China Policy

China Going Global

between ambition and capacity

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contents

cover photo Colombo Port 10 April 2017 courtesy Hu Yifan, China Policy

1 strategy

Emerging in 1999, the Going Global strategy sought to bid farewell to the Mao-era mindset of self-reliance, urging Chinese firms to take advantage of booming world trade to invest in global markets.

As an ideological as well economic departure, it frames China's ambitions for global leadership and cooperation. Under the Xi–Li leadership, Going Global has evolved to reflect domestic goals: moving from an investment- to an innovation-driven economy, and bolstering Party claims to legitimacy by becoming an effective global actor.

Led by two high-profile initiatives—Belt and Road and Capacity Cooperation—Going Global 2.0 is the policy rubric behind China's claims to now be the 'champion of free trade'.

Going Global cartoon 2012. 'IPO response' fighters head towards a distant city, taking off from aircraft carrier 'Chinese firms'

2 going global 1.0

policy challenge

adapt global engagement to balance soft power and return on investment

The first years of Going Global coincided with China's 2001 admission to the WTO. It hit high gear under the Hu–Wen leadership (2002–12). The global financial crisis (2008–10) saw aspirations peak: the Party moved from thinking of the country as a late-starting outlier, to possessing unique cultural solutions for other nations' problems. Going Global 1.0 provided a framework for guiding firms to find resources and markets offshore. To domestic players, this meant exporting practices that worked within the PRC business world. Results have been mixed.

By the launch of the anti-corruption campaign in 2012, Going Global was in trouble. Rarely breaking even, projects were plagued by economic and governance issues. Corruption was only one of these; rent-seeking rooted in state-enterprise culture was another. A high-handed, self-justifying posture frequently stirred up local civil society and business against Chinese investment. Faltering global demand, particularly in OECD countries, exacerbated macro-level problems.

case study: COVEC in Poland

Under Going Global 1.0 Chinese firms often ignored or struggled to deal with local regulatory frameworks. In 2009, construction giant COVEC won the tender to build 50 kilometres of a Polish highway for US$450 million, half the Polish government's estimate. Though heralded as a breakthrough for Chinese firms entering the European infrastructure market, plans failed to include the required metre-high culverts to allow small animals passage under the road. Faced with rising costs and opposition from domestic companies, Poland cancelled COVEC's contract in 2011.

3 going global 2.0

Going Global 2.0 emerged from the spotlight thrown on these issues, aiming to address 1.0's failings and ensure firms invested abroad more wisely, with greater concern for local sensibilities and China's image.

policy challenge

offset single-digit growth by stimulating global demand

going global 1.0	going global 2.0
solving resource security	ensuring return on investment
buying whole value chains	stimulating global demand
buying majority stakes	switching to portfolio investment
seeking local political patronage	avoiding dividing political elites
projecting the China Model	blending with local operators

domestic restructuring

The re-invigoration of Going Global policy reflects Xi Jinping's 习近平 desire for global leadership, and offers a channel to boost domestic economic restructuring by stimulating non-OECD demand. Industry plans, such as Made in China 2025 or the many sector-specific 13th 5-year plans, aim for a new economy rising from sci-tech, innovation, services and consumption. Chinese industry needs to move up the value chain to avoid a fall into the 'middle income trap' and Japan-style stagnation. State-sector mergers make national champion firms 'bigger and stronger', and better able to engage with global markets.

Going Global 2.0 permeates all domestic policy areas, from healthcare and agriculture, to state-sector reform and SMEs, and advances trade agreements like RCEP (Regional Comprehensive Economic Partnership) and FTAAP (Free Trade Area for the Asia Pacific).

exporting capacity

policy challenge

take capital where it can grow while 'digesting' domestic overcapacity

An ageing population and rising labour costs, declining returns on domestic investment and a bloated real estate market prompt firms to look abroad for new opportunities. As China moves up the value chain, and environmental awareness increases, many capital- and labour-intensive industries—construction, manufacturing and energy—are shifting production abroad. Firms must deal with overcapacity, not just in traditional industries like steel and cement, but also in low-end manufacturing and in emerging industries like robotics—exporting part of it abroad makes sense. Going Global 2.0 provides a nuanced framework for guiding firms to seek, beyond resources and markets, what are now termed win-win solutions.

