The EU-China Relationship

ROBERTO FOA

Is this the beginning of the end of the much vaunted EU-China partnership, or merely the end of the beginning? The past decade has seen a remarkable blossoming of Sino-European ties, with bilateral trade having grown exponentially, and the EU having surpassed the United States as China’s largest trading partner. Cooperation has extended to other areas, with 100,000 Chinese now studying in the EU, against 60,000 in the United States, and the Chinese invited to join in a number of European technology projects, including the Galileo satellite navigation program.

Yet, over the past year, distrust and disappointment have set in. After a proliferation of bilateral summits and delegations, Chinese diplomats are reported to be frustrated by the ‘talking shop’ nature of their EU meetings, while for their part, European diplomats complain of cynicism from the Chinese, who, in the stinging words of a recent report by the European Council of Foreign Relations, treat their “relationship with the EU as a game of chess, with 27 opponents crowding the other side of the board and squabbling about which piece to move.” In December of 2008, a breaking point was reached when the Chinese cancelled their participation in the annual EU-China summit in retaliation against French plans to meet the Dalai Lama. Since then, the EU has taken a notably harder trade stance against China, imposing anti-dumping tariffs of up to 50 percent on Chinese-made candles sold in the EU, extending duties imposed on Chinese shoes, and partnering with the United States at the World Trade Organization to oppose China’s use of export restrictions on raw materials.

Why this sudden breakdown in Sino-European relations? Among the factors that pushed Brussels and Beijing closer during the early years of this decade, foremost were the unilateralism of the Bush administration, which led both Chinese and Europeans to see in each other the means toward a balanced international order, and the excitement generated by Europe’s Conventional Convention, which had raised the prospect that Europe could emerge as a credible alternative political and economic partner to the United States. Today, however, both sides feel disappointed and frustrated, having not got from their relationship what they hoped at the outset. The Chinese expected a purely economic partnership which, unlike its partnership with the United States, would not be marred by ethical or geostrategic challenges, but instead the Europeans have continued to press on Tibet, as well as on human rights and freedom of information. For its part, Europe expected access to Chinese markets and greater cooperation in international negotiations over carbon emissions, but instead, Europe has faced trade obstacles that have seen its trade deficit widen since 2000 from €49bn to €170bn, and suffered a spectacular rebuff at the
Copenhagen Climate Change Conference in 2009, when the Chinese delegation led opposition to European proposals for a binding treaty.

**From Honeymoon to Partnership**

So is this the end, already? Certainly, the ‘honeymoon’ in EU-China relations is over, with both sides taking a more nuanced view of the other. Niklas Swanstro, founder of the Institute for Security and Development Policy in Stockholm, reflects this new attitude, arguing that though “China is currently not a direct security threat to Europe in the classical military sense”, it “could possibly become an indirect threat depending on the future strategic choices Europe makes”.

Similarly negative assessments have been made by Charles Grant and Mark Leonard, the Director and the founder respectively of the Centre for European Reform and the Foreign Policy Centre, two other influential EU think-tanks.

However, even if EU-China relations are now guided a greater sense of realism than before, a definitive break between the two powers seems unlikely. Quite simply, both the EU and China have more to gain from each other than either has to lose. In particular, three forces which will continue to drive the EU and China to work together in defining the global agenda for the twenty-first century. These are the lack of a geostrategic sphere of conflict, the new institutional architecture of the European Union, and a convergence of economic interests. Each of these deserves to be tackled sequentially.

First, on the core geostrategic issues European states have no ‘fundamental’ area of conflict with China. Taiwan is close to irrelevant for most European states, which have long since supported the ‘One China’ policy, and while the Tibetan cause has some traction in Europe, it does not have anything like the coalition of supporters that can be found in Hollywood or Washington, DC. The only two areas where China and Europe can be said to ‘compete’ for influence are in central Asia and Africa; yet both regions are ultimately of secondary importance for each side. This lack of any significant geostrategic sphere of conflict marks a fundamental difference to China’s relationship to the United States, which is characterised by the struggle for predominance in the Pacific, or the EU’s relationship to Russia, which has been marked by repeated tension over Eastern Europe and the Balkans.

