

## COSCO'S HAMBURG TERMINAL ACQUISITION: LESSONS FOR EUROPE

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COMMENTARY

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Europe is waking up to the dangers of overreliance on authoritarian powers, but largely lacks the toolkit necessary to mitigate dependencies on the very regimes most willing to exploit them. Russia's invasion of Ukraine and subsequent weaponization of Europe's energy dependency on Moscow has hit every corner of the continent's economy. Meanwhile, Xi Jinping has a track record of imposing economic coercion in response to slights against Beijing. While the discussion of these risks has advanced, the policy framework and how it is used to respond to such dependencies needs urgent change. Europe may be rapidly

adapting after the fact to Russia's coercive use of its control over European critical infrastructure and the oil and natural gas that flow through it, but the opposite has happened regarding China's increasing role in European ports and the shipping services that flow through them.

Most recently, this involved China's massive state-owned shipping company COSCO seeking a 35 percent share in the Tollerort Terminal at the Port of Hamburg. After months of debate, the German government approved an amended investment which, if COSCO accepts the counteroffer, will lead to 24.9 percent ownership.

Absent other factors, this decision does not present an immediate risk to German or European security, but when contextualized with broader trends, it adds to growing medium to long-term risks for Berlin, and for the European Union more broadly. The impacts on the common market stem from Berlin being only the most recent of a long trend of member state governments to allow China's state-owned COSCO to exploit market advantages to capture market share in the European Union. Importantly, the decision also comes in the context of different times — not only has Beijing changed, but so have its ties with Moscow. Furthermore, this is the first major investment to take place after the establishment of an E.U.-level investment screening mechanism.

## BECOME A MEMBER

To manage this issue, European policymakers should first understand the manner in which COSCO is able to rapidly build market share in European ports and shipping services in a way that would be impossible going the other direction. That means understanding the nature of COSCO as a company that differs from its European competitors, the uneven playing field it benefits from, and the growing scale of its footprint in the common market — all of which generate long-term dependency risks.

Beyond grasping the scale of the challenge, European policymakers have a range of options at their disposal. First would be further Europeanization of the European Union's Foreign Direct Investment screening mechanism, which has been operational since 2020. The mechanism still primarily captures sharp and immediate national security or public order risks, and even then its ruling is not binding. Instead, an updated mechanism should be able to capture not only the "smoking gun" types of risks but also the "slow-burning" types that drive longer-term dependency risks in critical infrastructure and logistics. Furthermore, the European Union has other measures in the pipeline that can help, like the measure to regulate foreign subsidies that are inbound. Yet further changes, such as the way European anti-monopoly rules are applied, as well as aligning E.U. maritime cabotage law with land and air cabotage laws, can also chip away at the distortions that COSCO can inject into the common market in the status quo.

## **The Slow-Burning Fuse**

COSCO presents national and economic security risks not through a single investment in any European port, but because of three key factors.

First, COSCO is not just another shipping company. While its competitors like Hapag-Lloyd or MAERSK have fiduciary responsibilities to shareholders to maximize return on investment and shareholder value, COSCO is a tool for Beijing to advance its strategic interests. The Chinese shipping giant is one of 97 centrally owned state-owned enterprises owned and managed by the State-owned Assets Supervision and Administration Commission, which itself is directly under China's State Council. Of course, COSCO is expected to grow and prosper, and so engages in plenty of normal commercial activity. However, it can also be given other goals, such as focusing on taking market share abroad, profitability in those markets be damned. They can do this because COSCO can afford to take a hit on its margins, which like most Chinese state-owned enterprises are already lower than private competitors, and make up for it with subsidies, cheap Chinese government financing, or favorable terms in its protected home market.

Beyond just being an explicit tool for Beijing to advance its strategic goals, COSCO's position gives it unprecedented potential to act with monopolistic powers. Much of COSCO's value chain is also managed indirectly by China's government through the State-owned Assets Supervision and Administration Commission or is state-owned by another entity. COSCO as a shipper receives demand from China Logistics Group, uses its own ports as well as China Merchant Groups, its ships are chiefly built by China State Shipbuilding Corporation and its subsidiaries, using steel from firms like Bowu Steel, which in turn gets its iron and coal chiefly from state-owned traders and miners. The distortions that this can lead to are exactly why market economies have robust anti-trust/anti-monopoly laws — such value chains can be easily manipulated to crush their competitors and bring greater market share under their control.

