Don’t let the Hinkley C delay sour Sino-British relations post-Brexit

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The shock of the UK’s vote to leave the EU stunned China. The new PM, Theresa May, delayed approval of the Hinkley Point C nuclear project – perplexing Beijing and unexpectedly aggravating UK-China relations. ***Yu Jie (Cherry)*** *says Chinese decision-makers regard post-Brexit relations as a test of mutual trust of the so-called “golden era” of Sino-Britain relations.*

In ancient Chinese philosophy, a crisis is synonymous with an opportunity. Brexit will also probably provide Beijing with opportunities to develop a more grounded economic partnership with London, as well as a useful lesson in conducting its foreign policy. The delayed approval of Hinkley Point C should not be the sole benchmark of the success and maturity of post-Brexit UK-China relations.

While China’s initial frustration may be understandable, overreaction would be foolish. Hinkley Point C is a unique and intricate project for all the stakeholders involved. Hinkley C is commercially complex and an intricate political issue for plenty of reasons that have little to do with China.

Premier Li visits Britain in 2014. Photo: Number 10 via a CC-BY-NC-ND 2.0 licence

For domestic reasons alone, Theresa May was justified in seeking a comprehensive review and adding “extra strings” for future infrastructure projects in the UK. The deal itself is intertwined with delicate diplomatic relations between the UK and France, making it difficult for the new PM to strike the right balance given France’s position in the forthcoming Brexit negotiations.

China is disappointed – but a strong bilateral deal is possible

Brexit has indeed diminished Beijing’s hopes of treating the UK as a strong advocate for China in the EU over the market economy status debate. Nor will the UK serve as a “gateway” for Chinese investors’ grand plans to enter the

500m-strong European market.

But Britain's departure makes a robust commercial relationship with China indispensable. One of the arguments made by Leavers was that Brexit could forge stronger economic and trade ties with non-EU member states. On this front, engaging with China economically should feature on the very top of the "to-do" list by a post-Brexit government. Beijing should seize the opportunity to negotiate an advantageous bilateral trade agreement with London once the UK has left the EU.

The UK, a service-oriented economy, does not pose a great challenge to the Chinese manufacturing sector. Indeed, the complementarities of the bilateral trade ties are positive enough for the two sides to reach a new trade agreement when the conditions are right. However, a successful Brexit negotiation with Brussels is a prerequisite.

Another post-Brexit opportunity for China and the Chinese companies is to learn how to deal with political risks associated with dramatic shifts in democratic governments in a mature, free market environment. If Chinese companies want to fulfil their ambition to become leading players in world economic affairs, mitigating non-market related risks is *de rigueur* for their business strategy planning.

Chinese companies' close association and somewhat submissive relationship with the Chinese government have largely impeded their overseas business plans. In particular, the Chinese state-owned enterprises (SOEs), such as China General Nuclear Group(CGN), China National Offshore Oil Company (CNOOC) and China International Investment Corps (CIC), have long favoured investment in major infrastructure projects in the UK and worldwide. Their close links with the state have become a double-edged sword for Chinese firms, providing support for overseas expansion but also hindering growth and profit-making in foreign markets, where their direct links with Beijing have often provoked suspicions and hostility.

Chinese SOEs often lack a transparent corporate governance framework and have little experience of explaining the purpose of their investments – whether to the British public, or elites. Unlike Western multinational companies, their non-state shareholders play little role in determining their corporate strategies and overseas investment plans. Instead, party secretaries hold the final decision-making power with regard to corporate strategies. Given their direct ties to the government, it is difficult to judge whether Chinese SOEs' overseas investments plans are political decisions or are based purely on commercial merit.

In the mindset of both the Chinese government and investors – regardless of their ownerships – investing in the UK will ultimately increase their exposure to mature market economies, allowing them to learn sophisticated management skills and to create long-lasting brand value for their products. These intangible assets are abundant in the UK but relatively scarce in China. This is one of the key reasons why the CGN and many other Chinese SOEs are enthusiastic about participating in infrastructure projects in the UK—a stepping stone in the effort to show their global success by entering developed economies. In addition, those companies that take the opportunities to invest abroad will reap the benefits as they enjoy a competitive advantage over other Chinese firms.

From the UK's perspective, one of the reasons why Chinese investment is attractive is because it creates more local employment and job opportunities. This will become even more important after Brexit. And if Chinese investors do not deliver the promised jobs, it will trigger hostility from both the British political elite and ordinary people.

On the foreign policy front, Brexit is also an opportunity to re-assess Beijing's own foreign economic policy. There is no doubt China has flexed its muscles to pursue economic statecraft in order to attain its global political ambitions, as well as to invigorate its domestic economy. However, this statecraft needs an update after Brexit. Chinese policy makers must be aware that simply shopping around the UK with grand infrastructure projects will not automatically generate sufficient returns on their investment, both economically and politically.

Economically, Beijing will carefully calculate the commercial profitability and analyse the real costs and benefits of engaging with certain infrastructure projects. Contrary to conventional wisdom, the state-owned owned banks can offer cheap credit to its SOEs. Indeed, financing the £6bn ($9bn) already committed by CGN to the Hinkley project is a daunting task which involves some very careful financial due diligence and planning from China's state-owned banks and investors.

Rethinking the Sino-British relationship

China and the UK have very different political systems and institutional establishments. When it comes to negotiating bilateral relations between Beijing and London, their motives and interests are not the same. It would not be constructive to use investments to conceal these differences when it comes to normative issues such as human rights and the rule of law. Nor can relying upon infrastructure investments alone eliminate existing historical prejudices.

Instead, both sides should offer clearer policy objectives, explain their diplomatic efforts better, achieve bureaucratic transparency and explain what kind of partnership China and the UK wish to forge after Brexit. Other areas – especially international financial reform, with the UK being the founding member of China-led Asia Infrastructure Investment Bank (AIIB) – as well as climate change and innovation, are crucial for future fruitful collaboration, as became evident during the recent G20 Summit in Hangzhou.

Overall, the UK's painful divorce from the EU is likely to bring tremendous economic and political uncertainty, putting China's recent engagement efforts into doubt. China has already been closely involved in three politically controversial infrastructure projects (coincidentally, all begin with an "H" – Heathrow, Hinkley, and HS2) in the UK. There will be plenty of unexpected twists and turns in Sino-British relations, as China has already found in other advanced economies around the world. A long-lasting and healthy diplomatic partnership is not only about the "reddest red carpet" and "investments"; it requires measured calculations, grounded analyses and honest dialogue. Both Beijing and London should "keep calm and carry on".

This article represents the views of the author and not those of the Brexit blog, nor the LSE.

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