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03.05.2018, ASIA POLICY BRIEF

## Balancing China

The looming superpower rivalry between the US and China has massive implications for Germany and its European partners. While Donald Trump is forcing Europeans to think outside the transatlantic box, it is Xi Jinping who is posing more fundamental challenges. Time to balance China's influence in a reasonable way may be running out.

Three key areas to watch.




Bernhard Bartsch

## Relevance





The looming rivalry between the US and China is changing the world order and has massive implications for Germany and its European partners. German chancellor Angela Merkel has reportedly named China's rising influence a key challenge in global affairs. Europe is trying to find strategies to balance Beijing's growing power, without alienating it.


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## Focus



Chinese investments in Europe have become the primary focus of efforts to control China's influence. EU-Lawmakers are currently finalizing legislation that would give national governments more discretion to review Chinese investments. However, this can at best be a defensive strategy and European initiatives to support innovation and a more pro-active industrial policy should be on the agenda as well.


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## Forecast



The more assertive China acts on the world stage, the more pressure the US will feel to counter China's rise. The Trump administration can be expected to continue flirting with the danger of escalating one of the existing tensions, be it North Korea, the South China Sea or a trade war. But for the time being, China will not be provoked into an open conflict and instead try to push its own agenda.

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## Information

### Information Where we know too little



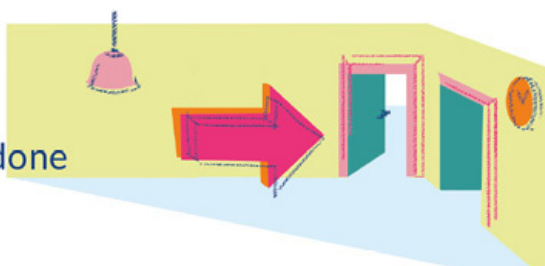
The relationship between the US and China is an equation with many unknowns. China's 19. Party Congress has once again demonstrated how little we know about the inner workings of the Communist Party. Increasing restrictions on independent reporting and research in China make it difficult to assess political, economic and social developments. Chaos in the Trump administration is greatly adding to the uncertainties in US-China relations.


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## Options

### Options What should be done





European governments and companies need to develop strategies for cultivating good relations with the United States on the one side and China on the other – while retaining strategic neutrality in both directions. The multilateral, rules-based world order that Europeans hope for is under pressure. For Europe to play any significant role in the future world order, it has to act as one.

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Where would Germany stand if forced to choose sides in an open conflict between the US and China? This was a question Bertelsmann Stiftung discussed in spring 2017 with groups of decision makers from German and European politics, business and think-tanks. Donald Trump had just been inaugurated and it was easy to imagine how the US and China might steer into a confrontation, be it political, economic, military or a mix of all.

Working through various scenarios left participants alarmed as much as frustrated. Obviously, any movement in Sino-American relations will also impact Europe. However, there is little that Europe can do to influence the relationship between the world's two most powerful nations, and it cannot rely on being able to maintain strategic neutrality towards both sides. While political decision makers tended to stick to the transatlantic alliance, business representatives felt a stronger pull towards China with its still high economic growth. And while all agreed on a need for greater European unity, few were willing to put a bet on it. If push comes to shove, will leaders in European capitals be able to agree on a common position? Or will Europe get stuck in the middle between the two superpowers?

A year later, the course of events has shown that - unfortunately - these questions were not a vain intellectual exercise. The US and China are currently gearing up for what could (or could not - who knows, these days?) escalate into a global trade war, in which economically everyone would lose, even though some may claim political victories.

Nevertheless, from a European perspective, the situation looks grim, but not hopeless. For many, this past year of looming crisis has been a wake-up call. Across the board, leaders in politics and business have embarked on a process of reconsidering positions in a rapidly changing global environment. While it is currently the US that has its finger on the trigger of disrupting the global order, China is driving the more fundamental long-term changes. And unlike

Washington, Beijing has recently sent clear signals about its plans for the coming years.

China has used every stage at its disposal to display its growing global ambitions, be it at the 19. Party Congress in late 2017, the National People's Congress in March 2018, the Belt and Road Summit, the World Internet Conference or most recently the Boao Forum. Under Xi Jinping, China finally appears to feel self-confident enough to be a key player in re-defining spheres of geopolitical influence and the rules of global governance as well as becoming a world leader in strategic industries and technologies.

Many in the West see this as an open challenge, made possible sooner than expected by the global power vacuum or confusion that is the Trump administration. In rhetoric, China maintains its dedication to a multilateral world order, continued reform and opening up of its markets and a level playing field for businesses. But many of its actions now point in a different direction, as documented by numerous reports, such as from the European Chamber of Commerce, various think-tanks and international media. China now seems to be putting a strong bet on its ability to set its own standards, both economically and politically.

