PROSPECTS FOR THE CHINA-EUROPE RELATIONSHIP AND GLOBAL IMPLICATIONS

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Japan-U.S. Exchange Program

THE SASAKAWA PEACE FOUNDATION

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Europe and China stand half a world apart: they lie at the antipodes of Eurasia. The two represent the core of contrasting civilizations, which have enjoyed only sporadic and intermittent past contact with one another. Their relationship suffers from a complex heritage of both cultural distance and past imperialism. Yet Europe and China are growing ineluctably closer—in social, economic, and even political dimensions, with fateful long-term implications for the broader structure of world affairs.

How Europe and China evolve, both internationally and in their relationship with each other, matters greatly for world affairs, because they are the largest entities in the international system, apart from the United States. The European Union, with a GDP of $18.5 trillion, generates about 24 percent of the global product, while China contributes another 13 percent. Together, they make up 37 percent of global output, compared to 22 percent for the United States.[1] And given the huge population, rapid growth rate, and still-low per capital income level of China, as well as the substantial growth potential of Europe also, it is likely that the Sino-European aggregate will wield increasing weight in world affairs in the years to come, should it have any substantial coherence of its own.

How that Sino-European relationship evolves, and what influence it enjoys on the global scene, will naturally be shaped not only by international forces, but by domestic developments as well. The Greek debt crisis and the Chinese stock-market volatility of 2015-2016, not to mention Britain's June 2016 decision to leave the European Union, all illustrated the domestic uncertainties that continue to prevail. Brexit, in particular, could have a profound impact on the Sino-European relationship of the future, as we shall see, although it will take some time for the concrete implications of Brexit to clearly manifest themselves.

This monograph review the evolution of Europe's relations with China since ancient times, placing those relations in global context. It pays particular attention to post-Cold War changes in European security relations and financial structure, arguing that the expansion of

1 Figures for GDP at market prices, in current US$, at the end of 2014. In PPP terms, the GDPs of the European Union and China together were 34 percent of the global total. "The Chinese economy" in this case excludes Hong Kong and Macao. Source: The World Bank.

NATO, and the currency integration that followed the Maastricht treaty created not only a more unified continent, but a more fragile one as well. Post-Cold War Europe, it is argued, has assumed a political-economic structure that renders it receptive to and potentially reliant on trans-regional relationships with large outside powers. China is one such candidate. As China rises, Sino-European financial and diplomatic relations will likely deepen, with fateful implications for global political-economic architecture, which are considered in the following pages.

Almost any piece of quality research is the work of many hands. That is certainly true in the case of this monograph. Yun Han and Alex Evans, Reischauer Policy Research Fellows at the Johns Hopkins University/SAIS Reischauer Center for East Asian Studies, have played a central supportive role. They have done an outstanding job of critiquing the ideas presented here, finding supporting data, and reinforcing the arguments made with additional graphic presentation. Michael Kotler, Sophie Yang, and Jaemin Choi have also provided valuable assistance. Any failings in the work remain the responsibility of the author alone.

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CHAPTER ONE

CLASSICAL PATTERNS OF INTERACTION: FROM VOLTAIRE, MALRAUX, AND ZHOU ENLAI TO THE EUROPEAN UNION

CHAPTER ONE: CLASSICAL PATTERNS OF INTERACTION

China and Europe are close to geographically contiguous, across the sprawling Eurasian land mass. Yet they have been economically and politically remote from one another throughout most of recorded history. And they have not known one another well in cultural terms, despite the periodic infatuation that so often correlates with distant acquaintance. The interpersonal contact of China and Europe, intimately entwined with the history of the Silk Road, dates back at least to intermittent trade between Han China and the Roman Empire two thousand years ago. From its onset around 130 BC, when the Han officially opened trade with the West, the trading network known as the Silk Road was used regularly until 1453, when the Ottoman Empire boycotted trade with the West, and closed the routes. The establishment of sea routes to the East by Vasco da Gama and others, around the end of the Fifteenth Century, further confirmed the demise of the Silk Road.[2]

Trade between Europe and China along the Silk Road over the past two millennia has ebbed and flowed in intensity. Yet in both good times and bad, it has generally been conducted through intermediaries. For the first half and more of Silk Road history, from the pre-Christian era until the Middle Ages, Europe and China knew each other only quite indirectly, through the stories of Sogdians, Parthians, and other traders, whose partners in turn dealt with the major party at the other end. One of the first Europeans who actually seems to have experienced China at length and popularized his views was Marco Polo, writing in the Thirteenth Century.[3]

Polo had the rare opportunity of travelling freely from Europe to China and back due to the unusual political stability and openness provided, ironically, by the brutal Mongol Empire. The Mongols had invented the passport and inhibited the numerous brokers and middlemen who more normally limited Silk Road transactions and travel. Following their expulsion from China with the collapse of the Yuan Dynasty in 1368, direct intercourse between Europe and China became much more difficult. It was not until the Sixteenth

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2 Joshua J. Mack, "Silk Road", Ancient History Encyclopedia, at: http://www.ancient.eu/Silk-Road

3 L.F. Benedetto, and Aldo Ricci. The Travels of Marco Polo. Florence: Taylor and Francis, 2014.

Century that direct European relations with China began to revive once again, this time through the efforts of Jesuit missionaries. They saw, in the huge Chinese population, a bountiful potential harvest of souls for the Christian faith.

Among the most active and articulate of these Jesuits was another Italian, Matteo Ricci, who lived in China for nearly three decades, from 1583 to 1610.[4] Ricci, as Jonathan Spence points out, "admired the industry of China's population, the sophistication of the country's bureaucracy, the philosophical richness of its cultural traditions, and the strength of its rulers."[5] His meticulously detailed journals provide one of the best early European accounts of classical China, albeit from the laudatory perspective that was quite standard in Europe until at least the mid-Eighteenth Century.

The French Jesuits, who dominated Christian interaction with China during the early Qing period (late Seventeenth Century), especially late in Kangxi's reign (1661-1722), were even more laudatory of Chinese practices and potential than their Italian counterparts had been. Behind this approach was a clear appeal to the "Sun King", Louis XIV, to back their efforts with more money and personnel.[6] The French Jesuits highlighted, in particular, the Confucian Classics, whose ethical content, they argued, showed that the Chinese were a profoundly moral people. At one point, the Jesuits maintained, Chinese had practiced a form of monotheism so close to the Judeo-Christian tradition, that they should be natural converts to Christianity.

For two centuries and more, the works of the Jesuits on Chinese government and society were the most detailed available in Europe. They profoundly shaped European views of China, even as Jesuit influence waned in Europe itself, with the order being suppressed altogether in 1773. As the Eighteenth Century Enlightenment era dawned on the Continent, Europe's view of China remained very much the positive one that Ricci and the French Jesuits had espoused. Both the German philosopher Gottfried Wilhelm von Leibnitz and his French contemporary Voltaire, for example, read and reflected on the works of the early

4 On Ricci's views of China, see Jonathan D. Spence. The Memory Palace of Matteo Ricci. New York: Penguin Books, 1984.

5 Jonathan D. Spence. The Search for Modern China (second edition). New York: W.W. Norton, 1991, pp. 132-133.

6 Ibid, p. 133.

missionary commentators in detail, although the anti-cleric Voltaire brilliantly reinterpreted their laudatory view of Chinese moral probity, contending that it demonstrated clearly why Christianity need not be the basis of a moral society, since the Chinese were not Christians.[7]

Voltaire's fascination with China reflected a broader European cultural sympathy of his age that reflected another common trait in trans-continental Euro-Chinese relations: a tendency to view the Other through the prism of one's own frustrations and hopes for the future. Europe in the mid-Eighteenth Century was at once opening to the outside world and teetering on the verge of revolution, seething with the frustrations of social transition—in some respects like the Europe of the 1960s, two centuries later. China presented a large and distinct alternative paradigm, whose attraction lay precisely in its ambiguity and freshness.

A cult of China, literally *chinoiserie*, spread broadly across Europe—far beyond the socio-political sphere. "In prints and descriptions of Chinese houses and gardens, and in Chinese rugs, silks, and colorful porcelains," as Spence points out, "Europeans found an alternative to the geometrical precision of their neoclassical architecture and the weight of baroque design."[8] Chinese aesthetics powerfully influenced everything from French rococo design to the pagodas that were erected in public parks, the sedan chairs that the wealthy used for transport, and the lattice work surrounding ornamental gardens.

With the Enlightenment, however, also began an anguished socio-political debate in Europe over China's true nature, and the implications for Europe's relations with that enigmatic nation. That debate has continued to be a hallmark of the Eurasian trans-continental relationship to this day.[9] Voltaire and Leibnitz were generally complimentary toward China. Rousseau and Montesquieu, however, were sharply critical.[10] The latter argued that, for all their cultural sophistication, the Chinese did not enjoy true liberty; that their laws were based more on fear than on reason; and that their elaborate educational system could well lead to the corruption of Chinese morals rather than to its improvement.

The Enlightenment debates of the Eighteenth Century thus eerily prefigured the

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7 Ibid.

8 Ibid., p. 134.

9 On mutual perceptions in the Sino-European relationship, see David L. Shambaugh, Eberhard Sand Schneider, and Hong Zhou. China-Europe Relations: Perceptions, Policies, and Prospects. London: Routledge, 2008.

10 Spence. The Search for Modern China (Second Edition), p. 134.

intellectual confrontations, over issues ranging from human rights and the status of the Dalai Lama to high-technology trade, that continue to roil the Sino-European relationship today.

Deepening Yet Contested Interdependence

However intimate Europeans and Chinese felt their mutual relationship to be in the Age of Enlightenment, it evolved by quantum leaps in succeeding years, at an accelerating pace from the 1960s on that has over the past five years taken on some dimensions of entente. The European Union today is China's largest trading partner, and China is the Union's #2, following only the United States. Cross investment is surging, with Chinese direct investment in the EU rising 111 percent during the 2003-2013 decade alone.[11] The Eurasian continent and even the Arctic are beginning to offer increasingly attractive transit possibilities. European and Chinese leaders hold annual summit conferences, and the Europeans shocked Washington in late 2014, by eagerly joining the Asian Infrastructure Investment Bank (AIIB) organized by China, that did not include the United States.[12]

To understand where the increasingly dynamic Sino-European relationship stands today in the broadest sense, and how it will evolve in future, it is useful to recall where that trans-continental tie has been in the recent past. After the cultural intimacy of the Enlightenment, China and Europe fell into a more distant and ambivalent relationship with the rise of European imperialism. In 1842, as a result of the first Opium War, the British annexed Hong Kong, and unequal treaties with France, Germany, Czarist Russia, and even Japan were to follow. And the Soviet Union followed its czarist predecessor into neo-imperialism, stationing the Red Army in the strategic Liaodong peninsula of Manchuria for nearly a decade after World War II.

Even as it brought China and surrounding nations under its imperial yoke, Europe also nurtured and gave voice to the nationalists and revolutionaries who ultimately ended colonial and neo-imperial rule across the continent. Both Zhou Enlai and Deng Xiaoping,

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[11] UNCTAD bilateral direct foreign investment statistics.

[12] Jamil Underline, "UK move to join China-led bank a surprise even to Beijing", Financial Times, March 26, 2015.

together with Ho Chi Minh and other future East Asian leaders, studied and worked in Europe, especially in France, where many of their revolutionary movements were incubated. Indeed, the Communist Parties of both China and Vietnam were founded in Paris during the early 1920s; both Deng and Ho picketed for Asian self-determination at the Versailles Peace Conference.

In 1949, in Mao Tse Tung's immortal words from the Gate of Heavenly Peace atop Tienanmen Square, China stood up. Europe, despite its imperialist heritage, responded more flexibly and favorably than did the United States, with Britain recognizing the PRC in early 1950. In June 1954, the UK and China formally established diplomatic relations at the level of charge d'affaires, upgrading those ties to the ambassadorial level in March 1972.[13]

Most of continental Europe moved more slowly than Britain, but faster than the United States. One landmark development was Sino-French cross-recognition in 1964, followed by the triumphal visit to Beijing of the French Minister of Culture, whose seminal work *La Condition Humaine* (Man's Fate) had sympathetically and eloquently portrayed the Chinese Revolution. Once again, France was leading Europe's intellectual engagement with China.[14] It was not until 1972 that Nixon visited China, and not until 1979 that US relations with the People's Republic of China (PRC) were formalized.

Most nations of Central and Eastern Europe, of course, have longstanding and relatively intimate relations with the People's Republic of China, dating from soon after the 1949 revolution, as a result of their membership in the Soviet bloc of the Cold War years. Even after the Sino-Soviet split in the late 1950s, smaller Warsaw Pact nations such as Rumania and Hungary maintained friendly ties with China, as part of their continuing effort to balance and inhibit their huge Soviet neighbor. All these countries, of course, are now members of the European Union. Albania went so far, after 1960, as to establish a full-fledged, if informal, military alliance with the PRC, to counter Soviet regional influence in Europe.

Despite superficial parallels to the past, today's Sino-European relationship is

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13 Embassy of the People's Republic of China in the United Kingdom of Great Britain and Northern Ireland, "Overview of China-UK Relations", May 10, 2010, at: http://www.chinese-embassy.org.uk.

14 Andre Malraux. Man's Fate

qualitatively different from that of the pre-Cold War period, in ways that profoundly enhance its potential for the future. First of all, there is a sophisticated institutional structure for interaction, much of it multilateral, and thus involving a broad range of European nations. That structure facilitates political-economic contacts, gives them predictability, and helps to insulate them from the anguished intellectual debates over China's political system, which have wracked Europe since Voltaire and Rousseau.

The central interlocutor with China is the European Commission, founded in 1975. This supra-national actor stands above the politics of individual nations, providing a technocratic, apolitical dimension that helps to stabilize the relationship, complemented by the European Central Bank, founded in June 1998.[15] ASEM (the Asia-Europe Economic Meeting), founded in 1996, provides an ongoing "Track 1.5" structure for interaction among government officials, academics, and NGOs. In the security sphere, NATO, based in Brussels, provides another technocratic contact point, albeit one with sensitive geopolitical implications.

IN CONCLUSION

Europe and China lie at the opposite ends of Eurasia, by far the largest continent on earth. They represent the core of two contrasting civilizations, arguably the most influential in the world, that have had only sporadic past contact with one another. Their relationship suffers from a complicated heritage of both cultural distance and past imperialism. Yet these two areas are becoming closer, in multiple dimensions, with potentially important long-term implications for the architecture of international affairs.

The interaction of China and Europe is an old one, intimately entwined with the history of the Silk Road. It goes back at least to intermittent trade between Han China and the Roman Empire two thousand years ago. For the first millennium and more of that relationship, it was conducted mainly through intermediary trading kingdoms, many of whom, such as the Sogdians and the Parthians, have disappeared in the sands of time.

15 Hans Peter K. Schaller. The European Central Bank—History, Role, and Functions. Frankfurt am Main: European Central Bank, 2004.

From the Thirteenth Century, the trans-Eurasian relationship grew more dynamic, driven by the Mongol conquests and the fragile political-economic order which they created. Two centuries after Marco Polo Jesuits such as Matteo Ricci reached and began reporting on China, followed by European traders at the port of Canton. These relationships evolved over time not only into deeper cultural contacts, but also into imperialism, including the Opium Wars and Britain's occupation of Hong Kong in 1842.

Meanwhile, in Europe, a distant China was becoming both a cultural fascination and, especially in France, a paradigm for characteristics that Europeans either feared in themselves or desired to emulate. Voltaire, Rousseau, Montesquieu, and Leibnitz all pronounced, during the Enlightenment, on Chinese characteristics, without direct personal contact. With the coming of the French Revolution and the ensuing continent-wide turbulence, however, consciousness of China in Europe receded, even as the age of imperialism quietly began to dawn ten thousand kilometers to the east across the Eurasian continent.

Europe responded more flexibly to the Chinese revolution of 1949 than the United States, with Britain recognizing the PRC soon after its establishment, and France following in 1964. With the establishment of the European Commission in 1975, relations began to take on a new multilateral dimension. Multilateral institutions such as ASEM, linking both Europe and China, have proliferated since then, while trade and financial ties have steadily deepened. It has been fateful structural changes in Europe over the post-Cold War years, however, leveraged by recent Chinese economic growth, that have brought Sino-European ties to a qualitatively different stage. It is to these developments, and their broader global implications, that we now turn.

CHAPTER TWO

EUROPE'S POST-COLD WAR TRANSFORMATION

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Since the 1980s, just over a quarter century ago, the European Union has undergone a little-noticed yet fundamental transformation, with major implications for the evolution of EU-China relations. Most importantly, it has expanded greatly in geographic terms, to twenty-eight members, including two new and distinctive groups of countries, with internal political-economic traits and historical experiences that contrast significantly to those of the original Cold War West European Six[16] and Nine.[17] Those two new entrant groups included: (1) nations of Eastern and Central Europe, formerly under Communist rule, who joined in 2004 and after; as well as (2) Mediterranean countries, including Spain, Portugal, and Greece, which joined between 1981 and 1986, following their democratization.

The transformations of the 1980s and 1990s in the political-economic profile of Europe are best seen against the backdrop of what existed before. As indicated in Figure 2-1, a unified Soviet Union extended, until nearly the end of the 1980s, into the very heart of Europe, including the Baltic states, Byelorussia (later Belarus), and the Ukraine within its national borders. Beyond its own borders, the USSR was surrounded on the west by six satellite buffer states—all members of the Warsaw Pact, which the Soviets dominated. Even though Yugoslavia had seceded from the bloc in 1948, with Albania leaving informally in 1960 to become a Chinese ally,[18] the Soviets continued until late 1989 to dominate Central and Eastern Europe, both politically and militarily.

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16 The Six include the original signatories to the Treaty of Rome in 1957: France, the Federal Republic of Germany, the Netherlands, Belgium, Luxembourg, and Italy.

17 The additional three Cold War entrants were Britain, Ireland and Denmark, which all joined the EU in 1973.

18 Albania formally left the Warsaw Pact in 1968, eight years after it first sided with China in the Sino-Soviet split.

FIGURE 2-1: THE WARSAW PACT IN THE TWILIGHT OF THE COLD WAR

Source: https://en.wikipedia.org/wiki/Iron_Curtain#/media/File:EasternBloc_BasicMembersOnly.svg

Serious trouble began for the Warsaw Pact in mid-1989, when the Communist regimes of Poland and Hungary crumbled, in June and October of 1989 respectively. The collapse of the Berlin Wall in November 1989 led to even more dramatic, sweeping, and geopolitically significant changes in the political-military profile of Central and Eastern Europe. First of all, the remaining Communist regimes of the Soviet satellite states collapsed, in quick succession, during the spring and summer of 1990—only months after the Wall went down, as indicated in Figure 2-2.[19] With the Soviet-linked German Democratic Republic rendered politically unviable, nearly half a million Soviet troops were withdrawn from Germany, and the country was reunified on October 3, 1990.[20] Yugoslavia collapsed, and six fledgling successor nations were born on its territory during 1991. The political-military changes west of the Soviet frontier came to an end with the collapse of the Communist regime and the ascent of the Democratic Party to power in Tirana, Albania during March 1992.

19 The East German regime collapsed in March, 1990, followed by those of Romania (May, 1990); Bulgaria (June, 1990); Czechoslovakia (June, 1990); and finally, over the course of 1990, the constituent republics of Yugoslavia—socialist, but not a Warsaw Pact member.

20 "Reunification of Germany", The Cold War Museum, at: http://www.coldwar.org/articles/90s/reunification_of_germany.asp.

FIGURE 2-2: THE POST-COLD WAR TRANSFORMATION OF CENTRAL AND EASTERN EUROPE, 1990-1992

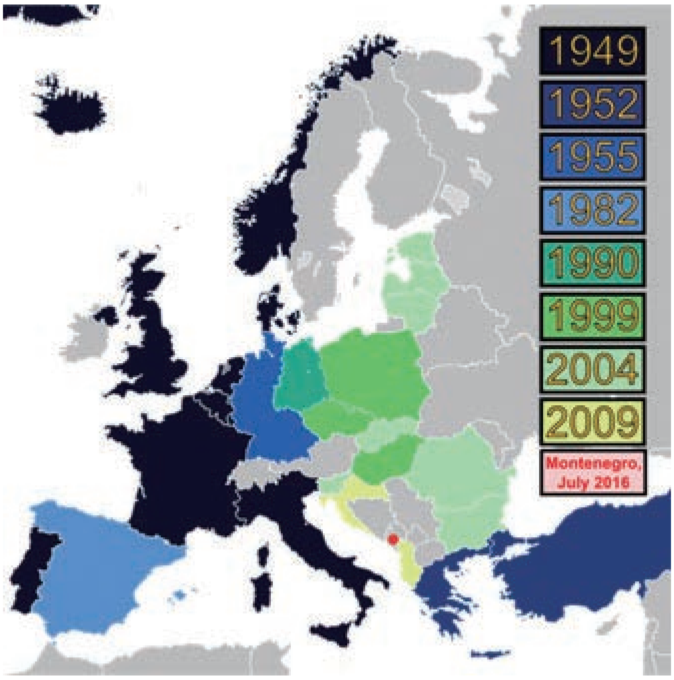
Source: https://en.wikipedia.org/wiki/Iron_Curtain#/media/File:EasternBloc_PostDissolution2008.svg

Note: Both Figure 2-1 and Figure 2-2 were originally found in "Iron Curtain," Wikipedia, https://en.wikipedia.org/wiki/Iron_Curtain#Iron_Curtain_speech

The most dramatic and significant changes of all began occurring in the spring of 1990, within the borders of the Soviet Union itself. First, two Baltic states—Latvia and Lithuania, seceded from the USSR, followed by twelve of the other former Soviet republics. Finally, at the end of 1991, the Soviet Union itself was dissolved, and the Russian Federation formally took its place.

As the Soviet bloc collapsed, a power vacuum emerged in Central and Eastern Europe. Following the widespread collapse of Communist regimes across the region, democratic governments emerged in most countries. These fledgling new administrations manifest both ideological affinity with fellow democracies to the West, and simultaneously a strong desire to consolidate their new westward-leaning political-economic orientation, with parallel and reinforcing ties to the West as well. This new situation led, as indicated in Figure 2-3, to a historic expansion of NATO into areas that had long fallen within the Warsaw Pact, and even within the borders of the Soviet Union itself.

