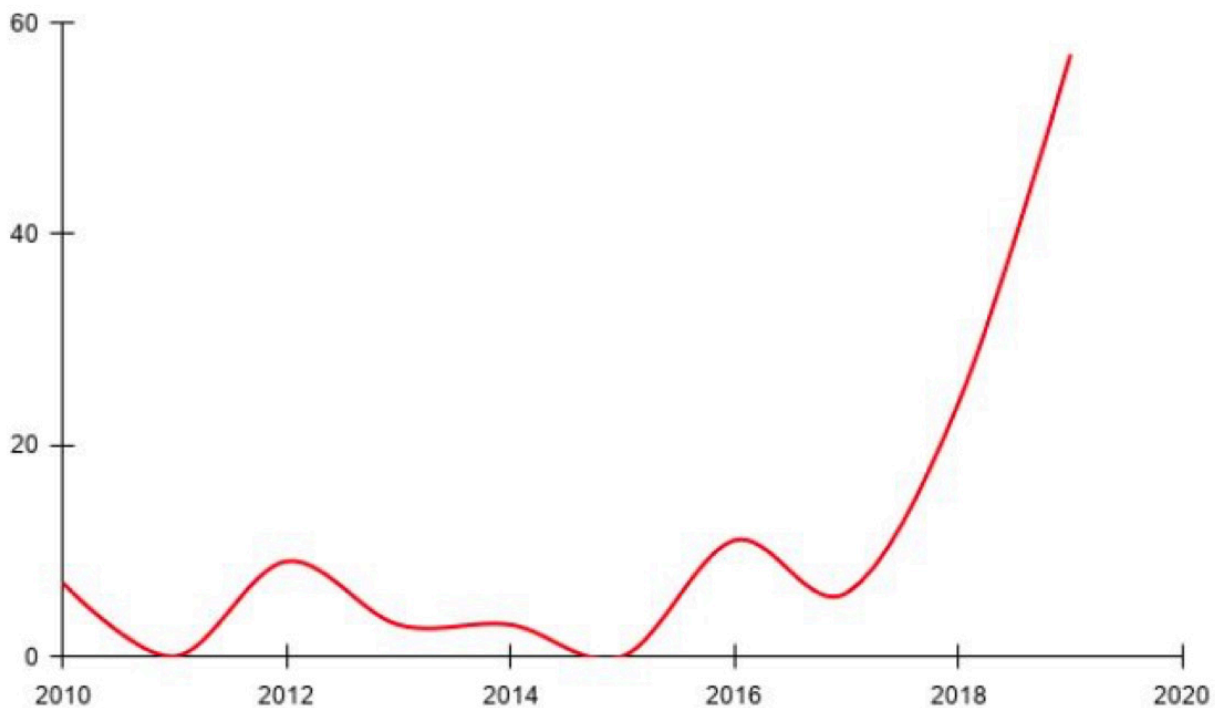
President Joe Biden has made it abundantly clear that the cornerstone of his foreign and trade policies will be working with friends and allies to restore American leadership and advance the cause of democracy in a more contested world. But in the face of China's epochal challenge, neither goal will be achieved unless the Biden administration demonstrates tangible support for hard-pressed democratic allies like Australia. The 'Land Down Under' has been on the receiving end of an unprecedented campaign of intimidation and coercion from Beijing, clearly designed to bend Australia to China's will and decouple it from an alliance system that has underpinned and sustained American power for 75 years.

Senior administration figures have publicly declared their support for Australia, telling their Chinese counterparts that relations won't improve until they

cease their "blatant economic coercion of Australia" and "a more normal interplay between Canberra and Beijing is established."¹ But they have yet to spell out how they intend to address the issue. Unless Washington imposes costs on nations that use coercion, China has little incentive to stop using a tactic that has been successful in forcing smaller countries to submit to its demands.

Under President Xi Jinping, economic statecraft has become an integral part of a distinctive approach to foreign and trade policy in which coercion is used for geopolitical purposes to cement China's place as a leading global power. Beijing also uses inducements — in the form of investment, trade and development assistance — to reward countries. When skilfully orchestrated, these inducements encourage compliance and the formation of pro-China constituencies within targeted countries, making it

Figure 1: China's economic and coercive diplomacy 2010 to 2019.



Source: Australian Strategic Policy Institute

more difficult for their governments to resist Beijing's demands.² Although important, this paper examines the lesser-known coercive dimension of China's trade and foreign policies — using Australia as a case study — and proposes a countervailing strategy.

