



August 2016

Bernhard Bartsch

The End of Panda Politics

Germany enjoys a special relationship with China – for now. The more political and economic competition that takes place between them, the more Germany will have to prepare for conflicts. Yet the instruments Germany has at its disposal for achieving its considerable interests have often been weak at best.

Somewhere in the west of China, in the bamboo forests of Sichuan Province, two pandas are being readied for their journey to Germany. The animals are to accompany Chinese President Xi Jinping when he visits Berlin next year, serving as goodwill ambassadors in the city's zoo. Everyone loves pandas: They are cute, vulnerable, peaceful and vegan. Policy makers in Beijing would like nothing more than if the world were to feel for the entire country the kind of sympathy it accords China's national animal. "Panda diplomacy" has therefore long been a part of the country's soft-power portfolio.

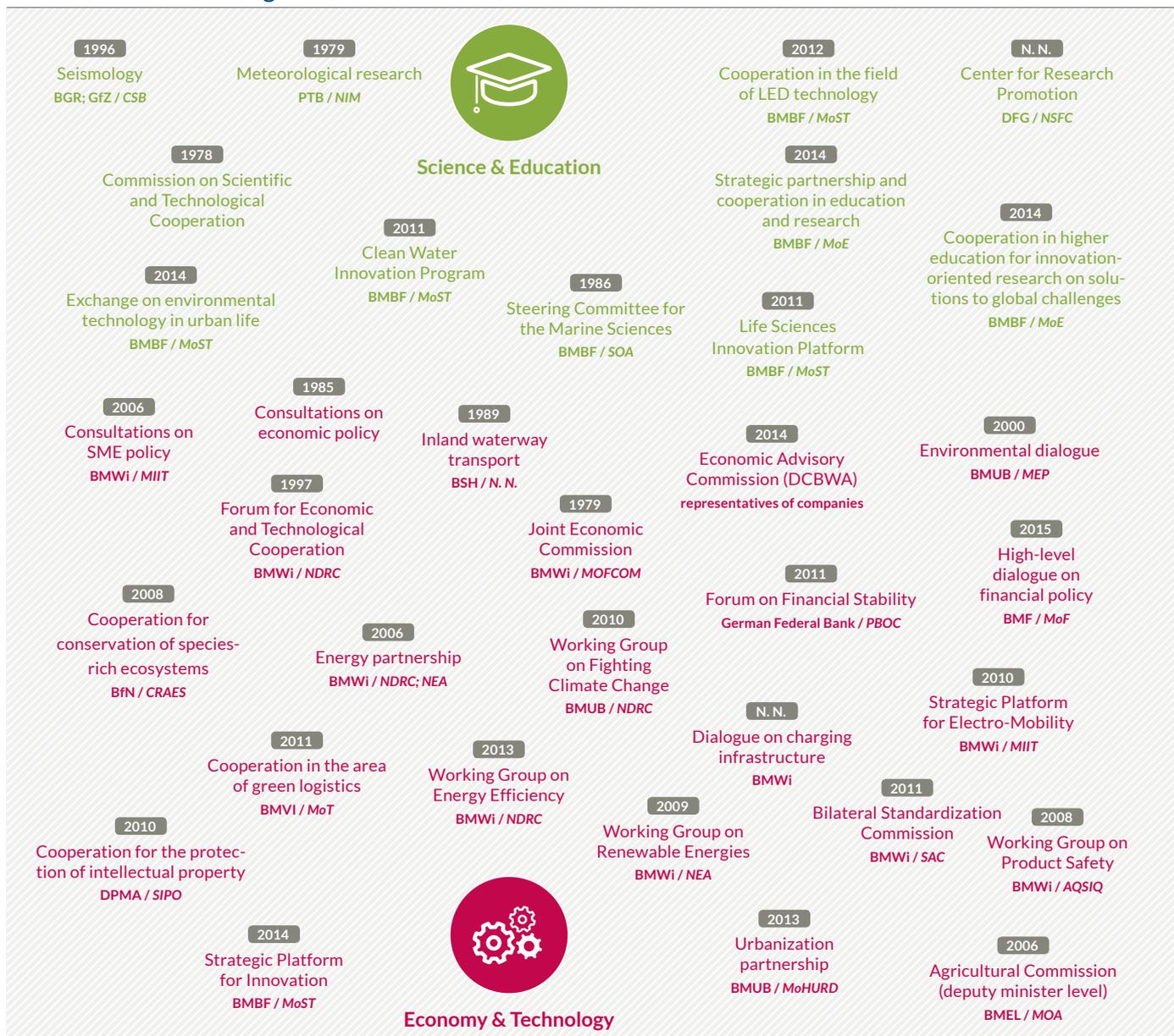
Not only are the creatures highly symbolic, so are the arduous negotiations that have been preceding their dispatch. Germany's first pandas were simply a