Surely, China's outside projections may look more impressive than many of its internal realities. After all, China's domestic challenges remain enormous, be they economic, social, environmental or even political. Nevertheless, Germany and other European countries now acknowledge that a core belief about the direction in which China is moving can no longer be upheld: China seems to have left the course towards more openness, market oriented reforms and eventually maybe even some kind of political renewal. (While it may seem absurd today that this was once expected, let's not forget that until a few years ago, it was mainstream thinking even in Chinese policy circles. Xi Jinping's new era never was - or is - China's only option.).

Instead of waiting for eventual convergence, German policy makers are now gearing up for what some have begun to call a "competition of systems". The term may be overblown. After all, China is not exporting a political system, but business opportunities and real-political options, many of which appear particularly attractive to populist or autocratic leaders. But the challenge is obvious: Europe will have to find a way to balance China's influence.

Balancing China does not at all mean containing China, as some in Beijing fear and claim. China cannot and should not be contained. Building a strong partnership with China and supporting the country's increasing integration into the global system - both economically and politically - remains the primary

objective. But Europe has a strong interest in fighting against the erosion of open markets, a level playing field for businesses and a multilateral, rules-based global order. Without significant counter weight in the form of alliances, regulations and political or economic initiatives, it would be naïve to expect that Germany or other European countries could remain at eye-level with an increasingly assertive China. From a European perspective, balancing China must be an attempt to keep the playing field as level as possible, with China as one of its most important players.

German Chancellor Angela Merkel is reported to have named China's rising influence as the key challenge in global affairs for her final years in office. It will be a rough ride, with uncertain outcomes. But some contours how Germany and other European governments are trying to balance China are already emerging. Three areas that will be at the centre of attention are Chinese investments, China's cyber security policies and the Belt and Road Initiative. In any of these areas, the time to come up with reasonable policies and agreements is limited.

## Chinese investments

Chinese investments in Europe have become the primary focus of efforts to control China's influence. Supporters of stricter investment screening claim that the EU is currently allowing China to take its liberal system for a ride. Concerns include that Chinese investors may benefit from Chinese subsidies that put them at an unfair advantage, or that they may be acting on behalf of Beijing to seek control of strategic technologies, such as the ten areas defined in its "Made in China 2025" strategy. Adding to the tensions is a striking lack of reciprocity, with China keeping many key sectors off limits for foreign investors.

Mostly at the initiative of the German, French and Italian governments, lawmakers in Brussels are currently finalizing legislation that will give national governments more discretion to review and authorize Chinese investments. Specific measures, their effectiveness and broader implications are currently topic of heated debates.

Whatever the technicalities designed to control investments, they will have to cater to differing political realities. Countries like Germany want to have the possibility to protect Germany's high-tech industries from takeovers that seem to undermine the strength of the overall economy, while other countries, in particular in Eastern Europe, are much keener to attract Chinese investment.

In any case, investment controls can at best be a defensive strategy. After all, any investment regulation runs counter to European beliefs in free and open

markets. Sceptics warn that attempts to "out-Chinese the Chinese" are doomed to fail. Monitoring Chinese investment flows may be able to protect some key industries for a certain time. But it does little to reverse the trend that the most dynamic markets for many European companies are increasingly in Asia. Likewise, investment controls do not help much in promoting innovation.

To actually balance China's - legitimate! - attempts at becoming a world leader in strategic industries and controlling important value chains, European governments will therefore have to do much more in terms of supporting innovation and possibly come up with a more pro-active industrial policy.

## Cyber Security

Xi Jinping has spent much of his first term as President (and General Secretary of the Communist Party, arguably the more influential of his positions) with re-affirming the power of the Communist Party. This included ensuring control of all information flows on the internet. New laws on what China calls "cyber security" now demand that foreign enterprises store all data from their activities in China on Chinese servers, where protection of sensitive data cannot be taken for granted.

It were not the laws alone that concerned many European companies and diplomats, but also the lack of transparency with which the new guidelines were implemented. On April 1, China was set to enforce rules that forbid the use of unregistered VPNs, a technology that allows users to access sites that are blocked in China. VPNs are a means for many foreign companies in China to communicate with their headquarters without making it too easy for outsiders to hack into the conversation. They are also a way for foreigners (and many Chinese) to access services such as Google, Facebook, Twitter, Youtube or Whatsapp. Foreign companies complained that enacting these rules would dramatically hurt their business. Despite months of intense diplomatic efforts to find a solution, China didn't offer much beyond VPN services from China's state owned telecom operators. These would be much more expensive than existing services by international providers and allow authorities to monitor all data flows.

