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Transatlantic Dialogue on China: Perceptions, Conflicts, and Potentials

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How do the bilateral relationships between the U.S. and China and Germany and China compare?

What role should transatlantic cooperation have vis-a-vis China?

What are China's policy objectives and how can the U.S. and Germany respond?

Ever since Deng Xiaoping's *Gaige Kaifang* (reform and opening-up) and the introduction of the market economy, China has generated incredible economic growth, transforming itself into a global workshop and in the process lifting more than 800 million people out of poverty.¹ Now the second biggest economy in the world, China is expanding its economic footprint globally, chasing markets, resources, and technologies to sustain its growth. At the same time, China's outreach is pushing the once isolated regime to the center of global governance, challenging the conventional wisdom of a West-advocated development model and further shaping an increasingly multipolar world order.

China's expanding influence presents both challenges and opportunities across a wide range of issues including, but not limited to, free trade, climate change, cyber security, and conflict resolution. For both Germany and the United States, formulating a set of long-term strategic policies regarding China is crucial to the future of their economic growth, security, and global engagement. The future of global governance is very much dependent on Beijing's policy objectives and how we respond to them. Neither Germany nor the United States should assume that it alone can manage China's strategic competition. The key to preserving German and U.S. strategic interests and maintaining a rules-based international order in the era of a shifting world order and China's growing assertiveness on the world stage requires close transatlantic policy coordination at all levels² and on a wide range of issues. Extracting valuable insights from candid discussions between American and German experts during AICGS' year-long transatlantic dialogue on China, this Issue Brief introduces some common and enduring transatlantic ideas on these issues, and identifies areas of practical cooperation in which Germany and the United States can combine their respective policy tools vis-à-vis China.

Pursuing Growth, Managing Competition

Having achieved double-digit growth for decades on the back of market reform and an export-oriented economy, China is now in urgent need of structural reform and industrial transformation to sustain growth and escape the middle-income trap. Close trade ties with China have brought different experiences for Germany and the United States. Although huge inflows of Chinese manufactured goods have caused a bilateral trade deficit with China for both countries, Germany's overall trade surplus and its exported-oriented economy contrasts with the U.S.' large, chronic trade deficit with China.

American public and political discourse on the China-U.S. economic relationship has increasingly focused on the persistent and growing trade imbalance, generating a \$347 billion deficit in trade in goods alone for the United States in 2016, down from a record high of \$367 billion in 2015.³ Such a large deficit—more than double that with the U.S.' top trade partner, the European Union⁴—has made China an effigy of the United States' economic problems, especially in the declining manufacturing sector with acute job loss and wage decreases. President Donald Trump tapped into this sentiment in his fiery campaign rhetoric toward China, vowing to disrupt the bilateral trade imbalance and take back American jobs. So far, however, his loud talk has yielded few results as bilateral trade talks continue.⁵ Despite Trump's allegations and threat of a potential trade war, bilateral trade relations are growing more interdependent.

U.S. exports of goods and services to China supported an estimated 911,000 jobs in 2015 and U.S. exports of services with China generated a \$37.4 billion surplus in 2016.⁶ While U.S. foreign direct investment (FDI) to China has been a key component of bilateral China-U.S. economic relations in post-reform China, totaling \$228 billion from 1990 to 2015,⁷ Chinese investment in the United States has increased exponentially in the past decade, tripling in 2016 over the previous year to \$46 billion⁸ and boosting cumulative Chinese investment in the U.S. to \$109 billion in the period since 2000.⁹ Chinese companies in the United States directly employed 141,000 Americans by the end of 2016.¹⁰ Increasing cross-border Chinese acquisitions, especially in strategic industries, has caught the attention of some in the U.S. Congress, with members considering proposals of expanding the relatively narrow national security-focused mandate of the Committee of Foreign Investment in the United States (CFIUS) to allow more stringent review of Chinese transactions.¹¹

In contrast, Germany has in recent years branded its close economic ties to China a "special relationship." Low production costs and a 1.3 billion strong consumer market continue to attract German companies to China. Bilateral trade flourished and in 2016, China overtook the United States as Germany's biggest trading partner.¹² For many years, German FDI in China has been a win-win strategy for both countries, creating jobs and building industrial infrastructure for China while generating handsome profits for German firms. Now, as China seeks to upgrade its industries and the rise in local manufacturing wage far outpaces labor productivity,¹³ German companies face growing challenges in China and are increasingly frustrated by the huge gap of reciprocity in market access. The most recent Chinese Foreign Investment Industrial Guidance Catalogue, while promising to open a number of currently restricted and prohibited sectors to foreign investors, falls far short of symmetrical market access in the EU.¹⁴