state gift, given to then Chancellor Helmut Schmidt in 1980. Their successors, however, have required many years of detailed discussion at the highest levels in order to address the many political conditions, the legal framework and the considerable sums of money involved. (This time the pandas are not a gift from China, but are being lent to Germany as part of a specially organized bilateral research project).

The pandas are the warm and fuzzy part of German-Chinese relations. In other areas, the contact is becoming less pleasant, a development that Germany's politicians and business community are observing with growing unease. For many years the relationship was reciprocal: Germany's innovative power and China's modernization complemented each other perfectly. Now, however, there is a greater awareness of the economic and political competition between the two nations – and of the conflicts that could result.

Bernhard Bartsch is Senior Expert in the Bertelsmann Stiftung's Germany and Asia program.

German-Chinese Dialogue Mechanisms



List of Abbreviations

Germany:

AA – Federal Foreign Office
 BAKS – Federal Academy for Security Policy
 BGR – Federal Institute for Geosciences and Natural Resources
 BMAS – Federal Ministry of Labor and Social Affairs
 BMBF – Federal Ministry of Education and Research
 BMUB – Federal Ministry of Environment, Nature Conservation, Building and Nuclear Safety
 BMEL – Federal Ministry of Food and Agriculture
 BMFSFJ – Federal Ministry of Family Affairs, Senior Citizens, Women and Youth
 BMG – Federal Ministry of Health
 BMI – Federal Ministry of the Interior
 BMJV – Federal Ministry of Justice and Consumer Protection
 BMVg – Federal Ministry of Defense

BMVI – Federal Ministry of Transport and Digital Infrastructure
 BMWi – Federal Ministry of Economic Affairs and Energy
 BSH – Federal Maritime and Hydrographic Agency
 BfN – Federal Agency for Nature Conservation
 DAAD – German Academic Exchange Service
 GFZ – Federal Agency for Nature Conservation
 DFG – German Research Association
 DPMA – German Patent and Trade Mark Office
 PTB – National Metrology Institute of Germany
 SPD – Social Democratic Party of Germany

China:

ACYF – All-China Youth Federation
 AQSIQ – General Administration of Quality Supervision, Inspection and Quarantine

Source: own presentation



Policy & Administration



Culture & Society

CASS – Chinese Academy of Social Sciences
 CPC – Communist Party of China
 CRAES – Chinese Research Academy of Environmental Sciences
 CSB – Chinese Seismic Bureau
 LAO – Legislative Affairs Office of the State Council, P. R. China
 MEP – Ministry of Environmental Protection
 MIIT – Ministry of Industry and Information Technology
 MOA – Ministry of Agriculture
 MOD – Ministry of National Defence
 MoE – Ministry of Education
 MoF – Ministry of Finance
 MOFCOM – Ministry of Commerce
 MoH – Ministry of Health
 MoHRSS – Ministry of Human Resources and Social Security
 MoHURD – Ministry of Housing and Urban-Rural Development

MoST – Ministry of Science and Technology
 MoT – Ministry of Transport
 MPS – Ministry of Public Security
 NDRC – National Development and Reform Commission
 NEA – National Energy Administration
 NIM – China International Institute of Metrology
 NPC – National People's Congress
 NSFC – National Natural Science Foundation of China
 PBOC – People's Bank of China (Zentralbank)
 SAC – Standardization Administration
 SIPO – State Intellectual Property Office of China
 SOA – State Oceanic Administration

Diplomacy and well-functioning business partnerships demand that discord be avoided if at all possible – and for good reason. Yet when they are able to speak freely, Germany's managers and politicians are now asking how much longer they can count on German-Chinese relations remaining harmonious and how Germany should position itself vis-à-vis China in the future. Until now, the instruments available for serving Germany's considerable interests have often been weak at best.