The use of coercion to achieve geopolitical ends is not new or confined to China. In an insightful analysis of Albert Hirschman's largely forgotten 1945 book, *National Power and the Structure of Foreign Trade*, economist Robert Atkinson details how autocratic German regimes weaponised trade policy in the first half of the 20th century to achieve global power.³ Pre-World War 2 Germany was a "power trader", manipulating trade for military and commercial advantage. But Xi has refined, and modernised, the use of coercive tools to threaten the independence and sovereignty of other states and undermine the foundational principles of the international trading system.

Over the past decade, there have been 152 recorded cases of Chinese economic and diplomatic coercion affecting 27 countries.⁴ They include de-facto trade sanctions, boycotts and investment restrictions that transgress established norms and exploit weaknesses in World Trade Organisation rules. The most common non-economic measures are arbitrary detention, restrictions on official travel and state-issued threats.

These coercive practices have increased sharply since 2018. No country has suffered more than Australia, which once enjoyed a warm and productive

relationship with Asia's rising power. Of the 27 affected countries, Australia was subjected to the highest number of recorded cases of Chinese coercion (17 cases), followed by Canada (10 cases) and the United States (9 cases), reflecting the sharp rise in bilateral tensions over a range of political, economic and geopolitical disputes.⁵ They culminated in the publication of an extraordinary list of 14 Chinese grievances against the Morrison government and the imposition of a raft of punitive trade measures on Australian coal and the agricultural sector that have cost exporters billions of dollars in lost revenue and plunged the bilateral relationship into a deep freeze.⁶

The souring of Australia-China ties is a salutary warning to other countries that they may be next if they fail to comply with Beijing's demands. Even the US will not be immune. In the simmering trade and tech war between them, China is chipping away at traditional American strengths. The fundamental problem for the US, as Kurt Campbell — Biden's Asia tsar — acknowledges, is that coercion threatens "the existing order's organizing principles and legitimacy."⁷ But Xi's power trading also aims to weaken the US alliance system by peeling away the core democracies that sustain it.

America's democratic Asian allies have all been targeted. Often referred to as the 'northern anchor' of the US alliance system in Asia, Japan came under early coercive pressure when China leveraged its near-monopoly of rare earths — used in the

production of a wide range of military and commercial applications – to remind Japan of Beijing’s economic power.⁸ In September 2010, China suspended exports of rare earths to Japan, forcing Tokyo to turn to a small Australian company that produced the only other significant quantity of the processed ore.⁹ Seven years later, South Korea found itself on the receiving end of an 18-month orchestrated campaign of threats, intimidation and economic punishment from Beijing after allowing the US to station elements of a missile defence system on a golf course outside Seoul.¹⁰ Chinese officials have restricted the number of tourists visiting implicit US ally Taiwan in response to Taipei’s “independence activities.”¹¹ And Australia has struggled to prevent China from establishing ports, airfields and infrastructure in nearby Papua

New Guinea and small Pacific Island states that could eventually be militarised and bring the Peoples Liberation Army to Australia’s doorstep.¹²

Capitulation to coercion would embed its malign use in a new, China-dominated authoritarian world order in which smaller states risk being reduced to vassals. Conversely, US support for Australia would send a powerful signal to friends and competitors alike that the US is prepared to resume a global leadership role after the chauvinism of Donald Trump’s ‘America First’ approach. It could also stimulate the emergence of a more formal alignment of democracies, strengthening their collective ability to stand against China’s coercive practices and by extension the authoritarian, state-dominated model that China promotes.

China’s playbook

Understanding how China operationalises coercion is the key to developing effective policy responses. Australia is an instructive case study. It has the dubious distinction of being punished more severely than any other country and its resistance shows that China’s coercion can be withstood with fortitude and smart power, even in the absence of collective action. The early signs that Canberra might have a China problem were largely ignored by Australian political, business and university elites heavily invested in the China growth story. Admittedly, in 2015, the picture looked decidedly different. After decades of stellar trade growth, China had become Australia’s largest trading partner and export market. The signing of a watershed Free Trade Agreement and a ‘strategic partnership’ seemed to signal the beginning of a new golden era in which the two countries’ highly complementary economies would be the platform for closer political ties.¹³

