

CAN CHINA ESCAPE FROM ITS OWN TRAP? — CHINA'S POST-G20 FOREIGN RELATIONS AND MARKET LIBERALIZATION —

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CHINA CORNERS ITSELF WITH ITS HARDLINE STANCE

On September 4–5, 2016, the China-chaired G20 Summit was held in the city of Hangzhou, Zhejiang Province. As China had positioned the G20 as a place for debate on economy, it was a perfect opportunity to demonstrate its leadership in the world economy. However, what drew the most attention at the G20 Summit was whether the security issue over the South China Sea would be brought to the table.

In a way, it was China that created such a situation for itself. The biggest factor was its response to the arbitration court's ruling in July that almost categorically denied China's claims to the South China Sea. From the beginning, China insisted that the arbitration case initiated by the Philippines was illegal, and publicly claimed its refusal to accept the ruling. Immediately after the arbitration ruling, China met with President Donald Tusk of the European Council. Urged by President Tusk to observe the ruling, President Xi Jinping declared that China's rights in the seas would not be affected by the ruling and that China would not accept any claims or actions based on that ruling. Consequently, their joint statement scheduled was cancelled and China's hardline stance became a known fact. Moreover, government officials including Foreign Minister Wang Yi called the ruling "political farce" and "a piece of wastepaper," which accentuated China's eccentricity in disrespecting international law and the rule of law. President Tusk said that rule-based international order is in their common interest, but they understand that differently. China's response only contributed to projecting itself as a nation incapable of negotiation under common rules, thus leading to mounting distrust of China, in particular among the US and European countries.

Such distrust surfaces in part in response to Chinese companies' investment deals overseas. At the end of July, the UK government postponed giving its final approval to China's new nuclear power plant project at Hinkley Point, located in southwest England. It is said that Prime Minister Theresa May, considered to be wary of Chinese companies' massive investments in the UK, has a strong security concern about allowing a Chinese state-owned enterprise to hold a one-third stake in the project. In addition, on August 11, the Australian government decided to reject the sale of Ausgrid, a state-owned company that transmits electricity to Sydney, among other areas, to Chinese bidders. The bidders are two Chinese companies, including China's largest state-owned electric transmission company, and the Australian government stated that the decision was due to security reasons.

China criticizes this decision as protectionism. However, China also strictly restricts, by regulations and management, foreign-affiliated companies from investment and contribution in fields such as land acquisition, electricity transmission, communications, and broadcasting. Every country restricts foreign investors' entry into fields pertaining to national security, although the level of restriction may be different depending on the country. China is regarding itself as a great power comparable with the US as well as a developing country. Given this, China's criticism without regard to the South China Sea ruling is likely to be taken as undue pressure with power

behind it. In the case of the UK, the Chinese Ambassador to the UK contributed an article to the Financial Times to keep the UK government in check, strongly claiming that the UK's review of the plan would impair the trustful relationship between the two countries, which was reported as a "warning" by the media. Eventually, the project was approved with strings attached. A UK consultant, however, says that China's response was only counterproductive for Prime Minister May, who is proud and vigilant about China.

Meanwhile, growing voices indicate that China's market liberalization is insufficient in a number of fields, while the US and Europe have the corresponding markets open. On September 1, the EU Chambers of Commerce in China released a report calling for open markets based on reciprocity. According to the report, while Chinese companies are acquiring European market leaders in fields including finance, automobiles, robots, and infrastructure, European companies are significantly restricted from investing in the same fields in China. On the same day, the US Chamber of Commerce also released a report that points to the problems of exclusive policies implemented by countries, including China, against foreign investment in the ICT and Internet service sectors.

China's Foreign Ministry Spokesperson rebutted that criticism, by claiming that foreign investment in China was increasing, then touting China as an ideal destination for investment. In addition, while demanding an objective and fair judgment on China's investment environment from relevant countries, the Spokesperson called on each country to provide a transparent investment environment to Chinese companies and not to block investment under the veil of national security. That response, as well as the territory issue, gives the impression that China strongly insists on nothing but its own interests, but disregards common rules such as the reciprocity principle, and it might work against Chinese companies' trade or foreign investment.¹

In terms of trade, there is a problem with the market economy status of China, which has been a member of the World Trade Organization for 15 years. If not certified, China will be subject to disadvantageous treatment in dumping reviews and the like. The EU had been inclined to grant the status by mid-year, but now its decision is up in the air. (The US is consistently taking the stance of not granting it.) It is undeniable that China's response to the South China Sea ruling is negatively affecting the judgment on whether to grant market economy status to China based on common rules.