Special relationship with cracks

Germany still enjoys a special relationship with China. Each country plays a key role for the other politically and economically. No other European nation has more extensive ties to China. The two countries jointly organize more than 60 programs and events for promoting dialogue (see Figure 1). Their government consultations are the most prominent among them. As part of the consultations, German Chancellor Angela Merkel traveled to Beijing in June, accompanied by six cabinet members and five secretaries of state. Germany is the only country with which China regularly holds cabinet meetings at the highest level of government.

Economically the two countries are the most important trading partner each has on the other's continent. Exports to the People's Republic account for approximately 2 percent of Germany's gross domestic product (see Figure 2). For many German corporations and mid-sized technology firms, China is a make-or-break market. More than 5,000 German companies are currently active in China and over 1,000 Chinese companies are present in Germany. Chinese have been the largest cohort of foreign students at Germany's institutions of higher education for many years (currently: some 23,000) and are thereby establishing a growing network of connections on both the personal and societal levels.

The political, economic and social ties are now so close that it is hard to imagine a fundamental upheaval in the countries' relations because of any single conflict. Yet the more the relationship develops, the more complex it becomes. China is hardly a panda simply strolling likeably, vulnerably and peacefully across the global stage. The country is defending its interests with growing constancy and insistence.

Beijing has a right to do exactly that, but it is forcing Germany to reconsider its own interests and how it will pursue them.

Three current issues illustrate the cracks which threaten to undermine the harmony that has previously been the hallmark of German-Chinese relations.

Example 1: Kuka

This summer the name Kuka became synonymous with the question of how welcome Chinese investment is in Germany. The robot manufacturer Kuka is considered a key player in Industry 4.0, Germany's strategic initiative to combine manufacturing and high-tech. Wanting to acquire the company, the China-based Midea Group made Kuka's shareholders an attractive offer, unleashing fears that the Chinese could gain access to Germany's core know-how – and not just at Kuka, but also at firms such as Daimler and Siemens who use Kuka's robots in their production lines.

The German government went to work behind the scenes to assemble a consortium of German players who could make a counteroffer and ensure Kuka remained in German hands. The rumor was also spread that Berlin might hinder a foreign takeover by dragging out the approval process for years. Critics accused the government – and Economics Minister Sigmar Gabriel, in particular – of heading in the direction of protectionism, thereby chipping away at the cornerstone of Germany's economic policy, namely support for free markets. Yet can Germany adhere to this principle when dealing with a major economic power that uses protectionist barriers to shield many of its own economic sectors?

Gabriel's efforts occasioned considerable displeasure in Beijing and ultimately failed at home because of the tactical disinterest exhibited by German industry and due to the country's shareholding laws. The steps Midea will take as majority owner remain to be seen. Yet as China aggressively expands into world markets, there will be an ongoing discussion about the difference between engaging in protectionism and ensuring business locations remain viable, a discussion that will undoubtedly feature – contentiously – in German-Chinese relations.

Example 2: Market economy status

Similar concerns underlie the debate about whether China should be granted market economy status (MES), something Beijing is demanding the EU do as of this December. The Chinese are justifying the move based on the country's 2001 accession agreement to the World Trade Organization (WTO). If MES is awarded, it would be more difficult for European companies to defend themselves against Chinese price dumping. The decision about granting MES is being made at EU level; Germany, however, has a major say in the matter.

Policy makers in both Berlin and Brussels are frustrated that the various alternatives Europe can choose from are all unsatisfactory. On a substantive level, a broad consensus exists that China does not meet the requirements for MES. Businesses complain about conspicuous asymmetries in the competitive conditions faced by foreign firms in China and Chinese companies in Europe – in terms of rule of law, for example, the awarding of contracts for public projects and the openness toward investment.

