FOREIGN AFFAIRS
Sep/Oct 2019

The Old World and the Middle Kingdom

Europe Wakes Up to China's Rise

By Julianne Smith And Torrey Taussig

Europe is beginning to face up to the challenges posed by a rising China. From the political debates roiling European capitals over the Chinese telecommunications giant Huawei's involvement in building 5G mobile networks to the tense EU-China summit earlier this year, recent events have shown that European leaders are growing uneasy in a relationship that until recently both sides saw as immensely beneficial. They worry about the political influence China has gained, especially over the EU's smaller members, and its growing economic clout and technological prowess. They are starting, tentatively, to push back.

To better promote its interests, Europe should use its economic, political, and diplomatic power to level the economic playing field with China, guard against Chinese political influence, and defend democratic values at home. Yet two things stand in the way of such a strategy. First, Europe remains divided over how seriously to take the Chinese challenge. In contrast to the strategic shifts happening in Berlin, Paris, and the EU capital, in Brussels, the leaders of many smaller states still see only the economic benefits of deeper engagement with China. Second, Europe finds itself caught in the middle of a growing U.S.-Chinese rivalry. It cannot abandon its long-standing ties to the United States (even as it squabbles with the Trump administration over everything from tariffs to defense spending), but it also cannot afford to weaken a trade relationship with China worth well over $1 billion a day. Europe is walking a fine line by nominally resisting China's predatory trade and investment practices but not issuing any meaningful threats. So far, playing it safe has failed to persuade China to change course.

Europe needs a new approach, one that acknowledges the gravity of the problems posed by China's rise and outlines a distinctly European, rather than American, response. Europe and the United States should better coordinate their policies on China, but they will never agree on everything. Even without copying Washington's every move, Europe can defend its economic and technological sovereignty and serve as a bulwark against China's efforts to promote its values and system of government abroad. To do that, however, Europe will need to achieve two goals that have so often eluded it: unity and autonomy.

FROM OPPORTUNITY TO THREAT

Germany is well positioned to lead this effort. Few other European countries can match its economic ties with China. This grants Berlin a unique ability within the EU to push back against Beijing—a process that it has already begun. A decade ago, Germany was busy cozying up to China. In 2010, after unsuccessfully advocating an EU-wide China strategy, German Chancellor Angela Merkel returned to the bilateral relationship between Germany and China, aggressively seeking closer economic ties. In 2013, she fought EU plans to slap tariffs on China for selling solar panels below cost, fearing the effect on German businesses operating in China. In 2014, she elevated Germany's relationship with China to "a comprehensive strategic partnership." Although she did regularly raise human rights concerns with Chinese leaders, the trade relationship took precedence over most other issues.

Merkel's efforts paid off. Germany became China's leading trading partner in Europe and is now one of only three EU countries (along with Finland and Ireland) that run a trade surplus with China. Some 5,200 German companies operate in China, employing more than one million people. By 2017, four out of every ten cars sold by Volkswagen were going to China. That same year, China surpassed the United States as Germany's biggest trading partner.

Germany still treasures its special relationship with China, but it has grown unhappy with Chinese behavior. In 2015, the Chinese government announced its state-led Made in China 2025 strategy, modeled on Germany's Industrie 4.0 initiative, with the goal of making China the global leader in high-tech manufacturing. The strategy prioritizes progress in areas such as 5G networks, robotics, aerospace, advanced railway equipment, and clean energy vehicles. It aims to replace foreign technology with Chinese-made alternatives, first in China's domestic market and eventually abroad. In response, Germany and other European countries have started to limit Chinese investment in crucial industries.

China's repressive political turn has also alarmed Germany. Chinese President Xi Jinping's consolidation of power has shaken Germany's confidence in China's future political stability. The Chinese government is using technologies employing artificial intelligence (AI) to monitor its citizens' every move and power a social credit system that will judge their trustworthiness. In the name of national security, the government has detained more than one million Muslim Uighurs in the western province of Xinjiang in "reeducation camps." To many in Germany and across Europe, these developments raise troubling questions over what a Chinese-led world would look like.

