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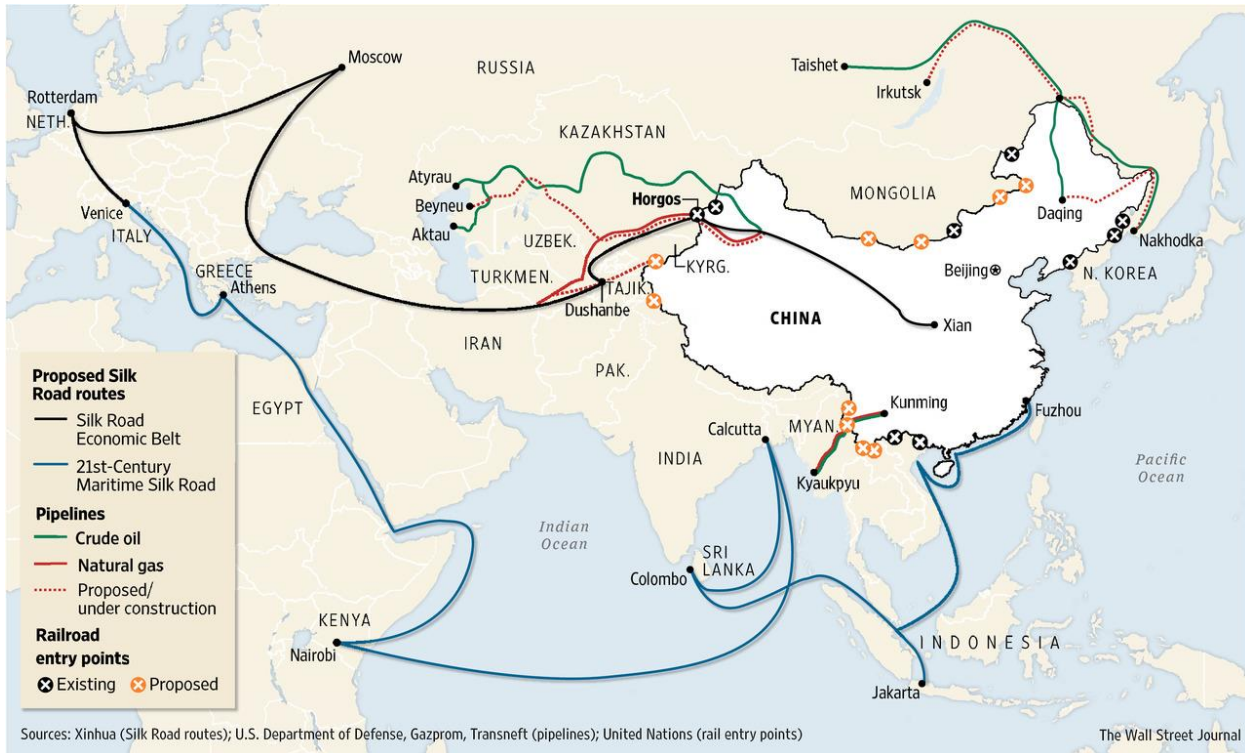
Foreign Investment: *Caixin* reporter expects reduced restrictions in updated foreign investment catalogue will yield limited change for China's troubled steel industry.

China's Foreign Policy

People's Daily Argues for Extension of Maritime Silk Road to Latin America

China's "21st Century Maritime Silk Road Initiative," first announced by President Xi Jinping in October 2013,¹ represents an effort to expand international maritime transportation infrastructure and thereby bolster economic cooperation, in the spirit of the historic Silk Road.² However, it has heretofore been regarded as primarily a "Eurasian" initiative, as illustrated in Figure 1. An "exclusive" published in Chinese Communist Party (CCP) newspaper *People's Daily* on March 16, 2015, sheds light on the primary reasons for advocating such an expansion, foresees specific obstacles China might face in such an effort, and provides several concrete policy recommendations. Its author, Dr. Tang Jun, is the deputy director of Zhejiang International Studies University's Latin America Research Institute and is also a member of the Chinese Academy of Social Science's China-Latin America Society.

