BANQUE
ERIC STURDZA

THE UNITED STATES AND EUROPE IN THE FACE OF CHINESE IMPERIALISM.

WHAT CONSEQUENCES FOR FINANCIAL MARKETS?

"Know your place in the world", Confucius.

Bruno Desgardins

Conference, ***11th March 2019***

In the midst of rivalries between powers, this saying by Confucius rings true, because this is the key issue for markets and geopolitics. There are many question marks, but Chinese history helps us understand and recent history illustrates the changes.

The question marks: from sun to shadows, possibly before the darkness.

- The sunny side is performance: how has a Communist country which promotes State capitalism been able to profit from globalisation to such an extent?
- The shadows are inequality and imperialism: how has a regime for which equality was the cardinal value been able to produce one of the most inegalitarian societies? What should we think of the aggressive imperialism of the Belt and Road Initiative, for example? What are the threats for Western countries and companies?
- The darkness is possibly to be seen over the coming decades: is the country not cushioning the slowdown by excessive use of debt? Can growth persist with such pollution? Can growth continue if the population declines? Will China be able to attain the status of a high-income country? Can a parallel be drawn with Japan at the end of the 1980s, just before its bubble burst?

In this context, could not Xi Jinping's centralisation of power be explained by his fear of a collapse of the regime like that which swept away the Soviet Union?

Ancient history: a great power.

Since the founding of the Chinese Empire in 221 BC, China has been dominated by the Hans and formed a Confucian civilisation several millennia old which held sway in Asia and gave the world the compass, gunpowder, printing and even, writes ***David Landes*** in "***The Wealth and Poverty of Nations***", metallurgy 1,500 years before Europe. According to ***Angus Maddison***, at that time China represented 15% to 20% of the world's wealth, and yet, after the exploit of the navigator Zheng He, who reached the coasts of Africa around 1430, China shut itself off from the rest of the world.

Recent history: a renaissance.

Of all countries it is China which, since the start of the Industrial Revolution in Great Britain in the 18th century, has posted the strongest growth cycle. China has managed to avoid crises. Whereas in 1990 it accounted for 3% of global industrial production, the figure is now around one-quarter. Since joining the WTO in 2001, China's export market share has increased from 4.3% to 14%, Chinese GDP has been multiplied by 12 and its weight in the global economy has increased from 2% to 15%. The country is the leading exporter in the world and it is increasingly investing abroad.

In 2018, US GDP was approximately $20,000 billion, the European 27 were at $15,000 billion and China $12,500 billion. China's GDP is equivalent to 60% of US GDP, but in purchasing power parity terms it is 120% and, according to some pundits, by around 2025 the Chinese economy could exceed

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the US economy in absolute value terms. The GDP of the other three BRICs, Russia, India and Brazil, totals less than 8%.

Given such economic performance, it raises the question of stock market performance, and we will endeavour to answer it. While the S&P 500's performance in US dollars has been 17.7% annually since its low point in March 2009, the annualised performance of the Chinese stock market has been just 11.8%.

To try to answer these questions, we will devote a first part to a triumphant China, a second to the impact on the West and, finally, see China on the defensive.

I. **China triumphant**: ***"The man who moves a mountain starts by shifting small stones", Confucius.***

China's conquering attitude is a reaction to several sources of its resentment: the humiliation of the Opium Wars in 1842, when the English forced the Chinese to buy opium produced in India to finance the purchase of the Chinese products they were very fond of; the humiliation of 1860 further to the sacking of the Summer Palace by the English and French; the humiliation of the Treaty of Shimonoseki in 1895, when the Japanese took over Taiwan; and the humiliation of the 1931 invasion of Manchuria by the Japanese.

It was only following the death of Mao in 1976 that Deng Xiaoping, who held power until his death in 1997, introduced a policy inspired by Lenin's NEP (New Economic Policy in 1921), opening up the country, introducing agrarian reform, and initiating investments in industry and education which would set the stage for 40 years of robust growth.

Since 1978, China has succeeded in transforming itself from a predominantly rural society (70% of the population in 1978), to an industrial and 55% city-dwelling society, while avoiding the pitfalls of shanty towns.

Of the 700 million people worldwide who came out of poverty between 1990 and 2010 (less than $1.25/day in PPP (purchasing power parity) terms according to the World Bank), 500 million are Chinese. The percentage of people below the poverty line in China fell from 80% to 12%. With reference to the development of the middle classes, the figures produced by Peter ***Frankopan*** in ***"The New Silk Roads"*** are impressive: in 1990, Chinese tourists spent $500 million abroad, and in 2017 $250 billion, and these figures are set to soar, because only 5% of Chinese currently hold passports. Infrastructure development (rail and road) is startling: in 1968, China had no motorways and France had 1,000 kilometres, while the figures are now 130,000 kilometres and 12,000 kilometres respectively.

