

China to Europe's rescue: "Benevolent generosity" or "financial Machiavellianism"?

Analysis by Yang Chan based on:

- Ding Chun, "Why is China offering fuel to Europe when it's snowing?", *Shehui Guancha – Social Outlook*, no. 2, February 2011, pp. 53-55.
- He Zhicheng, "The European debt crisis: A trap to short China," *Caijing wang*, 21 June 2011.
- Shang Hao, "Yin Jianfeng: To save the euro is to save the multipolar monetary model," *Huaxia Shibao – China Times*, 7 January 2011.
- Yin Zhongli, "The European sovereign debt could be an opportunity for China," *Zhongguo Shichang – China Market*, no. 29, 2011.
- Zhao Boying, "Whilst continuing to promote European diplomacy, China is developing the Sino-European strategic partnership," *Dangdai Shijie – Contemporary World*, no. 3, March 2011, pp. 12-17.

Since the eruption of the sovereign debt crisis that has particularly affected those countries situated on the periphery of the eurozone, China has repeatedly declared itself willing to buy European government bonds. During their official visit to Europe in autumn 2010, Chinese President Hu Jintao and Prime Minister Wen Jiabao both expressed China's concern over the situation in Greece and promised, in the name of the Chinese Government, to buy part of that country's public debt, without mentioning a precise sum. During a visit to Spain in January 2011, Li Keqiang, a member of the standing committee of the CCP Politburo and Deputy Prime Minister, confirmed China's intention of continuing to buy European sovereign debt. Against the background of the worsening Greek crisis, the Chinese Minister of Foreign Affairs reiterated the PRC's support for Europe, stating that China had been continually accumulating stock in euro since the financial crisis of 2008. According to certain Western sources, including Standard Chartered, the total amount of Chinese purchases of euro zone government bonds is estimated at 650 billion euros, a figure that has never been officially confirmed by the Chinese authorities.

European feeling over the Chinese purchase of Greek, Portuguese, and Spanish debt remains ambivalent: on the one hand, the Europeans hope to take advantage of the Chinese market and capital to redress the economy of the Old Continent, but on the other, they remain anxious and sceptical as to what Chinese political ambitions this apparent generosity might be hiding. For some observers, it is the very sovereignty of Europe that is threatened. Faced with this suspicion and distrust, the Chinese authorities, as well as very many economists, would like to present the image of a China that is increasingly responsible and involved in the international financial situation, a stance that seems more in tune with its new economic and financial importance. According to Ding Chun,⁽¹⁾ Zhao Boying,⁽²⁾ Yin Jianfeng,⁽³⁾ and Shen Jianguang⁽⁴⁾ in particular, it is in the mutual interests of China and the EU to work together on redressing the economy of European countries in difficulty. The European sovereign debt crisis could have considerable repercussions for the Chinese economy, in particular as regards the following four points:

- in the first instance, new monetary policies of quantitative easing (量化宽松货币政策 – *lianghua kuansong huobi zhengce*) engendered by the crisis risk introducing inflation into China through imports;
- next, a worsening of the economic climate in Europe – the primary destination of Chinese exports since 2005 – would constitute a blow to Chinese exports;

- thirdly, the crisis is likely to trigger a currency war, increasing pressure on the appreciation of the *yuan*;
- and finally, the risk of devaluation of the euro would not be good news for the safeguarding of Chinese foreign exchange reserves, all the more so since the percentage of Chinese assets in euros has been steadily increasing in recent years.