But even before the ink was dry on the FTA, the relationship began to run into geopolitical headwinds. The Turnbull government pushed back against China’s illegal militarisation of disputed islands in the South China Sea and attempts to interfere in Australia’s domestic affairs. Rising concerns about the national security implications of China’s control of Australia’s 5G telecommunications rollout led to a world-first ban on Huawei and the rejection of bids by Chinese companies for stakes in the electricity grid and other critical infrastructure. Canberra also began to speak out about China’s ill-treatment of its Uyghur population and harsh crackdown on the democracy movement in Hong Kong — drawing Beijing’s ire and accusations that Canberra was ‘doing Washington’s bidding’.¹⁴

The first inkling that China had decided to teach Australia a lesson was unusually trenchant criticism of the Morrison government’s call for an independent

inquiry into the origins of the coronavirus in March 2020, as the pandemic began to spread rapidly across the globe. This cast doubt on Xi’s narrative that he had moved with alacrity to manage the virus — a narrative that was discredited by some of his own doctors and a January 2021 independent inquiry which found that Chinese authorities could have acted “more forcefully” to protect public health.¹⁵ Foreshadowing retaliation, China’s Ambassador to Australia, Cheng Jingye, called the decision a “dangerous” move that could lead to an economic boycott.¹⁶

It didn’t take long for Beijing to act on Cheng’s threat. Beef shipments from Australia were suddenly suspended in May, followed in rapid succession by disruptions to exports of coal, barley, wheat, lamb, seafood, timber and wine. It soon became clear that the Morrison government’s farming constituency was being deliberately targeted in a tactic reminiscent of the tariffs imposed on the produce of US farmers at the height of the trade conflict with China in 2018. Reaching into their extensive trade coercion toolbox, Chinese officials used a variety of disruptive measures from the blunt to the artful. Among them were undeclared boycotts, administrative go-slows, a 200% tariff on Australian wine and refusing to unload cargo — stranding up to 80 ships loaded with coal for almost a year and leaving tons of prime lobsters and fresh food to rot. Affected Australian exporters took an estimated \$16 billion (A\$20 bn) hit to their revenue in 2020.¹⁷

Publicly, China resorted to plausible deniability. Officials dismissed Australian concerns as unfounded and Xi maintained his customary aloofness at arms-length from the developing crisis. Any illusions that this was a normal trade dispute to be resolved by negotiations or quiet diplomacy were quickly dispelled. Chinese ministers refused to take calls from their Australian counterparts. The state-run

media ran a campaign of threats and denunciations against Australia with the Chinese Community Party's hawkish daily, *Global Times*, warning the "writing is on the wall" for the relationship unless Canberra reversed course.¹⁸ And in a particularly egregious

example of inflammatory overreach, Ministry of Foreign Affairs spokesman Zhao Lijian — a leading 'wolf warrior' diplomat — tweeted a confected image of an Australian soldier on operation in Afghanistan appearing to slash the throat of a child.¹⁹

Why is China punishing Australia?

If the Biden administration is to take a leadership role in helping Australia and other targeted nations to defend themselves against China's coercive practices, it must first understand why Australia has been singled out for punishment, what's at stake, and what can be learned from China's tactics and Australia's response.

Simply stated, Australia is being punished for failing to kow-tow and acknowledge China's hegemony in Asia using a tactic known colloquially as "kill the chicken to scare the monkey" — a blunt warning to other countries that non-compliance will not be tolerated.²⁰ Xi can't afford to have "small" nations defy him because, in his mind, this would undermine China's authority and position in the world. Australia is an acute risk as an influential, democratic middle-power and ally of the US, China's main competitor for global leadership. Xi fears that Canberra's defiance could embolden others to resist his mix of blandishments and heavy-handed coercion leading to the emergence of an anti-China coalition that could threaten his expansive ambitions.

But these strategic considerations don't fully explain China's rhetorical assault. Xi's anger seems tinged with a personal edge born of disappointment that the political capital expended in wooing Australia over decades has failed to inspire obeisance. Retribution has been swift but lacking in emotional intelligence, displaying all the hallmarks of the cultural autism that frequently drives China's responses to the outside world. As Bilahari Kausikan, a former head of Singapore's Foreign Ministry observes, the "ethno-nationalism that animates Chinese policies often leads to arrogant, diplomatically clumsy and tone deaf — if not culturally autistic — behaviour."²¹ Zhao's tweet depicting Australian soldiers as child killers was a calculated barb designed to appeal to nationalist sentiment in China and portray Australia in the worst possible light, to undermine Canberra's moral standing. But it was a profound misreading of Australia's democracy.