Figure 1: China's Proposed Silk Road Concepts and Other Regional Infrastructure



Source: Jeremy Page, "China Sees Itself at Center of New Asian Order," *Wall Street Journal*, November 9, 2014, <http://www.wsj.com/articles/chinas-new-trade-routes-center-it-on-geopolitical-map-1415559290>.

Reasons for Expansion

Dr. Tang presents several historical and practical arguments for the "necessity" of China's extension of the Maritime Silk Road to Latin America. He first ties this effort to a historical "Maritime Silk Road" that ran from China to Latin America via Spanish and Portuguese trade routes during the 16th to 19th centuries, enabling China to export manufactured goods for Spanish silver and maintain a longstanding trade surplus with this region. According to Dr. Tang, this network also promoted cultural exchange, incentivized migrations of Chinese settlers who introduced advanced manufacturing techniques to Southeast Asia, and brought Latin American crops into China to the benefit of its own agricultural development. Today, the author states, China and the region share a high rate of economic growth, a strong and expanding trade relationship, and "a political foundation of mutual trust." He points out that China is Latin America's second-largest trading partner and has formed "strategic partnerships" with several countries in the region, despite geographic distance. He also makes extensive comparisons to China's relationship with the Association of Southeast Asian Nations (ASEAN),* pointing out that China-Latin America trade volume exceeded \$260 billion in 2013 and is projected to reach \$500 billion by 2020, relative to totals of \$400 billion and \$1 trillion with ASEAN, respectively.

Several additional reasons cited are more strategic in nature. By including Latin America in its new Maritime Silk Road, Dr. Tang argues, China can expand its overseas markets, reduce dependence on foreign trade with "the West," and inject new energy into its "export-oriented economy." He believes the Maritime Silk Road, when linked with the Silk Road Economic Belt, will benefit China's overall level of foreign engagement and establish its position at the core of the global trade and economic structure. Finally, as the United States in the author's view is attempting to encircle and contain China through the Trans-Pacific Partnership (TPP) agreement, essentially coopting a treaty

* ASEAN is comprised of Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. Association of Southeast Asian Nations, *ASEAN Member States*, 2014, www.asean.org/asean/asean-member-states.

originally intended for ASEAN and Latin America, extending the Maritime Silk Road would protect China's core interests and strongly counter the United States' strategy.

Dr. Tang's argument concludes that China, ASEAN, and Latin America—the world's “three most dynamic, healthy economies,” full of developing countries promoting peace and pushing for a new global political order that “constrains international hegemony” and pluralizes governance, and even being regions that once gave birth to great ancient civilizations—are poised from political, economic, and cultural perspectives to benefit from such a partnership.

Obstacles to Expansion

The author identifies three obstacles to the success of this strategy, of which two are related to relative levels of political integration and the third directly involves the United States:

- Dr. Tang notes that “integration” among Latin American countries is proceeding, but has not yet reached the level of Europe, for example. Because this process has been slow, China has developed strong relations with some countries in the region but not others. He specifically points out that some countries “lack a deep understanding of China” due to geographical distance, and instances of business mismanagement by a few Chinese enterprises in Latin America have caused estrangement, misunderstanding, and a lack of trust.
- Dr. Tang assesses the relationship between ASEAN and Latin America as a whole to be relatively loose and undeveloped—a dynamic over which China has little control that will delay implementation of the 21st Century Silk Road strategy.
- Dr. Tang asserts that Latin America is viewed by the United States as its “strategic backyard,” while the Obama Administration's “Pivot to Asia” strategy involves increased efforts to “win over” ASEAN. Thus, his logic proceeds, if the Maritime Silk Road does bring China, ASEAN, and Latin America together, it will represent a huge challenge not only to the TPP effort, but also to the entire shape of global U.S. hegemony, possibly leading the United States to obstruct the implementation of the strategy.