FIGURE 2-3: THE EASTWARD EXPANSION OF NATO, 1990-2016



Source: Author's recreation of https://en.wikipedia.org/wiki/NATO#/media/File:History_of_NATO_enlargement.svg

The post-Cold War NATO expansion into Central and Eastern Europe occurred in four phases. The first phase involved the reunification of Germany in 1990; the newly consolidated nation emerged as a full-fledged NATO member, albeit one in which the presence of foreign military forces was limited to the western part of the country— conforming to an understanding with the Russians accompanying the withdrawal of the Red Army from the former German Democratic Republic. This was the only change in NATO's configuration for nearly a decade, despite the sweeping political-economic transformations in the former Communist nations of the region.

The collapse of the Soviet Union, as well as the satellite regimes, did, however, create a major political vacuum in the region, that the United States, with the daughter of a former Czech diplomat, Madeleine Albright, as Secretary of State, was not surprisingly tempted to help fill. In 1999, Poland, the Czech Republic, and Hungary all became members of NATO, bringing the Western alliance to the borders of the former Soviet Union. Boris Yeltsin was still president of the Russian Federation, leading a nation just re-emerging from a serious financial crisis, and Yeltsin did not mobilize effective opposition.

In 2004, NATO undertook an even more ambitious move, welcoming four Central European nations (Slovenia, Slovakia, Romania, and Bulgaria), as well as three republics of the former Soviet Union (Latvia, Lithuania, and Estonia) into its ranks. This step definitively confirmed the dissolution of the Soviet Union, and extended Western defense protection to areas that had fallen within the USSR's formal boundaries until 1991. Russian President Vladimir Putin had publically declared the collapse of the Soviet Union to be the greatest tragedy of the twentieth century, and this new gesture by the Western alliance rubbed salt into Putin's psychological wounds. A few months later, the Orange Revolution in the Ukraine deepened Western intrusions into the former Soviet space, triggering deep geopolitical apprehensions in Moscow of Western encroachment that have reportedly continued to this day.[21]

In 2009, NATO expansion resumed, extending this time to the Balkans. Croatia and Albania joined the Atlantic alliance in that year. Seven years later, in July 2016 Montenegro joined NATO as well.[22] NATO thus now includes as members virtually all of Europe west of Russia, Belarus, and Ukraine, except four successors of the former Yugoslavia (Serbia, Bosnia, Macedonia, and Kosovo), as well as the traditional neutrals (Switzerland, Austria, Sweden, and Finland) of Cold War days.

This steady expansion of NATO has been, for the fledgling Central and Eastern European democracies concerned, a felicitous development. It has reassured them against a resurgence of Russian aggressiveness and intimidation from the East, with the decline in country risk leading to substantial new foreign investment, and a welcomed surge of economic growth in many cases. At the same time, however, it has compounded the lingering Russian resentment at the West for the diminution of great-power standing that accompanied the collapse of the Soviet Union.

The Russians retain substantial geo-economic leverage against the new eastern members of NATO. Most of those members, for example, are heavily dependent on Moscow

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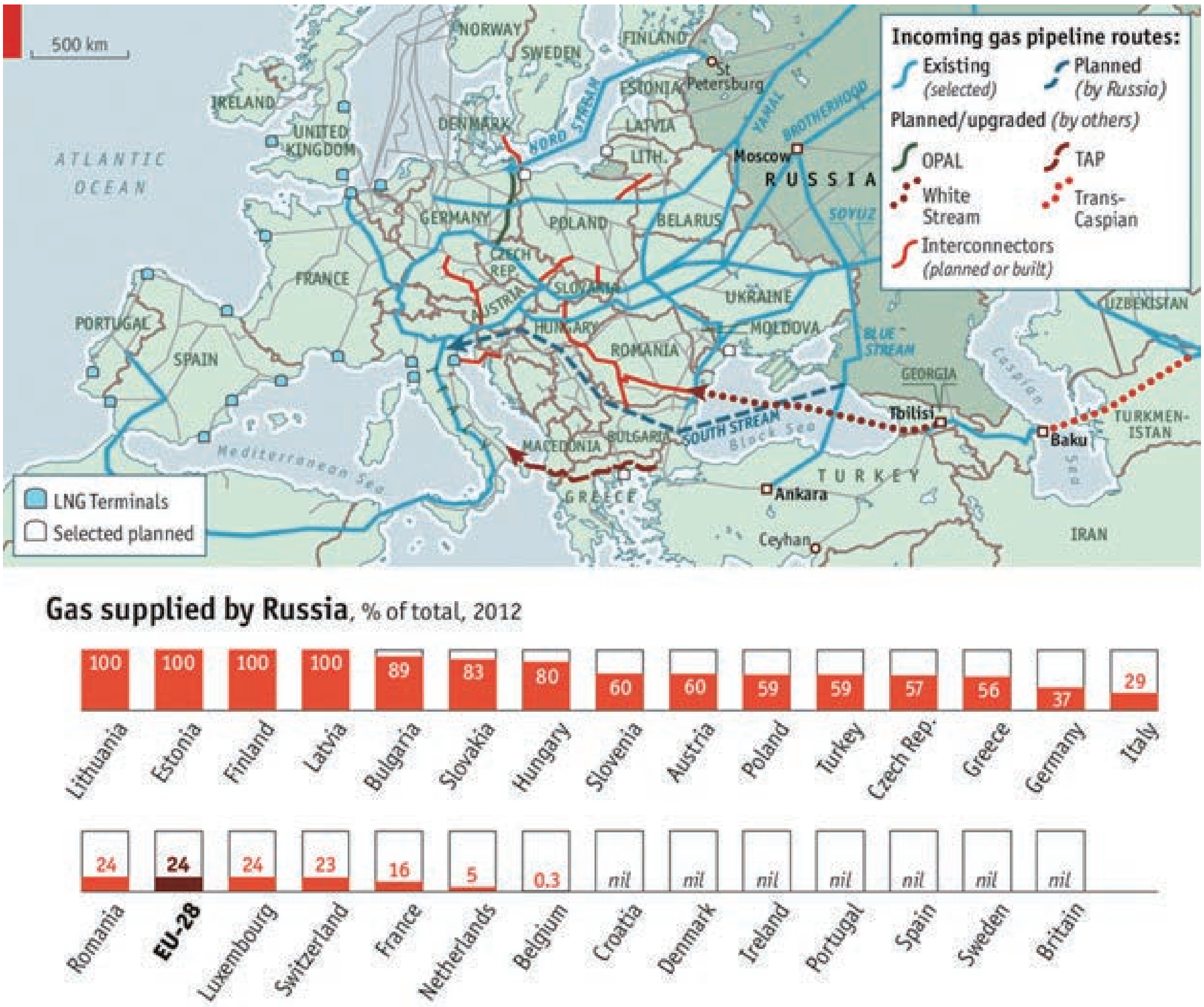
21 Ukraine's Orange Revolution took place between November, 2004 and January, 2005, with sweeping implications for subsequent Russian foreign policy. See Jeanne L. Wilson, "The Legacy of the Color Revolutions for Russian Politics and Foreign Policy", Problems of Post Communism, Volume 57, No.2, 2010, pp. 21-36.

22 Montenegro was formally invited by NATO to begin accession talks on December 2, 2015, and formally joined NATO at the July, 2016 Warsaw summit. See "Relations with Montenegro: Milestones in Relations", NATO, at: http://nato.int.

for energy supplies. None of the new members, save Romania, have major domestic energy reserves, while embedded infrastructural links, such as the ironically named Druzhba (Brotherhood) gas pipeline, link them closely to their Russian neighbor to the east, as indicated in Figure 2-4.[23] Russia is also an important market for many of them, including even powerful Germany, with respect to both agricultural products and manufactures.

FIGURE 2-4: EUROPE'S EXTENSIVE EAST-WEST GAS GRID



Source: Eurogas
Economist.com/graphicdetail

Some eastern members of NATO, especially the Baltic states, are also vulnerable in political-military terms. One of the former Soviet Union's most important western bases,

[23] The twenty-eight nations of the EU average around 24 percent reliance of Russian gas, with that share reaching 100 percent in Lithuania, Latvia, Estonia, and Finland, as well as more than 50 percent in nine other nations. See "Putin's pipelines", The Economist, April 3, 2014.

Kaliningrad, lies sandwiched between Poland and Lithuania. In part to avoid provoking the Russians, there are no major NATO defense facilities in the Baltic states, and Russian forces in the region greatly outnumber their Baltic counterparts. To make the situation even more delicate and combustible, all of the Baltic states have substantial Russian ethnic minorities frustrated at the collapse of the Soviet Union and their sudden relegation to second-class citizenship status.[24]

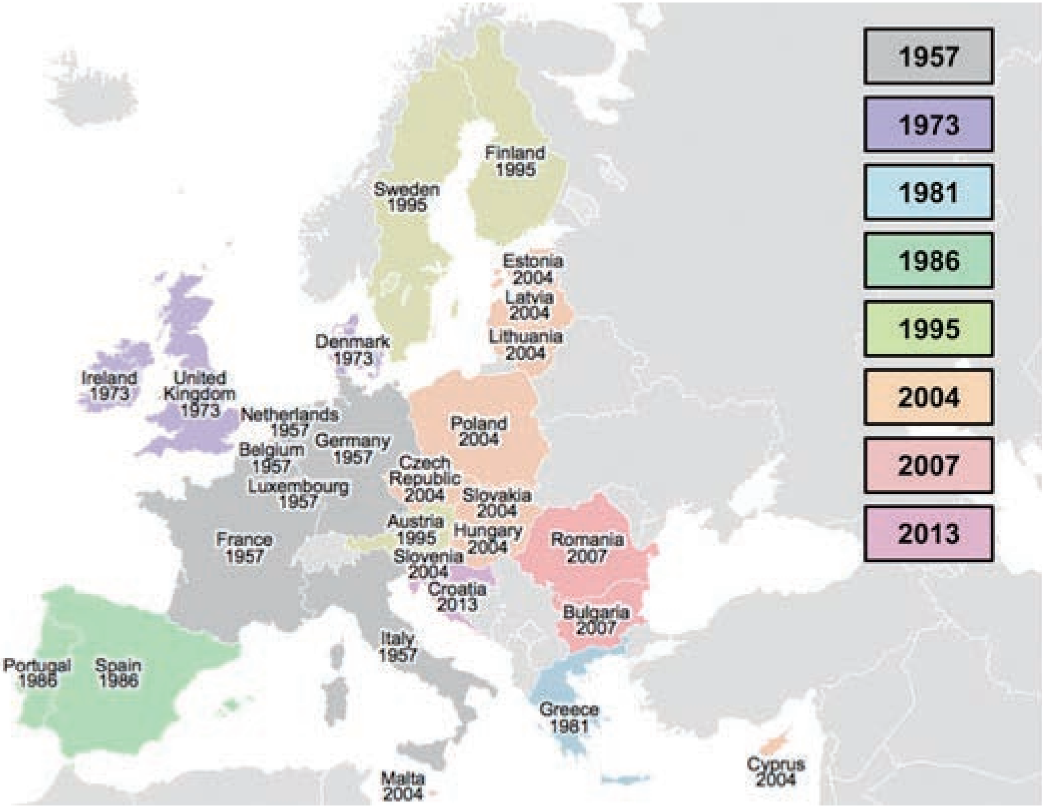
Economic Transformation of Europe and its Global Implications

Even as the expansion of NATO was transforming the post-Cold War profile of Europe in the political-military realm, parallel developments in trade and finance were radically altering the political-economic face of Europe as well. As indicated in Figure 2-5, the European Union expanded from six members in 1957, to thirteen by 1990, when the major post-Cold War transformations began, and ultimately to 28 members today. In its post-Cold War expansion, the EU took in virtually all the new members of NATO, and a few other states as well.[25] This EU expansion created arguably the largest multinational trading bloc in the world.

[24] Ethnic Russians make up a large share of the populations of Latvia (27 percent); Estonia (25 percent); and Lithuania (5 percent). See Jan Pull, “The Baltic Front: Where Putin’s Empire Meets the EU”, Spiegel Online, July 3, 2015, at: http://www.spiegel.de.

[25] Norway and Montenegro were in 2016 members of NATO, yet not the EU, while Austria, Sweden, and Finland were conversely members of the EU but not of NATO.

FIGURE 2-5: EXPANSION OF THE EUROPEAN UNION, 1990-2016



Author's recreation of https://upload.wikimedia.org/wikipedia/commons/6/6c/Evolution_of_the_European_Union_SMIL.svg

Note: Britain in June, 2016 voted in a national referendum to leave the European Union, although as of late 2016 it had not submitted formal withdrawal documents

Even more fateful than the expansion of the European Economic Community, with its common trading area and provisions for regulatory harmonization, was its ambitious steps toward financial integration. In 1992, the Maastricht Treaty committed the core members of Europe to currency integration, with both intensified and stabilized, at least in the short-run, their trade and financial interdependence. The treaty also mandated an increased level of fiscal and regulatory coordination as well. Following the actual birth of the Euro in 1999 with eleven members[26], followed by expansion to nineteen members by 2015[27], the new

[26] Those original members included Austria, Belgium, Finland, France, Germany, Iceland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. See Cynthia Kroft, "A timeline of the euro's growth", Politico, December 26, 2014.

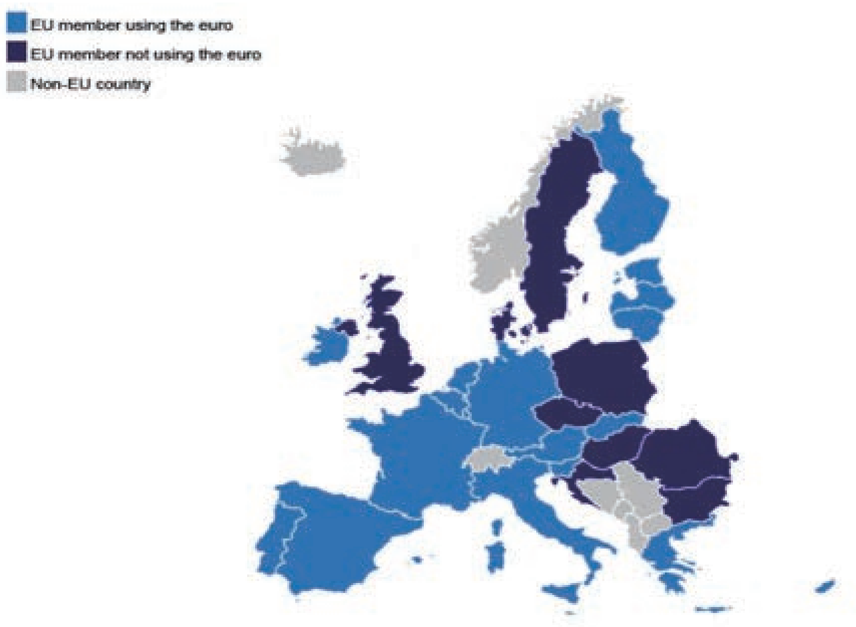
[27] Additional euro members include Greece, which joined in 2001; Slovenia (2007); Cyprus and Malta (2008); Slovakia (2009); Estonia (2011); Latvia (2014); and Lithuania (2015). See Ibid.

monetary integration initially led to a spurt of growth in the new member nations, both in Eastern Europe and the Mediterranean. Governments, businesses, and consumers all rushed to avail themselves of the lower interest rates and expanded borrowing opportunities that flowed almost miraculously from the monetary union.

As indicated in Figure 2-6, not all members of the European Economic Community elected to join the Euro, or, indeed, were invited to do so. Conspicuously, the United Kingdom, although a core member of the EU, decided to retain the pound sterling as its national currency, while aligning it closely with the Euro under a controlled float[28]. Sweden, Denmark, and several nations of Eastern Europe also failed to join the common currency, thus retaining added flexibility in their monetary and fiscal policies. Fatefully, however, the Mediterranean members of the EU—Greece, Spain, and Portugal, together with EU core member Italy—did not avail themselves of this option, despite the indifferent productivity and fiscal discipline prevailing in many of their economies. These Mediterranean states thus gained the short-run benefit of greater financial flexibility—the opportunity to borrow extensively, at a variety of levels, from EU banks, while also retaining easy access to EU debt markets. At the same time, however, financial integration created the long-term prospect of serious political-economic crisis, if the fiscal and monetary policies of individual member nations were called into question. And the shadow of Brexit complicates EU vulnerabilities still further, even if Britain has not itself been a member of the Euro-zone.

[28] The British electorate voted in a June, 2016 national referendum to actually leave the EU, although the UK government did not immediately submit withdrawal documents to EU authorities.

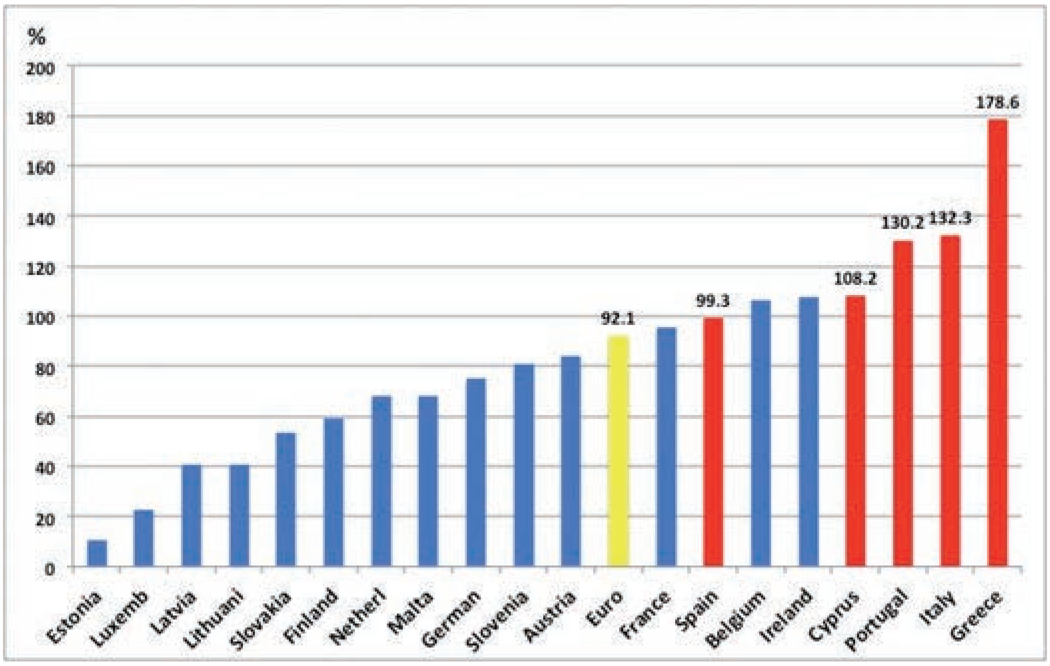
FIGURE 2-6: THE EURO AREA, 1999-2016



Source: European Central Bank

With the growth that followed post-Cold War EU expansion, however, came a steady expansion of debt. This took a variety of forms—government and corporate borrowings; real-estate lending; and household finance. Quantitatively, the debt was naturally concentrated in the nations with the largest economies. There was, however, a little-noticed but geopolitically important corollary, presented in Figure 2-7: relative to GDP, the debt came to be concentrated heavily in the nations on the periphery of the EU—especially in Mediterranean countries with unusually fragile economies, such as Greece, Cyprus, Portugal, and Italy.

FIGURE 2-7: HIGH DEBT TO GDP RATIOS IN THE MEDITERRANEAN EU NATIONS



Source: Eurostat

EU Expansion: Implications for the Changing EU-China Geopolitical Calculus

Fresh EU entrants from the "New Europe" thus fall into two broad categories: former Warsaw Pact members, such as Poland, the Czech Republic, and Hungary; as well as former constituent parts of the Soviet Union itself until the early 1990s. The latter group includes the Baltic states (Estonia, Latvia, and Lithuania). These newly empowered actors had a long history of independence themselves before being absorbed into the Soviet Union by Stalin in 1940, although they also included within their borders large minority ethnic Russian populations, most of whom had settled in the Baltics during half a century of Soviet rule (1940-1991).

The Varied Utilities of China for the New Europe

The "New Europe" members of the EU, including both Warsaw Pact-era satellite nations and successor states of the Soviet Union, share two distinctive traits deriving from Cold

War days: (1) positive traditional relations with China, with whom they traditionally balanced, to increase autonomy from the former Soviet Union; and (2) delicate, often hostile, relations with Russia, their former imperial master, dominated by a fear of renewed Russian geopolitical assertiveness. The "New Europe" thus provides distinctively strong geopolitical support for deepened relations with China, apart from the economic motives often stressed, even as it also introduces a pronounced cautionary note into the EU's relations with Russia. Indeed, the very ambivalence about neighboring Russia's renewed assertiveness under Vladimir Putin intensifies the New Europe's interest in having far-off China as a balancer; the more threatening Russia becomes, the more attractive China therefore seems to be.

The second group of recent post-Cold War EU entrants—admitted in part to balance the enhanced influence of Berlin flowing from German reunification in 1990—was somewhat different from the first. Spain, Portugal, and Greece, who all entered the EU in the 1980s, had not been part of the former Soviet bloc. They thus failed to share either the New Europe's strong trade and inter-personal relations with China, nor its Socialist heritage. The new Mediterranean members were nominally democratic (a condition of entry into the EU). Yet they were also still fragile democracies, with traditionally interventionist militaries, strong labor unions, weak bureaucracies, and a rich tradition of civic distrust of government. China, as its economy grew in size and strength, held increasing attraction for those countries, as an economic supporter and stabilizer.

China and Europe's Transformation

The deepening Sino-European relationship flows from developments within China, as well as the historic post- Cold War changes in Europe that are outlined above. Chinese growth, first and foremost, has made the PRC a more and more attractive market for Europe, while enhancing China's ability and inclination to invest in Europe also. The Chinese economy, after all, is now ten times as large, in purchasing power parity (PPP) terms, as it was in 1990; it passed the US in that important measure of economic scale during 2014, to rival the EU itself as the largest economic unit on earth.[29]

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[29] "GDP, PPP (constant 2011 international $), World Bank website, at: http:// data.worldbank.org

Trade between the two poles of Eurasia has soared, to the point that the EU is now China's largest market, absorbing 16 percent of China's total exports, and providing 12 percent of its imports.[30] China is also the EU's largest market apart from the United States, with the PRC's share of European exports doubling from 5 percent in 2003 to 10 percent in 2014.[31] In 2005, China also surpassed the US, to become the EU's largest supplier of goods. Trade thus plays a key role in solidifying Sino-European trans-continental ties.