A month later, the VPN ban still remains to be fully enforced. For the time being, many of the channels that companies previously used remain accessible. But much trust has been lost - and concerns are rising about China's next, even broader policy for enforcing the Party's control over its people. It has been announced that in 2020, the so-called social credit score system will be rolled out nationwide. While details of the system are still subject to much speculation, it can be expected to be dystopian by the standards of Western

societies that attribute high value to the rights of individuals. The reach of the system may extend well beyond China's borders.

Whatever the limitations of China's control mechanisms, they probably won't be of technical nature. China appears to be on the forefront of developing digital technologies and artificial intelligence. European policy makers are only beginning to acknowledge that the regulatory challenges posed by the internet era come from China as much as from Silicon Valley. Europe's new laws on data protection are a positive first step (and in light of the latest data security scandals not as bad an idea as its critics claim). Rewriting competition laws for the digital age will be a next and even more ambitious initiative. With respect to China's ICT giants such as Huawei, Alibaba or Tencent, a next step might be to establish a rule of reciprocity, demanding that similar cyber security rules as in China might apply in Europe.

## Belt and Road Initiative

The Belt and Road Initiative (BRI) is Xi Jinping's strategy for defining China's role on the global stage, promising investment and economic cooperation to basically any country willing to subscribe to Beijing's grand vision. Over the last years, winning support for BRI has been a main task for Chinese diplomats around the world.

Despite initial support, European governments have growing reservations. In April, a leaked report by European ambassadors in Beijing delivered a scathing criticism of BRI. All European ambassadors - with the notable exception of Hungary - had signed the report. While acknowledging that the initiative had the potential to spread growth and prosperity, in reality it mainly serves China's geopolitical interests.

Germany's new coalition agreement therefore explicitly calls for a "European answer" to China's so-called New Silkroad. This may include stronger European investment and forming new alliances to counter China's geopolitical advances. At the same time, Germany will have to maintain a constructive dialogue with Beijing and avoid outright confrontation. After all, major German companies with high stakes in the Chinese market are eager to demonstrate their support for Belt and Road (In fact, they have no other choice but to do so if they want to stay in business.).

European diplomats will therefore have to perform the balancing act of taking China up on its rhetoric to make the BRI a truly multilateral initiative and at the same time establishing alternative alliances. One option could be reaching out to the so-called QUAD countries Japan, US, Australia and India. Similarly,



the Japanese concept of a "Free and Open Indo-Pacific" could serve as a counter narrative to BRI by offering developing countries in Asia infrastructure and financing at better conditions. Forming such an alliance will not be easy, and for the time being, Beijing has a long head start. But only with a credible alternative may China be persuaded to level the playing field along the Belt and Road.

## Time for reasonable solutions may be running out

Germany and many other European economies have been major beneficiaries of China's economic rise. But the relationship is set to become more complex. A lot is at stake - for all sides.

A look at the relationship between the US and China may give us some indication what may be coming. For American politicians, Republicans and Democrats alike, China has become a key adversary. Using China as a scapegoat for America's woes has worked all too well.

In Germany and most other European countries, the discussion is still much more sober. This is a good thing because it gives policy makers a chance to come up with strategies and policies without the need to constantly signal how they are being "tough on China". It would be desirable for things to stay this way, but we shouldn't rely on it. Discussions will heat up. Concerns about China's political influence and so-called "sharp power", that have received a lot of attention in Australia and the US, are reaching Europe. They lead to a necessary, but also much more public and confrontational discourse.

Likewise, high-profile investments by Chinese companies in prominent European companies may also have the potential to tip the scale. In Germany, the Chinese carmaker Geely recently made headlines by becoming the largest shareholder in Daimler. The announcement came as a surprise and kicked off speculations about Geely's intentions. It is easy to make the case why it might make sense for Geely to take control of Daimler: getting access to all its technologies, know-how and one of the most valuable brands in the world.

What would happen, if one of the brands that is a symbol of Germany's economic strength (and often enough: Germany's superiority complex) were to become Chinese? In any case, it wouldn't make efforts to find reasonable solutions for bringing the Chinese-German partnership back on track any easier.

But even though bilateral partnerships will remain important: In the long run, European countries will only be able to balance China's influence by acting together. Among the many good reasons for strengthening the EU, the imminent shifts in the global order may be among the most compelling. As a whole, Europe still is the world's largest economy and enjoys some of the highest living standards on the planet. This makes for collective bargaining power and attractiveness that no single country could bring to the table on its own.

China is well aware of this and tries to play European countries against each other, e.g. by launching the 16+1 format. European diplomats have reacted by demanding that China respect the "One Europe Principle" as much as it expects other countries to respect the "One China Principle". This has raised eyebrows in Beijing. It is up to Europe to show that this was not only a rhetorical move, but that its unity can be reckoned with.

## PROJECTS

### Germany and Asia