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# China's Geoeconomics and the 'New Cold War'

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**Glenn Diesen**

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# About the Author

## **Glenn Diesen**

Professor at the National Research University Higher School of Economics

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42 Bolshaya Tatarskaya st., Moscow, 115184, Russia

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# Introduction

Chinese geoeconomics is making a great leap forward to adjust to rapid technological developments and a changing international distribution of power. The world is entering a new industrial revolution that further decouples the relationship between capital and labour, which incentivises Beijing to abandon its reliance on low-wage competitiveness and instead take the lead in developing high-tech strategic industries with its digital Silk Road. Technological leadership in the new industrial revolution is funded by the scale of demand, which China is filling by monopolizing on the growing Chinese domestic market and strengthening economic connectivity with the world. The Belt and Road Initiative (BRI) restructures global value chains as new transportation and energy corridors lead to China, which are financed by Chinese-led international financial instruments. Russia and China are becoming natural allies due to the shared objective of restructuring global value chains and developing a multipolar world. China offers a model for developing national technological platforms as an imperative asset in modern geoeconomics. Furthermore, China's BRI is harmonized with Russia's own ambitions for increased economic connectivity in Greater Eurasia.

Western sanctions that would in the past have marginalized Russia from international market are now merely pushing Russia towards China-centric global value chains. To the detriment of both Russia and the West, sanctions are making Russia excessively reliant on China by undermining Moscow's ability to diversify its economic connectivity and technological autonomy. The 'new Cold War' is relegating Russia to an asymmetrical partnership with China aimed to construct a multipolar world order. Concurrently, the West is developing increasingly unfavourable asymmetry with China as an adversary challenging Western-centric value chains.

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# China's Geoeconomic Strategy in the New Industrial Revolution

In the 1970s, China embarked on the so-called peaceful rise by opening its markets to the West and keeping a low profile in international affairs. Translated into geoeconomics, China employed neo-mercantilist policies such as wage suppression and currency devaluation to maximize exports and minimize imports. Exporters are subsidised with tax exemption and extensive trade credits, while external access to the huge Chinese market is conditioned on local production and transfer of technology and know-how. A temporarily suppressed domestic market and a lower standard of living was the price paid for long-term leadership while the world's manufacturing capabilities were transferred to China and huge amounts of foreign reserves were accrued. Furthermore, China gradually ascended in global value chains from the factory of the world for cheap manufacturing to increasingly high-tech production by absorbing foreign technology through acquisition of Western corporations. Beijing is also frequently accused of stealing intellectual property rights and reverse-engineering. Washington grew increasingly apprehensive about economic power shifting from the West to the East, yet this did not translate into forceful policies due to reliance on China using its trade surplus to purchase growing American debt and thereby subsidising a higher standard of living in the US. Subsequently, American elites extolled the virtues of economic interdependence as an absolute gain rather than addressing the symmetries caused by relative gain.

China's initial development strategy was unavoidably temporary for its growing economy required safe and reliable access to natural resources, transportation corridors, and financial instruments. Prolonged and rapid economic growth under the former development model also created environmental degradation, rising inequality and pending political instability. Furthermore, low production costs as a key comparative advantage erodes since the surplus of labour migrating from the agriculture sector is rapidly being exhausted. The mounting pressure to relinquish capital control, decouple from the US dollar, and allow the yuan to surge will heighten

production costs and reduce competitiveness. Furthermore, holding an ever-increasing amount of the US Treasury becomes a risk: China will never get repaid a hundred cents on the dollar if the US inflates/devalues its currency or defaults. No longer content to be the factory of the world that uses its proceeds to finance the US debt, China is asserting itself by using its vast foreign reserves to rival Western-centric value chains.

China's new development strategy adapts to the dominant geoeconomic trend in the world, which is the disruption of the relationship between capital and labour. Between the Second World War and the 1970s, the economic reward of increased efficiency due to technological advancements was shared by companies and workers in the West due to the need for increasingly skilled labour. However, the relationship between capital and labour has gradually decoupled since the 1970s. Technological innovations continue to increase efficiency, yet the economic reward has increasingly concentrated among capital owners while the wages for labour stagnated.