At the same time, Germany and other EU members must concede that, from a legal perspective, China has a number of solid arguments on its side. The risk must therefore be avoided of having China contest its case at the WTO. If they want to avoid a trade war with China, the Europeans will, for the most part, have to accommodate China's request – and begin looking for new trade-protection mechanisms that do not violate WTO regulations.

Example 3: South China Sea

Although China is insisting on adherence to international law when it comes to being given market economy status, it is more than willing to dismiss international jurisprudence when the issue is sovereign rights in the South China Sea. In July, the Permanent Court of Arbitration in The Hague rejected most of China's claim to territory near the Philippines and Vietnam. Although China has signed the UN Convention on the Law of the Sea, it refuses to accept the ruling. Thus, the conflict with its neighbors and with the US, which maintains a military presence in the Pacific, threatens to escalate.

Although Germany's policy makers and business community are happy not to be directly involved in the dispute, Berlin is being forced to watch from the sidelines as a conflict smolders in East Asia, a conflict that has the potential to destabilize one of the globe's most important economic regions. At the same time, China's outright rejection of the ruling in The Hague shows how difficult it is to include the country in international governance mechanisms – something Germany has a fundamental interest in doing.

Scenarios for China's development

The current discussions show not only where the potential for tension exists in German-Chinese relations. At least as important as individual examples of discord is the general uncertainty surrounding the direction China's development will take. For a long time – too long, from today's perspective – Germany's political and business leaders acted on the assumption that the Chinese system would converge with the western model over the medium term. The trend toward a less regulated economy, stronger rule of law, an ongoing opening to the rest of the world and, to some extent, a lessening of political control seemed irreversible. Such assumptions were what allowed Europeans to assert that China could be recognized as having a market economy within 15 years. They presumed it would happen as a matter of course.

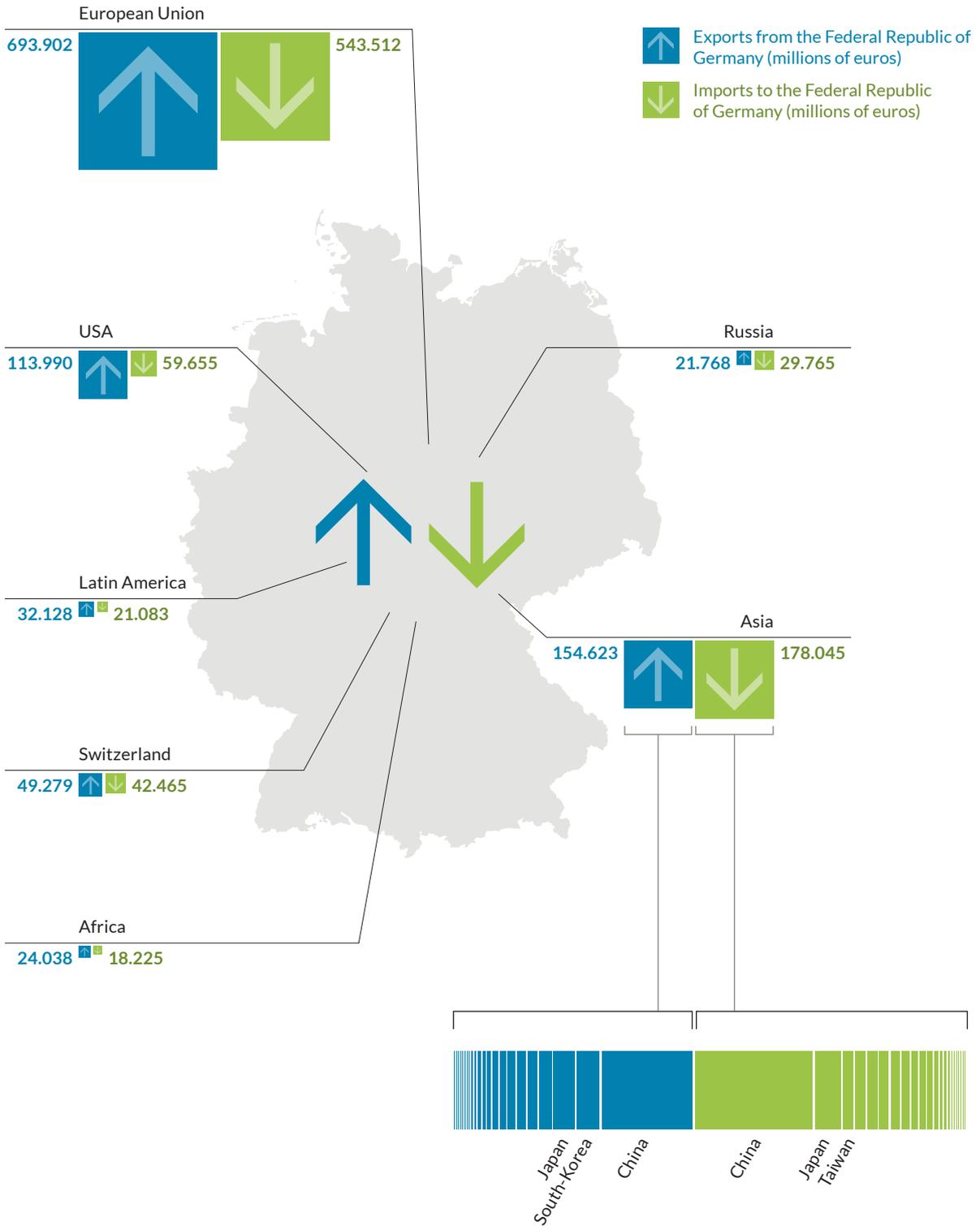
Now, however, as the Xi Jinping era begins, that certainty has largely dissipated. China finds itself in a phase of structural upheaval instead, with the outcome anything but certain. The degree to which China does or does not succeed in transforming itself will also impact its relationship with Germany.