setting standards

policy challenge

raise China's voice in setting global standards

Most obvious in headline-grabbing infrastructure projects, Going Global 2.0 also involves a louder voice in global norm setting, in standards such as in 5G mobile technology, and in international law. Initiatives include the *Seabed Law* and emerging foreign trade paradigms such as cross-border e-commerce. New online compliance models take advantage of China's trade weight to promote its standards globally. The strategy anticipates increased collaboration between Chinese and overseas universities, such as the Torch Science Park at the University of New South Wales in Australia; and MoUs such as that between Federal University of Rio de Janeiro and Tsinghua Science Park (TUSPark).

The transition from Going Global 1.0 to 2.0 is, though, a simplification. Some firms, such as SOE ChemChina, whose acquisition of Swiss pesticide and seed firm Syngenta now only awaits Chinese approval, were already operating in 2.0 terms in the 2000s, under founder Ren Jianxin 任建新. And 1.0, by the same token, is far from dead.

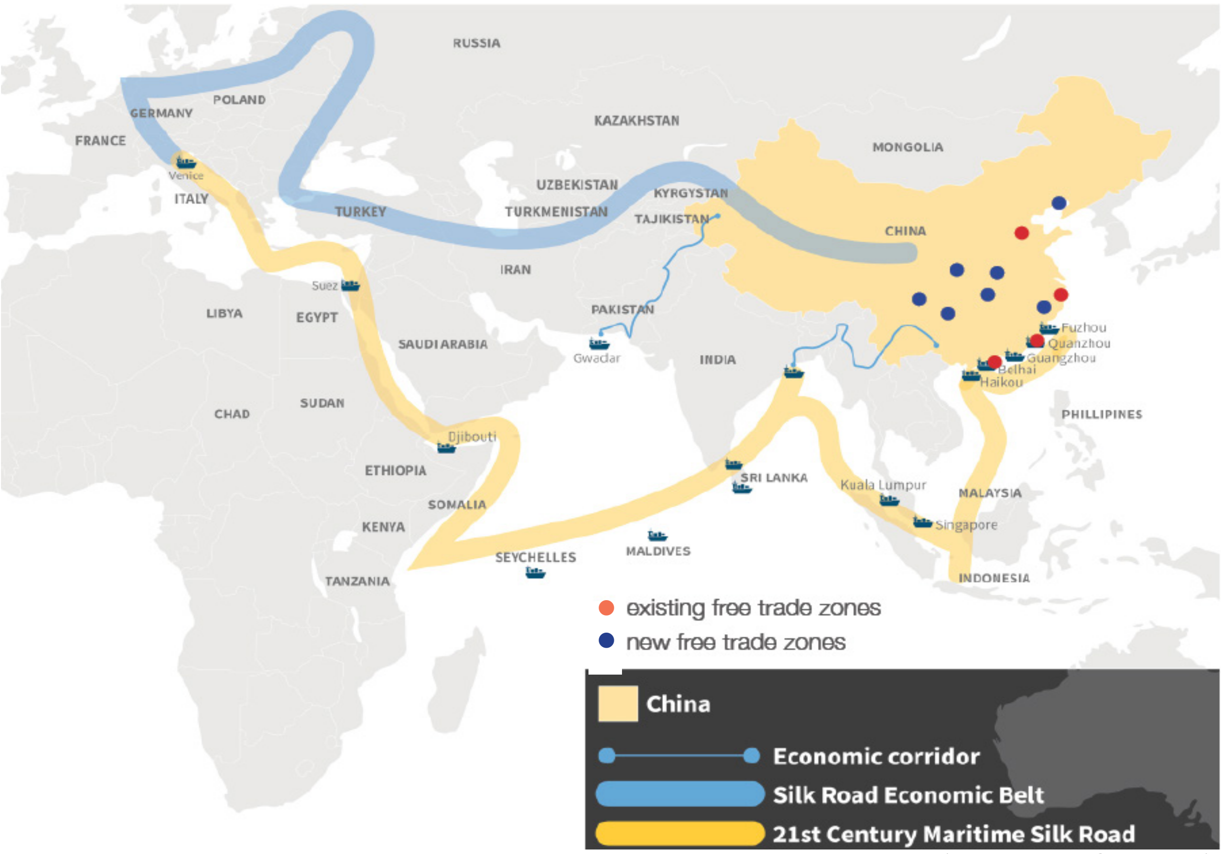
Chinalco's staff pictured in Aurukun Queensland, Australia, with Wik representatives and young Wik leader Gina Castelain (holding baby) in 2006.

