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China and Europe: Trade, Technology and Competition

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ABSTRACT

Over the last five years, Brexit, the victory of Donald Trump in the US and the assumption of power by Xi Jinping in China, the seizure of Crimea and the Ukrainian crisis, the South China Sea disputes, and the emerging Iran crisis, have all helped upend the world order. Amidst these crises, the surge of Chinese acquisitions and investments in Europe did not draw much attention. The acrimony, however, between China and the US on trade and industrial policy has led to a greater scrutiny in Europe. China is being accused of using the openness of market economies to acquire an edge in emerging technologies, an effort often directed and subsidised by the state. Besides raising the demand for equal market access, the Europeans have tightened their scrutiny of Chinese investments and placed restrictions on those relating to sensitive industries. This process can result in China reforming its system; at the same time, the growing Sino-US schism can complicate matters, too.

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INTRODUCTION

Like the United States (US) and other countries in different parts of the world, Europe has a history of fruitful and mutually beneficial relations with China. In recent years, following the US—albeit not with the same intensity or methods—the European countries are re-assessing certain aspects of their relationship with China. This re-examination is driven in great part, ironically enough, by the very success of their relations with China: As China gained access to the markets and technologies of Europe, it emerged as a worthy competitor in the same realms previously dominated by the continent such as railways, automobiles, chemicals and machinery. Indeed, in some areas like 5G telecommunications technology, China has already become a dominant player, besting two prominent European rivals. While the dominance in technology of a nation (or a group of nations) can be considered a given, the nature of the Chinese state, and the primacy of its huge state-owned enterprises and banks, pose an entirely new set of challenges to global trade systems. The opacity with which China's systems operate, complicate things further.

This paper examines how China's "full spectrum" strategy in moving up the global value chains—from an aggregator of high-end products to a producer and consumer of such goods—is playing out in Europe. This strategy has been systematic, involving, among others, the acquisition of European companies or the purchase of strategic stakes in them. Again, acquisitions—often with the view of accessing a particular technology—happens in market economies. In the case of China, however, the process is often aided by hidden subsidies and support from state-run or -controlled entities, crossing the line to the *illegal* in most market economies. China's strategy also involves gaining political and economic leverage in the poorer Central and East European Countries (CEEC) through investments.

The paper pays particular attention to the Belt and Road Initiative aimed at tightening China's links with Europe through overland and maritime connectivity, as well as trade and investment. This project now represents the cutting edge of the China-led connectivity and globalisation plans. The paper then looks at Europe's evolving response, especially that of Germany which is China's principal partner in the continent. The US-China dynamic is beyond the scope of this paper, whose purpose is to see whether or not China and Europe can reconcile their goals in a way that is mutually beneficial. It does, however, examine the Huawei issue and the American pressure on Europe to block the company. This could well be a pointer for a more fraught world pursuing mutually exclusive visions of globalisation.

HISTORICAL BACKGROUND

China and Europe share a relationship that goes back to antiquity. Their contemporary relationship, however, took off understandably only after the opening up of China in the 1990s. European companies saw China as a lucrative place to invest, and the latter found great advantages in a relationship with Europe as both a source of technology and a market for its products.

While China has trading partners in much of the world, its principal relations are with the US and Europe. In 2018 Chinese exports to the EU were valued at Euro 394.7 billion, while those to the US, Euro 406.317 billion; meanwhile, EU exports to the US were Euro 406.372 billion in the same year, and to China, Euro 210 billion.[1] China's earnings from its trade with Europe, along with foreign direct investment (FDI) from European companies, have aided Beijing in establishing a domestic infrastructure of industries that are now emerging as competitors of the European companies. In turn, many European companies like the car giants Volkswagen and Daimler depend on the Chinese market for their growth, and others like Volvo have been acquired by Chinese companies.[2]

China's rapid economic transformation has expanded the sheer size of its domestic market. European companies are seeing China as a lucrative place to invest in, as the latter views the former as a source of technology, investment and market for its products. In the past decade China has spawned companies and banks of global scale, and is looking to become a leading industrial power in the 21st century. Already, companies like Baidu, Alibaba, Tencent and Huawei are serving fierce competition to their American counterparts, Google, Amazon, Facebook and Cisco. (Similar competitors remain absent in Europe.)

China is therefore developing cutting-edge technologies that could lead to the next industrial revolution. In its desire to leapfrog, however, it appears that China is choosing to bypass certain rules of the road. For example, even as it has purchased a technology or obtained licence to its use—or else obtained it through the acquisition of a foreign company—China has also either forced foreign partners to transfer technology or used cyber theft to gain them.[3] Further, whether implicitly or explicitly, China has articulated its vision of not only developing self-sufficiency, but displacing existing technology leaders and achieving global dominance. Not surprisingly, this has generated concerns in many parts of the world.[4] Despite this, China realises the benefit of the common market for goods and services that the European Union (EU) provides and its standing as a key pole in a multipolar world order. For their part, the European countries are not entirely happy with the current state of affairs with China. This would help explain the popular reluctance to join either the BRI or the Asian Infrastructure Investment Bank (AIIB). After the UK became a founding member in 2015, and despite US pressure, several other European countries—e.g., France, Germany and Italy—also joined the Bank. Italy's formal signing up to the BRI provoked great interest as it is the first major European country to do so.[5] The 16 (now 17)+1 grouping of Central and East European countries and China, is also being viewed with alarm.

Despite the various concerns, the European countries have been carefully calibrating their response. On one hand, the EU has made it clear that it will apply the reins on the aggressive acquisition of technology by Chinese companies. On the other hand, it also wants to ensure that the rules will continue to allow legitimate Chinese investments and even merger and acquisition activities.