For many years, German FDI in China has far surpassed Chinese investment in Germany. The Chinese government's drive to transform its economy from low-value-added manufacturing to sustainable, high-value-added technological innovation has sprung a surge of Chinese investment in Europe, and Germany in particular. In fact, 2016 saw a record €11 billion in Chinese investment in Germany, accounting for 31 percent of total Chinese investment in Europe.¹⁵ The technological knowhow and innovation capacity of German companies, especially the *Mittelstand* (small and mid-sized companies) in the sectors of mechanical engineering, electronics, consumer goods, and information and communication technology have become the focus of Chinese investment in

Germany.¹⁶ Chinese acquisition of companies such as robotics maker KUKA and industrial machinery maker KraussMaffei Group have generated mounting public backlash over the growing appetite for German companies, many of which are on the cutting edge of engineering and computer technology.¹⁷ A combination of apprehension over national security, strategic intentions of Chinese state-owned companies, and sentiment toward keeping certain industries in national hands is prompting a reconsideration of the previously open, welcoming policy toward Chinese investment in Germany. However, unlike CFIUS

in the United States, a lack of investment review process in the EU means Germany has few avenues for blocking Chinese acquisitions.

Despite different experiences in bilateral economic relations with China, Germany and the United States are seeing more of their trade and investment interests converging. Both

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German and U.S. companies have brought large volumes of FDI to China and have sustained interests in continuing and expanding operations in the Chinese market and the Asia-Pacific region. The lack of true reciprocity in market access for foreign companies and a strong, protectionist national industrial policy in China increasingly frustrate American and German companies alike. On the trade front, both European and U.S. governments are taking actions against unfair competition of subsidized Chinese export products such as steel, which are said to benefit from preferential lending, tax rebates, and other financial help.¹⁸ Closer U.S.-German/EU cooperation, for example regarding China's market economy status, could exert more pressure on China to open up its market and improve investment reciprocity as stipulated by WTO regulations. The Transatlantic Trade and Investment Partnership (TTIP), if successfully concluded, will strengthen the U.S. and EU's ability to set international trade rules and further compel China to modify its trade and investment policy.

Another area of common interest is China's outbound investment in Europe and North America. As previously mentioned, Chinese investment in Germany and the United States has increased exponentially in the past three years. Chinese FDI continues to concentrate in strategic sectors, real estate, transport, and consumer products in North America, and information technology, infrastructure, and industrial assets in Europe. At the same time, the number of cancelled Chinese deals in both regions rose to a record high \$74 billion in 2016 as a result of heightened U.S. and EU scrutiny, especially in cases involving concerns over transfer of sensitive technologies to China.¹⁹ Closer coordination between the U.S. and the EU, using CFIUS as a guideline, while providing additional resources to implement practical and nonintrusive review processes that can adequately address national security concerns accompanying quickly-expanding Chinese investment across the Atlantic will improve the existing regulatory tools for Germany and the United States. Both governments will benefit immensely from more streamlined, transparent review processes that better assess cross-border Chinese investment that have both local and international implications on national security and strategic competition.

China is no longer just an important trading partner for Germany and the United States. Its quest to upgrade to a high-tech, innovation-driven economy as well as its agenda to

expand China's global economic engagement present strong competition for German and U.S. industries and serious challenges to existing rules and norms on international trade and

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development. China's One-Belt-One-Road Initiative (OBOR), aimed at recreating the ancient silk road trade route and constructing a new maritime trade route linking China to Europe, provides more than massive investment and development opportunities for the Eurasia region. The strategy will also seek to shape China's economic and security environment and influence patterns of commerce and geopolitics according to its perceived national interests.²⁰ Additionally, despite record increase in Chinese merger and acquisition (M&A) deals in Europe and North America, the majority of Chinese outbound investment went to developing regions. An influx of Chinese FDI and government-financed development projects in countries from Asia to Africa to Latin America raise

concerns over project standards, lack of conditions on good governance and human rights, a non-transparent administration process, and limited benefits for aid recipients.

While both Germany and the United States are trying to tackle key challenges in their respective bilateral economic relationships with China, the need for transatlantic cooperation is more urgent than ever. It is not enough to play good defense; Germany and the United States can realize great strategic advantage by pursuing closer coordination with allies. Such transatlantic partnership, however, appears to be arduous in the Trump era. The Trump administration, guided by its protectionist agenda, has vowed to disrupt international free trade to the detriment of American leadership in global economic governance. The U.S. government's withdrawal from the Trans-Pacific Partnership (TPP) abandoned an historic opportunity for the United States to assemble a trade and investment alliance in the Asia-Pacific region that both boosts economic growth at home and prescribes the rules of global trade and investment for years to come.