Author's Policy Recommendations

To overcome these obstacles and achieve these objectives, Dr. Tang offers four recommendations for Chinese policymakers:

- He advocates for increased diplomacy from the Chinese side to seek the support of more ASEAN and Latin American countries and build collaboration in planning the Maritime Silk Road's construction. Brazil, Mexico, and Argentina are named as particularly important.
- He suggests China use the Maritime Silk Road as an opportunity to negotiate free trade agreements (FTAs) with more Latin American nations, eventually working toward a region-wide China-Latin America agreement and finally a China-Latin America-ASEAN FTA, emphasizing the favorable results of China's existing FTAs with ASEAN, Chile, Costa Rica, and Peru.
- He advocates advancing infrastructure assistance to ASEAN and Latin America through development banks, stating that infrastructure construction in these regions is comparatively weak and restricts economic development.
- He recommends cultural exchanges between the three regions, emphasizing youth, think tanks, nongovernmental organizations, parliaments, and community organizations, to enhance intercultural understanding and friendship and build wider support for the initiative.

Conclusion

Dr. Tang takes the stance that the TPP is a vehicle for U.S. containment (despite the U.S. inviting China to join³) and calls for China to strongly oppose it. He advocates a strategic approach to China-Latin America relations, in view of the region's potential to provide China with economic profit, political support for its "developing country" perspective, and central positioning in the global trade structure. He recommends that China pursue more comprehensive, sustained investment in Latin America and Southeast Asia's maritime infrastructure in the coming years, using infrastructure investment banks and other financial platforms. Finally, he asserts that the United States views challenges to its global hegemony such as those posed by this strategy as intolerable, and predicts that on this basis it may obstruct actions taken by China in the political, economic, or cultural realm in Southeast Asia and Latin America.

- 应将“21世纪海上丝绸之路”延伸至拉美地区 (The 21st Century Maritime Silk Road Extends to Latin America)

People's Daily, March 16, 2015

<http://world.people.com.cn/n/2015/0316/c187656-26698584.html>

Think Tank: China Welcomes International Support for AIIB, Sees Challenges Ahead

Key U.S. allies, including the United Kingdom, France, Germany, and Italy, have expressed interest in joining the China-led Asian Infrastructure Investment Bank (AIIB) (亚洲基础设施投资银行 (简称: 亚投行)), a World Bank-like institution formally launched by President Xi last year.⁴ This development was reportedly met with strong objections from the Obama Administration over fears that lending standards would not be high enough.⁵

In an opinion piece published in CCP-run tabloid *Global Times*, one Chinese academic questioned the validity of U.S. concerns about the AIIB, casting them as baseless. Wang Yong, professor at the School of International Studies and director of the Center for International Political Economy Research at Peking University, argues in the article that the "new economic order" driven by BRICS countries (Brazil, Russia, India, China, and South Africa) and led by China arouses three main concerns for the United States: first, that it will lose control over the post-World War II international financial system it helped establish; second, that the AIIB will become China's geopolitical strategic tool for countering the United States' "pivot to Asia" strategy; and third, that China will attempt to drive out U.S. influence from Asia altogether. According to the article, looking at China's establishment of the AIIB only from the geopolitical perspective is a mistake for the United States that only hurts its reputation as a leader of international economic cooperation.

In an article in the privately-owned business and financial magazine *Caixin*, a senior researcher at leading Chinese public policy think tank Anbound argues China's actual motivations for establishing the AIIB are strongly based in economics. The article cites the importance of infrastructure development in promoting economic growth among fund-deficient Asian countries like India and Indonesia, arguing that only through improved infrastructure investment and construction did Asian giants like China, Japan, and South Korea attain opportunities to develop their economies rapidly. The article also notes there is a sizeable gap in infrastructure financing in Asia—a void China can fill. According to ADB and World Bank statistics presented in the article, annual investment for basic infrastructure in Asia will range from \$730 billion to \$800 billion over the next eight to ten years, but the ADB and World Bank combined can provide at most approximately \$300 billion in investment funds. Thus, the article concludes, with the AIIB, China is in a unique position to take the lead in jumpstarting regional economic development.