German industry is growing concerned about Chinese technological progress. German business leaders who have long supported deeper economic ties with China are now apprehensive about China's state-led quest for technological supremacy at the expense of German companies. In January, the Federation of German Industries released a widely cited report cautioning companies to reduce their dependence on the Chinese market. Then there is the long-standing issue of Chinese hackers stealing foreign industrial and technological secrets. In December, the heightened frequency of Chinese hacking led the German government's cybersecurity agency to warn German companies about the growing risk of Chinese cyber-espionage. That came on top of a 2017 case in which German intelligence agencies accused China of creating fake LinkedIn accounts to connect with more than 10,000 German citizens, including lawmakers and government officials, in order to gain information, recruit sources, and infiltrate the Bundestag and government ministries..

These grievances are having a mounting effect on German policy toward China. Merkel, who now refers to China as a "systemic competitor," is pushing for a strong and united EU stance and has publicly criticized decisions that undercut EU unity on China, such as Italy's official endorsement of the Belt and Road Initiative (BRI), China's massive global infrastructure-building scheme. She has also made clear that she values talks between the EU and China as much as direct German-Chinese ones. Earlier this year, she successfully proposed that the 2020 EU-China summit, to be hosted by Germany, include not only EU officials, as is the norm, but also national leaders from all the EU countries. That will make it harder for China to undermine EU unity by negotiating with individual countries.

Germany is not alone in its awakening. Europe's two other biggest powers—France and the United Kingdom—along with Poland, Spain, and the Scandinavian countries, all maintain that cooperation with China on global challenges, such as climate change and nuclear proliferation, serves Europe's interests. But they also believe that China is undermining Western values, rules, and standards. During Xi's recent visit to Paris, French President Emmanuel Macron declared an end to "European naiveté" on China. Macron also invited both Merkel and Jean-Claude Juncker, the president of the European Commission, to join his meetings with Xi in order to present a united front. The message was clear: Europe will resist China's attempts to divide it.

Many European countries are experiencing what one senior EU official described to one of us as "China fatigue," after years of investments that were big on promises and short on follow-through. In 2009, a Chinese construction firm promised to build a new highway from Warsaw to Germany for a fraction of the cost of other bids in a project that was meant to showcase Chinese prowess and open up new deals in the EU. Two years later, the Polish government had to terminate the contract after the Chinese firm hit cash-flow problems and stopped work.

The Czech Republic has also grown disillusioned. In 2014, the Czech government proclaimed that it would serve as "China's gateway to Europe." At the time, the Chinese megacompany CEFC China Energy was promising to invest billions of dollars in the country. Czech President Milos Zeman named the company's chair, Ye Jianming, as an honorary adviser, a move that vindicated critics who had argued that China's investments were never solely economic—they were also about building political influence. CEFC then went on a shopping spree, snapping up stakes in everything from Czech football clubs and media groups to transportation companies and breweries. In 2018, after years of negligible progress on the investments, Ye was suddenly arrested in China on corruption charges. CEFC, along with its Czech acquisitions, was taken over by the Chinese state.

In response to such incidents, several European countries have tightened up their screening of Chinese investments. In 2018, the German government, citing national security, blocked a Chinese investor from buying Leifeld Metal, a leading German producer of metals for the automobile, space, and nuclear industries. It was the first time that the German government had vetoed a Chinese takeover. The move was followed by a new law giving the government the power to block a non-European investor from buying a ten percent or higher stake (down from 25 percent) in a German business. The law includes media companies, a sign that Germany is worried about Chinese information influence. A number of other European countries have adopted similar measures. In part as a result of more rigorous screening, as well as shifts in Chinese decision-making, Chinese foreign direct investment in the EU has fallen by 50 percent from its peak in 2016, according to a report by the Rhodium Group and the Mercator Institute for China Studies.