The collapse of the TPP didn't erase the demand for an extensive regional free trade agreement in Asia-Pacific. It merely left a leadership vacuum, which allowed China to seize the opportunity and push for the Regional Comprehensive Economic Partnership (RCEP) and the Free Trade Area for the Asia Pacific Region (FTAAP), both of which would significantly enhance Beijing's ability to dictate its terms. Similarly, China's national Energy Administration recently laid out a plan that commits \$360 billion through 2020 on renewable power

sources in a bid to dominate the fast-growing global renewable energy industry²¹ at a time when Europe and the United States are squabbling over Trump's decision to pull out of the Paris Climate Accord.

Trump's repeated attacks against Germany have created a serious rift in the transatlantic partnership. Chief trade advisor Peter Navarro's claim that Germany was a main obstacle to a deal between the U.S. and the EU, compounded with Trump's accusation of Germany's currency manipulation as well as his threats of high tariffs on the German auto industry, compelled German chancellor Angela Merkel to pledge her country's commitment to fight for free trade with China.²² Increasing Sino-German cooperation, although on a case-by-case basis

and not strategic in nature, still threatens to fragment a transatlantic agenda on global trade and economic development.

Effective strategies to promote economic growth at home and to manage increasingly strong competition from an expanding state-directed Chinese economy must be built with close transatlantic partnership. While overcoming narrowly nationalistic and protectionist impulses and seeking closer policy coordination helps to preserve U.S.-EU leadership in global trade and investment, active alliance building through comprehensive regional trade agreements such as TPP and TTIP is the key to long-term strategic offense that enables the United States and Germany to manage economic competition from China.

Bolstering Alliances, Forging Stability and Security

In both Germany and the United States, growing security concerns and regional instabilities are central themes of their foreign policy agendas. On the one hand, Beijing's aggressive assertion of power in the South China Sea continues to pose a threat to stability in the region and challenges U.S. influence in Asia-Pacific. On the other hand, China's growing political influence, expanding economic reach, and stature as a non-Western power could assist transatlantic efforts in a range of issues including combating climate change, aiding regional development, and facilitating international negotiations on sectarian and regional conflict. The key for both Germany and the United States is to enhance transatlantic coordination at all levels in order to gain better understanding of China's strategic goals and engage Beijing in ways that nudge it toward becoming a responsible stakeholder in a rules-based international order.

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The Sino-U.S. relationship is defined by a mix of competing values, intertwined economic interests, and conflicting geopolitical agendas. Through trade and investment, China's growing economic ties with Asian-Pacific countries have increasingly translated into political influence, challenging U.S. dominance in the region. The Obama administration's "pivot to Asia" strategy acknowledged an ongoing shift of global power toward Asia and reflected the need to build a framework of engagement with allies and partners and manage big power relations with China more effectively. Although key regional issues such as halting North Korea's nuclear weapon program could benefit from Sino-U.S. cooperation, competition for strategic leadership limits the scope of cooperation, as both countries chose to pursue separate regional platforms.²³ Furthermore, there has not been a coherent China strategy with clearly defined goals in U.S.

foreign policy beyond security interests in the Asia-Pacific region and disproportional bilateral trade imbalances.

While close economic ties have been the main characteristic of the Sino-German "special relationship"²⁴ in recent years, fundamental differences in values and political ideologies

prevent meaningful cooperation beyond mutual economic interests. The Chinese government's growing authoritarian tendencies, repression of human rights activists, and heightened censorship stand in direct contradiction to Germany's liberal democratic values of human rights, free speech, and the rule of law, fueling growing skepticism about China's conduct at home and abroad. Despite Germany's lack of a set of clearly defined strategic interests in Asia, China's revisionism, its aggressive territorial claim in the South China Sea, and its stark rejection of international arbitration, attracted intense public denunciation in Germany, further heightening the danger of revisionism and the importance of international rule of law, a lesson the country recently relearned from the Ukraine crisis.²⁵

China's reemergence as a global power reflects the world order in transition, from Western dominance to Asian prominence and from unipolar U.S. superpower to multipolar leadership. After enduring a century and half of "national humiliation," China has rediscovered its leadership through rapid economic development and expanding geopolitical outreach. Having undergone major shifts in its foreign policy in the past four decades, China has benefited immensely from globalization and is firmly implanted in most international regimes.²⁶ Like the United States, it now enjoys "special relationships" with many countries, including Germany. It wants and deserves a greater role in the global order. It is important

to understand that if the United States and Europe won't make room for it, China will simply create its own international institutions and push for an alternative world order. Certainly, Western democracies do not see eye to eye with China's authoritarian one-party system. Its record on the rule of law and human rights is often a point of contention at home and abroad. However, Chinese elites today reject that its pursuit of power and influence in global governance is any less legitimate than that of Western liberal democracies. They often criticize those in the West for being hypocrites who decline to examine their own paths to global dominance. The Trump administration's radical "shakeup" of U.S. foreign policy, pulling out of TPP and the Paris Climate Agreement, as well as threatening to withhold support for NATO allies, makes Chinese leadership look responsible, disciplined, and committed in comparison.