In order to better access long-term strategies, the Bertelsmann Stiftung and the Fraunhofer Institute for Systems and Innovation Research developed several scenarios of how things could develop through the year 2030¹. From the German perspective, three scenarios seem equally troubling:

- In the Status Quo scenario, China's political and economic system remains largely stable. According to this scenario, China would continue to be

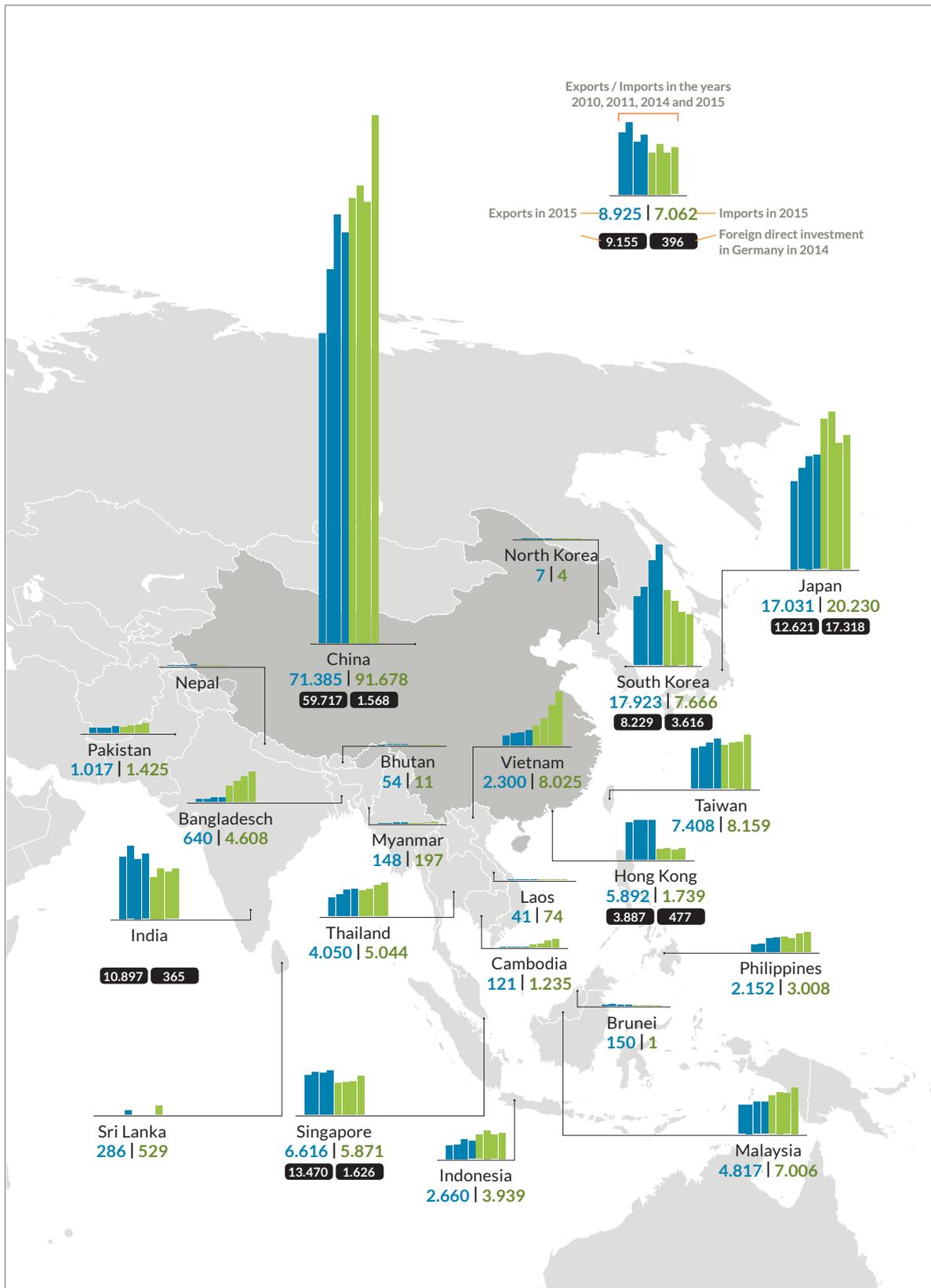
¹ China 2030: Szenarien und Strategien für Deutschland (China 2030: Scenarios and Strategies for Germany). Bertelsmann Stiftung, June 2016.

Exports from and imports to the Federal Republic of Germany, 2015



Source: German Federal Statistical Office (DEStatis) https://www.destatis.de/EN/FactsFigures/NationalEconomyEnvironment/ForeignTrade/TradingPartners/Tables/OrderRankGermanyTradingPartners.pdf?__blob=publicationFile

German exports to and imports from Asia



Quelle: German Federal Bank, „Bestandserhebung über Direktinvestitionen“, April 2016

a difficult but relatively reliable partner for German companies and policy makers.

- In the Chinese Dream scenario, China's government successfully implements its ambitious economic reforms. This would make the country more of an economic competitor for Germany, although it would continue to be a growth market and stable political partner.
- In the Great Wall scenario, several of the current problems escalate, causing China to become isolated, similar to what has happened with Putin's Russia. German-Chinese relations would suffer, as would the German business community.

What all the scenarios have in common is that dealing with China will become more of a challenge. Another commonality, however, is that Germany can benefit from all of the coming developments if its business and political leaders respond appropriately and soon. Although it is not possible to formulate a concise strategy for dealing with China, several areas exist that will play a crucial role in determining how German-Chinese relations evolve.

Focus areas for Germany's China policy

International governance

Regardless of how China develops, Germany has an interest in including the People's Republic to a greater degree in international governance mechanisms so that Beijing can take on more responsibility addressing global issues – in the G-20, for example, in diplomatic coalitions formed to overcome current crises, or at the UN. China has publicly expressed the desire to become a leading power, yet it remains unclear to what extent it can take on this role within existing structures or wants to make use of its own parallel institutions.