photo courtesy Gina Castelain

case study: Chinalco in Australia

Chinalco, the monopoly SOE in China's aluminium industry, was able to gain support of the Wik people, an Australian indigenous group, to mine bauxite on their land at Aurukun. Senior Chinalco executives travelled to the region to negotiate with local communities as required by Australian law. While the project was aborted due to an aluminium price collapse, Chinese critics of Going Global took Chinalco's consultative approach as a model for ventures in the global South. When Chinalco later sought to diversify into iron ore, leading the Australian to agitate against 'selling out' national assets, the Wik issued a statement, noting that Chinalco's deal with them had been far preferable to other extractive investors.

4 belt and road



map courtesy Lowy Institute, Australia (FTZs added by China Policy)

policy challenge

improve connectivity to reduce flagging demand and address development gaps

Proposed by Xi Jinping in 2013, Belt and Road is a major geopolitical expression of Going Global 2.0. Hedging against US influence at its front door, the strategy focuses south and west, seeking to build up infrastructure, trade, investment and human linkages across Eurasia. It comprises of a 'Silk Road Economic Belt' through Central Asia and a 'Maritime Silk Road' extending via the Indian Ocean to the Middle East.

While focused outward, Belt and Road is shaped by domestic issues. Provinces formulate their own plans, linking with the broader national-level strategy, and setting up fierce competition between provinces vying for projects.

To date, the economic growth 'miracle' has largely occurred on the eastern seaboard, causing severe regional wealth disparities. The land-based Belt seeks to shift more development west, principally through greater economic integration with countries in South and Central Asia and the Middle East. The next batch of free-trade zones—in Liaoning, Zhejiang, Henan, Hubei, Chongqing, Sichuan and Shaanxi—are intrinsic to the strategy, linking coastal to inland provinces and on to Central Asia. Moves to revitalise the northeast—the former heavy industry powerhouse—will also link up with the promised synergies flowing through Belt and Road.

Mao Siwei 毛四维
former consul general, Kolkata

The China–Pakistan Economic Corridor is over-hyped. A cross-border railway to Pakistan linking China to the Indian Ocean is not feasible as the route is earthquake prone. A public road destroyed by natural disaster in 2010 took the two countries five years to fully restore; rail will be harder to build and maintain. Chinese workers in Pakistan are often targeted by extremist groups, and the railway is also unlikely to be profitable—the Sino-European railway, functioning under much better conditions, operates at a loss. *Aisixiang*, 19 Dec 2016

Bringing development to Xinjiang, situated in China's far west, is a major concern. Treating Uighur pressure for autonomy as separatism, Beijing's stock response is to offer material incentives, especially development projects, to achieve local buy-in. The US$46 bn China–Pakistan Economic Corridor (CPEC), launched 2015, is integral to this plan, envisaging a series of road, rail and pipeline projects linking Kashgar in Xinjiang with Gwadar, a port city on 'all-weather friend' Pakistan's southwestern coast.

case study: Piraeus port

China Ocean Shipping Company (COSCO) took a 51 percent stake in Greece's Piraeus port for €280.5 million in August 2016, and is entitled to buy another 16 percent in 2021. Piraeus is the only seaport in Europe solely managed by a Chinese company; Beijing hopes it will become a gateway linking to central Europe. COSCO had already operated one of the port's container terminals since 2009, but the project was pushed ahead under GG 2.0, with Premier Li Keqiang 李克强 calling the port 'a pearl in the Mediterranean sea' during a visit to Greece in 2014.