Second, the passage of the Lisbon Treaty has made the European Union a more credible negotiating partner, by creating a permanent President of the Council, as well as an External Action Service that will substantially improve policy stability. The Chinese will never see in Europe the potential for a geopolitical counterweight to the United States, but with the new institutions in place they do at least welcome the prospect of replacing the existing network of discussion fora with substantive negotiation, capable of making progress on sensitive issues. The appointment of the EU’s Trade Commissioner Catherine Ashton to the new post of High Representative for Common Foreign and Security Policy (in effect, the EU’s ‘foreign minister’) was welcomed by the Chinese government, as it has given China a contact at the top of the EU’s administration with whom they are already familiar through trade negotiations.
Third, and perhaps more importantly in the long term, both China and Europe share similar views about the need for a multilateral global economic order less dominated by the United States. For its part, China is frustrated at the degree to which it has become invested in the future of the US economy as a result of its vast dollar currency reserves, and is struggling to find a way to extricate itself at minimal cost. The proposal that has been advanced by Zhou Xiaochuan, Governor of the People’s Bank of China, to replace the dollar as a global reserve currency by the International Monetary Fund’s Special Drawing Rights (SDRs) - which are based on a basket of currencies – ultimately amounts to a covert scaling down the salience of the dollar and supplementing it, inter alia, with the euro⁸. On the European side, the European Central Bank has long held the objective of establishing the euro as a global reserve currency. Due to their large current account surplus with the eurozone, the Chinese are well into the process of amassing euros alongside their dollar holdings, making the euro a larger component of global currency reserves. While the composition of China’s foreign currency reserves are officially kept secret, unofficial estimates suggest that the euro component could exceed twenty per cent⁹.

The growing need for the Chinese to purchase euros will also create growing opportunities for the EU to sell sovereign debt to China, while China will in turn become steadily more invested in the monetary stability of the eurozone. A recent example of such cooperation was provided by the Greek effort – admittedly denied by the Greek government – to persuade China to purchase 25bn euros of bonds, in order to prevent the possibility of a bond failure. As China looks for ways to reinvest its surplus euros, similar bond sales could occur with other highly indebted eurozone member states, including Portugal, Ireland, Italy and Spain. The need for China to reinvest in Europe is a structural consequence of its growing trade surplus, and is likely to remain a constant feature of the next decade: any current account deficit must be balanced by a capital account surplus, and thus until China revalues its currency, Europe finds itself with the ambiguous blessing of drawing on a Chinese necessity to purchase low yielding eurozone sovereign debt. After having seen how the Chinese purchase of low yielding treasuries fuelled the present financial crisis in the United States, Europeans may have misgivings about drinking from this same poisoned chalice. Yet under conditions of fiscal austerity, eurozone governments can hardly complain at the presence of a ready source of external financing to ease their sovereign debt concerns.

**Risks on the Road to Rapprochement**

While the underlying political and economic dynamics ought to favour a Sino-European rapprochement, ultimately the outcome will depend on diplomacy. The first risk here is that China and the EU enter a trade war, as the EU follows the advice of Fox and Godement – authors of the European Council of Foreign Relations report mentioned at the start of this article – to engage in tit-for-tat retaliation against Chinese trade practices¹⁰. While China’s membership of the World Trade Organisation (for which European states pushed strongly) makes a drawn out and acrimonious dispute a little less likely, as disputes can now be submitted to WTO arbitration, the cycle of moving from WTO cases, to sanctioned reprisal, to reconciliation, is a long one. It took a decade for the EU and the United States to fight their cases in the WTO during the 1990s, before an eventual resolution was achieved by Pascal Lamy and Robert Zoellick in the early
years of this decade. It now looks like the EU and China will fight out a similarly drawn out struggle, as China has moved to challenge EU restrictions in the WTO, most recently over the EU’s extension of anti-dumping duties against Chinese and Vietnamese footwear.

The second danger is that the Chinese despair at the EU’s unwillingness or inability to grant their two main outstanding requests: the lifting of the EU’s arms embargo, and the granting of market economy status to the country. The European Union imposed an arms embargo on the People’s Republic of China following the Tiananmen Square incident of June 1989, when the then 12-member European Community issued a one-sentence declaration condemning repression of the protests and calling for greater respect for human rights. As a result of the declaration, military cooperation was suspended, scientific and technical cooperation programs were reduced, the visas for Chinese students were made more restrictive. Though some aspects were subsequently rescinded or poorly followed by EU member states, the essence of the arms embargo remains in place11.