According to the *Caixin* article, it is not surprising that leading European countries have made an about-face and signaled AIIB participation because, despite its slowdown, China's economy is performing comparatively well on a global basis such that no country wants to miss out on an opportunity for deeper cooperation. But the increased attention puts China under pressure to ensure the AIIB operates successfully, states the article. It predicts China and the AIIB will become more influential in instances of multilateral economic cooperation, but China's success in securing international votes of confidence in the AIIB is only superficial until the bank begins operations.

The article points out another challenge China now faces: with so many European actors considered leaders in world financial affairs participating in the AIIB, China will have a harder time steering the institution than it otherwise would. Thus, argues the article, in order to ensure smooth operation of the AIIB, China's government must step up its efforts in establishing rules and regulations and managing international relations.

- “高大上” 亚投行的挑战 (Challenges for the “High-End” Asian Infrastructure Investment Bank)
Caixin, March 18, 2015
<http://opinion.caixin.com/2015-03-18/100792243.html>
- 王勇：亚投行考验美国心胸和能力 (Wang Yong: Asian Infrastructure Investment Bank Tests America's Patience and Capabilities)
Global Times, March 18, 2015
http://opinion.huanqiu.com/opinion_world/2015-03/5940577.html

Domestic Policy Agenda

National People's Congress Delegate Pushes for Biomass in 13th Five-Year Plan

On the sidelines of the concurrent March 2015 sessions of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference, two annual meetings of China's political leaders, delegates are strongly pushing for the inclusion of their policy proposals in the initial draft of China's 13th Five-Year Plan (FYP).⁶ These FYPs establish China's industrial policy for the next five years by outlining the Chinese government's priorities and signaling to central and local officials and industries the areas for future, large-scale government investments and preferential government support.*

In an interview with the privately-owned Chinese financial newspaper *Economic Observer*, one NPC delegate urged the government to support the development of China's biomass energy (生物质能源) program in the forthcoming 13th FYP. Chen Yilong, who also serves as chairman of green tech company Sunshine Kaidi New Energy Group,[†] told *Economic Observer* that biomass can provide an “independent, secure, [and] stable” energy source in the face of fossil fuel shortages at home and increasing dependence on imported energy resources from unstable regions.

Mr. Chen argues China's status as a global agricultural giant makes biomass a more beneficial and efficient choice of power. For one, he says, biomass efficiently utilizes agricultural waste, and therefore has the potential to eliminate environmental pollution. Second, because the carbon dioxide emitted during the biomass power production process can be integrated into the natural carbon cycle, it can help China achieve carbon neutrality. Finally, Mr. Chen believes plant biomass has the potential to repair environmentally damaged areas in China with reforestation.

Additionally, government support of biomass energy production and consumption in China could lead to rural economic and social development, Mr. Chen told *Economic Observer*. If China's nearly 300 million acres of crop land and 1.4 billion acres of woodlands were converted to biomass, he estimated, the energy it would generate would be more than that generated by five billion tons of coal. For comparison, that same amount of energy could fuel approximately four million homes in the United States for a year.⁷

Despite these advantages, Mr. Chen believes the Chinese government lacks a clear strategy for the development of the domestic biomass industry. First, only 5 percent of the biomass energy equivalent of 460 million tons of coal is currently utilized. Second, the Chinese government has directed significantly more attention and support to wind and solar energy development at the expense of biomass energy.[‡] In 2014, Bloomberg New Energy Finance found

* For an overview of the 12th Five-Year Plan and Five-Year Plan drafting process, see Katherine Koleski and Joseph Casey, “Backgrounder: China's 12th Five-Year Plan,” *U.S.-China Economic and Security Review Commission*, June 24, 2011.
http://www.uscc.gov/sites/default/files/Research/12th-FiveYearPlan_062811.pdf.

† Sunshine Kaidi New Energy Group Co., Ltd. is a high-technology investment company focused on green energy.

‡ For an in-depth analysis of China's support for wind and solar industry, see Jacob Koch-Weser and Ethan Meick, “China's Wind and Solar Sectors: Trends in Deployment, Manufacturing, and Energy Policy,” *U.S.-China Economic and Security Review Commission*, March 9, 2015.
http://origin.www.uscc.gov/sites/default/files/Research/Staff%20Report_China%27s%20Wind%20and%20Solar%20Sectors.pdf.

that 77 percent of China's \$89.5 billion in clean energy investment went to solar and wind.⁸ Finally, insufficient financing and investment mechanisms further limit growth of the domestic biomass industry.

