



EMBRACING THE DRAGON

The EU's partnership with China

Katinka Barysch
with Charles Grant and Mark Leonard





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Foreword



British American Tobacco is delighted to be able to support the Centre for European Reform in its authoritative analysis of the EU and China. It is only by gaining a deeper understanding of the issues involved that businesses can try to ensure that they are approaching the opportunities presented by China in a sustainable way.

The EU is now China's biggest trading partner and one of the most important sources of foreign direct investment. The EU and China are also working together on many important issues, such as supporting science and research, protecting the environment, improving governance or protecting intellectual property rights. As this CER pamphlet points out, a stable and forward-looking political relationship is essential for EU-China economic relations to prosper. The authors show that the EU and China have many common interests on which they can build such a stable relationship. But the EU and China should also be aware of where their differences lie so that they can avoid tensions and exploit the full potential of their partnership.

Michael Prideaux

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1 Introduction

Relations between the EU and China will become a much more prominent feature of the international landscape in the coming years. Two trends underpin this prediction. First, China is manifestly becoming more central to European interests, and vice versa. Already, the EU is China's most important trading partner, and growing amounts of European investment are pouring into the booming Chinese economy. European companies want more open markets and predictable rules for doing business in China.

But that is not the only reason why the EU is keen to lend a helping hand to China as it reforms its economy. Europeans hope that a China with open markets and a firm rule of law will be more likely to respect human rights and allow democratic freedoms. They also believe that a more open, democratic and law-abiding China will be a better partner in building the kind of multilateral global order that most Europeans want. Conversely, China is keen to learn from the European experience, for example with unifying disparate markets and developing backward regions. So the EU and China are looking at various ways of working together on issues that matter to both of them.

Second, both China and the EU are reaching out beyond their respective regions and taking on greater roles in world affairs. Both the EU and China can still safely be described as economic giants with only a limited geopolitical role. Both struggle with various problems at home and focus their foreign policies on their immediate neighbourhoods. They only intermittently dabble in world politics. This, however, is changing.

The EU will increasingly act as a vehicle to defend European interests and values, not only in its own vicinity but also in the wider

world. Of course, individual EU governments – in particular the ‘big three’, Germany, France and the UK – will continue to have their own foreign policies, including their own special ties with Beijing. And on many occasions, their short-term interests and national rivalries will frustrate the EU’s attempts to forge a common position or act strategically. But the EU will continue to beef up its common foreign and security policy, to accumulate new powers, for example in counter-terrorism and defence, and to sharpen its international presence through Javier Solana, its foreign policy chief. The EU constitutional treaty, if ratified, would bolster these trends. In short, the momentum is towards ‘more Europe’ in foreign policy.

China, meanwhile, is groping its way from being a regional power towards becoming a global player. The pace of internal change leaves China little choice. For example, China’s communist leaders know that they need to deliver economic growth to enhance their legitimacy. For this, they need open markets and foreign investment. So China has become a big fan of globalisation. But the country’s growing economic clout also brings new responsibilities for managing the global economy, for example through pushing the Doha trade talks forward or addressing skewed exchange rates through negotiations with the G7. Another thing that a growing China needs is natural resources. Already China imports more oil than any country bar America. In its quest for energy security, China has forged close links with some rather unsavoury regimes in oil producing regions, including Africa and Central Asia.

Wherever the EU is likely to focus its attention in the coming years, China will be there too. And whatever the EU tries to achieve on key global issues – such as reforming the United Nations, preventing Iran from building nuclear bombs, or intervening in failed states – it will need China’s consent or co-operation. So the EU will want to make sure that it works closely with China as both increase their global roles. In theory, this should not be too difficult since the two have a lot in common. Both support multilateral organisations, such as the UN, and want all countries – including the big powers – to abide by

international law. Both are wary of the dominance of the US in global politics. Both care about sustainable development, the threat of terrorism and the spread of weapons of mass destruction.

These various common interests have provided fertile soil for a prospering EU-China relationship, which today consists of a plethora of co-operation programmes, dialogues and projects. What it often lacks, however, is consistency, strategic vision and an ability to plan beyond the next bilateral summit. Moreover, there are several issues that could hold back EU-China relations in coming years.

First, the EU and China do not always share the same values. Most Chinese now live vastly better than a couple of decades ago, and they also enjoy some political freedoms. But the EU will still struggle to build a strategic partnership with what is essentially an autocratic one-party state while at the same time upholding its own values and principles. Second, in many areas of international politics, the seeming agreement between the EU and China is little more than skin-deep. For example, China supports the UN but opposes the concept of humanitarian intervention, something that the EU is prepared to practice. Third, the EU’s deepening ties with China could damage its relations with its key global ally, the United States. Many Americans see a rising China as a potential threat that needs to be contained. The thorny question of the EU’s embargo on arms sales to China shows the potential for open disagreement between the Americans and the Europeans over relations with Beijing.

This pamphlet looks at some of these issues. Chapter 2 explains the EU’s policy towards China and its aims for the relationship. It also briefly looks at the role of the three biggest EU countries in the Union’s policy towards China. Chapter 3 tries to identify some of the forces driving Chinese foreign policy, and asks how the EU should react. It also gives an impression of how the Chinese see the EU. Chapter 4 provides an overview of what is still the main part of EU-China relations: trade and investment. It

speculates on how China's economic rise might affect the European economy. Chapter 5 explains why the EU should be involved in China's internal transformation process. It explores the EU's human rights policy. It provides some ideas on how the EU and China can work together in international politics. And it looks at US-EU disagreements with regard to China, including the arms embargo and the question of Taiwan.

This is the first major publication of the CER's China research programme. It aims to provide a broad overview of a relationship that is, in every aspect, in a state of flux. It is by necessity incomplete. And, given the pace of change in China, it risks being overtaken by events. Another limitation of the paper is that it mainly reflects an EU perspective though we have taken care to present Chinese views and arguments as much as possible. We have also tried to provide at least some background on the policies of individual EU member-states, in particular the big ones. But the main focus is on the EU's common policies towards China.

2 The evolution of a partnership

Over the last two decades, ties between China and the EU have developed from cautious commercial dealings into one of the most dynamic bilateral relationships on the world stage. EU-China relations have been, and continue to be, driven by economics. But as bilateral trade has boomed and European companies have ploughed billions of dollars into the fast-growing Chinese economy, the EU has sought to build a more coherent political framework around the economic relationship. Now the two sides hold annual summits and co-operate in more than 20 defined areas ranging from customs to space technology. The aim is to build a 'comprehensive strategic partnership', in other words a relationship that is broad-based, focused on the long-term and fuelled by common objectives and a sense of friendship.

Two factors in particular have determined the pace and intensity of EU-China relations over the years: developments within China, in particular the opening of the economy; and changes in the international environment. A 'comprehensive strategic partnership' cannot be sustained through occasional summits or other high-level meetings. It requires active co-operation in various areas, such as trade, energy, science, corporate governance and security. Such co-operation was, of course, impossible as long as China's economy was largely closed and state-controlled, when all decisions had to be sanctioned at the very top and entrepreneurs, local governors or NGOs were prevented from engaging with the outside world. It was only with greater openness and decentralisation that the EU and China could really begin to work together. The pace of China's internal reforms, both political and economic, will continue to be a key variable in the development of EU-China relations.

Secondly, changes in the global environment have at various times helped or hindered the development of EU-China relations. The end of the Cold War, for example, allowed the EU and China to take a fresh look at each other. For the first time, they could evaluate their bilateral relations in their own right, no longer seeing them primarily through the prism of their respective relationships with the US and the Soviet Union. Events elsewhere, such as NATO's bombing of Kosovo or the Iraq war, have also affected EU-China relations.

The EU's China policy

For the first 20-odd years of its existence, the People's Republic of China had few links with non-communist countries. But after Beijing fell out with the Moscow in the 1960s, it was forced to look for friends in what Chinese leaders saw as the 'grey zone between US imperialism and the Soviet bloc', namely Europe. China established diplomatic relations with France in 1964, with Italy in 1970 and with the UK and Germany in 1972. Diplomatic relations with the EU (then called the European Communities) followed in 1975, and the EU signed its first trade agreement with China in 1978.

It was only after the end of the Cold War that EU-China relations really began to take shape. Relations initially remained frosty after the 1989 bloodshed in Tiananmen Square, which was followed by a countrywide clampdown on all forms of political activity. Europe froze its political dealings with Beijing, cut off military contacts and banned arms sales. But economic ties between European countries and China continued to thicken. With the Asian economies booming, European businesses, in particular from export-oriented Germany, feared they would lose out on commercial opportunities unless political relations improved. The German government drew up its first China strategy in 1993. The European Commission followed suit with its first Asia strategy in 1994 and its first China policy paper in 1995.

Subsequently, the Commission issued policy papers on China with increasing frequency (1998, 2001 and 2003) as the EU sought to keep up with the breakneck speed of change in China and its rapidly developing ties with the country.¹ While objectives have become more ambitious and the scope of co-operation ever broader, none of the later policy blueprints deviates substantially from the original 1995 paper. EU governments, represented in the Council of Ministers, have broadly endorsed all of the Commission's policy papers. The Council also regularly issues its own China-related statements and conclusions, in line with these objectives.

¹ All documents are available on http://europa.eu.int/comm/external_relations/china/introl/index.htm.

In 1995, the EU looked somewhat incredulously at China's booming economy and growing political clout and decided that it needed "a long-term strategy that reflects China's worldwide, as well as regional, economic and political influence". It did so for two reasons: first, stronger economic ties were deemed crucial for the future competitiveness of European business. And second, the EU realised that it needed a coherent China strategy for the credibility of its emerging common foreign and security policy.

The EU's basic idea is to build its relationship with China from the ground up. Numerous concrete co-operation projects, many with rather modest short-term goals, form the basis. At the same time, the EU pursues a number of ambitious long-term objectives. According to the 1995 strategy, the EU's first objective is to "socialise China into the kind of international order that the EU supports", which includes support for the UN, adherence to international agreements on the environment, and the fight against the proliferation of nuclear and other weapons. This, the EU is convinced, will be easier if China continues down the path of economic and political reform. The EU's second objective therefore is to help China's internal transition. It vows to work with China "in many practical ways: progress towards full integration in the world market economy, strengthening of civil society, poverty alleviation, environment protection, human resource development, scientific and technological development, the

information society, trade and investment co-operation". The EU is convinced that it has much to offer the Chinese in terms of experience and expertise, be it on how to open markets, support poor regions or protect the environment (see Chapter 5). It therefore offers China aid, training, dialogue and co-operation across a large number of areas.

The flourishing EU-China relationship soon burst out of the existing institutional framework. Until 1994, the EU's political dialogue with China was limited to short annual meetings at the margins of the United Nations General Assembly and other international gatherings.

² *The troika now consists of the leaders of the country that currently holds the EU rotating presidency and the one that will take over next; the EU's high representative for foreign policy, currently Javier Solana; and the president of the Commission.*

But in the mid-1990s, the EU started building a more ambitious political framework, including annual summits at government or head of state level, and regular ministerial contacts. In 1998, the Chinese prime minister met with a 'troika' of EU leaders for the first EU-China summit.²

Diplomats judge the annual summits – which are held alternately in China and Europe – as largely symbolic. Too much time is taken up by statements and too little by real discussions. Although the Commission and Javier Solana provide some continuity, the quality of the summits often hinges on which EU country holds the rotating presidency. The fact that the presidency moves on to another country shortly after each summit makes it more difficult for the EU to ensure that there is follow-up on what has been agreed. The summits are nevertheless useful in three respects. First, they raise awareness of the EU in China and of China in Europe. Second, the fact that each summit needs 'deliverables' – positive announcements or agreements of some kind – has provided steady momentum for the relationship. Third, the summits give a top-level stamp of approval for the work done by European and Chinese officials or business people over the year.

What the summits have not done, however, is provide sufficient focus and strategic vision to the EU-China relationship. Each

summit adds more programmes and agreements to an already cluttered list. Today, the EU and China are engaged in more than 20 'sectoral dialogues' covering everything from intellectual property rights to regional security, education, maritime transport and environmental protection. The format of these bilateral dialogues is flexible enough to accommodate the vast number of issues under discussion. They can involve officials, politicians or business people, as need be, and they can take the form of working groups, conferences, annual formal meetings or informal exchanges. A dozen Commission departments (called directorates-general) are now involved in the dialogues, and commissioners regularly travel to China to encourage progress in 'their' area of co-operation. However, there is little linkage between the various dialogues, their short-term objectives sometimes clash, and they do not always serve the EU's overall objectives, as defined in its strategy papers. In the words of one Commission official: "Each dialogue takes place in its own little box."

Some diplomats blame this lack of priorities and leadership on the fact that the legal and institutional framework for EU-China relations is out of date. The main legal basis for EU-China relations is still the bilateral trade and economic co-operation agreement from 1985, drawn up at a time when the EU had few economic links with China and even fewer political ones. The agreement is a mere four pages long and focuses heavily on trade. It set up a 'joint committee' as the main body to manage EU-China relations, comprising representatives of the Chinese ministry of commerce (Mofcom) and the EU trade commissioner (or occasionally the external affairs commissioner). The joint committee meets twice a year and has done a good job in addressing economic problems. But it is singularly ill-suited to deal with the vast range of issues now on the bilateral agenda, such as non-proliferation, illegal migration or climate change, to name but a few. And it does not have the political clout to provide the kind of guidance that the EU-China relationship so badly needs. The EU therefore hopes that a new 'framework agreement' will involve the establishment of bilateral institutions

that are better suited to deal with the whole range of issues in EU-China relations, while at the same time facilitating the setting of political priorities.

However, the negotiations for the new agreement – which may start in the course of 2005 – are likely to be long and arduous. As bilateral ties have intensified, so has the room for friction, tensions and disappointments. The new framework agreement will bring all the contentious issues onto the negotiating table. Both sides hope that by creating linkages between different areas they will get the other side to make concessions on the issues they care most about. The EU, for example, wants the Chinese to co-operate more in fighting illegal immigration, to implement the promises it made when it joined the WTO, and to engage more seriously in the human rights dialogue. The EU hopes to achieve many of these objectives through getting China to sign up to ‘standard clauses’ on migration, intellectual property rights and ‘common values’. The Chinese, however, insist that, as a key partner for the EU, they should not be forced to accept the same clauses that the EU prepares for say, Vietnam or Uruguay. Beijing wants the agreement to reflect China’s specific interests and problems.