Lessons from Australia's response

Australian public opinion has shifted decisively against China as puzzlement over Beijing's actions turned to bewilderment, and then anger; stripping away the illusion that China's rise would be an unalloyed good for the country. A Lowy Institute Poll captured the shift in sentiment, finding that trust in China was at its lowest point in the history of the Poll with 94% of those surveyed wanting the government to reduce economic dependence on China.²² These findings were reflected in a Pew Poll showing that unfavourable views of China had reached historic highs in a majority of surveyed countries, topped by Australia with the biggest negative shift.²³

As it became clear that China's actions were premeditated and politically motivated, the Morrison government pushed back. It refused to engage in tit-for-tat rhetorical exchanges to limit the political and trade damage; asserted Australia's right to make "sovereign" decisions on issues considered fundamental to its interests and security; contested

China's justifications for its trade actions in the court of public opinion; accelerated trade diversification; enlisted the support of friends and allies; took China to the appellate court of the WTO; but left the door open for eventual reconciliation.²⁴

Three conclusions can be drawn from Australia's experience. First, there is an inverse relationship between coercion and independence. Xi's use of economic pressure for geopolitical ends would have been far less effective if Australia had not allowed itself to be seduced by the vast promise of the China market. In 2019/20 Australian exported \$116 billion (A\$150bn) of goods to China representing nearly 40% of total exports, an unusually high level of export dependence on a single market.²⁵

Second, although China's trade bans have been extremely disruptive Australia has been able to manage the fall-out through a combination of judicious crisis management and the law of

unintended consequences. Surging iron ore prices, driven by a spike in China's infrastructure spending, have more than compensated Australia for the loss of income from coal and primary exports and made it virtually impossible for China to suspend shipments of Australian iron ore.²⁶ Doing so could devastate the Australian economy. But it would also be a serious act of economic self-harm since China's critical manufacturing sector relies on Australia for 60% of its iron ore and there are no immediate substitutes. The lesson here is that co-dependency reduces vulnerability to economic coercion, but not as much as trade diversification.

Third, to get their way, China's leaders are prepared to sustain trade pressure for a long time; provided the economic costs are less than the geopolitical gain. When the Nobel Peace Prize was awarded to Chinese democracy activist Liu Xiaobo in 2010, Norway was punished with a series of licensing and customs restrictions on its lucrative salmon exports and an effective six-year freeze on diplomatic relations.²⁷ And despite Chinese consumers shivering through a particularly cold winter, ships full of Australian thermal coal used for power generation were left sitting outside Chinese harbours when they could have significantly alleviated the heating crisis.²⁸

What Australia wants from America

Although Australia has been able to resist China's economic coercion, how long it can continue to do so without US support is an open question. Xi's China is a far more challenging proposition than the Soviet Union, and America is weaker today than at the start of the Cold War. No longer the world's indispensable nation, the US needs dependable, resolute allies. Biden can't afford to have Australia succumb to Chinese pressure because it could trigger an unravelling of the US alliance system in Asia and weaken democracies everywhere. Australia wants two things from his administration: a coherent, effective counter-coercion strategy and leadership of a fit-for-purpose coalition of the willing committed to free and open trade. If Biden can deliver on both, he will go a long way to restoring America's tarnished international reputation, strengthening a diminished alliance system and blunting China's exploitative trade practices.

He should start by advising his senior policy advisors to read Atkinson's apposite policy recommendations to avoid repeating the mistakes of the past. In the debates that followed Germany's earlier attempts to manipulate the global trading system by degrading the capabilities of competitors and creating dependencies, arguments were made for autarky, protectionism and fighting "fire with fire." None of these responses are solutions to economic coercion. Autarky is prohibitively expensive and doesn't work, as North Korea regularly reminds us. Protectionism accelerated the march to war in the 1930s.²⁹ It is the antithesis of free trade and won't resonate with a trading nation like Australia which needs open markets. Emulating China's approach would completely undermine the moral and practical case for a collective response and expose the world to a power-based trading system where the strong do what they want and the weak suffer what they must.³⁰

Instead, Biden should develop a multi-pronged strategy that plays to America's strengths by building a united front of democracies; recalibrating US

diplomacy; supporting agile multilateralism; and prioritising neglected ties with Southeast Asia, an increasingly important market and arena of great power competition.