China is skeptical of the existing institutions for global governance since it does not feel it is adequately represented in them. Parallel institutions such as the Asian Infrastructure Investment Bank (AIIB) or the Shanghai Cooperation Organization (SCO) diminish the influence of traditional institutions. The degree to which Germany should participate in these Chinese initiatives is, diplomatically, a sensitive topic. On the one hand, Germany has an interest in maintaining and strengthening existing mechanisms. On the other hand, it does not want to be excluded from the new

organizations in the event they should become generally accepted.

In the case of the AIIB, Germany decided to become a member, not least in order to exert influence on the bank's development. The establishment of the AIIB is, however, a good example of how China is able to play western nations off each other, since the United States tried until the last minute to prevent the new organization from being seen as a serious alternative to institutions such as the World Bank and the Asian Development Bank.

Political alliances

As much as Berlin has benefitted from and wants to maintain its special relationship with Beijing, it will not be able to count on receiving preferential treatment over the long term. In all of the scenarios examined, as a mid-sized power Germany would gain in coming years if Europe had a coordinated, effective foreign policy in place vis-à-vis the People's Republic. There are many reasons why the EU's existence should be safeguarded. China's rise is one of them.

China's development is changing the international power structure. In order to be heard within it and to secure its own interests, Germany would be well advised to seek new coalitions, for example with other Asian countries. This applies both if China's global political and economic influence increases, and if China becomes involved in international confrontations. Forging new alliances is, however, not without its risks. China mistrustfully monitors where partnerships arise around the world which could offset its own increasing importance and which might be designed to contain it.

Promoting reform and upholding values

Germany has a strong interest in China's remaining stable and having an effective government. Stability and reforms, moreover, are mutually dependent: In the past, China's stability was the prerequisite for the reforms successfully implemented in many areas. In the future, it will only be possible to maintain stability if additional reforms are carried out. There is no lack in China of ambitious, intelligent goals for revitalizing the country. Yet great uncertainty exists as to whether China is indeed on the right path to achieve these goals – and quickly enough to keep pace with its growing problems.

In the past Germany has supported China's reform policies in many areas and it should continue doing so. However, this includes recognizing that China's reformers are not only to be found among its politicians. Human rights activists and critical journalists are regularly subjected to repressive measures; openly supporting them is politically risky, since China's government views this as interference in its internal affairs. Conversely, not supporting them entails the risk of hindering reforms instead of promoting them. All of the scenarios that envision successful reform show that progress in this area is not possible without better rule of law, a system of values that espouses freedom, and a lessening of restrictions on digital media.

Maintaining the balance between pursuing interests and upholding values is one of the toughest challenges Germany's policy makers face in dealing with China. The German public expects the country's leaders to actively defend western values such as democracy, freedom of expression and freedom of the press. China's government resists counsel offered by western nations and sanctions countries that get too involved in its internal affairs. Defending Germany's values without endangering its business or economic interests is a balancing act that the country's diplomats will have to maintain in all of the scenarios likely to develop in coming years.

Innovation

Regardless of how China develops, the competition to remain a leading innovator will be a key factor determining Germany's future prospects. Germany's economic strength stems from the innovative power of its businesses. For the most part, Germany alone will decide if it retains this competitive edge. The competition, however, is growing. China is investing enormous sums of money to catch up with the world's innovators, especially in sectors in which Germany has traditionally excelled, such as mechanical engineering, renewable energies and hybrid vehicles.

This plan has only been partially successful until now, although China has become a global leader in a number of industries such as telecommunications technology and high-speed trains. In any event, the new competition is forcing German industry to develop more products faster and better in order to maintain the innovative advantage of offering goods

“Made in Germany.” The country's policy makers must make this possible by putting the relevant educational policy framework in place.

Should China succeed in becoming an innovation leader in the relevant industries, it would be a serious competitor for German firms and, at the same time, a business location that offers many promising opportunities. If Germany's businesses want to benefit from China's innovative power and have access to its brightest and best, they must make their Chinese employees and research centers an integral part of their global development strategies.

First movers would have a considerable advantage here. Until now, however, few German companies have been confident enough to transfer their core knowledge to China, since such a step will only truly pay off when a level playing field exists in the People's Republic, one that effectively protects intellectual property rights and ensures open access to the country's markets. This development can only be found in the scenarios that assume the greatest willingness on the part of China's leaders to introduce reforms.