There are four keys to understanding this triumphant China: exploitation of the rules of the WTO (World Trade Organisation), support for State-owned enterprises, the Belt and Road Initiative and the resurgence of ideology.

1. ***Exploitation of the WTO rules***:

When it joined the WTO in 2001, China enjoyed emerging-country status, enabling it to prohibit foreign investment in eleven sectors and limit it in many others. Admittedly, the current-account surplus, which was 10% in 2007, has fallen to a level close to 0, and in 2017 exports no longer accounted for 35% of GDP as in 2006, but just 20%. Admittedly, China exploits social dumping less and relies more on technology, but the restrictions on Western investment in China are disputable and disputed. Both the Europeans and Americans would like to eliminate these restrictions, even though

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China remains an emerging country in terms of per capita income and still has between 300 and 400 million people living on less than $2 per day. The law on openness presented to the People's Congress last week remains vague.

2. ***Support for State-owned companies and technological ambition***:
   China protects its domestic market, allows its companies to acquire critical size and, thanks to attractive loans from its State banks, helps its national champions conquer markets.
   - *In conventional sectors* such as steel production, China's global market share has increased from 4% in 1997 to more than 50%. In the case of cement, China has produced more in five years than the United States did in the entire 20th century, and estimated capacity is 3 billion tonnes, while estimated demand does not exceed 2.2 billion tonnes.
   - *In high-tech sectors*, China no longer wants to play just the role of an assembly plant. The "China 2025" programme provides for €2,000 billion in investments in ten sectors of the future, such as robotics, the autonomous vehicle, electric vehicles and electronic chips, ten sectors that it wants to boost in order to raise local production in these key technologies to 40% by 2020 and 70% by 2025. To achieve this, research spending increased from 0.9% of GDP in 2000 to 2.1% in 2016 and is expected to reach $400 billion in 2020. According to the WIPO (World Intellectual Property Organisation), by 2016 the Chinese filed as many patents as the Americans, the Japanese and the South Koreans combined, i.e. 38%, versus 20%, 11% and 7% respectively, while the Europeans accounted for only 5.5%. Admittedly, 95% of these patents were filed in China, which puts the technological breakthroughs into perspective.

   Aerospace is one example of a strategic sector, with the development of *Avic*, a group with 400,000 employees, which could compete with Airbus (who generates one-quarter of their sales in China).

   Robotics is another example. China wants to make up lost ground, because it has only 36 robots per 10,000 inhabitants compared with 315 in Japan and 478 in South Korea. According to the International Federation of Robotics, in 2016 China acquired 27% of the robots produced in the world.

   The trend is the same in *electronic chips,* because China no longer wants to be 80% dependent on American chips.

   In *5G,* an essential technology for data transmission, operators will find a fantastic tool for information, surveillance or even data destruction. For these three reasons, the Americans and Australians, and possibly some Europeans in the future, will refuse to work with Huawei, accused of having stolen a T-Mobile technology in the United States and having violated sanctions against Iran. *Huawei*[1] is world leader in mobile networks, and third behind Samsung and Apple in smartphones.[2] Although the company is not listed on the stock exchange, it posts revenues exceeding $100 billion and has a research budget of $13 billion. Despite being a private company, it is forced by law to collect information abroad and, in China, to perform digital surveillance.

[1] *Huawei*, a private company founded by a colonel in 1987 and which has part of the employees as shareholders, has benefited from an estimated $10 billion in State support in the form of generous loans.
[2] (206 million in 2018 versus 293 and 212 million for the two others) and No. 4 in the world for patents after Qualcomm, Ericsson and Nokia.

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Among the other groups to be watched in the future are Alibaba, Tencent, Baidu, Xiaomi and many others.[1] All these large enterprises are often listed on the stock exchange outside China, pending the creation of a Chinese Nasdaq.

3. ***The Belt and Road Initiative***: the ambition and the obstacles.