Meanwhile, Huawei's 5G offering has generated tensions with their trans-Atlantic ally, the US; the episode is also sharpening the issue of trade and technology ties between the West and China. Here is an instance where a Chinese company holds many advantages—including price and experience—in a technology, namely 5G, which is projected to be a revolutionary innovation. What the US is saying is that it will not trust China as a technology leader and is urging its allies to follow its lead in denying Chinese giants like Huawei and ZTE any role in rolling out 5G technology in their countries.

China may have earned such distrust largely by its own actions. After all, China divided the internet world into two technospheres in a bid to promote its national champions like Baidu, Tencent and Alibaba. The rampage of China's cyber-espionage activities has also generated a great deal of distrust for its telecommunications giants like ZTE and Huawei. There is also its National Intelligence Law, which binds Chinese companies to cooperate with the state. Countries and companies may have profited enormously from the Chinese connection, but the process has not yielded the kind of trust and cooperation that would have benefited China.

The difficult relations between the US and EU on account of trade frictions and military spending tinge European policy with regard to China. This, however, is just a nuance as the EU remains the number one trading partner of the US, and, of course, it is a military ally through the NATO. Nor can it be denied that Europe's recent articulation of its grouses with regard to China's business practices and industrial policies has received an unexpected boost from the changed American attitude towards China. The EU attitude has been summed up in a European Commission document issued in March 2019 which noted that China was simultaneously:

> "A cooperation partner with whom the EU has closely aligned objectives, a negotiating partner with who the EU needs to find a balance of interests, an economic competitor in pursuit of technological leadership and a systemic rival promoting alternative models of governance." [6]

CHINA IN EUROPE

China's economic growth continues to offer Europe new opportunities. In turn, the European market and technology fit well with China's current needs and plans for the future. More than half of the total known Chinese investment in Europe is concentrated in the continent's five largest economies—i.e., the UK, Germany, France, Italy and Spain. The smaller countries like Greece, Portugal and Cyprus have seen significant amounts of investment as well, especially following the 2008 economic crash and the subsequent Euro crisis.[#] Chinese companies

\# When it was introduced in 2002, the Euro was one of the world's strongest currencies. But by 2009, the expansion of the Eurozone led to the accumulation of massive and unsustainable deficits and public debt, triggering a sovereign debt crisis that required the EU and the IMF to bail them out.

have been strategic in their acquisitions, focusing on areas where the country seeks to become a major, if not the dominant, global player. These industries include robotics, biopharamaceuticals, renewable energy, environment, micro-electronics and electrical vehicles, as well as real estate, ports, railways, high-voltage electricity grids, and 5G—an enabling technology in a range of areas like driver-less cars and the Internet of Things that is a class in itself.

The first wave of Chinese acquisitions came with the economic crisis of 2008 and the subsequent Euro crisis. Among the companies they took over or where they bought significant stakes included the UK mining giant Rio Tinto, the Swiss petro company Addax Petroleum, and the Swedish Volvo cars in 2009, the Portuguese power company, Energias de Portugal (EDP) in 2011, the exploration division of Engie SA of France in 2011, the East African unit of the Italian giant ENI in 2013, and in 2015, the Italian tyre maker Pirelli.

That the Chinese are working to a larger strategic plan is evident from its acquisitions relating to grids. The Chinese have specialised in ultra-high voltage grids and expect it to be a technology of the future. In 2017, China's State Grid Corp, the world's largest utility bought a 24-percent stake and became the second largest stakeholder after the Greek government in the country's national power operator ADMIE. State Grid also has a 25-percent stake in the Portuguese national grid operator Redes Energeticas Nacionais (REN), and 10 percent in the national grid of Italy. In 2018 it unsuccessfully sought to get a 20-percent holding in a German grid company.[7] In April, Three Gorges Corp made a bid for a majority stake in Energias de Portugal (EDP), where it already has a significant stake. But this collapsed after opposition by shareholders.[8]

Table 1. Key acquisitions by Chinese companies (2016-2018, select European countries)

Country	Company	Chinese principal	Year of acquisition	Industry
Germany	Kuka	Midea	2016	Robotics
	Kraus Maffei	China National Chemical Corp	2016	Plastics and rubber
	EEW Energy from Waste	Beijing Enterprise Holdings	2016	High tech waste disposal
	Ista	Li Ka-Shing	2017	Smart meter
	Daimler	Zhejiang Geely	2018	Motor cars
	Thuringia	CATL	2018	Batteries
	Beijing Auto	Borgward	2018	Electrical cars
	Creat	Biotest	2018	Biological drugs
UK	Creat	Bioproducts Lab	2016	Biotherapeutics
	Logicor	CIC	2017	Logistics
	Imagination Technologies	Canyon Bridge	2017	Graphics processors
	Dialog Semiconductor	Tsinghua Unigroup	2017	Semiconductors
	Global Switch	Ping An, Citic Bank and AVIC	2018	Data centre developer
France	Linxens	Tsnghua Unigroup	2018	Smart chip component maker
Sweden	Volvo trucks	Zhejiang Geely	2017	Trucks
Switzerland	Syngenta	China National Chemical	2017	Agrochemicals
Greece	Port of Piraeus	China Ocean Shipping Company (COSCO)	2016	Port
	ADMIE	State Grid Corp	2017	Power
Netherlands	NXP RF Power	China Jianyin Investment Ltd	2016	Semiconductors
	OEP	Shenzen Invengo	2018	Digital library
	Wingtech	Nexperia	2018	Semiconductors

Source: American Enterprise Institute, China Global Investment Tracker http://www.aei.org/china-global-investment-tracker/

The acquisition spree shown in Table 1 immediately raised concerns. The watershed was the May 2016 takeover of Kuka in Germany, a company specialising in making robots for automobile plants, by the Midea Group, China's largest manufacturer of home appliances. It sent a shock to the German public as the company had been the embodiment of the country's industrial prowess.

