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Marriage of convenience

In China, business and politics are strongly intertwined. But how successful is the country's unusual economic model?

We are living through a period of historic global upheaval. After the Second World War, a set of economic and political structures emerged that afforded a dominant status to Western industrialised nations, especially the USA. These structures are now undergoing a fundamental transformation. In recent decades, an interconnected economy has expanded to almost every corner of the globe. Countries have abolished national trade and investment barriers, allowing capital to move freely. This has enabled companies to build international value chains, to outsource production to low-cost developing countries, and to develop global sales strategies.

Former developing countries, especially in Asia, have successfully integrated into this globalised economy. Meanwhile Western industrial nations are anxious, fearing a loss of status in the world order. The American president Donald Trump wants the USA to withdraw from the global free trade economy. The Chinese president Xi Jinping, by contrast, announced a 'glorious' new phase of globalisation at May's International Silk Road Conference in Beijing.

Following Communist Party chairman Deng Xiaoping's reforms in eighties, China became the poster child for economic development. In just three decades, the People's Republic went from being poor and isolated to the world's second-largest economy. And whilst China was once primarily on the receiving end of foreign capital, its companies are now investing all around the world. The list of Chinese acquisitions is long, and includes companies of all sizes and from every sector.

China's foreign spending spree

The first wave of Chinese overseas investment focused on natural resource extraction in developing countries. Chinese investors have since turned their attention to developed markets in industrialised nations.

The open European market has become a particular target for Chinese investment. Back home, however, China places tight restrictions on foreign investment in its own markets. There are growing calls for fairer competition.

To understand the debate properly we need to delve into China's political and economic system. China sees itself as a socialist market economy ‘with Chinese characteristics’. The People's Republic was accepted into the World Trade Organisation in December 2001. During the subsequent 15-year transition period, it carried out a series of reforms aimed at turning it into a liberalised market economy. Doing so without endangering political stability has been a significant challenge for a country with 1.4 billion inhabitants living in extremely varied circumstances. Now that this transitional period is over, the Chinese government is insistent China should be recognised as a market economy by European governments and the USA, in accordance with WTO rules.

The Chinese government continues to exert considerable influence on economic and social development, in particular through its five-year plans that give political and economic guidance to businesses, and to national and regional authorities. This does not make China a planned economy. Competition plays an important role in Chinese society. Even primary school children compete with their peers to get into the best secondary schools.

There is also competition in the world of politics. Politicians rise to national leadership positions by achieving success as party functionaries or administrators at local and regional level. Due to the size and variety of this enormous country, there are significant differences between politics in different provinces. At local level, special economic zones and approved pilot projects make it possible to try out new ideas, privatise state-owned companies, incentivise the founding of private companies or allow international investment in restricted sectors. When Hong Kong returned to Chinese sovereignty in 1997, China found itself in possession of a long-established international financial centre that was closely enmeshed in the global economy. The principle of ‘one country, two systems’ has been practised ever since.

So the first hallmark of the Chinese economic system is legal and administrative diversity. The second hallmark is a close intertwining of business and politics on the basis of a national development strategy.

Stepping up a gear

Take the car industry, where foreign companies may participate in the rapidly growing market, but only if they invest in China and set up a joint venture with a Chinese partner. They cannot hold a majority stake in Chinese companies. Production must be carried out locally, resulting in technology transfer and the development of a local supply infrastructure.

The government steers technological development in areas such as e-mobility by providing funding and setting quantitative targets. It also helps Chinese companies acquire majority or minority stakes in foreign competitors (Volvo is an example of the former, Peugeot of the latter). This strategy has borne fruit: the quality, attractiveness and market share of Chinese-made cars have all increased significantly.

China’s industrial policy has been especially effective in the IT, internet and communications sectors. A combination of state aid and restrictions on foreign competitors' access to the Chinese market has allowed Chinese companies to break into the top international tier. Huawei now has 170,000 employees in over 120 countries, and has overtaken Ericsson as Europe's market leader for telecommunications infrastructure. Alongside Apple and Samsung, the company is one of the world's largest smartphone manufacturers. Other success stories of Chinese industrial policy include Alibaba, Baidu (a rival to Google) and the internet company Tencent. Such is the Chinese market's importance that even major international players such as Apple submit to Chinese rules.

China cannot be expected to give up its successful economic and social model. The international situation has changed, and it is no longer viable to cling to a naive free market philosophy that insists on China privatising state-owned companies and refraining from state intervention in the economy.

International competition doesn't just exist between companies. In the global economy of the 21st century, it also exists between political and regulatory systems. And that's not just true in China. The US Government also exerts a massive influence on the economy through public procurement, military research expenditure and security checks on foreign investment.

European policymakers need to adapt to this competition between political systems. They also need to learn from the successes of the Chinese model. The answer can't be isolation and national protectionism. Rather, we need to develop structures at national and European level that are capable of withstanding this intersystem

competition. The only way to secure long-term competitiveness is through successful collaboration between government bodies, universities and companies.

We need integrated policies that coordinate education, research, public procurement, entrepreneurship training, funding for private and public investment, industry standards, competition regulations and legislation on social security and the environment. In many areas, it will be necessary to build on Europe-wide rules within the framework of the single market.

It is not a matter of creating a master plan that predicts social and technological developments. Rather, we need to develop a European industrial policy that increases planning certainty for private investment and state intervention. Access to the European single market must be used as a bargaining chip in international negotiations to secure equal competitive conditions for European companies in foreign markets.

There has been some progress. In June, Germany made an amendment to its Foreign Trade and Payments Ordinance that allows foreign acquisitions to be blocked if they threaten German security interests. At European level, there has been increased willingness (especially since the UK's Brexit vote) to give the EU greater power over foreign trade. In September, European Commission president Jean-Claude Juncker proposed increased coordination of national processes and the screening of sensitive foreign investments by the Commission. If adopted, these proposals would strengthen the Commission's hand in its on-going negotiations with China over an investment agreement.



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