Three Recent Critical Junctures Catalyze a New Sino-European Relationship

Throughout the 1990s and 2000s, Sino-European relations continued to deepen—in trade, investment, and cultural relations. Yet so too, under the pressures of globalization, did China's relations with North and South America, as well as Africa, and Europe's ties with Southeast Asia, and with South America as well. The general pressures of globalization were operating to propel trans-regionalism throughout the world, with deepened Eurasian ties just one of many manifestations of a broader worldwide trend toward enhanced interdependence.

Six critical junctures since the mid- 1970s, as we have seen, gave birth to the increasingly integrated geo-economic playing field that is the New Eurasia. These CJs included China's Four Modernizations (1978); the Iranian Revolution (1979); the Indian interest-rate reforms (1990-1991); and the collapse of the Soviet Union (1991)[32]. Since late 2013 two new CJs—one a security development and the second an economic phenomenon-- have accelerated the pace of regional integration; meanwhile, Brexit has generated major uncertainties for both processes. All these could critically shape the evolution of Sino-European relations.

The first of these recent yet fateful developments was the Ukraine crisis, erupting first in November 2013,[33] whose geographical flashpoints are depicted in Figure 2-8. The

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30 International Monetary Fund. Direction of Trade Statistics, at: http://data.imf.org.

31 Eurostat, "Extra-EU trade by partner", at: http://ec.europa.eu.

32 For more details on these fateful developments which created an increasing interdependent Eurasia, see Kent E. Calder. The New Continentalism, pp. 47-99

33 "Ukraine crisis: Timeline", BBC, updated on November 13, 2014, at: http://www.bbc.com.

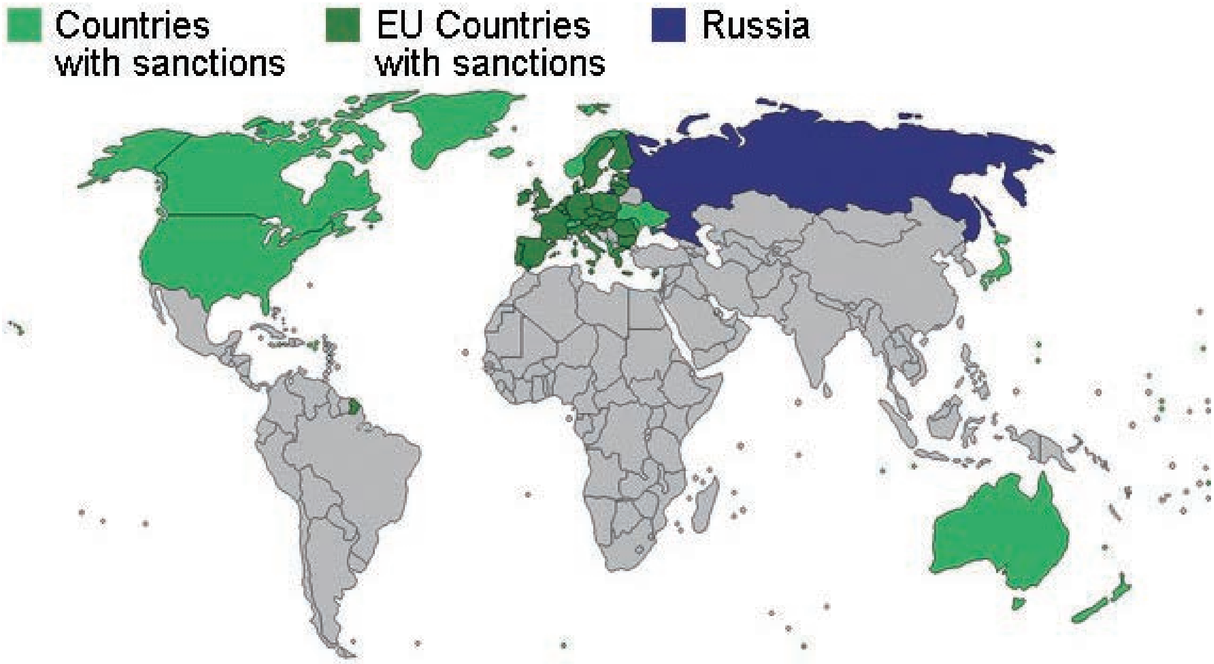
Yanukovich administration rejected the prospect of affiliation with the European Union, provoking sustained protests on the Maidan, Kiev's central square, that spiraled upward into violence and ultimately revolution. The pro-Russian regime was deposed, replaced by a militantly anti-Putin coalition, with whom an escalating conflict ultimately provoked Russia's March 2014 annexation of the Crimea, and Western sanctions. Those in turn led to intensified East-West military confrontation—not only in the Ukraine, but also involving intensified pressure on the Baltics, and other recalcitrant parts of the former Soviet Union.

FIGURE 2-8: THE UKRAINE CATALYST FOR EURASIAN CHANGE

Source: "Ukraine in graphics: Crisis in Ukraine", The Economist, June 4, 2015.

East-West tensions over the Ukraine have enhanced Sino-European relations in several ways. First, they have seriously eroded Russian ties with Europe, thus forcing the Russians into the arms of the Chinese. This has given China more leverage in Central Asia, long a Russian preserve, as well as in Belarus, making it easier for the Chinese to use the former Soviet Union as a transit way-station to Europe, even as its intrinsic economic importance declines under the weight of international sanctions, whose configuration is presented in Figure 2-9. Tensions over the Ukraine have also made China more geopolitically attractive to the Europeans as a prospective balancer against an increasingly proactive Putin administration.

FIGURE 2-9: THE EUROPEAN CATALYST: SANCTIONS AGAINST RUSSIA



Source: Author's recreation of https://en.wikipedia.org/wiki/International_sanctions_during_the_Ukrainian_crisis#/media/File:Sanctions_2014_Russia2.png

The Ukraine crisis and resultant Western sanctions against Russia have also provoked the Putin administration to pursue cooperative policies toward China that are further accelerating the progress of Eurasian continentalism, and thus indirectly facilitating Sino-Russian economic integration as well. In May 2014, for example, Russia's Gazprom and China's CNPC concluded a $400 billion, thirty-year natural-gas supply agreement in Beijing;[34] Putin visited Beijing again in September 2015 for China's World War II Victory Day commemoration.[35]

In June 2015, China signed deals with Moscow to build a Russian domestic high-speed rail line between Moscow and Kazan, on the Volga.[36] Meanwhile, Russia also took initiatives to strengthen the Eurasian Economic Union of Russia, Belarus, and Kazakhstan.[37] The net

34 "Gazprom, CNPC sign 30-year natural gas supply contract", Oil and Gas Journal, May 21, 2014.

35 Jonathan Caiman, "Who's who (and who isn't) at China's big parade", Los Angeles Times, September 2, 2015.

36 Paul Sonnet, "China to Design New Russian High-Speed Railway", Wall Street Journal, June 19, 2015.

37 Russian Prime Minister Putin went so far as to suggest a single currency to supplement free-trade arrangements. See Jon Stone, "Putin suggests single currency for Eurasian Economic Union", The Independent, March 20, 2015.

effect of these trade and infrastructural deals, ironically, was not so much to generate autonomous Russian development in the face of Western sanctions, as to facilitate a counter-intuitive outcome: deepening Sino-European ties, which are being consolidated for reasons unrelated to Russian interests.

Strategic Implications for the Eurasian Future

Looking forward, it appears that the tensions unleashed in the Ukraine crisis, on both the Russian and Western European sides, could be quite fundamental. They call into question the longstanding concept of a "common European home", espoused by both Russian and European leaders since the late Cold War days of Mikhail Gorbachev. Coupled with expanded Russian military pressures against the Baltic states and Poland--- now members of NATO— those tensions also call into question the credibility of the Western alliance itself. The NATO allies cannot easily back down in the face of Russian pressures. And the Russians, themselves threatened by the strategic dangers that they perceive from an alliance already intruding into the heart of the former Soviet Union, cannot easily avoid pressuring the West to withdraw.

China, in contrast to Russia, is hardly challenged by the new strategic reality dramatized by the Ukraine crisis. A NATO ensconced in the heart of the former Warsaw Pact, and indeed increasingly in the very heart of the former Soviet Union itself, does not challenge Beijing the way it does Moscow. To the contrary, this new reality presents expanded leverage for China, since it can remain on good terms with both Russia and Europe, even as these European powers feud with one another. And since the new reality of a NATO expanded eastward is structural, this situation is quite basic, and likely to institutionalize both Russo-European tensions and related Chinese opportunities in Europe, for years to come.

China and the Crisis of the Euro

A second recent critical juncture, qualitatively different from the Ukraine crisis, yet nevertheless also reconfiguring the Sino-European relationship, is the intermittent crisis of the Euro. This has bubbled on episodically since 2010, affecting all of the Mediterranean countries (Spain, Portugal, Cyprus, and Italy, as well as Greece). It came to a head, however, in the Greek financial difficulties of 2015. As with the Ukraine crisis before it, the Greek crisis has its roots in an ambitious political-economic effort to bind the nations of Europe together that ran into serious difficulty. And as in the Ukrainian crisis also, a rapidly rising China—the largest creditor nation in the world, with well over $3 trillion in foreign-exchange reserves -- looms as an important and empathetic potential stabilizer for Europe, in contrast to the impotence or perverse intentions of Russia, and the reticence of the United States.

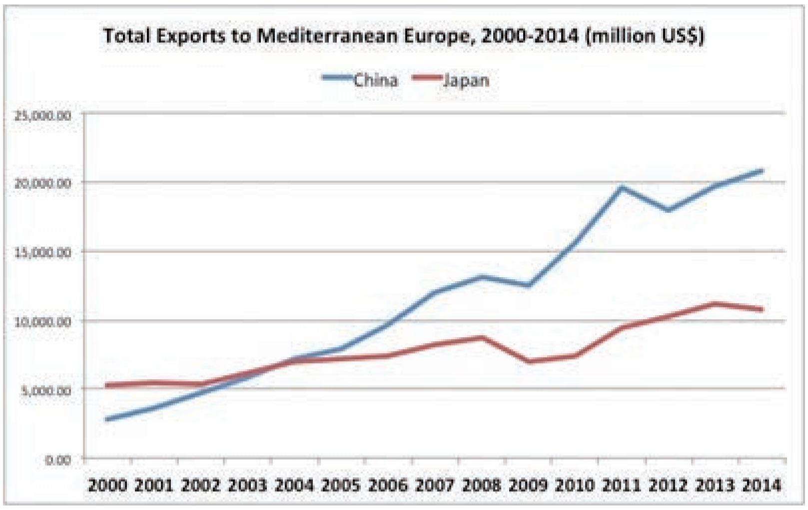
In relation to the Ukraine crisis, and the broader geostrategic problem of protecting the vulnerable Central and Eastern European states from Russian encroachments, China's role is only implicit, as a balancer on Russia's eastern flank. In relation to the crisis of the Euro, however, China's potential role is much more direct. The Euro zone has expanded, for geopolitical reasons, to include nations, many of them Mediterranean, that find it difficult to adjust socio-politically to the austere, frugal policy standards of Northern Europe. The result of this disjunction has been periodic financial crises in the southern-tier Euro members, as they struggle with chronic budget deficits and with structural reform.

With the introduction of the Euro in 1999, and its steadily broadening usage across the continent, the fates of the stronger economies of northern Europe came increasingly linked with the success of the weaker ones to the south. China has become increasingly important in trade and investment terms to the nations of the European south, which also have particular geopolitical attraction for Beijing, given their proximity to major global sea lanes. Thanks to Chinese growth and eagerness to engage, each of the Mediterranean nations has grown increasingly dependent on China over the past five years, even as dependence on Japan has significantly fallen, as indicated in Figures 2-10A and 2-10B.[38]

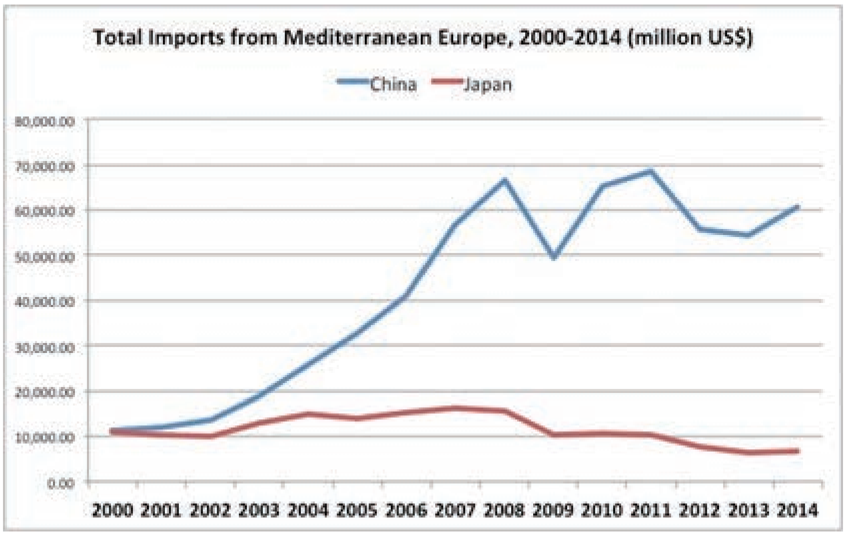
[38] China surpassed Japan as both 'export destination' and 'import origin for the four major Southern European countries in the early 2000s, just after joined the WTO. See IMF. Direction of Trade Statistics.

FIGURE 2-10: DEEPENING MEDITERRANEAN EU TRADE DEPENDENCE ON CHINA

(A)



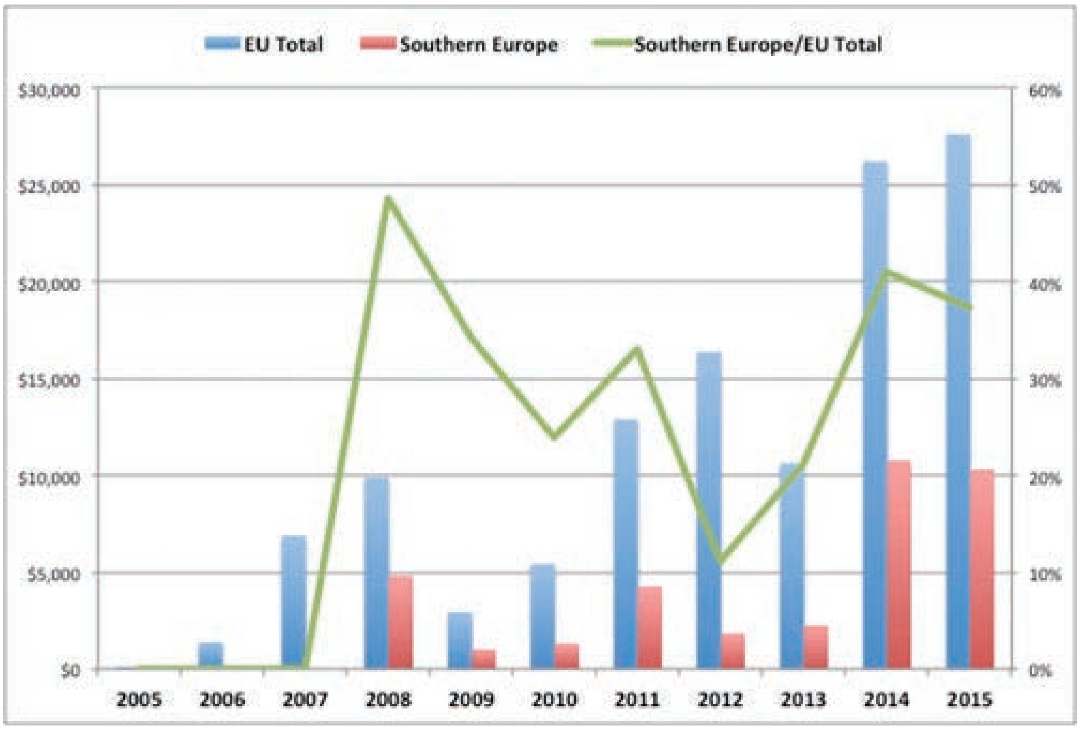
(B)



Source: IMF, Direction of Trade Statistics

Direct foreign investment has followed a similar pattern. Capital outflows from China to the European Union as a whole have accelerated substantially in the past decade, as indicated in Figure 2-11. And relative to the size of local economies, the flows have been especially large since 2007 to the nations of the Mediterranean—Europe's vulnerable southern tier—even though these countries have also experienced lower growth and higher inflation than their brothers to the north.[39] Interestingly, those flows have been sharply less to Ireland—a target of the 2010 financial crisis, but not on the Mediterranean—than to the southern tier. China, in short, has been increasingly important in propping up the weaker nations of the European Union—a role that naturally brings it more importance and appreciation not only in the weaker nations themselves, but with EU authorities in Brussels as well.

FIGURE 2-11: CHINESE INVESTMENT IN THE EU'S SOUTHERN TIER



Source: Data from AEI/Heritage Foundation, "China Global Investment Tracker", at: http://aei.org.

China's overall investment in the EU has grown explosively, from just $100 million in 2005 to $27.6 billion in 2015, as indicated above. The sectoral composition of recent Chinese investment in Europe is as interesting as its magnitude. There are, of course, the luxury investments in Bordeaux vineyards. Yet more striking are the heavy investments in infrastructure, with construction being the area of most intense Chinese investment in Europe. This investment seems to have been most intense during 2010-2013, just after the

[39] Roughly 1/3 of Chinese investment in the EU has flowed to the four major southern European countries, which generated only 23 percent of EU GDP in 2014, according to World Bank statistics.

Lehman crisis, with a relatively heavy portion concentrated in Balkan and Central European countries outside the EU itself.[40]

Such investments within the European Union will likely lay the groundwork for still deeper Chinese political-economic involvement with Europe in future years, while enhancing Chinese geopolitical influence as well. A clear example of how Chinese investments can lay the basis for greater future influence is the port of Piraeus, directly adjacent to Athens, with respect to which the US in the early 1970s concluded an agreement to homeport US forces, and ultimately an aircraft carrier,[41] around the same time as a decision was made to homeport the Midway in Japan. Unlike the US-Japan case, the Piraeus homeport agreement was only partially implemented, due to differing views between the US and Greece of optimal arrangements, and the US soon abandoned its efforts.[42] Yet those efforts did suggest the strategic and logistical importance that the US attached to Piraeus during the Cold War.

More than three decades after the US Navy withdrew, China Ocean Shipping (COSCO), China's largest shipping company, arrived in Piraeus. Since 2009, it has invested nearly $5 billion in this strategic Greek port. COSCO currently owns two of the major piers at Piraeus, with a 35-year lease on broader facilities. And in April 2016, China Cosco Holding Company formally purchased a 67 percent share of the Piraeus Port Authority as a whole.[43]

China is also financing substantial infrastructure northward into the Balkans. Current projects include two highways in Macedonia,[44] and the principal Belgrade to Budapest high-speed rail line.[45] China is also investing heavily in infrastructure still further north, in Belarus and Poland, as we will see in greater detail in the next chapter.

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40 Ibid.

41 In a January 8, 1973 agreement between the US and the Greek navies, the Greek government granted home-porting facilities to serve around 9000 US military personnel and dependents, assigned to escort ships, and ultimately to a carrier. See Stephen G. Xydis, "Coups and Counter-Coups in Greece, 1967-1973", Political Science Quarterly, Volume 89, No. 3, 1974, pp. 507-538.

42 US Defense Secretary James Schlesinger postponed the second stage of homeporting, involving the carrier deployment, in the mid-1970s, and the concept was never revived. See US Department of State. Foreign Relations of the United States, 1973-76: Greece, Volume XXX, Document 10.

43 "Greece sells Piraeus port to Chinese bidder", Deutsche Woleaian 8, 2016.

44 "Macedonia Taps Chinese Loan for Motorways", Balkan Insight, October 1, 2013.

45 This will be financed by the Export-Import Bank of China. See a Baijiu, "High-speed rail set for Hungary, Serbia", The State Council of the People's Republic of China, November 25, 2015, at: http://english.gov.cn.

Building the Economic Highways to Europe

There is little question that Chinese trade with and investment in Europe itself is rapidly expanding, both absolutely and relative to Chinese economic involvement in other parts of the world outside developing Asia.[46] This is true even though Europe is a formidably long distance from China, across a Eurasian landmass that traditionally has been neither economically or politically hospitable to transit travel. Beijing, after all, lies over 4600 miles from Berlin, and the western reaches of the continent in the Iberian Peninsula lie nearly 1200 miles further away.

Despite the raw distance, however, transit travel from China, across Eurasia, to Western Europe and back has begun to accelerate rapidly since the beginning of 2011, capitalizing on the dramatic differences in shipping time (as little as ¼ in recent cases in favor of overland rail as opposed to sea) between inland China and central Europe.[47] In January 2011, a railway route connecting Chongqing and Duisburg in Germany was opened.[48] In 2013, the first regular, direct line between China and Europe was inaugurated, connecting Chengdu in Szechuan and Lodz, Poland. Scheduled overland shipping routes from the massive logistical hub of Yiwu in China's Zhejiang province to Madrid in Spain have been operating since November 2014.

Cargo flights between China and Europe have also been rapidly expanding. Air China Cargo, for example, opened two new air routes, from Shanghai to Amsterdam and Frankfurt respectively, in March 2013.[49] Large new transit air-cargo facilities like Navoi in Uzbekistan are also being erected along the way, to accommodate the increased air freight across the continent, mainly from China to Europe and back.

Cargo traffic is rising across Eurasia, between China and Europe, in part due to the rising scale of trans-continental trade, including bulky items such as industrial machinery and

46 The EU's share of Chinese foreign direct investment outflows beyond developing Asia rose from 8 percent of that total in 2003 to 23 percent in 2012. See UNCTAD. Bilateral Foreign Direct Investment Statistics.

47 Wade Shephard, "Why the China-Europe 'Silk Road' Rail Network is Growing Fast", Forbes, January 28, 2016.

48 "Regular cargo trains link Chongqing, Germany's Duisburg", Xinhua, April 8, 2014, at: http://news.xinhuanet.com.

49 "Air China Cargo opens two new European freight routes", Supply Chain, March 26, 2013.

heavy electronic equipment, that travel more easily by rail. Rising Chinese plant investment in central Europe—as well as European investment in the interior of China—is also inspiring greater movement of capital goods for building and equipping new factories. China has, after all, rapidly become the manufacturing hub of the entire world, and an increasing share of its industry is emerging in such inland centers as Chengdu, Chongqing, and Xian.

Trade between China and Europe, however, has been substantial for well over three decades. Yet little of it, until recently, moved by land, despite the clear geographical benefits of doing so. The overland route from China to Central Europe is less than half as long as that by sea, and lately takes only a quarter of the shipping time.[50]Yet until recently the land alternative was little used.