Second, COSCO is also able to take greater market share and increase European dependency on Chinese shipping due to unequal market access. Of the three basic categories of shipping — international shipping (import and export between countries, which goes through customs), transshipping (reorganization of cargo between vessels at a port, which stays outside of customs), and domestic shipping (movement of cargo between ports/inland waterways within a single country, which stays inside of customs) — COSCO can access all three in Europe: international shipping and transshipping as COSCO, and domestic shipping through subsidiaries like COSCO (Europe) or Diamond Line. Meanwhile, European shippers can only do international shipping in China, with only a small pilot program for niche transshipping and a ban on domestic shipping for any company that is not “Chinese-owned”.

That not only means COSCO has more markets in which to seize market share from European players, but it also enhances the value of its port investments, leading to market distortions. This is akin to a situation in which European and Chinese firms can buy gas stations in each other's markets, but in China, the Europeans are only allowed to sell gas, while in Europe, the Chinese can sell gas as well as drinks and snacks in the store. This is a very different value proposition for the investment, and also an imbalance whereby the Chinese

petrol stations can lower fuel costs to seize market share while making up for the difference with their food and drink sales. COSCO's investments in European ports thus create a clear market distortion, as they can use their holdings there to facilitate all three categories of shipping, while the shares that European shippers hold in China, while still lucrative, can only facilitate international shipping for their own operations.

Third, COSCO, as well as another State-owned Assets Supervision and Administration Commission entity called China Merchants Group, have steadily expanded their footprint across the E.U. common market. With shares in 15 different European ports in Greece, Malta, Italy, Spain, France, Belgium, and the Netherlands, plus Germany if COSCO accepts the German government's deal, the State-owned Assets Supervision and Administration Commission holds a significant amount of market share in the port infrastructure itself. None of those investments necessarily post an immediate risk individually, but together, they begin to appear as a source of concern. Added to that is the steady growth of COSCO as a shipping service provider for international shipping, transshipping, and domestic shipping services which European firms cannot compete for in COSCO's home market, as well as the vertically integrated monopoly power that COSCO wields through the State-owned Assets Supervision and Administration Commission. The combination of these unique advantages, the strategic role within the Chinese Communist Party, and the current and growing market shares in both ports and shipping services generate a real and growing dependency risk over the long run.

This does not mean that Germany or the European Union should aim to block all investment from COSCO, restrict all of its ships from European ports, or purge the investments it has already made. But reconfiguring the framework for how to manage dependencies on companies from authoritarian regimes is necessary in a changing world.

## **Why Policy Needs an Update**

But why now? One argument in favor of approving the Hamburg deal was that other major ports nearby, Rotterdam and Antwerp, have similar shareholding positions with COSCO. This is true, but those investments took place at a time when European strategy was to attract more Chinese investments, and well before the Russian invasion of Ukraine. Between the early 2000s and the mid-2010s, when these agreements were signed (2016 for Rotterdam and 2004 for Antwerp), neither the European Union nor Belgium nor the Netherlands had investment screening mechanisms in place — the E.U. mechanism came into force in 2020, and the Dutch and Belgian ones should come in in 2023. Germany offering a modified deal to COSCO at a time where not only screening mechanisms for investments are in place but also the debate has shifted towards decreasing dependencies from China is politically different, but also suggests that the framework is not yet commensurate to the task of managing dependencies with China. A new framework necessitates two main areas be dealt with — investment screening of critical infrastructure for the European Union, and measures to mitigate the distortions of an entity like COSCO and its fellow State-owned Assets Supervision and Administration Commission firms.

First, investment screening in critical infrastructure should be Europeanized and strengthened in the case of critical infrastructure, as the ultimate decision to greenlight or block an investment is currently a member-state competency. Past cases such as those of the investments in the Greek Port of Piraeus, which faced no screening mechanism, to begin with, in Hamburg, which was approved with an amendment, and in Trieste by China Merchant Group, which did not materialize, relied on member-state assessments. Yet, any individual investment by a firm like COSCO introduces the kind of distortions outlined above into the European Common Market, affecting every member state. Since COSCO can always threaten to approach another port, any given jurisdiction may as well accept the deal, so it gets the benefits of the investment. The Europeanization of such decisions would help prevent the “tragedy of the commons” between member states and weaken Chinese enterprises’ coercive power. The fact that a decision regarding the acquisition in Hamburg was taken in part due to fears

that COSCO may redirect shipping flows to Rotterdam or Antwerp exemplifies the weakness of the current system and the strength of China's enterprises' leverage capabilities.

