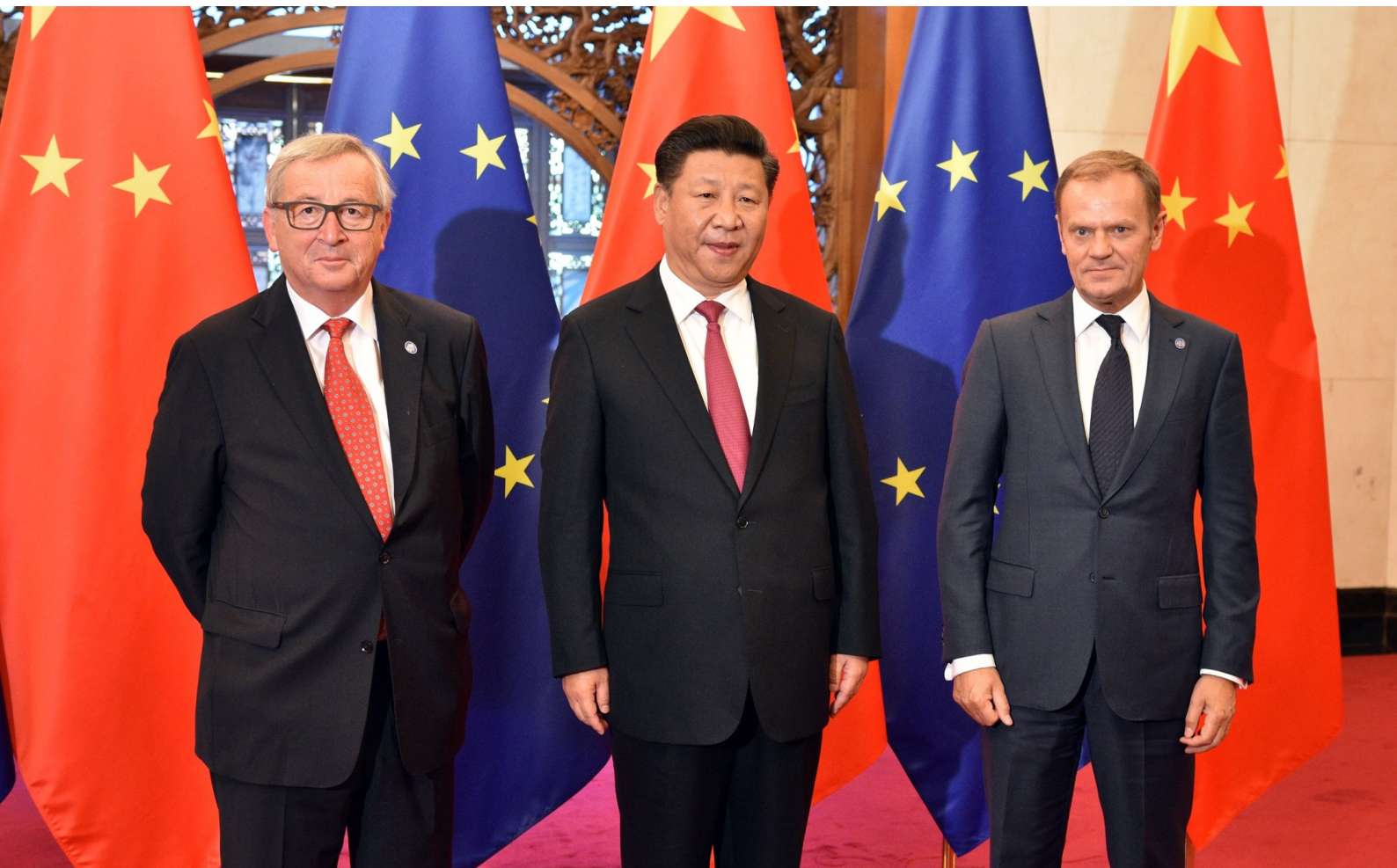


AUTUMN 2016

WHAT NEXT FOR EU-CHINA RELATIONS?

REPORT



This event is part of our policymakers' lunches series, which gather key stakeholders including senior officials from the EU and international institutions, MEPs, diplomats, academics and business and NGO representatives for an informal roundtable discussion on a topical issue. They allow for frank and open off-the-record discussions.

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EU-CHINA RELATIONS ABOUT MORE THAN JUST TRADE

Cooperation between the EU and China – which ranges from trade to climate change – is a strategic necessity for both sides and for global peace and prosperity even if there are differences on some questions, participants told a Friends of Europe Policymakers' Lunch.