China's BRI has drawn particular skepticism from EU policymakers, who see golden handcuffs behind Beijing's promises of lavish spending. In some places, the handcuffs are already snapping shut. In 2016, Greece and Hungary—both recipients of massive Chinese economic investment tied to the initiative—watered down language issued by the EU on Chinese aggression in the South China Sea. In 2017, Greece torpedoed an EU statement on Chinese human rights violations. Earlier this year, Portuguese Prime Minister António Costa, whose country has received significant Chinese investment, took a strong stand against tighter European screenings of Chinese investments. "We've now reached a situation where China essentially has veto power inside EU decision-making bodies," one senior EU policymaker observed recently to one of us.

As some European countries have grown disenchanted with China's behavior, they have started to push for a more coherent EU-wide strategy. A recent EU white paper on China labeled Beijing a "systemic rival promoting alternative models of governance" and called on the EU to pursue a more reciprocal relationship with China and to strengthen its own industrial base. At this year's annual EU-China summit, which took place after the white paper was published, the mood was more tense than in previous years. The Europeans came ready to extract significant commitments from their Chinese counterparts on trade and economic policies, and the Chinese delegation arrived weakened by the trade war with the United States. Both sides wanted to signal to Washington that they could make progress without resorting to President Donald Trump's strong-arm tactics. The EU managed to win a number of concessions, including pledges to finalize a long-standing investment deal by 2020, improve market access for European companies, and limit forced technology transfers. The two sides also agreed to intensify their discussions on strengthening international rules on industrial subsidies in the World Trade Organization (WTO) that China is known to bend. Yet given China's past unwillingness to carry out structural changes and the EU's lack of enforcement measures, China is unlikely to keep its promises.

A HOUSE DIVIDED

The EU has come a long way on China, but internal differences remain. Some countries, including Greece, Hungary, and Portugal, continue to press for more economic investment from China and downplay the concerns of EU officials in Brussels. In a 2017 survey of public opinion in Greece, a majority of respondents listed the EU as the most important foreign power to Greece, but when asked which ranked second, more respondents (53 percent) listed China than the United States (36 percent). At least in some corners of Europe, China's strategy of making friends through economic engagement, cultural exchanges, and academic collaboration is working.

That success is reducing the EU's leverage over China. For example, Brussels has been unable to craft a united response to U.S. demands that European countries ban Huawei from their 5G networks. The EU Commission has issued recommendations on the cybersecurity risks, but it remains up to each member state to determine its own security standards. Most are still struggling to formulate national policies on 5G. Germany and the United Kingdom are tightening the security requirements for their 5G providers, and

France already has security standards that deter telecommunications operators from using Huawei equipment in their 5G plans. None, however, is likely to pursue Washington's preferred approach of banning Huawei entirely, and an EU-wide policy is a long way off.

A similar problem is playing out when it comes to evaluating Chinese investments. Several EU members that depend heavily on Chinese investment oppose strict screening, and only 14 of the EU's 28 members have national investment-screening measures in place. In April, the EU enacted a new framework for determining when investments threaten European interests. But member states still have the last word on specific investments, and the regulation is much less ambitious than those that the G-7 countries have already adopted.

In addition to tackling its internal divisions over China, the EU is struggling to determine whether and how to cooperate with the United States on China. In theory, it should be easy for the two powers to develop a common approach. Both worry about China's lack of market access for Western companies, its encroaching political influence, and the debt burdens of BRI projects. Both doubt that China will become the "responsible stakeholder" that many China watchers envisioned a decade and a half ago.

Yet several obstacles stand in the way of transatlantic unity. Decoupling from the Chinese economy, Washington's current strategy, is not an option for even the largest European countries. The same German industry report that called on companies to reduce their dependence on China also said that German industry "rejects targeted and politically forced economic de-coupling." European governments and businesses may be troubled by China's unfair trade practices and hacking, but they are unwilling to pursue a trade war to force China to change.

Another problem is that Europe does not trust the United States. By withdrawing from the Paris agreement on climate change and the Iran nuclear deal, threatening to withdraw from the WTO, and slapping steel and aluminum tariffs on the EU, the Trump administration has damaged the United States' credibility among its closest allies and made China a more important partner for Europe on environmental and security issues. As the United States' relationship with Europe deteriorates, at least some European leaders see no choice but to jump on the Chinese bandwagon.