The majority of Chinese economists believe that China's purchase of European debt enables it above all to protect its economic interests. Many of these economists emphasise that the risk and cost of this involvement are largely inferior to the risk and cost of inaction. Firstly, in terms of Sino-European trade, Ding Chun explains that it is in China's interest to support the European economy in order to maintain Europe's purchasing power, and consequently, imports of Chinese products. This is vital for the Chinese economy, which still depends heavily on foreign trade. Zhao Boying is of the same opinion as Ding and at the same time recommends greater efforts on the part of China to adjust the imbalance of trade and favour imports from the EU. He also believes this contributes to the continued importation of innovative products and cutting-edge technologies as well as of the advanced managerial practices China still lacks. Moreover, this offer of Chinese capital could facilitate investments by Chinese companies in Europe by bypassing certain protectionist obstacles that they may encounter when exporting (notably non-tariff measures such as anti-dumping and anti-subsidy regulations and technical norms).

In an interview given to *Huaxia shibao* at the beginning of the year on the subject of the purchase by China of 6 billion euros' worth of Spanish government bonds, the economist Yin Jianfeng decodes Chinese financial interests. He reminds us that, according to IMF statistics, the international monetary system is dominated by the dollar, which represents a little less than 70 percent of world reserves, whilst the euro constitutes less than 30 percent. Up until the end of March 2011, the balance of China's foreign exchange reserves totalled \$3,040 billion,⁽⁵⁾ of which the majority (around 70 percent, according to certain estimates) was in dollars. The announce-

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5. Source: the Department of State for foreign currencies.

ment of "QE2" (Quantitative Easing 2) by the American Federal Reserve on 3 November 2010, which led to a competitive devaluation of the dollar, dealt a severe blow to Chinese assets. By directing part of Chinese investments towards European stock, therefore, China benefits not only from more diverse portfolios that limit the risk of losses in case of devaluation, but also from a reduction of its dependence on American Treasury bills with lower rates of return.

Support from China also reinforces the confidence of the international market, maintaining the position of the euro and limiting the risk for China of a monetisation of debt policy. This amounts to attenuating inflationist pressures within China and, according to Zhao Boying, to partially attenuating constant pressure from the United States to revalue the *yuan*. However, the majority of Chinese experts believe that Beijing's real intention is to counterbalance the predominance of the dollar in order to arrive at a multipolar or tripartite world monetary system made up of the dollar, the euro, and the *yuan* (三足鼎立的国际货币体系 – *sanzu dingli de guoji huobi tixi*). Nonetheless, the current sovereign debt crisis, if mishandled, runs a strong risk of threatening the very existence of the euro. The result of this is that so long as the *yuan* remains inconvertible in the short and medium-term, the most direct means for Beijing to arrive at this tripartite system is to continue to support the euro.

China's commitment to Europe also has a political and diplomatic dimension. Ding Chun points out that the sovereign crisis in the eurozone occurs against a background of Sino-European reconciliation after a period of diplomatic freeze, and of a return to the pragmatism of the EU since the entry into force of the treaty of Lisbon. By supporting Greece, Portugal, and Spain, Beijing is in effect making a gesture of solidarity towards the leading economy in the eurozone, Germany, and is showing itself to be more conscious of its image and international influence. Following China, Japan also intends to buy stock issued by the European Financial Stability Facility. Zhao Boying reveals the underlying stake in a Chinese strategy that consists of building a Sino-European partnership and rebalancing the strategic China-Europe-United States triangle to create a multipolar international order. Although the Chinese authorities have never explicitly said so, for many analysts such as Ding Chun and Zhao Boying, China could be led to exploit its position as a creditor to exercise pressure on the EU over certain sensitive subjects such as the recognition of China's market economy status, the lifting of the arms embargo on China, the relaxing of restrictions on the export of high technology products to China, and opposition to China's commercial protectionism of its products and investments. Moreover, Chinese Deputy Prime Minister Li Keqiang explicitly pleaded for greater effort on the part of Europeans in meetings with Zapatero, Wulff, and Cameron last January.