By 2018, these concerns had escalated to the point where several European countries progressively tightened their domestic laws to restrict FDI in certain areas deemed to affect national security. The EU itself began a debate on an EU-wide law to screen the sale or takeovers of companies deemed sensitive. To a considerable extent, these concerns were catalysed by the American critique of China's industrial policy. Not surprisingly, the European moves coincided with the strengthening in the United States, of the powers of the Committee on Foreign Investment in the US (CFIUS).

With the onset of US pressure on China in 2017, Beijing's investments moved dramatically towards Europe. According to a study by Baker McKenzie, in the first half of 2018 Chinese FDI to Europe totalled US$ 12 billion, representing an increase of four percent over the previous year, excluding the Syngenta acquisition. This was in contrast to the 92 percent plunge of the US-bound Chinese FDI, which came down to only US$ 2 billion. Germany, France, Sweden and UK were the destinations for Chinese investments.[9]

However, according to an analysis by *Foreign Policy*, as a result of Chinese controls on capital exports and the increased resistance of European and American regulators, Chinese investment to both the US and Europe declined sharply in 2018.[10] Completed Chinese transactions in Europe had gone down from some US$ 80 billion in 2017, to US$ 22.5

billion in 2018. However, investments have kept coming into France, Germany, Spain and Sweden.

Troubling tactics

The reason why China's expanding footprint in Europe is provoking concerns is that Beijing tends to utilise underhanded tactics. Such behaviour was seen in the purchase of two German companies, the semiconductor company, Aixtron and the automobile giant Daimler. Aixtron has long been in the business of fabricating advanced tools for making highly sophisticated semiconductors, and its attempted takeover by Fujian Grand Chip pointed to a possible collusion involving the Chinese government itself. In 2015, the German company fell to bankruptcy after a Chinese buyer, San'an Optronics, unceremoniously cancelled a large order. When it went up for sale in May 2016, a Chinese investment group, Fujian Grand Chip offered to buy it. The German think tank, Mercator Institute of Chinese Studies, investigated the issue and found that San'an and Fujian had a common principal investor in Liu Zhendong. Further, both companies were receiving huge amounts of funds from the Chinese government which, as a matter of policy, has set out to buoy up the country's semiconductor industry. Eventually the Aixtron deal collapsed after the US CFIUS vetoed it.[11]

The other case is related to the well-known Daimler company. Initially, in 2017, Daimler had turned down an offer from China's Zhejiang Geely for taking a five percent stake in the company. Geely, which also owns both the cars and trucks arms of Volvo, had been interested on Daimler's car battery technology for the electric car joint venture it was planning to set up in Wuhan.[12] In a surprise move, a few months later, Geely purchased a US$ 9-billion stake (9.69 percent) in Daimler, making Geely the company's single largest investor. The investment skirted disclosure requirements that are supposed to be triggered when investors cross three- and five-percent of voting rights, by using derivatives. While Daimler itself expressed satisfaction with the development, the German government said it would be carefully watching the situation.[13]

That Beijing bypasses government rules was evident in the case of the Chinese company, Contemporary Amperex Technology Ltd (CATL). CATL, the biggest maker of electric vehicle batteries in China, agreed to build its first foreign plant in the eastern German state of Thuringia. The state government there was ready to provide the company access to German high-tech R&D, something that the Federal Government had not been keen on. The federal government was pushing instead a European consortium for batteries to enable Europe to compete with China. Thuringia was ready to challenge Berlin because the CATL investment of Euro 240 million was the most important one in the state in decades.[14]

Another aspect was the role of the state in promoting business, something that is highly regulated in Europe. In early 2018 *Bloomberg* audited the Chinese purchases, analysing data for 678 completed or pending deals in 30 countries since 2008. The audit found that both Chinese state-backed and Chinese private companies had been involved in deals worth at least US$ 255 billion across the continent, including the takeover of some 360 companies.[15] Among the Chinese corporations that made the purchases, 100 were state-backed entities or investment funds, which were involved in US$ 162 billion or 63 percent of the reported deals. Eight of the ten largest acquirers that Bloomberg identified were state-owned or state-backed, including China Investment Corp, a sovereign wealth fund; the Aluminum Corp of China Ltd; and the Silk Road Fund Co, another sovereign wealth fund.[16]

Central and Eastern Europe

In 2011, Beijing revealed another side of its European strategy by establishing the 16+1 grouping of China and the 16 Central and Eastern European Countries (CEEC). (At the latest CEEC summit held in Dubrovnik on 12 April 2019, Greece became a member, thereby making it a 17+1 grouping.) This was apparently at the invitation of Hungary's Prime Minister Viktor Orban, who was then urgently looking for financial support in the wake of the 2008 economic crisis. The CEEC is a loose grouping of 12 EU countries and five candidate members. What unites them is the fact that they are poorer than Western Europe and in need of foreign investments. China is helping fill the investment vacuum in CEE countries but the EU authorities and the US worry that these countries will become beholden to Beijing and undermine a common posture against China.