According to official statistics, Chinese firms invested US$14.35 bn in the real economies of 53 Belt and Road states in 2016. They also signed 8,158 project contracts worth US$126.03 bn with 61 Belt and Road states, up 36 percent from 2015, and accounting for 51.6 percent of the total value of foreign contracts. Funding support is largely through the Silk Road Fund, set up in December 2014, and, for infrastructure projects, the Asian Infrastructure Investment Bank AIIB.

Asian Infrastructure Investment Bank

Founded October 2014, the AIIB is a China-led multilateral bank designed to overcome reliance on Bretton Woods institutions like the World Bank and International Monetary Fund. Conceived by Xi Jinping in 2013 (like Belt and Road), it swiftly attracted members, eventually including the UK and Australia, to the discomfort of the US, who lobbied fiercely against it. Touted as a case in point of China's 'right to be heard' in view of its leading role in the developing world, AIIB has so far maintained existing banking norms rather than breaking new ground. The majority of China's infrastructure loans still come from Exim Bank of China and China Development Bank.

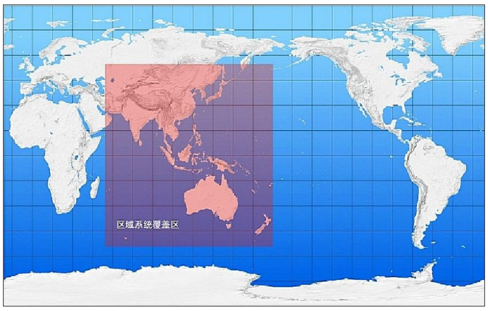
policy challenge

forestall global capacity shortfalls while easing China's rise in supply chains

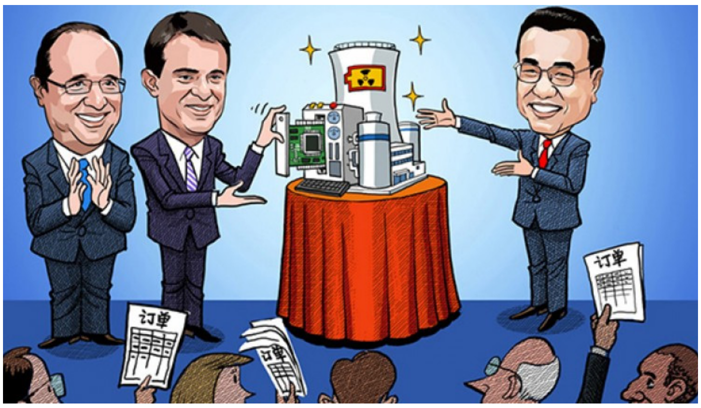
belt and road	capacity cooperation
focus on connectivity	focus on production, food security
lead agency: NDRC	lead agency: MofCOM
soft power based on 'Silk Road' cultural heritage	agnostic on cultural values
signature policy of Xi Jinping	associated with Li Keqiang, State Council

5 capacity cooperation

Emerging in mid-2015, (International Production) Capacity Cooperation—largely eclipsed by the more dramatic Belt and Road—was little noticed outside China. Promoted in both Xi Jinping's and Li Keqiang's tours to Europe, Latin America and Central Asia 2014–16, it aims to build partnerships between domestic and overseas firms; elevate Chinese industry in global value chains by boosting technology and investment; promote high-speed rail, nuclear energy and major construction projects; and develop third country industries and markets to sustain China's growth. Projects are scattered around the world, with each province connected to a series of countries. In many deals to date the quid pro quo for developing countries is to take on China's foreign policy viewpoints when signing Capacity Cooperation agreements. Agreements in Europe, such as one with the Czech Republic, look to European states' tech and innovation advantages to upgrade China's manufacturing quality and efficiency. Priority here is placed on integrated circuits, aerospace and aviation, nuclear, robotics and artificial intelligence. Capacity Cooperation also has major food security implications, anticipating a need for food production capacity to be built up beyond China.



