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Nicola Casarini

Chinese leaders tend to think strategically about Europe. By following the process of European integration closely in the last decades, they have succeeded in identifying at different historical junctures those European integration initiatives that would serve China's national security and foreign policy objectives. EU policymakers, instead, appear unable to think strategically about China as EU member states tend to focus on bilateral relations with Beijing, thus undermining Brussels' capacity to fashion a clear and coherent China policy. There is thus a glaring disparity between Beijing and Brussels when it comes to strategic thinking. With China's economic and political rebalancing towards Europe underway, there has never been more need for an adequate response from the Union.

Keywords: China, Europe, rebalancing, strategic thinking

The sustained economic development experienced by the People's Republic of China (PRC) in the last decades has transformed the country into one of the central players in international affairs, with interests and policy goals that now stretch to every corner of the world. China has embarked on a strategy of 'going out' beyond Asia, including a global quest for raw materials and energy resources in the developing countries of Africa, Latin America and the Middle East.[1] Concurrently, Chinese leaders have pushed forward relations with the advanced nations of the West and Japan, given the importance of these markets for Chinese exports and for obtaining the capital goods, industrial know-how and technology deemed necessary for speeding up China's modernisation.

Europe has become China's most important trading partner (ahead of the US and Japan) and its primary source of advanced technology. Moreover, the process of European integration has acquired strategic significance for Chinese leaders who have come to view a stronger and more united Europe in world affairs as instrumental for countering US primacy and advancing multipolarity – two of China's traditional foreign policy objectives.

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[1]Kaplan, "The Geography of Chinese Power".

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Since 2010 – coinciding with the outbreak of the euro crisis and the announcement of the US pivot to Asia – China's rebalancing towards Europe has accelerated. The official discourse in Beijing is now on 'upgrading' (*shengji*) relations with Europe, following the landmark visit by Xi Jinping to EU institutions in Brussels last year – the first time for a Chinese president and an evident sign of the growing interest in the Union. In the second policy paper on the EU issued by the Chinese Ministry of Foreign Affairs in April 2014, soon after Xi's visit, Beijing committed itself to increasing the political and security elements of the partnership with Brussels, while continuing to foster economic and trade relations.[2]

China's interest in fostering relations with Europe is not a recent phenomenon. Since the late 1950s, Chinese leaders have developed a distinctive strategic thinking about Europe, including the role that the process of European integration could play in support of China's national security and foreign policy objectives.

Strategic thinking

From the beginning, the process of economic and political integration in Western Europe was seen by Chinese leaders as important for Beijing's national security and its stated goal of opposing international hegemony. In Mao's three-world view, Europe belonged to the second world and, as such, could be mobilised into a worldwide anti-Soviet front. Mao enunciated his three-world view in 1974, adapting the 'intermediate zones' concept of the early 1960s. In this worldview, the US and the Soviet Union were in the first world, Europe and Japan in the second world, and China with the rest of Asia and Africa in the third world. The idea of having a second-world partner against first-world hegemons was in line with China's traditional approach of making friends with distant countries in order to facilitate an attack on the neighbouring foe.

Mutual diplomatic recognition between China and the European Community came in May 1975. Chinese leaders hoped that the European Community would take on a higher political profile in world affairs, thereby helping to play a more active role in containing the Soviet Union while contributing to the PRC's economic development and technological modernisation. Indeed, Chinese scholars would increasingly interpret the role of a united Europe as a compromise between traditional dependence on the US, and greater autonomy in the future. Such a reading was in tune not only with China's own strategic considerations and desire to exploit the differences between the transatlantic allies, but also with the growing hope that the European integration process would have a major part to play in the political emancipation of Central and Eastern Europe from the Soviet Union.[3]

[2]Chinese Ministry of Foreign Affairs, *China's Policy Paper on the EU*, http://www.fmprc.gov.cn/mfa_eng/wjdt_665385/wjzcs/t1143406.shtml.
[3]Yahuda, "China and Europe"; see also Fardella, *Sino-European Relations*.

Since the early 1980s, West European countries have become an important economic partner for Beijing. Enhancing relations with Europe has allowed China to diversify from its dependence on Japan and the US for imported capital goods and technology. As Deng Xiaoping stated, "We should lose no time in seeking their [West Europe] cooperation so as to speed up our technological transformation…it is a matter of strategic importance."[4] In 1985, China and the European Community signed a Trade and Cooperation Agreement (TCA) which covered economic and trade relations.