Following the November 2016 CEEC meeting in Latvia, China agreed to set up a Euro 11-billion fund to boost investments in the region. The fund will be managed by the Sino-CEEF Holding company, a subsidiary of the state-owned Industrial and Commercial Bank of China. China plans to raise another Euro 55 billion to finance joint ventures in logistics, clean energy and pharmaceuticals in the CEEC region.[17] After the 2017 CEEC summit in Budapest, Chinese premier Li Keqiang launched the construction of a US$ 3.64-billion upgrade of a high-speed rail link between Belgrade and Budapest. Chinese investments in the CEEC countries have crossed US$9 billion as of June 2018.[18]

Its ties with the CEEC countries have helped China deflect EU actions on issues of human rights violations as well as international laws relating to its disputes in the South China Sea. In 2015, CEFC China Energy opened its European headquarters in Prague, making huge investments in real estate and media and developing ties with the Czech government to the point where its chairperson Ye Jianming was named adviser to Czech President Milos Zeman. Not only did the company invest in a range of areas, the Czech government was also persuaded to cold-shoulder pro-Tibet activists.[19] Greece, along with Croatia and Hungary, initially blocked the EU from issuing a statement on the 2016 South China Sea UNCLOS arbitration tribunal ruling against China. Eventually, after negotiations, a watered-down version of the original statement was issued.[20] In March 2017, Hungary refused to sign a joint letter denouncing the alleged torture of detained lawyers in China. Also that year, Greece blocked an EU statement at the UN Human Rights Council criticising China on the issue of human rights, charging that it was "unconstructive" and "selective criticism."[21]

The Belt and Road Initiative

China's Belt and Road Initiative (BRI), initiated in 2013, emerged from an earlier concept of the Silk Road Economic Belt (SREB) and the Maritime Silk Road to reconstitute the historic routes between China and Europe going back 2,000 years. While China's interest in developing connectivity and overseas investments pre-dated this project, most overseas Chinese investments and planning have now been subsumed in the larger rubric of the BRI and been given new momentum. All maps of the scheme show that Europe is the destination of the system; this illustrates the elemental role that Europe will play in China's future global strategy. Indeed, Chinese connectivity schemes targeting Europe predate the BRI. The first set of trains travelled from Yangtan in Hunan to Hamburg in 2008 using the Russian railroad system. Likewise, COSCO acquired the franchise rights for two terminals in Piraeus in 2008. In August 2018, the China-Europe freight railway service saw its 10,000th trip since its beginning in 2011. These have been ferrying garments, auto parts, chemicals and other Chinese goods to Europe and bringing back food, timber, machinery and equipment. As of mid-2018, China's freight services linked 48 Chinese cities with 42 European ones.[22] These are heavily subsidised by Chinese local governments and it remains to be seen whether they have any relevance beyond fulfilling strategic objectives.[23]

However, China's BRI investments are already imprinting themselves onto Europe. In Duisburg in western Germany, often seen as the western terminus of the BRI, China has created the world's largest inland port and one of Europe's biggest transport and logistics hubs. Duisburg receives 30 trains a week from China and ships out products by train and road to various European destinations.[24] In Poland, the infrastructure is groaning under the weight of the rail traffic from China and companies are scrambling to expand facilities in towns like Lodz which have historically been an important crossroads of transportation.[25] On the southern part of Europe, the port of Piraeus in Greece, controlled by the Chinese giant COSCO, has grown at a frenetic pace since 2016. It has become Europe's seventh busiest container port where it was not even in the top 15 a decade ago.[26] Chinese giants like COSCO and China Merchants Ports Holdings have been buying ports along the European rim, beginning with Piraeus in 2016, a 40-percent stake in Vado Ports in Italy in 2016, Noatum Port in Spain in 2017, and Zeebrugge in Belgium in 2018.[27]

These are all part of a far more ambitious project of tightening China's economic links with Europe through trade and investment. The EU as a whole, however, has taken what an analyst says is a "lukewarm approach" towards the BRI.[28] The EU made its viewpoint clear when it refused to endorse a statement on trade at the end of the first Belt and Road Forum in Beijing in May 2017. The EU insisted that the BRI follow principles of transparency and co-ownership, as well as uphold issues of social and environmental sustainability.[29] In February 2017, the European Commission had opened a formal investigation into a major

BRI project—the high-speed rail link covering 350 km between Belgrade and Budapest. The process has resulted in the Hungarian component of the project getting stuck in EU procedures, while the Serbian one covering 187 km is moving ahead. Still, this has not prevented individual EU countries and non-EU European countries from joining up with the BRI. Among those whose heads of state and governments figure in the joint communique issued following the 2nd Belt and Road Forum in April 2019 were Mediterranean countries like Italy, Greece, Cyprus and Malta, all the Balkan countries, the Caucasian republics, and CEEC countries. The event that created waves in Europe was Italy's decision to sign up on the BRI, since it is the first of the G 7 to do so.[30] Italy's location and its robust transportation links with other West European countries makes it a major asset for the Chinese effort to consolidate their presence in Europe.

EUROPEAN RESPONSE

In December 2017 the United States issued its momentous National Security Strategy pronouncing China as a "strategic competitor", rather than a mere stakeholder in the post-World War II global order. The declaration added to the disquiet that was being felt by the European countries over the nature of Chinese policies of acquiring stakes in their companies, and the lack of reciprocity on the part of Beijing on issues relating to industrial policy as well as market access. To be sure, Europe is not yet on the verge of imposing tariffs on Chinese products, sanctioning Chinese companies, excluding Chinese companies from official government procurement, or placing restrictions on Chinese scholars—as the US has done.

