

China Watch

A China Business Report prepared by David Mahon, Executive Chairman,
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W I N T E R 2 0 1 6 - 2 0 1 7

*...the wise man, embracing unity as he does, will become the world's model.
Not pushing himself forward he will become enlightened;
not asserting himself he will become distinguished;
not boasting of himself he will acquire merit;
not approving himself he will endure.
Forasmuch as he will not quarrel, the world will not quarrel with him.*

Laozi, fifth century BC

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Tremors in the East

The relative regional stability to which China and its Asian neighbours, together with the United States, had grown accustomed over the last two decades was severely shaken on three occasions this year. Tsai Ing-wen's election to the Taiwanese presidency in January resulted in the effective suspension of eight years of détente with China. In November, the new president of the Philippines, Rodrigo Duterte, announced on a visit to Beijing that he would distance himself from the US and resolve the dispute over the sovereignty of the Scarborough Shoal directly with China. In doing so, he released pressure from the debate over the sovereignty of the South China Sea itself, weakening the regional influence of the US and opening the potential for China to enter into further unilateral negotiations with other states in the region. Duterte signed investment deals with Chinese companies valued at billions of dollars, while the Chinese blockade of the shoal was eventually lifted.

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Then in December, US President-elect Donald Trump's telephone call with Tsai Ing-wen and later tweet referring to Tsai as the 'President of Taiwan' tacitly recognised Taiwan as a sovereign entity separate from China. No major power since 1979 has contradicted Beijing's

One-China policy so directly. The Chinese Government responded publicly with sanguinity, but was privately shocked at the audacity of the move. On 21 December, Beijing announced that the tiny African islands of Sao Tome and Principe had ended diplomatic relations with Taiwan and

now recognised Beijing. This breaks the agreement reached in 2008 between Taipei and Beijing not to poach each other's diplomatic partners. Now only 21 similarly small states recognise Taiwan's sovereignty, more of which will change loyalties in the coming months and years. The Vatican is the most important of these. Taiwan has been weakened by the Tsai-Trump phone call. In the space of twelve months, China's regional considerations and the uncertainties surrounding them shifted dramatically.

It is as if the issue of the South China Sea has been swept from the table, or at least to the edge of it. If America can no longer rely on the Philippines as an ally in the region, its influence will be reduced considerably. Even if the US were to deploy more naval vessels to Asia in the future, its inability or reluctance to invest and support regional development will mean that its influence continues to diminish while China's increases.

Chinese diplomat

We thought Trump didn't understand the regional strategic issues so we were not too concerned when he made anti-Chinese statements during his campaign. His challenges over trade, the South China Sea and the One-China policy seemed to be in keeping with previous American presidential elections, in which criticising China was just campaign rhetoric. In the early 1990s, President Clinton said he was going to be tough on dictators from Baghdad to Beijing yet, as president, played a vital and even-handed role in repairing America's relationship with China. My colleagues and I have assured each other that in the end, Trump is a businessman and will be practical. Now I am not so sure, and it looks like he may be as unpredictable and contradictory when president as he was during his campaign. So far, we have responded carefully to Trump's statements. I just hope that he does not push us so far that we feel forced to react.

Chinese Communist Party official

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China will continue to restate its right to occupy Taiwan in the event of a Taiwanese government declaring full independence. Despite President Tsai Ing-wen's strong stance on independence, she has made no firm moves to that end since her election. The manner in which she played

down the recent phone call with Donald Trump indicates that she sees some value in the relative stability of the present stalemate. Taiwan is likely to be marginalised further over the next few years as the United States and China adjust their economic and diplomatic clinch over uncertain ground. China's economic interdependence with other countries in the region and its economic bonds with the US are vital to Chinese domestic, economic and social equilibria, just as Chinese trade and

investment are to the US, despite Donald Trump's threats of placing high tariffs on all Chinese goods. In the first half of 2016, Chinese investment into the US tripled compared with the same period the previous year, and the countries remain crucial trade and investment partners. As China manages a difficult economic transition to a slower, more consumer- and service-driven economy, it will look to mitigate any potential regional instability or downgrading of its trade with the United States. A serious trade dispute is unlikely to be precipitated by China.