The role of the ‘big three’

The future EU-China framework agreement may create a better institutional framework for the relationship. But it will not fix the other key problem in the EU’s China policy, namely the inconsistent policies of the EU’s member countries, in particular those of the ‘big three’ (Germany, France and the UK) but also those of Italy, Spain and others. On the one hand, the larger EU countries have been and continue to be instrumental in shaping the EU-China relationship. They provide vision, ideas and expertise; they brighten the EU’s image in China through cultural work and student exchange programmes; they fork out millions of euro to help China’s transition; and they foster trust through political dialogues, joint military exercises or human rights projects. But on the other hand,

their efforts would be more potent if they were better co-ordinated with each other, and with the EU’s overall strategy. The member-states’ policies should reinforce each other and the common EU position, not undermine it.

In principle, all EU countries have endorsed the objectives of the EU-China strategic partnership. In practice, divisions and rivalries between individual countries often undermine EU objectives. This problem is not unique to the EU-China relationship. It characterises the Union’s dealings with all large and important countries. However, in the case of the US, and to a lesser extent Russia, political disagreements are the main reason for intra-EU divisions. In the case of China, short-term commercial rivalry among the member-states tends to predominate.

From a business perspective, the competition is perhaps inevitable. As Peter Nightingale, head of the China-Britain Business Council, explains: “Foreign companies in China face brutal competition. These companies then look to their own governments for help. The result is competition at the political level.” Although China has made much headway with economic reform and opening, the government in Beijing, alongside provincial authorities, still controls large chunks of the economy. Political lobbying is therefore part and parcel of doing business in China. This applies particularly to the multi-billion dollar contracts that flow from China’s massive infrastructure needs. In the coming years, China is planning to construct over 30 nuclear reactors, 20,000 kilometres of rail capacity and subway systems in some 20 cities, in addition to numerous dams, airports and pipelines.

The Chinese authorities have become rather good at exploiting commercial rivalries for political purposes. Like Russia and the US, they hope to ‘divide and rule’ in their relations with the EU. European diplomats recount instances where Chinese officials warn them that a lack of political support (for example for lifting the arms embargo) or too harsh a mention of human rights could

Chronology of EU-China relations

1975 The European Communities (EC) establish diplomatic relations with China.

1978 The European Commission and China sign their first trade agreement and set up a first joint EU-China committee.

1979 Roy Jenkins is the first president of the European Commission to visit China.

1984 First EC-China political consultations at ministerial level. First EC-China co-operation projects on business management training and rural development.

1985 The EC and China sign a trade and economic co-operation agreement.

1988 The European Commission opens its Delegation (diplomatic representation) in Beijing.

1989 The EC freezes China relations and imposes sanctions in reaction to the Tiananmen Square events.

1992 Most EC-China relations are normalised, but the arms embargo remains in place.

1993 The European Commission opens an office in Hong Kong.

1994 The EU and China establish a new political dialogue. The European Investment Bank finances its first project in China.

1995 The EU adopts a strategy paper on "A long-term policy for China-Europe relations". The EU for the first time provides humanitarian aid to China.

1996 China and the EU take part in the first Asia-Europe Meeting (ASEM). The EU and China launch their human rights dialogue, but suspend it again the same year.

1998 The EU adopts a policy paper on "Building a comprehensive partnership with China". The first EU-China summit takes place in London. The human rights dialogue resumes.

2000 The EU and China conclude bilateral negotiations on China's WTO accession. Zhu Rongji is the first Chinese prime minister to visit the European Commission in Brussels.

2001 The Commission publishes a paper on the "Implementation of the 1998 [EU-China strategy] communication and future steps for a more effective EU policy". The EU and China start consulting on illegal migration.

2002 External relations commissioner Chris Patten pays his first official visit to China.

2003 The Chinese government releases its first-ever policy paper on the EU. The EU responds with a policy paper on "A maturing partnership – shared interests and challenges in EU-China relations". Seven EU commissioners visit China throughout the year.

2004 The new Chinese premier, Wen Jiabao, meets Commission president Romano Prodi twice in six months. The EU and China sign key agreements on customs, competition, trade, textiles and tourism. For the first time, members of the European Parliament take part in the closing session of the National People's Congress in China.

2005 The EU prevaricates on lifting the arms embargo. The EU and China consider negotiating a new, comprehensive bilateral treaty, called the framework agreement.

damage the business interests of companies from their countries. As the then prime minister Li Peng put it in 1996: “If the Europeans worked with China in all areas, not only economically but also politically and in other areas, I think they would get more contracts with China.” Some EU governments appear to have taken this warning to heart. Politicians from London, Paris and Berlin (but also Rome, Madrid and elsewhere) think twice before they speak out on Chinese human rights violations or back ‘tough’ EU policies. Their apparent focus on short-term commercial advantage has elicited criticism from NGOs and many voters, caused divisions within the EU (the Commission, the European Parliament and the Nordic EU countries want a stronger emphasis on human rights) and angered many Americans. Worse, this kind of ‘competitive bilateralism’ has led to some rather rash decisions in EU-China relations. The EU’s abortive promise to lift its arms embargo on China is a good example (see Chapter 5).

The French president, Jacques Chirac, first started calling for an end to the arms embargo in late 2003. When he visited China in October 2004, he argued strongly that the EU should lift the embargo as soon as possible, and upgrade China to market economy status. Chirac was of course aware that the decision about market economy status is a matter for the European Commission (see Chapter 4). And he knew that intra-EU divisions on the arms embargo were too deep to allow for a quick decision on that issue. Yet, by telling the Chinese what they wanted to hear, he may have hoped to generate business for the 50-odd executives travelling with him. Indeed, French businesses signed an unprecedented \$4-5 billion worth of contracts during the state visit.

Other EU countries took note. German businesses called on Chancellor Gerhard Schröder to redouble his own efforts to woo the Chinese. When he visited China just two months later, Schröder called for a rapid lifting of the arms embargo, which he described as “a relic of the Cold War”. The 42 German business leaders who travelled with him signed contracts worth \$2 billion. Following the

Chirac and Schröder visits, the Chinese felt in a much stronger position to lobby for the rapid lifting of the arms embargo. They worked hard on those EU governments that were still opposed, in particular the Nordic countries and the Netherlands. In the end, the momentum towards lifting the embargo became almost unstoppable, without China giving reassurances on human rights or regional security (see Chapter 5).

While it is clear that economic rivalries undermine the EU’s China policy, it is debatable whether they guarantee commercial success. Although the Beijing government still decides the biggest commercial contracts, most Chinese leaders stress the separation between politics and economics, arguing that each follows its own logic. Business people freely admit that many of the deals thrashed out at the margins of political jamborees never come to fruition. At the end of the day, the Chinese tend to put commercial considerations first when choosing their business partners: the deal goes to those who offer the best terms, not the nicest words.

And even if political lobbying does occasionally sway a commercial decision here or there, it only serves the narrowly defined interests of the company that signs the contract. The company’s competitors moan about unfair interference and the lack of a level-playing field. Some company bosses fear that the rivalry between their governments weakens the EU’s hand in commercial negotiations with China. A unified EU could lean more heavily on the Chinese to open markets, protect intellectual property rights and get rid of senseless regulations – things that all EU companies operating in China desperately desire (see Chapter 4).

In theory, it should not be too difficult for the Europeans to stick to a common line. When it comes to China, the foreign policy strategies of the EU members, including the big three, are very similar to each other. And they match the common EU strategy closely in their main objectives. Yet each of the big three is building its own ‘strategic partnership’ with China, has its own bilateral human rights

dialogue, its own student exchange and science co-operation programme, its own chamber of commerce in China and its own aid programme for China.

★ Germany

Germany is by far China's biggest trading partner in Europe, accounting for around 40 per cent of total EU exports to China. Germany's industrial sector specialises in exactly the kind of investment goods – machinery, tools, electronics – that China needs for its investment boom. German sales to China have grown at annual rates of more than 20 per cent since the late 1990s, turning China into one of Germany's most important markets. Imports have grown even faster, and in 2004 Germany ran up an €11 billion trade deficit with China.

Germany is also one of the biggest foreign investors in China. Germany's car producers, pharmaceuticals companies and industrial giants such as Siemens and ThyssenKrupp all have a long-established presence in the Chinese markets. China's emerging middle classes respect the brand 'made in Germany'.

Germany's commercial success has been underpinned by large amounts of government aid and preferential loans. In the second half of the 1990s, Germany alone accounted for more than half of EU aid to China (defined as aid from the 15 members and European Commission). In its aid efforts, Germany focuses on judicial and legal reforms, environmental protection and transport infrastructure projects.

While commercial ties have flourished, political ties between China and Germany have remained rather underdeveloped. Although some Chinese look to Germany for support on Taiwan ("you too were once a divided country"), most Chinese still mainly value Germany as an economic partner. Germany has traditionally tied its foreign policies closely to those of its

fellow EU members. Only relatively recently has Germany sought to boost its independent profile on the world stage. Since he was first elected Chancellor, Schröder has visited China more often than any other non-EU country. However, the Chancellor's determination to be friends with the Chinese has at times caused him trouble at home. In particular his support for lifting the arms embargo has come under fire from the political opposition, the media, the federal parliament and human rights activists, in particular Germany's vocal 'free Tibet' lobby. The arms embargo has also caused divisions within the ruling coalition, with much of the Green Party vehemently opposed to lifting it.

★ United Kingdom

In the UK's relationship with China, the colonial past – in the form of Hong Kong – still looms large. The other elephant in the room is the US: London's close ties with Washington have at times complicated its relationship with Beijing. Recent debates about the arms embargo are a case in point. The UK was initially reluctant to support France's and Germany's move towards ending the arms ban and it was the first to call for a delay in lifting it when US opposition mounted in early 2005.

Disagreements over Hong Kong still occasionally sour UK-China relations although they now rarely make it to the top of the bilateral agenda. The UK handed the territory over in 1997, having received assurances that Hong Kong would keep a large degree of autonomy and a high level of democratic freedom under the 'one country, two systems' principle. But the British are unhappy with the state of democracy in Hong Kong, which resulted in some sharp exchanges between London and Beijing in 2004. Every six months, the British Foreign Office sends a critical update on Hong Kong developments to Parliament. And every six

months the Chinese protest that this is an interference in their internal affairs.

While the UK government is still more likely to speak out about democratic shortcomings in Hong Kong than are other EU governments, it does not generally make a big fuss about human rights in China. The Foreign Office website declares that the “human rights situation in China continues to be a matter of serious concern” and it expresses particular concern about the treatment of Falun Gong members (a small handful of whom have set up a permanent vigil outside the Chinese Embassy in London). But when Prime Minister Tony Blair met his Chinese counterpart Wen Jiabao in May 2004, human rights were not a big part of the agenda. In its political dialogue with China, the UK is trying to engage Beijing specifically on African development, climate change and non-proliferation.

As a trading partner for China, the UK ranks well behind Germany, some way behind the Netherlands and roughly on a par with France. In 2004, the UK imported four times more from China than it exported there (£10.6 versus £2.4 billion, according to UK government statistics). But the UK remains one of the most important foreign investors in China, with a cumulative total of almost \$19 billion at the end of 2002. Although there are now some 4,000 British-Chinese joint ventures, most of the investment capital has come from the energy giants BP and Shell.

Historical ties and the English language have been a big advantage in fostering cultural and educational ties with China. Since the US tightened its visa requirements in the aftermath of September 11th, the UK has become the number one overseas destination for Chinese students. In the 2003-04 academic year, some 40-45,000 Chinese students were enrolled at British universities, according to the UK’s Royal Institute of International Affairs, with a similar number studying English and taking courses at non-university institutions.

★ France

Although France lacks Britain’s historical ties with China and Germany’s strong commercial links, its political relationship with China is in many ways the strongest of any EU country. France regards itself very much as a pioneer when it comes to bringing China into the international system. In 1964, France was the first large western country to establish full diplomatic relations with the People’s Republic. France’s current president, Jacques Chirac, can claim that he has sought closer ties with China ever since he – as France’s then prime minister – first met Deng Xiaoping in 1975. France launched a bilateral ‘strategic partnership’ with China in 1997, ahead of the EU and the other big member-states. By refusing to censure China in the UN Commission on Human Rights, France led the EU’s move towards dialogue and quiet diplomacy on human rights (see Chapter 5). France also prides itself on having spearheaded plans for the Asia-Europe summits (ASEM). And in late 2003, France kicked off the campaign for lifting the EU arms embargo on China.

France’s strong relationship with China mainly rests on the two countries’ similar assessments of international developments, and their similarly strong feelings about US hegemony. China has been a long-standing supporter of France’s ‘Gaullist’ foreign policy – one that is independent of, and often in opposition to, the United States. Both French and Chinese policy-makers cherish the idea of multipolarity, that of constraining US influence through the establishment of alternative poles of power (see Chapter 5). In many ways, therefore, the Franco-Chinese partnership is a function of their respective relationships with the US. Their joint opposition to the 2003 Iraq war, for example, led the two countries to co-ordinate their positions in the UN Security Council and strengthen their overall ties. The Chinese tend to speak highly of their French partners, with some claiming that “Chirac is the

only European who really supports us”. The pomp and heady rhetoric that characterises Franco-Chinese summits and state visits sets them apart from the more business-like atmosphere of other EU-China meetings.

France’s main objective now is to move towards a more ‘balanced’ relationship, away from grand declarations and towards more concrete co-operation, in particular in trade, investment and technology transfer. France’s foreign ministry admits that French commercial ties with China are “modest and imbalanced”.³ French companies only supply 1.4 per cent of Chinese imports, and the share has been shrinking in recent years. The trade deficit with China is France’s largest with any country. Commercial ties are heavily dominated by big, one-off deals, such as the sale of Airbus aircraft or Alstom trains, while the involvement of smaller private companies is underdeveloped,

³ <http://www.diplomatie.gouv.fr>. especially when compared to Germany.

3 China’s emerging global presence

One of the biggest challenges for the EU in building a strategic partnership with China is the incredible speed with which the country is changing. Policy-making in the EU is slow at the best of times. But compared with China’s breakneck pace of development, it often looks positively glacial. As a result, the EU’s stance towards China is often reactive rather than proactive.

The EU’s China policy does take into account the rapid pace of China’s internal transition. European companies are doing well out of China’s economic boom. The EU – plus its members – are helping the Chinese to cope with the problems created by the boom, such as pollution or the need for better laws. And they are keen to assist with China’s internal political transformation. But when it comes to foreign policy, the EU’s picture of China is more static. China is seen as a huge inward-looking status-quo power, a bit like the EU itself. Policy-makers in the EU need to wake up to the fact that China’s rapid internal developments are driving radical changes in foreign policy. The latter may turn out as important for the EU-China relationship as the former, if not more so. Conversely, China is trying to come to terms with the way the EU is changing. The Chinese are waking up to the fact that the EU is becoming an increasingly important international actor. And they are determined to take advantage of that fact.

