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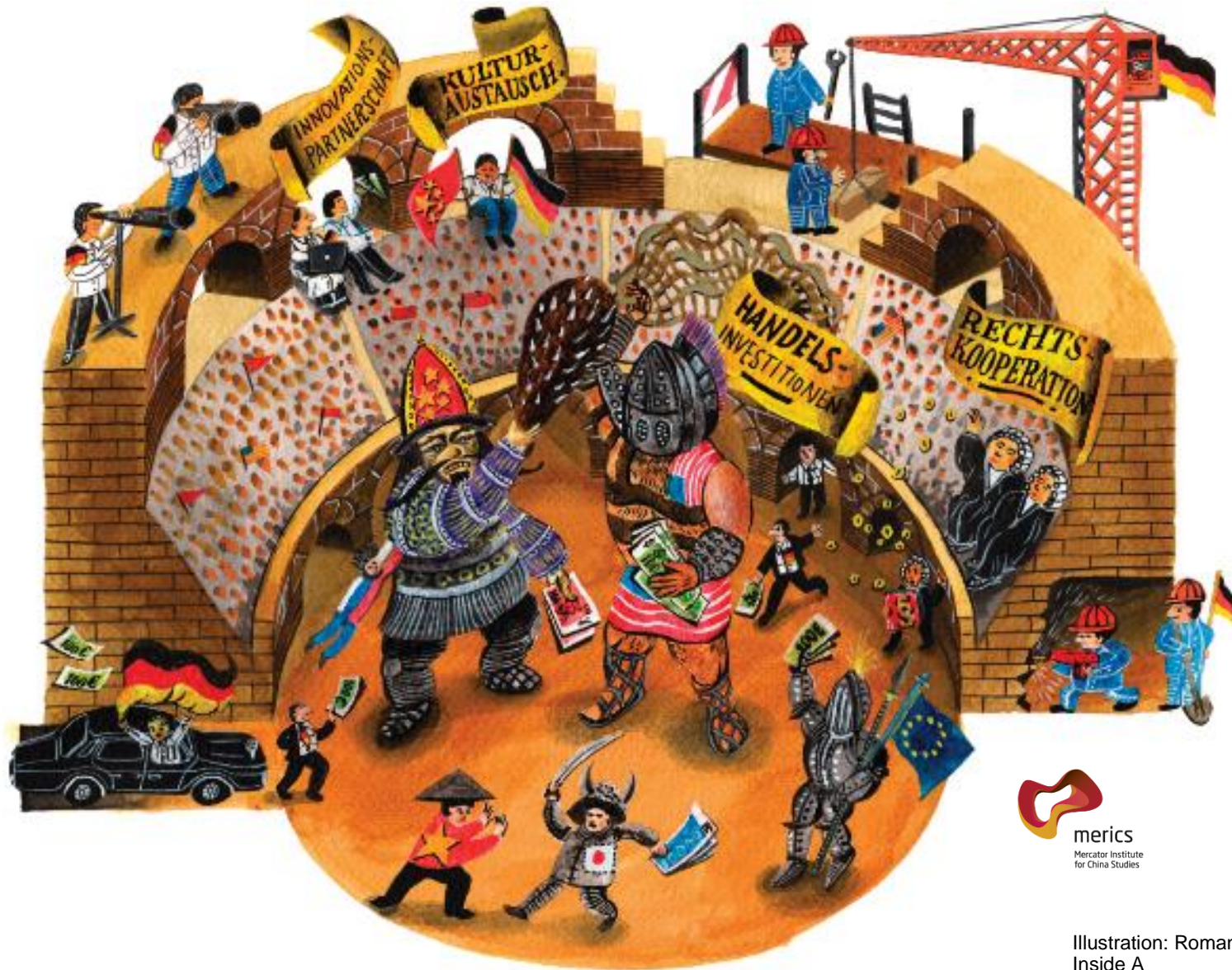
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## Niche Diplomacy at Work: Germany's Catalytic Role in European-Chinese Relations