Building a united front of democracies

Biden's coalition of the willing must span the globe but be Asia-focused, because the centre of global economic power has shifted decisively from the Atlantic to the Pacific, and China seeks regional hegemony. Australia can help with both. As the southern anchor of the US alliance system in Asia, it is globally respected and has significant regional clout — boasting arguably the best small defence force in the world and an economy almost the size of Russia's. Australia is also a vibrant democracy, and democracies must be central to the pushback against China's coercion. Bound by shared interests and values, advanced industrial democracies have the economic weight to make a difference. They also have most to lose in a China-dominated world.

In return, the US should use its unmatched convening power to build a united front of democracies to broker agreement on an actionable definition of economic coercion and a strategy for effective joint action. Biden's Summit of Democracies has been panned by critics who argue the US needs to get its own house in order first. But the Summit will be important to reassure friends and allies that coercion will not be tolerated and to remind the world that there is a clear alternative to dirigiste authoritarianism.

Australia, along with other democratic victims of Beijing's power trading, will expect concrete outcomes. Biden can demonstrate bipartisanship and policy continuity by building on the Trump administration's plan to create a system to collectively absorb the economic punishment from China's coercive diplomacy and offset the cost. The North Atlantic Treaty Organisation provides a precedent.

Article 5 of the Treaty allows NATO members to take joint action if any member is attacked. The same principle could apply to any coercion assessed as endangering the sovereignty of a member state, triggering a measured diplomatic or economic response. Alternatively, if China plays the boycott card to cow trading partners into submission, collaborating nations could agree to purchase the goods, provide compensation, or jointly apply tariffs on China for the lost trade.

Recalibrating US diplomacy

Proactive diplomacy, in cooperation with allies and like-minded countries, is the key to countering China's coercion. Biden must reposition the US at the centre of a matrix of like-minded countries to defend their sovereign interests — a task made easier by China's mistaken belief it can get its way by bullying countries into submission. Uniting other nations fearful of a coercive China in an interlocking, but differentiated, set of arrangements, partnerships and understandings would make it much more difficult for Beijing to pick off smaller countries at will. Strategic patience in a team-based defence of shared interests is the only way to counter China's wedge tactics.

Matrix diplomacy would be a significant departure from the hierarchical hub-and-spokes architecture of the US alliance system. This is not an argument for weakening this system, but strengthening it through diversification and democratisation. The objective of the strategy must be to change Xi's risk-reward calculation by dispelling the notion that he holds all the cards. Leveraging the strength of many to make Xi realise that he risks collective action and the formation of a powerful anti-China coalition is the best antidote to coercion.

The US must also take a more holistic view of trade diplomacy; recalibrating for geopolitical as well as economic impact. There is no point in pushing for freer and fairer trade without a supporting infrastructure of enforceable rules that penalise the weaponisation of trade by dirigiste states. Trump deserves credit for exposing China's unfair trade practices and cynical manipulation of WTO rules. But he erred in paralysing the WTO's dispute resolution mechanism and withdrawing from the high-standard Trans-Pacific Partnership trade agreement. These were own goals, which have been ruthlessly exploited by Xi, making it more difficult for nations like Australia to defend against China's power trading and promote the virtues of trade liberalisation.

The US needs to get back into the game by pushing for serious reform of the WTO, joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (the TPP's successor), rejuvenating America's declining industrial base and strategically investing in sovereign capabilities to loosen China's stranglehold over manufacturing and

critical minerals. Placing economic coercion on the agendas of the Group of Seven developed nations (US, Japan, Germany, France, UK, Italy and Canada) and 21-member Asia Pacific Economic Cooperation forum, would put China's more egregious trade practices under a global spotlight. These initiatives would be firmly supported by Australia, which wants a seat on an expanded G7 and was instrumental in persuading the US and China to help establish APEC in 1989.³¹ APEC is the only international governmental agreement in the world committed to reducing barriers to trade and investment without requiring its members to enter into legally binding obligations.³²

None of this will be easy. As a practised user of united-front strategies, Xi well understands the danger of a united front of democracies and will do everything in his power to prevent its formation. Domestically, Biden faces opposition from within his own party to joining the CPTPP and resistance from Wall Street and big business to actions they perceive as jeopardising their China investments. But as the Morrison government has argued in Australia, a failure to stand up to coercive practices now will incur far greater costs in the future. And they won't be just commercial. Although it's impossible to put a dollar value on independence and freedom, their loss would be felt by all Americans.