   - *The ambition*: this project, initiated in 2013 with 65 countries, now concerns about one hundred, or 4.4 billion inhabitants, representing more than 30% of global GDP, from China to Italy perhaps, and to the Middle East and Africa, and is designing two roads, one maritime and one terrestrial. China founded the AIIB (Asian Infrastructure Investment Bank) in 2014, has apparently already committed $240 billion and plans $1,000 billion of financing, in the form of loans or BOT (Build, Operate, Transfer) projects,[2] and with this economic bonanza it hopes to forge an instrument of geopolitical power. By comparison, remember the Marshall Plan, worth $13 billion between 1948 and 1951, the equivalent of $130 billion in today's money, mostly in the form of gifts made to 16 countries.

   - ***"Imperialism, the highest stage of capitalism"***. This book by ***Lenin*** characterises the current situation of China which, grappling with slackening growth and overcapacity, is looking for a growth driver. By investing in infrastructure along the Silk Roads, the Chinese want to facilitate their procurements of raw materials and agricultural produce and boost sales of Chinese goods.

   - Features of these investments are that they are often useful, not always adapted to requirements, sometimes polluting, always costly for the finances of these countries and with no consideration for human rights:

   Useful, in the case of the construction of a new town near Cairo to relieve its traffic congestion, or the enlargement of the port of Bagamoyo in Tanzania to relieve the port of Dar es Salaam.

   Not profitable, if we analyse the $4.5 billion railway line between Addis-Ababa and Djibouti almost two years after its inauguration.

   Polluting, if we consider coal-fired power station projects in Kenya or Bangladesh blocked by local populations.

   Costly: the IMF is concerned about Pakistan, a country whose GDP is only $280 billion, where China has made loans for more than $60 billion in order to build a deep-water port at Gwadar, wind-power farms, electric power stations, water treatment units and a high-speed train line 1,600 kilometres long between Karachi and Peshawar. The country's foreign exchange reserves of $10 billion cannot suffice to repay the debt, and finance imports from China.

   Excessive, in the case of small countries such as the Maldives (between $1.5 and $3 billion worth of budget allocations for a GDP of $5 billion!) which allow themselves be tempted by big projects.

[1] **Alibaba**, the No. 1 distributor in the world, a leader in mobile payments and with rich stakes in the Chinese Twitter and YouTube. **Tencent**, the Chinese Facebook, buoyed by the success of WeChat with around 1 billion users, and also very strong in online auctions and video games and a 5% shareholder in Tesla. **Baidu**, the Chinese Google, which is also developing the autonomous car. **Xiaomi**, a specialist in entry-range smartphones, ranks No. 4 in the world. **Didi Chuxing**, the Chinese Uber, also active in ride sharing, which has acquired Taxify in Estonia to expand in Europe.

[2] The Chinese firm collects revenues from operations to recoup the initial investments before transferring the plant to the country.

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No concern for human rights, as in the Central Asian countries with which China trades, and considering the role played by China in the UN to protect President Omar al-Bashir in the Sudan.

It is therefore not surprising to see some countries rebel against this control, these unequal deals and this colonialist approach: this has been the reaction of the new Malaysian government of Mahatir which, according to the Financial Times, has cancelled $22 billion worth of infrastructure contracts. The problem is the same in Tajikistan, which abandoned land to China in return for forgiveness of a debt which it could not honour, in Kyrgyzstan with a per capita debt of $700 owed to China compared with an average annual income of $1,000, and in Sri Lanka, at Hambantota with a $1.3 billion deep-water port, which could not be made profitable and had to be given up to China with a 99-year lease, and could become a military base.

4. ***The resurgence of ideology***: four points are worth noting.

- The reference to historical greatness:

While Xi tends to forget Deng Xiaoping, he refers to both Confucius and Mao, although to a Confucius expurgated of his texts on human dignity and his writings on the need for the political authority to listen to the people and to a Mao in the great times of the Revolution, far from the period of famine which left between 30 and 60 million victims. As a child, Xi was sent into the countryside during the Cultural Revolution but did not call into question the regime, denigrated Western democracy and could readily subscribe to the assertion of ***Lee Kuan Yew: "The West elects rulers in whom it has no confidence whereas China does not elect rulers in whom it has confidence"***.

- The crushing of opposition:

There is nothing seductive about Xi, the product of a hierarchic society, inheriting a culture which sees the individual as merely a cog in the machine. In 2019, he is spending more on defence, officially $179 billion, less than 2% of GDP and less than one-third of the US budget. He employs two million people to keep watch on net surfers, has got rid of more than one million opponents on the pretext of combating corruption, he impedes freedom of the press in Hong Kong, and is supported abroad by the Confucius Institutes, financed by the Communist Party.

