Is the Eurozone crisis changing EU-China relations? (ARI)

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Theme: The economic and financial crisis affecting Europe seems to be changing the map of the interests involved in the EU-China relationship.

Summary: The debate on the EU'S leadership in the international arena is closely linked to its (in) ability to define its interests and act accordingly. As a result, the EU has insufficient credibility as an effective global actor. It is generally recognised that there is too much rhetoric and declaratory diplomacy combined with a large deficit of action, and Sino European relations confirm this. However, the situation is changing very quickly. China is not only a distant trade partner. The economic and financial crisis affecting Europe seems to be changing the map of the interests involved in the EU-China relationship.

Analysis: International relations in this 'multipolar' and 'interpolar' world, where over the past few years new powers have emerged or are emerging, are facts that other significant international actors or powers must recognise in order to reorganise their foreign policy instruments and positions.

China, because of its economic, political, territorial and demographic size, is an international and security actor that poses numerous challenges for a *sui generis* actor such as the EU and, despite the rhetoric used in Brussels, EU-China relations appear to be not as strategic as they should be in political terms.

Political dialogue between the EU and China started in 1975. Formal relations were established under the 1985 EC-China Trade and Economic Co-operation Agreement. The agreement continues to be the main legal framework for EU-China relations in 2011.

In the early 2000s, expectations could not be better. The EU, its institutions and their leaders seemed willing to take important steps to consolidate the 'EU pole' in the world, with an institutional framework that would enable it to exercise an important role in the world: with a new currency, with a long-term strategy that would make Europe the most competitive economy in the world (the Lisbon Strategy), as well as in the security sphere, it launched several initiatives such as the Helsinki Headline goal and the European Capabilities Action Plan, aimed at addressing the European partners' lack of the military capabilities necessary to make credible the emerging European security and defence policy.

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Apparently the goal was clear: to make the EU a credible international actor in the strategic world. This narrative extended to both academics and practitioners and also began to permeate government leaders in other parts of the world. In those years, Beijing decided to pay more attention to understanding the complex process of European integration. In 2003, the Chinese Ministry of Foreign Affairs produced its first (and so far only) policy paper regarding the EU, as against five Commission communications on China. After several decades of contact and cooperation, the establishment of a Strategic Partnership in 2003 was a significant upgrade in relations.

However, building a real partnership between two such complex entities as the EU and China does not depend exclusively on political agreements and declaratory documents. There are a set of controversial issues that hinder a more fluid and fruitful EU-China relationship. From 2005 there have been difficulties arising from textile disputes, the failure of the lifting of an arms embargo, a growing trade deficit and the human rights dossier. Until that moment, Sino-European relations had undergone a convergence process. Some experts described it as a 'honeymoon period'. The year 2008 was a turning point. The cancellation of the summit by the Chinese authorities during the French Presidency (when President Sarkozy met the Dalai Lama in December 2008 despite pressure from the Chinese authorities) of the EU Council made clear the red lines of China's foreign policy in general, and to the EU in particular.

The EU must realise that the only aspect with regard to which it has enough weight and scope is in trade and economic issues. China and other international powers do not see the EU as a real player, except in the economy and trade. The problem is that commercial partnership does not automatically translate into stronger political ties. The constant failure of the 27 partners to reach a consensus is deeply frustrating and has caused disillusionment to many Chinese officials. Expectations are high that the Lisbon Treaty and the new institutional architecture (a reinforced High Representative, a permanent President of the EU Council, a European External Action Service, etc.) will give impetus and coherence to the EU's external action. But it is also recognised that the Lisbon Treaty is not enough to solve the problems relating to the EU's lack of international relevance. Thus, beyond the intention of the European institutions, it seemed that China had reached the conclusion that Brussels was important for trade issues and investment with each member state bilaterally, but that in foreign and security topics the Chinese authorities must continue to talk with France, Germany and the UK.

As Pablo Bustelo has described,[1] China is not only an economic and trading power, but also an international financial power. During the last few years, China has sought to adequately represent its economic weight in the political sphere and, thus, it is looking for more influence in international institutions and forums, particularly the economic ones. In the negotiations between China and EU regarding the Chinese contribution to the European Financial Stability Fund (EFSF), Beijing could demand an integral governance reform of the IMF, seeking to change the actual balance of power within this international institution. China would like to not only change the rule that the Managing Director is European, but also to increase its stake. It can be said that China's rise is already a fact, beyond all the difficulties and limitations of its regime. And as occurs with other international powers, the multiple interests involved in the EU's relationship with China, promotes divisions among its member states that make it very difficult to develop a

[1] Pablo Bustelo (2011),'¿El banquero del mundo? Sobre el peso financier international de China', ARI nr 147/2011, Elcano Royal Institute.

European policy towards the Asian giant. The EU member states with significant economic and trade interests in China are not pushing for a more comprehensive or stronger EU policy towards China that might limit their bilateral relations.

According to several studies on the European partners' attitudes towards China until the economic crisis, Germany, the UK and France are those who traditionally fostered (and limited) the European policy towards China, while the remaining European countries are not key players in this issue, at least so far. Trade interests and the human rights situation in China are the main topics that cause divisions between European countries. However, the financial crisis seems to have changed the map of European interests regarding China, which has until now been just a distant trading partner. Furthermore, it appears that China has changed its strategy towards Europe, using its economic and financial power to gain more influence in order to reach two key objectives in its relationship with the EU: full market status before 2016 and the lifting of the arms embargo.

