http://thediplomat.com/2016/11/china-and-gemany-the-honeymoon-is-over/

China and Germany: The Honeymoon Is Over

A visit to China by Germany's economics minister highlighted a blunter approach to bilateral relations.

By Klaus Larres
November 16, 2016

The prolonged honeymoon between China and Germany has come to an abrupt halt. In Berlin awareness has grown that Beijing has moved from being an economic partner to a serious global competitor. German economics minister Sigmar Gabriel's recent visit to China came in the middle of an atmosphere of crisis in German-Chinese economic relations. Instead of attempting to improve matters, however, Gabriel set out to teach the Chinese a lesson. Whether it is a wise and forward-looking strategy to deal in such a blustering way with the "800 pound gorilla" in Beijing remains to be seen.

Gabriel is not just Germany's economics minister and vice chancellor, he also is chairman of the Social Democratic Party (SPD) and the party's possible candidate for chancellor. The German general elections will take place in September or October next year. It appears that Gabriel's tough and rather undiplomatic talk in Beijing and Chengdu had quite a lot to do with the German domestic scene and the forthcoming elections, rather than with a considered new foreign policy strategy. Gabriel's SPD, after all, has plummeted to 22 percent in recent polls while Chancellor Angela Merkel's party, its senior coalition partner, is still at 34 percent. The economics ministry insisted, however, that Gabriel's strategy in China was closely coordinated with the chancellor and the Foreign Ministry.

It is true that Berlin's disillusionment with China has been obvious for some time now. What was once applauded as an emerging German-Chinese "special relationship" has turned into a much less happy association, at least at the level of policymakers and leading industrialists. According to the OECD, China is by far the most restrictive industrial country in the world. Unlike the freedom of maneuver Chinese companies enjoy in the West, foreign firms in China are not allowed, for instance, to invest in the banking, telecommunication, or media industries. Public tenders usually are awarded to Chinese companies rather than to foreign ones.

Just prior to Gabriel's visit the situation was not helped when Germany's EU Commissioner Guenter Oettinger made derogatory remarks about the Chinese in a speech in Hamburg. While Oettinger, who is known for his silly gaffes, later apologized, policymakers in Beijing were not amused.

China's Investment Binge in Germany

In Berlin, China's recent investment drive has led to much concern. In the first half of 2016 alone Chinese investment funds have bought more than 40 German companies and also made six minority-stake investments. In fact 17 percent of all of China's investments abroad since 2010 have targeted Germany. Worldwide in the first six months of 2016 China purchased more foreign companies than during the entire course of 2014. China invested €72 billion ($77 billion) within the EU in the same period of time, including €11.3 billion ($12.1 billion) in Germany. This was eight times the level of purchases in 2015.

Most of the German firms the Chinese acquired are at the cutting edge of the latest engineering and computer technology and their purchases provide China with much needed technical knowhow. This past summer the purchase of high-tech robotics firm Kuka by the Chinese company Midea, the country's largest manufacturer of household goods, caused much soul-searching in Germany. Berlin became seriously concerned that important technological knowledge was being handed over to an ever-more aggressive economic competitor. The government's attempt to persuade German or European companies to make a good counter-offer came to nothing; the Chinese offer proved to be unbeatable.

Just a few weeks ago, spurred on by American concern, the German government suddenly developed second thoughts about the offer of Fujian Grand Chip Investment Fund (FGC) to purchase Aixtron, a highly specialized German chip company that manufactures metalorganic chemical vapor deposition (MOCVD) equipment for the semiconductor industry with production sites in Germany, Britain, and California. Most of its customers are in Asia. After having already issued the required "certificate of unobjectability," the economics ministry withdrew the certificate to examine the purchase further. Apparently it was the CIA which alerted Berlin to the fact that Aixtron's expertise had security implications and that militarily important technology ought not to fall into Chinese hands.

In view of the fact that since the early 1980s Aixtron products have been sold to semiconductor industries globally (including China), some analysts are wondering whether the United States was perhaps above all concerned about the resulting strengthening of Chinese economic competition in the semiconductor production field, if Aixtron were to be sold to China. Gabriel's economics ministry also signaled its discomfort about the interest of the Chinese regarding the purchase of the lighting lamps business Ledvance, a subsidiary of Osram, and perhaps even of Osram itself. The long-serving Chinese ambassador in Berlin, Shi Mingde, voiced his "concern." In an article for the *Frankfurter Allgemeine Zeitung* he outlined that "this was no way to treat a partner." He feared new protectionist tendencies in Germany. The *Global Times*, one of the mouthpieces of the Chinese state, expressed the hope that Gabriel's visit would provide the minister with a much greater understanding of China.

For Gabriel, his long-arranged visit to China seemed to be a good opportunity to make a big splash. In an interview in Berlin and in a subsequent newspaper article published in *Die Welt* just days before his journey, he reminded the Chinese that international trade relations were all about a "level playing field" and "fair competition." Everyone needs to observe the "rules for investments, market access and competition," he explained. Germany and Europe were not prepared to accept the "foul play" of trade partners. In particular, Gabriel referred to China's dumping policy regarding steel and aluminum and discriminatory market access practices with respect to the important car industry.