He has not hesitated to repress 1 million of the 11 million *Uyghurs* in camps. The latter, Turkish-speaking Muslims, live in the largest province of China, *Xinjiang*, three times the size of France, conquered by the Qing dynasty in 1760 and bordering on Pakistan, India, Russia and many other countries. A key region, rich in coal with half of the country's reserves, rich in oil and gas and the site of nuclear test facilities. The Hans who were sent to "colonise" this province now represent 40% of the population.

Another sensitive province is *Tibet*, a strategic region, the source of the three major Chinese rivers, the Yellow River, the Yangtze and the Mekong.

- The reassertion of the role of the Chinese Communist Party, the CCP:

The book ***"Dans la tête de Xi Jinping"*** (Inside the Mind of Xi Jinping) by ***François Bougon*** underlines the fact that the CCP is present in companies and supervises society, from birth rates to scoring people's behaviour, from teaching Marx to conducting surveillance of intellectuals. This is reminiscent of the action taken by Mao following the Hundred Flowers Campaign.

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- *Pressure on Taiwan*:

Taiwan, the 23rd biggest world power with its 23 million inhabitants and a wealth of brands in the electronics sector, is disturbing for China because the country presents the image of compatibility between the thinking of Confucius and democratic values. Only 130 kilometres away from China but more than 10,000 kilometres from the United States, which has undertaken to defend the island in the event of aggression, Taiwan is dependent on China, which is the destination of 40% of its exports. Taiwan was ousted from the UN at the start of the 1970s by China, and is now recognised by only about fifteen countries, a figure that decreases each year. About twenty years ago, more than 20 African countries recognised Taiwan but now, due to Chinese commercial and diplomatic pressure, there remains only landlocked Swaziland.

- *Cooperation-confrontation with Asian countries:*

China vacillates between joint military manoeuvres and confrontation. It disputes the sovereignty of around 200 islets and reefs in a region through which 40% of China's trade passes. China has landed a military aircraft on an artificial island in the *Spratly Islands*, giving rise to protests from the Philippines and Vietnamese. It lost the case before the International Court of Justice in 2016, but is ignoring the court’s ruling.

In the event of conflict, the Chinese would have difficulty obtaining access to the Pacific Ocean because of the obstacle of the Kuril Islands and the Sea of Japan, and they know that the Strait of Malacca, 800 kilometres long and only 38 kilometres wide at the narrowest point between Malaysia, Singapore and Indonesia, which are US allies, could be blocked. All these reasons explain why the Chinese are trying to set up bases in the heart of the Indian Ocean, in Myanmar, Bangladesh and Sri Lanka.

II. **The West impacted**: ***"The supreme art of war is to subdue the enemy without fighting", Sun Tzu.***

After China triumphant, let us look at the West, and note four impacts: sectors, commodities, currencies and sensitivity to the economic cycle.

1. ***Sectors undermined by often disloyal competition***:

Over-investment in numerous sectors by Chinese State-owned enterprises has been a deflationary factor for the global economy and a factor undermining Western companies. Examples are the steel sector, cement, renewable energies, solar power and wind power, where numerous companies have been overpowered by their Chinese competitors. In all these sectors, China has achieved a remarkable breakthrough, but MIT’s Professor ***Acemoglu*** attributes only one-quarter of the four million jobs lost in the US manufacturing sector between 1990 and 2011 to Chinese competition.

The list could be very long, but note that:

- In *electricity grids*, State Grid, with 1.1 billion Chinese customers and 1.7 million employees, is making numerous equity investments in Australia, Greece and Italy.
- In *nuclear power*, CGN has inaugurated the first EPR reactor, ahead of EDF.

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- In *solar cells*, 6 of the 8 leading firms are Chinese,[1] leaving one American and one South Korean.

- In *wind power,* 5 of the 10 leading equipment producers are Chinese[2] and they install half of the wind turbines in the world. This leaves four Europeans, Denmark's Vestas, number 2, the Germans Siemens and Enercon and Spanish firm Gamesa, and one American firm, GE.

- In *electric batteries*, 5 of the 10 leading producers are Chinese,[3] three are Japanese (including Panasonic, number 1), and two are South Korean.

- In *the space industry,* China Aerospace recently landed a probe on the moon.