What one really needs to ask is why the recent shift from sea to land transport between Europe and China—or from Europe to Northeast Asia more generally-- is at last occurring. This has four central aspects. First, transport technology is changing. Secondly, customs clearance is growing easier. Thirdly, infrastructure itself is physically improving. And finally, inland centers of both China and Europe have been developing with unaccustomed speed—for domestic, as well as for international reasons.

Technological change is doubtless reducing transport costs. Container shipping is growing cheaper and more efficient, while cargo trains are growing faster and more powerful. Yet an even greater catalyst for trans-continental transit trade comes from increasingly efficient border clearance procedures. Massive clearance centers, like Horgos on the Chinese-Kazakh frontier, have arisen, fostered by multilaterals like the Asian Development Bank, and supported by computerization, which process cargo rapidly and much more transparently than even a few years ago. The inauguration of the Russian-inspired Eurasian Economic Union in January 2015 now means that there are effectively only two land frontiers to be crossed—the newly streamlined China-Kazakh border and the frontier between Belarus and the European Union—between the Pacific and the Atlantic, across Eurasia. And both western China and Central Europe—the areas now being fatefully linked by trans-continental infrastructure—are both overcoming their longstanding economic under-development.

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[50] The distance between the Port of Chongqing and that of Duisburg, Germany is around 24,167 kilometers. Yet the equivalent railway distance is only 11,179 kilometers. See http://ports.com; and http://www.infinitycargo.com.

Taken together, these four important changes in the political-economy of overland transit trade between China and Europe are accelerating the attractiveness of interdependence across the continent itself. So are developments around the continent, along another long-neglected but increasingly promising transit route: that across the Arctic itself. Like overland transit across Eurasia, the northern sea route between China and Europe has substantial geographic attraction, cutting 35 percent off the sailing distance between Shanghai and Hamburg, for example.[51]

Due ironically to the generally perverse consequences of global warming, the northern seas from the Bering Strait to Murmansk and beyond are growing passable, albeit still with icebreaker support. In 2012, 46 commercial vessels, with over 1.2 million tons of goods on board, traversed the northern sea lanes, initially mostly between Russian ports. In 2013, the number of commercial passages along the full Arctic sea route rose by 54 percent. COSCO, among others, has announced plans for a regular shipping route between China and Europe, which could cut as much as ten days, or 7000 kilometers, from that lengthy voyage.[52]

In June 2016, the British electorate voted narrowly, in a national referendum, to leave the European Union. Despite strong pressured from Brussels for clarity, British leaders did not immediately tender a formal withdrawal, despite the referendum outcome. Yet the Brexit vote did presage major changes in both the profile of European integration and in overall European relations with China.

From an intra -European perspective, Brexit intensifies the burden on Germany to sustain financial and political economic equilibrium on the continent, even as it intensifies the uncertainties that the EU as a whole confronts. Britain, the second largest economy in the EU, and heretofore a market -oriented partner, will be gone. And nationalist pressures for their own withdrawal, from within same of the weaker remaining members, such as France and Spain, could well intensify.

From a trans-continental perspective, China's underlying interest in Europe will undergo little change. The PRC's interest in Britain, the first nation to join the AIIB, and to issue sovereign bonds in renminbi, is primarily financial. And London's attractive offshore

51 "COSCO announces Arctic shipping route to Europe", Japan Times, October 27, 2015.
52 Ibid.

financial infrastructure, which inspired emergence of the Euro- dollar half a century ago, remains largely impact, despite Brexit. For Britain, China's attractions as a growing market could loom even larger than before, as EU accesses grows more difficult. Certainly, Anglo-Chinese financial ties have been growing rapidly in recent years.

For the continent as well, China's attractions will also remain, and even intensify, especially for Germany. The Germans will have heavier burdens within the EU, making China's support for infrastructure and in other financial dimensions, more attractive. For China, both geopolitical and economic logic will make European continental technology and diplomatic ties of continuing interest. With Europe divided, China may be able to extract ever better terms than before, from both Britain and the continent.

IN CONCLUSION

New transit routes across and around Eurasia, between China and Europe, are thus rapidly growing both more numerous and easier to use. These developments are rapidly drawing Europe and China closer together, and are synergistic with the financial and industrial complementarities described earlier. Structural transformations of early post-Cold War days now embedded in the political economy of Europe, including the expansion of NATO and the birth of the Euro, create serious, fundamental strategic tensions between Europe and Russia that render impractical Mikhail Gorbachev's idealistic dream of a "common European home".

At the same time, these historic changes create a natural space for steadily deepening Sino-European relations, routed in the need for global financial stability, that even the United States cannot realistically oppose. Those deepening ties across Eurasia, in turn, give the continent the sheer mass and integrity in global geo-economic terms that Mackinder foresaw a century ago, leading both Eurasia and the world ever closer to potential reconfiguration of the global geo-economic chessboard. The intra-European divisions created by Brexit appear unlikely to meaningfully affect this tendency, relations with either Britain or continental Europe. Indeed, they may actually accelerate the pace of transcontinental interaction.

CHAPTER THREE

EMERGENCE

OF

THE NEW CONTINENTALISM

CHAPTER THREE: EMERGENCE OF THE NEW CONTINENTALISM

China's ties with Europe are undeniably deepening. That intensification of ties is driven not only by rising Chinese economic capabilities and diplomatic assertiveness, but also by important structural transformations and critical junctures within Europe itself, as we have seen. Yet these fateful new developments between the two poles of Eurasia need to be seen in a much broader systemic context. They cannot be understood solely as the product of China's rise, or of Europe's frailties and aspirations for autonomy from Washington alone. Indeed, as we shall see, a major reason that the deepening ties of Europe and China hold such long-term importance for the global future is that they involve the concrete manifestation in the political-economic realm of a latent geo-economic reality: that adjacent areas of the Eurasian continent— including but transcending Europe and China—have symbiotic potential relations with one another that have not been developed.

In May 2012, I published a book, based on nearly five years of previous research, pointing to the profound underlying economic complementarities prevailing across the Eurasian continent, and the critical junctures in the political realm that were opening the prospect of deeper interdependence.[53] Five months later, Professor Wang Jisi of Beijing University, an influential advisor to the Chinese government, published a widely noted monograph stressing the importance to China of trans-continental diplomacy.[54] And in October 2013, President Xi Jinping formally announced China's new "One Belt, One Road" initiative, with important addresses in Kazakhstan and Indonesia.[55]

Since President Xi's announcement of the "One Belt, One Road" (OBOR) initiative, the ambitious promotion of infrastructure projects linking China with Eurasian continental destinations to the west, by both land and sea, has been widely recognized as a central element of Chinese foreign policy. Before considering the details of the OBOR initiative

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53 Kent E. Calder. The New Continentalism: Energy and Twenty-First Century Eurasian Geopolitics. New Haven: Yale University Press, 2014.

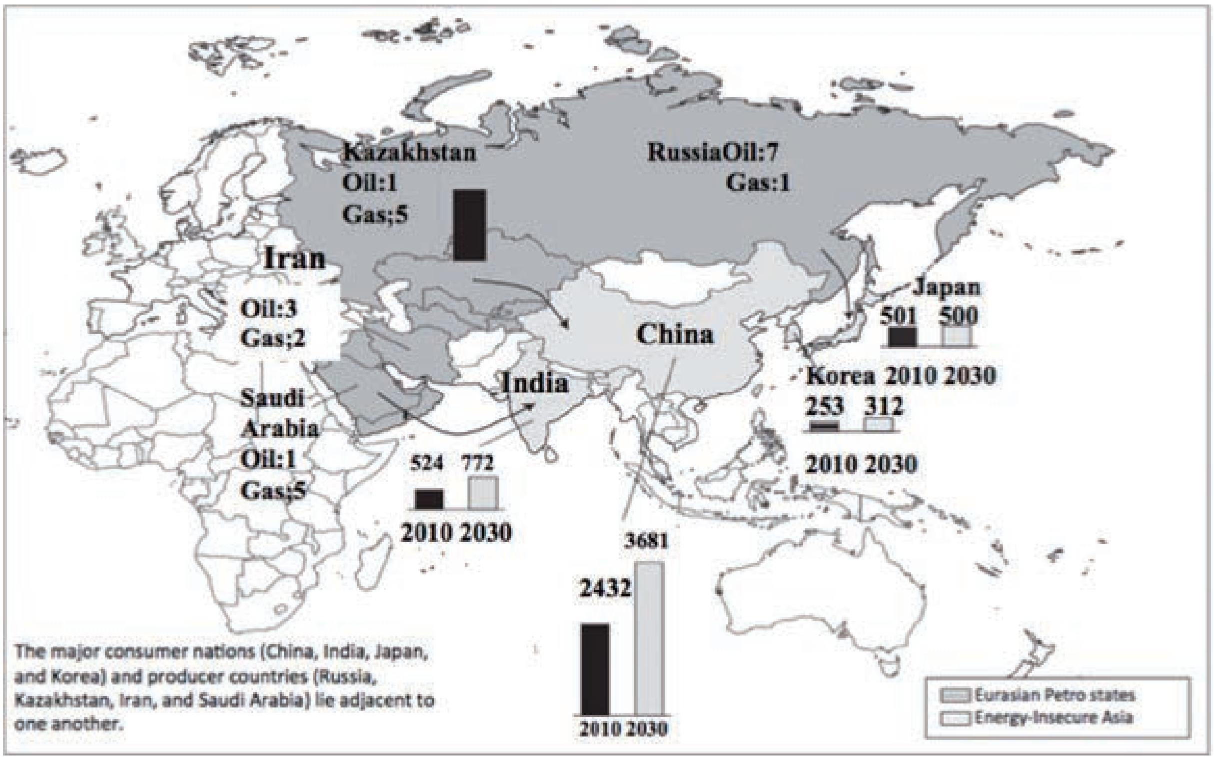
54 Wang Jisi, "March West: China's Geopolitical Strategy of Rebalancing", Global Times, October 17, 2012.

55 Scott Kennedy and David A. Parker, "Building China's 'One Belt, One Road'", Center for Strategic and International Studies, April 3, 2015, at: http://csis.org.

and its geostrategic significance, however, it is important to understand the reasons why the initiative emerged at this time, and why China and other Eurasian nations are pursuing it so energetically. It is also important to consider, of course, what tools China has to realize OBOR objectives, what concrete obstacles lie in its path, and what the ultimate prognosis might be.

Underlying the latent potential for Eurasian continental synergy are deep underlying complementarities with respect to energy. As noted in Figure 3-1, the nations with the largest populations on earth—China and India—lie almost directly adjacent to the areas—the Persian Gulf and the former Soviet Union—with the largest reserves of conventional oil and gas. Across the millennia of human civilization, those complementarities have not been developed, for a variety of reasons—economic stagnation and under-development; Stalin's Socialism in One State policies, which inhibited interdependence; the Sino-Soviet split of the 1960s, 1970s, and 1980s; and the autarkic impulses of China's Cultural Revolution, to mention just a few barriers over the years.

FIGURE 3-1: LATENT ENERGY FOUNDATIONS FOR EURASIAN CONTINENTALISM



Source: U.S. Department Energy, Energy Information Administration International Energy Outlook: BP Statistical Review of World Energy.

Over two decades, beginning in the early 1970s, the political geography of Eurasia began to change, in a series of fateful institutional earthquakes that I have entitled "critical junctures".[56] The most important developments, presented in Figure 3-2, were Deng Xiaoping's Four Modernizations in China (1978); Manmohan Singh's economic reforms in India (1991); and the collapse of the Soviet Union, followed by the rise of Vladimir Putin (1991 and 1999); as well as the Iranian Revolution (1979). Together, these fateful changes gave birth to a Eurasian continent that was infinitely more rapidly growing, more interdependent, and turbulent than had been previously true. The changes have rendered traditional categories for conceptualizing regional affairs and conducting diplomacy, such as "East Asia", "South Asia", "Southeast Asia", and "the Middle East", less and less accurate and operational. Conversely, the critical junctures of the recent past have made trans-continental analysis—as epitomized in the OBOR concept—increasingly relevant to the actual emerging realities of Eurasian diplomacy and political economy today.

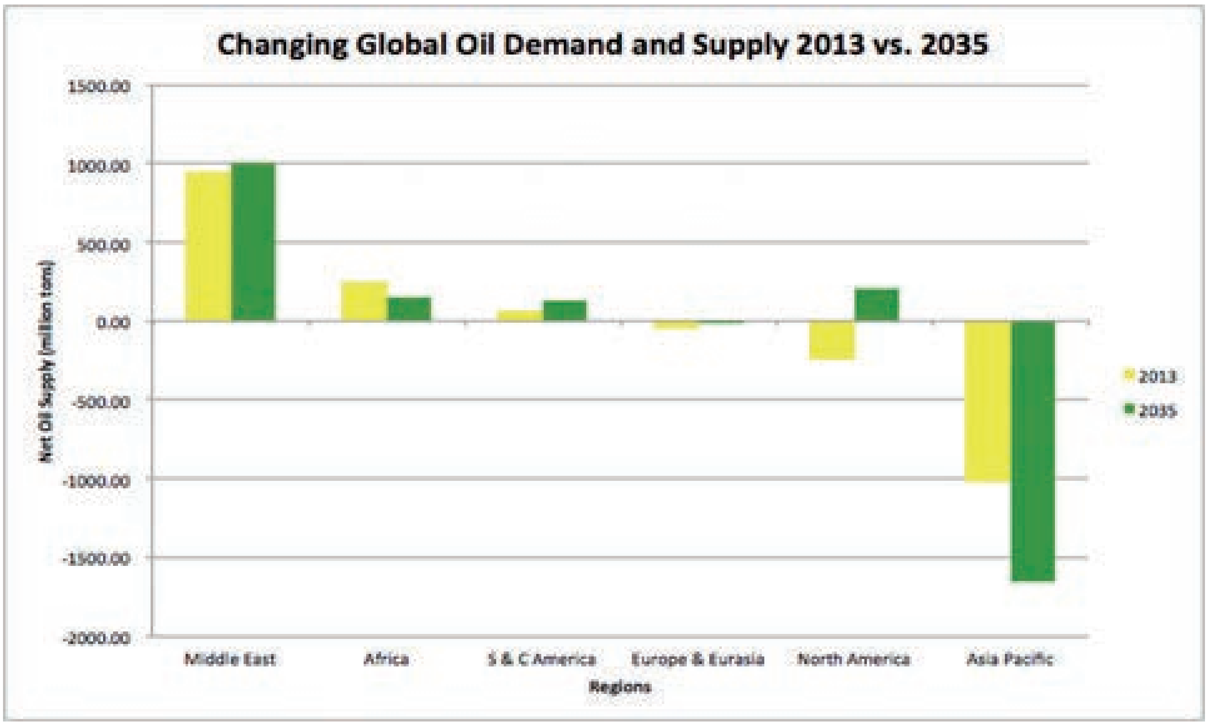
FIGURE 3-2: CLASSICAL CRITICAL JUNCTURES AND EURASIAN INTERDEPENDENCE

Source: Kent E. Calder. The New Continentalism: Energy and 21st Century Eurasian Geopolitics

[56] Calder. The New Continentalism, pp. 50-58.

Looking to the future, there is a strong prospect that the rapid growth and deepening trans-continental interdependence unleashed by the critical junctures of the 1978-1999 period will lead to a trans-figured global energy equation, involving deepened energy links between Asia and the Persian Gulf. Certainly that is the expectation of the International Energy Agency (IEA), which is arguably the most authoritative energy forecaster in the world today. As noted in Figure 3-3, the IEA projects that oil imports into the Asia Pacific region will rise by more than a third in the two decades up to 2035, while exports from the Middle East will rise as well.

FIGURE 3-3: PROSPECTS FOR FUTURE ENERGY INTERDEPENDENCE

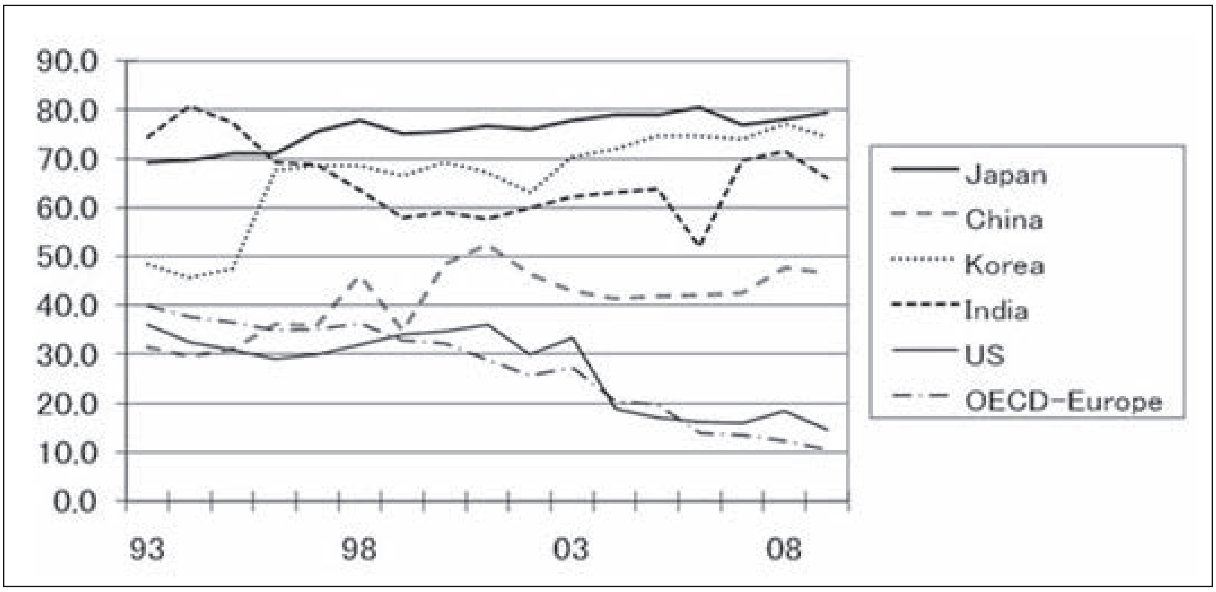


Source: BP Energy Outlook 2015

The IEA does, of course, also forecast that exports from both North and South America will also rise. Some of that new oil, much of it produced from shale, will find its way into East Asian markets. Indeed, South Korea has already contracted to purchase 3.5 million tons a year of LNG from the Sabine Pass project, operated by Cheniere Energy, which in early 2016 became the first US gas project to actually export LNG.[57] Yet the scale of such exports, unprecedented in the past, are unlikely to loom large in future, in part due to high fixed costs of handling such exports, prospective volatility in international energy markets, and continuing competition from low-cost Persian Gulf producers.

As indicated in Figure 3-4, all the major nations of Northeast Asia are heavily dependent on the Persian Gulf for their oil supplies. And that dependence, in the case of Japan and Korea, has actually been increasing. Meanwhile, Western dependence on the Gulf, already low relative to that of Asia, has been declining. The gap between Asian reliance on the Persian Gulf and Western independence thereof has thus been growing greater and greater. If the shale revolution proceeds more rapidly in North America and Europe than in Asia, as seems likely, the East-West gap in Persian Gulf dependence will grow greater still.

FIGURE 3-4: A DEEPENING EAST-WEST GAP
IN PERSIAN GULF OIL DEPENDENCE



Source: Department of Energy, Energy Information Administration; United Nations, Commodity Trade Statistics, and Planning Commission of India, Integrated Energy Policy: Report of the Expert Commission.

57 The first US shale exports went to Brazil, rather than Asia, but exports to Korea were scheduled to occur soon thereafter. See Eric Yep, "Korean Executive Recommends Limit on Shale-Gas Imports from US", The Wall Street Journal, March 24, 2014; and Jacob Groenhout-Pedersen, "US exports first shale gas as LNG tanker sails from Sabine Pass terminal", Reuters, February 24, 2016, at: http://www.reuters.com/article/us-shale-export-idUSKCNOVY08B.

China, as also indicated in Figure 3-4 above, is conspicuously less oil-dependent on the Persian Gulf than its Northeast Asian neighbors, or even than India. Politically inspired hedging and diversification—away from sea lanes and from a region of the world traditionally dominated by the United States—is no doubt part of the reason. Another factor, however, is the proximity of Russia, particularly important in energy terms to China north of Shanghai. Russia, like Central Asian petro-states such as Kazakhstan and Turkmenistan, has become an increasingly important overland energy partner of China over the past decade. This trend may well deepen in future, as is discussed later in further detail.

The New Continentalism Broadens Beyond Energy

One powerful initial catalyst for deepening Eurasian interdependence, as suggesting in the preceding pages, has been energy. The rising demand for steel, petrochemicals, transportation, consumer goods, and energy-intensive services like air conditioning that high growth generates naturally provokes deepening ties between energy producers like Russia and the Persian Gulf nations, on the one hand, and large consumers like China on the other. It also provokes the construction of long-distance pipelines, as well as large-scale electric-power transmission grids, to transport energy from one part of Eurasia to another.

Although energy has been a key initial catalyst, the new continentalism has begun to broaden far beyond the world of energy. Long-distance transportation infrastructure has been one especially dynamic area. Rapid Asian growth, against the backdrop of underlying complementarities among land-rich, labor-rich, and capital-rich nations that live side by side on the Eurasian continent, has created powerful incentives for road and railroad building, leveraged still further by the stimulus to real-estate prices, as well as heavy industry, that new transportation infrastructure creates.

Eurasian Geography Reserves a Catalytic Role for China

China is by no means the only nation motivating, or affected by, the new continentalism. The creation of a more interactive and dynamically growing Eurasia is a phenomenon well beyond the capacity of any one nation. China does, however, naturally have a central role in the emergence of a Eurasian continentalism—not only due to its huge population, increasingly substantial economy, or diplomatic intent. China's geographic centrality itself within Asia gives it natural incentives and capabilities to serve as a catalyst for continental integration.

As is clear from Figure 3-5, China lies at the very heart of the most productive and highly populated portion of the Eurasian continent. Russia is larger, and has its own geographic centrality, but lies in a more forbidding and inhospitable portion of the continent, bordered in the north by the Arctic Ocean, and in the east by the North Pacific. China, by contrast, is surrounded by major countries, and borders on fourteen nations in all. While this centrality creates serious security challenges for China, especially where it faces powerful neighbors like Russia, it also endows China with a potential leadership role in periods when it is capable of being strong and assertive.