The discomfort of Europe is reflected in the European Commission report discussed earlier that calls China an "economic competitor". A report of the German Mercator Institute for China Studies that looked at the 'Made in China 2025' policy bluntly notes that countries like Germany and South Korea, whose high-tech industries contribute a large share to the global industrial output would be most vulnerable to the emergence of a Chinese manufacturing superpower.[31] Such concerns have led to a tightening of rules; many governments have adopted rules giving them powers to block deals in all sectors of the economy that may result in sensitive industries falling into foreign hands.

Britain, second only to the US in the number of mergers and acquisitions by Chinese companies, has already moved in this direction.[32] For his part, French President Emmanuel Macron was one of the earliest amongst his peers to raise the issue of Chinese takeovers of European industry in 2017. In November 2017, Sweden modified its takeover rules following the takeover by the Chinese company, HNA Tourism Group, of Carlson Hotels a year earlier. Carlson Hotels owned the Radisson brand, and the acquisition gave them an indirect majority stake in Rezidor, a Belgian hotel group. The two groups have now been rebranded as the Radisson Hospitality Inc. In September 2018, the French Parliament began debating a bill proposed by the government to include sectors such as artificial intelligence (AI), data storage and robotics among those which the state can block from acquisition by foreign companies. The current rules cover deals with voting stakes greater than one-third in defence, energy, transportation and some other industries.[33]

The problems appear to be rooted in the very nature of the EU where policy is made by consensus. Even so, Chinese policy, coming up in the era of Brexit[$], has been attracting scholarly attention like never before. Recently, for example, to emphasise European unity, French President Macron invited German Chancellor Angela Merkel and the European

$ The word Brexit is a compound of "British Exit", referring to the fact that, following a referendum, UK decided on June 23, 2016 to leave the European Union. The process is still underway.

Commission President Jean-Claude Juncker to join him in the meeting with Xi Jinping in Paris in the French leg of his tour in March 2019. In contrast to the US, the current theme of the relationship, continues to emphasise engagement and negotiation. Xi's recent European tour was followed by the annual EU-China summit in early April and the annual meeting with the CEEC where Chinese premier Li Keqiang was in attendance.

The case of Germany

In June 2016, shortly after the Kuka takeover, German Chancellor Angela Merkel, on a visit to Beijing publicly expressed her frustration on the issue of Chinese policy. She called on China to grant foreign firms the same rights and privileges as domestic ones.[34] In 2017 Germany would pass a new law that allows the government to block a company from outside the EU from acquiring more than 25 percent of a German entity that is in "critical infrastructure". The law defined these as industries like electricity and water supply, hospitals, transport and advanced defence technologies. The following year, Germany rebuffed two Chinese purchases, the first such cases of outright bans issued by the government of Chancellor Merkel. State-owned investment bank KfW was asked to temporarily acquire 20 percent holdings in 50Hertz Transmission GmbH to prevent an attempt by a Chinese firm, State Grid Corp., to buy it from a Belgian operator. This was part of a pattern of Chinese companies acquiring grid operators around the world. Germany also blocked the acquisition by China of an engineering company.[35] Subsequently, the Economy Ministry opposed the Chinese takeover of the Leifeld Metal Spinning, a company that specialises in high-strength materials for aviation, space and nuclear technology. The proposed takeover collapsed.[36]

At the same time, however, various other acquisitions came through. In April 2018, for example, the Economy Ministry approved the takeover of a German aerospace company Cotesa by the Chinese company Advanced Technology and Materials (AT&M) after several months of investigation. The middle-sized German company specialises in making carbon fibre components for aviation companies like Airbus and Boeing and it was sold for a price of some Euro 100-200 million.[37] Likewise, the Economy Ministry approved the acquisition of a German data analytics startup, Data Artisans. Germany has sought to ensure that its crackdown does not affect its larger investment and trade partnership with China.

On 29 December 2018 Germany tightened its Foreign Trade Regulation, expanding the ability of the government to prohibit certain direct or indirect acquisitions of shareholdings in German companies on grounds of national security. Under the new rules, the threshold for the screening has come down to 10 percent and includes weapons of war, specially designed engines and gear units for combat tanks and military vehicles, products with IT security functions and crypto-technology, critical infrastructure, manufacture of technical devices for surveillance of telecommunications, cloud computing and media enterprises.[38] In early 2019, the German Economy Minister Peter Altmaier joined his French counterpart in championing a new industrial policy. Equally significantly, he proposed that the country create a state-owned fund that can protect key companies from takeovers such as the ones initiated by China. If passed, this would signal a major shift in the German government's policy, which has historically taken a hands-off approach in these matters.[39]

Incidentally, only after the government has taken the lead on these issues did Germany's leading industry association BDI put across its view on the need to take a tougher policy towards China at the beginning of this year. In a paper presented in early January, the BDI said that while German firms needed the Chinese market, there was also a need for Beijing to open up its own domestic market. It called on the EU to create a stronger economic framework to bind companies from non-market economies to its own liberal system and said that non-European firms receiving state subsidies should not be able to sell their products in an unrestricted manner.[40]

The EU

The nature of the 28-member EU renders the making of consensus on new procedures and processes a lengthy process. Only 14 of the 28 EU countries—i.e., Austria, Denmark, Germany, Finland, France, Latvia, Lithuania, Hungary, Italy, the Netherlands, Poland, Portugal, Spain and UK—now have formal systems in place for screening FDI, though they vary widely in scope and design. With its political structure and investment-friendly posture, the EU has sought to balance the issues relating to FDI screening and the sovereign rights of individual states to decide who can invest within their borders.