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### EXECUTIVE SUMMARY

- Governments across the globe must adjust their China policies. In diplomacy, Beijing's forceful geostrategic initiatives challenge traditional Western dominance in many world regions and international institutions. In business, China engagements are becoming more risk-prone due to slowing growth, intensifying competition, stricter regulation, or aggressive industrial policy.
- This poses a fundamental gravitational dilemma to China policy: Even as diplomats and firms may seek to diversify their activities away from China, they will not be able to detach themselves from it.
- In economic diplomacy with China, Europe and Germany need to build up their leverage vis-à-vis China. The on-going negotiations over a bilateral investment agreement, as well as China's wish to establish a full-scale Sino-European free trade area in the longer term, offer new opportunities to negotiate with China on an equal footing.
- European China policy, however, continues to be marked by severe deficits in coordination and decisiveness at both the EU-level and among EU member states. In order to avoid across-the-board stagnation of European China policy, Germany must act as a catalyst and take the initiative on substantive issues. Berlin has the standing with Beijing, as well as the capacity and continuity within its foreign policy community, to make consistent efforts at expanding interactions with China beyond trade and technology cooperation.
- German diplomacy and business have worked to consolidate many specific areas of activity, or niches, for productive cooperation with China. German involvement sets its sights on select areas one by one, rather than submitting all policy fields to one set of grand China strategy. This niche diplomacy provides policy-makers with a versatile framework to manoeuvre through the shifting conditions for China policy.
- Europe can benefit considerably from the establishment of new Eurasian transport corridors that are part of China's geostrategic ambitions. Germany should cautiously participate in some of China's current endeavours on a project-by-project trial basis.
- For cultivating a fall-back position in case of open conflict with China over trade, security or legal issues, Berlin would be well advised to strengthen the existing communication channels between American and German diplomats and researchers who work on China affairs.
- Germany and Europe, however, must avoid being dragged into the intensifying great power rivalries between China and the U.S. that imperil a core European interest: keeping the Asia Pacific as open as possible for European and multilateral engagement.



### The Shifting Context of China Policy

Governments across the globe have to rethink their China policies. Under the leadership of Xi Jinping, China's foreign policy is making determined efforts to reshape the geostrategic environment. Beijing's ambitions have wide-reaching implications for international trade, diplomacy, and security. The Chinese government is committing vast diplomatic and financial resources to the development of continental and maritime economic corridors ("new silk roads"). Through China-centred intergovernmental organizations, funding mechanisms and infrastructural mega-projects, Beijing is targeting developing countries and emerging markets in a forceful novel approach to South-South cooperation.

While China's long-established relations with Western states and markets remain indispensable, China's diplomacy is trying to find ways around Western influence and is strengthening its relations with non-Western powers. This includes major challengers of the West such as Russia but also smaller marginalized countries such as Venezuela or Zimbabwe. China is no longer willing to limit itself to Western dominated international institutions. It is therefore currently building a broad range of parallel alternative mechanisms that bypass the US-led post-Cold War order. In the Asia-Pacific

region, the long-hidden great power rivalry between China and the U.S. is a blunt fact today and encroaches on all regional interactions.

Domestically, China's political leadership is taking a much tougher approach not just against internal corruption and dissent but also against long established forms of civil society cooperation with foreign organizations. A number of non-governmental communication channels with China that had worked continuously over decades – including Western NGOs and foundations – currently find themselves under suspicion of being part of "hostile foreign forces" that work towards undermining Communist Party rule.

On the economic front, Chinese growth is markedly slowing and major sectors such as property, construction, finance and manufacturing appear increasingly fragile. Overcapacities and cut-throat price competition are making China's business environment much more difficult. In addition, an aggressive national industrial policy that aims at protecting strategic industries and promoting national champions has built up novel pressures on foreign investors that had benefited handsomely from their market presence, or even sectoral dominance, in China previously. Without a doubt, China's economy has entered a new stage of development. Lower long-term growth rates and

painful restructuring are likely to render trading and investment relations less lucrative in many branches of the economy. Yet, due to both its huge size and its continuing above-average growth, the Chinese market will remain irreplaceable for foreign businesses in the foreseeable future.

All this poses a fundamental gravitational dilemma for diplomatic and economic relations with China: Even as diplomats and firms see growing risks and seek to diversify their activities away from China, they will not be able to detach themselves from it.

### Germany's Catalytic Role in European-Chinese Interactions

Germany's China policy will need to develop a creative response to this gravitational dilemma. It must adapt to the shifting conditions in China's development and critically assess traditional goals and priorities.

Germany's central objectives in dealing with Beijing have traditionally consisted in:

- (1) supporting China's integration into the structure of established international



institutions and organizations shaped by the West,

- (2) promoting domestic economic and political liberalization by engaging China in intense business and diplomatic exchanges,
- (3) securing the economic interests of Germany as a global trading power in the Chinese market, particularly by taking a stand for open market access and an effective protection of intellectual property.