The digital economy produced larger corporations with fewer employees, while the automation of the cognitive processes further marginalizes the value of labour. Assets such as intellectual property rights and know-how now make up a majority of corporations' value. Corporations thus shift focus to ownership of high-value assets, as product design is more important than actual production. Similarly, states are under growing pressure to develop technological autonomy as an increasingly important geoeconomic tool. Nonetheless, the ideological advocacy of *laissez-faire* capitalism has contributed to a purge of historical memory while corporations such as Microsoft, Intel, and Apple are incorrectly portrayed as maintaining dominant positions in the market solely due to the free-market capitalism. These companies benefitted greatly from low-cost access to technological innovations due to state support through public financing of research and development.<sup>1</sup> Technologies in the era of automation and robotics will only intensify the shift of power from labour to capital simply because increasingly efficient machines outperform humans. There is subsequently a growing need for a strong state to avoid excessive reliance on foreign capital and technologies.

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<sup>1</sup> Perelman, M, 2003, 'Steal This Idea: Intellectual Property and the Corporate Confiscation of Creativity', Palgrave MacMillan, New York.

China is likely the last major power to have used low wages as a competitive advantage to take over global manufacturing and benefitted from the revenue to acquire strategic assets and climb global value chains. Automation and robotics are remaking global value chains, and manufacturing is returning to developed countries with more sophisticated infrastructure. Countries with high robot density are experiencing 'reshoring' as their robots outcompete low-wage manufacturing states such as Bangladesh and Vietnam. The new industrial revolution entails a transition to globalization 2.0, when supply chains are getting simplified and states can attain greater autonomy. The lowering of transportation costs, ideological embrace of free-market capitalism, and comparative advantages, which enabled increasingly complex supply chains to develop, spurred globalization. Today, as manufacturing skills are converted into software, there is less incentives for long supply chains where a variety of countries manufacture different components that are then assembled in several other countries before reaching the consumer. Furthermore, the extreme economic liberalism embedded in the first globalization wave and rapid technological innovations are giving way to economic nationalism while uninhibited market forces and creative destruction are disrupting society and political stability.

China's new geoeconomic model was launched with the BRI with its vast foreign reserves used to develop strategic industries, transportation corridors, and financial instruments such as international investment banks, trade regimes, global transaction/payment systems, and establishing the yuan as a trade/reserve currency. For China, developing strategic industries meant 'going global' by acquiring natural resources and advancing technological competencies. The new strategic industries are developed with the so-called digital Silk Road, which entails digitalizing the economy and developing artificial intelligence, big data, robotics, quantum computing, nanotechnology, cloud storage, and other related technologies.

The Made in China 2025 Initiative recognizes that state intervention is imperative to develop leading technologies and support domestic corporations to implement these innovations. The European Union Chamber of Commerce in China released a report in 2017 accusing the Initiative of offering excessive subsidies for high-tech industries to the extent that

European firms could not remain competitive.<sup>2</sup> China is maintaining its manufacturing power by replacing its human workers with robots at an exponential rate. Production at factories is automated, smart warehouses are run by robots, self-driving trucks and drones are used to transport goods, and fully automated ports are developed for more competitive exports. Meanwhile, Chinese advancements in additive manufacturing (3D printing) reduce reliance on complex supply chains and logistics – for instance, machines with ever-more efficient algorithms can already print biological material, entire buildings, and complex components with moving parts.

With less need for cheap labour, China is permitting wages to rise and thereby making its domestic market a source for global growth in the years to come. Yet, the domestic market is shielded by foreign penetration to ensure technological leadership. The pending commercialization of driverless cars will shed tens of millions of jobs around the world that are tied to the transportation industry. China cites national security concerns to limit foreign filming and mapping of its streets, which will ensure that the domestic market is dominated by self-driving cars developed by Chinese companies. Didi, the Chinese copy of Uber, is set to launch an entire fleet of self-driving robot taxis. With successful testing of solar panelled highways, these electric robot taxis may in the future recharge as they drive on the solar panel highways.