China’s foreign policy revolution

China has traditionally regarded itself as a regional power rather than a global one. Deng Xiaoping’s instruction to “bide our time, build our capabilities” has been the watchword of a Chinese foreign

policy that was relatively uninterested in events outside the Asia-Pacific region. But at the turn of the century, China's leadership made an explicit decision that rapid economic development and an insatiable need for energy and natural resources required the Peoples' Republic to develop a global foreign policy.⁴ Today, China increasingly sees itself as a shaper of world order rather than a passive recipient of globalisation – with its own priorities, its own values and its own way of doing things. On the international stage,

⁴ *'China's grand strategy: A kinder, gentler turn'*, IISS *Strategic Comments*, November 2004. China has already acquired a vast amount of 'virtual power' – based not on its actual assets but on its potential.

China's growing strength, however, represents the leadership with a dilemma. One thing that has not changed is the determination of the Communist Party to maintain its grip on power. Communist ideology has been replaced as a source of legitimacy by a mixture of nationalism and economic growth. However, China's economic success – and the military muscle and political self-confidence that flow from it – have alarmed many countries around the world. Similarly, rising Chinese nationalism is fuelling tensions with Taiwan and Japan, as well as fears of China in the wider neighbourhood. If China started to look too threatening, its neighbours could club together in a countervailing alliance and/or move closer to the US. The US could reinforce its military bases in Central and South-East Asia, and strengthen its ties with Pacific powers like Australia, Indonesia, Thailand and Singapore. If China was encircled by less than friendly powers, it could become distracted from its priorities of keeping the economy growing and the political system under control.

Beijing's response to fears of a Chinese empire has been the strategy of 'peaceful rise'. Although Chinese officials no longer use the term (they now talk about peaceful development or co-existence), the basic idea still stands: China will concentrate on gathering strength while at the same time re-assuring other countries in Asia, as well as the United States, that its rise will not threaten stability and security.

Instead, China stresses its commitment to peace, its lack of hegemonic ambitions, its desire for amicable relations with the US and a closer partnership with Europe, its commitment to multilateral and regional institutions, and a concerted use of 'soft power' and culture to reassure the world.

As part of this strategy, Beijing has resolved virtually all land border disputes with its neighbours, and has developed a strategy that favours regional integration. With the Association of South East Asian Nations (ASEAN) China has signed a non-aggression pact, a free trade agreement and a number of other co-operation deals. Although China's rivalry with Japan is complicating wider regional initiatives, China has backed plans to transform ASEAN+3 (with Japan, South Korea and China) into an East Asian Community, complete with regular regional summits, free trade deals and a security forum. China has been actively engaged in the Asia-Europe Meetings (ASEM) in which the EU meets with 30-odd Asian countries. And it is a founder-member of the Shanghai Co-operation Organisation, which brings it together with Russia and four Central Asian republics.

Another aspect of China's 'peaceful development' is a new-found penchant for multilateralism, which involves a subtly changing attitude towards issues such as peacekeeping and non-proliferation (see Chapter 5). Some observers, in particular but not only in the US, are cynical about China's strategy of peaceful rise. They fear that China will only be nice to its neighbours and praise the UN until it has gathered enough strength to become an aggressive unilateralist. However, the EU should treat China's changing attitude to foreign policy as an opportunity to work towards its key objective of helping China to become a more responsible and predictable member of the international community.

China's current preference for regional initiatives could open the door for the EU to play a greater role in fostering regional security. Too many Europeans still think that what happens in this far-away

region does not affect them. But if there was a showdown over Taiwan, the Europeans might have to sacrifice their relationship with China in order to stand by their American allies in a conflict over which they had no control (see Chapter 5). Rising tensions between China and Japan, perhaps even a military conflict, would stunt the region's economic development, with devastating consequences for the world economy.

The EU cannot and should not try to rival America's role in the region. But while many in the US are suspicious of China's support for regional integration (they see it as an attempt to push the Americans out of Asia), the EU should wholeheartedly encourage China's ambitions in this regard. The EU should therefore devote more attention and resources to regional forums, such as ASEM, ASEAN and the embryonic East Asian Community. It should insist on conducting more and more of its business with China and the other Asian countries through these multilateral organisations. The EU's own experience shows that closer economic ties, political dialogue and the habit of working together can turn even the most quarrelsome neighbours into peaceful cohabitants.

However, while some changes in China's foreign policy offer opportunities for the EU, others are becoming a big problem. China's fierce quest for energy and other natural resources is one of them. China has been a net importer of oil since 1993, but its appetite for energy has increased exponentially since then. Oil imports grew by more than 30 per cent in both 2003 and 2004, making China the world's second biggest oil importer after the US. The International Energy Agency predicts that by 2025 China will be importing almost 10 million barrels of oil every day. For the Chinese leadership, securing the energy that their country needs for continued growth tops the political agenda.

As a result, Beijing is suddenly taking a keen interest in oil producing regions around the world, not only the Middle East but also Central Asia, Latin America and Africa. Since western oil majors and Middle

Eastern governments control many of the biggest oil fields, China has focused its attention on other producers such as Sudan, Angola, Gabon, Algeria, Venezuela and Libya.⁵ Here, China swaps much-needed investment capital for long-term supply contracts with no political strings attached. While western oil majors are prohibited or discouraged from doing business in places such as Zimbabwe or Iran, China is happy to step into the void. Once China has built up a stake in an oil-producing country, it seems to feel obliged to prop up the incumbent government and shield it against international pressure. China's support for unsavoury regimes around the world increasingly pitches it against the EU, which is seeking to promote democratisation, economic opening and human rights. In other words, China's oil needs are turning into a headache for the EU's foreign policy.

⁵ 'China's scramble for Africa', IISS Strategic Comments, March 2005. Drew Thompson, 'China's global strategy for energy, security and diplomacy', Jamestown Foundation China Brief, 2005. Paul Mooney, 'Beijing's delicate balancing act in Africa', International Herald Tribune, January 7th 2005.

For example, after massive investment from China's National Petroleum Company, Sudan now exports growing amounts of crude oil to China. In 2004, when the Europeans and other members of the UN Security Council wanted to impose sanctions on Sudan to stop the atrocities in the Darfur region, China threatened to wield its veto. Similarly, China already relies on Iran for around 15 per cent of its oil supplies. And in 2004, the Chinese energy giant Sinopec signed a \$70 billion, 30-year contract for Iranian oil and gas deliveries while also promising Chinese investment in the development of Iranian gas fields. Here again China could use its casting vote on the UN Security Council to block western sanctions (see Chapter 5).

In the past, Europe and America have often supported nasty regimes around the world in their quest for energy security. But they are now rethinking such policies. The EU could use its political dialogue with Beijing to point out that China's energy diplomacy may not necessarily contribute to security of supply.

First, propping up autocratic regimes may perhaps contribute to political stability in the short run. But it can exacerbate tensions and turmoil in the medium-term. Second, China's preference for acquiring direct control over energy assets, and buying oil and gas under long-term supply agreements, risks undermining the functioning of the world oil market. Most economists would argue that a well-functioning spot market is a better guarantee of energy supplies than restrictive bilateral agreements. As one EU diplomat put it: "If China continues to buy up energy assets at that speed we won't have much market left."

China comes to terms with the EU

China will not change its regional policies or energy diplomacy only because the EU says so. But the EU does have some leverage in Chinese policy-making circles, and it could maximise this leverage by taking account of the dynamic changes in Chinese foreign policy. While China is re-assessing its interests and policies, it is also adjusting its views of the EU. And most of this adjustment has so far been positive.

Traditionally, Beijing had seen the EU almost exclusively through the prism of its relationships with other powers, first the Soviet Union and then the United States. The EU mattered mainly as a potential counter-weight to American hegemony. It is only in the last 15 years or so that China has started developing its ties with Europe for their own sake. Yet China initially continued to focus its attention on the capitals of the big European countries. Since the Chinese have very traditional ideas about national sovereignty, they have struggled to take the EU's supranational model seriously.

⁶ *Hervé Dejean de la Batie, 'L'Union européenne vue de Chine: Un partenaire majeur?' IFRI, December 2003.* Several developments have changed Beijing's view of the evolving European Union and its potential as a serious partner.⁶ Successive rounds of enlargement proved the attraction of the European model. The completion of the

internal market and the introduction of the euro indicated that European integration was becoming irreversible. But it was only during their negotiations of WTO membership that the Chinese authorities realised the importance of the EU as an international actor in its own right: trade policy is a genuine Community competence, with decision-making power resting mainly in Brussels, not Berlin, London or Paris. China was somewhat taken aback when demands from Brussels threatened to delay its WTO entry. The Commission also manages day-to-day trade relations as well as the many 'sectoral' dialogues that together form the backbone of EU-China relations. So China started taking EU institutions seriously.

The Chinese have also realised, perhaps more so than Russians and many Americans, that the EU is not 'just' a trading bloc. With its emerging common foreign and defence policies, the Union is also becoming an important political actor on the world stage. Some Chinese are worried that a stronger EU may pursue policies that run against China's own interests, such as intervening in foreign countries or becoming more assertive in the Asian region. But most appear to welcome further progress in European integration and a stronger EU foreign policy, mainly because they still hope that a more unified EU could counter US hegemony in a multipolar world (see Chapter 5).

China's interest in Europe rose further after the leadership change in Beijing at the start of 2003. While Jiang Zemin had given priority to building a functioning relationship with the US, the new leadership under Hu Jintao moved EU-China relations near the top of its foreign policy agenda. Divisive issues, such as the status of Hong Kong and Macau, had moved off the agenda. Meanwhile, China's and Europe's worries about George W Bush's foreign policy acted as a unifying factor. China acknowledged the EU's growing importance in 2003 by choosing the EU as the subject of its first-ever policy paper on a foreign partner.⁷ It then declared 2004 'the year of Europe' in China. Growing enthusiasm for the EU has also been reflected in the

⁷ www.fmprc.gov.cn/eng/wjbxzjg/xos/dqzywt/t27708.htm

China's 2003 policy paper

The Chinese foreign ministry published its first-ever policy paper on China-EU relations in October 2003. It provides an upbeat assessment of current relations and lays out China's objectives for EU-China relations for the following five years. Hitherto China had regarded the EU mainly as an economic actor; the paper for the first time spells out China's vision for a broader relationship.

The current relationship

EU-China relations are better than ever before. There is no fundamental conflict of interest between the EU and China, and no mutual military threat. There are of course substantial differences in historical background, culture, political systems and level of economic development. So it is natural that the EU and China should disagree over some issues. But the common ground – for example on multilateralism, the role of the UN and sustainable development – outweighs the disagreements. The economies of China and the EU are complementary (cheap labour versus high-tech equipment).

China's objectives

★ China wants closer political ties with the EU. These should be based on mutual respect and equality, and aim to promote global stability. China will continue to deepen its relations with individual EU governments to maintain stability and continuity in its overall relationship with the EU. The one China principle is a "cornerstone" of EU-China relations, so all contacts between the EU and Taiwan must be strictly non-official. China encourages Europeans to learn more about Tibet but requests that they do not meet the Dalai Lama or other members of the government in exile. China appreciates the EU's non-confrontational attitude to human rights in China; it wants to continue the human rights dialogue but practical

implications should be restricted to social and economic rights, not political rights. China wants to work with the EU in the UN and globally to uphold the UN's authority. China welcomes exchanges between non-governmental bodies, including political parties and parliaments, provided they do not interfere in the internal affairs of the partner countries. China would welcome co-operation in the military sphere, leading to a "strategic security consultation mechanism" and it encourages the EU to lift the arms embargo at an early date.

- ★ China seeks to continue economic co-operation and integration with the EU. Economic ties should be based on reciprocity, which means China will open its markets only if the EU does too. China wants the EU to abolish "irrational restrictions and technical barriers", let in Chinese high-tech goods, upgrade China to market economy status and make less use of anti-dumping and other safeguards. China wants closer co-operation with the EU in finance, agriculture, environment, IT, energy and transport.
- ★ China encourages frequent people-to-people exchanges with the aim "to learn from each other". China wants to see more co-operation in science, technology, and research and development, as well as student and cultural exchanges. The latter should be managed by the state and be strictly reciprocal. The EU should make it easier for the Chinese to get visas, in particular tourist visas.

frequency of high-level contacts: between 2002 and 2004, members of the Standing Committee of the Politburo of the Communist Party (the top policy-making body), made seven trips to EU member countries, and only one to the US.

Occasionally, the Chinese have found the EU's policies a little condescending, in the sense that "you have a problem, and we are willing to help".⁸ On the whole, however, Chinese leaders tend to stress their commonalities with Europe, rather than their

⁸ Lanxin Xiang, 'China's Eurasian experiment', *Survival*, Summer 2004.

differences. China's dealings with the EU are fuelled by a kind of open-mindedness and goodwill that Europeans look for in vain in Russia and sometimes the US. Chinese officials, academics and commentators are usually well informed about EU developments and knowledgeable about the Union's internal workings. Foreign ministry officials in Beijing know the ins and outs of EU policies and many can recount exactly how many votes each EU country has in the Council of Ministers. One would be hard pressed to find officials in Moscow able to do the same. Also, while Russians tend to dismiss the EU as 'too difficult to deal with', the Chinese express sympathy for the Union's internal complexities. They say they understand that decision-making in the Union's multi-layered system of governance is often cumbersome and time-consuming. And they are acutely aware that the EU member countries, quite predictably, do not always agree when it comes to the EU's policies towards third countries. As Lanxin Xiang has pointed out: "A political and diplomatic model of muddling through fits perfectly well with [China's] traditional mentality [of yin and yang]".

4 EU-China economic relations

China's economic challenge

China's economic rise has been nothing short of revolutionary. With annual average growth rates of close to 10 per cent since the early 1980s, China has gone from economic backwater to one of the world's top markets and exporters in two decades. Last year, China's output was worth around \$1.5 trillion, which puts it somewhere between Spain and Italy in terms of economic size. But Chinese growth continues to outstrip that of most other countries in the world. So its economy is forecast to overtake Germany's by 2007, Japan's by 2015 and America's by around 2040.⁹ If China's output is measured at purchasing power parity (a measure that strips out the effects of skewed exchange rates),⁹ *Dominic Wilson and Roopa Purushothaman, 'Dreaming with BRICs – the path to 2050', Goldman Sachs, October 2003.* China is already the third biggest economy in the world, after the EU-25 and the US.