The end of the Cold War, the adoption of the Treaty of Maastricht – including provisions for a Common Foreign and Security Policy (CFSP) – and plans for the introduction of a European common currency contributed to a new understanding of the role that the EU could play in upholding China's national security. In the late 1980s and early 1990s, the main reading by Chinese scholars was that the economy had become a major factor in determining the rise and fall of nations. This seemed to vindicate the view, popularised by the book by Paul Kennedy,[5] that only economically sound countries were able, in the long term, to wage war and assert their influence on the global stage. The essence of competition would, thus, increasingly be a contest for overall national power based on the strength of the economy and the development of science and technology. In this vein, Chinese thinkers begun to redefine the linkage between China's economic security and the bolstering of relations with the EU, especially with regard to the possibility of acquiring capital investment and advanced technology, which would be more difficult (if not impossible) to obtain from the US or Japan.[6]

Technology

Over the years, the EU has become China's primary source of advanced technology and industrial know-how. Access to China's attractive market is often used as leverage to push European companies to provide their technology on terms that most of them would not accept anywhere else. Likewise, contracts for larger joint ventures require the European company, on an increasing scale, to contribute to the establishment of cooperative R&D departments, if not outright transfer of some production lines. Chinese leaders have succeeded, for instance, in obtaining from companies, such as Airbus, technology transfer conditions that have made Chinese producers critical suppliers of components and sub-assemblies for some of the most important Airbus products.

[4]Deng, "Use the intellectual resources of other countries and open wider to the outside world", 8 July 1983 (in *Selected Works of Deng Xiaoping*, 43).
[5]Kennedy, *Rise and Fall of Great Powers*.
[6]Ding and Zhang, *Opportunity, Policy and Role*.

China's active industrial policy was boosted in May 2015 after the State Council unveiled the 'Made in China 2025' campaign, a sweeping national strategy designed to enhance competitiveness through automation and overall improvement in technology. This is part of a Chinese vision of an economy driven less by exports and investment and more by services and smart industrial production. It involves moving the Chinese economy away from labour-intense and low-value production towards higher value-added manufacturing, and includes plans to improve innovation, integrate technology and industry, strengthen the industrial base, foster Chinese brands and enforce green manufacturing.[7]

'Made in China 2025' is complemented by – and finds support in – the country's international investment strategy, geared towards the acquisition of advanced foreign technologies, R&D establishments, and expertise in developed economies. In this case also, Europe – and in particular Germany whose 'Industry 4.0' concept was a major source of inspiration for the broad-based Chinese strategy – has become the main target of Chinese purchases.

Chinese investments in Europe are facilitated by the absence of conflict issues between the two sides. As a result, they are – generally speaking – devoid of those strategic considerations and security concerns there would be if made in the United States or Japan.

Investments

Europe is one of the main beneficiaries of China's investment outflows. In 2014, China became a net exporter of capital for the first time after the country implemented legislation that reduces restrictions on outbound investment and encourages companies to look overseas for mergers and acquisitions. In November 2014, President Xi Jinping announced that Chinese offshore investment will reach USD1.25 trillion over the next decade, nearly tripling current Chinese outbound direct investment. This sum includes a USD40 billion contribution to the Chinese-led 'Silk Road Fund' for infrastructural development supporting his vision of "a new silk road and maritime silk road" linking China with Europe and the Mediterranean. To support this project, Chinese officials have declared that Europe is one of the primary destinations of capital outflows.

China's outward investment strategy is bolstered by a number of banks, financial institutions, state-owned enterprises and government agencies, including the State Administration of Foreign Exchange (SAFE), China's Investment Corporation (CIC – Beijing's sovereign wealth fund) and the newly-created Silk Road Fund. Under the direct supervision of the State Council, both the CIC and the Silk Road Fund are mandated to invest, manage and add value to the country's massive

[7] http://english.gov.cn/policies/latest_releases/2015/05/19/content_281475110703534.htm.

foreign exchange reserves, currently held in safe, but low-yielding instruments such as US treasury bonds. The CIC, for instance, is allowed to go 'equity-heavy', as the declared aim is to generate as much return as possible on the reserves, under the preconditions of security. This is taking the form of profitable participation in private equity funds, as well as strategic participation in foreign investment companies running businesses considered of importance.

By the end of April 2015, China had invested more than USD60 billion in the stocks of European companies, becoming the fourth largest investor in Europe, for the first time surpassing Japan.[8] China has also stepped up its involvement in project financing and merger and acquisition activities. In addition to Germany, which remains China's top destination for outward investments, Beijing is now showing great interest in Eastern and Southern Europe. Since early 2014, the People's Bank of China (PBOC), through SAFE, its investment arm, has invested more than €3.2 billion in stakes of about 2 percent each in eight of Italy's largest companies: these include Fiat Chrysler Automobiles, and the state-controlled ENI (oil and gas operator), making PBOC the twelfth largest investor on Italy's stock exchange. Moreover, in May 2014 the Shanghai Electric Group bought a 40 percent stake (€400 million) in the Ansaldo Energia power engineering company. This was quickly followed by the China State Grid's acquisition of a 35 percent stake in the energy grid holding company, CDP Reti, for €2.1 billion.

By April 2015, Beijing had invested more than €6 billion in Italy, a sum that represents around 10 percent of China's total investments in Europe and brings Italy almost on a par with Beijing's investments in France and the United Kingdom. The Italian government has unwaveringly supported Chinese investments, a move mirrored by other austerity-hit peripheral countries of the eurozone. In June 2014, Greece and China signed a ship-building deal worth €2 billion, financed by the China Development Bank. In Portugal, Chinese investors swept up 45 percent of the total assets – mainly infrastructure – put up for privatisation under the Economic Adjustment Programme inspired by the EU and the IMF.