He also expressed deep concern about China's investment binge in Europe. While foreign investors were very welcome in Germany, his country was worried, he explained, if "a state-dominated company wishes to combine the appropriation of technology with the geopolitical expansion of power." These were clearly very strong words. But according to the minister, disputes need to be talked about openly and clearly. "No one takes cowards or cajolery seriously," Gabriel said, defending his rather robust attitude.

Gabriel also warned both sides not to escalate economic conflicts as no one would benefit from trade wars. He expressed his full understanding "that China doesn't want to be an extended workbench but wants to create its own value and technology," as is the substance of Beijing's industrial development program "Made in China 2025." Within a matter of years Chinese technology companies plan to be among the world's leading firms. By 2049, on the 100th anniversary of the establishment of the People's Republic, the country intends to be one of the globe's leading industrial powers. It is obvious that this will only be possible by means of the purchase of technological knowhow and high-tech companies. Indeed Xi Jinping's grand and ambitious "One Belt, One Road" initiative has very much the same objective.

Despite the benefits of China's investment spree for German jobs and R&D funding, the Germans feel that they are being taken advantage of. "Fair rules" that "regulate investment, market access, and competition that all parties adhere to are a precondition for trade growth," Gabriel believes. China goes shopping in Europe "with a long list of purchasing strategically important key industrial technology," he wrote, but it is important that "we must prevent a new wave of protectionism." This, however, cannot be achieved "by accepting and adapting to unfair and aggressive trade practices."

Gabriel admonished the Chinese that it was one of the great tasks of our age to realize "a new era of free trade policy" which is based "on fairness and social standards." In fact the German economics ministry has begun working on the concept for a new industrial policy that perhaps will serve eventually as an EU-wide approach to make it legally possible to prevent company take-overs if they are politically influenced or subsidized by a foreign state.

A New Chill: Merkel's Visit to China

It would be wrong to fault Gabriel personally for the deterioration of German-Chinese relations. In fact during Chancellor Merkel's ninth official visit to China in June 2016, things went less well than in previous years. Merkel's visit to China, in the context of the Chinese-German governmental consultations, turned out to be unexpectedly difficult. It became apparent that a faint chill had descended on the bilateral relationship. While both sides were highly interested in further economic cooperation and a number of substantial economic deals were indeed concluded, many other issues proved to be contentious. Throughout her visit Merkel emphasized the importance of the long-standing German-Chinese dialogues on human rights and the rule of law, which Beijing, however, has come to view as of only marginal importance. Instead the Chinese were much more interested in Merkel's support for obtaining Market Economy Status from the EU within the WTO framework, as envisaged 15 years ago when China joined the organization, but this the chancellor could not offer. Similarly Merkel's repeated insistence on reciprocity in market access for German companies in China were acknowledged and then largely ignored by her hosts.

While in public both sides made great efforts to portray relations as friendly as always, below the surface things went much less smoothly than during Merkel's previous eight official visits to China. Merkel's large delegation, consisting of six cabinet ministers, five deputy ministers, numerous officials, and a sizable number of CEOs, became quickly aware that this time the meetings were characterized by a somewhat different atmosphere. The Germans were faced with a testy and overly self-confident, if not at times abrasive and arrogant, Chinese leadership. This became particularly obvious, for instance, when during a press conference in the Great Hall in Beijing Chinese Prime Minister Li Keqiang took it upon himself to answer a reporter's question about the South China Sea conflict that had been addressed to Merkel. He indicated that with his answer that the theme had been exhausted.

This was too much even for the ever polite chancellor, who replied not without a certain sharpness that she wanted to take the liberty to say something herself about the issue. Merkel managed to defuse the tense situation when Li wanted to take over again by adding with a laugh, "I simply say what I like." With this disarming strategy both sides eventually could refer to a friendly and productive atmosphere in the final communique of Merkel's ninth visit to China as chancellor last June.

Taking on the "800-Pound Gorilla"

By contrast, economics minister Sigmar Gabriel, with his 60-strong entourage of officials and a large number of CEOs and managers, did not want to embark on a charm offensive in China. He wanted to prove to himself, the German voters, and indeed to the Chinese that he could be as tough as anyone to defend Germany's economic interests. Luckily the agenda for his visit to

China did not foresee the signing of any concrete economic deals, for the Chinese were more than displeased with Gabriel's frank words.

Even before his plane had touched down in Beijing, two influential politicians, including an important adviser to President Xi Jinping, had canceled their appointments with the economics minister. Moreover, the day before Gabriel's arrival, the minister (deputy ambassador) at the German embassy in Beijing was called to the Foreign Ministry and presented with a complaint about the handling of the Aixtron purchase and negative German media reports.

On the first day of his visit, Gabriel and Chinese Commerce Minister Gao Hucheng met over a small luncheon. The discussion took place in "a good atmosphere," both sides emphasized, but the talks were also "very frank and controversial."

