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China's Economic Empire

By HERIBERTO ARAÚJO and JUAN PABLO CARDENAL

HONG KONG — THE combination of a strong, rising China and economic stagnation in Europe and America is making the West increasingly uncomfortable. While China is not taking over the world militarily, it seems to be steadily taking it over commercially. In just the past week, Chinese companies and investors have sought to buy two iconic Western companies, Smithfield Foods, the American pork producer, and Club Med, the French resort company.

Europeans and Americans tend to fret over Beijing's assertiveness in the South China Sea, its territorial disputes with Japan, and cyberattacks on Western firms, but all of this is much less important than a phenomenon that is less visible but more disturbing: the aggressive worldwide push of Chinese state capitalism.

By buying companies, exploiting natural resources, building infrastructure and giving loans all over the world, China is pursuing a soft but unstoppable form of economic domination. Beijing's essentially unlimited financial resources allow the country to be a game-changing force in both the developed and developing world, one that threatens to obliterate the competitive edge of Western firms, kill jobs in Europe and America and blunt criticism of human rights abuses in China.

Ultimately, thanks to the deposits of over a billion Chinese savers, China Inc. has been able to acquire strategic assets worldwide. This is possible because those deposits are financially repressed — savers receive negative returns because of interest rates below the inflation rate and strict capital controls that prevent savers from investing their money in more profitable investments abroad. Consequently, the Chinese government now controlsoil and gas pipelines from Turkmenistan to China and from South Sudan to the Red Sea.

Another pipeline, from the Indian Ocean to the Chinese city of Kunming, running through Myanmar, is scheduled to be completed soon, and yet another, from Siberia to northern China, has already been built. China has also invested heavily in building infrastructure, undertaking hugehydroelectricprojects like the Merowe Dam on the Nile in Sudan — the biggest Chinese engineering project in Africa — and Ecuador's $2.3 billion Coca Codo Sinclair Dam. And China is currently involved in the building of more than 200 other dams across the planet, according to International Rivers, a nonprofit environmental organization.

China has become the world's leading exporter; it also surpassed the United States as the world's biggest trading nation in 2012. In the span of just a few years, China has become the leading trading partner of countries like Australia, Brazil and Chile as it seeks resources like iron ore, soybeans and copper. Lower tariffs and China's booming economy explain this exponential growth. By buying mainly natural resources and food, China is ensuring that two of the country's economic engines — urbanization and the export sector — are securely supplied with the needed resources.

In Europe and North America, China's arrival on the scene has been more recent but the figures clearly show a growing trend: annual investment from China to the European Union grew from less than $1 billion annually before 2008 to more than $10 billion in the past two years. And in the United States, investment surged from less than $1 billion in 2008 to a record high of $6.7 billion in 2012, according to the Rhodium Group, an economic research firm. Last year, Europe was the destination for 33 percent of China's foreign direct investment.

Government support, through hidden subsidies and cheap financing, gives Chinese state-owned firms a major advantage over competitors. Since 2008, the West's economic downturn has allowed them to gain broad access to Western markets to hunt for technology, know-how and deals that weren't previously available to them. Western assets that weren't on sale in the past now are, and Chinese investments have provided desperately needed liquidity.

This trend will only increase in the future, as China's foreign direct investment skyrockets in the coming years. It is projected to reach as much as $1 trillion to $2 trillion by 2020, according to the Rhodium Group. This means that Chinese state-owned companies that enjoy a monopolistic position at home can now pursue ambitious international expansions and compete with global corporate giants. The unfairness of this situation is clearest in the steel and solar- panel industries, where China has gone from a net importer to the world's largest producer and exporter in only a few years. It has been able to flood the market with products well below market price — and consequently destroy industries and employment in the West and elsewhere.

THIS is the real threat to the United States and other countries. However, most Western governments don't seem to be addressing China's state-driven expansionism as an immediate priority.

On the contrary, European governments dealing with their own economic crises see China as a country that can help, either by buying sovereign debt or going ahead with investments in their countries that will create jobs.