The commercialization of its 5G network in 2019 will significantly heighten internet speed and allow for domestic growth in the market of technology of things (Internet of Things, IoT). Furthermore, China's Industrial Internet of Things (IIoT) with connected sensors and big-data analytics will greatly enhance productivity and delivery. Digital advancements and big data have enabled artificial intelligence to be developed, which contributes to advance all other technologies from neurotechnology, biotechnology, and robotics. Banking is also set for a major disruption – distribution ledger technology (blockchain) is creating banking without banks. China's previous disregard for intellectual property rights during the catch-up phase can be expected to reverse. Beijing may instead become a leading proponent of intellectual property rights to ensure that rivals pay them royalties.

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<sup>2</sup> 'China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces', 2017, European Chamber of Commerce, March 7.

While China's development of strategic high-tech industries enhances its autonomy, the success of the BRI largely depends on cooperation with Russia. Moscow can be an indispensable partner in support of Beijing's BRI – or an insufferable obstacle. The integration of Russia and Eastern Europe into Western-centric value chains under the auspices of 'Greater Europe' would have created significant obstacles to restructure the world economy around China. In contrast, Russia's commitment to Greater Eurasia in partnership with China contributes to restructure global value chains to Beijing's favour. A partnership with Russia improves China's ability to diversify energy supplies and transportation corridors. Harmonization of interests can produce substantial common benefits as 'Moscow and Beijing would have Central Asia as well as Mongolia to themselves, effectively shutting out all external powers from the heart of Eurasia.'<sup>3</sup>

The China–Pakistan Economic Corridor (CPEC) could also become more viable as Russia considers linking the Trans-Siberian Railway to the port of Gwadar through the CPEC. Development of ports in the Russian Far East and supporting rail infrastructure connects China's landlocked Northeast provinces of Jilin and Heilongjiang to the Pacific. The connectivity between China and Mongolia also strengthens from the economies of scale by developing the China–Mongolia–Russia economic corridor. Furthermore, cooperation between Russia as the world's largest energy producer and China as the greatest energy consumer creates synergy effects by being instrumental to internationalize the yuan, developing new investment banks, rating agencies, and trade regimes. Furthermore, new China-centric financial instruments are also strengthened with Russian cooperation with the Asian Infrastructure Investment bank (AIIB), the BRICS' New Development Bank, and with great geoeconomic potential for the Shanghai Cooperation Organization (SCO).

Moscow has strong incentives to harmonize its Eurasian geoeconomic development strategy with Beijing irrespective of relations with the West. Russia's geoeconomic Turn to the East enhances economic connectivity with China, South Korea, Japan, and other world leaders in robot density and other technologies. To date, Russia has been a slow

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<sup>3</sup> Lukin, A, 2015, 'Eurasian Great Power Triangle', in A, Klieman (ed.), 'Great Powers and Geopolitics: International Affairs in a Rebalancing World', Springer, Ramat-Aviv, pp. 183–206, p. 201.



adopter of automation and industrial robotics due to insufficient skills to operate the technology and a shortage of platforms to educate and train industry and businesses to implement these innovations. Yet, Russia is equipped to make a forceful entry. Russia is one of the few countries in the world with almost a completely independent digital platform consisting of an ecosystem of domestic corporations providing search engines, email services, social media, and other digital critical infrastructure. This development strategy can also be extended into the new industrial revolution, considering that Russia has kept up with robotics within the military sphere and can convert revenue from sales of natural resources to energy-hungry East Asian states into acquisition of new technologies and advancement of the technology readiness level. Moreover, developing Russia as an East–West and North–South transportation corridor heightens Russia's economic clout in Europe, while new financial instruments can augment Moscow's financial autonomy.