Free trade and investment

As a major exporter, Germany has a core interest in promoting free trade. China will remain an important sales market for its products. How the global trade regime develops will also determine the options Germany has for further reducing trade barriers. New breakthroughs seem unlikely within the framework of the WTO. Germany should therefore aim to create additional European free trade agreements (FTAs) in order to prevent German exporters from being disadvantaged by other bilateral or regional FTAs. One possibility is a European-Chinese FTA, in particular one that also reduces non-tariff barriers.

Chinese foreign investment is increasing and as long as the country prospers economically, this trend is likely to continue. This activity stems, on the one hand, from the desire to profitably invest foreign currency holdings, for example in real estate. On the other, it is part of a strategy to create global corporations based in China, for example through the acquisition of successful western companies. The latter goal, in particular, is not uncontroversial.

How great the political and economic resistance will be in the future depends largely on how positively or negatively China is perceived on the international stage. Germany, however, has a fundamental interest in attracting Chinese capital. It can increase its appeal by reducing bureaucracy and doing more to market itself as an advantageous business location.

Conclusion

China and Germany are key partners for each other. Their economic, political and social ties are closer than ever before. This is a welcome development, since Germany and China need each other: as markets and fair competitors, as political allies working to address global challenges, and as sources of social inspiration.

The closer connection means, however, that never before has so much been at stake. The German and Chinese economies no longer simply complement each other, but are increasingly becoming rivals as well. That is a natural development. Conflicting interests in the political sphere must also be expected. At the same time, both Germany and China face enormous pressure to implement reform. The stress this is producing in each of their systems is also being felt in their bilateral relations.

It is not advisable to create conflicts unnecessarily. At the same time, they should not be ignored. Germany should prepare itself for disputes with China that are more difficult than those of the past. Until now the two countries have had little experience dealing with such situations. The challenge will be to create structures that make it possible to endure these conflicts and prevent them from spilling over into other areas. This will require Germany to become more aware of its own interests and to develop instruments capable of achieving them. That might be painful, since it could disrupt what has previously been a harmonious relationship. It will also require recognizing that Germany's possibilities for taking action vis-à-vis China are often limited. But after all, German-Chinese relations involve much more than just pandas frolicking in a zoo.

The author is grateful to Fabienne Frauendorfer for her research assistance.

Further reading:

China 2030: Szenarien und Strategien für Deutschland. Bertelsmann Stiftung, June 2016 (in German).

The Bertelsmann Stiftung has made an online tool available in conjunction with this study. It allows users to compare their own expectations of how China will develop with those of the experts: <https://china-szenarien.bertelsmann-stiftung.de>.

More than a Market – How German companies are growing roots in Chinese society. Bertelsmann Stiftung, May 2016.
Link: <https://www.bertelsmann-stiftung.de/en/publications/publication/did/more-than-a-market/>.

What Economic Slowdown? Asia looks at China. Asia Policy Brief by Jabin T. Jacob. Bertelsmann Stiftung, April 2016.
Link: <http://www.bertelsmann-stiftung.de/en/publications/publication/did/-a862681310/>.

Latest editions:

Asia Policy Brief | April 2016

What Economic Slowdown?

Asia Looks at China

Jabin T. Jacob

Asia Policy Brief | November 2015

Modi's Reform Agenda:

Change You Can Believe In?

Milan Vaishnav

Asia Policy Brief | November 2015

China's Confidence Issue: Hard or Smart

Landing – What Can We Expect?

Bernhard Bartsch

**Responsible according
to German press law**

Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
33311 Gütersloh
www.bertelsmann-stiftung.de

Stephan Vopel
stephan.vopel@bertelsmann-stiftung.de

Dr. Peter Walkenhorst
peter.walkenhorst@bertelsmann-stiftung.de

If you have any questions or if you wish to
subscribe to the "Asia Policy Brief" please
write to asien@bertelsmann-stiftung.de.

All "Asia Policy Brief" editions can be
downloaded from www.bertelsmann-stiftung.de/asien.

ISSN 2364-8562