FIGURE 3-5: THE CENTRAL POSITION OF CHINA
ON THE EURASIAN CONTINENT

Source: Kent E. Calder. The New Continentalism; Energy and 21st Century Eurasian Geopolitics

As is also evident from Figure 3-5, China's geographical profile also makes it a natural conduit between the easternmost reaches of Asia and areas to the west—the Middle East, Russia, Central Asia, and ultimately Europe as well. Two thirds of the distance between the Bohai Gulf and the Strait of Hormuz, for example, lies inside China itself. Similarly, nearly half the distance between China's east coast and the eastern borders of the European Union lies inside China, with only two nations—Russia and Belarus—in between. Putin's creation of the Eurasian Economic Union will simplify the transit challenge in dealings with Europe even further: once past Kazakh border formalities at Khorgos, for example, shipments from China will presumably need only undertake one additional clearance procedure, at the Belarus western boundary, before entering the European Union itself at the Polish frontier.

China's policies since 2013 have implied tacit recognition of the momentous political-economic changes within Eurasia since the Cold War ended, and have shrewdly capitalized on the new geopolitical centrality on the continent that those changes have conferred on Beijing. Most importantly, of course, President Xi Jinping during the fall of 2013 unveiled the PRC's "One Belt, One Road" (OBOR) initiative, with two important and related speeches half a continent apart, in Kazakhstan and Indonesia.[58] As suggested in Figure 3-6, the ambitious program—the details of which are only gradually materializing--is to involve the comprehensive development of both land and maritime infrastructure (port facilities as well as superhighways, high-speed railways, and pipelines) linking China with nations to the west and south—in Southeast, South, and Central Asia, as well as the Middle East, Africa, Russia, and ultimately Europe also.

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[58] In September, 2013 President Xi introduced the "Silk Road Economic Belt" concept, in a major speech delivered at Nazarbayev University in Kazakhstan. The next month, in October, 2013, he offered guidance on constructing a "21st Century Maritime Silk Road", at the Indonesian parliament in Jakarta, where he also proposed establishing the Asian Infrastructure Investment Bank (AIIB). See "Chronology of China's Belt and Road Initiative", Xinhua, March 28, 2015, at: http://news.xinhuanet.com/english/2015-03/28/c_134105435.htm.

FIGURE 3-6: EURASIAN ECHO EFFECTS:
CHINA'S ONE BELT, ONE ROAD INITIATIVE

Source: "China Sees Itself at Center of New Asian Order," Wall Street Journal, November 9, 2014.

The OBOR initiative, as also suggested in Figure 3-6, has two clearly distinct components, as enunciated in President Xi Jinping's Kazakh and Indonesian addresses. One (the "Silk Road Economic Belt", presented in Kazakhstan) is overland—nominally following the historic Silk Road itself, from China's ancient capital of Chang'an (today's Xian, in Gansu province) through Central Asia, Iran, Turkey, and Russia, and finally to Western Europe. The other route (the "21st Century Maritime Silk Road", presented in Indonesia) is maritime, and also has historical antecedents in the classical voyages of Ming-era seafarer Zheng He, who voyaged out from Fuzhou in Fujian province, as well as overseas Chinese emigrants to Southeast Asia and beyond of more recent times.

The Maritime Silk Road initiative proposes to involve extensive port construction and overseas development assistance (ODA) in support of littoral nations along the shores of the South China Sea, Bay of Bengal, and Indian Ocean. Two already apparent priorities of the initiative are large-scale port-development projects in Bangladesh and Sri Lanka, with the east coast of Africa likely to benefit as well. The new PLA Navy facility at Djibouti, announced in early 2016, and expanded COSCO presence at Piraeus, the port of Athens in Greece, relate the OBOR maritime initiatives closely to China's deepening relationship with Europe as well.

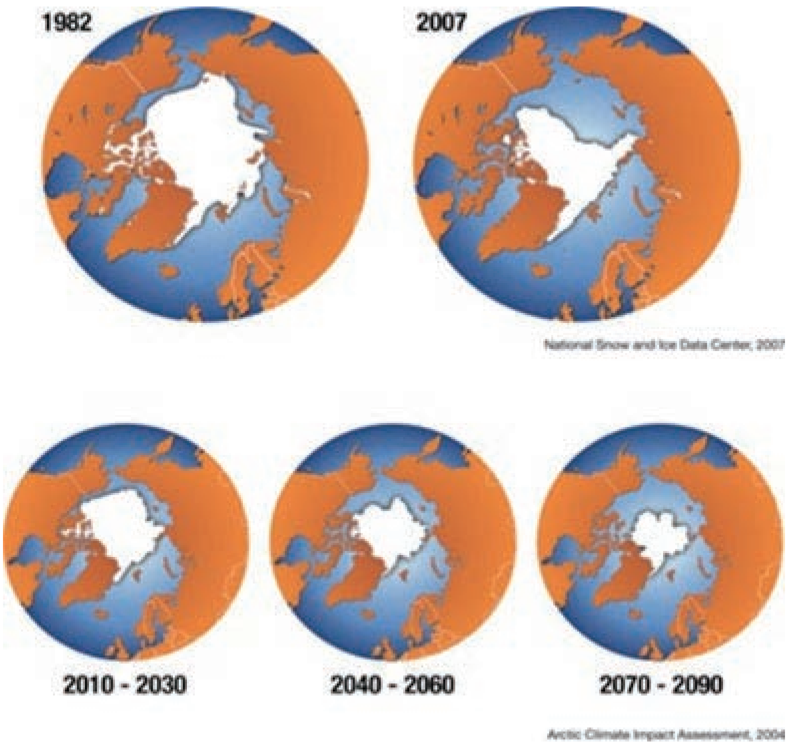
The Arctic and Eurasian Continentalism

The rapid accumulation of CO2 emissions in the earth's atmosphere, due mainly to the large-scale burning of hydrocarbons, is generating a "greenhouse effect", trapping heat inside the CO2 layer, that is rapidly warming the world's atmosphere, in the virtually unanimous opinion of reputable climate scientists worldwide. [59] The impact of global warming appears to be especially dramatic, and serious from a global climatic point of view, in the Arctic region, since the ice sheet there, which helps cool the earth, is relatively thin, and overlays an Arctic Ocean that itself is also warming, and thus accelerating the ice erosion process so important to stabilizing global climate.

As indicated in Figure 3-7, the Arctic polar ice gap has already retreated by roughly one third over the past quarter century, since the economic growth of China and India, both fueled by a heavy reliance on coal, began to accelerate. The prospect appears strong that this erosion will continue, with another thirty percent diminution in the scale of the polar ice cap over the coming two decades. By the close of the twenty-first century, if present trends continue, the ice sheet at the top of our world will have almost disappeared, significantly accelerating the warming process for the world as a whole.

[59] Most recent research suggests that temperatures are rising in the northern hemisphere at 0.25 C per decade by 2020. By contrast, over the 900 years preceding the 20th century, the warming trend only averaged 0.1C per decade, or only 40 percent as much as recently. On the details and the scientific logic, see, for example, Steven J. Smith, James Edmonds, Corinne A. Hardin, Anuria Mudra, and Katherine Calvin, "Near-term acceleration in the rate of temperature change", Nature Climate Change, Volume 5, April 2015, pp. 333-336.

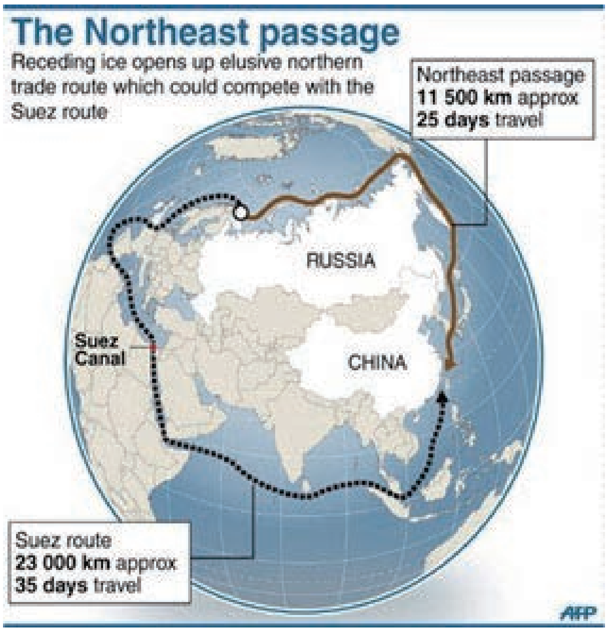
FIGURE 3-7: THE ARCTIC OCEAN AND THE FAR EAST IN EAST WEST RELATIONS



Source: Hugo Ahlenius, "The decrease of Arctic sea ice, minimum extent in 1982 and 2007, and climate projections," UNEP/GRID-Arendal, uploaded on February 25, 2012, http://www.grida.no/graphicslib/detail/the-decrease-of-arctic-sea-ice-minimum-extent-in-1982-and-2007-and-climate-projections_acef#

Apart from the serious environmental effects, which have animated the COP series of global environmental conferences, from Rio de Janeiro (1992) to Paris (2015) over the past two decades, global warming also has geopolitical and geo-economic implications directly relevant to the study at hand. Most importantly, it is opening sea lanes across the top of the world, between Northeast Asia and Europe, which are potentially shorter and more efficient for shipping between the two poles of Eurasia than traditional routes around the southern rim of the continent. As indicated in Figure 3-8, the so-called "Northeast Passage", from northern European ports such as Hamburg or Oslo to northeast Asian ports like Shanghai, Yokohama, and Pusan, is half as long as the southern route, via the Suez Canal, and can potentially be traversed in 40 percent less time.

FIGURE 3-8: THE NORTHEAST PASSAGE



Source: "Chinese cargo ship opens new trade route," The Citizen, August 10, 2013, http://citizen.co.za/afp_feed_article/chinese-cargo-ship-opens-new-trade-route-to-europe/

Pack ice is obviously still an impeding factor. Yet trans-Arctic commercial traffic has already begun. In the summer of 2014, the first trans-Arctic commercial voyage took place, from South Korea to Norway. In October 2015, COSCO announced plans to launch regular services through the Arctic Ocean between China and Europe. [60] This trans-Arctic route, opening first along the relatively ice-free waters adjacent to Russian shores, where ice-breaking capacity is also greatest, will be one further transportation bridge consolidating the New Continentalism in future years.

IN CONCLUSION

Eurasia is by far the world's largest land mass, and links two of the three major geographic centers of the industrialized world—Northeast Asia and Europe. Its economic and political configuration thus naturally holds broader implications for global architecture, and diplomatic relationships as well. Throughout most of global history, the key nations of the continent, including Europe and China, have been economically and culturally distant from one

[60] "COSCO announces Arctic shipping route to Europe", The Japan Times, October 27, 2015.

another, despite profound resource complementarities. Yet there are important signs that the era of mutual isolation is approaching its end.

There are powerful complementarities within the Eurasian continent, where the formidable natural resources of the Persian Gulf and the former Soviet Union lie directly adjacent to the largest population centers on earth, in China and India. Across most of modern history, however, the nations of Eurasia were separated from one another, and restrained from exploiting natural complementarities, by two contrasting types of obstacles: (1) impenetrable political impulses to autarky, such as the "Socialism in one state" policies of Stalin's Soviet Union, paralleled by Maoism in China; and (2) a lack of economic incentives for interaction, epitomized also by the dominance of non-market economies across most of the Eurasian land mass. These obstacles inhibited both growth and interdependence across continental Eurasia for more than three quarters of the twentieth century.

Over the past three and a half decades, as noted above, continental Eurasia has entered a decisively different new era. A series of "critical junctures"—sharp, sudden periods of historic transition, precipitated by political-economic crisis—have transformed the continent, rendering it an integrated playing field, albeit a volatile, competitive one, to an unprecedented degree. The most important of these junctures have been the Four Modernizations of China; the Indian interest-rate reforms; the collapse of the Soviet Union; and the Iranian revolution. Together, they have sharply accelerated economic growth; energy demand; energy-driven trade interdependence; and the construction of ambitious new infrastructural networks.

The "One Belt, One Road" policies of China's Xi Jinping have capitalized, in an arguably far-sighted way, on the new potential for trans-continental integration opened by the critical junctures of the recent past. They propose a variety of infrastructural projects, some practical in a market-oriented calculus and some less so, that would undoubtedly accelerate the economic integration of the continent, albeit most probably in a manner that is geopolitically propitious for China—literally the "Middle Kingdom", in the center of the economically active portion of the continent. These projects, as has been suggested above, are not specifically addressed to consolidating the Sino-European relationship, especially as many relate to the flow of energy supplies and related commerce among the Persian Gulf, China, India, and Russia. Ultimately, however, the new infrastructure across the continent would facilitate deepening ties between China and Europe—the two poles, after all, of the Eurasian continent.

Deepening continentalist ties between China and Europe will also be furthered, in coming years, by the deepening advance of global warming. Commercial shipping along Arctic routes only half as long as those around the southern rim of Eurasia, through the Suez Canal, has already begun. And the gradual erosion of pack ice—first along Russian shores—will make polar shipping between Northeast Asia and Europe ever faster and more economic.

A New Continentalism is thus arising that is drawing Europe and China together in a variety of ways. Economic growth is leading to trade interdependence, with energy trade as a major, but by no means exclusive, driver. The ambitious program of infrastructural construction under OBOR is accelerating that process. It cannot be fully understood without an appreciation of domestic political-economic forces within China, a topic to which we now turn.

CHAPTER FOUR

STRUCTURAL TRANSFORMATION OF A RISING CHINA

CHAPTER FOUR: STRUCTURAL TRANSFORMATION OF A RISING CHINA

"…in a kingdom of almost limitless expanse, an innumerable population, and abounding in copious supplies of every description, though they have a well-equipped army and navy that could easily conquer the neighboring nations, neither the king nor his people ever think of waging a war of aggression. They are content with what they have, and not ambitious of conquest. In this, they are not much different from the people of Europe."

Matteo Ricci[61]

Across the centuries, many commentators have pointed to the defensive bias; cautious, long-term orientation; and prioritization of non-military tools in Chinese strategic thinking.[62] Clearly the underlying geopolitical and internal realities of China—a nation bordering on fourteen other nations, with 1.3 billion people inhabiting the fourth largest nation on earth, situated close to the center of the largest continent in the world—suggest formidable challenges of domestic governance and external threat. Those alone would naturally dictate a cautious yet self-centered policy approach to international affairs, on the part of the Chinese themselves. The same underlying qualities, however, also make China an automatic challenge to its neighbors, and a country whose internal transformation and purely domestic impulses can have great, often unintended ramifications beyond its borders.

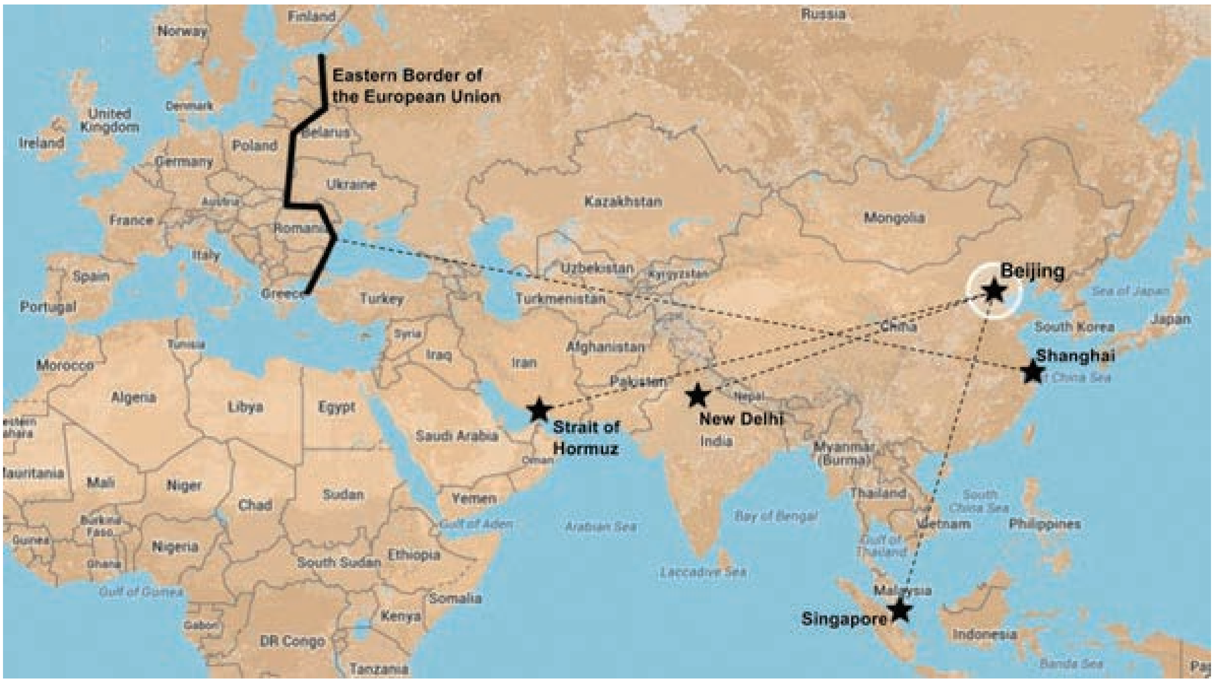
China's western regional development policies are a graphic case in point. Two thirds of the distance from Beijing to the Strait of Hormuz, noted previously in Figure 4-1, lies inside China itself. Similarly, well over half the distance from Beijing to Singapore, or Beijing to New Delhi, also lies within the borders of the PRC. Even half the distance from Shanghai to the eastern border of the European Union runs across Chinese territory. China is thus

61 Quoted in Jonathan Spence. The Memory Palace of Matteo Ricci. New York: Viking Penguin, 1984, pp. 54-55.

62 See, for example, Sun-Tzu. The Art of War, translated by Ralph D. Sawyer. Boulder, Colorado: Westview Press, 1994; and Charles Hacker. The Traditional Chinese State in Ming Times (1368-1644). Tucson, Arizona: University of Arizona Press, 1961.

veritably a Middle Kingdom; the decisions it makes for domestic reasons can have fatefully broad implications for Eurasian continentalism as well, due to China's distinctive centrality on the continent.

FIGURE 4-1: CHINA'S GEOGRAPHIC CENTRALITY WITHIN EURASIA



Source: Author's illustration with Google Map.

The Domestic Rationale for Strategic Development of China's West

Despite its generally cautious external orientation, China has feared intruding barbarians since ancient times. Strategic development of outlying territories, where barbarians might intrude, has been a typical means of simultaneously promoting both national defense and national prosperity. So it was that the Qing Dynasty colonized Xinjiang (literally "New Territories") in the Eighteenth Century, so as to inhibit intrusions from the Zunghars.[63]

In the early twentieth century, Sun Yat-sen argued that the post-World War I foreign powers should invest in his country's western regions for economic reasons, to create the

[63] James Millard. Eurasian Crossroads: A History of Xinjiang. New York: Columbia University Press, 2007, pp. 88-97.

massive Chinese domestic market that they desired to service.[64] In the 1960s, Mao Zedong made a different but parallel plea, contending in his Three Front Strategy that China's inland provinces should be developed, as a strategy for in-depth national defense.[65] Deng Xiaoping also supported Western development, although in the context of a broader "two overall situations" approach, that placed priority first on support for the coastal areas of China, due to their stronger prospective export competitiveness in the early stages of the Four Modernizations, before turning westward.[66]

The intellectual basis for the Open Up the West campaign of the recent past was laid by Hu Angang, director of the Research Institute on National Conditions and a prominent professor at Tsinghua University in Beijing.[67] Hu stressed the importance of an economic gap between eastern and western China that he contended was so excessively large that it should not be allowed to grow further.[68] Hu emphasized that while the market's role was to safeguard efficiency, that of government was to promote equality and justice, especially in the western part of China, including Xinjiang and Tibet, where restive ethnic minorities were concentrated. Support for the West needed to be arrived at, he argued, through financial transfers and extensive construction, supporting the weaker and more remote provinces.

Jiang Zemin reportedly agreed with Hu's general argument, and linked it to his own legacy of bringing China into the twenty-first century and the World Trade Organization (WTO).[69] Long Yongtu, China's chief WTO negotiator, repeated the latter theme: Only if western China were allowed to advance would it be possible to establish an adequate development mentality, to absorb the inflow of international factors of production, and to raise its overall quality through the global exchange of information, without overwhelming China itself, as had been true in the 19th Century.[70]

Under the new Open Up the West Program, formally enunciated by Jiang Zemin at

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64 Sun Yassin. The International Development of China. New York: G.P. Putnam's Sons, 1922.

65 Goodman. China's Campaign to Open Up the West, p. 22.

66 Calder. The New Continentalism, p. 159.

67 On Hu Anyang's arguments supporting the Open Up the West strategy, see Goodman. China's Campaign to Open Up the West, pp. 24-27.

68 See, for example, Hu, Kang, and Wang. The Political Economy of Uneven Development

69 Ibid., p. 28.

70 Gao Zhengang. The Path Towards Opening Up the West, pp. 2-3, cited in Goodman. China's Campaign to Open Up the West, p. 29.

China's ancient capital of Xian in 1999, numerous new infrastructure projects were authorized, in a domestic forerunner to Xi Jinping's "One Belt One Road". Among these projects were the West-East pipeline from Xinjiang to Shanghai—long considered economically infeasible by foreign observers—which was nevertheless completed in 2004; the Langhai-Lanzhou-Xinjiang railway; and the proactive development of the Tarim Basin in Xinjiang, including the Desert Petroleum Highway, running across the Taklamakan Desert.[71] These ambitious projects collectively bridged with Chinese government funding the vast distances between China's economic heart on the east coast and distant outposts in Xinjiang adjoining Central Asia and the Middle East. The projects also encouraged commercial and industrial development in Xinjiang itself, thus proving to be a crucial catalyst for China's relations with the Silk Road nations to the west, on a direct continental route leading ultimately—although not intentionally, in the first instance—across Eurasia to Europe.

The mutually reinforcing synergies between Chinese politics under Hu Jintao and the evolution of a new continentalist cast in Chinese policymaking should also be noted. Hu had extensive experience with western regions before his ascent to overall leadership in China, as had incoming Prime Minister Wen Jiabao. Hu had served previously in Gansu and in Tibet; Wen in Gansu as well. While deputy prime minister, Wen had also directed, under both Jiang Zemin and Zhu Rongji, the Western Regional Development Leading Group, which coordinated national policy formation on such issues within the State Council.[72]

Once he had assumed formal leadership of China, Hu Jintao selected income differentials and advocacy of the poor as transcendent personal policy concerns. These were major problems in the west, where income levels were generally lower than in most regions,[73] and fit his personal agenda well. In addition, the political balance of power in the Politburo that Hu faced on assuming office strongly supported western development. A full one-third of the twenty-four full members of the Politburo had a personal background in the west, including President Hu and Prime Minister Wen. In addition, Wang Lequan, the Chinese

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71 Goodman. China's Campaign to Open Up the West, p. 24-27. The Desert Petroleum Highway was built between 1993 and 1995, at an investment of RMB 785 million.