To make sense of China's strategic goals and come up with adequate responses, it is important to understand the Chinese Communist Party's core interests: sovereignty, stability, economic growth, and expanding global impact, in that order. China's stability and the Communist Party's firm political control of the country are always the top priorities in any Chinese international engagement. Thus, effective China policies must carefully navigate issues that directly correspond to China's primary core interests and simultaneously take advantage of Beijing's flexibility and strength on issues of common interests. Transatlantic cooperation on China should focus on common responses and utilizing their respective available policy tools. Here are some platforms that can benefit from practical U.S.-German cooperation:

Cybersecurity

The Chinese government has used its growing cyber arsenal toward tightening domestic internet censorship and allegedly attacking commercial and government entities in the West. Its promotion of "Cyber Sovereignty"—that national governments have legitimate authority to censor and control internet activities within their borders—poses a serious threat to the free flow of information and the freedom of expression in cyberspace. Both Germany and the United States have started negotiations with China. In 2015, the U.S.-China cyber agreement jointly announced by then-U.S. president Barack Obama and Chinese president Xi Jinping declared that neither the U.S. nor the Chinese government "will conduct or knowingly support cyber-enabled theft of intellectual property, including trade secrets or other confidential business information for commercial advantage."²⁷ While not perfect, the mechanism reportedly saw significant decline of targeted cyber attacks from China in the year that followed.²⁸ Germany is pursuing a similar agreement with China as well as deepening exchanges on cybersecurity through a high-level security dialogue mechanism.²⁹

However, strategic mistrust and deep division over many other issues, such as the free flow of information and internet governance, are the main obstacles in realizing concrete cooperation with China. A close U.S.-German partnership in cybersecurity would be highly beneficial to setting standards of internet governance and cyberspace conduct, taking advantage of the German defense ministry's new investment of substantial financial and personnel resources in the Bundeswehr to booster Germany's cyber security capacities as well as the European Commission's recent launch of a public consultation of the European Union Agency for Network and Information Security (ENISA) aimed at reengineering the agency to better support member states with modern cybersecurity challenges as well as fostering closer cooperation between national cybersecurity institutions.³⁰

Effective transatlantic cooperation could see enhanced information sharing with NATO and the EU and harmonized cybersecurity norms and standards for cyber threat penalty.³¹

Global Governance Institutions

For years, China has decried Western opposition to reforming existing global governance institutions to reflect China's growing influence. Repeated calls for international cooperation from Chinese leadership seems to point to China's strong commitment to contributing to global governance. Nevertheless, the Chinese government has adopted a paradoxical strategy. On the one hand, it enjoys membership in the Western-led institutions such as the WTO, World Bank, and IMF, touting the renminbi's inclusion in the IMF's Special Drawing Rights basket of currencies and Beijing's ratification of the Paris Agreement. On the other hand, China is also contesting these institutions, denouncing their West-centric principles, and seeking to establish alternative institutions with its self-proclaimed "developing country" status as well as its well-advocated "non-interference" foreign policy.³² China has repeatedly used its permanent membership on the United Nations Security Council to reject Western-backed resolutions during the course of the Syrian civil war. The OBOR initiative, buttressed by the newly-founded, China-led Asian Infrastructure Investment Bank (AIIB), promises to offer connectivity and development opportunities that have not been adequately addressed by existing international institutions. In the process, Beijing benefits from new partnerships and creates opportunities to set up development rules and standards throughout Eurasia. The need for institutional leadership and international cooperation does not diminish while American foreign policy is growing more isolationist under Trump and the EU is entangled in a soul-searching crisis after Brexit.