The Chinese state-owned company Cosco currently manages the main cargo terminal in the biggest Greek port, Piraeus, near Athens — a 35-year concession deal. And China'ssovereign wealth fund, C.I.C., took a 10 percent stake in London's Heathrow Airport in 2012, as well as a nearly 9 percent stake in the British utility company Thames Water. The state-owned firms Three Gorges Corporation and State Grid are the main foreign investors in Portugal's power-generation sector, and C.I.C. also bought a 7 percent stake in France's Eutelsat Communications.

In the Greek port the Chinese have been able to triple capacity, amid local unions' criticism of worsening labor conditions. It's too early to measure China's impact in the other investments, but the fact that Chinese companies are able to invest in sectors that are closed or restricted for European firms in China says a lot about how minimal Europe's leverage with China is.

Take Germany, which accounts for nearly half of the European Union's exports to China. It's highly unlikely that Berlin would make unfair competition the cornerstone of its China policy. Moreover, the lack of leverage and leadership in Brussels means that the union is unable to take firm action to force China into adopting measures that would level the playing field or guarantee reciprocity in its domestic market.

The only exception is the United States, which seems to be addressing the issue by pushing forward the Trans-Pacific Partnership, a regional trade association that is seen by critics in Beijing and elsewhere as an American-led policy to contain China. The club is thought to be restricted to countries that meet high American standards on issues like free competition, labor and environmental standards and intellectual property rights. As China doesn't meet those standards, it will have to reform or risk regional isolation. Moreover, the United States has made life difficult for the Chinese telecom giant Huawei by refusing to grant it contracts from leading American telecom companies. This is not just about national security concerns but also about sending Beijing a clear message that the United States government is willing to block one of China's most visible and successful companies.

While Western companies complain about barriers to public procurement and bidding and struggles to compete in restricted sectors in China, Chinese companies enjoy red carpet treatment in Europe, buying up strategic assets and major companies like Volvo and the German equipment manufacturer Putzmeister.

The perception is that China is now unavoidable and, consequently, the only option is to be accommodating — offering everything from a generous investment environment to essentially dropping human rights from the agenda. "We don't have any stick. We can just offer carrots and hope for the best," a senior European official told us.

Greenland, a massive resource-rich territory largely controlled by Denmark, is a case in point. Last year, it passed legislation to allow foreign workers into the country who earned salaries below the local legal minimum wage (the minimum wage there is one of the highest in the world). Chinese representatives had made it clear that Chinese state-owned banks and companies would invest in the high-risk, costly exploitation of Greenland's vast mining resources only if the modification of local regulations would allow the arrival of thousands of low-wage Chinese workers.

The Arctic territory didn't have too many alternatives. No other country is in a position to become Greenland's strategic partner for its future development, given the business risks involved in the Arctic region and the scale of the investment needed in a territory bigger than Mexico but without a single highway. An American oil company couldn't have handled the task alone. The Chinese state capitalist system, by contrast, allows multiple state-owned companies to work together, making it possible for the China National Petroleum Corporation, for instance, to extract oil while China Railway builds basic infrastructure.

Greenland's leaders accepted China's terms because they likely believed these costly projects might never go ahead if the Chinese didn't get involved; only China has the money, the demand, the experience and the political will to proceed. Moreover, there are not enough skilled workers in Greenland for such projects, so the Greenlandic government made an exception to the law, allowing Chinese laborers to earn less than minimum wage figuring that local residents would benefit from new infrastructure and royalties.

China's deep pockets, as well as its extensive labor force and unlimited demand for natural resources, made all the difference, and accordingly Greenland was prepared to pass tailor-made legislation to meet Chinese needs. Even Denmark, which holds authority in Greenland in areas like migration and foreign policy, decided not to interfere.

