



Statement before the
House Committee on Foreign Affairs
Subcommittee on Europe, Eurasia, Energy, and the Environment

***“China’s Expanding Influence in Europe and
Eurasia”***

A Testimony by:

Stephanie Segal

Deputy Director and Senior Fellow, Simon Chair in Political Economy,
Simon Chair in Political Economy

Center for Strategic and International Studies (CSIS)

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2167 Rayburn House Office Building

Introduction

Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee, thank you for the opportunity to contribute to today's discussion on China's expanding influence in Europe and Eurasia. I appreciate the opportunity to offer my perspective on this important topic.

As former United States Trade Representative Charlene Barshefsky and former U.S. National Security Advisor Stephen Hadley [wrote](#) recently about China's expanding footprint, "Since World War II, a bipartisan mainstay of United States foreign policy has been preventing the emergence of a leading hegemon on the Eurasian supercontinent, where most of the economic capacity and population of the world resides."

With those stakes in mind, my testimony will focus on Chinese investments in Europe and Eurasia, including in the context of China's Belt and Road Initiative (BRI), and the response of recipient countries as well as the European Union (EU). I will elaborate on areas where greater cooperation between Europe and the United States would be beneficial, focusing on investment as well as trade-related policies.

Macroeconomic Context

To orient the discussion, it's worth considering China's place in the global economy. China's gross domestic product (GDP), at over \$13 trillion, is second in the world only to the United States, while the 28 economies comprising the EU have a combined GDP of \$23 trillion. With China's economy growing above 6 percent annually according to official statistics, most analysts expect it to surpass the United States in size within a generation. In terms of purchasing power, China's economy is already the world's largest, having overtaken the United States earlier in the decade. China is also the world's largest trading economy, with exports and imports (goods and services) equal to \$5.2 trillion dollars or about 40 percent of GDP. While the data have established China as an economic giant for most of the 21st century, it's only in the past five years that attention has shifted to China's role as a strategic investor abroad, including in Europe.

China's foreign assets have been steady as a percent of its GDP; however, the composition of assets has changed. In particular, Chinese direct investment abroad has increased both in absolute terms and as a percent of China's foreign assets, growing by more than \$1 trillion from less than \$900 billion (14 percent of China's total foreign assets) in 2014 to \$1.9 trillion (26 percent of foreign assets) at the end of 2018. According to the International Monetary Fund (IMF), [foreign direct investment](#) is a category of cross-border investment associated with a resident in one economy having control or "a significant degree of influence" on the management of enterprise in another economy. (In statistical practice, ownership of equity by a direct investor that entitles it to 10 percent or more of the voting power is used to determine a significant degree of influence.) The changing composition of Chinese investment abroad, combined with factors detailed below, has stoked concerns about the motivations behind such investment.

China's Motivations

While China's "going out" strategy can be traced back to the reforms of Zhu Rongji in the late-1990s, Chinese outbound direct investment gained momentum following the 2008/09 Global Financial Crisis (GFC), as Chinese policymakers sought to diversify their external holdings away from U.S. Treasuries and government-backed securities. Whereas the post-GFC shift is generally understood to reflect a desire on the part of China to diversify risk and maximize returns, more recent initiatives under the leadership of President Xi Jinping have focused attention on possible strategic and geopolitical motivations. These include the launch of "One Belt One Road" in 2013; the creation of the Asian Infrastructure Investment Bank (AIIB) in 2014; and the release of "Made in China 2025" in 2015.

Belt and Road Initiative

Launched in 2013 as One Belt One Road (OBOR) and renamed Belt and Road Initiative (BRI) in 2016, BRI is China's most ambitious "going out" effort to date. According to Chinese state media, over [125 countries](#) have signed BRI cooperation documents. In April, Italy became the first Group of 7 (G-7) country to sign-on to the BRI, while its incorporation into the Communist Party Constitution in 2017 underscores the importance President Xi places on the initiative. Given the fragmented nature of projects under BRI, it has been difficult to estimate the total capital invested in BRI projects. Data provided in the U.S.-China Economic and Security Review Commission's 2018 [report](#) suggest that BRI equity and debt funding topped half a trillion dollars through end-2017, coming from a mix of Chinese policy banks, Chinese state-owned commercial banks, the Silk Road Fund, as well as the multilateral AIIB and New Development Bank (NDB). Last month, People's Bank of China (PBOC) Governor Yi Gang [estimated](#) that Chinese financial institutions have provided more than \$440 billion for BRI, while Chinese capital markets provided another RMB500 billion (\$87 billion) in equity financing for BRI projects.

To date, European interests under BRI are most directly implicated in Central and Eastern Europe. Through its "16+1 format," initiated in 2012 and recently expanded to "17+1" with Greece's participation, China has increased its activities in the region. According to CSIS data collected before the group's most recent meeting, 70 percent of China's announced deals have been in non-EU member states even though they make up only 5 of the 16 (now 17) participants and only 6 percent of the group's collective GDP. This disparity reflects the higher bar that Chinese firms face within the EU, where procurement and environmental standards are higher and alternative sources of investment are more abundant.