China's economy compared with the EU, US and Japan

	China	EU-25	US	Japan
Population, million	1,300	456	293	127
GDP, \$ billion	1,450	12,700	11,700	4,700
GDP per head, \$	1,200	27,800	40,000	37,000
GDP at PPP, \$ billion	7,500	11,600	11,700	3,700
GDP per head at PPP, \$	5,800	25,500	40,000	29,000
Share of world GDP at PPP, in per cent	14	21	22	7
Share of world exports, in per cent	7	21	9	6
Stock of FDI, \$ billion	540	3,660	2,550	90

All figures are 2004 estimates from the Economist Intelligence Unit. Trade figures include intra-EU trade.

¹⁰ Official figures show that 40 per cent of China's GDP comes from foreign trade, more than double the share of the US or the EU. But these figures probably overstate China's openness since they compare trade measured in dollars to GDP measures in undervalued renminbi.

even the big industrialised ones.¹⁰ This is the result of radical trade liberalisation in the run-up to China's entry into the World Trade Organisation (WTO) in 2001. Average import tariffs came down from a punitive 43 per cent in 1992 to 17 per cent in 2001. Today, Chinese tariffs are only a little higher than those of the US and the

¹¹ Razeen Sally, 'China's trade policies and its integration into the world economy', Paper prepared for the IGD/SAIIA SACU-China FTA Workshop, Johannesburg, September 2004.

EU. In line with its WTO promises, China is also in the process of dismantling non-tariff barriers to trade and throwing open its services markets, although perhaps less quickly than the West would like.¹¹

Conversely, WTO membership has given China much better access to western markets and propelled it into the ranks of the world's top exporters. China is now the world's biggest exporter of bicycles, toys, microwaves, TVs and many other consumer electronic goods. It produces more than half of the world's shoes and looks set to capture a similar share of the world's market for clothes in coming years.

Foreign direct investment (FDI) has been instrumental in China's export success. Initially, China only allowed foreign companies to invest in joint ventures in 'special economic zones'. These ventures produced only for sales abroad and they were not allowed to sell to local markets. Although such rules have been abolished, there remains a close link between FDI and exports: half of China's exports are produced by companies with foreign investment. Over the last five years, China has attracted FDI worth around \$250 billion, and the total stock of FDI now amounts to one-third of its GDP.

The main force behind the economic boom has been China's integration into the world economy. Only 25 years ago, China was largely closed to foreign trade and capital. State agencies had a firm grip on all commercial dealings with the outside world. Today, China is much more open than most other developing countries, and

even the big industrialised ones.¹⁰ This is the result of radical trade liberalisation in the run-up to China's entry into the World Trade Organisation (WTO) in 2001. Average import tariffs came down from a punitive 43 per cent in 1992 to 17 per cent in 2001. Today, Chinese tariffs are only a little higher than those of the US and the

EU. In line with its WTO promises, China is also in the process of dismantling non-tariff barriers to trade and throwing open its services markets, although perhaps less quickly than the West would like.¹¹

The economic boom that followed the opening of the economy has lifted hundreds of millions of Chinese out of poverty and created a burgeoning middle class. But it has also brought upheaval and intractable problems. Growing competition has forced inefficient state industries to lay off well over 30 million workers since 2001, and job-shedding continues at a rate of 2-3 million a year. Hidden unemployment in the countryside is estimated at 150 million. Tens of millions of ex-farmers and laid-off workers move to the booming coastal cities each year, exacerbating existing problems of overcrowding and pollution. The social safety net that was once provided by state-owned companies has all but collapsed. Income gaps are widening, not only between the rich eastern provinces and the dirt-poor west, but also within the booming industrial areas where there is a growing chasm between an emerging professional class and poorly paid manufacturing workers. Protests by desperate job-seekers and impoverished peasants are becoming more frequent.

Economists say that to soak up surplus labour, China needs to generate GDP growth of at least 7 per cent and create 8-9 million new jobs each year. Since it is the private sector – mostly with the help of foreign investors – that is creating these jobs, China has little choice but to continue improving its business environment and opening the economy to attract foreign capital and know-how. But at the same time, the authorities are trying to slow the pace of change, fearing that embattled state enterprises will sack millions more, that shanty towns will start spreading around the booming coastal towns, that social tensions will get out of hand and that pollution will become unmanageable.

The Chinese authorities know that the only way to guarantee rising living standards is to support the upgrading of the economy from sweatshops to high-tech manufacturing and services. Although China is exporting more and more high-tech goods, most of these are simply assembled out of imported components. China itself is short of the things it needs to move into higher-value added

production, such as highly educated professionals, skilled workers, investment in research and development (R&D) or innovative enterprises. Therefore the authorities insist that foreign investment involves the transfer of cutting-edge technologies, and they are also overhauling the education system and directing investment to pet industries. But analysts are sceptical about the government's ability to pick 'winners' and allocate investment in an effective way. Already, misguided investments by state-owned banks have left China with a massive pile of bad loans, which now binds the authorities' hands and starves the private sector of loans. And there is another dilemma: high-tech industries have higher productivity so they can pay higher salaries. But they also need fewer workers than sweatshops – so China's objective of moving up the value chain may clash with its other objective of creating enough jobs to contain social tensions.

As China's biggest trading partner and one of its most important foreign investors, the EU matters greatly for China's economic development. The EU can use its economic clout to push for faster market opening and deregulation. It can offer aid and expertise to tackle some of the problems created by economic opening and growth. European companies that produce in China can help to improve labour and environmental standards. Europe can transfer technology and know-how to push Chinese production up the value chain.

Europe has a stake in China's economic development that goes beyond the profit and loss balance of European businesses. If China's boom creates pollution or social upheaval on a massive scale, Europe will suffer from global warming and more illegal migration (Chapter 5). But some people in Europe are nevertheless questioning whether and how much the EU should help China with its economic development. Many EU companies are already struggling with fierce competition from low-cost Chinese goods. What, ask the critics, if China moves into exporting sophisticated engineering, IT products, cars and services? Will Europe stay competitive in anything?

Trade and investment

China's exports to the EU have grown by an astonishing 4,300 per cent since the beginning of the 1980s, when China got serious about opening its economy. EU sales to China have risen by around 2,000 per cent over the same period, which leaves the EU with a sizeable trade deficit vis-à-vis China (see below). In 2004, the value of EU-China trade reached €175 billion, making the enlarged EU China's most important export market. Conversely, China is now the second most important market for the Europeans, after the US.

EU-China trade, 2000-2004, € billion

	EU exports to China	EU imports from China	Trade balance
2000	25.8	74.4	-48.6
2001	30.6	81.6	-51.0
2002	34.9	89.6	-54.7
2003	41.2	105.4	-64.2
2004	48.0	126.7	-78.7
Average growth rate, in per cent	16.9	14.3	14.9

Source: European Commission, DG Trade

In the 1980s, the EU included China in its 'general system of preferences' (GSP) that offers lower tariffs on many goods from developing countries. By the mid-1990s, half of China's exports were covered by preferential tariffs, making the country the biggest beneficiary of GSP. But the system semi-automatically 'graduates' countries out of preferential treatment if their exports grow too fast or take up a certain market share in the EU. So by 2000 the share of Chinese exports benefiting from GSP was down to 30 per cent, and by 2005 only a small handful of products was still covered. At the same time, however, China's WTO membership guarantees it much

broader market access around the world. Under WTO rules, the EU must grant China the same access to its €10 trillion internal market as all other WTO members (although there are still some transitional arrangements that allow for extra protection).

The composition of EU-China trade is changing rapidly. In the past, China mainly sold basic manufacturing goods – toys, shoes, bicycles and the like – to the West. But in recent years, it has rapidly upgraded its exports to electronic products such as TVs, computers and other sorts of equipment. Usually, countries that move up the value chain stop producing the basic goods with which they started out. But since China has an almost unlimited pool of workers, it has managed to move into new high-tech sectors without greatly reducing its production of basic manufactures.

The EU is selling China the inputs it needs for its economic boom: machinery, tools, cars, chemicals and fibres, as well as sophisticated consumer goods. In many areas, such as electronics and chemicals, trade is still fairly balanced. This could change however, as China continues to become more competitive, with the help of western investment (see opposite).

EU-China trade, 2004, € billion

	EU imports from China	EU exports to China	Trade balance
Total	126.7	48.0	-78.7
Of which			
Machinery & electronics	58.8	24.6	-34.2
Cars	1.9	5.8	+3.9
Textiles & clothing	14.9	0.8	-14.1
Misc. manufactured goods	13.6	0.4	-13.2
Metals	6.9	4.2	-2.7
Precision instruments	4.8	2.4	-2.4
Shoes	4.1	0.0	-4.1
Leather goods	4.0	0.4	-3.6
Chemicals	4.0	3.3	-0.7
Plastics	3.6	1.8	-1.8
Food & animals	1.7	0.5	-1.2

Source: European Commission, DG Trade

While trade has boomed, EU companies have also become major foreign investors in China. By the end of 2002, they had ploughed more than \$30 billion into the Chinese market, about the same as US investors.¹² European and American investment is dwarfed by that coming from Hong Kong, Taiwan, Korea and Japan. But so far these countries have mainly used China as a cheap manufacturing hub. Their companies in China

¹² Chinese trade and investment statistics have to be interpreted with caution since a lot of exports and investments are channelled through Hong Kong, which distorts the numbers.

import components to assemble DVD players or microwaves and re-export them to the West, adding little value in the process. European and US investment projects and joint ventures tend to be more high-tech and therefore have a catalytic impact on Chinese economic development.

The Americans were quicker to invest in China's booming economy, establishing a strong foothold in IT, electronics and consumer markets – Coca Cola is everywhere and a tiny Starbucks nestles inside the Forbidden City, Beijing's magnificent imperial palace. But the Europeans are catching up fast. Like US companies, European ones are now mainly investing in the production of goods and services for the fast-growing local market. European brands are popular: China's emerging middle classes love French designer handbags (usually fake), German cars (mostly real ones) and Italian pizzas (more often than not cooked by US fast food outlets).

For some European companies, China has become a major source of profits. Cars are a prime example: about 40 per cent of the four million cars sold in China each year are European brands, while only 10 per cent come from US producers. Germany's Volkswagen alone controlled half of China's passenger car market at one point, although its share has recently fallen closer to 10 per cent, as the company has struggled with increased competition, sluggish demand and plummeting prices. Italy's Fiat designed a small passenger car especially for the Chinese market. And France's Peugeot is also making a comeback to China, having pulled out in 1997.

Success stories can also be found in other sectors. France's Carrefour is the pioneer of Chinese retail, it opened its 59th Chinese hypermarket in March 2005. Finland's Nokia and Sweden's Ericsson have been pushing into China's booming mobile telephony market, now the world's largest, with more than 330 million subscribers. Britain's BP has been the leading foreign investor in China's petrochemical, gas and fuel sectors. But for every company that has made money, there are many more that have failed to turn a profit.

Some have given up in frustration. But the majority struggle on under the motto 'you cannot afford not to be in China'.

All companies agree that they would do better if China fully lived up to the promises it made when it joined the WTO to reform and liberalise its economy. In many cases, China has followed the letter of its WTO commitments but used implementation legislation and so-called non-tariff barriers to keep its markets closed in practice. The resulting uncertainty has made life very difficult for foreign businesses in China since 2001. The EU Chamber of Commerce in China, which monitors WTO progress, concluded in 2003 that "the business environment has become even more difficult than it was before the WTO accession".¹³ Although the Chamber's 2004 report was more upbeat, it contained the same list of grievances:

¹³ *European Union Chamber of Commerce in China, 'Position paper for the 2003 WTO-China transitional review mechanism', October 2003.*

★ **Intellectual property rights.** Investors in China bemoan the widespread infringement of trademarks, copyrights and other intellectual property rights. China adopted the WTO's trade-related intellectual-property-rights (TRIPS) agreement in 2001 but implementation and enforcement have been poor. According to estimates from the International Intellectual Property Alliance, the Chinese illegally copied software, DVDs and books worth \$2.6 billion in 2003. Chinese companies also continue to fake branded goods on a massive scale – from cigarettes and designer handbags to entire cars and gas stations. Counterfeiting not only makes it difficult for European companies to sell the 'real' stuff in China: some 60 per cent of all fake goods that are sold in the EU are Chinese.

★ **Services.** China uses administrative barriers to keep foreign banks, insurance and telecoms companies out of its services sector. The authorities promised to open the country's banking market to foreign competition by the end of 2006, and also to lift most geographical and other restrictions on foreign

insurance businesses. But in practice it has used nonsensical regulations (such as very high capitalisation requirements) to keep out foreign banks and insurers. Similar complaints have come from foreign companies in those markets where China committed itself to partial liberalisation, including telecoms, professional services (accountants, consultants, lawyers and so on), construction and transport.

★ **Red tape.** A plethora of rules and regulations make life difficult for foreign investors. For example, foreign car companies cannot operate more than two joint ventures at a time. They also have to build separate distribution channels for those cars they produce locally and those they import from their factories elsewhere (although this issue is being addressed).

★ **Imports.** China imposes restrictions on imports of both intermediate goods that go into local production and finished products for the Chinese consumer market. For example, every imported cosmetics product has to be registered twice, with the health ministry and then with a quality supervision agency.

Although both the EU and the US have produced long lists of complaints about China's WTO compliance, neither has lodged a formal complaint with the WTO.¹⁴ Instead they are relying on

¹⁴ Thomas Rumbaugh and Nicolas Blancher, 'China: International trade and WTO accession', IMF working paper, March 2004.

bilateral channels to address these issues. The EU uses its bilateral dialogues on intellectual property rights, industrial policy, trade policy and trade in textiles.

Dialogue alone might not persuade the Chinese to speed up the implementation of its WTO commitments. The EU holds a big carrot in the shape of 'market economy status' (MES) that could entice the Chinese to work harder. When China joined the WTO, the existing members, including the US and the EU, insisted that it remained classified as a non-market economy for a period of 15 years. Such a classification makes it easier for other countries to

impose anti-dumping duties on Chinese exports. China argues that it has already made tremendous progress with market reforms, and that more than 20 countries have already upgraded China to MES, most recently Australia in April 2005. But the EU (as well as the US and Japan) has so far refused to follow suit – a fact that has rankled the Chinese, particularly since both the EU and the US upgraded Russia to MES in 2002. Russia has yet to join the WTO and its economy is not necessarily more liberal than that of China.