Yet, getting embroiled in an asymmetrical partnership with China remains a legitimate and lingering concern for Moscow. A restrained and responsible economic integration with China requires Russia to maintain negotiation power. Rather than a free-trade agreement with China, Russia requires a trade agreement that incorporates a combination of tariffs and subsidies for selected industries to mitigate creative destruction and to enhance competitiveness of high-tech strategic industries. Instead of shifting from intolerable dependence on the West towards excessive reliance on China, Russia should develop its own technological platforms and economic connectivity with other states to establish an equilibrium. Albeit, the conflict with the West and anti-Russian sanctions compelled Moscow to rapidly shift to the East.

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# The Irrationality of the ‘New Cold War’

The ongoing and intensifying ‘new Cold War’ between the West and Russia could be the greatest geoeconomic blunder of the century against the backdrop of the rivalry taking place in the shadow of a rising China as a domineering geoeconomic newcomer. The inclination to refer to the ongoing conflict between the West and Russia as a ‘new Cold War’ repeats the common mistake of fighting the previous war. Using Cold War terminology invokes undertones and even nostalgia for a familiar and less complicated past, which is conducive to mobilize political and material support in the rivalry against Russia.

Yet, the Cold War comparison is deceptive as there is no longer a bipolar international distribution of power or the ideological divide between capitalism and communism. The West largely monopolized economic statecraft during the Cold War as its main adversaries were communist states largely divorced from international markets. The Russian-British rivalry in the 19th century is a more suitable historical reference, when Russia as an expanding Eurasian land power challenged the maritime empire of Britain. Instead of resulting in Russia or Britain claiming victory in the form of global hegemony, a more multipolar world emerged with the rise of new rivals such as the US, Germany, and Japan.

The escalating conflict between the West and Russia contributes to the restructuring of global value chains around the increasingly powerful China. The fierce confrontation against Russia is a puzzle as the ‘rational’ policy for the West would be to harmonize interests with Russia to create a ‘Greater West’, rather than pushing Russia into the arms of China as the main geoeconomic challenger. Even Zbigniew Brzezinski, who was no friend of Russia, recognized the need for the US to include Russia in the ‘expanded West’ to exert influence into Eurasia and balance a rising China.<sup>4</sup> Yet, a ‘rational’ policy is obstructed by the zero-sum structures in Europe inherited from the Cold War. Completely zero-sum relationships

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<sup>4</sup> Brzezinski, Z, 2013, ‘*Strategic Vision: America and the Crisis of Global Power*’, Basic books, New York, p. 123.

are more vulnerable to instability and 'pure conflict' where the winner takes all.<sup>5</sup> Harmonization of interests among great powers is therefore imperative to limit geoeconomic competition to skewing the balance of dependence. Much like the zero-sum structures deriving from the hegemonic aspirations of NATO, the no less hegemonic geoeconomics of the EU makes it impossible to harmonize basic interests with Russia.

Anti-Russian sanctions have contributed to make the Russian Turn to the East largely a pivot to China, which weakens both Russia and the West. The \$400 billion Power of Siberia energy agreement reached immediately after the initial anti-Russian sanctions in 2014 was symptomatic of how the 'New Cold War' strengthens Chinese geoeconomics. Russia is believed to have settled on terms and prices that were more favourable to China due to Moscow's unfavourable negotiation position. The agreement was also detrimental to the West as it signified the launch of a Sino-Russian strategic partnership by redirecting Russian energy architecture towards the East.