In the longer term, Europe's interests may also be impacted by the New Eurasia Land Bridge (NELB) Corridor, and to a lesser extent, the China-Central Asia-West Asia Economic Corridor (CCWAEC), two of six geographic corridors under the BRI. However, [analysis](#) conducted by CSIS's Reconnecting Asia project last year found no significant relationship between corridor participation and project activity, with the exception of the China-Pakistan Economic Corridor. While five years may be too early to judge the results of a longer-term effort, the analysis underscores the challenges of capital deployment and project completion for infrastructure investing, notwithstanding Chinese involvement.

It is possible that BRI projects will ultimately deliver economic benefits to recipient countries; however, in addition to the modest tangible results suggested by the analysis to-date, criticism of the BRI has mounted particularly in the areas of transparency and debt sustainability. One

cautionary example is Montenegro, the most recent country to join the North Atlantic Treaty Organization (NATO), which has taken on a Chinese-financed [highway](#) project that has sent its debt soaring and could allow China to access land as collateral. Individual countries, as well as the European Commission and [international financial institutions](#) have called on China to develop “a clearer overarching framework governing BRI investment, better coordination and oversight, more focus on debt sustainability of the partner countries, and a transparent mechanism for dealing with project disputes, non-performance and debt service problems, as well as more open procurement and greater transparency over contracts.”

That collective response implies that the first phase of BRI – one characterized by speed, scale and easy access to financing with few visible conditions attached – is likely over. At last month’s Belt and Road Forum in Beijing, Chinese officials addressed criticisms dogging BRI projects, including charges of corruption and privileged treatment of Chinese companies on BRI projects. PBOC Governor Yi Gang [announced](#) that China will henceforth “let the market play a major role” and called on various stakeholders to “work together” to finance the BRI. China’s revised approach may well make traditional obstacles to infrastructure investment more binding in the BRI context. Attracting third party investment will require enhanced disclosures and improved project transparency, including of financing terms, and should also force more disciplined decisions on the part of creditors and investors. Of course, these promises will require further monitoring.

Made in China 2025 and its Aftermath

When announced in 2015, Made in China 2025 (MiC 2025) aimed to upgrade China’s economy and establish it as a global leader in various innovation industries. Unlike BRI, which aims to project Chinese influence outward, MiC 2025 focused domestically and included date-specific targets for the domestic content of certain products sold in China. The program sought to strengthen China’s competitive position in sectors such as next-generation information technology and advanced robotics through domestic supports as well as technological acquisition. A [report](#) from the Council on Foreign Relations in March notes that Chinese companies, both private and state-backed, have been encouraged to invest in foreign companies to gain access to advanced technology, while much of Chinese investment abroad is directed by state-owned enterprises or companies backed by the Chinese government.

In response to external pressure including from the United States and Europe, China seems to have [abandoned](#) the formal MiC 2025 slogan earlier this year. However, there is little doubt that China will continue to prioritize domestic innovation, not least to reduce its reliance on imports of advanced technology.

The 2014 acquisition of German robotics company KUKA is widely seen as a wake-up call to German industry as well as policymakers across Europe with regards to MiC 2025 and China’s strategic ambitions. Since KUKA’s acquisition by Chinese electrical appliances company Midea, and the subsequent dismissal of KUKA’s Chief Executive Officer in 2018, concern has been building in Europe that Chinese investment may ultimately undermine European companies as China acquires the capacity to domestically produce the high-end components it previously imported. In addition, there is concern that China, with its protected market and access to state support, will be able to compete on non-market terms, thereby taking global market share and

driving foreign competitors out of business. Critics of China point to Chinese overproduction in steel and solar panels as examples of China's strategy to dominate global markets which could play out again in high tech sectors.

Europe's "Calibrated" Response

Europe's unique governance structure – with national security authorities vested in individual EU member states but much of the capacity to track trends and protect the integrity of the single market residing in Brussels – presents a unique challenge and distinguishes EU members from other countries in Eurasia. Notwithstanding significant efforts to take a more consistent approach to China, it remains to be seen if Europe can maintain a unified front, a point underscored by Italy's recently announced participation in BRI, Greece's membership in "16+1" and ongoing discussions related to next generation (5G) communications networks. Having said that, in recent months Europe has sharpened its approach towards China while maintaining constructive engagement in areas of common interest.

EU-China Strategic Outlook

In March of this year, the European Commission (EC) delivered a [Strategic Outlook](#) to the European Parliament and European Council ahead of President Xi's visit in April. The report references "a growing appreciation in Europe that the balance of challenges and opportunities presented by China has shifted." It calls on China to accept greater responsibility for upholding the rules-based international order, as well as greater reciprocity, non-discrimination and openness of its system. It also calls for a calibrated approach to China which would simultaneously deepen engagement to promote common interests; seek more balanced and reciprocal conditions governing the economic relationship; and strengthen Europe's own domestic policies and industrial base.

