CHINA’S OFFENSIVE IN EUROPE

by

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FOREWORD

China goes global

The emergence of China on the international scene is a subject that occupies many academics, economists, and strategists – both within government and in the think tanks of Washington, Berlin, Tokyo, and London. Daily (especially in the United States) Chinese economics, finance, politics, security, and sociology are deciphered and interpreted. Meanwhile in China, experts at major universities and think tanks analyze the various facets of America’s politics, economy, and society – and sometimes of Europe as well.

In the last ten years the world has been shaken by crises of all kinds: climatic, social, humanitarian, economic, financial, - and of course, security. From Europe to the Middle East by way of Africa, no continent has been spared instability, even if Asia seems less subject to “chaos” than others. Some see this as the coexistence of a sizeable American military presence alongside a China that is increasingly determined to occupy its place at the heart of Asia, as demonstrated by the Sino-Japanese tensions in the China Sea, especially over the Diaoyu Islands.

The mandate of Xi Jinping, the Chinese premier has since its beginnings at the end of 2012, known its share of geostrategic tensions (the nascent
crisis with Japan, contentious relations with Southeast Asia, a persistent rivalry with India and the United States), political turmoil (the democratic movement in Hong Kong) and economic crises. Of course, the Chinese economy since 1980 has enjoyed frenetic growth of almost 10% per year on average, which today gives it a predominant place globally, but the country remains profoundly inegalitarian. In 2015, GDP per person remains almost five times lower than that of the United States and Europe; more recently Chinese growth has shown signs of weakness, dropping for the first time below the symbolic level of 7%.

The Chinese political system, which the Chinese Communist Party intends to control by every means possible for the sake of its survival, is evolving – but not in the direction of some kind of democratization, as all the signals from Xi Jinping and his entourage have shown. Instead they have chosen a diehard nationalism that includes a whiff of Confucian tradition and culture, rising regional powers, an anti-corruption campaign aimed at thousands of officials at all levels of the power structure, and the renaissance of the “Chinese dream” meant to echo the “American dream.”

Corruption is a widespread phenomenon in China that is linked to the economic openness of recent decades and the boundless enrichment of some officials who have profited from the financial manna of exports and the economic “miracle” of the last thirty years. Corruption had evidently reached a stage that was unbearable to Xi Jinping and the team that has surrounded him since 2012. The Party is not insensible to
criticism, especially in the era of the social media (Weibo, WeChat, Baidu) that by 2015 had attracted more than 600 million Chinese. Despite censorship and firewalls, a new form of on-line popular condemnation is operating, and Chinese officials cannot ignore it. This anti-corruption campaign touches not only China but also some foreign corporations that are accused of having taken shares of illegal profitering.

China is also present on new fronts. It has launched a vast program of economic development outside its borders, starting with the plan for a new Silk Road (“One belt, one road”) revealed during a trip by Xi Jinping to Kazakhstan in October 2013, and often reaffirmed during official speeches and regional tours in 2014 and 2015. This mega-project of great breadth will take the form of a railway line of 11,000 kilometers between the Chinese autonomous province of Xinjiang and heading into Central Europe, passing through Kazakhstan, Azerbaijan, Pakistan, Iran, and the Balkans (although the list of countries is not definite).

In April 2015, Xi visited Islamabad and concluded the trip with the announcement that China would invest 46 billion dollars in infrastructure, much of it for an “economic corridor” encompassing roads, railways, and pipelines along 3,000 kilometers to the Pakistani port of Gwadar, which is intended to give China its first access to the Indian Ocean. If all the elements of this plan are realized, Chinese investment in Pakistan will greatly exceed total U.S. investment in the country. Another portion of the new Silk Road will traverse the oceans,
in order to link the China of Southeast Asia with the Mediterranean via the Persian Gulf.

These grandiose announcements have been accompanied by the creation in Beijing of the Asian Infrastructure Investment Bank (AIIB) that in 2015 registered more than 70 countries among its founding members, including from Europe (the United Kingdom, Germany, France, and Italy) and from traditional allies of America in Asia-Pacific like South Korea and Australia. Many questions remain about this new bank, which will directly compete with the World Bank, the International Monetary Fund, and the Asian Development Bank - organizations until now controlled by the West and Japan. The rationale for AIIB is simple: failing to obtain a major voice in the governing bodies of these institutions, China decided to create a new one, designed at investing in new infrastructures especially for its neighbors of Central Asia or Pakistan. China has performed a diplomatic coup, however, by attracting to the coffers of AIIB many American allies such as Australia, South Korea, the UK or Germany, to Washington’s chagrin.

China’s capacity to invest can be seen on other continents. Since the end of the 1990s, the key idea has been that in order to pursue growth, Chinese expansion must be international. State enterprises that benefit from the gigantic financial power of the Chinese government (almost $4 trillion in reserves) have received orders to invest abroad. Moreover, private enterprise, (sometimes facilitated by the Chinese diaspora) doesn’t want to be left out. Africa, Latin America, Australia, and Asia are
all targeted by the phenomenon of Chinese internationalization. Between 2002 and 2014, Chinese investment abroad has gone from $2.1 billion to $130 billion (according to the Heritage Foundation) while Chinese Premier Li Keqiang estimated this amount at $103 billion in 2014.¹

But access to the Chinese market remains grossly insufficient. Notable obstacles are the absence of transparency and the weak protection of intellectual property in China. Many foreign corporations that had made China one of their principal terrains in the 1980s and 1990s are now reexamining their presence there. Reading the annual reports of the European Chamber of Commerce (EuroChamber, with 1,800 members) and the American Chamber of Commerce in China (AmCham, with 3,500 members) in parallel leads to the same conclusion: the Chinese market is no longer what it once was. The 2015 White Paper from AmCham puts at the top of its priorities for reform: the rule of law, access to markets, standardization norms, and protection of intellectual property – all the flaws of the current system.