Barriers to China accessing Russia's strategic industries and markets have gradually been lifted, paving the way for Chinese acquisitions in the Russian upstream energy market and for Chinese companies to gain invaluable experience in Russian markets. Energy cooperation between Russia and Japan has suffered as Washington objected to Japan participating in joint offshore exploration of oil from the Russian coast near Sakhalin. The plans from 2013 to construct an LNG plant in Vladivostok to increase supplies to Japan were postponed in 2015, and Russia instead prioritized constructing gas pipelines to China. With Russia's relative economic connectivity shifting from Japan to China, political loyalties are expected to follow. Russia potentially abandoning its official neutral status in the Pacific in favour to overt alignment with China could be detrimental to US interests in the region. Similarly, US sanctions against European companies contributing to the Nord Stream 2 gas pipeline undermines the energy security of Europe and creates greater incentive for Russia to increase its deliveries to China. As the RUSAL incident revealed, US sanctions were even rebuked by its partners and were subsequently walked back as it severed Western markets from its vital supply chains.

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<sup>5</sup> Schelling, TC, 1980, *The Strategy of Conflict*, Harvard University Press, London, p. 3.

Russia's previous restrictions on exports of advanced military equipment and sensitive technologies have also been scaled back. Russia has already commenced delivering the S-400 missile defence system and Su-35 fighter jets to China, while the submarine technology of the Amur-1650 and components for nuclear-powered satellites are also accessible. Chinese exports to Russia have also replaced Western suppliers. For example, Chinese reengineering and duplications of previously imported engines from Germany enabled China to replace it as a supplier when German suppliers halted delivery of engines used for the modernization of the Russian military. While the Chinese engines have lower quality, the increased economies of scale from exports to Russia will contribute to further development of China's military industry. Similarly, within the space industry, Russia's Roscosmos (Russian State Corporation for Space Activities) is gravitating towards cooperation with China rather than the US in terms of development of technology and space exploration.

While Russia would seek to limit growing Chinese economic expansion into Europe in the past, it is increasingly viewed as a symptom of a more multipolar system now. China's acquisition and rapid expansion of the port of Piraeus in Greece demonstrated greater geoeconomic ambitions in Europe. China is connecting the Port of Piraeus to Hungary with a high-speed railway, which will allow Beijing to project influence in Eastern and Central Europe, where several states are growing increasingly dissatisfied with the intrusiveness of the EU. Not only does the initiative enable the port of Piraeus to cannibalize the traffic to Western European ports such as Rotterdam, China also replaces Western funding and creates debt dependence. As the European Commission investigated and complained, Hungary accepted funding from China rather than having a required public tender process that would likely have favoured the loan conditions from the EU. While the EU has made efforts to halt the project, China continues its 16+1 format for cooperation where China engages 11 Central and Eastern European states and 5 Balkan states. The EU is seeking to counter China's strategic acquisitions by establishing a Committee on Foreign Investment (CFIEU), similar to the US counterpart, Committee on Foreign Investment in the United States (CFIUS). However, at a time when the EU

seeks to augment its internal cohesion and obtain greater control over trade policies, the unpopular anti-Russian sanctions is sowing discord among members and contributing to the rising of anti-establishment political groups to power.

Instead of opposing China's southern maritime route into Europe, Russia is accommodating the Northern Sea Route. Russia has abandoned the previous consensus among Arctic powers to limit the access of non-Arctic states such as China due to the lack of Western partners. Accommodating China in the Arctic to project collective Sino-Russian influence is an opportunity to restore symmetry within the strategic partnership. Russia's Greater Eurasia and China's BRI are more balanced in the Arctic as Russia monopolizes on the territory, while China contributes with funding and the trade volume. Synergy effects and economies of scale are important to justify infrastructure investments, as the Arctic transportation corridor can also support energy extraction, scientific exploration, tourism, and military deployments. The Arctic transportation corridor will likely favour Russian and Chinese shipping and industry, while the funding of these initiatives will strengthen non-Western development banks and be instrumental to internationalize the yuan.

Beijing's ambitions to obtain greater control with the international financial instruments are also aided by the rivalry between the West and Russia. The West's effort to cripple Russian economy by restricting access to debt markets resulted in the Russian market being handed over to China. Western sanctions aimed to shut down key Russian assets, such as Rosneft, Gazprom, the Yamal LNG project, which was then rescued by China. While Chinese banks initially had to adhere to Western sanctions, a parallel economic infrastructure has been developing between China and Russia to immunize it from Western economic warfare. Local currencies are increasingly used in trade. While trade in local currencies and yuan-denominated debt had a slow start due to the learning curve, the experience and institutions enables China and Russia to expand similar practices to other states.