For China, market economy status has become a question of political prestige. Although MES is a technical term, the Chinese believe that an upgrade would signify a different 'status': that of an equal economic partner of the EU. So the Chinese hope for a quick, politically motivated decision, as was the case for Russia.¹⁵ But

¹⁵ *The US was about to grant Russia MES so the EU quickly decided to do so as well. The US is unlikely to give MES to China soon since this requires the consent of Congress. And unlike the EU, the US considers a 'fair' exchange rate a precondition for MES.*

China's case is different. First, the European Commission, which manages EU trade relations, was not happy when EU leaders hastily promised MES to the Russians. So it will do its best to ensure that this time proper procedures are followed. Second, in the case of Russia, the upgrade was of little economic relevance: Russia accounts for less than 5 per cent of EU imports and it mostly sells oil and gas, which enter tariff-free anyway. China's upgrade would have a significantly bigger impact on Europe's economy. Imports from China make up 12 per cent of total EU imports, and they compete with EU industries that are considered 'sensitive', such as textiles, and certain metals and chemicals.

The EU went some way towards an upgrade in 1998, when it reclassified China from a non-market economy to a transition economy. The move effectively codified the existing practice of giving individual companies – mainly EU-China joint ventures in the export sector – market economy status, provided they fulfilled the relevant EU criteria. Nevertheless, China remains the number one target for EU anti-dumping actions. In 2004 the EU initiated nine

new anti-dumping actions against Chinese goods, bringing the total in force to 34.¹⁶ Although anti-dumping duties affect only a small share of China's exports to the EU (estimates vary from 0.5 per cent

¹⁶ http://europa.eu.int/comm/tradefissues/respectrules/anti_dumping/stats.htm.

to 3 per cent), economists warn that they have wider effects, for example by impeding investment in 'sensitive' sectors or encouraging cartels.

In mid-2004, the Commission judged that China did not yet meet four of the five criteria required for an upgrade. China still had to make much more progress on reducing the government's role in the economy, protecting property rights and creating a level-playing field for all companies. Such improvements will require difficult reforms of the tax system, corporate governance, the bankruptcy regime, the

¹⁷ Tobias Buck and Mure Dickie, 'EU refuses to recognise China as market economy', *Financial Times*, June 28th 2004.

financial sector and, not least, of the judicial system which has to be willing and able to enforce rules even-handedly.¹⁷

There is no doubt that state interference remains widespread in the Chinese economy – witness the politically determined cycle of boom

¹⁸ Minxin Pei, 'China is still far from being a free-market economy', *The Asian Wall Street Journal* August 24th 2004.

and bust that accompanies the five-yearly meetings of the Communist Party's national congress.¹⁸ However, some economists argue that the main reason why Chinese exports are so competitively priced is low labour costs, rather than state support or 'unfair' business strategies.¹⁹

¹⁹ Stephen Green, 'China's quest for market economy status', *Chatham House Briefing Note*, May 2004.

The Commission's criteria for MES are vague enough to leave some room for interpretation. So inevitably, there will be some political horse-trading before the upgrade. Although there is no formal link between China's WTO commitments and its MES status, the two overlap in many areas. For example, financial market reform is something the Chinese promised the WTO, and it would also be required for MES. Similarly, better protection of intellectual property rights falls under WTO commitments and is relevant for

MES. EU trade commissioner, Peter Mandelson, when in Beijing in February 2005, suggested that the EU may link MES to even broader issues: "The technical aspects are vital, but I also believe that attitudes in Europe and elsewhere towards granting market economy status will be influenced by a broader perception of how China is developing, in its political, social and economic behaviour, both at home and abroad."

China's rise, Europe's reaction

The issue of the MES upgrade fits into Europe's wider debate on how to react to China's economic rise. As Chinese exports continue to soar and the EU-China trade deficit widens, European sentiment might turn against China. So far, the EU-China trade deficit has not turned into a hot political topic, as is the case in the US. Many Americans blame cheap Chinese imports for the 2.7 million job losses in their industrial sector since 2000. They accuse China of shielding its own economy while taking advantage of open markets in the West. The US administration has launched more anti-dumping actions and safeguards against China than the EU, and the US Congress is frequently calling for more protection. Moreover, the US accuses the Chinese of keeping their currency pegged to the dollar at an artificially low rate, thus giving their producers an 'unfair' advantage (see box on pages 48-49).

China's market share, as percentage of total imports

	1970	1980	1990	1995	2000	2002	2003 (Jan-June)
EU*	0.6	0.7	2.0	3.8	6.2	7.5	6.9
US	0.0	0.5	3.2	6.3	8.6	11.1	11.3
Japan	1.4	3.1	5.1	10.7	14.5	18.3	18.8

Source: IMF, *Direction of Trade Statistics*.

* Excluding intra-EU trade.

There are several reasons why the EU-China trade deficit is not (yet) so politicised. First, Europeans are less aware of the impact of China's currency peg on their trade. Second, although the EU's deficit has been growing at rates of up to 50 per cent a year recently, it is still significantly smaller than the US-China trade deficit.²⁰

²⁰ *The US-China deficit topped \$160 billion in 2004, according to US statistics. Chinese data, which do not include trade that is channelled through Hong Kong, report a deficit of only \$80 billion. Similarly, EU numbers show a deficit with China of roughly \$98 billion, while China records its surplus with the EU at less than \$40 billion.*

Third, the deficit with China is more than compensated by the big surpluses the EU runs with other countries around the world. In the case of the US, Chinese trade exacerbates an overall trade deficit that reached a whopping \$620 billion in 2004. Fourth, Europeans still mainly care about their national trade balances, not that of the EU or the eurozone as a whole.

And perhaps most importantly, EU enlargement has to some degree obscured the impact of the economic rise of China. Eastward enlargement has provided Western Europe with a large pool of relatively low-cost labour directly at its doorstep. West European companies have invested at least three times as much in the Central and East European countries as in China – and they continue to outsource more to this region than to China. The new member-states are now selling growing amounts of electronics, furniture, cars and other manufactured goods to Western Europe. So when Germans, Austrians or French people worry about cheap imports or the outsourcing of their jobs, they point their fingers at Eastern Europe, not China.

For the time being, therefore, China's economic success is not as central to public debate in Europe as it is in the US. Also, the EU is divided on how to react to the 'China challenge' since Chinese competition affects different EU countries in very different ways. In other words, there are winners and losers.

Germany, and to a lesser extent the UK, Italy and France, have gained massively from China's insatiable appetite for machinery and

equipment. The machine-building industry is less vulnerable to Chinese competition since it is characterised by small, highly specialised companies, not the gigantic, mass-producing plants that give China its competitive edge.

Among the losers are those countries that directly compete with Chinese exports in labour-intensive manufacturing, such as textiles, shoes, basic consumer goods and, increasingly, electronics. Most of the 'old' EU (perhaps with the exception of Portugal and Greece) has long since moved to sophisticated manufacturing and services that do not directly compete with China. But the new member-states rely on the kind of low value-added goods and consumer electronics that China is specialising in. Hungary and the Czech Republic mainly export electronics and IT equipment, an area where Chinese exports are growing fast. Only Poland can feel a little safer since it relies more on exports of car parts and furniture.²¹

²¹ *European Commission, 'The challenge to the EU of a rising China', European Competitiveness Report 2004.*

Another sector that is coming under heavy pressure from China is textiles and clothing. Until recently, a global trade agreement allowed developed countries to use strict quotas to keep out cheap garments from Asia and elsewhere. But these quotas have gradually been phased out, and at the start of 2005 the agreement expired altogether. Both the US and the EU produced statistics in early 2005 that showed a surge in imports of cheap Chinese T-shirts, skirts and so on – although they had to admit that these largely replaced those made by other developing countries, such as Mauritius or Bangladesh. The EU launched an investigation into Chinese textile imports and threatened to activate a special safeguard clause that is contained in China's WTO accession agreement. The safeguards would allow the EU to restrict the growth in Chinese textile imports, but only until 2008. Thereafter, China's market share in the European textiles market could quickly grow from its current 30 per cent to more than 50 per cent. In the 'old' EU-15, the textile industry now employs only 1-2 per cent of all workers, since much of the production has already

moved to lower-cost locations in Central and Eastern Europe. Most vulnerable to a Chinese import surge are those countries that are still queuing for EU membership: Bulgaria, Romania and Turkey are all big exporters of textiles and clothing to the EU.

Clearly, the East European countries (and to a lesser degree Turkey) retain many advantages over China: geographical proximity, highly skilled workers, a business environment that is very similar to that in the 'old' EU, and full integration into the EU's single market. But Chinese competition is forcing the new member-states to move quickly into higher-value added goods and services since they simply cannot compete on price: the average Polish or Hungarian worker earns \$600-700 a month, a Chinese one around \$150. With unemployment rates of up to 20 per cent, shrinking FDI inflows and very high budget and trade deficits, the East Europeans are not looking forward to increasing competition from China.

As EU members, the East Europeans can no longer use their own trade policies to shield their markets against imports. They may therefore lobby the European Commission to take a tougher stance in trade talks with China. They may find support from the EU's Mediterranean members, and also from smaller companies all over the EU. While Europe's big enterprises can boost profits through outsourcing labour-intensive production to China, smaller ones find this option prohibitively expensive. Small companies also struggle to get a foothold in the massive Chinese market, since navigating the jungle of rules and regulations is often beyond their capacity. Trade unions and anti-globalisation groups may also back calls for protectionism, claiming 'unfair' competition from low-wage China.

They will be up against powerful business lobbies in the larger EU countries. Many European companies in China produce for exports and will therefore want western markets to stay open. More and more European companies source their inputs cheaply from China, so they too oppose trade restrictions. Western retailers, banks and insurance companies are hoping to move into China's rapidly developing services

market and will also want good trade relations. Growing competition from China may therefore cause divisions within the enlarged EU, on top of the rivalry for contracts that is already visible among the larger member-states. It seems that Europe cannot quite decide what it fears more: a booming China or a stagnating one.

Economists predict that China's exports to the EU will continue to grow at double-digit rates. The bilateral trade deficit will continue to widen, especially if the euro keeps on rising against the renminbi (see box on pages 48-49). China will continue gaining market share in both textiles and electronics – sectors that are suitable for mass production. China's almost unlimited labour supply allows it to produce with massive economies of scale, while the influx of western investment helps to drive double-digit productivity growth. Some observers believe that 70 per cent of global electronics goods and components production could be located in China by 2007, and that China will soon be producing more than half of the world's clothing.

If China succeeds with the rapid modernisation of its economy, it may soon also be able to compete with some of the industries in the 'old' EU member-states. Economists say that it is only a question of time before China stops importing cars and instead floods world markets with its own, much cheaper models. Already, foreign investment is pouring into telecoms, office equipment, automobiles and electronics, leading to a massive expansion of capacity. The number of Chinese science and engineering doctorates has soared, and China now has more researchers than Japan. R&D spending is rising five times faster than in the US, albeit from a very low level. Europeans are not – yet – as panicky as Americans about China's ability to combine cheap labour with modern production techniques to create "the most competitive manufacturing platform ever".²² ²² Peter Engardio, 'The China price', *Business Week*, December 6th 2004. But it is by no means assured that the EU-China economic relationship will always remain cordial.

The renminbi, the dollar and the euro

China has kept its currency, the renminbi (RMB), pegged to the US dollar at RMB8.2 = \$1 for more than two decades. As the US-China trade deficit has continued to grow, the exchange rate peg has become increasingly contentious in America. Many Americans argue that the peg keeps the value of the RMB artificially low and so gives Chinese producers an unfair competitive advantage over US-based companies. The US administration has repeatedly called on China to revalue its currency to restore 'balance' to global exchange rates. China has, in theory, promised to move towards more exchange rate flexibility. But it has not given details of when and how it is likely to do so. The Chinese fear that a soaring RMB could play havoc with its fragile banking sector and that it would reduce China's competitiveness vis-à-vis its Asian neighbours.

In Europe, the RMB's alleged undervaluation has been less of an issue. The RMB-dollar peg affects Europe just as much as the US, perhaps even more so. But it does so in a less direct and understandable way. Since 2002, the dollar has fallen by one-third against the euro, and it has dragged the RMB down with it. Since most other Asian countries also seek to keep their currencies stable against the dollar, the euro has so far borne the brunt of global currency adjustment.

Some economists think that the dollar needs to fall another 30 per cent (on a trade-weighted basis) for the US current account deficit to return to a sustainable level. Unless the Chinese and other Asian countries allow their currencies to rise against the dollar, most of this adjustment will have to take place against the euro. European companies would then face a very hard struggle to retain competitiveness in their biggest markets in America and Asia. Therefore, many European economists support the idea that China should revalue and move from pegging to the dollar to a basket of currencies

consisting of dollars and euro. To alleviate Chinese fears about a loss of regional competitiveness, they say that China should co-ordinate such a move with its Asian neighbours.

So far European policy-makers and commentators have focused mainly on the falling dollar, and the US budget and external deficits that cause it. China's peg has remained a secondary thought. But this may be about to change. In 2005, the EU started a new macro-economic dialogue with the Chinese, which also allows them to talk about exchange-rate issues. Another forum to discuss exchange rates is the G7, in which Germany, France, the UK and Italy take part. China often (though informally) takes part in the meetings of G7 finance ministers and central bankers (Russia joins political talks among the G7 government leaders, but not economic consultations). Since China is now one of the world's largest economies, it is likely to become a full member of the G7 sooner or later. But the Americans and Europeans are wary about letting in a country that is not a democracy. China is also cautious about joining the G7: it argues that, as a developing country, it cannot be expected to assume too much responsibility for global economic management.

5 The political dialogue

Trade and investment form the backbone of EU-China relations. But both sides are also determined to strengthen their political ties and work together more closely in global politics. The EU's and China's respective objectives for this emerging political partnership are either broadly similar or, at times, complementary. The EU wants to help China's internal transition; China is keen to learn from the EU's experience. And when it comes to international politics, both European and Chinese leaders never tire in stressing how much they have in common.

But in many areas the agreement between the EU and China is only skin-deep. There is ample scope for disagreement and disappointment as the relationship moves beyond short-term objectives and business ties. A real political partnership will touch on sensitive and vital issues such as Taiwan, human rights, the sustainability of economic growth, the partners' respective ideas about national sovereignty and their relations with the US. It is important for both sides to be aware of potential pitfalls and to plan ahead. Otherwise they risk squandering the potential of a mutually beneficial relationship. The arms embargo is a good example of how rash decision-making and the raising of unrealistic expectations can damage EU-China relations.