EVER-CLOSER UNION

Barring domestic setbacks, China's economic, technological, and political power will continue to grow. But China is not preordained to write the rules of the new international order. Leading democracies across Asia, Europe, and North America still have overwhelming advantages when it comes to trade, intellectual property, economic heft, and political alliances. They can use those strengths to oppose the more divisive and negative aspects of China's global influence.

For Europe, that will mean developing a more coherent and distinctly European strategy that capitalizes on the EU's unique strengths. So far, Europe has gone to great pains to avoid confrontation with either the United States or China. That is understandable, but it has left the EU on the sidelines. Brussels does not need to adopt Washington's hard-line approach to China, but neither should it accept all of China's attempts to expand its economic and political influence in Europe.

Disunity on foreign policy is nothing new for Europe. On crises from the Balkan wars to Russia's annexation of Crimea, the EU has had to reconcile the different cultural, historical, and strategic perspectives of its member states. Consensus often seems elusive. But it's not impossible. During the negotiations that led to the Iran nuclear deal, for example, a group of large member states managed to unite the EU around a single position. Similarly, with more impetus from the countries that have experienced firsthand the downsides of Chinese investment or Beijing's forced technology transfers, the EU could narrow the gaps between its members over China. Brussels should invite German industry representatives to brief EU officials on their knowledge of working inside China or ask Czech and Polish officials to share their experiences with Chinese investment.

More European autonomy, far from deepening transatlantic divisions, would bring much-needed balance to a spiraling confrontation between the United States and China. EU members have been calling for autonomy on defense for years, and nascent initiatives, such as the Permanent Structured Cooperation (which enables members to develop joint defense capabilities and invest in shared projects) and the European Defence Fund (which will provide support for joint research projects and shared military hardware), suggest that the EU may finally be moving in the right direction. France and Germany now need to work together to ensure that those initiatives meaningfully strengthen Europe's defense capacity.

Even more important for its competition with China, Europe must boost its economic and technological sovereignty. That could mean more state investment in key industries, such as transportation and technology, as Germany's economy minister, Peter Altmaier, has proposed. The EU could also amend its competition laws to allow governments to foster national and European champions that could compete with their counterparts in the United States and China. Some French and German policymakers have called for such an approach, especially after the European Commission rejected a proposed merger between a German rail subsidiary of Siemens and the French transport manufacturer Alstom in early 2019 despite increasing competition from Chinese rail providers. Although building European monopolies would be a bad idea, the EU should consider allowing mergers in industries at risk of being swamped by U.S. or Chinese rivals. Some analysts have suggested creating a cross-border European AI company modeled after Airbus, which was originally formed as a joint government initiative among France, the United Kingdom, and West Germany in the 1960s. To complement such policies, EU countries should do more to encourage entrepreneurs and develop training and academic pipelines to feed growing technology sectors.

Europe can also help set regulatory and ethical standards for the rest of the world. Many foreign companies are already moving to comply with the EU's General Data Protection Regulation, even in their operations outside the EU, highlighting Europe's ability to project its digital values. The GDPR is only the first step in Europe's technology leadership. In April, the European Commission released its first guidelines on the ethical development of AI. EU policymakers hope that they will give European technology companies a competitive edge and provide a distinctly European model for international companies to emulate.

A TRANSATLANTIC STRATEGY

An autonomous EU strategy need not preclude Europe from working closely with the United States on China. But first, the two sides will have to repair their deteriorating trade relationship and return to their 2018 joint pledge to work toward "zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods." Although Brussels and Washington are unlikely to strike a comprehensive free-trade agreement, they could pursue a more piecemeal process that could give them some smaller but much-needed victories, prevent a trade war, and demonstrate transatlantic unity. Resolving at least some of their trade disputes would allow Europe and the United States to turn to a more ambitious global agenda.

That agenda should involve joining with like-minded states to address China's trade violations within the WTO. The United States already coordinates closely with the EU and Japan to counter China's market distortions. All three should do more, particularly on protecting intellectual property, lowering nontariff barriers, and stopping cybertheft—all issues that Trump raised with Xi at the G-20 summit in December 2018.