The participants, who made their contributions under the Chatham House Rule, discussed recent events in bilateral relations, including the July China-EU summit in Beijing and the China strategy paper released by the European Union in June. Unusually, no joint statement was issued after the summit, mainly due to economic disagreements. But that highlighted how far the relationship has evolved in recent years, said **Gunnar Wiegand**, Managing Director Asia and Pacific at the European External Action Service (EEAS), agreeing to speak on-the-record. "If you are in a mature relationship you do not celebrate all the time," he said. "We want to identify a positive agenda that does not hide the fact that we have certain differences and that we need to manage these differences."

Despite a traditional emphasis on trade, relations between the EU and China have broadened to include topics as various as cybersecurity, law enforcement and global warming. "The summit achieved very constructive and positive results", said **Zhang Lirong**, Minister and Deputy Head of Mission of China to the EU. "It was held at a time when there are many challenges in the world, and the summit's main message was positive and forward-looking."

The wide-ranging areas of engagement and the longevity of the EU-China relationship mean it can withstand bumps in the road, said **Shada Islam**, Director of Europe & Geopolitics at Friends of Europe. "There is more resilience in the relationship than ever before."

The maturity of the relationship is to a large extent due to China's heightened status in the world, said a participant. "China is no longer a new, emerging power in the Far East, but a key strategic partner of the EU," the participant said. "China has roles in the Middle East and Afghanistan, for example. The EU is not questioning China's role as a key partner – or as a leading regional nation and global actor. But rather we are engaging with China."

The EU, in contrast, is struggling with what European Commission President Jean-Claude Juncker has called an "existential threat". Many Member States have still not recovered from the financial crisis, and are suffering from low growth and unemployment. That has contributed to a rise in populism and anti-EU feeling. This was given concrete form in June, when a majority of voters in a British referendum chose to leave the EU, a vote that disturbed Europe's trading partners across the Atlantic and in Asia. "The summit came just after the UK referendum, and the backdrop was how to deepen cooperation to take on challenges," said a participant. "We hope to see a united and stable EU."

Many Europeans have become pessimistic over the future of their continent, fearing that it may lose influence in a new bipolar world dominated by the United States and – instead of the Soviet Union – China.

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Gunnar Wiegand,
Managing Director Asia and Pacific at the
European External Action Service (EEAS)

“The EU is on a trajectory of self-effacement and China is on a trajectory of assertiveness,” said a participant. “China has already reached a level where its economy is at parity with the US. But its internal market growth is twice that of the US, and Chinese GDP per head is one fourth that of the US. The risk is that in 10 or 20 years’ time, the world will go back to bipolarisation.”

RISING TRADE, RISING FRICTION

China’s growing industrial production and trade with Europe have led to a number of disputes. China says it has a right to market economy status (MES), 15 years after joining the World Trade Organization. But some Europeans think it sells some products at unfairly low prices, and that corresponding duties should thus be imposed. Disagreement over MES was one reason for the lack of a joint statement after the July summit. “The commonality of language was not sufficient,” said a participant.

The most concrete source of trade friction is overcapacity in the steel industry. “China sees overcapacity as a global problem,” said Wiegand. “We see it as a global problem that China makes a significant contribution to.”

The two sides agreed at the July summit to create a bilateral working group to monitor steel overcapacity and steps taken to address it. However, China says the platform will be used to exchange information, and not to monitor Chinese policy. “I see it as positive response from the Chinese side, though we didn’t agree that China should be blamed,” said a participant. “We export less than 10m tons of low-standard steel products to the EU, and import 3m to 4m of high-standard steel from European countries. According to Chinese estimates, the resulting job losses for Europeans are between 10,000 and 20,000, not the 1.5m to 3m that some have claimed.”

Though the economic relationship between Europe and China is still dominated by trade, investment is growing – both from European corporations in China and Chinese in the EU. “China is now a bigger investor in Europe than Europe is in China,” said a participant. “Europe can no longer treat Chinese companies with benign neglect. To achieve reciprocity, we need to negotiate as partners and build up our bargaining positions. The US limits Chinese investment there and the participant said that Europe should make the opening of its markets conditional on China doing the same: “Reports from European chambers of commerce say that market access to China is very limited. Only 1.8 percent of the Chinese banking market has been taken by foreign banks.”

EU BUSINESS DEMANDS EQUAL TREATMENT

As Chinese companies have grown in stature, calls for reciprocity have increased. “We do not see China as a developing economy,” said a participant. “We see China as competitive, making big investments. So we want to have a more balanced approach for our companies in China and

Chinese companies in Europe. Our relations are changing, and we are being more demanding towards China.”

Beyond formal barriers, especially smaller companies find a range of hurdles to doing business in China, said a participant. “There are obstacles in the path of developing our presence in China. I am not talking about the global policy level, but non-tariff barriers that businesses find on the ground in China.”