- In *railway rolling stock*, *CRCC* (China Railway stock Corp) was created in 2014 by the merger of two groups, is majority-controlled by Sasac (i.e. the State) and is world No. 1, with more than half of global locomotive deliveries in the past three years. It generated €27 billion in revenues in 2018, versus €8.7bn for Siemens' railway business, and €8bn for Alstom. The group profits from the State's proactive approach to infrastructure, with 150,000 km of railway tracks scheduled by 2020, including 30,000 km of high-speed rail lines and the Belt and Road Initiative. Based on the experience acquired in the Chinese market, it is expanding in Asia and Africa, and also in the United States, with subway or train contracts for Boston, Philadelphia and Los Angeles. In Europe, it still only has minor contracts in Macedonia, the Czech Republic and Serbia, but a breakthrough can be expected, because it is backed up by a broad offering including construction of the lines (the two leading companies in the world are Chinese) and signalling.

2. ***Commodities***: a destabilising influence on prices.

   - Between 2000 and 2013, China's primary energy consumption doubled from 14% to 28% of the world total, and its consumption of metals such as copper often represents 50% of global production, so that prices are influenced by Chinese growth.

   - In the mining of rare earths, essential for the production of computers and mobile phones, where, according to ***Pitron in "La guerre des métaux rares"*** ("The Rare Metals War"), China has between 50% and 70% market shares, it has a fantastic advantage, because the West has abandoned this highly-polluting mining practice. The West is developing recycling, but this remains costlier than mining. Rare earths are therefore a weapon available to China in the event of tensions.

3. ***US debt and currencies***: means of pressure available to the Chinese.

   - Along with Japan, China is the leading holder of US government bonds, worth $1,170 billion, and reducing this position is a weapon of deterrence.

   - China is postponing the internationalisation of its currency to prevent capital outflows which would push up interest rates (foreign exchange reserves have fallen from $4,000 billion to $3,200 billion in the past two years). The yuan was recently included in the composition of SDRs (Special Drawing Rights), but it is only the fifth most traded currency, with a 2% market share

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[1](Trina Solar, JA Solar, Jinko Solar, Canadian Solar, Yingli Solar and Shungfeng).

[2](Goldwind, No. 1, United Power, Mingyang, Envision and CSIC)

[3] (BYD, No. 2, Epower, Beijing Pride Power, Air Litium and Wanxiang)

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- The Chinese are also increasingly investing in foreign real estate. According to ***Peter Frankopan***, they spent $50 billion in 2016 and $40 billion in 2017, which apparently drove up prices in California, Vancouver, Australia and Southeast Asia.

4. ***Sensitivity to the Chinese economy***:

In recent years, Chinese growth accounted for up to 30% of global growth. On the regional level, many Asian countries have profited from China's growth. This is illustrated by the weight of exports to China from countries such as Australia for commodities, Japan, Taiwan, Singapore and others for capital goods, and Vietnam and others for components. For some countries, exports to China represent the equivalent of 15% of their GDP.

III. **China on the defensive, or the limitations of State capitalism**: ***"Good fortune has its roots in misfortune, and misfortune lurks beneath good fortune", Lao Tzu.*** Domestically, China faces a slowdown, environmental problems and population ageing, and abroad it faces Western reactions.

1. ***The growth slowdown and the debt burden:***

- *Is China the new Japan*? The question may seem provocative, but China is showing symptoms similar to those that affected Japan at the start of the 1990s: the same undervalued currency, the same financing of relatively unprofitable exports by a banking system which was thereby weakened, the same population decline (although it is more dramatic in China) and the same bubble in certain sectors. However, while Japan was a geopolitical partner, China is a military power and it weighs more in terms of relative weight in the global economy than Japan at the time.

- *The difficulty of understanding Chinese statistics*: one preliminary comment is that Chinese statistics must be analysed cautiously, because the provinces are keen to be well viewed by Beijing and therefore inflate their growth figures. A *Brookings* study considers that China's GDP has been overestimated by 12% in recent years, the equivalent of 2 percentage points per year.

- *Five explanations for the cause of the slowdown*:

First, overcapacity arising from competition between the provinces; for example, at the end of the 1990s there were 8,000 cement producers (4,000 even now) and 120 carmakers. As a consequence, the national investment rate exceeds 40% of GDP and China accounts for more than one-quarter of global investment.

Second, the effects of catch-up, which are beneficial to all emerging countries, are fading while the productivity gains driven by the rural exodus are also slowing, as the migrants who were forced to accept wages in the cities 30% lower than those of the local residents are now less numerous.

Third, far fewer young people are entering working life.

Fourth, the loss of competitiveness as a result of wage increases: the minimum monthly wage in Shanghai has been multiplied by four since 2006 and is now €315, higher than in Bulgaria (€285). There is offshoring to other countries in the region, where wages may be three times lower.