Europe and the United States should also be developing alternatives to the BRI. For many countries, Chinese investment—even with its associated debt burdens—feels like the only option to address ailing or nonexistent infrastructure and build domestic industries. In many places across the European continent, such as Serbia, the EU has tried to offer alternatives. But the bureaucracy-laden and painfully slow aid on offer from Brussels is no match for cheap, unconditional Chinese loans.

The West needs better options. The EU's Europe-Asia Connectivity Strategy, which was unveiled in late 2018 and aims to strengthen digital, transport, and energy links between Europe and Asia and promote development, could provide alternatives to the BRI. So could the United States' BUILD Act, which Congress passed last year, creating a new development finance institution with a $60 billion budget to invest in developing countries. Yet such efforts will inevitably pale in comparison to the BRI, whose funding already amounts to more than $200 billion and could run as high as $1.3 trillion by 2027. If either project is to succeed, therefore, it will need clearer priorities, more money, and greater political backing.

Another, less ambitious approach would be for Brussels and Washington to send policymakers and economists to independently evaluate projects that countries are considering with China. Last year, the U.S. Treasury Department sent a small team to Myanmar to help the government there renegotiate a Chinese port deal. The Wall Street Journal reported that Myanmar officials got a better deal and steered clear of debt traps thanks to U.S. assistance. Brussels and Washington should offer the same expertise in places such as Portugal and Serbia.

EU member states and the United States should also work together to counter Chinese influence in their political systems. Washington and several EU members have already signaled concern over the issue and are looking to the anti-foreign-interference legislation that Australia passed last year as a model for dealing with Chinese political meddling. But such resistance should go beyond national governments. Europe and the United States must better understand the channels of Chinese influence at the local and societal levels to see the full effects on open debate, academic integrity, and public discourse. European and American universities that host Confucius Institutes could share best practices for securing academic freedom in the face of Chinese state funding. Local and regional government officials on both sides of the Atlantic should assess Chinese investment plans, such as that in Duisburg, Germany, where the mayor has decided to partner with Huawei to developed a "smart city" based on advanced infrastructure, cloud computing, and better city logistics.

A transatlantic strategy on China should not focus only on countering Chinese policies. All three actors—the EU, the United States, and China—have come together in the past to address common challenges, such as climate change. They can do so again. China's environmental policies will be critical to making global progress on climate change; Europe and China should pursue every avenue of cooperation until the United States comes back to the table. Promoting development need not be solely competitive, either. Western governments and companies should try to encourage China to raise the labor and environmental standards, use transparent contracts, and focus on financial sustainability in its investment and infrastructure projects by combining their resources and expertise to offer their own high-quality investments to emerging-market countries, creating a race to the top among development projects. Japan's connectivity strategy, launched by Prime Minister Shinzo Abe soon after China introduced the BRI, offers a good model. The associated $110 billion fund has boosted Japan's ability to finance high-quality and financially sustainable development projects, at times in cooperation with China, if it abides by Japan's principles. What the Japanese seem to have learned faster than their transatlantic counterparts is that states will follow China's lead if it is the only player in the game, but when other countries compete, the developing world gets better options.

ALL TOGETHER NOW

These are tough times for the EU. Brexit, illiberal triumphs across Europe, a resurgent Russia, and deteriorating transatlantic ties have sent European leaders scrambling to preserve both the European project and the international system. That has left them with less time and energy to focus on China. Although some countries are developing responses to China's growing economic engagement with and political influence in Europe, too many are ignoring the challenge from China.

During the Cold War, Europe was a battlefield for ideological competition between the United States and the Soviet Union. It had little say in the outcome. Today, Europe has the ability to prevent a new Cold War and promote a more stable and prosperous future. If that is to happen, Germany will have to take the lead. It should urge the continent to develop a coherent strategy that draws on Europe's unique strengths and liberal democratic values. Only then can the EU work with the United States to revamp a tired international system—from updating the global trading architecture to managing new and disruptive technologies—and protect the liberal order's open, democratic nature from Chinese influence. If the democratic world cannot rise to the task, China will remake the system as it sees fit. Europe will not like the result.