An effective strategy to manage China's institutional competition needs to employ strong transatlantic cooperation on two fronts. One is that the United States and Germany should heed the call from Xi and other developing country leaders

A close U.S.-German partnership in cybersecurity would be highly beneficial to setting standards of internet governance and cyberspace conduct.

and push forward wider reforms within existing international institutions to reflect China's growing importance and contribution, boosting institutional legitimacy. At the same time, both countries need to hold China accountable for the responsibilities accompanying a large institutional stakeholder, preventing a double standard based on its "developing country" and non-Western identity. The other is that Germany and the United States should seek active participation in China-led parallel international institutions. Being inside of these new institutions affords an opportunity to shape their rules and agendas and take advantage of their new initiatives that address previously neglected issues such as industrial infrastructure development in Southeast Asia and Africa.

International Security

Another platform for German-U.S. cooperation is international security. In an era where historical revisionism, sectarian conflict, and religious extremism loom, neither Germany nor the United States alone could adequately meet these security challenges around the world. A beneficiary of globalization and the international system, China has an active stake in ensuring security and stability in volatile regions in Eurasia and Africa. The Chinese OBOR initiative needs a secure and stable Eurasia corridor that guarantees the safe movement of goods, services, and personnel. Security hotspots such as Afghanistan, Iraq, and Syria pose serious risks for Chinese investment in the region and beyond. Beijing is also concerned about Islamic extremism spilling over from neighboring countries in central Asia, encouraging jihadist separatist sentiments among its predominantly Muslim Uyghur population in the Northwest province of Xinjiang. Thousands of ethnic Uyghur fighters are fighting in Syria with the Turkistan Islamic Party

Conclusion

China's rise presents both opportunities and challenges for Germany and the United States. On the economic front, the transatlantic partnership needs to play good defense and offense. Closer EU-U.S. coordination using CFIUS as a template to streamline the reviewing process for Chinese investments will simultaneously enhance government oversight of rapidly increasing Chinese investments in strategic sectors in Europe and North America and assist government efforts to address Chinese competition with industrial policy. A common stance on China's Market Economy Status will help to assert pressure for China to comply with WTO regulations and improve reciprocal market access for Western companies. Pursuing transatlantic cooperation on regional trade agreements such as TTIP will extend the reach of EU-U.S. regulations, thus strengthening the U.S.' and the EU's ability to set international trade rules and further compelling China to modify its trade and investment policy.

(TIP), a successor organization of the East Turkistan Islamic Movement (ETIM) seeking to establish an independent Islamic state in Xinjiang, and allied with the al-Qaeda affiliate al-Nusra Front.³³ Meanwhile, the rise of China's revisionism on the issue of the South China Sea with its aggressive island building and beefed up military patrols raised serious security tensions with its surrounding neighbors, many of whom are U.S. allies. Transatlantic policy coordination needs to confront China's revisionism in the South China Sea and push for bigger Chinese contributions to peacekeeping and conflict resolution especially in Asia, the Middle East, and Africa.

On the issue of the South China Sea, the United States and Germany can combine different but complementary policy tools. While the United States continues to pledge security support for regional allies and maintains a visible military presence, Germany through the EU should pursue a broader bilateral partnership with the Association of Southeast Asian Nations (ASEAN), offering expertise in regional integration as well as development opportunities in infrastructure, technology, and trade through closer economic relationship with the EU. In Syria, Germany and the United States need to recognize China's common interest to end armed conflict and begin reconstruction, stabilizing China's land route connection to Europe, and utilize China's position as a close partner to Russia as well as its cordial relations with most regional stakeholders including Turkey, Iran, Saudi Arabia, and the Council of the Arab League to expedite the search for a political solution. Some form of EU-China dialogue on Syria's reconstruction, including reconstruction aid and access to the common European market as well as a common U.S.-EU position on China's market economy status, could persuade Beijing to assert more pressure on its partners to reach an agreement.

In order to preserve a rule-based global governance system, Germany and the United States need to realize China's growing influence in international affairs and accommodate its new status with existing international institutions while engaging and participating in China-led parallel institutions. Combining respective EU and U.S. policy tools, upgrading information sharing, and harmonizing standards could prove much more effective in dealing with strategic challenges from China ranging from cyber security to Chinese revisionism in Asia-Pacific. At the same time, the transatlantic partners should not overlook China's positive contributions and actively engage Beijing to play a more constructive role in mediating regional conflicts and combating global terrorism, and encourage China to become a responsible source of global development opportunities.

NOTES

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For both Germany and the United States, China has become a foreign policy priority: a major strategic competitor in the Asia-Pacific region for the United States, and a willing partner on the topic of trade, technological development, and climate change for Germany. For the next two years, the United States and Europe will be in a crucial state of flux, with a new administration in the United States and the Bundestagswahl in Germany in 2017. It will be an excellent opportunity to rethink the German and U.S. approaches to their relationships with China and for new leadership both in Washington and Berlin to engage in a serious policy dialogue over their respective interests in and approach to China.

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