IT is even happening in progressive bastions like Canada. President Obama's refusal thus far to approve theKeystonepipeline project has made Prime Minister Stephen Harper's conservative government turn to China to secure an export market for Canadian crude oil reserves. The Calgary-based oil industry has lobbied Mr. Harper to adopt a new diversification strategy that includes the construction of a controversial pipeline to western British Columbia, despite strong opposition from environmental groups, the First Nations aboriginal communities and the public. In the meantime, Canada also signed a Foreign Investment Promotion and Protection Agreement with China, which gives remarkably generous investment protection to the Chinese.

With China in the center of debates over FIPA and the west coast pipeline, Canada's government then approved the takeover of the Canadian energy giant Nexen by the Chinese state-owned oil firm Cnooc. The $15.1 billion transaction was China's largest foreign takeover.

Closer economic ties have had political side effects; the Harper administration now seems much more cautious in criticizing China's human rights record. Given that Canada was until very recently one of the fiercest voices on China's handling of dissidents, this is not only a remarkable 180-degree turn, but also a clear indication of how China's economic influence can push the political agenda to the sidelines, even in the West.

In Australia, Chinese accumulated investment inflows at the end of 2012 surpassed $50 billion. The trend is striking: Chinese direct investment in Australia in 2012 increased 21 percent from 2011 levels to reach $11.4 billion, making it an important player in Australia's mining industry. Australia's trade portfolio remains highly diversified, but the Chinese share is growing rapidly.

China has also become the biggest investor in Germany (in terms of the number of deals), surpassing the United States. Chinese companies are looking for companies that, like Putzmeister, have a technological edge and have become world leaders in niche markets. Those takeovers also allow them to absorb Western know-how on branding, marketing, distribution and customer relations. Others are more opportunistic. Faced with recession, struggling European firms like Volvo quickly welcomed Chinese partners who were ready to inject capital and take full control.

The loans that Beijing is giving worldwide are even more significant, in dollar terms, than direct foreign investment. These loans include $40 billion to Venezuela and more than $8 billion to Turkmenistan in recent years. China's policy banks (China Development Bank and Export-Import Bank of China) are the key institutions supporting China's "Go global" strategy, as they provide billions of dollars in loans to foreign countries to acquire Chinese goods; finance Chinese-built infrastructure; and start projects in the extractive and other industries.

This is clearest in countries where the West claims to link its aid to human rights and good business practices. Chinese loans have been crucial in countries like Angola that have faced threats of a cutoff in financing from Western creditors, the World Bank and the International Monetary Fund. Ecuador, Venezuela, Turkmenistan, Sudan and Iran have all faced such difficulties, and China has stepped in without political or ethical strings attached. Chinese statistics reveal little about these loans, but a study by The Financial Timesshowed that, between 2009 and 2010, China was the world's largest lender, doling out $110 billion, more than the World Bank.

It is important to remember what is really behind China's global economic expansion: the state. China may be moving in the right direction on a number of issues, but when Chinese state-owned companies go abroad and seek to play by rules that emanate from an authoritarian regime, there is grave danger that Western countries will, out of economic need, end up playing by Beijing's rules.

As China becomes a global player and a fierce competitor in American and European markets, its political system and state capitalist ideology pose a threat. It is therefore essential that Western governments stick to what has been the core of Western prosperity: the rule of law, political freedom and fair competition.

They must not think shortsightedly. Giving up on our commitment to human rights, or being compliant in the face of rapacious state capitalism, will hurt Western countries in the long term. It is China that needs to adapt to the world, not the other way around.

Heriberto Araújo and Juan Pablo Cardenal are the authors of "China's Silent Army: The Pioneers, Traders, Fixers and Workers Who Are Remaking The World in Beijing's Image."