72 Ibid. p. 31

73 In 2003 the average wage of staff members and workers in Shanghai, for example, was nearly three times that of inland regions like Jiangxi. See National Bureau of Statistics of China. China Statistical Yearbook, 2004 edition.

Communist Party (CCP) leader in Xinjiang, was promoted to the Politburo in 2002, just before Hu Jintao assumed leadership.[74]

Domestic Forces for Transformation

Collectively, China's new leadership after 2003 thus strongly backed Western development for its congruence with five distinct and already established policy agendas: (1) quest for equality; (2) foreign investment; (3) infrastructure investment; (4) support for minority nationalities; and (5) sustainable development. Western development has also been politically attractive in Beijing for the renewed raison d'etre that it gave conservative forces. The CCP and state investment, in particular, played much greater roles in lagging areas like Xinjiang than in more economically attractive areas on the east coast, where market forces and overseas Chinese investment held sway. Western development has also been attractive for the People's Liberation Army (PLA), as it traditionally was for the CCP, due to the way it reinforced stability and national security in China's remote border regions.

Globalization began to proceed in the world economy during the late 1970s and the 1980s, just as the Four Modernizations were gaining momentum within China as well.[75] Indeed, the worldwide trend and Chinese domestic developments were intimately related. Within China, the rapid expansion of exports from provinces such as Guangdong, Fujian, and Jiangsu, heavily related to foreign investment,[76] led to explosive growth along the coast, and deepening regional inequalities. As coastal areas from Shanghai to Hong Kong grew richer, the interior stagnated. A related rise of private Chinese entrepreneurs also put state enterprises on the defensive—a political-economic development compounded by privatization.

The new export surges relating to globalization also began to realign China's industrial structure, across the 1990s and 2000s. Light industry and electronics grew rapidly. Heavy

74 Goodman. China's Campaign to Open Up the West, p. 40.

75 Niall Ferguson, Charles S. Maier, Ere Manella, and Daniel J. Sargent (eds.). The Shock of the Global: The 1970s in Perspective. Cambridge, Massachusetts: Harvard University Press, 2010.

76 On the coastal development pattern, see Ezra F. Vogel. One Step Ahead in China: Guangdong under Reform. Cambridge, Massachusetts: Harvard University Press, 1989.

industry, concentrated inland and in the Northeast, faced relative stagnation.

Construction, of course, has always held potential to relieve the latent structural problems of heavy industry in a globalizing economy—steel, aluminum, and even petrochemicals are crucial in the urban development process. Construction is also attractive to local governments for the way it enhances the tax base, and also improves transportation infrastructure. This attraction is especially pronounced in China, where the sale and lease of land is a primary income source for local governments. Faced with rising budgetary needs, they are powerful and consistent supporters of new real-estate development projects across the country. And nowhere are these incentives more powerful—or more closely related to the strategic designs of China's leadership—than in the West and the Southwest.

The global Lehman crisis of 2008 added a macro-economic rationale for the development of China's West. Yet the domestic political-economic logic within China that spawned the original Western development policies of Jiang Zemin and Hu Jintao continues, with even greater intensity, under Xi Jinping. Heavy industry needs construction spending, and benefits greatly therefrom, due to its low marginal costs of production. Local governments similarly need real-estate development, fueled by construction, for fiscal reasons. The CCP and the PLA both find regional development congenial due to the central role that they institutionally play in developing Western regions, contrasting to their more peripheral role in the coastal economy, and due to the national-security implications of borderland development itself.

It is China's current leadership, of course, that has enunciated "One Belt, One Road." Behind that initiative, however, is a powerful, conservative domestic coalition, with roots going back to the Revolution itself. Globalization has, since the 1980s, helped fuse that coalition, in resistance to more cosmopolitan trends, and given the members purpose. That coalition has strong, self-interested impulses to promote the development of outlying portions of China, such as Xinjiang, Tibet, and the Southwest, and thus to defend the prerogatives of state power, as we shall see.

Xinjiang Emerges as a Regional Growth Pole

In March 2010, the State Council announced strategic plans for Xinjiang to achieve "leap-frog development and lasting stability", announcing a package of measures to both boost the local economy directly, and also to encourage greater investment in both public services and peoples' livelihood programs.[77] A central element was a "pairing assistance" program, that mobilized 19 affluent provinces and municipalities on China's east coast to invest more than 3 billion yuan (over $466 million) and to carry out 150 pilot projects in the region. The 19 local government aid providers, including prominently Shanghai and Guangzhou, made a ten-year commitment, and agreed to invest 66 billion yuan ($10.2 billion) between 2011 and 2015.[78] Nearly ten percent of this amount (RMB 5 billion) was ultimately invested in Silk Road tourism, concentrated in such historic trade-route centers as Kashgar, Hotan, and Aksu.[79]

Supported also by accelerated central government infrastructural spending, which has brought high-speed rail and expanded international airports to China's western borderlands, Xinjiang's GDP growth during 2010-2014 was double the national average, with foreign trade linking Xinjiang with the broader world growing explosively as well.[80] China Southern Airlines has made Urumqi International Airport a passenger and cargo hub for trans-continental flights from Guangzhou to Istanbul, Teheran, Novosibirsk, Dubai, and Islamabad, with a dedicated terminal freshly built, while Urumqi in September 2011 also inaugurated an annual China-Eurasia Expo.[81] The city is also expanding its export-processing zone, in

[77] Yao Bin, "Xinjiang Takes Off", Beijing Review, August 11, 2011, p. 2.

[78] Ding Ying, "Partnering for Development", Beijing Review, August 11, 2011, p. 24.

[79] For details on these development programs, see the website of the Pairing Assistance Program, at: http://yuanjiang.ts.cn/index.htm.

[80] Xinjiang's provincial GDP grew at an average of 16.9 percent annually during 2010-2014, while Chinese national GDP growth averaged 8.6 percent. Xinjiang external trade growth averaged 15.2 percent. Provincial figures are from the National Statistical Bureau of China; Chinese national growth figures are from the World Bank.

[81] The China-Eurasia Expo was co-organized by 29 Chinese government departments, co-hosted by 12 provinces and municipalities, and co-sponsored by 11 government agencies of Xinjiang. It was accompanied by a broad range of Track II activities involving over 20 Eurasian nations, including Kazakhstan, Russia, Iran, and Pakistan, as well as China. See Xiao Ding, "Gateway to Eurasia", Beijing Review, August 11, 2011.

cooperation with Turkish, Iranian, and Chinese partners, to provide halal-observant processed food products and other specialties for export to the broader Islamic world. Kashgar, nestled near the Kyrgyz, Tajik, and Pakistani borders along the historic Silk Road, is taking similar steps to strengthen its continentalist relationships, as are the 29 border crossings connecting Xinjiang with six surrounding Eurasian nations.[82]

Tibetan Development and New Continental Linkages to the South

Tibet, like Xinjiang, is one of the last frontiers in the entire PRC for Beijing's dominance. It occupies fully one-sixth of the PRC's entire land area, with a population that remains less than 10 percent Han Chinese.[83] Beyond the Himalayas lies populous India, growing at over 7 percent annually, and soon to overtake China as the most populous nation on earth. Tibet's own total population, however, remains less than 3 million—or less than one four hundredth that of China as a whole. Tibet's current indigenous majority could thus easily be overwhelmed by Han in-migration from China proper.

Infrastructure plays a key role, as in Xinjiang, in uniting Tibet more closely with the rest of the PRC, and thus indirectly in connecting China itself to regions beyond. The first step in recent years came with the building of the Qingzang railway, connecting Xining, in Qinghai Province, to Lhasa, the capital of Tibet.[84] A remarkable feat from an engineering standpoint, the Qingzang is the world's highest railway track, running as high as 16,600 feet above sea level, much of the way over permafrost, and providing both oxygen and ultraviolet radiation protection to each passenger. Construction involved more than 20,000 workers and over 6000 pieces of industrial equipment, with the finished railway line being inaugurated personally by President Hu Jintao on July 1, 2006.[85]

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82 Both Shanghai and Kashgar are cooperating to fund $250 million of projects in Kashgar, many with an international dimension. Cooperative local-level projects are providing as much as a quarter of Kashgar's total revenue, and equivalent amounts Xinjiang-wide. See Yuan Yuan, "More Help, More Prosperity", Beijing Review, August 11, 2011, p. 26.

83 In 2000 Tibet's population of only 2.6 million was 94.1 percent non-Han Chinese. See Goodman. China's Campaign to Open Up the West, pp. 8-9.

84 For a vivid description of the railway and its construction process, see Lustgarten. China's Great Train.

85 China Daily, July 1, 2006, at: http://www.chinadaily.com/cn/home/index.html.

Since completion of the Qingzang, China has been systematically expanding the rail network within Tibet, and planning further connections, to both the heartland of China and also to surrounding countries. In August 2014, a new rail line began operating between Lhasa and Xigaze, Tibet's second largest city.[86] Construction has also begun on a second line to China proper, parallel to the Qingzang, running from Lhasa through Tibet's eastern city of Nyingchi, and then on to Chengdu in Szechuan. The Lhasa-Nyingchi portion of the line is to be completed by 2020.[87]

Although intended initially to draw Tibet closer to China proper, the Qingzang railway and related infrastructure across Tibet will also ultimately deepen China's links with South Asia as well, potentially increasing still further an explosively growing transnational economic relationship that already involves well over $60 billion in annual trade, up more than twenty-one fold since 2000.[88] In April 2008, the Chinese announced, with Nepalese concurrence, an intention to extend the railway from Lhasa to Khasa, on the Nepalese border.[89] That project has yet to be realized, but is still on the bilateral China-Nepal policy agenda.[90] Another line will extend from Xigaze, Tibet's second city, to Yadong, also on the Indian border.[91]From those border posts, railway lines will presumably connect to parallel infrastructure extending northward from India, augmenting other direct linkages between China and India across the Himalayas. Economic exchanges have thus far been limited by the absence of easy land transport links, even though Nepal shares a 875-mile border with China. That infrastructural constraint on interdependence, however, is steadily eroding.[92]

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86 "Tibet railway opens to Xigaze", Railway Gazette, August 15, 2014.

87 "China to build second railway into Tibet", The Guardian, March 4, 2016.

88 Sino-Indian trade was $2.9 billion in 2000, and reached $61.7 billion in 2010. See International Monetary Fund. Direction of Trade Statistics.

89 Saibal Dasgupta, "Tibet rail to connect China with Nepal", Times of India, August 29, 2006,

90 Michelle Florcruz, "China-Nepal Railway through Mt. Everest", International Business Times, April 9, 2015.

91 Xin Dingding, "Qinghai-Tibet railway to get six new lines", China Daily, August 17, 2008.

92 Sudha Ramachandron, "Nepal to get China rail link", Asia Times Online, May 15, 2008, at: http://www.atimes.com.

Continentalist Ties with Southeast Asia also Deepening

China's continentalist relationships are also deepening rapidly with Southeast Asia. PRC trade with the ten nations of ASEAN quadrupled between 2003 and 2008, following the November 2002 agreement among the eleven countries to establish a free-trade area by 2010. The FTA was formally established, on schedule, at the beginning of 2010, together with a parallel arrangement between ASEAN and India. Trading relations among all parties have continued to grow rapidly, with those along China's land borders, particularly Laos, Vietnam, and Myanmar, being especially dynamic. Chinese trade with these three continental neighbors grew over the first decade of the twenty-first century (2000-2010) by 26, 12, and 7 times respectively, while it grew by only 5.7 and 5.3 times respectively with more distant and maritime Indonesia and Singapore.[93]

As in Chinese relations with Central Asia and Pakistan, infrastructure is a key aspect of deepening economic ties. Major oil and gas pipelines have been completed across Myanmar, connecting the Bay of Bengal with China's Yunnan province.[94] China is investing heavily in Burmese electric-power infrastructure, although the controversial Myitsone Dam project, which would triple Myanmar's hydro-electric capacity, although sending 90 percent of the incremental electricity generated to China, remains stalled by environmental and political concerns in Myanmar.[95]

In the context of its domestic regional development schemes, the PRC has designated Guangxi, bordering on Vietnam, as a free cross-border renminbi settlement trial location, to expand trade cooperation, strengthen investment, and promote the development of coastal high-tech and modern service industries.[96] And high-speed rail lines are under construction across Vietnam, Cambodia, Laos, and Thailand, reaching ultimately from Nanning to

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93 Edward C. Chow (editor). Pipeline Politics in Asia: Energy, Markets, and Supply Routes. Seattle: National Bureau of Asian Research, 2010.

94 The gas pipeline from Kyaukpu to Kunming began operating in late July, 2013. The oil pipeline started trial operation during January, 2015. See "Myanmar-China gas pipeline starts to deliver gas to China", China Daily USA, July 28, 2013.

95 Ye Mon and Clare Hammond, "CPI pushes for restart of Myitsone Dam", Myanmar Times, June 5, 2015.

96 Lan Xinzhen, "Nanning-Singapore Economic Corridor", Beijing Review, August 26, 2010.

Singapore. They are also in progress across Laos and Thailand from Kunming to Singapore.[97] China's continental ties are thus expanding steadily across its land borders to the south, as well as to the north, to the west, and to the southwest.

IN CONCLUSION

External activism has not been a consistent feature of China's historic relationship with the world. The sheer size of the country, together with its wealth of tradition, and the natural complexity of governance, have made assertiveness difficult beyond its immediate frontiers, and of limited interest to many Chinese dynasties in any case. The classical paradox has thus been explaining external ambition and expansion.

A structural transformation in the Chinese political economy has begun, since the 1980s, that is reconfiguring the Chinese domestic system, with potentially fateful implications for the broader world. The coastal areas have grown rapidly, prospered, and developed more market-oriented economic practices, stimulated by the foreign investment and foreign markets that integration with the global system have brought. Inland areas and heavy industry for years declined in relative terms, while the positions of the CCP and the PLA grew progressively less socio-economically central, as Chinese proto-capitalism evolved.

The response of three generations of Chinese leaders, beginning with Jiang Zemin, was regional development—to rectify rising regional inequalities, solidify socialist rule, and thus to offset at least some of the perverse perceived consequences of deepening globalism. This response took the form of Western, Northeastern, and Southwestern development policies benefitting inland-China's periphery. These policies enjoyed strong domestic support from traditionally conservative forces like the CCP and the PLA, as well as heavy industry, and many construction-oriented local governments.

China lies at the geographic heart of Eurasia. Two thirds of the distance between Beijing and the Strait of Hormuz lies inside the PRC, while close to half the distance between

[97] The section between Thailand and Singapore is already complete, although it needs upgrading. Construction on the China-Laos section began in December 2015, to be completed around 2020. See Nirmal Ghosh, "China's dream of rail link to Southeast Asia coming true", Straits Times, January 21, 2016.

Shanghai and the European Schengen states lies within China as well. The domestic transition in China's political economy over the past three decades, creating greater stakes in inland and trans-continental development, thus naturally projects China more deeply into Eurasian affairs. Those ambitious, trans-continental stakes are implicit already in the OBOR proposals of President Xi Jinping, including the AIIB concept. Yet China's domestic transition has much larger future implications for relations with Europe, and with the world beyond, as succeeding chapters will suggest in greater detail.

CHAPTER FIVE

DOMESTIC POLITICS

AND

THE SINO-EUROPEAN RELATIONSHIP

CHAPTER FIVE: DOMESTIC POLITICS AND THE SINO-EUROPEAN RELATIONSHIP

Over the past three decades, fueled by the information revolution, rising overall national affluence, painful national inequities, and the rise of an articulate middle class, international relations has increasingly assumed the character of a "two-level game".[98] Reasons of state remain important in national calculations, but they are increasingly constrained, in many nations, by parochial pressures from below. Domestic interests fuel trade protectionism, nationalism, and ethnic exclusivity. These patterns prevail both in parliamentary democracies, like those of Europe, and in soft authoritarian regimes such as that in China.

Despite broad commonalities, there are also, of course, significant differences in the way that domestic politics and foreign policy relate to one another in Europe and China respectively, not coincidentally because the antipodes of Eurasia have very different political systems. In this chapter we will survey the domestic forces supportive of deepened interdependence on both sides, and weigh them against the forces subversive of interdependence, which are also significant. The final analytical goal will be to assess the net impact of domestic politics on the stability of the trans-continental relationship between China and Europe, and to determine how the distinctive features of the overall relationship are shaped by what is happening at home or likely in future to transpire there.

From the outset of any discussion of how domestic politics intrude into Sino-European relations, it is important to note the distinctive overall character of their relationship, and how it contrasts to Sino-US or Sino-Japanese relations. Europe and China are geographically detached from one another, at the opposite ends of Eurasia. Neither today has strong pretensions to be a dominant world power, yet both remember wistfully a time when they were more consequential internationally than at present. Due to their relatively modest current aspirations, the super-power geopolitical tensions that color the US-Russia or the Sino-US diplomatic relationships, spilling over into domestic politics as occasional jingoism,

98 On this concept see Robert Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games", International Organization, Volume 42, No. 3, Fall, 1988, pp. 427-460.

are largely absent between China and Europe. Conversely, substantial segments of both the European and the Chinese articulate publics share a common aversion to superpower pretensions on the part of others. They also manifest a common desire to see a more broadly multipolar architecture emerge in international affairs. And due to their considerable geographic detachment from one another, neither the Chinese nor the Europeans experience a strong sense of geopolitical threat from the other, in contrast to the dynamic of Sino-American or Sino-Japanese relations.

Supportive Economic Players

Since a consciousness of geopolitical challenge tends not to pervade the Sino-European relationship, and military actors are marginal within it, economic considerations are conversely dominant. In Europe, many of the key actors that determine the profile of the overall relationship with China are business leaders. In Germany automotive firms like Volkswagen and Daimler Benz, with long relationships and large stakes in the PRC, are major actors, as are financial enterprises like Deutsche Bank and Dresdner Bank.

In Britain, the City of London, one of the world's major financial centers, with strong historic and institutional ties to Hong Kong, looms large, through entities like HSBC, a British bank which for many years has been a primary issuer of Hong Kong currency. The City, supported by former Chancellor of the Exchequer George Osborne, reportedly played a pivotal recent role in Britain's surprise March 2015 decision to join the AIIB.[99] Osborne had previously been an enthusiastic supporter of the British government's October 2013 sovereign RMB bond issue, the first by a Western government, and is reportedly eager to establish the City of London as a platform for overseas business in the Chinese currency, as the PRC comes to play an increasing role in global economic affairs.[100] In France and Italy, fashion houses and banks similarly have major stakes in China, comparable to those of London's City in finance, and actively help to define the overall Sino-European relationship as well.

[99] Geoff Dyer and George Parker, "US attacks UK's 'constant accommodation with China'", Financial Times, March 12, 2015.
[100] Ibid.

The Netherlands and Portugal likewise retain important ties to China, rooted in history. Indeed, the level of Dutch investments in China and Hong Kong together exceeded 12 billion euros in 2012.[101] Ministry of Commerce statistics show that the Netherlands was the eighth largest investor in China during 2012, with Philips and Royal Dutch Shell both having a substantial presence.[102] Portugal's relations with China go back over four centuries, with Lisbon continuing to hold a strong domestic interest in the future of Macao.

The nations of East and Central Europe, it is important to note, also have longstanding and relatively well-developed relationships with China dating from early Cold War days. Their major firms are not, by and large, global economic players, but their politicians and business people do often have extensive personal contacts; historic ties have also helped give China a relatively positive image in domestic politics. Germany has benefitted, ever since its reunification in 1990, from both Socialist and capitalist networks in China; its broad networks have also facilitated the relatively positive image that China enjoys in Germany itself.

European Public Opinion and China

In a detailed 2014 study of German public opinion regarding China, for example, the PRC ranked fifth among nations toward which Germans had especially positive images, after France, Britain, Japan, and the US, but well ahead of India and Russia.[103] 60 percent of German respondents believed that the impact of the Chinese economy on Germany was "large", or "very large". And 37 percent of the Germans surveyed noted that the preeminent image of China that they held in 2014 was "economic power", up from 28 percent in 2012.[104]

In some countries, such as France, nationalist empathy toward China, as a rising power similarly challenging US superpower dominance has frequently been a factor strengthening

101 Embassy of the Kingdom of the Netherlands in Beijing. Trade and Investment between the Netherlands and China 2013, at: http://chinanlambassade.org.

102 Ibid.

103 Huawei Technologies in partnership with the GIGA German Institute of Global and Area Studies. Deutschland und China: Wahrnamung und Realitat (Germany and China: Perception and Reality), at: http://www.huawei-studie.de.

104 Ibid.

bilateral relations. Charles de Gaulle, for example, prioritized relations, supported by domestic opinion. He made France, in 1964, the first major European power to recognize the PRC, following only Britain, for whom the security of Hong Kong made recognition of the PRC imperative soon after the 1949 revolution itself.

The Supra-National Dimension

Together with sub-national forces such as business interests, supra-national actors—preeminently the European Commission—have also been unusually important in defining Sino-European relations. The Commission has taken special, and persistent, interest in relations with China during the early twenty-first century, because China, with its rapidly expanding foreign investment and development assistance programs, has been both able to and interested in supporting the Commission's regional-development goals. A substantial portion of Chinese direct foreign investment, as well as Chinese infrastructural spending under the OBOR program, has been directed either toward poorer EU members in East and Central Europe, or to the Mediterranean states—both of which have been priority recipients of the Commission's own development assistance.

A detailed look at European structural adjustment programs makes clear the pronounced synergies between China's investment and assistance programs toward the periphery of Europe, and the parallel activities of the European Union itself. The fifteen largest recipients in 2014 of support from the EU's Cohesion Fund, for example, which focuses on transport networks, were all East European or Mediterranean nations with which China also has been developing ties.[105] Twelve of the fifteen largest recipients from the three major EU structural funds collectively were similarly Mediterranean or East European states.[106]

[105] European Commission European Structural Investment Funds Open Data Portal, at: https://cohesiondata.ec.europa.eu.

[106] Ibid. The three funds were the European Regional Development Fund; the European Social Fund; and Cohesion Fund.