Pressure from the US has played its own role. In January 2016, the US Committee on Foreign Investment in the US (CFIUS) helped frustrate a proposal through which Philips NV would have earned US$2.8 billion by selling its LED business to a Chinese venture-capital firm.[41] Later that year, the Aixtron deal was nixed by the CFIUS because it had a US subsidiary. More recently, the Huawei issue had also been used by the US to ratchet up pressure on Europe.

As part of its efforts to level the playing field with China, the EU has demanded reciprocity in public procurement; it hopes to have an EU-wide instrument to promote this by the end of 2019. The European Commission also plans to publish guidance on the legal framework on the participation of foreign bidders and goods in the EU market. This will introduce EU norms on labour and environmental standards in addition to price in the area of procurement. Another action plan envisions filling existing gaps in EU law to address the distortive effects of foreign state ownership and state financing in the internal market.[42]

On 20 November 2018, the EU announced political agreement for a new framework for FDI screening. The Commission was also expected to come out with a study on FDI flows into Europe and create a coordinating group of member states to help identify joint strategic concerns.[43] Following up on this, on 14 February 2019, the European Parliament set up an EU-level tool to screen FDI on grounds of security to protect technologies and infrastructure in Europe. The vote was 500 in favour and 49 against, with 56 abstaining. Under this instrument, the European Commission will investigate foreign investments in critical sectors and give its view on whether or not they undermine European interests. However, the decision to bar an investment would remain with the individual EU state. The new regulation covers critical infrastructure, data, space, finance and technologies including semiconductors, AI and robotics. Added to these were sectors like water, health, defence, media, biotechnology and food security. The European Council formally endorsed the agreement in early March, but it will enter into effect in October 2020, 18 months after it is published in the Official Journal.[44]

Another aspect of the European response is the debate about how to compete with China's state-backed firms. As is well known, Europe has extremely tough anti-monopoly rules which prevent the consolidation of large companies. Germany's BDI's position paper earlier this year also called on Germany and Europe to undertake policies that would allow the emergence of European champions.[45] The debate played itself out in relation to the proposed merger of Siemens of Germany and Alstom of France in 2017, aimed at enhancing their competitiveness vis-à-vis the Chinese giant CRRC Corp. The merger was promoted by President Macron of France who saw it as the emergence of a new Airbus-type company. It was opposed by several other countries, however, as well as the European Competition Commission which felt that it would drive up costs for other European companies. Eventually, after an investigation, in early February 2019 the European Commission prohibited the proposed Siemens acquisition of Alstom under the EU merger rules.[46]

Yet earlier, in December 2018, the EU's Competition Commission had approved a proposal by France, Germany, Italy and the UK to allocate upto US$ 9.1 billion in public and private funding by 2024 for research centres and companies to work together to create "smarter and more energy efficient microchips and sensors."[47] On 18 February 2019, Germany's Economy Minister Peter Altmaier and his French counterpart Bruno Le Maire jointly put forward a new plan for Europe to create its own champions. The National Industrial Strategy 2030 is part of a wider Franco-German response to tackle the Chinese competition and deal with Trump's 'America First' approach. The Ministers have made it clear that there is need for the European Union to review and amend its competition law. The proposal calls for more investment for the EU to back 10 strategic sectors, including metals, chemicals, 3D printing, machine engineering, medical devices, aerospace, defence and the automotive sector.[48]

In September 2018 the European Commission came up with its own Joint Communication on a "comprehensive strategy to better connect Europe and Asia." The strategy document noted that at its core was a "sustainable, comprehensive and rules based connectivity". This would involve transport links, energy and digital networks and human connections. It spoke of the "significant opportunities for EU companies" in the estimated Euro 1.3-trillion infrastructure investment that was needed, "provided that robust legal frameworks are in place." But while it hailed the vision of better Europe-Asia connectivity, it did not name any country, especially not China.[49] For the EU, as for Japan, an issue that cannot be ignored is the fact that China is already spending huge sums of money on BRI projects. By staying out of it, they could be harming their own business interests. Not surprisingly, therefore, they are looking for opportunities to shape the connectivity agenda as well.

The Huawei issue

The gap between American and European attitudes towards China was most manifest in the case of the telecommunications giant, Huawei. In Europe, Huawei is one of the largest providers of network backbone technology in countries like UK, Germany and Spain. Now with the European Commission's push for the EU to adopt 5G technology, concerns have emerged because Huawei is acknowledged to have the most advanced and cheapest 5G technology in the world. While Huawei's competitors like Ericsson and Nokia charge that they have little access to the Chinese market, Europe is wide open for the Chinese companies.[50]

In 2012, a US House Intelligence Committee issued a report stating that the Chinese-owned Huawei and ZTE were both threats to national security and were barred from obtaining US government contracts. The US has argued that Huawei's ties with the Chinese government and as a supplier of key hardware in telecommunications makes it a potential tool for espionage.[51] This issue involves both the worry that the Chinese state will use its companies for the purposes of espionage, as well as straightforward commercial considerations. As a world leader in 5G, Huawei will play a major role in setting its standards in a technology that has wider implications with regard to the innovations such as the Internet of Things (IoT) and driver-less cars. Nevertheless, it is difficult not to pay attention to the nature of the relationship between the state and private enterprise in China as well as the national law of the People's Republic of China. As analysts have pointed out, China's national law makes it mandatory for private corporations to cooperate with the state for intelligence work.[52] Party committees are now obligatory in all private sector companies. In any case, many of them are linked to the state through state sector banks, state-backed funds and special purpose vehicles.