BeiDou, a domestically developed navigation system with coverage across South and East Asia, hopes to compete with the US GPS. Aiming to have 35 satellites in orbit by 2020 for global coverage, Beidou projects concentrate in ASEAN nations, involving cooperation with: Thailand, launching three ground-based augmentation system demonstration bases; Cambodia, setting up worldwide satellite navigation base stations; Malaysia, data service centres; Laos, precision agriculture and pest and disease monitoring; and Indonesia, maritime positioning and navigation information.



Li Keqiang with the president and prime minister of France promoting a nuclear power plant to an international audience; some are holding up 'orders'

case study: Hinkley Point C

China General Nuclear Power Corporation (CGNPC) partnered with French-owned utility EDF on the 3,200 MW nuclear power station, Hinkley Point C, planned for Somerset, England. Expected to cost £24.5 bn, the plant will use French reactor technology. The deal gave China priority in designing subsequent UK power plants using its Hualong One reactors. The Cameron government strongly backed China's participation, despite energy infrastructure security concerns, though doubts about its feasibility grew. On 8 August 2016, ambassador to the UK Liu Xiaoming 刘晓明 warned in a confronting *Financial Times* op-ed that 'the China–UK relationship is at a crucial historical juncture'. Subsequent approval of the project may have owed more to the UK's need to bolster relations with France than with China.

6 risks of going global

Serious issues for firms Going Global persist, with huge political, natural, economic and market risks.

Central coordination of Belt and Road infrastructure projects is more notional than real. The nominal lead agency, NDRC, lacks international project experience. Both state and civil society have widely varying goals between and within countries. These countries themselves have their own geopolitical goals. Discrepancies between institutions and law of participating states persist. The limited experience of the agents in investment, construction, management and operation of infrastructure projects exacerbates these issues.

A rash of overseas M&As 2015–16, such as Midea's US$5 bn acquisition of Kuka, the German robotics company, repeat some of the fixations and assumptions of Going Global 1.0. Many overseas investments are launched without sufficient prior evaluation, often generating little value and exposing firms to unjustified risks. Some firms carry out 'conglomerate building' investments, such as into real estate, entertainment and sports, that stray from their competence and add little to their core business. In 2016, Suning, an online/offline integrated commerce group, paid €270 million for 70 percent equity in football club Inter Milan, for example. Others take on excessive risk by striking deals when already highly leveraged. In mid 2015, Fosun's overall debt level hit 55.7 times its EBITDA, when it went on a buying spree, committing to 18 M&As totaling US$6.5 bn. Capital outflows entailed by such deals deplete China's forex reserves, adding to downward pressure on the RMB.

policy challenge

rationalise capital outflows, prioritising quality and miminising risk

Xu Niansha 徐念沙
China Poly Group Corporation chair

CEO with a strong suit in marine industries, real estate and culture, Xu ranks high in military-industrial circles. Chinese firms along Belt and Road still face many challenges, warns Xu: investment risks are high, and many companies lack experience in overseas markets; consulting support is underdeveloped and risk assessment inadequate. Firms also face asymmetric information, resource fragmentation and vicious competition, he says. *People's Daily*, 26 Jul 2016

In late 2016, the state moved to rein in rash overseas spending, encouraging firms to make more targeted, strategic investments. Investment in real estate, entertainment and sport will be closely scrutinised, along with sizeable investments outside a firm's core business.

policy challenge

ease suspicion over Chinese investment through closer supervision of ODI

Heightened supervision of SOEs' ODI brings in third-party institutions to advise on target countries' cultural, political and legal environments, and ease suspicion over Chinese investment. Domestic firms have more scope, however, to acquire foreign debt, as the central bank's new cross-border financing policy allows onshore firms to leverage up to twice their net assets. Contradictory signals, some ramping up foreign engagement and some curbing capital outflow, do nothing for investor confidence.