Eventually, European public opinion will not accept an imbalance in market openness, said a participant. “We want to continue to have an open trade policy – a rules-based trade policy – but it must be based on full market access in both directions,” the participant said. “A simple political reality is that certain steps will not get through the legislative process. There needs to be a clear, level playing field, and clear rules need to be applied.” The participant pointed out that the Chinese government actively promotes Chinese corporate interests in individual EU Member States. “Chinese foreign policy does not only operate in diplomatic statements but also in the concrete defence of corporations’ interests in Member States. It has become more and more a key feature of the relationship with China, and there will be negative consequences.”

Reciprocity is a good principle, but Europeans need to recognise differences in China and the progress it has made, said a participant. China’s 13th five-year plan, which covers the period from 2016 to 2020, specifies reforms such as a shift away from heavy industry, more international cooperation and a strengthening of the rule of law in business. “We think our progress in the last 30 to 40 years is a good result of a policy of opening up,” the participant said. “China will continue to push its reforms forward. We will not go backwards. China is different from the EU and EU countries in its historical and cultural background and its stage of economic development. So it takes time.”

The EU and China launched talks towards a bilateral investment agreement in 2013. The EU hopes this will improve market access for European investors by guaranteeing that they will not be discriminated against and by addressing regulations related to transparency, licensing and authorisation.

One participant said more attention should be paid to China’s actual and potential contribution to the European economy. “Europe is coming out of a crisis, so it could use the extra investment that might result from a comprehensive agreement on investment,” the participant said. “China has grown, but Chinese exports have not come at expense of the EU. We often import from China and then export higher-value products.”

INCREASING THE SCOPE OF COOPERATION

The EU and China are cooperating in an ever-wider array of fields, showing increasing ambitions for the relationship. One project currently being considered¹ is the development of a sound legal environment for business. Another area is connectivity, where potential joint projects are being considered in rail freight cargo, customs facilitation specifications and

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transport standards. “Everyone talks about connectivity; everyone loves connectivity,” said a participant. “But connectivity is understood in different terms by different players, and we must make sure that this is not connectivity which would just benefit one side. It must benefit all sides participating.”

One participant emphasised the 5G, the proposed next major phase of mobile telecommunications standards. “For us this is an important issue in cooperation with China. Market access issues are really important for us, and we are working very hard on our bilateral contacts on that.” The participant added that, while EU research programmes are relatively open to outside participants, European researchers do not appear to be as welcome to participate in those of other countries, including China.

But China’s most notable commitment in recent years has been on climate change. China announced earlier in September that it would formally ratify the Paris climate change agreement, and plans to roll out a nationwide emissions trading system (ETS) in 2017. The EU originally pioneered such a scheme, and a joint project will help China to launch its system by making available Europe’s leading experts on ETS, said a participant. “China is an important partner when it comes to dealing with emissions,” the participant said.

In addition, the concept of green growth was written into the 13th five-year plan. “China has always regarded the EU as a very important partner in political and international affairs – not just trade,” said another participant. “China and the EU had very frequent contacts on climate change, and China has learned much from the EU.”

China’s rise has also increased scrutiny of its human rights record and of its claims to sovereignty in the South China Sea. The EU is trying to deal with these issues in a practical manner, said a participant. “We don’t have difficulties in talking about EU interests, and we have to be pragmatic at times to achieve results. But this has to be principled pragmatism.”

In any case, it is not certain that China’s power and influence will always rise and Europe’s fall, especially given the rapid aging of the Chinese population. “There is no linear trajectory,” said a participant. “Look at the demographic developments in China and Japan, which are both aging. There is no guaranteed dynamism – certainly if you are not reforming.”

This all means that, instead of achieving a fixed state, the EU-China relationship will be a dynamic one. “Reciprocity does not mean we should all do the same,” said a participant. “The EU is also different from what it was 30 or 40 years ago. When EU enterprises entered the Chinese market, there were preferential conditions for foreign companies there. They no longer enjoy these now, and they are competing on the same footing as Chinese enterprises. Chinese companies too are facing challenges as they go up the value chain and find that the competition with European enterprises is fiercer.”

DIFFICULTIES AND OPPORTUNITIES

In conclusion, future EU-China relations need to take into account the different problems the two sides are grappling with. Amid pessimism over Europe's economic prospects, Europeans need to feel they are being treated fairly by China in trade and investment relations. China has its own challenges, such as providing jobs for a rapidly urbanising population, and Europeans should recognise this too.

However, links are growing rapidly in non-economic spheres, as illustrated by the efforts in climate change and a multiplication of people-to-people contacts. By expanding the areas of practical cooperation – for example in urbanisation, innovation and education – the EU and China can make their relations increasingly robust. The two sides also have the potential to solve global problems together. “To sum up,” said Zhang Lirong, “the opportunities for strengthening our partnership are bigger than the difficulties.”

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Zhang Lirong,
Minister and Deputy Head of
Mission of China to the EU



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