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China’s Global Reach

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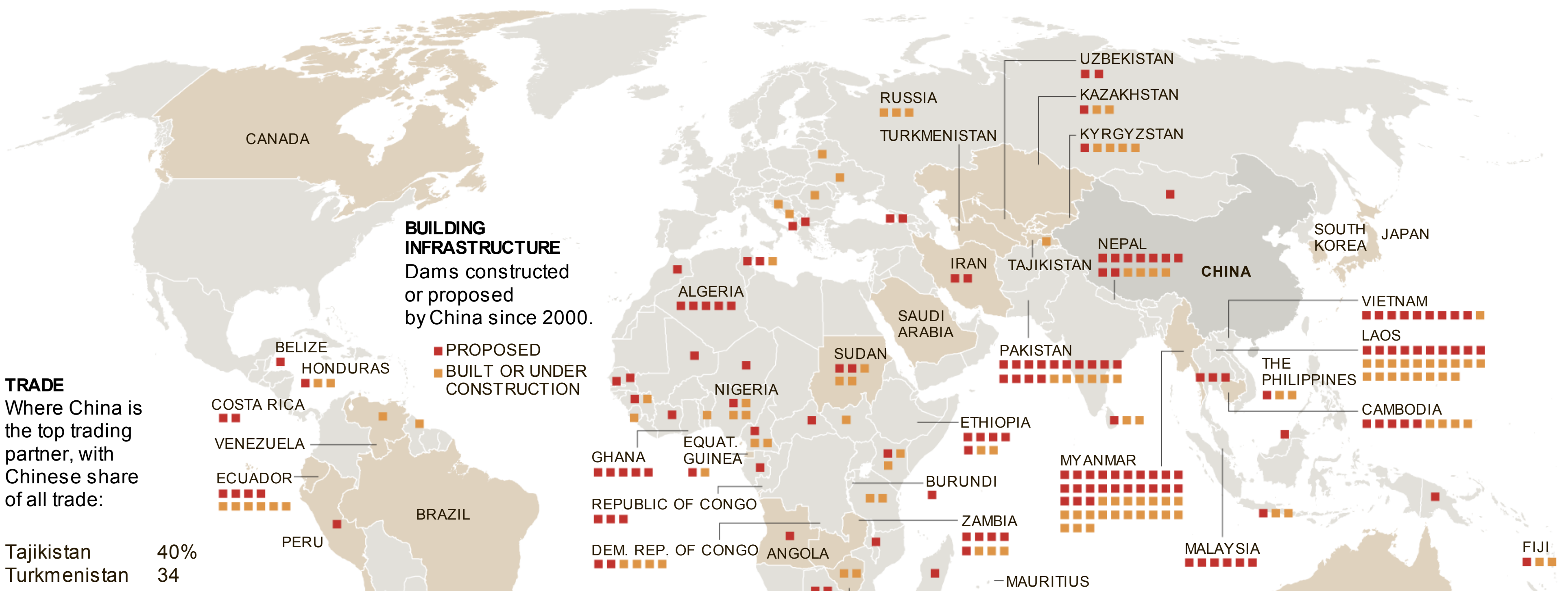
Selected countries where China was a major trader, foreign investor or lender.



Kyrgyzstan	33
Australia	24
Iran	20
Angola	19
Japan	11
South Korea	10
Chile	10

China second-largest:

Kazakhstan	29%
Uzbekistan	14
Equat. Guinea	14
Saudi Arabia	11
Brazil	8
Peru	8
Venezuela	9
South Africa	7

DIRECT INVESTMENT AND LOANS
Top investor or lender (from 2005-12, unless otherwise noted):

VENEZUELA
$50 billion, including loans; mainly oil.

IRAN
Accumulated contracts in energy up to $40 billion.

CANADA
$20 billion in 2012, mostly in oil and gas sectors.

ANGOLA
$15 billion in loans (2004-12).

MYANMAR
$14 billion.

CAMBODIA
$8.8 billion.

ECUADOR
$7 billion, including loans repaid with natural resources.

ZAMBIA
$5.6 billion, mostly in mining.

SUDAN
$5 billion, mostly in oil.

ZIMBABWE
$1.7 billion (2011-12).

Sources: Juan Pablo Cardenal and Heriberto Araújo; European Union (trade); Heritage Foundation (investment); International Rivers (dams)