Going Global suffers from cognitive weaknesses as well. Zhao Lei 赵磊 Central Party School, bemoans the plethora of 'thoughtless' Belt and Road thinktanks. Often launched primarily to access earmarked funds, they are incapable of on-the-ground survey research; this is fundamental, Zhao insists, for understanding the regions they study. Neither they nor university departments do much to attenuate state media hype. Poor educational foundations make it difficult to adjust to other world views, critical to a global enterprise.

policy challenge

balance non-intervention with growing security needs

Belt and Road crosses many politically unstable territories, incurring threats of terrorism or regional rivalries. This is already straining China's traditional non-intervention policy, as human security grows as an issue for its firms and agencies overseas. A naval base under construction at Djibouti is a case in point of China becoming more proactive.

Increased political, even military, involvement will amplify fears as to China's strategic aims. India is sensitive about the CPEC, not least regarding projects in what it deems Pakistan-occupied Kashmir, or the possibility of a Chinese military presence that would protect the corridor. China's closer political and military ties with Central Asian countries, collaborating for example on counterterrorism, will likely upset Russia, for whom the region is a traditional sphere of influence and natural component of its own Eurasian Economic Community project.

Some recipient states are also uneasy about the implications of Chinese involvement in strategic sectors. The Hinkley deal (see case study above) was criticised on national security grounds, such as making the UK vulnerable to Chinese hacking, and was approved only when 'national security safeguards' were provided. China's acquisitions in technology, telecommunications, energy or air transport are sensitive. The Obama administration blocked Fujian Grand Chip Investment Fund from acquiring US assets of German semiconductor maker Aixtron due to national security concerns. The deal collapsed.

policy challenge

channel soft power from developing to developed world

Firms, especially in hardware, are increasingly reliant on Chinese capital, but overzealous investment, for example in Silicon Valley, risks rekindling the political divides that Going Global 2.0 set out to overcome. US politicians are already calling for a review of the role of CFIUS (Committee on Foreign Investment in the US), giving it more scope to block tech-related purchases. There is similar unease in Europe and Australia.

Consistent with its self-image as the 'leader of the developing world', China has a propensity to stump up credit for countries with poor governance, avoided by Western lenders. The losses are multiplying. China has lent Venezuela US$56 bn since 2007, but recent political turmoil makes defaults likely.

7 china solution: between ambition and capacity

Qin Hui 秦晖
Tsinghua University

Long recognised as an opinion leader, Qin Hui has supported left-liberal political causes since the 1980s, seeking to reconcile market economy with state welfare. Some ten years ago he concluded China's competitive advantage lay in its 'low human rights' providing 'low-cost labour'. Migrant labour, he argued, suppressed by the *hukou* (internal passport) system, was behind China's export economy, allowing it to out-compete the US and Europe, with stronger worker protections. When it comes to Going Global 2.0, he warns, 'we must think clearly'. He asks, 'what kind of China Solution do we really want? What kind of China Solution do we want to propose to the world?'

A series of world crises has bolstered Going Global's ambition as a truly global enterprise beyond mere industry and trade. Wars in the Middle East, and the global financial and refugee crises, brought windfall gains, opening space for China to stake its claim to create global public goods: stability and development. This picked up speed through 2016, as Brexit and Trump's election saw Western powers move to withdraw from global leadership.

The latest repackage of Going Global 2.0, the 'China Solution', became prominent at the G20 Summit in Hangzhou (September 2016), as the appeal of alternatives weakened. It was later reissued as a thoroughly global enterprise, with Xi Jinping making a powerful appeal to it at Davos in early 2017, presenting China as eager to step up to the plate vacated by the US under Trump. This smooth narrative is bolstered by the Party-state, which runs a powerful propaganda machine skilled in neutralising, compromising and intimidating critics within China, if not always outside it.

Yet vulnerabilities are left in open sight. Fundamental weaknesses are in part logistical: China's apparent wealth papers over deep inequalities and conflicts of interest, to say nothing of debt and the 'new normal' of slower economic growth. Cognitive conflicts and weaknesses run just as deep. Starting with partisan framing of its own historical and cultural record, the leadership paints the outside world in often simplistic terms, weakening China and Chinese firms' ability to deal with complex global realities. Rising so swiftly has left gaps between ambition and capacity in Going Global.

China Policy

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