In December 2018, Huawei's Chief Financial Officer Meng Wanzhou was arrested in Canada after the US sought her extradition.[53] On 29 January 2019, the US Justice Department announced a 13-count criminal indictment against Huawei, two affiliates and its CFO Meng. The charges, which are retroactive to ten years, are related to bank and wire fraud as well as violations of US sanctions on Iran. A formal demand for the extradition of Meng was made to the Canadian authorities. The Chinese foreign ministry accused the US of using "its government power to discredit and crack down on specific Chinese companies in an attempt to stifle their operations."[54]

The US has been actively campaigning its allies to break with Huawei. All of the "Five Eyes" countries—US, UK, Canada, Australia and New Zealand—are seeking to exclude Huawei from their 5G network plans. Japan, too, banned Huawei from obtaining government contracts. In UK, telecommunications giant BT Group has said it would remove Huawei equipment from existing 3G and 4G networks and will not use any of the key parts from Huawei for its 5G network.

In early February, police in Denmark expelled two Huawei workers who did not have valid work permits, making sure to clarify that the arrests were not linked to any espionage charges. Meanwhile, Norway's domestic intelligence head Benedicte Bjornland noted the need for caution with regard to Huawei because of its link to the PRC government and cited China's intelligence law "requiring private individuals, entities and companies to cooperate with China".[55] Huawei played a role in creating the country's 3G and 4 G network and now Norwegian companies are working on the rollout of 5G systems.

The US has not hesitated to lean hard on its NATO partners in a bid to get them to sanction Huawei.[56] In early 2018, in talks with German officials, a US delegation had said that they were not particularly sanguine about the idea of cheaper Chinese telecommunications equipment connecting the switches of Europe's giant fibre optic lines that intersect in Germany—the officials said this could pose a threat to NATO security.[57] This was followed by a letter of the US Ambassador to Germany's economics minister Richard A Grenell, saying that allowing Huawei to participate in the 5G rollout would mean that US-German intelligence cooperation would lessen the level of security cooperation between the two countries.[58]

In early March 2019, Germany announced a set of tough requirements for the coming 5G auctions. Its Federal Networks Agency said that critical components could only be sourced from "trustworthy" suppliers certified by the Federal office for Information Security (BSI). Further, all bids would require compliance with national security regulations, telecom confidentiality and data protection, all of which would be monitored by the BSI constantly. It declined, however, to ban Huawei from the auctions.[59] The measures will require the company's equipment to be certified by the Federal Officer for Information Security and disclose the source codes operating the system, something that could facilitate the discovery of any "back doors" and detect the monitoring of other encrypted data flows. The new policy could effectively block Huawei computers, routers and switches in the core 3G, 4G and 5G networks. Once again, the main consideration for German officials is the legal obligation of Chinese companies to cooperate with their intelligence services.[60]

A piquant situation has arisen in UK where the intelligence services are one with the call for the US ban, but the government has taken a more nuanced position. In UK, the company set up the Huawei Cyber Security Evaluation Centre (HCSEC) in 2014, where its circuit boards and codes are checked by security-cleared British nationals and monitored by GCHQ, the Cabinet Office and the Home Office, who constitute a Huawei Oversight Board chaired by the head of the GCHQ's National Cyber Security Centre (NCSC).[61] Speaking at a conference in Brussels in February 2019, Ciaran Martin, who heads the NCSC expressed confidence that the risks posed by Huawei could be managed. He noted that Britain had perhaps the "the toughest and most rigorous oversight regime in the world for Huawei" and that, in any case, the company would be excluded from providing core equipment for sensitive networks.[62] At the end of March 2019, the Huawei Oversight Board issued a report that said there were "significant technical issues in Huawei's engineering processes leading to new risks in the UK telecommunications networks." But these were more by way of being security flaws that had not been adequately addressed by the company, rather than tools of espionage. Even while expressing pessimism over the company's ability to deal with the issues, the report did not call for an outright ban on Huawei's equipment.[63]

Pressure against Huawei was also built up in countries like the Czech Republic where the intelligence service has warned against the activities of the company and the danger of using its software and a controversy developed over the Prime Minister seemingly apologising for this.[64] There have been echoes of this in Poland as well, where Prime Minister Mateusz Jakub Morawiecki recently spoke about the need to maintain "deterrence" against China and Russia. The Polish foreign ministry also issued a statement in December 2018 raising concerns about cases of cyber espionage "including those attributed by our partners to China."[65] The US has told Poland that future deployments of American troops and plans for a permanent base to be established there could depend on the Polish response.[66] Over the New Year 2019, Polish authorities arrested two people, including Wang Weijing, a Chinese employee of Huawei, for spying for Beijing. A court ordered them to be held for three months, though both have pleaded not guilty.[67] Investigations into this case have led the Polish and US authorities to worry about the deeper nature of the Chinese penetration of the country. The other person arrested with Wang was Piotr Durbajlo, a former senior Polish counter-intelligence officer. The investigations have come up with troubling evidence that the Chinese penetration of Polish intelligence could be deeper, facilitated by the Huawei company.[68]

Another country which is resisting US pressure is Hungary. Its prime minister, Viktor Orban, has said that even while it is a member of NATO, it would like to maintain a sense of neutrality. Orban has invited Chinese investment in Hungary and is resisting approving a defence agreement with the US.[69]