Fifth, inequality: higher income inequality than in Western countries, but also inequality of access to education, even though the percentage of illiteracy in the 15-24 age group is only 0.4%, versus 20% in India. The State education budget is equivalent to less than 4% of GDP, compared with more than 6%

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in Western countries, primary school is costly, and the number of children of migrants from the hinterland who are excluded from the school system is estimated at 35 million. University education benefits more than 30 million people, mainly city dwellers (rural dwellers are only 17%, although they represent 44% of the population).[1]

Widening inequalities are exacerbating individualism to the detriment of the socialist model. Welfare spending, at 10% of GDP versus 22% on average in developed countries, provides hardly any compensation.

- *The debt burden*

The debt burden of the provinces is due to central government's transfer to the provinces of the obligations to finance spending on education, infrastructure construction and the coverage of welfare benefits. It has worsened, because the central government has imposed restrictions on expropriations and the conversion of farmland into industrial land. Of 30 provinces, three have debt exceeding 1x GDP and some of them are having debt repayment problems.

Corporate debt: Chinese companies are the most heavily indebted in the world, at 155% of GDP according to the OECD. State-owned enterprises account for 40% of GDP, but they obtain 80% of new lending, and together they account for two-thirds of the debt and a large proportion of the non-performing loans, and ultimately 40% are probably losing money. The recent payment default on a foreign loan by a State-owned enterprise in Quinghai points to the urgency of shutting down excess capacity, but that will affect employment.

Government debt: government debt is low but it is underestimated by the amount of non-performing loans held on banks' balance sheets, although sometimes, admittedly, they are converted into investments.

This pessimistic view is *tempered by three factors*: the savings ratio which is exceptionally high at 48% of GDP, representing about $6,000 billion each year, the percentage of foreign holdings of Chinese bond debt, only 2%, and the nominal interest rate on this debt, which is lower than the economy's growth rate. Nevertheless, if a crisis were to break out in China, the global repercussions would be serious, because China would have to dispose of foreign assets.

Overcapacity in real estate: the speculation surrounding real estate reflects a concern for precautionary saving. But at present household debt has increased to 49% of GDP, many property developers are heavily indebted, tens of millions of apartments are empty, often in ghost towns, while in Beijing a 75 m² apartment could cost up to 50 times buyers' income.

2. ***The environmental obstacles:***

Pollution of the water, arable land and air are forcing the country to take radical measures because, as ***Jared Diamond*** teaches us, the cause of a country's enrichment or impoverishment lies in its geography or the deterioration of the environment. Some societies, like Easter Island or Mayan civilisation, vanished because they had neglected their environment.

[1] The higher education rate, 27% in 2012, is still low compared with South Korea (98%), Japan (61%) and even Thailand (51%).

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Admittedly, China is the country which invests the most in renewable energies, but it is also the biggest polluter, accounting for 27% of greenhouse gas emissions, while the United States remains the biggest polluter per capita.[1]

Water pollution: China has only 8% of the planet's water reserves but consumes one-quarter of them, and thus does not hesitate to divert part of the waters of the Yangtze River which supplies Shanghai. According to the UN, China, especially in the North-East, is one of the 13 countries most affected by water shortages. An example is the Yellow River, home to one billion Hans in an area half the size of the United States, the cradle of China like the Nile for Egypt, which has dried up several times in recent decades, with consequences for agriculture. We may add that 280 million Chinese do not have access to potable water and that the Chinese authorities estimate at 20% the proportion of water unfit for human contact.

Pollution of arable land: displacing populations to regions that are poor in water has exacerbated soil desertification; this reflects the limitations of State capitalism. The fact that 20% of arable land is polluted is a problem in this country where it is scarce. Property development on land that has not been decontaminated is also a worry.

Air pollution: according to the WHO, between 2008 and 2015, the inhabitants of Beijing breathed pure air only 55 days, or 2% of the time. Korea, Japan and Taiwan are impacted. The culprit is coal, which is used to generate two-thirds of electric power. China consumes more coal than all other countries combined. Beijing and its surrounds consume more coal than the United States! Plant shutdowns now take place in winter, but it is too soon to assess the impact of this.

3. ***The problem of population ageing***:

- *The one-child policy and the sacrifice of girls*: in a record time of less than ten years, China halved the number of children per woman from 6 to 3 by authoritarian measures, and then imposed the one-child policy in 1978, but it will have to assume the consequences. Girls were sacrificed and, in 2014, there were still 116 boys born for every 100 girls. There are therefore fewer potential mothers, and 35 million Chinese born since 1980 will not find wives, just as though a country like Germany had no women![2] From 28 million in 1960, the number of births fell to 15.2 million in 2018, a figure less than that recorded in 2015 before the one-child policy was abandoned. Despite government entreaties, couples are giving priority to the quality of their life over the choice of a second child.