The EU's role in China's internal transformation

The EU has made support for China's internal transition one of two key objectives of its China strategy, for at least three reasons. First, the EU thinks that as a partner and friend it should, and can, offer China help in reforming its economy, strengthening its legal system and coping with the stresses and strains of economic

development. The EU insists that “in many areas, China and the EU face similar problems and favour similar approaches to solving them”.²³ But the EU is a couple of decades ahead in addressing these problems, such as building an internal market, protecting the environment and helping poor regions. So it thinks it has a lot of valuable experience and expertise to offer to the Chinese. “Officially

²³ *EU Delegation to China* www.delchn.cec.eu.int/ we call it ‘exchange of experience’”, says one EU official “but in reality we are exporting our model to China”.

China, in turn, likes to pick, mix and adapt the best policies from around the world. The Chinese are acutely aware of the challenges resulting from their economic boom, ranging from pollution to growing social discontent. They are looking around for ideas and experiences that might help them address these problems. The EU – with its hybrid model of governance and various country-specific systems – has more to offer than most other parts of the world.

The second reason why the EU cares about China’s internal transition is the sheer magnitude of the challenge. “In China, every problem has an additional zero”, as one seasoned investor in China puts it. If, say, Bangladesh fails to tackle pollution, social deprivation or migration, Bangladesh has a problem. If China fails to tackle these challenges, the world has a problem. Thirdly, the EU believes that a China that moves towards market economics, the rule of law and greater democratic accountability will be a more reliable and responsible player. So the EU hopes that its aid for China’s reform processes will contribute to its other key objective, that of ‘socialising’ China into the multilateral international system.

²⁴ *European Commission, ‘China: Country strategy paper 2002-2006’, March 2002.*

The EU’s aid programme for China includes technical advice, training and cash.²⁴ Although the money available has grown substantially since the mid-1990s, the overall sums remain small.

The €250 million the EU has earmarked for 2002-06 represents only about 1 per cent of total official development assistance to China, and 2 per cent of grant aid. But EU money could potentially make a difference to China’s transition process – provided it is well targeted and co-ordinated with the aid efforts of the member-states. That, however, is not always the case. As one analyst puts it: “The programmes of the individual EU countries and the EU usually remain unco-ordinated, which undermines the impact of even the generous aid programmes.”²⁵

²⁵ *Sebastian Heilmann, ‘Grundelemente deutscher Chinapolitik’, China Analysis No 14, August 2002.*

The EU should consider targeting its limited aid budget on areas that serve all three objectives listed above. And it should not be afraid to ask for something in return for its help. Two examples can illustrate this idea: energy and the environment; and internal and international migration.

★ **Energy, the environment and climate change.** The EU already has a number of programmes for transferring ‘green’ technologies and those that promote energy efficiency to China. Under its Environmental Management Co-operation Programme, the EU works with foreign investors, local governments, and other decision makers to raise awareness of sustainable development issues in the Chinese business community. The EU-China environmental dialogue has been upgraded to ministerial level, while the bilateral energy dialogue gets European and Chinese experts together twice a year to discuss things like energy efficiency and renewables. But much more can and should be done, given the scale of the problem.

China relies mainly on coal to satisfy its voracious energy needs. In 2003, China burnt 30 per cent of the world’s entire coal production – to produce a mere 4 per cent of global GDP. At least six of the world’s ten most polluted cities are in China. The country’s environmental agency reports that

breathing the air in some of these cities does more damage than smoking two packets of cigarettes a day. The costs of pollution to the Chinese economy are already running at 3-8 per cent of GDP every year. By 2020, about 550,000 Chinese

²⁶ Elizabeth Economy, *The river runs black: the environmental challenge to China's future*, Cornell University Press, 2004. a year could be dying prematurely of chronic bronchitis from airborne pollution, and tens of millions will be affected by respiratory illness.²⁶

The current Chinese leadership appears more serious than its predecessors about making growth sustainable. It plans to spend 1.3 per cent of GDP, some \$90 billion a year, on improving the environment and it is pushing energy providers to use more wind, solar and water power. Europe can help by transferring technologies to make coal cleaner, allow natural gas to be burnt more efficiently, and promote the use of renewable sources of energy.

In return, the EU should ask China to play a constructive role in the negotiations for a post-Kyoto regime for climate change, which start in 2006. China is already one of the world's biggest generators of CO₂. But as a developing country, it is not required to reduce its emissions under the Kyoto protocol. Energy experts predict that China's reliance on coal and other fossil fuels will only increase over coming decades. Merely the additional coal-fired plants that China is planning to build by 2012 will produce another 850 to 1,900 million tons of CO₂ a year. By comparison, total emission cuts envisaged under the Kyoto protocol until 2012 amount to 480 million tons per year.²⁷ Even under relatively optimistic projections by the British government, China alone will produce around 18 per cent of the world's total emissions of

²⁷ Mark Clayton, 'New coal plants bury Kyoto', *Christian Science Monitor*, December 23rd 2004. greenhouse gases by 2030, about the same as the US. Without China's active and serious commitment, any post-Kyoto agreement will be almost meaningless.

★ **Internal and international migration.** China's economic boom has been accompanied by a rapidly growing gap in regional living standards. Many of the 800 million Chinese that live in rural areas (townships and farming areas) miss out on the economic opportunities that stem from China's export-driven growth. The average Chinese city-dweller easily earns twice as much as a countryside resident. The rural-urban divide is exacerbated by two factors. One is uneven geographical development: the economic boom in the east of the country has not spread to the northern industrial rustbelt and the underdeveloped western provinces. The western parts also suffer some of the biggest environmental challenges, such as chronic water shortages and desertification. The other factor is the collapse of the healthcare, pension and social support systems, which used to be provided by state-owned companies and agricultural communes. While the government has had some success with reconstructing a social safety net in the cities, most rural residents effectively remain without social security.

Millions of impoverished farmers have already packed up and moved to booming coastal towns. The authorities expect that another 300-500 million people will migrate to the cities over coming decades. This raises the spectre of unmanageable urbanisation and environmental collapse. But keeping the poor in the countryside is not an option either: inequalities are already fuelling social unrest in many parts of the country. So it is no surprise that the Chinese authorities are looking for ways to develop the country's backward areas. Having examined various regional development schemes operating in different parts of the world, the Chinese have expressed a strong interest in learning from the EU's own experience in this field. Again, the EU is willing and able to help, with advice and money. But it should ask the Chinese to be more co-operative on an issue that is at the top of the EU's own agenda, namely illegal emigration.

According to some estimates, around 200,000 Chinese people a year are smuggled illegally to other countries, and many of them to Europe. Migrants often suffer appalling conditions along the way, a fact that was shockingly revealed in 2000, when 58 illegal Chinese immigrants were found suffocated in a lorry in the British port of Dover. The EU is urging the Chinese to do more to crack down on the criminal gangs ('snakeheads') who profit from trafficking people, and to tackle the problem of forged documents. The EU also wants China to sign a readmission agreement, which would oblige the country to take back Chinese illegal immigrants that are caught in the EU. So far, the Chinese have shown little interest in co-operating in this area, however.

Human rights

While the Chinese have been happy to work with the EU to address some of their internal challenges, they have been less keen on outside involvement in their political transformation process. For the EU, this poses a dilemma, because it usually insists that any strategic partnership with another country is based on 'shared values', such as the rule of law, democratic principles and the protection of human

²⁸ For the case of Russia see Katinka Barysch, 'The EU and Russia: strategic partners or squabbling neighbours?' CER, May 2004. rights.²⁸ China was supposed to be no exception. "Human rights" declared the Commission in its 1995 China strategy paper, "must be at the core of all EU foreign policy".

Back in 1995, EU governments were still mainly relying on public criticism to encourage China to respect human rights. Every year between 1989 and 1996, the EU countries supported a resolution about China's human rights situation in the UN Commission for Human Rights (UNCHR) in Geneva. And each year a coalition of developing countries made sure that the resolution was not adopted. In January 1996, the EU launched a bilateral human rights dialogue with China. And in 1997 a number of EU countries, namely France, Italy, Greece and Spain, for the first time refused to sign up to the

UNCHR's China resolution. The other EU countries initially refused to follow, but eventually supported the EU's move away from open criticism towards quiet diplomacy and on-the-ground co-operation on human rights. The effectiveness of this strategy is hard to assess.

There is no doubt that the plight of most Chinese has improved significantly over the last 20 years. Economic opening and reform have lifted 400 million Chinese out of poverty.²⁹ More Chinese than ever are travelling and studying abroad. Within China, people are much freer to choose their career, and where and how they want to live. In the coastal provinces, a burgeoning middle class enjoys a thoroughly westernised lifestyle. In recent years, political reforms have been added to economic liberalisation. Entrepreneurs are now allowed to join the ruling Communist Party. The amended constitution acknowledges private property and, at least in theory, protects human rights. Local governments are experimenting with elements of democracy, such as elections for township officials. Newspapers and other media outlets have gained a degree of freedom to report on corruption and social problems. Many Chinese, and not only officials, are content with the current situation. They believe that stability is more important for China's development than a rapid spread of 'western' democracy and individual rights.

Others, however, are highly critical of the slow pace of political reform. They point out that, despite all the recent progress, China is still an autocratic, one-party state. The ruling Communist Party and its top cadres remain largely above the law. Party officials, bureaucrats, judges and policemen can harass, expropriate and persecute people, usually with impunity. The benefits of economic liberalisation have bypassed millions, in particular those laid off by ailing state industries and farmers who can no longer earn their livelihood. Journalists who test the limits of their newly acquired freedoms are sometimes jailed on trumped-up charges. Regional governments clamp down on street protests – which are increasingly

²⁹ World Bank, 'World Development Report for 2005', September 2004.

widespread in response to unpaid wages, mass layoffs or arbitrary land confiscations. Non-registered religious and spiritual groups, such as Tibet's Buddhists and the Falun Gong movement, are suppressed and their members persecuted. Ethnic minorities, most notably the Turkic-speaking and Muslim Uighurs in the north-western province of Xinjiang, face a similar plight – which the authorities often justify in terms of the 'fight against terrorism'. A

³⁰ Based on reports by Amnesty International (www.amnesty.org), Human Rights Watch (www.hrw.org) and the UK Foreign Office (www.fco.gov.uk).

corrupt and politicised court system cannot be relied upon to deliver fair trials. Although there are no official figures, NGOs estimate that around 3,500 people are sentenced to death each year, more than in all other countries in the world put together.³⁰

Many people initially expected the new leadership under President Hu Jintao to accelerate political reforms. But human rights organisations report a harsh clampdown on critical intellectuals, as well as an increase in the use of ideological re-education and labour camps. Such setbacks undermine EU hopes that economic opening and growth will quasi-automatically lead to more democracy and better protection of human rights. Some experts argue that economic

³¹ Kay Möller, 'Wirtschaftliche Öffnung und politische Blockade in China', *Stiftung Wissenschaft und Politik*, August 2004.

opening and political autocracy are ultimately incompatible and that China is steadily but surely heading towards crisis, possibly in the form of a massive political clampdown.³¹

The EU's human rights policy reflects the very mixed situation on the ground, as well as the EU's lingering sense of impotence. The EU insists that the bilateral human rights dialogue is a useful forum for raising concerns, having a frank discussion away from the limelight, pressing the Chinese on individual cases and offering concrete help, for example by training prison officers and judges.³² NGOs acknowledge the EU's goodwill. But they also point out that the EU

³² Council of the European Union, 'EU annual human rights report 2003'.

has so far failed to produce any proof of the dialogue's impact on the ground. Human Rights Watch, for example, is "deeply

concerned that the EU-China human rights dialogue has become largely a rhetorical shell, lacking in accountability, transparency, and clear publicly expressed benchmarks for progress".³³ *Human Rights Watch letter 'The EU-China human rights dialogue'*, November 20th 2003.

All countries that are conducting bilateral human rights dialogues with the Chinese (including Germany, France, Sweden, Switzerland and the US) are facing the same difficulties to some degree: the lack of high-level participation from the Chinese side; the often overly rigid format of the sessions, where much time is spent reading out prepared statements; China's evasiveness when answering queries about concrete cases; a lack of follow-up action; and last but not least the inability to link any progress on the ground to what has been said in the dialogue. However, the EU's dialogue is beset by a number of additional problems. Each of the six-monthly dialogues is chaired by the country that happens to hold the EU rotating presidency, so there is little continuity and follow-up from the EU. A lack of resources on the EU side means that EU negotiators are not always as well prepared as they should be.

Last but not least, the EU-China human rights dialogue is insufficiently backed up by high-level political lobbying from the member-states. Ever since the 1997 disagreement about the UNCHR resolution, the Chinese have sought to play off individual EU members against each other, threatening to withhold lucrative commercial contracts from countries that are too outspoken. There is little evidence that China has ever followed up on such threats. Nevertheless, human rights play a rather subordinate role in the China policies of the EU and its member-states.

The lifting of the arms embargo will leave the EU even more open to accusations of commercial opportunism. Although the EU did not construct an official link between lifting the arms embargo and concrete human rights measures, it made it very clear to the Chinese what it wanted: the ratification and implementation of the International Covenant on Civil and Political Rights (ICCPR, which

China signed in 1998) and the release of the remaining prisoners from the Tiananmen Square protests. China has committed itself to ratifying the ICCPR “as soon as possible” but it has not given a concrete timetable. Nor has it released the remaining Tiananmen Square protesters.

The arms embargo

The long, complex and bitter arguments over the EU’s arms embargo on China reveal as much about the EU’s embryonic and still incoherent foreign policy, and the uncertain state of transatlantic relations at the start of the second Bush administration, as the EU’s relationship with China. None of the parties in this story comes out well. The EU and its various governments have proved incapable of giving serious strategic thought to the issue of China, with some member-states appearing to be interested only in their immediate commercial advantage. Many Americans have reacted emotionally to the question of the EU embargo, preferring bluster and intemperate threats to a rational analysis of the issues. Meanwhile, some of China’s diplomacy has lacked finesse and been counter-productive, giving extra ammunition to those who oppose lifting the embargo.

The EU imposed an embargo on sales of lethal weapons to China after the bloodshed in Tiananmen Square in 1989, vowing not to lift it until the human rights situation had improved substantially. Although the embargo is not enshrined in law (being merely a statement by the European Council) its lifting requires the unanimous agreement of all 25 member-states.

For the Chinese, the arms embargo has become an issue of national pride and its rapid lifting is now the number one objective in their EU policy. The Chinese point out that the EU currently applies similar embargoes only to Congo, Liberia, Myanmar, Somalia and Zimbabwe. They argue that the EU cannot be serious about building a strategic partnership with China while leaving it in the same

category as Africa’s and Asia’s worst-run countries. They are also convinced that they have done enough to improve the human rights situation to warrant a lifting of the embargo.