To address these challenges, Mr. Chen proposes a comprehensive, state-led approach through increasing high-level attention to mobilize resources and public awareness; implementing a biomass energy plan to expand utilization of existing biomass resources; creating "green financing," including public financing, green banking, bonds, insurance, and a carbon market to spur investment growth; and promoting industrialization of biomass fuel. Mr. Chen strongly recommends the inclusion of biomass energy into the 13th FYP because it is important to driving the development of strategic emerging industries.

- 人大代表陈义龙：生物质能源应列入“十三五规划”重大专项 (NPC Representative Chen Yilong: Biomass Energy Should Be on the Agenda for the 13th Five Year Plan)
Economic Observer, March 14, 2015
<http://www.eeo.com.cn/2015/0314/273643.shtml>

Foreign Investment

Caixin Reports Updated Foreign Investment Catalogue Yields Limited Change for Steel Industry

A much-anticipated revision of the policies governing foreign investment in key Chinese sectors is nearing implementation. On March 13, 2015, China's National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) published the updated Catalogue Guiding Foreign Investment in Industry (2015 Catalogue; 《外商投资产业指导目录(2015年修订)》), slated to take effect on April 10. The catalogue has guided foreign investment in China since 1995, categorizing industries in which foreign investment is encouraged, restricted, or prohibited.⁹ This method has long been a sore point for the U.S. administration, which argues the catalogue "reflects China's market access restrictions" and confuses investors due to often unspecified overlap with other measures.¹⁰

In a *Caixin* "expert's column," Ren Qing, partner and specialist in international trade and investment law at Beijing-based multinational law firm Zhong Lun and former deputy director of MOFCOM's Department of Treaty and Law, compared restricted and prohibited investments in the 2015 and 2011 Catalogues.* He made the following observations:

- The number of items where foreign investment is restricted decreased from 79 in the 2011 Catalogue to 38 in the 2015 Catalogue, while the number of items where foreign investment is prohibited fell from 38 to 36. Most notably, he said, restrictions were lifted in manufacturing and in services industries including real estate, e-commerce, finance, and wholesale.
- New categories in which foreign investment is now prohibited include geological surveying, Internet publishing, and the operation of antique stores and auction houses selling Chinese cultural relics, among others. The tobacco distribution and sales industry changed from restricted to prohibited. Legal services, which hitherto has remained prohibited despite China's World Trade Organization (WTO) commitment to open the sector to foreign investment, was renamed "Chinese legal services" and classified as prohibited.
- Some specific restrictions that were eliminated in the October 2014 draft version of the catalogue, such as the printing of publications with Chinese parties as controlling shareholders, were put back into the restricted category in the 2015 catalogue.
- From now on, only "legal statutes" (法律法规) can stipulate which categories are restricted or prohibited from foreign investment. Neither the Chinese State Council provisions nor industrial policy will stipulate foreign investment items any longer.

* For a more detailed outline of the 2015 Catalogue, see *Practical Law*, "China Releases New Foreign Investment Catalogue," March 16, 2015. <http://us.practicallaw.com/1-604-7265>.

A separate *Caixin* article examines a key implication of the 2015 Catalogue: it will overturn the Chinese government's 2005 "Steel Industry Development Policy," which prohibited foreign control of Chinese steel companies. Specifically, it will eliminate the industry-specific shareholding rules for foreign investors in steel and in other sectors—including ethylene, paper-making, crane machinery, power transmission and distribution equipment, and liquor-making.

According to the *Caixin* article, this seemingly ground-breaking policy change is unlikely to impact the steel industry, and is more a reflection of a change in the industry's development. The ten-year-old ban on foreign control of Chinese steel companies to protect domestic companies from competition resulted in rapid industry expansion—at 1.1 billion tons, China's steel production capacity is reported to be the highest in the world. Recently, however, the industry's strength has atrophied. The article reports that profit margins in China's steel industry have shrunk from 8.1 percent in 2004 down to 0.85 percent in 2014.