- *Population ageing is drastic*: in 2050, the number of elderly people in China will exceed the total population of Europe and the US. China had one out of five of the planet's inhabitants at the end of the 20th century, but it may only represent one out of ten in 2100, with Africa making up 4 billion of the 10 billion at that time.

[1] If China had three vehicles for every four inhabitants, like the United States, that would represent 1.1 billion cars. Per capita CO_2 emissions in 2012 amounted to 6.6 tonnes in China but 17 tonnes in the United States. An American consumes 8 tonnes of oil equivalent per year versus 4 for a European and 1 for a Chinese.

[2] In 2000, there were slightly more than 180 million girls aged 7-14, while in 2010 there were only 115 million.

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Confucianism professes great respect for the elderly among young people, but this is changing and, with the migration of 260 million people from rural areas to the cities, distance is weakening relationships, even though the migrants sometimes leave their children to be cared for by their grandparents. People of working age are torn between the duty of supporting their parents and the cost of financing studies. The low level of pensions explains why, in 2010, over half of pensioners' expenses were paid for by their children.

- *The consequences of population ageing*: the retirement age, 55 years for women and 60 for men, will have to be pushed back, because the percentage of women in employment is already high. The population is worried and maintains a high savings rate, detrimental to consumption.

4. ***Western reactions***:

- *US positions*: the Americans are tempted by a hard line, because US exports to China represent less than 1% of US GDP whereas US imports from China are equivalent to 4% of Chinese GDP. However, the US trade deficit in 2018 amounted to $620 billion and the bilateral deficit with China reached a record $419 billion, worsening by 12% due to a decline in US exports. The Americans are also combating corruption and apply the principle of extraterritoriality if an email goes through an American mailbox or if a transaction is denominated in US dollars. They expect the Chinese to take measures against intellectual property theft and unfair subsidies for the takeover of foreign companies. The first consequence in 2018 was a fall in Chinese investments in the United States from $30 billion to less than $5 billion.

But Donald Trump will be unable to repatriate a large number of firms to the United States. In the case of assembly units harmed by the tariffs, they will move offshore from China to other Asian countries benefiting from attractive labour costs. If the Chinese buy more American products, such as soya beans, this will be to the detriment of purchases from Brazil or Canada. The US trade deficit with China will decline, but the overall US trade deficit will not be reduced. With China, Trump focuses too much on the protection of industries such as steel, with no potential for growth, and not enough on the promotion of services such as consultancy, insurance and credit cards (Visa and Mastercard are not yet authorised in China), a trade component which posts a surplus but for a still limited $50 billion, where the United States should be dominant and China is still modest.

- *European positions*: ***"In a world of geopolitical carnivores, the Europeans are the last vegetarians. Without the United Kingdom, we will become vegans", Sigmar Gabriel.***

As ***Godement*** notes in ***"La Chine à nos portes"*** (China at our Gates),[1] the Chinese are interested in the aerospace industry, technology and ports in Europe.

Some partnerships with the Chinese are beneficial, an example being Club Med's expansion in China thanks to its Chinese shareholder *Fosun*. But others bring nothing, an example being Peugeot which, despite *Dongfeng* owning a stake, has not increased its sales in China [2].

[1] Europe received €35bn of the €200 billion in foreign investment by China, but it was able to make only €7 billion worth of investments in China.[2] Quite the contrary, in 2018 the group sold only 260,000 cars, representing 7% of its sales, compared with 25% four years ago, and it made a loss of €600 million!

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The European Parliament recently enacted measures to control Chinese investments, but China is clever at exploiting divisions. *Greece*, which benefited from Costco's investments in Piraeus, where container traffic has multiplied by five since 2010, and *Portugal*, which benefited from Chinese investments in EDP (Energias de Portugal), are not prepared to pass motions which would adversely affect China, and so the required unanimity is not achieved. The Brussels Commission, as illustrated by the Alstom-Siemens case, is too concerned about competition in Europe and not sufficiently aware of the global implications.

China has also launched numerous charm offensives in Eastern Europe, offering an alternative to Russia to exert pressure on the West, but its investments there are modest, several projects have been discontinued, and China sometimes prefers to invest in Germany, where it finds industrial expertise. The Germans, hurt by the 2016 takeover of specialist robotics company Kuka by Chinese household appliances group *Midea,* are nevertheless watchful.