Many economists underline the opportunities that the crisis can also bring China, in particular, a step towards internationalisation of the *yuan* and the restructuring of its economic sector. Shen Janguang⁽⁶⁾ holds the opinion that in the long term, the most positive response to the European debt crisis would be to accelerate the agenda for the internationalisation of the *yuan*. Due to the inconvertibility of Chinese currency and the control of the flow of capital, the *yuan* still cannot become a world reserve currency. Despite the many problems of the American and European economies, at present China can only continue to hold assets in dollars and euros and accumulate massive foreign exchange reserves. The internationalisation of the *yuan* could diminish the losses caused by depreciation of the dollar and the euro. Other economists such as Yin Zhongqing⁽⁷⁾ recommend greater diversity in Chinese investments by progressively increasing

the percentage of raw material reserves, in particular precious metals, oil, and other energy resources.

Yin Zhongli⁽⁸⁾ is also fairly optimistic as to the potential opportunity the sovereign debt crisis represents for the Chinese economy, and in particular puts forward two short-term measures. As regards foreign policy, he advises Beijing to participate moderately but positively in solving the European sovereign crisis in order to strengthen the "affective" link with Europe, where the alter-globalist movement is likely to intensify with the worsening of the Greek debts crisis, leading to a rise in protectionism. As for the domestic situation, he suggests that as a countermeasure to QE2 by the United States and possibly the eurozone, China should implement a restrictive monetary policy and in particular maintain pressure on the sudden rise in the price of assets. In the first instance, this will doubtless lead to the appreciation of the *yuan*, a fall in exports, corporate bankruptcy and a rise in unemployment. Nonetheless, Yin Zhongli insists that China could seize this opportunity to promote economic modernisation and industrial restructuring towards sectors with greater added value so as to prepare for the challenges of reindustrialisation in developed countries.

Not everybody sees life through rose-coloured spectacles, however. A few discordant notes have also been sounded contesting the measures envisaged by Beijing, among them remarks by He Zhicheng, senior economist at the Agricultural Bank of China. He Zhicheng believes that the sovereign debt crisis in the eurozone may prove to be a trap to short China (欧债危机实际是做空中国的一条暗线 – *ouzhai weiji shiji shi zuokong zhongguo de yitiao anxian*). The losses on the Chinese stock exchange, in free-fall since mid-April, are concomitant not only with the positions taken by the financial giants who speculate on China's crash, but also with the sovereign crisis that is spreading throughout peripheral European countries. According to He, China holds at least 600 billion euros' worth of European debt, including 100 billion euros of government bonds issued by PIIGS. If the sovereign debt crisis really does erupt (triggered perhaps by payment default by Greece), China will then suffer a colossal loss, very probably accompanied by an explosion of tension – economic, social and political – on the domestic front. He seems convinced that the least costly solution to resolve the Greek crisis would be to expel Greece from the eurozone. He believes that the current situation, in which the European leaders are desperately attempting to delay the inevitable, will increase the possibility of a crash landing for the Chinese economy.

He also observes that when certain major financial institutions in Europe began to reduce their purchases of Greek stocks (up to around 40 percent, according to his sources), Beijing continued to lend money to Athens. For He, only two measures can save the Chinese economy: either a drastic reduction in purchases of European sovereign debt, or an adjustment of the composition of the stock by buying more German bonds or shares in financially solid companies. Another economist, Yu Yongding,⁽⁹⁾ also calls for caution and exhorts the People's Bank of China to buy more AAA-rated stock issued by the European Financial Stability Facility.

■ Translated by Elizabeth Guill

6. Shen Janguang, "Chinese responses to the European debt crisis," *Diyi caijing ribao*, 19 January 2011.
7. Zou Liang, "Yin Zhongqing: To withstand the European debt crisis, China must further improve the exchange rate mechanism," *Shanghai zhengquanbao* – *Shanghai Securities News*, 21 June 2010.
8. Deputy Director of the Financial Markets Department of the Institute of Financial Research, Chinese Academy of Social Sciences.
9. Yu Yongding, "China must buy stock issued European Financial Stability Facility," *Diyi caijing ribao*, 27 April 2011. Yu is President of the CSWE (China Society of World Economy) and a member of the Chinese Academy of Social Sciences.