Many in the EU would agree with Jacques Chirac and Gerhard Schröder that the embargo has become an “anachronism” in the EU’s rapidly evolving partnership with China. They stress that lifting the embargo would be mainly a symbolic act since individual EU governments, and the European Council, have promised that it would not be followed by a significant increase in the quality or quantity of weaponry sold to China. That does not mean commercial considerations are absent from European deliberations. As Chapter 2 explains, the French and German governments probably hoped to gain big, non-military contracts by promising China their support on this key issue.

While France and Germany have thrown their weight behind the lifting of the embargo, other EU countries have remained more sceptical. The British government has been torn between concerns about its commercial interests and fears of US opposition. The EU’s new members in Central and Eastern Europe have also worried about Washington’s reaction. The Americans’ main argument against lifting the embargo is that the transfer of European military technology would give China the upper hand in any conflict across the Taiwan Straits, and thus destabilise the regional security balance. They also question whether Chinese human rights have improved sufficiently to warrant a lifting of the embargo. The second argument is shared by the Dutch and the EU’s Nordic states, which tend to emphasise human rights in their foreign policies and are less likely to win large-scale contracts in China.

Despite such hesitations, by December 2004 the EU’s 25 governments had reached a consensus that the embargo would be lifted in the course of 2005. The governments agreed that they would at the same time put in place a stronger version of the ‘code of conduct’ on arms sales that the EU introduced in 1998. The code

applies to all arms sales from EU countries to other parts of the world. As far as potential arms sales to China are concerned, the revised code of conduct would provide a much stronger control regime than the existing embargo, which each government is free to apply as it sees fit.

³⁴ *The US arms embargo on China – although legally binding and more restrictive – does not seem watertight either. According to figures from the Stiftung Wissenschaft und Politik, the US sold more weapons to China in 1998 than the EU. Subsequent figures are not available. According to the Stockholm International Peace Research Institute, which registers only large weapons deals, the US sold weapons worth \$31 million to Beijing in 1999-2003.*

The EU reports that despite the embargo, EU governments approved arms sales to China worth €416 million in 2003, and this figure is likely to have risen further in 2004.³⁴ For example, countries such as Britain and France have approved sales of radar systems that cannot be used in an offensive context. Unlike the embargo, the code covers some sorts of non-lethal equipment and sets out a number of

procedures that governments must follow when considering an application for a sale. Under the rules of the existing code, EU governments only need to inform their peers when they turn down an application. The revised code would require them also to disclose those sales that are approved. Furthermore, the code already obliges EU governments to take into account a broad range of issues when deciding on arms sales. While the arms embargo is linked explicitly only to human rights, the code of conduct lists political oppression, threats to regional stability and the concerns of partners and allies among the criteria to be considered before approval of an arms sale.

³⁵ *At the time of writing in April 2005, the Europeans were considering making the code of conduct legally binding.*

legally binding and that it would not cover dual use technologies, which are suitable for both civilian and military purposes.³⁵ They generally ignore the argument that the national arms control regimes

Nevertheless, most Americans are dismissive of the prospect of a stronger code of conduct. They point out that even the revised code would not be

of the EU countries would prevent most weapons sales to China, even if there was no embargo and no code of conduct. They continue to assume that the EU's desire to lift the embargo is about selling more weapons and appear not to listen when EU governments deny this.

Nor are Americans reassured by China's statements that it would not buy much more weaponry from Europe if the embargo was lifted, on the grounds that it is too expensive. Since the late 1990s, China's official defence budget has grown at double-digit rates of around 13 per cent a year. Some defence experts reckon that the true level of Chinese military spending is two to five times bigger than official figures indicate, giving China a total defence budget of \$50-70 billion a year, one of the biggest in the world.³⁶ China spends this money not only on the modernisation of its massive but backward armed forces, but also on a rapid build-up of missiles along the coast facing Taiwan, and the development of an ambitious nuclear weapons programme.

³⁶ *Report of the US Congress, 'US-China economic security review commission', June 2004.*

Already, China is the world's biggest importer of military hardware, with the bulk of its imports coming from Russia. But Russia cannot and will not provide China with much in the way of the sophisticated 'C4ISR' (command, control, communications, computers, intelligence, surveillance, reconnaissance) systems that it needs to upgrade its forces. Since Russia worries about China's rise as a military rival, it has refused to sell some of its most advanced products to Beijing.³⁷

³⁷ *Frank Umbach, 'Bring China into the game!' Internationale Politik, April 2003.*

The US worries not only about EU arms sales to China, but also about the transfer of sophisticated technology, and specifically about China's participation in Galileo. In 2003, the EU and China signed an agreement to cover China's participation in the EU's satellite navigation programme, a potential rival to the US's global positioning system.³⁸ The Chinese have agreed to invest

³⁸ *Carl Bildt et al, 'Europe in Space', CER, October 2004.*

€230 million in the development of Galileo, and can expect to take part in some of the research, manufacturing and technical work that will flow from it. Some Americans fear that China's involvement in Galileo will give it access to technologies that would help it to develop its own positioning system – or to derive military benefits. Officials at the European Commission maintain that the agreement on Galileo contains stringent safeguards. In the words of one Commission official, “we can switch off the signal if it is going to be used against us or the US. China will have the civil frequency codes but there is a firewall between them and the military codes – if they were able to break into them, we would know at once.”

Americans are particularly worried about the transfer of dual-use technologies. For example, the French plan to build a commercial transport helicopter with the Chinese, and the engine for that – which is partly British and partly French – could be used in a military helicopter. The export of the most sensitive dual use technologies is supposed to be regulated by the so-called Wassenaar agreement, which replaced the Cold War era Cocom system and is regarded by some experts as rather ineffective.

While the US State Department and the White House showed at least some understanding of the European position, the Pentagon refused to even discuss the matter with the Europeans. And on Capitol Hill there was cross-party support for sanctions against companies from countries that do business with China. This made the British especially uneasy, since two British firms, BAE Systems and Rolls-Royce, have large businesses in the US. There were also Congressional threats to punish Europe with stricter rules on the transfer of military technology if the EU lifted the embargo. Such changes would hit Britain harder than any other EU country, since its defence industry is closely linked to that of the EU – for example it is a senior partner in the Joint Strike Fighter ‘F-35’ fighter programme.

By early 2005 the US was turning the issue of the China arms embargo into a loyalty test in the transatlantic relationship. No longer was the

key issue the alleged destabilisation of the balance of power across the Taiwan Straits. The question put to European governments was: “Why are you ignoring American wishes when we care so much about this issue?” When the US demands the loyalty of its European allies it generally splits them. By March 2005 the EU was having second thoughts about ending the embargo by June, as initially planned. Since it is highly unlikely that the UK will agree to a lifting of the embargo while it holds the EU's rotating presidency in the second half of 2005, the embargo will probably remain in place until at least 2006.

This shift in EU policy was influenced by American arm-twisting. But Chinese diplomacy also played a crucial role, though not in the way Beijing would have wished. In March 2005, the National People's Congress passed up yet another opportunity to ratify the ICCPR. Instead, it passed the new Taiwan ‘anti-secession law’ (see below), strengthening the hand of those Europeans who opposed lifting the embargo.

The EU's policy on lifting the embargo – with the differing views of the member-states, and several changes of direction – has been a shambolic mess. In the long run, the EU should lift the embargo. Whatever the faults of the Beijing regime, it is very different to those of Myanmar and Zimbabwe. Although its human rights record is poor, China is a serious and cautious international actor. It is an important partner for the EU in areas ranging from economics to space technology to the environment.

Although the EU should lift the embargo, it should do so in ways that advance European objectives on human rights and regional stability. It should not ‘give away’ the embargo for free. It should therefore encourage China to take concrete steps on human rights, including the ratification of the ICCPR, the release of Tiananmen Square protesters, access for the International Red Cross to Chinese prisons and the abolition of labour camps.

The EU should also expect movement from the Chinese in other areas, for example by asking China to strengthen its own regime for

controlling the export of military technology. There are real concerns about the Chinese government's ability to ensure that all its defence companies respect its rules on arms exports. The EU may not want to shift the goal posts by formally adding a new set of conditions at this stage. But it should emphasise that if China was able to strengthen its arms control regime, it would help to reassure those who have doubts about transferring military technology to China.

Before lifting the embargo, the EU should put in place a strengthened code of conduct. The EU also needs to talk to the US about the most sensitive dual use technologies. Together they should draw up a common list of technologies that should not, for the time being, spread beyond the EU and the US. In effect the US and the EU should set up a tighter, stricter dual use technology regime, within the broader, looser Wassenaar arrangements. The EU and the US should establish an informal consultation channel, so that if a sensitive arms export issue arises, they can talk about it before decisions are made.

The EU's long-term objective should be the normalisation of relations with China through the lifting of the embargo, but in ways that do not affect the balance of power in East Asia; that do not alarm the Americans or other interested parties; and that advance European objectives, such as an improvement in China's human rights situation and in its non-proliferation regime.

The EU, the US and China

The reason why the EU and the US clashed so vehemently over the arms embargo is that Americans and Europeans tend to interpret the rise of China rather differently. Even if the two sides sorted out their differences on arms sales tomorrow, China would remain one of the key topics in transatlantic relations for years to come. However, existing transatlantic institutions are not well suited for the EU and the US to exchange their views and co-ordinate their policies, for example on arms sales. A panel of European and

American foreign relations experts warned in 2003 that unless the two sides start a more regular and open dialogue on their respective China policies, they "may find themselves pursuing competitive or incompatible policies on non-proliferation, trade, technology transfer, and global financial and economic management".³⁹ The risk is that China could exploit these transatlantic differences to its advantage and the mutual detriment of the US and Europe.

³⁹ Henry Stimson Centre and German Council on Foreign Relations, 'Transatlantic dialogue on China', final report, February 2003.

In many ways, Europe's relationship with China is much easier than America's because Europe is so different from the US: Europe is not a unitary state, nor an Asian power and hence is not a potential geo-strategic rival. The issue of Taiwan, which always looms large in US-China relations, hardly features in the EU-China relationship (see next section). The high levels of ambivalence and suspicion that characterise the US-China relationship do not trouble China's relationship with Europe. The EU points to the lack of both historical baggage and profound disagreements as fertile soil for a flourishing bilateral relationship.

Based on their own experience, the Europeans believe that political co-operation, economic integration, multilateral organisations and international law can and do restrain great powers. Their strategy is therefore about fostering positive change in China and 'socialising' the country into a multilateral world order. When it comes to China, the Europeans are optimists: they see a modernising economy, growing social freedoms, some improvements in human rights, spreading prosperity, initial efforts to protect the environment, and reasonably responsible regional and global policies. When they worry about China, they mainly worry about internal sources of instability, such as environmental disasters, economic crises or social upheaval. They think of China as a status quo power that will be primarily preoccupied with its own internal challenges for the foreseeable future – a bit like the EU itself.

Most Europeans see China as an authoritarian regime in transition. They think they can help China along the path to more democracy and prosperity by working with it and offering Europe's own model of economic opening, democracy and the rule of law. Europe sees

⁴⁰ Thomas Heberer, 'China's domestic development, China-EU relationship and EU-China policies', *Institute of East Asian Studies, Gerhard-Mercator University of Duisburg*, 2002. its China policy as 'strategic' in the sense that it tries to effect long-term positive change in the country through soft power.⁴⁰

In the United States there has been a long-running debate between those who want to 'contain' China and those who advocate engagement. Many Americans stress the similarities between the US and EU strategies towards China: both want to bind China in the international institutional architecture; persuade China to play a more active role in non-proliferation; work with China on fighting terrorism; encourage China to stick to its WTO commitments; and strengthen human rights and the rule of law within China. But even those in the US who support engagement tend to see China as a totalitarian country and they highlight existing problems, such as widespread poverty, human rights violations and an intractable business environment.

Those Americans who argue in favour of containment assume that China's growing economic clout and military capabilities will – sooner or later – translate into expansionist foreign policies. They suspect that China's increasing willingness to be nice to its neighbours and work with multilateral regimes is a tactical manoeuvre to bide time until the country is strong enough to act unilaterally. Some observers go as far as saying that "the United States therefore has a

⁴¹ John Mearsheimer, 'The future of the American pacifier', *Foreign Affairs*, September/October, 2001. profound interest in seeing Chinese economic growth slow considerably in the years ahead".⁴¹

For these Americans, the EU's objective of building a strategic partnership looks irresponsible, even dangerous. By helping China with its internal problems, by transferring technology and perhaps

even weapons, the Europeans will allow China to get stronger and more assertive.⁴² A more powerful China, they fear, could become a dominant force in Asia, a region where the US has clearly defined strategic objectives. Some Americans complain that Europe's lack of strategic interest in the region leaves them free to concentrate on making money in China while leaving all the 'hard work' – pressuring China on human rights, safeguarding regional security and worrying about China's growing power – to the Americans.

⁴² David Gompert, François Godement, Evan Medeiros, James Mulvenon, 'China on the move: A Franco-American analysis of emerging Chinese strategic policies and their consequences for transatlantic relations', *Rand Corporation* 2005.

The question of Taiwan

The most important and immediate difference between American and European policies towards China concerns Taiwan. For the People's Republic, Taiwan is not a question of foreign policy or legal status, but something fundamental to its national identity. The 'loss' of Taiwan is seen as a humiliation that can only be overcome through unification with the mainland. Rather than slipping down the agenda, the Taiwan question has moved up since China regained sovereignty over Hong Kong in 1997 and Macao in 1999. Given that Beijing insists that Taiwan is part of the People's Republic, it views relations with Taipei as an issue of domestic, not foreign policy. It therefore rejects any outside interference in the issue.

Both the US and the EU adhere to the 'one China' principle, which means they do not recognise Taiwan as a sovereign country and they do not have any diplomatic relations with Taipei. However, unlike the EU, the US is in principle committed to defending Taiwan in case of an attack under the 1979 Taiwan Relations Act. The US has been instrumental in building the island's defence forces.⁴³ However, the US has never clarified the circumstances under which it may intervene in a potential cross-Strait conflict. This 'strategic ambiguity' has enabled Washington to build better relations with the mainland while at the

⁴³ *The Economist*, 'Survey of Taiwan', January 13th 2005.

same time supporting Taiwan. And it has also allowed the US to slap down Taiwanese leaders when they openly talk about independence.

The EU has traditionally followed a hands-off policy on Taiwan, giving priority to its relationship with the mainland. France, Germany and the Netherlands sold some arms to Taiwan in the early 1990s but stopped further deliveries after hefty protests from Beijing. No EU country has diplomatic relations or other official links with Taiwan. The Commission follows a similarly cautious approach. It waited until 2003 – two years after Taiwan’s WTO accession – before it established a trade representative office in Taipei. The EU has sought to develop its economic relationship with Taipei without endangering its ties with Beijing.