Trade war mongering

There is no plausible evidence behind Donald Trump's accusations that China has manipulated its currency for trade advantage in recent years. His claims that China is responsible for the reduction of American industries and unemployment are equally spurious. Since the 1960s, as a natural result of globalisation, the United States has been relocating industries to Japan, Korea, Taiwan, Mexico and Latin America. Many of the companies which moved low-cost production to China in the 1990s have since moved production to other industrialising nations, such as Mexico, Vietnam and Bangladesh. In 2015, China's exports to the US were largely comprised of electronics and industrial machinery, totalling USD 140 billion. China also sold USD 40 billion of relatively cheaper products, such as footwear and sports goods last year. The industries that Donald Trump

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has pledged to return to America are scattered across the developing world and cannot be brought home. Should he convince or coerce American companies to produce in the United States, it would be likely to result in the employment of more robots than American workers.

Despite some speculation that the new American president could initiate a trade war with China, it would be difficult for him to do so without congressional approval and complex negotiations with the World Trade Organization. Most in America's pro-free trade, Republican-controlled congress would also resist such initiatives, as would US multinational companies with their powerful Washington lobbyists. The American political system is heavily dependent on funding from American industry.

There will, nevertheless, be more disputes and erection of nontariff barriers as national leaders of industrialised nations struggle to find solutions, wavering between sustaining free markets and bending to the pressure to be more economically nationalist. China has become more protectionist in recent years, but its dependence on imports of raw materials, technology, and safe agricultural and food products will restrain it from going too far. Strategic tensions have existed between America and China since 1949, albeit obscured by economic interests. Donald Trump is

merely stating the obvious underlying stress points, not out of historical or present political insight, but from a crass hope for commercial deals that in reality will be more complex than any he has negotiated in his business career.

Western revolution

Antiglobalisation forces are gathering momentum in developed economies, as expressed by Brexit, the rise of nationalist parties in Europe, the support for Bernie Sanders in the Democratic primaries and the election of Donald Trump. The West is in the throes of a still diffuse, but broad, grassroots revolution of disillusionment and discontent, contained by democracy and law. The lines between traditional left- and right-wing

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parties are blurring, as those in political establishments and elites, perceived to have failed in protecting common wealth and preventing monopoly interests, struggle to respond. It is not that democracy is failing, it is that many of those elected to protect and administer it have failed to consider the needs and rights of the majority over minority interests of large corporations and their blind

hunt for higher profits, lower costs and increased global market share. Although globalisation has brought economic growth to the West and improved living standards in many emerging nations, governments are on notice to ensure a more balanced and inclusive process, not only in the West, but also in China.

China may have no intention of embracing democratic institutions, but it is not removed from the popular discontent manifesting in the West. The Chinese Communist Party remains in power because of a form of populism as broad and varied as any in the West. China adopted capitalist principles in the mid 1990s and now depends upon a free market economy, but lacks some of the independent institutions and checks and balances that are common features of more established free market systems. China is watching its former economic role models, the US and Europe, and having lost faith in aspects of the Western free market model after the Great Recession, is alarmed that Western political processes have become so dysfunctional. Many in China look at this situation with a degree of schadenfreude.

China is stable, isn't it? Look at America and people fighting in the streets during the election. If that is democracy, then I don't want it. Give me the Party any day. The West told us for too long that we were poor and undeveloped. But I sense things are a bit different now. We at least have stability, but you in the West do not.

Beijing vegetable seller

Donald Trump is an unpredictable, authoritarian and at times impetuous politician, but American traditions of political governance and law are strong and will likely restrain his potential excesses. The world must nevertheless be prepared to deal with a more isolationist and less compromising American administration over the next four years.

Chinese people underestimate the extent to which American presidents are constrained by their own systems in the same way that Americans underestimate the degree to which our leaders debate ideas while being constrained by the Party. The mistake is to focus on the personality of leaders. We have always placed too great an emphasis on the characters of these people. It is true that in China our leaders are powerful in comparison with Western leaders, but in the end even President Xi Jinping is bound by this political system, economy, and these social realities. We must not let ourselves be baited by Trump, but just realise that he can't follow through on many of his threats. There are also some hard heads in the Party for whom national pride is more important than economics and trade. I just hope that in the end, we will be practical.

Chinese trade official

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The one factor that could be more destabilising than the United States showing more demonstrative support for Taiwan, challenging the One-China policy, or trying to pressure China on trade would be a significant military withdrawal from North Asia. This would be a catalyst for Japan to militarise further and for

Korea and Japan to consider nuclear armament. Although the potential for heightened regional tensions is dangerous on many levels, a measure of chaos and the disruption of the status quo may force all parties to deal more frankly with the long-standing underlying tensions and misperceptions. But we may have to wait longer than four years to see this come to pass. ☹