Most significantly, the report refers to China as "an economic competitor;" and a "systemic rival promoting alternative models of governance", echoing language from the [National Security Strategy](#) (NSS) of the United States which refers to "competitors such as China" and calls out China's ambitions to "expand the reaches of its state-driven economic model". It also warns that China is gaining a strategic foothold in Europe by expanding unfair trade practices and investing in key industries, sensitive technologies, and infrastructure; and it commits the United States to working with allies and partners to contest China's unfair trade and economic practices and restrict its acquisition of sensitive technologies. Overall, the language in the EC's Strategic Outlook represents a meaningful departure from the [Joint Statement](#) of the 20th EU-China Summit in 2018, which sought synergies between BRI and the EU and marked the 20th Anniversary of the EU-China Science and Technology Cooperation Agreement.

Investment Screening

A new EU-wide foreign investment screening mechanism entered into force in April and will be fully applied starting in November 2020. The final decision to allow or not a foreign investment will remain with the individual member states; however, the EU mechanism mandates information sharing in certain circumstances, which in turn incentivizes all EU members to develop the capacity to review transactions. In addition to the EU-wide reform, some EU members with established mechanisms have recently tightened them, reflecting concerns

stemming from Chinese as well as Russian investment. A joint [report](#) from the Mercator Institute for China Studies and the Rhodium Group found that Chinese investment in Europe declined again in 2018 after peaking in 2016 due in part to greater regulatory scrutiny in recipient countries as well as conditions in China.

Given the nature of the potential national security threat and focus on cutting-edge and dual-use technologies, coordination among U.S. allies and partners is essential to ensure potentially problematic investments are not simply diverted from one economy to another. Such cooperation can take the form of greater information sharing, including of classified intelligence as well as privileged company information, but only under strict conditions that protect the confidential nature of information shared.

Export Controls

With the investment screening mechanism now in place, focus has shifted to the adequacy of export controls to address potential risks from “outbound investment,” namely the sale or licensing of technology or other sensitive information. While multilateral regimes already exist to control certain items (e.g., nuclear technology) on a multilateral basis, emerging technologies are too new to appear on existing control lists. Delays in listing and controlling a technology can pose a potential national security risk; while a decision to control a technology absent coordination with other countries is likely to be ineffective. As indicated in the EC’s Strategic Outlook, European policymakers are considering modalities to address national security risks stemming from “outbound” investment and emerging technologies in particular to address the challenges of different jurisdictions between member states, the EU, and other advanced technology exporting economies.

World Trade Organization Reform

Europeans are outspoken in their support for multilateralism, which they fear is under threat from China and its distortive industrial policies as well as from the United States and its “America First” policies. U.S. reliance on questionable national security rationales for the imposition of tariffs including on U.S. allies undermines trust in the United States as a reliable partner. China has capitalized on U.S. rhetoric and actions, positioning itself as the unlikely champion of globalization. China’s ability to portray itself as globalization’s defender extends beyond trade. As just one example from last month’s BRI Forum, the PBOC’s Yi Gang asserted that “while the BRI originates from China, its opportunities and results belong to the world.” To reset the narrative, the United States should remove steel and aluminum tariffs imposed under Section 232 and end the threat of new 232 tariffs on autos and auto parts, especially on U.S. allies and partners.

Europe appears committed to working with China on WTO reform while at the same time calling on China to endorse and adhere to stronger disciplines on industrial subsidies. Alongside these efforts, Europe should continue working in the trilateral context with Japan and the United States to advance reform; and should be open to sectoral arrangements, for instance in digital trade, as the best way forward. Europe, the United States and other allies and partners should keep reciprocity on the table, mindful of the costs and benefits of such an approach. Unified pressure, for instance on China’s self-declaration as a “developing country” and failure to notify all subsidies may be the most effective way forward.

Cooperation is Key

Cooperation between the United States, Europe and other like-minded countries will maximize the chances of shaping China's behavior and protecting U.S. interests. There are reasons to believe that unified approaches, including pressure on China, can work (see for example, changes announced at the Belt and Road Forum to "ensure debt sustainability"). A unified and consistent approach could also yield results on difficult issues such as Chinese membership in the Paris Club and data disclosure, as reformers in China may well see such actions as also in China's best interest.

At the same time, we should be realistic about the limitations of external pressure to shape China's actions. China will not act in a way that it believes to be counter to its interests. Cooperation on these issues – for instance, disciplining China's behavior in the areas of subsidies, self-designation and even digital trade – is not only desirable but essential in terms of shaping global outcomes.

Again, I thank the Subcommittee for the opportunity to offer these thoughts, and I look forward to answering Members' questions.