By early 2019, it was clear that the US effort to block Huawei in Europe had not been working primarily because its own allies were resisting. Countries like UK, Germany, Hungary, Switzerland and Italy have signalled that they would not support any effort for a total ban on Huawei. Media reports said the US campaign suffered from "a scolding approach and a lack of concrete evidence that Huawei poses a real risk."[70] Another report says there is considerable scepticism among European companies about the course the US wants them to take vis-à-vis companies like Huawei. They say that Huawei "offers superior hardware, often at lower prices," and so a ban could mean Europe falling behind in rolling out 5G technology.[71]

While Huawei has escaped an outright ban, it will face a much more stringent regulatory regime. The EU is now considering proposals relating to 5G networks. This could result in an amendment of a 2016 cyber security law that required companies involved in critical infrastructure to take appropriate security measures. Given the EU processes, such an amendment could prove cumbersome, but is likely to be adopted.[72]

In mid-May 2019, the US escalated the Huawei issue using two drastic moves. First, President Trump signed an executive order blocking the purchases of Huawei equipment in the US.[73] Second, Huawei was added to the US "Entity List" which requires all US firms selling to the company to do so after obtaining a licence. If licences are not available, Huawei's business could be severely affected as, indeed, that of its US suppliers.[74] The implications of these developments are yet to unfold.

CONCLUSION

China's economic and political transformation has begun to pose major challenges to Europe in terms of geopolitics and industrial policy. This is as much a consequence of the rapidity of the Chinese advance, as the nature of its political and economic system that is skewed against Europe's longer-term interests. The choices for Europe are not easy. Its companies depend on Chinese markets for their profitability, and its poorer regions are looking for Chinese investment. Its telecommunications networks already use Chinese routers and switches and now they are being offered advanced 5G technology as well. There are other areas, too, where the Chinese are pressing ahead, such as electrical vehicles, where the country is both a key market and dominant player in their supply chains.[75]

While as NATO members they are commonly concerned about national security issues with the US, many feel that some of the problems being raised are really about maintaining American technology dominance and not security. Moreover, it is no secret that the US and EU have their own differences in both the economic and geopolitical fields. Recently, the dispute over subsidies for their aviation majors, Boeing and Airbus, has flared up even as there are efforts to ward off threatened American duties on autos and car parts.[76]

In the last two years there has been a sharp blowback against China in the United States; it is now being echoed in Europe. The European Union Chamber of Commerce in China recently reported a survey where some 20 percent of the 585 participant companies felt that they were being compelled to transfer technology to maintain market access in China. This proportion increased from 10 percent in 2017.[77] Whereas both the US and Europe used to view China as a responsible stakeholder, they now see it as a competitor and challenger that does not play fair, although the Europeans still see this in economic, rather than political terms. The American pushback has been significant and is being manifested by its hard-nosed negotiations with China using the instrument of tariffs. Yet, the issue is no longer restricted to trade alone, but to China's plans of becoming a dominant player in certain key technology areas. Drawing lessons from the 5G challenge, the US is pulling up the drawbridge; it wants the European countries to do the same.

The American approach has already seen a shift of some supply chains away from China towards Southeast Asia, and to a lesser extent, South Asia. The question is whether the world is headed towards being divided into two technospheres. Yet, there is a limit to how much can be shifted, given China's massive dominance in a range of areas. China holds more than half of the world's capacity for electronics: 357 factories of Apple's top 200 suppliers are in China, and only 63 are in the US. No country or set of countries can easily replace the huge production centres that China has created in certain technology areas.[78]

The key conclusion is that European well-being and prosperity will continue to depend on China to a considerable measure. The essence of the European response will have to be to continue promoting trade and investment, even while preventing the leakage of sensitive technology or being bested by China in key emerging technologies. In March 2019, Donald Tusk, the President of the European Council called for "achieving a balanced relation" with China, one that would ensure "fair competition and equal market access." He added that EU would press China to include industrial subsidies "as a crucial element of the WTO reform."[79]

Second, the EU needs to focus on certain key strategic sectors to maintain their global standing in areas like metals, chemicals, 3D printing, machine engineering, and micro-chips and sensors. The Franco-German National Industrial Strategy 2030 has laid out a plan that Europe could follow to its fruition. Third, the EU probably no longer has the luxury of pushing anti-competitive laws beyond a point. Such laws have prevented the emergence of EU champions that could rival a Google, Amazon, Alibaba, Baidu or Facebook. As a major industrial and trading entity, Europe needs to put down money to nurture its own champions, if it wants to maintain its standing as an industrial powerhouse. Fourth, it has been clear in the last one year that China lacks sufficient leverage to hit back at the US tariff measures. The Europeans can successfully leverage this to insist on better market access and reciprocity from the Chinese in the period ahead. Fifth, this could have an alternate future with the evolution of a Chinese and American technospheres, compelling the Europeans to navigate between the two.

Sixth, in his recent study of the BRI, Bruno Maçães, a former Portuguese minister, noted that the Europe-Asia connection, which is already the most important trade axis with over US$ 1.8 trillion trade in goods, is also one of the poorest in terms of infrastructure and rife with trade and tariff barriers. In other words, it offers a much higher potential for growth than the Transpacific or Transatlantic axes. Therefore, it is not just that Europe is vastly consequential for China's future; it is also that the latter can play a major role in the former's future. This is the leverage European countries have to persuade China to come up with a new version of the BRI that would be "an open platform which adheres to market rules and international norms..."[80] "BRI 2.0" could be effectively linked to the EU's own future connectivity plans and form the basis of a mutually beneficial partnership.

As in all things, uncertainties abound. The Sino-American stand-off may provide leverage to Europe, but it can also bring pressures to pull them apart. As things are, Europe is confronting not only economic challenges, but also centrifugal forces of right-wing nationalism and anti-immigrationism.

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