All three goals are being challenged in the current shifting geopolitical and geoeconomic environment.

First, through the establishment of novel China-sponsored international organizations and funding schemes, China attempts to create governance alternatives to traditional Western-dominated institutions and to reshape global patterns of interaction especially on the South-South axis.

Second, neither rapid economic-technological development nor intensive transnational and bilateral exchanges with the West have fostered domestic liberalization within China to the expected degree. On the contrary, we currently witness a

hardening of China's foreign and domestic policy stances.

Third, China policy will need to change with shifting fundamentals in economic relations. Key challenges include an increased competition from Chinese companies (within China and globally), a risky over-dependency of major German industries (cars, machinery) on the Chinese market, a potential loss of traditional advantages in major industrial technologies (mid-tech machinery as well as energy and environmental technologies), and novel patterns of Chinese outbound investments and Chinese business presence in Europe itself.

These challenges are serious. They do not, however, necessitate a sweeping negation of traditional goals and principles but rather an adjustment of expectations and policies. German China policy must hold on to overarching principles such as human rights, the rule of law, open markets and environmental sustainability. However, every inch of progress down this road will be much more difficult than previously assumed and will be slowed down by recurrent setbacks. Expectations must be adjusted accordingly.

More importantly, Germany and Europe should have a clear understanding of their limited capabilities: The traditional, rather self-absorbed,

ambition to transform China into a European-style democracy through outside advice is unrealistic and should be banished from the policy agenda. China's political modernization will have to be brought about by the Chinese themselves. It will be based on trajectories and institutions that diverge profoundly from Western historical experiences. Neither Americans nor Europeans will be able to provide magic recipes that pave the way for democracy in China.

### **European Policies Remain Uncoordinated**

With a view to the severe limitations of European China policy, German foreign policy-making needs a sobering reality check. With the notable exception of trade relations, chances for effective coordination of the EU's China policies are extremely dim. Despite the issuance of numerous EU strategy documents, all previous attempts to develop a joint and comprehensive European approach towards China have resulted in repetitive declarations of intent and poorly coordinated dialogue mechanisms.

Such weakly coordinated and discontinuous interactions with China are not just a feature of EU-level China policy. Weak capacities and recurrent disruptions in the foreign policy set-up also

constrain the China policies of many individual EU member states that lack the standing or the resources to pursue their interests and priorities vis-à-vis China in a continuous manner.

In order to avoid across-the-board stagnation of European China policy, Germany therefore must act as a catalyst on substantive issues. Berlin has the standing with Beijing, as well as the capacity and continuity within its national foreign policy community, to take the initiative and make consistent efforts to expand diplomatic, legal and social interactions with China beyond trade and technology cooperation. As soon as Brussels may gain the capacity to devise viable coordinated China policies, Germany's bilateral initiatives can be integrated into EU mechanisms. Yet for the time being, Berlin is the only European government that can work to keep channels of communication with Beijing open in the more conflictive areas of China policy, such as market access, industrial espionage, the law of the seas, or modernization of China's legal system.

### Identifying New Areas for Cooperation

There is both great potential and ample need for new formats of political, economic, financial and technological cooperation. As China's economy

and society keep developing, Chinese demand for German expertise has increased especially in the areas of sustainable urbanisation, spatial planning, water management, health services, medical technology as well as the management of welfare organizations.

China's new regional cooperation schemes, especially in Central Asia, require careful examination by European decision-makers. Europe could benefit considerably from the establishment of new Eurasian transportation corridors and the economic mobilization of Central Asian societies. Germany should cautiously support China's endeavours in Central Asia on a project-by-project trial basis by bringing those German and European infrastructure and energy programs into play that have been pursued with limited effects during the past two decades but may now be reinvigorated through joint projects with China.

Germany should also consider getting cautiously involved in individual parallel structures that China is currently building and that mirror the functions of traditional frameworks such as the Bretton Woods institutions (World Bank, IMF). For instance, German diplomats should consider taking an active part in the newly-established Asian Infrastructure Investment Bank (AIIB) – in spite of American

diplomatic efforts to keep allies such as Australia, South Korea and Germany away from the Chinese initiative. AIIB responds to massive investment needs in large parts of Asia that have only partly been addressed so far by the World Bank or the Asian Development Bank. And it may open up new diplomatic and business channels in the supported countries.