"We didn't mince our words – on either side," Gabriel later told journalists. In fact, the conversation was so frank and blunt that the Chinese minister decided not to attend the meeting of the influential German-Chinese economic commission of industrialists where he and Gabriel had been slated to make the opening statements. Gabriel had no choice but to also cancel his participation.

Both ministers announced that this was due to a lack of time rather than any rumored disputes. Their bilateral conversation had lasted longer than anticipated, it was claimed. Yet vice minister Gao Yan, who stood in for Gao Hucheng at the meeting of the economic commission, did not hold back. In her opening statement she referred to rising protectionism in Germany and to a growing hostility to investments and globalization.

Gabriel's subsequent half-hour meeting with Prime Minister Li Keqiang went ahead as scheduled, however. This clearly was an indication that Beijing did not wish to escalate the conflict with the Germans. Li promised to resolve the controversy regarding the dumping of Chinese steel products on Western markets but also expressed his confidence that the EU would soon grant China full Market Economy Status. However, Li was merely reiterating past assurances. Already the G20 summit in Hangzhou in early September had agreed that both steel overcapacity and steel subsidies were a global problem that distorted international markets and needed to be resolved cooperatively. A "Global Forum" was established for this purpose.

Gabriel's talk with industry minister Miao Wei was characterized by the same mixture of politeness and open words. Miao assured Gabriel that the vehicles of German car manufacturers that were produced in China would be treated just the same as cars manufactured by Chinese companies. Persistent rumors about the introduction of a discriminatory percentage quota for "new energy vehicles" that applied to German car manufactures in China were false, he emphasized.

But it was unmistakable: all of Gabriel's Chinese interlocutors were highly displeased by the German minister's unusually frank words. Yet no one wanted to make matters even worse. While China is Germany's fourth largest trading partner, Germany is also a highly important market and technology partner for China. Still, the Chinese media all but ignored Gabriel's criticism. Very few newspapers even informed the Chinese public that the minister was in the country. Nevertheless, as a token of goodwill the official Chinese news agency *Xinhua* announced during Gabriel's visit that the German deputy ambassador, in fact, had never been called to the Foreign Ministry for a dressing-down.

Gabriel Has a Point

While Gabriel's "gorilla diplomacy" was characterized by a lack of finesse and subtlety, substance-wise he was not wrong. In their heart of hearts Bejing may well have realized this.

China's investment strategy in the Western world is indeed targeted at obtaining technological knowhow China is unable to develop itself. Moreover, many of the investment funds and companies that are looking for purchases in the Western world enjoy the massive political and financial support of the Chinese state. This gives them a huge advantage when it comes to making competitive offers and beating rival offers in the process (though often rival offers don't even materialize). Increasingly countries such as Germany are waking up to this fact and putting up resistance.

At the same time, there is a huge gap of reciprocity in market access. While the Chinese can invest almost freely in Western markets and obtain companies such as Kuka and others, the Chinese authorities do not allow the purchase of high-technology Chinese firms by German and other Western companies. German car companies, for instance, are forced to enter into joint ventures if they wish to invest in the automobile sector in China. Further, they can't even choose their Chinese venture partners themselves and they are not allowed to be the majority shareholder, either. Some market sectors, such as the financial service industry, telecommunications, and the media, are entirely closed to Western companies. Other initiatives necessitate obtaining prior investments certificates by means of complex and quite discriminatory procedures. Although some improvements have been made, the infringement of intellectual property rights and patents still pose a problem for German and Western companies who wish to invest in China and are usually required to set up factories in the country.

Finally, the continued dumping of cheap Chinese steel and aluminum into Western markets clearly violates market rules and is a significant hindrance to the EU offering China Market Economy Status.

Thus, there is enormous room for improvement regarding German-Chinese business relations. The good thing is that neither side is interested in the escalation of the conflict. The German economics minister emphasized this in his statement at the Asia-Pacific Conference of German Business in Hong Kong, with which he concluded his visit to China. Perhaps Gabriel's visit has thus contributed to a cleansing of the atmosphere. It may well lead to a more energetic effort on both sides to reconcile their economic differences.

In Germany, Gabriel's visit was regarded as a partial success. He was applauded as someone who had shown "courage" and "stamina" when dealing with Germany's most formidable trading partner. And Gabriel's insistence on meeting with human rights advocates and lawyers and other intellectuals during his visit was also much appreciated by the German public.

What was not discussed in the media reports during and after Gabriel's visit was Germany's long-term strategy of how to deal with China in the future. In 2016, China still serves as a huge (though shrinking) market for German high-tech products. Soon China will manufacture an ever-increasing number of these innovative, cutting-edge products itself, be it luxury cars, pharmaceuticals, or high-tech manufacturing equipment. How is Germany (and indeed, how is the West) going to deal with this huge challenge? This ought to be discussed as a matter of urgency. Media reports that focus on canceled meetings and whether or not ministerial conversations were conducted in a tense or friendly way may be entertaining but rather distract from the essentials of German-Chinese relations.