Eurochamber’s 2014 annual report makes a somber commentary: “In China, the golden age is ending for European corporations, for the country is on its way to closing its window of opportunity in order to equilibrate its economy... Unless Chinese management makes and maintains reforms, there is a true risk that the economic miracle will dwindle.” In other

¹ Li Keqiang, Prime Minister’s report to the National People’s Congress, 5 March 2015.
words, the thirty years that enabled multinationals to get rich on the fat Chinese market are being gradually replaced by a period of “lean cows” for investors, especially European ones. It is hard for foreign investors to ask for better access because they are no longer truly “welcome”. The doors have closed in the case of many public markets, in particular with respect to sectors henceforth reserved for local enterprises (construction, infrastructures, telecommunications...) or sectors subject to anti-monopoly laws.

Today, the rules of the game are changing in China, and another strategy is springing up. Innovation has become the guarantee of survival, but the financial efforts of China to boost research (1.7% of GDP in 2014, as opposed to 2.9% in the United States) have not been sufficient to make China a “creative and inventive economy,” in the expression of David Shambaugh of George Washington University. To feed “indigenous innovation”, he adds, China must evolve on all fronts. Meanwhile, the government’s agenda is to invest abroad in order to fuel the Chinese economic motor, and notably to utilize the liquidity accumulated in the course of the last thirty years in order to acquire the technologies that are still lacking in China. This desire also governed the 2007 creation of the China Investment Corporation (CIC), the largest sovereign Chinese fund, which today manages the modest sum of $575 billion and has bought shares in many international technological companies.

2 David Shambaugh: China goes Global, the partial power. Oxford University Press, 2013.
The mutual distrust between China and the U.S. has gradually mutated into an open rivalry between the two foremost world economies, which are not on the same strategic level, however. For example, the American defense budget reached $581 billion (3.3% of GDP) as opposed to $129.4 billion for the Chinese defense budget (1.2% of GDP). And the two military capacities are not comparable, as Pentagon experts recognize.\(^3\) As an example, the United States has ten aero-naval groups, while China has a single aircraft carrier. And looking beyond the military domain, what about Chinese soft power? As Harvard professor Joseph Nye writes, \textit{“Much of American soft power is produced by civil society, running from universities and foundations to Hollywood studios and pop culture.”} While China tries to establish its military might (particularly in the China Sea), Chinese soft power is far from successful: “China makes the mistake of thinking that the government is the main instrument of government. But in today’s world, information is not scarce but attention is, and attention depends on credibility. For all the efforts to turn Xinhua and Central China TV into competitors of the BBC and CNN, there is little international audience for brittle propaganda.”\(^4\)

At the approach of the American presidential election of 2016, China is waiting to see whether Hillary Clinton – the Secretary of State who during her term orchestrated the \textit{“rebalancing/pivot”} toward Asia in 2011 – or a Republican candidate will emerge as the resident of the

\(^3\) Figures from the International Institute on Strategic Studies (IISS), London, 2015.

White House. This choice might well play a determining role in the future of Sino-American relations in the next four years.

The Chinese fascination with the United States has not yet been translated into large-scale investments, although investments that are exempt from the rules of the all-powerful Committee on Foreign Investment in the U.S. (the CFIUS examines aspects linked to national security) may relatively easily get a foothold on American soil. According to a report by the Rhodium Group that appeared in May 2015, Chinese investments enjoyed a veritable leap between 2010 and 2014, reaching $46 billion dollars for 1,583 subsidiaries throughout the country\(^5\). (5) We may cite Yunhua Chemical that invested $1.85 billion in a factory close to the Mississippi River in Louisiana, the purchase of Motorola factory by Lenovo in North Carolina in January 2014 ($2.9 billion), and the establishment of a production facility in Richmond, Virginia by the Shandong Tranlin Paper Group for $2 billion. On top of these industrial investments comes the strong presence of Chinese buyers in real estate, particularly in the State of New York. This situation, which will necessarily have an impact on Sino-American relations, is reminiscent of the deployment of Japanese investments in the 1980s.

**Especially during crises over hacking and cyber security**, distrust of China remains strong in Washington, and the electoral period may not

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be the best time to analyze Sino-American relations calmly. China is at times a strategic rival of America in the Asian-Pacific (according to the Republicans), and at times a destroyer of jobs (according to the Democrats), but often the scapegoat of choice for an anxious American political class, an anxiety sometimes fed by certain enterprises that try to block acquisitions that are deemed overly “strategic”, like the aborted purchase of the oil company Unocal by the Chinese CNOOC in 2005, or 3Leaf (cloud computing) by Huawei in 2011. Even the acquisition of the agro-food giant Smithfield by Shuanghui International in 2013 was almost blocked by pressure from interested groups. In short, American and Chinese strategic interests crash into each other in a great number of domains, obliging China to turn its attention to another part of the Western world: the European continent.

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FOREWORD

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