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Are economists China-blind?

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According to some in Australia's strategic community, economists just don't get China. Not with respect to the important stuff anyway.

Last month, the executive director of the Australian Strategic Policy Institute, Peter Jennings, declared that many economic commentators "show absolutely no understanding or interest in the broader direction of Chinese strategic policy". The insinuation is that economists and the business community are too busy looking at dollar signs to pay attention to China's island-building in the South China Sea.

But economics is at the heart of military and strategic power. Twenty five years ago, the rest of the world wasn't concerned by China's strategic intent. That's despite military spending accounting for 2.5 per cent of its GDP in 1990, far higher than 1.9 per cent last year. Of course, what really matters is that China's economy is now 11 times bigger. And according to recent IMF projections, in 2021 that number will grow to more than 15 times. This is the reason China's military budget is now larger than the rest of Asia's combined.

It might also be what former prime minister Paul Keating had in mind when he said recently that US hegemony in the region is "incapable of preservation". China will experience some bumps on the path to emerging as a predominantly middle-class country, with a debt crisis in the medium term among the most likely risks. But incomes are ultimately determined by productivity, not debt or anything else.

It wasn't that long ago that one out of every four pairs of shoes in the world was made in Guangdong. Now the manufacturing powerhouse in southern China produces nearly three-quarters of the world's drones. Shenzhen, one of the country's tech hubs, spends more than 4 per cent of its GDP on research and development. That's nearly double the OECD average.

Despite rapidly rising wages, the success that China is having in moving up global value chains is evidenced by its share of world trade reaching 14.6 per cent last year, a huge leap from 12.9 per cent just one year earlier.

The simple maths is that with a population of 1.4 billion, income per person in China only has to reach one quarter of that in the US for it to have the world's largest economy, allowing it to buy sophisticated weapons systems from abroad. In purchasing power parity (PPP) terms, relevant for paying soldiers' wages, the IMF estimates that at the end of this year China's economy will already be 12 per cent larger than that of the US.

Economics can also help to restore some clear-headed thinking on complex matters such as the South China Sea. The narrative proposed by strategic hawks is that since President Xi Jinping came to power in 2012, the Chinese government has begun aggressively pursuing expansionism.

Yet since the South China Sea arbitration decision was published in July, both China and the Philippines have shown restraint in their response, although neither side is backing down from their original positions. For economists, this restraint is readily understood. After all, it is economics that opens the possibility of international relations being a positive, or mixed interest, rather than a zero-sum game.

With income per person still only at 14 per cent of that in the US, 25 per cent in PPP terms, China can ill afford a dramatic recasting of its relationship with the rest of the world. This is the big reason why former Australian ambassador to China Geoff Raby calls China a "constrained superpower".

On concerns about freedom of navigation, economist John Quiggin points out that of the US\$5.3 trillion in trade that passes through the South China Sea each year, around US\$4 trillion is to and from China. Obviously, it has no interest in blocking this and wouldn't need to resort to land reclamations if it did. He adds that even in a worst-case scenario, the cost of traded goods avoiding the region is easily exaggerated.

To conclude that China's continued economic and therefore strategic rise is highly likely is not to suggest that Australia must never criticise Beijing's policies.

It is core to Australia's security and economic interests for China to embrace a rules-based order. Australia's response to the South China Sea arbitration – supporting the tribunal and calling for the decision to be respected, but not taking sides on territorial claims – should therefore not have come as a surprise to the Chinese. But how joining the US in conducting provocative patrols within the 12 nautical mile zone of Chinese claimed territory would incline China to follow a rules-based order is not at all clear.

Far more productive would be to press the diplomatic point that an international system governed by rules has served China's own national interest exceptionally well to date and will provide the most conducive external environment for it to become a 'moderately prosperous society' by 2020 and realise President Xi Jinping's 'China dream' beyond.

Canberra's decision-makers and others in Australian society are able to question and debate US policy towards China without being labelled 'pro-Beijing' propagandists. In early 2015, US President Barack Obama phoned then Australian prime minister Abbott and asked him not to join the China-led Asian Infrastructure Investment Bank. By June, Abbott had led Australia into the bank. A couple weeks ago, even the Canadians signed up. The US and Japan now stand alone in apparently not seeing value in giving the Chinese this opportunity to demonstrate their capacity for productive leadership. This is a bank whose first round of loans earlier this year were syndicated with the World Bank, the Asian Development Bank and the European Bank for Reconstruction and Development: hardly an attempt to overthrow the existing financial order.

Speaking on the sidelines of the recent G20 meeting in China earlier this month, Prime Minister Malcolm Turnbull followed a long line of predecessors in insisting that: "We are a thoroughly

independent nation. And we don't have to choose between China and the United States."

Nor does the US expect us to. In response to excited comments by a US army colonel last month, a Pentagon spokesperson said "the idea that Australia, or any country, needs to choose between its longstanding ties to the United States and its emerging links with China presents a false choice".

Last year, former Labor foreign minister Gareth Evans suggested that "in dealing with both Washington and Beijing, we should work hard at building and reinforcing the positives in each of these relationships, but stay clear-headed about the potential negatives and never become either side's patsy".

Surely that's a foreign policy approach that both Australian economists and all but the most extreme strategists can agree on.