Supporting agile multilateralism

Countering China's power trading will require the broadest possible coalition of the willing underpinned by the strength of leading democracies. But its structure must be sufficiently flexible to accommodate more agile institutional arrangements and allow members to contribute according to their ability and appetite for risk. The contours of this new multilateralism are already evident.

The longstanding 'Five Eyes' intelligence arrangement of Australia, the US, UK, Canada and New Zealand is evolving into a strategic alliance with Japan as a virtual sixth eye. India's border problems with China and new-found willingness to work more closely with Australia, the US and Japan has strengthened the once moribund Quadrilateral Dialogue. With a combined population of 1.8 billion contributing around 35% of the world's economy, the Quad of leading Indo-Pacific democracies is emerging as a serious regional and global counterweight to China. Add Europe to the mix, and China would find it hard to ignore a grouping of 2.25 billion people accounting for nearly half the world economy.

Expanding the G7 into a D10 club of democracies to include Australia, India and South Korea, is another option for aggregating the necessary geopolitical and economic muscle to impose real costs on China for coercion. The UK's decision, as G7 chair, to defer the mooted expansion underlines the challenge of developing a united front of democracies in the face

of China's economic power. Italy, which has signed up to Xi's Belt and Road Initiative, reportedly opposed the expansion for fear of offending Beijing.³³ But the D10 is an idea whose time has come. What is required to turn it into a practical reality is creative and committed American leadership.

Prioritising Southeast Asia

If the coalition is to be the broadest possible grouping, non-democracies must be included since they comprise most of the world's developing states. Many have been on the receiving end of China's power trading, debt diplomacy and intrusive nationalism. Developing countries may not be prepared to put their head above the parapet in the cause of free and open trade, but given a choice, most will support rules that protect the interests of smaller economies.

Trump spurned constructive engagement with the developing world, running down US aid programs and hollowing out the diplomatic corps. In repairing the damage, Biden needs to prioritise Southeast Asia for trade and geopolitical reasons. The Association of Southeast Asian Nations is an emerging economic powerhouse of 672 million people spread across 10 countries.³⁴ The archipelagic states of Indonesia, Malaysia and Singapore are the gatekeepers of the Malacca Strait — the most important waterway in the world. It is also China's economic 'Achilles heel' and a prime reason for Xi's determination to dominate the South China Sea. China's leaders fret that the US Seventh Fleet could blockade the Strait in a future conflict. The gatekeeper states, plus Vietnam, the Philippines and the oil rich Sultanate of Brunei, all have territorial disputes with China or concerns about its militarisation of the South China Sea.³⁵

The problem for the US and Australia is that ASEAN is slowly falling into China's orbit. Cambodia and Laos are effectively tributary states and Myanmar could soon join them if Western economic sanctions push the military junta into Beijing's embrace following the

coup against the elected government, led by army chief Senior General Min Aung Hlaing. The other seven ASEAN states are conflicted; united in their desire to keep China at arm's length but sceptical that America has the will and capacity to act as a regional balancer — a concern shared by Australia. Trump pushed back against Xi's gunboat diplomacy by increasing freedom of navigation operations. But despite the US being the single largest contributor of Foreign Direct Investment in the region, he failed to match China's recent economic and investment largesse or take a strategic approach to the region.³⁶ Like Australia, Southeast Asian governments have found it difficult to resist the siren call of China's market power even though they recognise the dependency trap.

Given its importance, the US needs to re-engage with Southeast Asia and ramp up trade, aid and investment to contest China's growing influence across the region and deliver what would be a winning trifecta — recruiting influential Southeast Asian states like Indonesia, Vietnam and Singapore to the cause of free and open trade; creating new trade and economic opportunities for the US as the economy emerges from its COVID trauma; and shoring up regional support for Australia and Southeast Asian victims of China's trade coercion.

None of this should be construed as a strategy for containing China — a political and economic impossibility given its size and strategic weight. Countering China's coercive diplomacy and power trading is a necessary defensive measure to protect the prosperity and security of every nation that values its sovereignty and an open trading system. Canberra has shown the way forward but needs Washington's support. If Australia fails to maintain its independence in the face of China's mounting pressure, other countries may well conclude that appeasement is the only feasible alternative. That would signal the end of American pre-eminence and the rules-based global order the US created and led for more than seven decades.

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