The European Union already possesses an instrument to block risky investments, the screening mechanism for Foreign Direct Investment. However, the E.U. can only advise member states' governments on how to proceed regarding transactions happening within their borders, and it focuses on security and public order, leaving little space for issues that do not fit the "smoking gun" security risks requirement. Some member states, such as Italy and France, have applied their screening mechanism more flexibly, but how to decline the instrument and its application remains in the hands of national governments.

In 2023, the European Union will review the existing screening mechanism for Foreign Direct Investment. This is a good occasion to take on two almost impossible tasks. The first is to expand the scope of the instrument to reflect the new dimensions of security linked to resilience and managed dependencies. The concept of security can no longer be fully separated from that of Open Strategic Autonomy, where Brussels not only focuses on the immediate security impact of Foreign Direct Investment but also the long-term implications of growing dependence. The second is to strengthen the opinion mechanism so that member states and Brussels can more heavily weigh on national decisions, as currently, European capitals can ignore the advice they receive from Brussels and from other capitals regarding investments.

Finally, the distortions that put at risk the E.U.'s level playing field and the common market can be mitigated. Updating screening can offer a solution to face less traditional and long-term security concerns, but does not necessarily address the market advantage COSCO possess in virtue of its state ownership, home market structure, and the uneven playing field it enjoys.

## **Conclusion**



One tool to remedy some of this is already in the pipeline. The European Union is in the process of approving a regulation on distortive foreign subsidies that would allow it to scrutinize non-E.U. enterprises subsidized by foreign countries that may cause market distortions and damage the level playing field. That will make foreign companies subject to the same strict regulations E.U. enterprises must follow. By virtue of their link to and support by the state, China's state-owned enterprises and the market distortive practices they may enact could be vetted, and acquisitions — as well as participation in procurements bids — blocked.

Another simple first step would be to look at how European and member-state anti-trust/anti-monopoly/anti-cartel laws could be applied where necessary. Plenty of investment from China comes from mostly normal market players, such as private firms like Geely and BYD Auto, that are advancing China's automotive sector and bringing competition into the common market. But entities like the vertically integrated and monopolistic value chain of the State-owned Assets Supervision and Administration Commission and its 97 state-owned enterprises should be examined in depth when participating in European markets. After all, it seems strange that European competition law blocked the merger of Siemens and Alstom, but does nothing to address the distortions brought in by the state-owned enterprises that form China Inc.

The uneven playing field could be also corrected through the Europeanization of what is known as cabotage law — the rules that determine who can transport goods or people within a given jurisdiction. Air cabotage law is already set at the E.U. level within the common market — this is why Ryanair, an Irish (and European) airline, can fly not only from Dublin to Paris, but also from Paris to Warsaw, while Air China can only fly routes into the European Union, but not between E.U. member airports. The same is broadly true of land cabotage law, which is essential to the functioning of the common market — if a container hauled across Europe had to change trucks and drivers at every internal border, the common market at the center of the European project would be dysfunctional.



Yet, for maritime cabotage law, rules are set at the member state level. This is what allows COSCO ships to move from port to port in the E.U. to perform international shipping and transshipping, so long as it is moving between member-states. If the E.U. were to be in charge for maritime cabotage law as it already has for land and air, this would do much to level the playing field, all while advancing the core tenets of the common market.

While many Europeans may be uncomfortable with these changes, the simple reality is that China is changing the environment in which European citizens and their companies exist. In many ways, China is choosing for us by advancing not towards the spirit of World Trade Organization membership in a rules-based order, but towards an international system more aligned with the one in Beijing. Preserving European values like fair competition and the common market will inherently mean finding ways to manage the distortions coming from China's national champions and their anti-competitive structure in their home market. Beyond that, preserving European strategic autonomy and combatting growing dependency on state-directed firms like COSCO will be similarly uncomfortable, but necessary nonetheless.

## BECOME A MEMBER

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