As a result of such policies, warns the article, China's steel industry is in a precarious state owing to its lack of competitiveness, low level of technology and management, and overcapacity. To recover, the article says, the Chinese government realizes its domestic steel companies must partner with foreign firms to upgrade production to "high-end" goods. In other words, for Chinese policy makers, opening the steel industry up to foreign investment would not only contribute to "upgrading" the industry, but also "shake up" dominant, inefficient players like state-owned enterprises, says the article.

The article offered one example of a foreign company navigating China's transitional steel policies: the attempt by ArcelorMittal, the largest steel maker in the world, to acquire Hunan Valin Steel Co., Ltd. (Valin) in 2005. ArcelorMittal downgraded to second-largest shareholder due to objections from the NDRC. The company's continued attempts to acquire Chinese steel companies Laiwu Steel and Dongfang Group were repeatedly denied. According to the article, ArcelorMittal was only able to succeed in breaking into the Chinese market by forming a joint venture with Valin to produce high tech automotive steel. The article describes the venture as a win-win partnership: for Valin, ArcelorMittal's superiority in auto steel production technology and its strength as a global competitor were attractive; for ArcelorMittal, the opportunity to tap into China's high-end auto steel market was enticing. So, while decreasing its shares in Valin Steel, ArcelorMittal increased its shares in the joint auto steel company from 33 percent to 49 percent—though Valin remained the controlling shareholder.

Going forward, the article argues, the future of China's steel industry will be determined not by whether foreign companies can invest but rather by whether foreign companies are willing to invest given the downturn in the steel market. The article cites ArcelorMittal's losses, which surpassed \$1.08 billion in 2014, continuing a three-year deficit. Even though the pressure on steel companies has been slightly lessened due to a fall in prices of raw materials like iron ore, says the article, their profits are still very low.

- 《外商投资产业指导目录》2015年版和2011年版对照 (Comparison of the 2011 and 2015 Versions of the Catalogue Guiding Foreign Investment in Industry)
Caixin, March 16, 2015
<http://opinion.caixin.com/2015-03-16/100791574.html>
- 中国放开投资限制 但钢铁巨头未必买账 (China Lifts Investment Restrictions but Steel Tycoons May Not Buy It)
Caixin, March 16, 2015
<http://opinion.caixin.com/2015-03-16/100791652.html>

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Endnotes

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- ⁵ Lingling Wei and Bob Davis, “China Forgoes Veto Power at New Bank to Win Key European Nations’ Support,” *Wall Street Journal*, March 23, 2015. <http://www.wsj.com/articles/china-forgoes-veto-power-at-new-bank-to-win-key-european-nations-support-1427131055?tesla=y>.
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- ⁷ U.S. Department of Interior Bureau of Land Management, *Electricity Conversion Calculations*. http://www.blm.gov/ut/st/en/prog/energy/coal/electricity_conversion.html.
- ⁸ Bloomberg New Energy Finance, “BNEF: Clean Energy Investment in 2014 Beats Expectations: Surges in Solar Investment in China and the US Helped to Drive the Global Total up 16% to USD 310 Billion,” *Solar Server*, January 9, 2015. <http://www.solarserver.com/solar-magazine/solar-news/current/2015/kw02/bnef-clean-energy-investment-in-2014-beats-expectations-surges-in-solar-investment-in-china-and-the-us-helped-to-drive-the-global-total-up-16-to-usd-310-billon.html>.
- ⁹ Ning Lu and Timothy P. Stratford, “Chinese Government Issues 2015 Foreign Investment Catalogue — Effective April 10, 2015,” *National Law Review*, March 25, 2015. <http://www.natlawreview.com/article/chinese-government-issues-2015-foreign-investment-catalogue-effective-april-10-2015>.
- ¹⁰ U.S. Department of State, *2014 Investment Climate Statement*, June 2014, 1. <http://www.state.gov/documents/organization/228504.pdf>.