CHINA NAVIGATED THROUGH THE G20

Table: Key Points of G20 Leaders' Communique

• The global economic recovery is progressing, while downside risks remain
• Using all policy tools (monetary, fiscal, and structural)
• Achieving a globally fair and modern international tax system
• Opposing all forms of protectionism against trade and investment
• Excess capacity being a global issue; forming a global forum to promote cooperation
• Promoting infrastructure investment with a focus on both quality and quantity
• Proactively addressing the consequences stemming from Britain's exit from the EU
• Proactively addressing climate change, the refugee crisis, and terrorism

(Source) Prepared based on the MOFA website

Given the backdrop against which the G20 Summit was held, it could be said that the G20 Summit was a success for China. By calling on the relevant states to only mention the South China Sea issue within bilateral

talks, China succeeded in excluding the issue from group meetings and having the agenda focused on the development of the global economy.²

Consequently, the G20 Leaders' Communique comprehensively incorporated the issues faced by the global economy and corresponding approaches (see Table). Initially, China is said to have opposed including the excess capacity issue in steel and other industries, but it ended up in the communique, which specifies that "(the Leaders of the G20) recognize that excess capacity in steel and other industries is a global issue which requires collective responses," and "call for increased information sharing and cooperation through the formation of a Global Forum on steel excess capacity." However, this is not intended to push China to take new measures, since China recognizes overcapacity as an important policy challenge and is already working on it.

Bilateral meetings between Chinese President Xi Jinping and other heads of state proceeded without a hitch. For the US, which has numerous concerns against China, including security and human rights issues, President Xi showed a cooperative attitude to the US, by ratifying the Paris Climate Agreement—President Obama's legacy on global warming—and demonstrated its coordination with the US. China had conflicts with Japan over the East China Sea and South China Sea issues, while its relationship with South Korea had been worsening over THAAD missile deployment. Nonetheless, China had talks with them, as well as almost all other countries, as a result of its high-level coordination in advance, and managed to avoid a scenario where China would not meet with its important neighbors. As was within the scope of China's assumptions, none of the talks achieved something on any issue. Helped by the participating states' consideration extended to the chair, China succeeded in controlling the issues at the G20 Summit and saved face.

CAN CHINA SHOW RESPECT FOR THE RULE OF LAW?

Having survived the G20 Summit, China will likely increase its hardline stance in foreign relations. There is only one year left before the National Congress of the Communist Party of China (CPC) in the fall of 2017, when a new leadership will be chosen. It is China's political season, when a tug-of-war will intensify within the CPC. Because giving an impression of being weak-kneed is a political disadvantage, momentum to demonstrate a firm stance externally is likely to occur at all levels.

In terms of security, China's adamant stance is clear. On the first day of the G20 Summit (September 4), the government of the Philippines announced that, by September 3, it had confirmed the presence of 10 Chinese ships, which apparently were military transport ships or dredgers, in the Scarborough Shoal, also known as Huangyan Dao in China, located in the Philippines' exclusive economic zone.³ The Ministry of Foreign Affairs of China asserted that it was not a new move, but by taking such action amidst the G20 Summit, particularly while the US President was visiting China, China may have wanted to demonstrate its strong desire to enhance effective control.

The ASEAN-related summit meetings, held in Laos immediately after the G20 Summit, proceeded more or less at China's pace. By having it specified in the ASEAN-China joint statement that ASEAN member states and China "undertake to resolve the territorial and jurisdictional disputes by peaceful means ... by sovereign states directly concerned," China held intervention by Japan and the US in check. Philippines President Rodrigo Duterte made no remarks on the South China Sea ruling, and, therefore, the significance of the ruling is beginning to decline. Having successfully managed the G20 Summit and ASEAN Summit Meetings at its own pace, even by disregarding the ruling, must have given confidence to China. Now it is highly unlikely that China will compromise with Japan and South Korea on the East China Sea and THAAD deployment.

On the other hand, in economic terms, now that China is the world's second largest economic power, expectations for China are continuously heightening in foreign investment, market liberalization, and deregulation. Amid this, if China continues to pressure other countries to accept Chinese companies' investment or takes a stance to justify its protectionist response regarding its domestic markets, it would follow, coupled with its hardline stance on security, that China would be further recognized as a nation that does not share values or rules with the international community even in the economic area. It would not be in China's best interest to cause more friction by taking an uncompromising stance against the US and European economies.

The G20 Communique compiled by the Chinese leadership contains the wording "reject protectionism." President Xi stated at the B20 Summit (business summit), which was held prior to the G20 Summit, that China would fully commit to providing an improved business environment by further relaxing restrictions on foreign investment. If China, the chair of the G20 Summit, reviews its own protectionist system, it could bring not only benefits to each member state, but also economic advantages to China. While China is unable to compromise on security, it would be extremely important for the country to demonstrate a cooperative stance, at least in economic terms, by showing respect for common rules along with the US and European countries, as well as for voices from the international community. China's security-related response might incur economically disadvantageous situations for itself, but China's further market liberalization should bring a certain strategic benefit to itself in mitigating such risks.

¹ The Parliamentary Library of Australia, in "Briefing Book: Key Issues for the 45th Parliament" for the House of Representatives meeting that began from the end of August, pointed to the political and strategic aims of the Chinese government-led "One Belt, One Road" initiative, and presented the view that it is a strategy based on China's claim in the South China Sea. It also suggests that Australia should be prudent in further developing its economic relationship with China.

² It is said that no heads of state or government reacted when Prime Minister Abe mentioned freedom of navigation and the rule of law.

³ China is in effective control of Scarborough Shoal but has not commenced land reclamation and construction yet. The US is highly wary of China's commencement of such activities.