Frictions over Trade and Human Rights

Domestic politics, to be sure, have at times been a constraint on Sino-European relations as well. Trade frictions have arisen due to fears of low-wage competition--of direct imports from China, in sectors like textiles; of analogous competition in third countries; and of Chinese immigrant communities operating systematically within the EU tariff wall itself.[107] Human rights have also been a periodic irritant, on both sides of the relationship.

Despite sharp differences in political systems and practices for managing political dissent, however, the impact of human-rights issues on the stability of Sino-European relations has been remarkably limited. The Tiananmen incident, to be sure, generated powerful shock waves in Europe, most of which was slower to resume normal diplomatic relations with China in the early 1990s than the United States. The Dalai Lama was also accorded warm welcomes in many European nations, including Britain, during the early 2010s, despite repeated Chinese protests.

Since 2013, however, the domestic political climate surrounding Sino-European relations seems to have improved markedly, on both sides of the equation. One factor has no doubt been rapidly rising Chinese investment in the European Union, at a time of relative economic hardship and stagnation in Europe itself. A related consideration has been the configuration of that Chinese economic input—oriented toward distressed regions, and toward objectives complementary to those of the European Commission itself.

OBOR and European Interests

The "One Belt One Road" initiative since 2013, including the establishment of the AIIB in early 2016, has also arguably reinforced the Sino-European relationship, for both political and economic reasons. Both the Chinese government and Chinese public opinion were elated that many European nations elected to join the AIIB, in the face of perceived American

[107] In the town of Prato, Italy, for example, a tragic factory fire in late 2013 drew attention to the controversial strategy of some entrepreneurs to systematically re-create labor-intensive Chinese factories, manned by recent immigrants, within the EU tariff wall. See Elisabetta Povoledo, "Deadly Factory Fire Bares Racial Tensions in Italy", New York Times, December 6, 2013.

opposition. The precedence that China has since given to Europe, through such gestures as President Xi Jinping's 2015 visit to Britain, together with that of German Chancellor Merkel to Beijing, and the frequent visits of Prime Minister Li Keqiang to EU headquarters in Brussels, have also arguably raised China's standing in Europe. The Xi visit to London, coming as it did on the heels of Britain's surprise decision to join the AIIB, and involving a major civilian nuclear deal, had a particularly strong domestic impact, in both Britain and China.

The lack of recent high-profile incidents on the human-rights front, that might otherwise estrange European opinion, has also helped to stabilize relations with China. It has been dramatic human-rights issues, like the 1989 Tiananmen incident, or developments in Tibet or Hong Kong, after all, that have ranked among the paramount irritants to Sino-European ties. The massive migrant crisis of 2015-2016 on Europe's own shores may also have recently inhibited Europeans to some degree from criticizing China on human-rights grounds.

On the economic side, OBOR creates the prospect of improved infrastructural links between China and Europe, which should facilitate both trade and investment—especially along Europe's periphery, as well as in western China. OBOR also markedly increases prospective opportunities for European and Chinese banks to finance new projects large and small, that are now in prospect. These look especially attractive for financiers in London, Hong Kong, and Shanghai.

Europe and Chinese Domestic Political Interests

Europe and China have a long mutual history, as was noted in Chapter One, within which imperialism lingers as a major theme. That uncomfortable reality has led to a certain caution in Chinese attitudes toward Europe, flowing from collective memories of a "century of humiliation" at foreign hands, in which Europe played a large role. That perception has been perpetuated and reinforced by public education. Sufferings at Japanese hands, however, have been given greater emphasis in recent years, with American imperialism also being stressed. Conciliatory European overtures toward China—from Hong Kong reversion to establishment of the AIIB—have also helped rehabilitate the European image, even as concrete perceptions of European imperialism have faded into the past.

As economic ties have deepened, Chinese enterprises—both public and private—have also gained deeper stakes in Europe.[108] COSCO, as noted earlier, is heavily invested in major ports like Piraeus in Greece. Geely Auto acquired Sweden's Volvo in 2007, and Britain's Emerald Automotive in 2014. China's Big Four banks, as well as Chinese exporters and investors, have major stakes in the emergence of London's RMB offshore market, while Dalian Wanda has invested billions in British real estate. And Huawei has major stakes in the European telecommunications market—especially since it is constrained in the United States, the alternative advanced-nation economic opportunity, from bidding on government contracts and the network equipment market on security grounds.[109] Chinese sovereign wealth funds like SAFE have also been very active in Europe.

Looking to the future, as Chinese interests grow more global, it seems likely that both Chinese business and Chinese diplomacy will devote more attention to Europe, and become more supportive of stable, deeply interdependent Sino-European relations. Europe, after all, provides socio-economic access to Africa, the Middle East, and South Asia that is superior in many ways to that via New York and Washington. It also provides autonomy from sanctions and other US political-economic whims not available on the other side of the Atlantic. Tourism will also likely bind the peoples of China and Europe more closely in future years, as both sides have regard for the rich history and culture of their trans-continental counterparts.[110]

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[108] For details on Chinese investments in Europe, see the AEI/Heritage Foundation's China Global Investment Tracker.

[109] Huawei can, however, access the US consumer-electronics market. It also manufactures Google's Nexus 6P, and sells its own branded smartphones, tablets, and smart watches in the US, as elsewhere in the world, albeit in relatively small quantities. On Huawei's product offerings, see http://www.gethuawei.com.

[110] British tourism authorities, for example, predicted in mid-2015 that Chinese visitors would double in less than a decade. In reality, they rose 37 percent in the first three quarters of 2015 alone. See Fu Jing and Gao Shuang, "Tourism can boost friendship between Europe and China", China Daily, October 14, 2015.

IN CONCLUSION

China and Europe, as we have stressed throughout, interact with one another in a strikingly different political-economic context than the framework within which either of these powers associates with the United States. Sino-European relations are less geopolitically fraught and more centered on mutual economic convenience. That does not mean, of course, that their relations are devoid of tension. Indeed, the lack of alliance and other geopolitical constraints on the escalation of tension does make it easier for protectionist or nationalist pressures to surface, should a *casus belli* transpire.

Two or three decades ago, trade frictions and backlash over human rights issues often flared up more explosively between China and Europe than they did between China and the United States. Over the past ten years or so, however, Chinese and European leaders have grown more willing to manage bilateral tensions, even as their counterparts in Beijing and Washington have grown less inclined to do so. Rising cross-investment, increased trade, and a confluence geopolitical interest in a multi-polar world have all played a role.

Sub-regional dynamics have also played an important, often neglected role. China has recently invested heavily in the periphery of Europe—economically and politically vulnerable areas like Greece and other Balkan states, that could otherwise be more unstable. The profile of Chinese investment has helped enhance political-economic support at both the national and supra-national levels in Europe for trans-continental interdependence, just as investment access in Europe, as well as rapidly expanding tourism, have enhanced domestic support for trans-continental ties in China as well.

CHAPTER SIX

THE CHANGING PROFILE

OF

TRANS-CONTINENTAL TRADE AND INVESTMENT

CHAPTER SIX:
THE CHANGING PROFILE OF TRANS-CONTINENTAL TRADE AND INVESTMENT

Although today both Europe and China are pillars of the global trading system, located at the antipodes of the Eurasian continent, thirty years ago they had only very limited economic relations with one another. In 1985, EU-China trade reached just $10.7 billion annually, while cross-investment was miniscule. Within a decade, however, this pattern had been sharply transformed, with bilateral trade tripling, to $35.7 billion in 1994.[111]

Sino-European trade began to expand rapidly during the 1990s, when China's own economy began to gain internationally formidable scale. In 1993 trade soared by 50.5 percent in a single year, and China became Europe's fourth largest trading partner. Even in the shadow of the Asian financial crisis, Sino-EU trade rose by 13.4 percent in 1998.[112] In 2006, the EU became China's largest trading partner.

Today the EU remains China's largest trading partner, while China is the EU's second largest trading partner, after the United States. Trade volumes between China and Europe continue to rise sharply; for 13 of the 17 years (1998-2014) following the Asian financial crisis, China's imports from the EU, for example, rose faster than from the United States.[113] Most of the China-Europe bilateral trade is in manufactured goods.[114] The EU runs a substantial trade deficit, reaching nearly $120 billion in 2013, with sectors such as telecommunications equipment, shoes, textiles, iron, and steel accounting for much of the bilateral gap. EU exports to China have nearly doubled over the past five years, however.[115]

Looking to the future, both sides appear to see substantial promise. Europe stresses the services: that important sector, comprising areas such as insurance and banking where European firms are globally competitive, currently constitutes only one tenth of

111 International Monetary Fund. Direction of Trade Statistics.

112 Ibid.

113 Ibid.

114 The European Commission, "Facts and figures on EU-China trade", atP http://ec.europa.eu/trade/policy/countries-and-regions/countries/china. ,

115 Ibid.

Sino-European trade. The EU exported five times more services to the United States than to China in 2012,[116] although the two economies were approaching comparable scale in PPP terms. Service-trade prospects, in such areas as investment banking and insurance, were arguably behind the receptivity of European nations, especially Britain, to China's offer of AIIB membership in 2015.

One might ask what impact Brexit will have on Europe-China service trade, given Britain's importance in this sector. No doubt the British interest will continue, and even intensify. Meanwhile continental service providers could well accelerate their China-related efforts, sensing new opportunities as Britain's role in European service provision is redefined.

For China, Europe's greatest attractiveness on the trade front has to do with technology. There is already a substantial two-way trade in this area between Europe and China, including large Airbus aircraft sales to China, as well as substantial Huawei telecommunications sales to Europe that have no counterpart in Chinese trade with either Japan or the US.[117] Huawei sales in the US are inhibited by Congressional restrictions, with NASA, as well as the US Justice and Commerce Departments, being forbidden from buying IT equipment from Chinese vendors, including Huawei, unless approved by federal law-enforcement officials.[118] In 2015, Huawei's sales in Western Europe increased 45 percent, to over $2 billion, with Huawei becoming the second largest Android manufacturer in the five largest European markets.[119]

Arms and defense-technology sales from Europe to China, however, have been formally banned since 1989, and the Chinese have been pressing strongly for their revival, despite objections from both the US and Japan on security grounds. The EU appears to be split internally on this issue, with Germany, Denmark, the Netherlands, and Sweden,

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116 Ibid.

117 In 2015 Huawei sold RMB 128 billion in telecommunications equipment to Europe, the Middle East, and Africa—an increase of 27 percent over 2014. This was more than triple sales to North and South America of RMB 39 billion. Total Asia-Pacific sales, including those to Japan, were only RMB 51 billion. See Huawei 2015 Annual Report,, at: http:/?.www,Huawei.com.

118 Alina Selyukh and Doug Palmer, "US law to restrict gov't purchases of Chinese IT equipment", Reuters, March 27, 2013.

119 Huawei was second, only to Samsung, in Android sales for the US, France, Germany, Spain, and Italy. See James Pearce, "Huawei sales in Western Europe topped $2 billion in 2015", mobile news, December 16, 2015.

in particular, insistent on linking a lifting of the ban to specific Chinese steps on human rights.[120] Leaked US cables suggest that the EU has been selling substantial amounts of dual-use technology to China, and has approved sales of military-grade submarine and radar technology as well.[121] Among the European arms equipment reportedly being used by China, despite the embargo, are the following: (1) French sonar and anti-submarine warfare helicopters, on board Chinese destroyers; (2) French and German diesel engines, on board surface warships; (3) British jet engines, on PLA fighter bombers; (4) British airborne early warning radar, on Chinese surveillance aircraft; (5) Euro-copter designs for attack and transport helicopters; and (6) German-engineered diesel engines from MTU Friedrichshafe, on a large number of vessels in the Chinese submarine fleet.[122]

China and Europe do, to be sure, also have important differences regarding trade restrictions. Europe has 52 anti-dumping measures and three anti-subsidy measures in place against Chinese imports[123], and had a protracted confrontation with China in the mid-2000s about textile imports. The European Commission recently imposed dumping duties on cold-rolled flat steel from China and Russia, and opened investigations during February 2016 on Chinese imports in three other steel categories.[124] It also speaks periodically about Chinese protectionism in the services, despite China's acceptance of WTO obligations when it joined that global body in December 2001.[125] Yet both the Chinese market and European exports to China are growing rapidly, inhibiting protectionist sentiment, as new opportunities also seem to emerge in connection with OBOR and the AIIB.

Traditionally virtually all trade between Europe and Northeast Asia, including China as well as Japan and Korea, was conducted by either air, in the case of high-value items, or by sea. Yet new possibilities overland have begun to arise, in just the past two years, that could provide substantial stimulus to overland trade, and to significant increases in overall trade

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[120] Andrew Rettman, "Leaked cable shows fragility of EU arms ban on China", EU Observer, July 25, 2011.

[121] Ibid.

[122] Stuart McMillan, "Europe's arms trade with China", The Strategist, February 11, 2014, at: http://www.aspistrategist.org.au/europes-arms-trade-with-china.

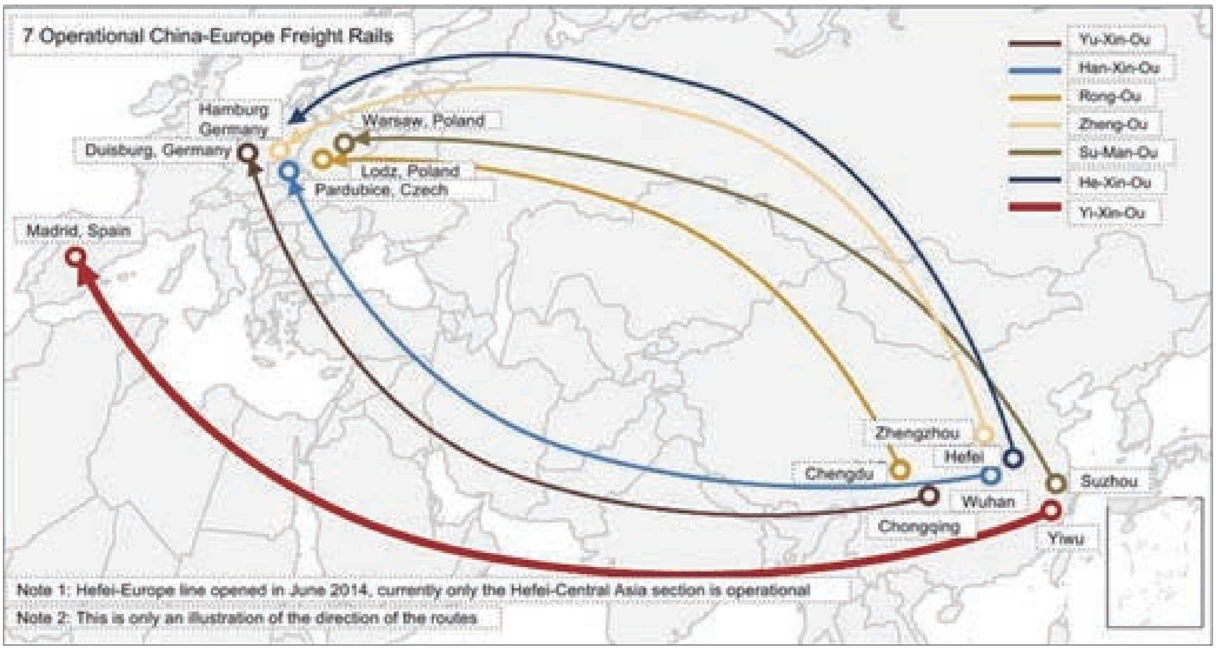
[123] European Commission, "Facts and figures on EU-China trade", at: http://ec.europa.eu.

[124] "Commission launches new anti-dumping investigations into several steel products", European Community, February 12, 2016, at: http://europa.eu.

[125] The OECD also ranks China as the most restrictive of 58 countries studied under its Foreign Direct Investment Regulatory Restrictiveness Index. See the OECD website, at: http://www.oecd.org.

volume in future. As indicated in Figure 6-1, several new dedicated freight routes, involving regularly scheduled train runs, and streamlined customs procedures, have been inaugurated, involving direct traffic between inland cities in China such as Chongqing, on the one hand, and destinations in Germany, Poland, the Czech Republic, and Spain on the other.

FIGURE 6-1: NEW OVERLAND TRANSIT TRADE ROUTES
FROM EUROPE TO ASIA



Source: Author's illustration based on information from "Made in China Enters Europe (in Chinese)," Phoenix Weekly, April 19, 2015, http://finance.ifeng.com/a/20150419/13645326_0.shtml

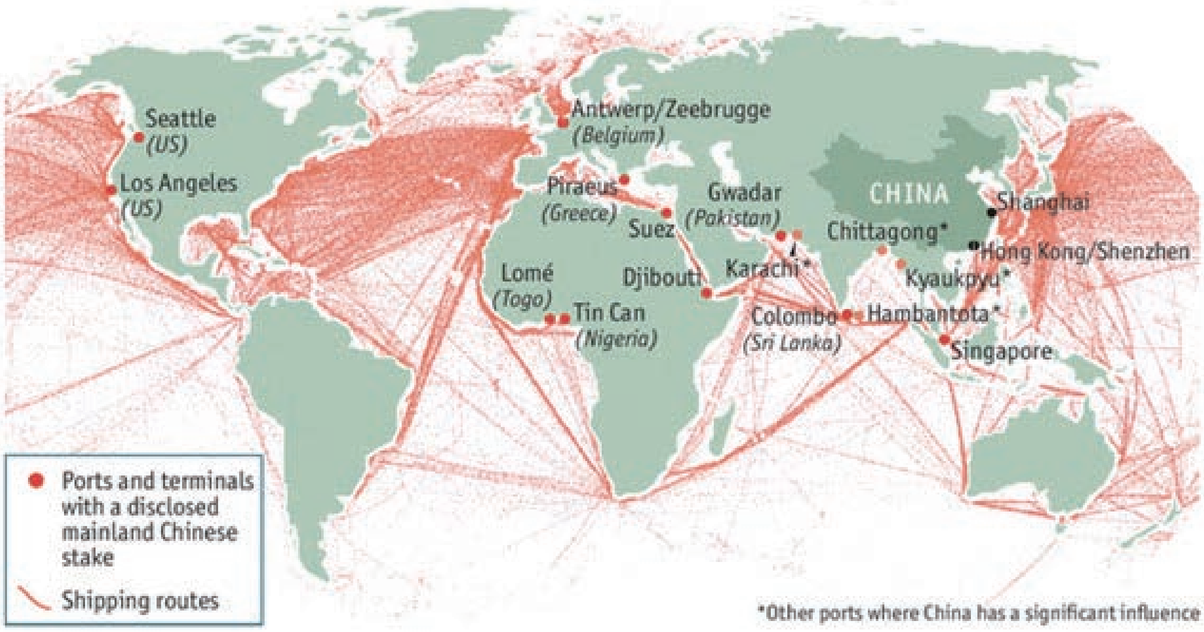
Another important new dimension of Sino-European trade, sharply increasing the prospects for meaningful expansion in future, is the rapid improvement of trans-continental infrastructure which is currently underway. This is strongly supported not only by China's "One Belt One Road" initiative, but by a broad range of complementary projects, such as those of the Asian Development Bank, and Japan's initiatives, recently announced by Prime Minister Abe Shinzo.[126] With an eye to sharply increasing Sino-European overland trade, which has an especially compelling logic between inland China and the nations of Central and Eastern Europe to which China's western provinces are geographically closest, China

[126] Masaaki Kameda, "Abe announces $110 billion in aid for 'high-quality' infrastructure in Asia", Japan Times, May 22, 2015. Japan's initiatives, however, are more directed at ASEAN than at Eurasia.

has invested heavily, over the past two years, in refurbishing rail lines in such countries as Belarus, Macedonia, and Poland, while establishing industrial parks and logistical centers to support increased trade as well.[127]

Maritime infrastructure for facilitating Sino-European trade has been another important priority. This has been especially true in the Mediterranean, where the logic of overland transport is not as strong as further north. China has been especially active in port development. China's port development activities are global, as suggested in Figure 6-2, but one of the most important focal points in recent years has been Piraeus in Greece, which was once briefly a home port for the US Navy. China Cosco Holdings, the PRC's largest civilian shipping line, recently purchased a 67 percent stake in the Port of Piraeus, in a bidding competition initiated by the Greek government to assuage its current financial difficulties.[128]

FIGURE 6-2: GLOBAL PORTS AND TERMINALS WITH A CLEAR CHINESE STAKE



Source: The Economist

Piraeus has traditionally been an important trans-shipment point for cargo destined

[127] China has established a major industrial park in Belarus, and offered over $3 billion in concessionary loans, including funding for railway electrification. It has also supported Poland's emergence as a regional logistics center in Eastern Europe, and helped finance Macedonian rolling stock. See, for example, John C.K. Daly, "China, Belarus Deepen Ties", The Jamestown Report, September 14, 2015.2

[128] "Greece sells Piraeus port to Chinese bidder", Deutsche Welle, April 8, 2016.

for all of Greece. It could also potentially be an important port of entry for trade between China and the whole of the Balkans. Such prospects will be further enhanced with rail infrastructural improvements in Macedonia and further north that are now underway, with Chinese assistance. Given the financial difficulties of Greece and its neighbors, it is questionable whether these much needed improvements could go forward in a timely manner without this Chinese assistance. This is especially true for non-EU members in the Balkans, such as Macedonia, which figure importantly due to their location in the development of comprehensive trans-European transport infrastructure, but do not have access to EU regional development funds as yet.