In recent years, the EU appears to have become a little more outspoken on the issue of Taiwan. The Commission’s 2003 strategy paper refers to the EU’s “insistence on a peaceful resolution of the Taiwan issue”. In 2005, the EU issued public statements on Taiwan for the first time since 1999: it first welcomed the temporary resumption of direct flights between Taipei and the mainland; and then expressed concern over China’s new anti-secession law. That law, passed by the National People’s Congress in March, calls for peaceful solutions to the Taiwan question. But it also includes a ‘trigger mechanism’ that would lead to the use of military force if Taiwan took steps towards independence. Britain’s foreign minister, Jack Straw, warned that the law had “created quite a difficult political environment” for lifting the arms embargo, while his German colleague, Joschka Fischer, talked about a “setback” in EU-China relations.

China is generally happy with the EU’s low-key stance on Taiwan. However, Chinese leaders do sometimes lobby the EU to further isolate Taiwan, and it appears quite possible that they may demand more ‘loyalty’ from the EU over Taiwan – once the arms embargo question is out of the way. Many Americans think that the EU approach is simply irresponsible: “Europe”, writes one US columnist

“has essentially eliminated Taiwan – a territory bigger than more than half of the EU member-states – from its frame of reference. It won’t be Europe’s concern if a democratic Taiwan is forced, under Chinese diplomatic and military pressure, to give up its de facto independence... The Europeans know and can count on the fact that whatever the consequences of its decision on arms on China, the responsibility to deal with them will be America’s alone.”⁴⁴ Some

Europeans also think that the EU could play a more active role in easing cross-Strait tensions. Unlike the US, the EU is not seen as openly biased. The EU could offer its own model of building inter-state relations through economic and political co-operation, thereby helping to overcome historical divides and shape a new post-national entity.⁴⁵

⁴⁴ Richard Bernstein, ‘EU vs. US vs. China: partnership paradoxes’, *International Herald Tribune*, January 21st 2005.

⁴⁵ Gunter Schubert, ‘Becoming engaged? The European Union and cross-Strait relations’, *Asien No 89*, October 2003.

Some experts think that the 2008 Beijing Olympics offer a unique opportunity for progress over Taiwan: the People’s Republic will want to project the image of a peace-loving, constructive country and will therefore avoid threatening force. But others fear that rising nationalism within China could easily lead to an escalation of cross-Strait tensions. That would leave the EU with a dilemma. Would the Europeans side with the US or stay neutral? Could Taiwan split the EU down the middle, like the Iraq war did in 2003? One thing seems certain: the Taiwan question will move up the agenda, not only in the EU’s relationship with the US but also in that with China. When we asked a well-known Chinese academic, Yan Xuetong, what China hoped to get out of its strategic partnership with the EU, he said: “If we go to war with the US over Taiwan, we would hope that you would remain neutral.”

EU-China co-operation in world politics

Taiwan is only one of a number of issues that could cause friction in EU-China relations. As Chapter 3 pointed out, the EU is concerned

about China's support for autocratic regimes around the world. But there is also ample scope for disagreements in other areas that the Europeans care deeply about, such as UN reform, non-proliferation and peacekeeping.

In their attempt to build a strategic partnership, the EU and China tend to highlight their various common views, interests and objectives in international politics. Both see themselves as regional powers that are grappling with defining their global roles. Both support international organisations, such as the UN, and uphold the importance of international law. Both worry about unrestrained US power in the world. Both are concerned with the proliferation of weapons of mass destruction, sustainable development and poverty alleviation. On the surface, therefore, it seems that the EU and China should find it easy to work together in the international arena. David Shambaugh, a China specialist at George Washington University,

⁴⁶ David Shambaugh, *'China and Europe – the emerging axis'*, *Current History*, September 2004. detects so many commonalities that he predicts the emergence of a "China-Europe axis" on the world stage.⁴⁶

However, examined more closely, some of these agreements turn out to be rather superficial. Differences are perhaps inevitable, given that both Europe's and China's policies on many global issues are in a state of flux. But it is important that both sides understand their differences so that they can work to avoid disappointment and tensions.

Chinese officials often state that they are in favour of a multilateral and multipolar world. They do not always seem to be aware that there is a difference. Multilateralism is about building a strong system of global governance, involving international rules, norms and treaties, with a defined role for supranational institutions. Multipolarity is about trying to prevent the creation of a unipolar world, through building alliances to constrain the power of a potential global hegemon. In essence, multilateralism and multipolarity are competing mechanisms for constraining American

power: the first is through international rules and organisations, the second through a countervailing alliance.

When the Chinese underline the need for a multilateral world, they will find a large number of Europeans with them. But when they talk approvingly about the emergence of a multipolar world, in which rising powers such as China, India and Russia, and perhaps a stronger EU, are pitched against the US they will find that only a minority of Europeans agree (notably a number of French people, together with some Germans, Spaniards and Belgians). Although most Europeans are quick to acknowledge their differences with the US, they would not support a foreign policy strategy that was built on outright opposition to their long-standing ally. Moreover, history makes Europeans wary of multipolarity: this doctrine is rooted in the balance-of-power politics of the 19th century, which led to the outbreak of devastating wars in Europe.

Today's Europe is based on a very different philosophy, that of mutual advantage or 'win-win' co-operation, deep economic and political integration and the pooling and sharing of sovereignty in supranational organisations. This 'post-modern' view of sovereignty also makes Europeans believe that countries should not turn a blind eye to wars and atrocities committed within other countries. Most Chinese are very cautious about supranational authority and extremely concerned about protecting the sovereignty and integrity of their own national territory. They do not share the European (and to a lesser extent American) conviction that under certain circumstances humanitarian interventions can be necessary and desirable.

Having experienced interventions by 'the international community' in the 19th and early 20th centuries, the Chinese are understandably cynical about the motivations of those supporting such interventions today. Moreover, since China defines itself as a developing country, it tends to sympathise with other developing countries that fear the prospect of western intervention. Finally, China's reluctance to see

others taking an interest in Taiwan and Tibet also makes it wary of the concept of humanitarian intervention.

For all these reasons, China has often used its status as a permanent member of the UN Security Council to try and block initiatives for intervention, be it NATO-led air attacks on Serbia in 1999, the invasion of Iraq in 2003 or UN intervention in the Darfur region of Sudan in 2004 and 2005. However, there are some signs that China might be shifting its stance on interventions. When Chinese officials opposed NATO action in Kosovo in 1999, their case rested firmly on the principle of non-interference, and China was very vocal in its condemnation of the attacks. In the run-up to the 2003 Iraq war, the Chinese were more subtle in their opposition. On Sudan, they have been careful to oppose intervention on grounds of practicality rather than principle. What is more, the Chinese government appointed a former foreign minister, Qian Qichen, to Kofi Anan's high-level panel on UN reform. This panel recommended in 2004 that the UN should accept that as a last resort humanitarian interventions may sometimes be necessary. The Europeans welcomed Qian Qichen's participation. China – as a permanent member of the UNSC and a de-facto spokesman for the developing world – could be expected to take a more proactive stance in the debates about UN reform. Instead, its rather narrow focus on national objectives, such as keeping Japan off the UNSC, has weakened its hand in the broader reform debates.

Similarly, for a country with a permanent UNSC seat, which also has the world's biggest army, China contributes surprisingly little to UN peacekeeping. The UN is seriously short of peacekeepers, and is likely to face a growing need for them in the coming years. China has contributed small teams of military observers, engineers and policemen on a number of UN missions. It has even sent a few hundred regular soldiers to Liberia and the Democratic Republic of Congo. But the total number of Chinese deployed on all missions since 1990 is 1,450, while many other Asian countries typically send several thousand on a single mission. Practical problems partly

explain China's timid role in international peacekeeping. Very few Chinese soldiers speak English or have the equipment and training required for rapid deployment to distant places. The recent establishment of a training centre for peacekeepers is an encouraging first step.

But there are also more fundamental obstacles to China shouldering more responsibility for peacekeeping. One, as mentioned above, is China's reluctance to engage in anything that could be construed as interference in the internal affairs of another country. Another is that the PLA's generals have not shown much interest in anything apart from "Taiwan, Taiwan, Taiwan", as one Chinese academic summed up the military's top priorities. The EU should work with China to help it to become more active in international peacekeeping. If China were able to show that a small fraction of its military capability was devoted to a global public good – peace support operations at the behest of the UN – rather than the pursuit of its own immediate national interests, its neighbours would be more relaxed. A larger Chinese contribution to UN peacekeeping would augment China's diplomatic influence and its 'soft' power.

Another area in which China should be encouraged to take on more international responsibility is the proliferation of military technologies. In December 2004, China and the EU signed a declaration on the proliferation of weapons technology. Yet there are real concerns about China's ability to ensure that all its defence companies respect its rules on arms exports. China needs to make its own system of policing the exports of arms and sensitive technology more transparent. It should also step up support for international efforts to prevent the spread of weapons of mass destruction. First, although China has engaged constructively in 'six-party' talks with North Korea, many observers feel that it could do more to discourage its ally and neighbour from acquiring nuclear weapons. If Pyongyang builds up a nuclear arsenal, Japan and South Korea may also pursue nuclear weapon programmes – and thus create a whole new security challenge for China. Second, China has so far

refused to join the Proliferation Security Initiative (PSI), an initiative launched by President George W Bush in 2003. The PSI encourages participating countries to work together to intercept shipments of WMD and related materials. France and Germany, but also Russia – none of them American stooges – have joined this venture. China has refused to join the PSI on the grounds that it lacks a solid basis in international law, and also because of its general reluctance to support military interventions that are led by the West.

China's co-operation is particularly urgent in the case of Iran's nuclear weapons programme – likely to become the world's number one strategic headache in the coming years. China seems happy to watch the drama of Iran's nuclear ambitions from the sidelines. The EU three – Britain, France and Germany – have been trying to persuade Iran to abandon its plans to enrich uranium, in return for political contacts, some technology transfer and more trade. This effort has had only the most grudging support from the US, which opposes all contacts with Iran. Russia, although initially reluctant, is giving some assistance to the EU's efforts. China, however, has done very little to influence the Iranians (although it has told the Iranians that it would not use its UNSC veto to shield them, which has strengthened the EU's hand). Again, fears of setting a precedent for intervention have influenced Beijing, as has China's rising dependence on Iranian oil and gas (see Chapter 3). China could use its economic ties with Iran as leverage to dissuade the Iranians from pursuing the option of nuclear arms. If Iran proceeds with its nuclear programme, it might provoke Saudi Arabia and Egypt to follow suit. And the US or Israel might launch attacks on Iranian nuclear facilities. Under these scenarios, the security situation in the Middle East would worsen and China's energy security would be threatened.

6 Conclusion

China's rise is changing the world. What happens in China will have a major impact on the future of world trade, climate change, the reform of the United Nations, the spread of democracy and the proliferation of weapons of mass destruction. The EU has decided that it cannot and should not try to hold China back. Instead, it wants to work with Beijing to make sure that China's rise will be as smooth and steady as possible.

The EU's two key objectives for a strategic partnership are to support China's internal transition towards market economics, the rule of law and democratic accountability, and to help China become a responsible and reliable global player that respects international rules. However, the EU's day-to-day dealings with China are not systematically linked to these objectives. The EU is China's biggest trading partner, one of the most important foreign investors and big provider of aid money. The EU is actively working with the Chinese in more than 20 different areas ranging from macro-economic management to improving local governments. The EU can offer a lot of things that the Chinese badly want, such as better access to the EU's €10 trillion single market, energy savings technology or a boost in international respectability that would come from lifting the arms embargo.

With so many different points of contact and so many things to offer, the EU should be able to influence changes in China. But it risks squandering its potential unless it starts thinking about China more strategically. At the moment, the EU's China policies often resemble a shopping list of priorities rather than a coherent strategy. Different EU-China co-operation programmes, like toy trains, run on separate tracks. EU members, in particular the larger ones, often

put short-term commercial advantage before the pursuit of long-term objectives. The planned negotiation of an EU-China framework agreement provides the EU with an opportunity to strengthen its China strategy. Here are some suggestions for EU policy-makers.

- ★ **Regard change as good.** The EU should not be too daunted by the pace of change in China. The fact that things are in a state of flux opens a window of opportunity. It potentially allows the EU to have an impact on the way China manages its internal transition and how it fits into the international system. The EU should not wait until China has become a super-power that is set in its ways. The time to try and influence China's rise is now.
- ★ **Make linkages.** The EU should become more courageous in linking the different aspects of its relationship with China. The Chinese want EU help on energy savings and reducing pollution. The EU should oblige – but ask China to actively engage in post-Kyoto negotiations on climate change. China wants a lifting of the arms embargo. The EU should wait for concrete steps on human rights and suggest that China strengthens its own controls on the export of military technologies. China seeks EU expertise on regional development. The EU in turn wants China to make more efforts to combat illegal emigration and people smuggling. The EU may well want to be careful not to make these links public – so as to allow the Chinese to save face. But a stronger sense of give and take would probably benefit EU-China relations.
- ★ **Ensure consistency.** Interests are an important driver of the EU's common foreign and security policy. But so are values. The EU would struggle to build a credible strategic partnership with a country that lacks commitment to the rule of law and human rights, and not only because the EU believes that such rights are in the best interest of 1.3 billion Chinese. China's support for autocratic regimes around the world and its power of example for many emerging nations could clash with Europe's wider

strategic objectives. The EU's ability to influence China on such sensitive issues is limited. But if it pushed human rights down the bilateral agenda with China, the EU would appear both irresponsible and inconsistent. How could the EU put values at the heart of its relationship with Russia while largely ignoring them in its dealings with China? Consistency is also important in other policy areas. If the EU had not 'given away' market economy status to Russia, it would now find it easier to make China work harder for an upgrade.

- ★ **Take more responsibility.** The EU needs to think more about regional security in Asia. It should foster China's current enthusiasm for regional integration and work more with and through emerging Asian multilateral forums. The Europeans also need to open a new dialogue with the Americans about their respective China strategies.

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EMBRACING THE DRAGON

The EU's partnership with China

Katinka Barysch

with **Charles Grant** and **Mark Leonard**

The EU is now China's biggest trading partner. European companies are ploughing billions of euro into the booming Chinese market. The EU offers Beijing help in areas such as fighting pollution and writing better laws. Both China and the EU back a strong United Nations and they are wary of US hegemony. But there are also profound differences, which – unless addressed – could hold back plans to build a 'strategic partnership'. China's policies on human rights, regional security, climate change, weapons proliferation and illegal migrants will move up the bilateral agenda.

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