Project financing has emerged as one of the most promising areas for Chinese involvement in Eastern Europe. At the Third Meeting of Heads of State and Government of China and the 16 Central and Eastern European countries (CEECs) held in Belgrade in mid-December 2104, Chinese Premier Li Keqiang pledged to inject more funds to boost infrastructure and sea and land connections between China and the region, in addition to the 69 cooperation projects between China and the CEECs already implemented after the second meeting in Romania in November 2013.

[8]See for instance the report, *Chinese Investment into Europe hits Record High in 2014*, put out by the law firm Baker & McKenzie in February 2015, http://www.bakermckenzie.com/news/Chinese-investment-into-Europe-hits-record-high-in-2014-02-11-2015/.

Monetary connections

The surge in Chinese investments in Europe has been accompanied by growing monetary relations between the PBOC and European central banks. This has occurred mainly through currency swap agreements and the establishment of yuan clearing banks – the so-called 'renminbi hubs' – across Europe.

In the past few years, the PBOC has signed bilateral currency swap agreements worth more than 3 trillion yuan (USD480 billion) with more than 30 central banks and monetary authorities. In October 2013, the PBOC and the European Central Bank (ECB) signed a bilateral currency swap agreement for a sum of €45 billion (RMB350 billion), the largest ever signed by Beijing outside the region. In November 2014, the ECB decided to add the Chinese yuan to its foreign currency reserves.

Most of Europe's major central banks have added – or are considering adding – the Chinese currency to their portfolios, often at the expense of the dollar. In October 2014, for instance, the United Kingdom raised 3 billion yuan via a landmark offshore sovereign yuan bond and kept the proceeds in its foreign exchange reserves rather than converting them into dollars.

Today, the renminbi is the world's second most used trade finance currency and the fifth-ranked global payments currency. More than 50 central banks have added the Chinese currency to their portfolios as growing trade ties and a growing number of reforms by Beijing are leading reserve managers to view it as a viable reserve currency. In the same vein, the number of yuan clearing banks, known as RMB Qualified Foreign Institutional Investors (RQFII), is growing fast. The PBOC has designated several hubs for renminbi trading in Europe: London, Frankfurt, Paris, Luxemburg, Prague and Zurich.

China's ultimate goal is to make the yuan one of the main currencies for global trade, putting limits on the role of the dollar in the international monetary system. Since 2008, Chinese officials and scholars have maintained that the US is abusing its position as controller of the main reserve currency by pursuing irresponsible economic policies. In March 2009, Zhou Xiaochuan, PBOC governor, explicitly called for the creation of a new international reserve currency. An op-ed by the Xinhua news agency on 13 October 2013 did not hesitate to call for a 'de-Americanized' world.[9]

The euro is seen in Beijing as the only serious counterbalance to the dollar. Consequently, China has come to support the eurozone politically, divesting away from the dollar and into the euro. Today, euro-denominated assets represent more than one-third of China's total foreign currency reserves which, at more than USD4 trillion, are the world's largest. This means that Beijing has bought around €1.4 trillion. Chinese purchases of euro-denominated assets were particularly

[9]Liu C., "Commentary: U.S. fiscal failure warrants a de-Americanized world", *Xinhua News*, 13 October 2013, http://news.xinhuanet.com/english/indepth/2013-10/13/c_132794246.htm.

important at the peak of the euro crisis. Beijing's concrete pledges for the purchase of Portuguese, Irish and Greek bailout bonds auctioned by the European Financial Stability Facility's (EFSF) €440 billion rescue fund sent a reassuring message to markets while lending political support to Europe.

Lessons for Europe

Chinese leaders tend to think strategically about Europe. This does not mean that they have always – nor correctly – understood dynamics within Europe and/or in transatlantic relations. Yet, by following the process of European integration closely in the last decades, they have succeeded in identifying at different historical junctures those European integration initiatives that would serve China's national security and foreign policy objectives. At the same time, Chinese leaders have not hesitated to play EU members off against each other when this was thought to be in China's interest. For instance, the decision by Europe's four biggest economies (Germany, France, the United Kingdom and Italy) to join the China-led Asian Infrastructure Investment Bank (AIIB) as founding members in March 2015 – despite opposition from Washington – owes much to the four countries' fear of losing out on Chinese investments and other monetary-related deals.

EU policymakers are unable to think strategically about China. EU member states, in particular the large ones, have tended to focus on bilateral relations with Beijing, hoping that such an approach will bring them positive (that is mainly economic) benefits. By doing so, however, they have undermined Brussels' capacity to fashion a clear and coherent policy towards Beijing. Moreover, there continue to be some EU members that do not want the Union to become a foreign policy actor commensurate with its economic weight and this places limits on the Union's ability to think – and act – strategically vis-à-vis Beijing.

There is thus a glaring disparity between Beijing and Brussels when it comes to strategic thinking. With China's economic and political rebalancing towards Europe underway, there has never been more need for an adequate response from the Union.

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