Since 2003 China has been increasing pressure on the EU to end the embargo, yet the EU has been unable to act in concert to do so. Initial attempts by France and Germany in 2004 to persuade the then 15-member bloc to rescind the declaration were derailed as a result of cross-straight tensions during that year’s Taiwanese Presidential election. By 2005, it seemed that the EU had overcome the objections of more hesitant members such as the United Kingdom and the Netherlands to lifting the embargo. However, the passage of the Anti-Secession Law in Beijing - committing China to use military means in the event of a Taiwanese declaration of independence - led the United States to place heavy pressure on the EU not to export arms to China. This strengthened the hand of those member states opposed to any change to the status quo, and in 2006, when the United Kingdom took over the rotating Presidency of the European Union, any plans to lift the arms embargo against Beijing were decisively withdrawn.

The issue of China’s market economy status is of more recent origin, but it has become a repeated mantra in Beijing’s bilateral meetings with Brussels. In 2001, China joined the World Trade Organisation, a move that was long supported by EU member states. The EU had already upgraded China from the status of ‘non-market economy’ to that of ‘transition economy,’ and granted Chinese firms the right to benefit from individual market economy treatment in anti-dumping procedures, so long as they are able to prove that they operate in a market economy environment12. However, the European Union has held out against granting market economy status to China as a whole, which would have the consequence of making it more difficult for Chinese firms to be found guilty of dumping goods on overseas markets. China has repeatedly noted that the EU has already made such a concession to Russia – a country that is hardly noted for its transparency and openness – and feels that the refusal to do the same for China is driven by political rather than economic considerations.

In part the EU’s refusal to grant market economy status to China is attributable to the fact that China’s exports are concentrated in areas which compete with domestic European manufacturers, whereas Russia largely exports raw minerals. Yet the EU feels it has legitimate reasons for withholding this concession, and has set down four conditions which must be completed before China’s status is altered. First, the EU has requested that China limit state interference in managing how firms are treated in its economy, which EU companies allege has seen domestic
firms prioritised over local joint ventures with European businesses, and as a result of which believes some exporters to have an unfair competitive cost advantage over comparable European producers. Second, the EU has requested that China’s accounting laws are enforced, and that Chinese firms improve their corporate governance. Third, the EU has requested that bankruptcy and competition procedures are fairly enforced among all domestic and foreign companies doing business in China. Fourth, the EU has requested that China undertake financial sector reform, with banks in China making lending and loan decisions independent of state intervention, which again European firms allege has discriminated against their local partners in favour of purely domestic competitors. The EU is not alone in insisting on these conditions, which are insisted upon also by other WTO members. Indeed, China’s focus on requesting market economy status from the European Union is not a result of the EU’s unwillingness to do so, but precisely because the EU is seen as more likely to do so than other WTO countries, and China hopes that by encouraging Brussels to change its stance other countries will then be forced to do likewise.

Towards A Lighter, More Pragmatic Partnership

Ultimately, both the issue of the EU arms embargo and granting China market economy status are of greater symbolic than substantive meaning, such that some form of eventual compromise is likely to be found. First, the EU is scheduled to grant China market economy status by 2014, and therefore the issue will eventually lapse if left unaddressed. Second, the four reforms that the EU has suggested China undertake in order to attain market economy status are reforms that the Chinese government itself intends to implement over the coming decade as a means of completing its economic transition process. Europe’s arms embargo remains a more sensitive area, yet of 27 member states, it only really affects potential French exports to the Middle Kingdom, as France is the only major weapons exporter within the EU that is likely to use the lifting of the embargo as an opportunity to make substantial deals in Beijing.

The next decade promises the possibility of a new era of EU-China cooperation, based around a pragmatic evaluation of what each partner has to gain from the other. However, both sides will have to work actively on a diplomatic rapprochement, if they are to avoid a continuation of the current drift in bilateral relations. Should this occur, the potential benefits for each side are great: the EU seeks a growing share for its companies in Chinese markets, and requires access to Chinese capital for its indebted member states, while China requires diversified exports, military and industrial technology transfer, and greater recognition in international organisations such as the World Trade Organisation, World Bank, and the International Monetary Fund. Whether these incentives are balanced enough to reach a consensus, remains to be seen. Nonetheless, the scale of interests would suggest an end to recriminations and the start of a lighter, more pragmatic partnership.
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