Some partners such as Iran are obviously eager to embrace new financial tools in a Eurasian format, yet even states reluctant to diversify away from the dollar have greater incentive to trade in yuan. Russia's

growing reliance on China as an export market for oil resulted in Russia replacing Saudi Arabia as the largest supplier of oil to China in 2015. For Saudi Arabia to compete with Russian oil deliveries to China, it will eventually need to accept yuan for oil payments rather than dollar. By winning over energy exporters, China is realizing its ambition to establish a 'petroyuan' to rival the petrodollar. China has finally launched its crude oil benchmarks to rival the US Brent and West Texas Intermediate (WTI), with yuan-denominated crude oil futures contracts traded from March 2018. China's establishment of a payment-versus-payment (PVP) system in 2017 for rouble and yuan transactions has similarly set a precedent to be expanded to other states affiliated with the BRI. While the relative use of yuan is still low, China is seeking to internationalize its currency rapidly by introducing it in trade finance, investments, and as a reserve currency.

Russia is also gravitating towards other Chinese-led financial instruments such as investment funds, rating agencies, transaction and payment systems as they are developed. Interests are sought to be harmonized with shared investment funds and in order to reduce reliance on access to Western funding. For example, Russian Direct Investment Fund and China Investment Corporation established the Russia–China Investment Fund (RCIF) as a joint venture. The China–Eurasian Economic Cooperation Fund (CEF) and the RCIF offer investments in shared projects and harmonize Russia's Eurasian Economic Union with China's BRI. Politically motivated, Western rating agencies such as Moody's, S&P, and Fitch downgraded Russia's ratings to 'near junk' or 'junk' to heighten lending costs to Russia. Equally politically motivated, Chinese rating agencies, such as Dagong Global, responded by giving Gazprom the highest rating to offer more favourable loans and replace Western financing institutions.<sup>6</sup>

Russian transaction systems are also being harmonized. China's development of the China International Payment System (CIPS) has made Russia less vulnerable to threats of being blocked from SWIFT. The US suspending Visa and Mastercard in Crimea and blocking of sanctioned

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<sup>6</sup> Lukin, A, 2015, 'Russia's Eastward Drive – Pivoting to Asia... Or to China?', *Russian Analytical Digest*, no. 169, June 30; Hille, K, 2015, 'Moscow seeks to unlock Chinese financing for Russian companies', *Financial Times*, May 7.

individuals in other parts of Russia motivated Moscow to reduce reliance on the US payment systems. Russia responded by launching its own MIR card and ensured its acceptance internationally by partnering with China's UnionPay. In 2017, the first UnionPay–MIR debit card was issued by Rosselkhozbank, which enabled MIR to use UnionPay's network, which spans more than 160 countries.

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## Conclusion: What Could Be Achieved by a Thaw in Russian-Western Relations?

The West is gradually recognizing that the Sino-Russian partnership has transitioned from a 'marriage of convenience' to a strategic partnership. Yet, the ambitions to repeat Kissinger's triangular diplomacy to split Russia and China is obstructed by the 'new Cold War'. The conflict between the West and Russia has exacerbated the asymmetry of China's relations with Russia and augmented China's ability to challenge Western-centric value chains. The lesson not learnt in the case of Iran was that Western sanctions merely allowed China to monopolize on the market and develop geoeconomic capabilities that would eventually rival the West. The intensification of anti-Russian sanctions has compelled both Beijing and Moscow to embark on a steep learning curve to reduce reliance on the West. Instead of compelling Russia to accept concessions and alter its policies, sanctions have made Russia prepared to accept painful reforms to spearhead a multipolar world order.



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[valdai@valdaiclub.com](mailto:valdai@valdaiclub.com)