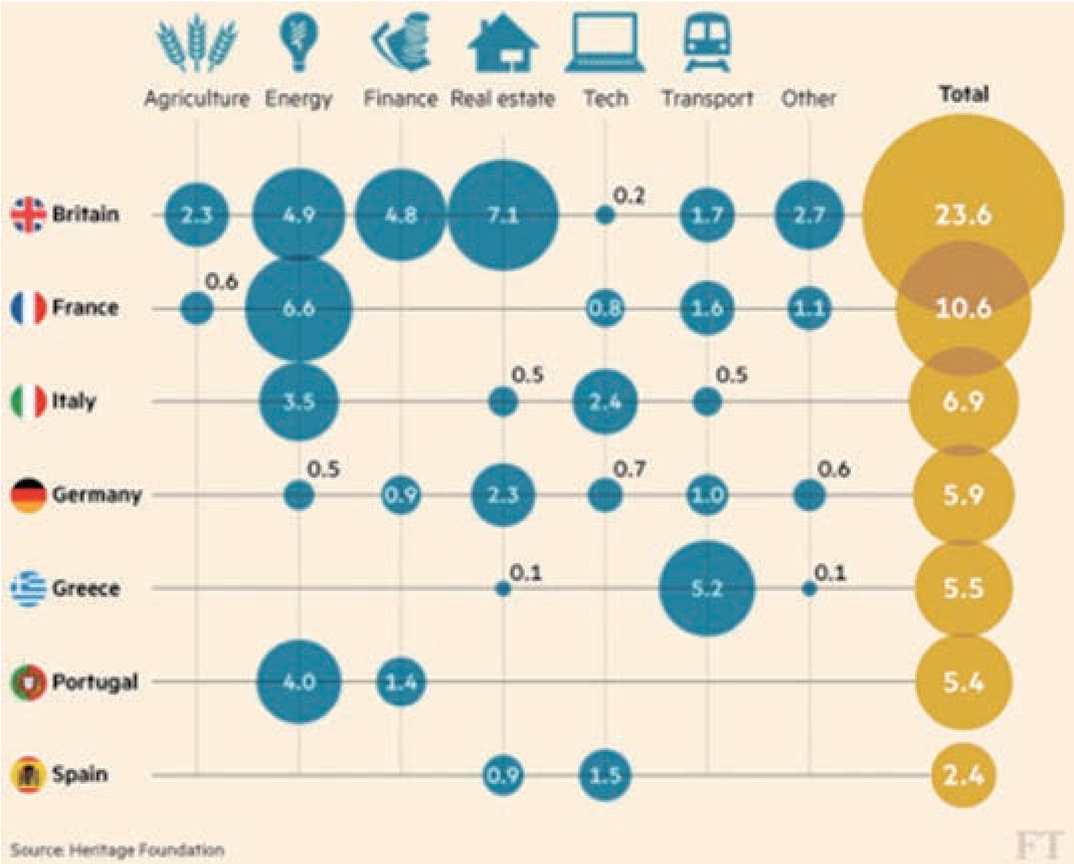
One final new dimension of the Sino-European economic relationship—especially timely due to the financial difficulties that weaker EU states have been experiencing—is rising investment flows between China and the European Union. Flows from the EU to China have of course been large— 53 percent larger over the 2003-2012 decade than those from the United States.[129] Converse flows from China to Europe have surged dramatically since the Lehman crisis of 2008, both relative to European inflows into China and also relative to Chinese capital outflows to the United States. For the 2003-2012 decade as a whole, Chinese bilateral FDI outflows to Europe, totalling nearly $25 billion, were nearly three times as large as those to the US.[130] The flows at the end of the decade were nearly 60 times larger than a decade earlier, albeit rising from a small base of only $113 million in 2003.[131] The distribution on a country-specific basis is indicated in Figure 6-3.

129 UNCTAD. Bilateral FDI Statistics 2914, at: http://unctad.org.

130 Chinese foreign direct investment flows to the European Union during the 2003-2012 decade were $24.6 billion, as opposed to $9.3 billion newly invested in the United States. See UNCTAD Bilateral FDI Statistics.

131 Ibid.

FIGURE 6-3: CHINESE MONEY AND THE EURO CRISIS



Source: Jamil Anderlini, "Chinese investors surged into EU at height of debt crisis," Financial Times, October 6, 2014, http://www.ft.com/cms/s/2/53b7a268-44a6-11e4-ab0c-00144feabdc0.html#axzz4DXh7ExCp

Chinese investment is naturally largest, as suggested in Figure 6-3, in the more economically advanced nations of the region. It is largest in Britain, which has strong historical ties with China, and especially strong links with China in finance. This Chinese investment will be largely unaffected by Brexit, as it is largely global rather than EU-specific in nature. Relative to economic scale, Chinese FDI in the Mediterranean, and around the periphery of the European Union is also striking. Italy, Greece, Portugal, and Spain all loom large on the list of Chinese investment destinations. Conversely, Germany—a primary trading partner of China, and a nation that invests heavily in China—conversely receives relatively little Chinese investment, relative to the size of its own powerful and stable economy.

IN CONCLUSION

Europe and China lie at opposite ends of a Eurasian continent that has traditionally lacked much cohesion or interdependence, in either socio-economic or political terms. Yet over the past thirty years, and particularly over the past decade, the two poles of Eurasia have grown closer to one another economically at an accelerating pace. The dynamics have also shifted, with European exports to China, and Chinese investment in Europe, rising much more rapidly in the past five to seven years than had previously been the case.

Economic ties between China and such core nations of the European community as Britain, where the trans-continental relationship of the modern era began close to two centuries ago, have continued to be important, across the past three decades of deepening interdependence. They will not be sharply affected by Brexit. Yet Europe's economic ties with China have, especially in the past five years, begun to take on dramatically different additional dimensions. China has begun making substantial infrastructural and logistical investments in Eastern and Central Europe. It has also invested quite heavily in the Mediterranean, considering the smaller scale of the economies there and their precarious financial condition. China's trade and investments in Europe are thus beginning to address political-economic questions of fundamental importance to Europe's future: how it sustains new, poor, outlying, and vulnerable members of the European Community and NATO, in an era when both NATO and the Euro financial venture are coming under stronger external pressure than ever before.

CHAPTER SEVEN

EUROPE, CHINA, AND GLOBAL FINANCE

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EUROPE, CHINA, AND GLOBAL FINANCE

The European Union, the United States, and Japan have stood since the 1970s as major pillars of the world economy. Abruptly, over the course of a mere decade, they have been joined by China, now indisputably the second-largest national economy on earth, and arguably the largest in purchasing-power parity (PPP) terms. Yet China, lacking well-developed domestic capital markets and clinging to capital controls, does not command as large a global presence in finance as in real-economic matters, despite foreign exchange reserves of over $3.2 trillion—by far the largest on earth.

Europe and China, as major economic centers, naturally aspire to play influential roles in international finance, just as they do in trade, and in diplomacy. Europe, for embedded historical reasons dating back to the early postwar years, does play a major role in some aspects of international finance—particularly at the International Monetary Fund, where a European official has served as Managing Director since the IMF began operations in 1947.[132] Although an American has traditionally served as World Bank president, European nations have substantial—and even disproportionate--voting rights at the World Bank as well, relative to their current, more modest economic and financial scale.

China, as a newly emerging geo-political power, and until recently an underdeveloped economy, has by no means a comparable role in international finance to that of Europe. Since July, 2011 it has, however, posted a Deputy Managing Director at the IMF, together with Japan, which had arrived earlier.[133] Yet China still has only 6.14 percent of total IMF voting rights, compared to 13.51 percent for Europe, and 16.68 percent for the United States.[134] At the World Bank, China's share of voting rights is only 4.85 percent, compared

[132] The IMF was conceived in July, 1944 at Bretton Woods; came into formal existence in December, 1945; and began actual operations on March 1, 1947. See International Monetary Fund, "History: Cooperation and Reconstruction (1944-1971), at: https://www.imf.org.

[133] Carla Grasso, a dual national of Italy and Brazil, is also "Chief Administrative Officer" of the IMF, while David Lipton of the United States is "First Deputy Managing Director."

[134] International Monetary Fund, "IMF Members' Quotas and Voting Power of the IMF Board of Governors", at: https://www.imf.org.

to 12.30 percent for Europe, and 16.2 percent for the United States.[135]

Apart from the global institutions, where Europe wields substantial clout, albeit second to the United States, the Europeans have also established several regional institutions to address their own developmental needs, including the EBRD (European Bank for Reconstruction and Development), founded in 1991. China until recently controlled no analogous institution of this kind. China is a member of the Asian Development Bank, and has a dominant voice, to be sure, in its CAREC subsidiary. Yet the presidency of the ADB has been held by a former Japanese official since the ADB's foundation in 1966, while the US and Japan together hold majority voting rights.

It is thus not surprising that in October 2014, China moved to establish the Asian Infrastructure Investment Bank (AIIB), and to so structure voting rights that it could play a dominant institutional role. China, to be sure, did not arrogate a majority share of voting rights to itself. It did, however, propose that 75 percent of voting rights at the AIIB be reserved for Asian nations, thus preventing American dominance. The PRC also decreed that Asian shares within the Bank be based on national GDP, thus making itself, as the largest Asian economy, also the largest shareholder. Thus, at last, China has established for itself a leadership role in one dimension of international finance, although the dominant overall role remains with the United States, as issuer of the world's principal key currency.

Three Key Arenas of Sino-European Interaction

China and Europe relate to one another, in the world of international finance, in three key dimensions. Most importantly, they inter-relate at the IMF, where Europe, with the Managing Directorate, in the person of Christine Lagarde, former French Minister of Finance, holds the key to a possible expansion of China's role at that institution. In November 2015, the Chinese renminbi was added, with the support of several European nations, to the basket of currencies used in calculating special drawing rights (SDRs), effective October 1, 2016; in the new SDR basket, the weight of the euro and the RMB together

[135] World Bank Group, "World Bank Group Finances", at: https://finances.worldbank.org.

(41.85 percent) will actually be slightly greater than that of the US dollar.[136] With over an eighth of total IMF voting rights, Europe could also be pivotal in the evolution of China's standing at the IMF, although it could come into subtle conflict with China itself on some issues. It is important to note that the RMB's addition to the SDR basket in late 2015 came mainly at the expense of the Euro and the pound, suggesting that neutralizing European ambivalence through careful consultation and side payments could be crucial to China's future rise in international monetary affairs.

The interests of Europe and China also inter-relate at the World Bank. There Europe does not hold so dominant a position as at the IMF, as the President is traditionally an American. Europe could therefore presumably be more flexible in accommodating Chinese interests at the World Bank in future. China's standing at the Bank seems quite likely to grow. And Europe's input will likely be pivotal in determining when that happens and how.

The third emerging arena for European and Chinese interaction in international finance is at the new Asian Infrastructure Investment Bank (AIIB), which commenced operations in January 2016. Fourteen of the 28 members of the European Union have already joined the new bank, including Britain, Germany, France, and Italy. The Europeans comprise almost one third of the total members, including virtually all of the most powerful, in what is evolving, as suggested in Figure 7-1, into a near-global institution. The AIIB also gained important new legitimacy on April 13, 2016 when AIIB President Jin Liqun signed its first co-financing framework agreement with none other than World Bank Group President Jim Yong Kim.[137]

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[136] From October 1, 2016, the weights of the five currencies in the SDR basket will be as follows: US dollar (41.73 percent); Euro (30.93 percent); Chinese RMB (10.92 percent); Japanese yen (8.33 percent); and pound sterling (8.09 percent). See International Monetary Fund, "IMF Executive Board Completes 2015 Review of SDR Valuation", December 1, 2015, at: http://www.imf.org.

[137] See "World Bank and AIIB Sign First Co-Financing Framework Agreement", on the World Bank website, at: http://web.worldbank.org.

FIGURE 7-1: A EUROPEAN CORE TO CHINA'S INCREASINGLY GLOBAL AIIB

Source: Zhao Yinan, "Nations investing faith in Asian bank plan," *The Telegraph*, April 26, 2015, http://www.telegraph.co.uk/sponsored/china-watch/business/11563429/aiib-asian-bank-plan.html

Deepening Sino-European Financial Policy Coordination

The evolution of the AIIB illustrates the capacity of China and the European Union, working in concert, to exercise a powerful influence on the evolution of international-financial architecture. China informally proposed the concept of the AIIB at a series of multilateral meetings, including the Boao Forum for Asia, in the spring of 2013, where former Deputy Prime Minister Zeng Pei-yuan and US Ambassador to China Gary Locke discussed the topic. This tentative unveiling was accompanied by internal policy debates within China.[138] During the fall of 2013, President Xi Jinping formally unveiled the idea, in the context of his early OBOR-related pronouncements in Kazakhstan and Indonesia. Prime Minister Li Keqiang reiterated China's intentions at the 2014 Boao Forum.[139]

It was not until Britain responded positively, however, over a year later, that the concept

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[138] Koh Gui Qing, "Insight—How China decided to redraw the global financial map", Reuters, September 17, 2015, at: http://uk.reuters.com.

[139] Keynote speech by H.E. Li Keqiang", Boao Forum for Asia, April 11, 2014, at: http://english.boaoforum.org.

gained a really substantial international following. Within four days of Britain's assent on March 12, 2015, however, Switzerland, France, Germany, and Italy had also joined.[140] The cohort of prospective members had thus spiraled from a handful to nearly 60, despite lack of enthusiasm in either the US or Japan, thus illustrating the power of Sino-European collaboration.

The prospective loan portfolio and *modus operandi* of the AIIB remain somewhat unclear, as the bank only commenced operations in January, 2016. Its declared mandate, however, is infrastructure, which tracks closely with a central priority of President Xi Jinping under the "One Belt, One Road" (OBOR) initiative. The infrastructural needs of Eurasia are also undeniably great. And the vast expanses of Central Asia, Russia, and Eastern Europe lie geographically between China and Europe. It thus seems predictable that if the AIIB gets off the ground successfully, as seems highly likely, it will become a key catalyst for even deeper economic as well as financial interdependence between Europe and China.

Growing Policy Collaboration

At the commercial and the bilateral policy level, China and Europe are collaborating to support expanded usage of the renminbi in international transactions. The People's Bank of China (PBOC) and the European Central Bank (ECB), for example, have signed bilateral currency swap agreements, such as the 350 billion yuan swap arrangement of October 2013.[141] Chinese and European financial authorities also cooperated in the establishment of four off-shore RMB centers, in London, Frankfurt, Paris, and Luxembourg, between June and September, 2014; and also in the authorization of RMB Qualified Foreign Institutional Investors (RQFII) programs for Britain, France, Germany, Switzerland, and Luxembourg.[142]

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140 Switzerland joined on March 13, 2015; France, Germany, and Italy joined together on March 16; and Austria joined a week later. See Jamil Anderlini, "UK move to join China-led bank a surprise even to Beijing", Financial Times, Mach 26, 2015.

141 See Yun Han, "Rebalancing the Powers: Deepening China-Europe Ties and the Implications for the Peace and Stability of the International System". Presented at the International Studies Association 2016 annual convention, Atlanta, Georgia, March, 2016.

142 Ibid.

IN CONCLUSION

Neither Europe nor China provides the principal key currency for global financial transactions. Yet these two poles of the Eurasian continent are growing increasingly interdependent in the world of international finance, and the prospect is for even deeper interaction. Their mutual interdependence is emerging at both the policy level— among finance ministries and central banks—and also at the commercial level, engaging investment and commercial banks, as well as insurance companies and other private financial actors.

In policy terms, there are three prominent arenas for Europe's interaction with China—the IMF, the World Bank, and the new AIIB. At the IMF, China's renminbi was admitted in November 2015 as a participant in the special drawing rights basket. European support was pivotal to this development, despite Sino-European differences of institutional interest, as with respect to voting rights. At the World Bank, China's role is expanding also. The AIIB, where European support has been crucial to the broad global legitimacy that China's new initiative is beginning to achieve, creates a potentially dynamic new forum for Sino-European cooperation. This is particularly true in the realm of trans-Eurasian infrastructural development, which itself will likely further the progress of Sino-European interdependence in real economic affairs as well.

CONCLUSION

CONCLUSION

Europe and China stand at opposite ends of Eurasia. They have very different cultural heritage, and sharply contrasting political systems. One is a collection of pluralist democracies, and the other is a soft-authoritarian state.

Despite their stark differences, and the geographical distance between them, China and Europe are growing increasingly interdependent in the ever more global political economy of the twenty-first century. Their bilateral trade has more than tripled over the past fifteen years,[143] while cross-investment has soared as well.[144] The European Union is now China's largest trading partner, according to IMF statistics,[145] and China stands second only to the United States in the EU's trading relationships as well.

Sectorally speaking, the China-EU economic relationship seems to be most dynamic in finance and technology. Service trade remains only a tenth of overall Sino-EU trade, and Europe has great competitiveness in insurance and banking. Liberalization of Chinese restrictions on service trade, or new global cooperative projects in the service area, could greatly benefit Europe. Chinese leaders such as Prime Minister Li Keqiang have hinted at the importance of greater dynamism in the Chinese service economy, and European capital and expertise could well be an important part of that equation. Europe's relationship with China in the services could also be enhanced by European cooperation with the One Belt One Road program in a variety of ways—through development of an offshore RMB market in European centers such as London; through European underwriting of AIIB bond issues, both in Europe and in Asian centers like Hong Kong and Shanghai; and through technical assistance and joint ventures within China itself. The potential attractiveness of such

143 The value of bilateral China-EU trade rose from $220 billion in 2005 to $615 billion in 2014. See IMF. Direction of Trade Statistics. European figures show the same basic pattern, but slightly less rapid expansion.

144 FDI stock in China from the EU more than doubled between 2003 and 2012, from $38 billion to $80 billion. Conversely, FDI stock in the EU from China expanded over sixty fold—from $442 million to $32 billion—during the same period of time. See UNCTAD. Bilateral FDI Statistics 2014.

145 IMF figures indicate that in 2014 China-EU trade totaled $615 billion, while that between China and the US totaled $551 billion. See IMF. Direction of Trade Statistics. European figures from Eurostat indicate, however, that the value of EU-China trade was still slightly smaller in 2014 than that between the US and China. Both sets of statistics agree that China stand second only to the US in EU trade.

cooperation was no doubt a major factor behind the decision of many European nations, beginning with Britain, to join the AIIB in the spring of 2015.

Brexit of course, could have a significant long-term impact on the Sino-European relationship, although the concrete manifestations will take quite some time to emerge. Britain's formal withdrawal from the EU may not occur until close to 2020; given the two-year negotiating period allowed under EU rules, and Britain's clear strategy of "pre-negotiation" before formal withdrawal notice is even given. Brexit seems unlikely to diminish the interest of any of the three central parties—Britain, the EU, or China-- in the Sino European relationship, if China's economy remains reasonably strong. The major impact of Brexit could ultimately be more leverage for China with both Britain and continental Europe, unless offset by greater US and Japanese activism with the European parties.

Sino-European cooperation in technology, as we have seen, is an agenda that the Chinese, in particular, consider a major priority. China already imports commercial aircraft such as the Airbus on a large scale from Europe,[146] as it did in the past from Boeing also, and has negotiated offsets that give its engineers increasing expertise in building competitive aircraft of their own. Chinese firms such as Huawei have achieved significant market share in Europe, and operate more freely there than they do in the United States. Europe has, since 1989, banned arms exports to China, but the consensus against defense-technology cooperation with China is eroding in Europe, as the broader economic stakes of Sino-European interdependence steadily grow.

European support at the IMF for Chinese inclusion in the special-drawing rights basket, as well as unexpected European support for establishment of the Asian Infrastructure Investment Bank, suggest that a coalition of Europe and China together have potential to change the international financial system itself, where both sides have parallel interests and coordinated strategies, juxtaposed with indifference or inadequate understanding on the

[146] China signed a deal for 45 Airbus aircraft, worth more than $11 billion, together with a $166 million agreement to build a cabin-completion factory for A330 jetliners in Tianjin for Airbus, during Li Keqiang's visit to France in late June/early July of 2015, for example. See "Airbus signs deal for second plant in China", *BBC,* July 3, 2015, at: http://www.bbc.com/news/business-33375915. China purchased 130 additional planes, worth $17 billion, during German Chancellor Angela Merkel's October, 2015 visit to China. See Victor Luckerson, "Airbus just signed a massive aircraft deal with China", Fortune, October 29, 2015, at: http://fortune.com/2015/10/29/airbus-china-deal/

part of Japan and the United States. This potential for change is magnified, of course, as the scale of China's foreign-exchange reserves and sovereign wealth funds rises. In recent months those accumulations may well have temporarily crested, but over the long term they will likely continue to rise, together with the scale of China within the global economy as a whole. As Chinese financial markets deepen, the prospect of the renminbi, or an Asian currency basket, as a global key currency also begins to emerge, with potentially serious economic and geopolitical implications for the United States.

Some changes in the profile of Sino-European cooperation, such as a relaxation of Europe's arms-export ban, could adversely impact the security of Japan, and potentially the United States, as well. Intensified cooperation in dual-use technologies relationg to telecommunications, aviation, and opto-electronics could have parallel, if more limited, implications also. It could thus be advisable for both the US and Japan to carefully monitor the evolution of high-technology ties between Europe and China. At the same time, there are important areas, such as breeder reactors and other forms of advanced civilian nuclear energy, where cooperative research and development can be a "win-win" proposition for all mankind. In such areas, broad global cooperation—involving both China and Europe—should be welcomed, thus dispelling the dangerous notion that technological cooperation with China should be discarded altogether.

The Importance of Cooperative Analysis and Action by the US and Japan

The Cold War is over, and the rapid progress of globalization is blurring the discrete interests of individual nations, and even regions. There are many "cooperative security" questions, such as combatting terrorism and environmental destruction, on which all major nations of the world—including China, Europe, and even Russia, as well as the United States and Japan—all share a common interest. Yet there are also unquestionably areas of technology and finance, in particular, where deepening ties between Europe and China could have adverse implications for the national interests of both the US and Japan.

At a minimum, it is important for both the United States and Japan to better understand the deepening relations between Europe and China, especially in technology and finance. It is also advisable that they closely monitor those relationships, as they are evolving rapidly. Special attention should be given, in particular, to the emerging debates within Europe as to how relations with China, and linkages to the human rights debate, should proceed. For these values debates, abstract as they seemingly are, could well influence how Sino-European relations on broader, more geopolitically relevant questions will proceed.

The urgency of US-Japan cooperation to counteract any perverse implications of the deepening Sino-European relationship is clearly intensified by Brexit. To the extent that Brexit exacerbates divisions between Britain and the continental European powers, it will likely give China greater leverage with both. It is in the common interest of Washington and Tokyo to neutralize this development.

The U.S. and Japan can work most easily together to deepen ties with Europe through two crucially important multilateral organizations: the G-7 and NATO. Neither, of course, includes either China or Russia although G-7 and NATO members naturally engage with the two Eurasian continental giants on many cooperative-security measures of common interest, such as terrorism. Within G-7, the US and Japan can work to develop productive frameworks for intellectual- property protection, transparency, and service trade that will deeper mutual relations among democracies and provide economic leverage with China. Although Japan is not a member of NATO, it should deepen ties with that key collective-security organization, as NATO will be an increasingly important trans-Atlantic coordinating body in the wake of Brexit. On issues such as cyber-security and technology-export coordination, NATO could be an important vehicle for reaffirming common interests of the US, Japan, and Europe in coming years—regardless of how trade and financial policies of the individual nations may evolve.

Prospects for the China-Europe Relationship and Global Implications

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