Telecom operators are embarrassed by the Huawei amendment, which obliges them to apply for a permit to deploy equipment, which could slow down the roll-out of 5G, weaken competition between suppliers, inhibit Ericsson and Nokia’s expansion in China, and expose Huawei's European suppliers to reprisals.

Conclusion:

In 1980, no one would have bet on the fall of the Soviet Union, Japan's decline and China's success, so let's avoid making dogmatic assertions about the future of China. It has strengths, but it is clear that it has to manage four prodromes which will have repercussions on the world, on demographics, on debt and on protectionist pressures.

- *The demographic wall:* the working population has been decreasing since 2010. China, rich with a population of 1.34 billion, will be overtaken by India as of 2025; it will reach a peak of 1.4 billion in 2030 but could have lost 200 million inhabitants by 2050. China spends little for elderly people, 2.5% of GDP, or three times less than the OECD average. But faced with this rapid population ageing, it will have to invest to maintain social cohesion, and choose between the development of robots, immigration, a law obliging people to have children, or even, as feared by some such as ***Laurent Alexandre*** in his book "***La guerre des intelligences***" (The Intelligence War), cloning. We might wonder whether China, grappling as it is with the decline of its population, has the right cards to dominate the world, or even whether it wants to do so.
- *The debt wall:* total debt, at 3x GDP according to the IIF (International Institute of Finance), is the highest in the emerging world and is increasing the most rapidly. In the past ten years, the return on capital employed has been lower. To generate $1 of GDP, $3 to $5 of debt is needed, and this is resulting in overcapacity, zombie firms and ghost towns.
- *The environmental wall*: in "***La crise environnementale en Chine***" (The Environmental Crisis in China), ***Huchet*** shows that it is not easy to enforce the recent anti-pollution laws, because local governments give priority to employment and therefore put off the closure of polluting plants. According to the World Bank, pollution costs 5 percentage points of GDP. Yet another illustration of the limitations of State capitalism.

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- *The globalisation wall*: China profited from the opening of international markets to sell its products, and would like to protect globalisation from a risk of decline, but two developments are taking shape. Caution by partners in the Belt and Road Initiative, who cannot repay debts contracted with China and fear property foreclosures. Vigilance of Westerners who demand reciprocity in trade. To have clout with China, the Western world must work together. Obama had realised this and had finalised the Trans-Pacific Partnership Agreement (TPP) which brought together the United States' Asian partners to contain China's economic power. Trump pulled out of the agreement and is toying with the possibility of dismantling NATO. This worries Europe, which will have to strengthen its unity and develop joint policies, in digital technology, artificial intelligence and other sectors of the future to exist in between China and the United States. If the United States no longer wants to guarantee the world's stability or maintain NATO, there will have to be a discussion on the exorbitant privileges it enjoyed in return: firstly, extraterritoriality, which is costly for European firms, and second, the dollar as the international reserve currency which allows Americans to live with a current-account deficit, i.e. to have their excessive consumption financed by the rest of the world. If the dollar lost its reserve currency status, it would weaken and interest rates would rise. So far, the structure set up by European countries to do non-USD barter trading with Iran is merely an embryonic change.

- *The growth wall*: China's growth is probably slowing by more than the statistics suggest. China's slowdown is structural and is bad news for the global economy. According to the OECD, 2 percentage points less growth for China would mean -0.4 percentage points for the global economy. That is worrying, because China's per capita GDP is only 15% of America's level, and 28% in purchasing power parity terms. No country has stifled consumption as much as China to promote savings and facilitate investment. ***Hayek*** has shown that no centrally-controlled system can replicate the complexity of a market economy in which prices are not controlled. Tomorrow, China will be different from the triumphant China of the 2000s. Although, in its dynamic period, it posted a growth rate double that of Japan in the 1970s, in terms of per capita GDP it ranks only 76th in the world, behind Brazil and after Russia, which has double its per capita income. China is still an industrial economy insufficiently developed in services, which represent 45% of its GDP compared with more than 70% in Western countries. One of the challenges facing China is consumption: whereas the Americans represent 4% of the global population, they account for 27% of global consumption, whereas China, with around 20% of the population, accounts for only 10% of global consumption, worth $4,700 billion in 2017. Some investors think that the growth of Chinese consumption is an opportunity for the planet, but it is to be feared that the savings ratio (37% of gross income) will remain high as long as the social welfare system is weak. The limitations of State capitalism are thus evident compared with more agile, liberal capitalism.

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