### Building up Constructive Leverage

In economic relations – which may become a lot more conflictive in the future due to intensifying competition and vigorous industrial policies on the Chinese side – Germany urgently needs to build its leverage vis-à-vis China. On the European level, the on-going negotiations over a bilateral investment agreement with China, as well as China's wish to establish a full-scale Sino-European free trade area in the longer term, offer Europe new opportunities to negotiate with China on an equal footing.

Negotiations over the EU-China bilateral investment agreement provide a major opportunity for Brussels and Berlin to push for thorough improvements regarding market access, non-discrimination of foreign companies, competitive public procurement and the protection of

intellectual property rights. At the very least, European policy-makers must insist on the consistent implementation of all WTO rules in China, including the WTO rules on public procurement that China still has to acknowledge. As to central conflictive issues of trade relations, such as market access and equal treatment, European and German trade diplomacy must not make concessions but rather push for Chinese commitments in a determined manner.

To reduce the dilemma of overdependence posed by the immense pulling power of China's market, German diplomacy and business must work more actively to diversify their political and economic initiatives away from China towards India and other emerging economies. If only a handful of prospering Special Economic Zones could be established in India with the help of Western investment and knowhow, the promotion of economic counterweights against one-sided gravitation towards China would become much more credible.

For cultivating a fall-back position in case of open conflict with China over diplomatic or security issues, Berlin would be well advised to strengthen the existing, yet only sporadically used communication channels between American and German diplomats and researchers who work on

China affairs. If open disruptions occur in interactions with China, transatlantic coordination will be an indispensable back-up for a stronger joint position vis-à-vis China.

In principle, however, Germany and Europe must avoid being dragged into the intensifying great power rivalries between China and the U.S. that obstruct a core European interest: keeping the Asia Pacific as open as possible for European and multilateral engagement.

### **Engaging China through Niche Diplomacy**

Ambitious strategy papers that rest on lofty goals, linear assumptions and static instruments are not conducive to making foreign policy in the volatile international context of the 21st century. Instead, especially when dealing with the rapidly shifting international role of China, contemporary foreign policy must be versatile in its instruments, yet persistent in its priorities, to manoeuvre in a profoundly unpredictable environment.

In recent decades, Germany's foreign policy approach towards East Asia has met this requirement by focusing on the niches within the markets and between the competing powers in the Asia Pacific. German diplomacy and business have

continuously worked to identify specific areas of feasible cooperation so as to keep exchanges with China open in as many niches as possible.

This niche diplomacy results from decades of diplomatic and business practice, not from a publicly formulated or coherently pursued strategy. Though several official papers on Asia policy have been issued by German government bodies since the 1990s, the practical implementation of policy remained incremental and cautious, yet remarkably agile. Niche diplomacy sets its sights on limited areas of cooperation one by one, rather than submitting all policy fields to one set of grand strategy. This down-to-earth approach to China policy must not be written off as mere opportunism. Rather, it is a means of creating space for cooperation that would remain closed if pursued with more aggressive tactics. Niche policies have been a pertinent approach to work with China on the nuts and bolts of economic cooperation while also addressing controversial issues such as legal and judicial exchanges that contributed, for example, to major (yet inadequately implemented) reforms in China's criminal procedure laws.

One crucial aspect of niche diplomacy concerns the question of linkage politics. In contrast to what the German public might expect, foreign policy will benefit in many areas and over the long term if

successful cooperation in one specific niche is not taken hostage from across other niches. Thus, even if there may be occasional calls in the public to link trade with human rights or tie investment to environmental standards, a successful niche policy will need to make sure that conflicts or even collapses in one niche do not damage or undo activities in other fields of cooperation. Niche policy can thus cultivate a framework of selective cooperation that is compatible with Germany's capacities and priorities.

The feasibility of niche diplomacy vis-à-vis China rests on the foundation that industrial and technological cooperation with Germany has proven highly useful in the eyes of Chinese policy-makers. As long as Germany keeps its competitive edge in helping China's industrial ambitions, Germany will be able to extend its unassuming, but effective practices of interaction with China.

So far, niche policy has opened up many channels in bilateral relations that go beyond trade and investment and include today administrative, legal, environmental as well as cultural and educational exchanges. Silently, Germany has also been able to avoid being drawn into intensifying Sino-American rivalries. Right now, German China policy is moving to open up new important niches with many potential bilateral benefits, such as

exchanges on fiscal policy or management of social insurance.

Niche diplomacy thus continues to provide policy-makers with the room to manoeuvre even through a turbulent international environment while reducing the risks and the costs in broadening exchanges with China.

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