The status of full market relates to anti-dumping cases in the context of China's WTO membership agreement, in accordance with which China agreed to be considered a non-market economy until 2016, because of the difficulties out of assessing the true price of goods.[2] China's perception is that the EU has applied 'double standards'. Chinese officials point out that market-economy status has been granted to Russia despite its economy being less market-oriented than China's. Currently, the MES is a political instrument used to pressure the Chinese government in other matters.

The second key objective is the lifting of the EU arms embargo that was imposed on China following the events in Tiananmen Square. The embargo is not a traditional one, it is not legally binding and each country applies it in a different manner. It is a symbolic issue for the Chinese government and also for the EU, because it is not the main instrument for regulating arms exports to China and others countries. The EU arms embargo is perceived by the Chinese authorities as a humiliation, because they are treated in the same way as Sudan or Zimbabwe. Likewise, on the European side, it is considered an instrument to put pressure on China in relation to human rights and the rule of law, and is a very sensitive issue in European relations with other partners such as the US and Japan. The last attempt to lift the embargo was in 2003, backed by France and Germany, and was a turning point in EU relations (during the Spanish Presidency in the first semester of 2010, there was another attempt but it failed to get the minimum support to be discussed). It was very badly managed and communicated. The lack of consensus within the EU and how the information was transmitted to the EU partners caused a significant imbroglio. The perception on the Chinese side was that the arms embargo was not lifted because of US pressure, and without taking into consideration others factors such as the position of the EP, European public opinion on the human rights situation in China or the position of certain Nordic EU member states. The consequence of this impasse has been an increase in the political and symbolic price for lifting the arms embargo.[3]

[2] House of Lords (2010), 'Stars and Dragons, The EU and China', European Union Committee – Seventh Report, p. 48.
[3] This argument had been developed previously in José María Beneyto, Alicia Sorroza, Inmaculada Hurtado & Justo Corti (2011), 'Political Dialogue in EU-China Relations', DT nr 50/2011, Instituto de Estudios Europeos, CEU.

China as an Emerging Country in the Euro Zone Crisis

The excellent economic performance of the emerging powers during this international economic crisis is well known. Despite the relative loss of relevance of European countries in the world economy, the EU as a whole is still the world's largest trade block, exporter of capital and source of funds and leadership for multilateral organisations.

According to HSBC forecasts, by 2050 there will be only seven European countries (the UK, Germany, France, Italy, Spain, The Netherlands and Poland) in the Top-30, or eight if Turkey finally joins the EU. China and India will be the largest and third-largest economies in the world, respectively, while the US will be the second-largest, losing first place but still remaining a dominant force.[4] Other European countries like Sweden, Austria, Norway and Denmark will be out of the top 30 by 2050, although the report also notes that their per capita income is still rising, so their populations will still have a very high standard of living. However, they will have less of an impact on global policy.

These forecasts reinforce the idea that China (and also other emerging countries such as India, Brazil and Mexico) will be, if they continue to record this economic performance, relevant partners for the EU. Of course, these kinds of forecasts have a relative value, because there are based on certain conditions, for instance, that the governments and policymakers concerned are making the right decisions. Other 'unexpected' issues such as natural and man-made disasters are not taken into consideration for such forecasts. But it should also be highlighted that the EU market (Turkey's future, in or out the EU is the unknown factor) will still be significant for Chinese exports. The EU is the main market for Chinese products (20%) followed by the US, which accounts for 18%.

According to several World Bank reports, annual average GDP growth has been much higher in Asia, excluding Japan, than in the rest of the world. It was around 8%-9% in East Asia and the Pacific and 6%-7% in South Asia, compared with 3% for the world as a whole. Moreover, growth has been at 10% in China since 1980 and at 8% in India since 2000. The result of this differential in growth has been that Asia has increased its participation in global GDP, from 17.6% in 1980 to 26.7% in 2010. China led the rise in Asia's growth from 1.9% in 1980 to 9.3% in 2010, while India's participation rose from 1.7% to 2.4%. It must be stressed that the increase has been at the expense of the EU, which dropped from 34.1% in 1980 to 24.9% in 2010, despite the successive enlargements, and of the US, whose share has declined from 26.0% to 23.3%. As noted by Bustelo,[5] in recent years, China has been the true driving force of the world economy, more so than other large economies. Even at this risk of oversimplifying, the numbers tell us that China has the extraordinary financial capacity (in other words, the cash) that the euro zone required in the midst of the debt crisis. China knows and exploits these advantages. A recent paper published by ECFR argues that there is a 'scramble for Europe' and that 'China is buying up Europe'. Beyond these arguments the fact is that Europe needs China and welcomes its presence in this troubled context. China is using the possibility of buying public debt as a tool of its public diplomacy.[6]

[4] HSBC Global research (2011), 'The World in 2050. Quantifying the Shift in the Global Economy', January, p. 23.
[5] Pablo Bustelo (2011), 'La UE ante el auge económico de Asia Pacífico', DT nr 15/2011, Elcano Royal Institute.
[6] François Godement, Jonas Parello-Plesner & Alice Richard (2011), 'The Scramble for Europe', ECFR Policy Brief, July.

China seems to have understood the need to strengthen its presence in Europe if it wants to be more influential there. It is taking advantage of this critical juncture and is employing a similar strategy to that used in developing countries.

Figure 1. Chinese Investments in Europe (US$ billion)

Quarter	Europe Total	Mediterranean Total	Mediterranean as a % of Europe
2008			
1Q	4.5	0	0
2Q	6.2	0.5	8
3Q	4.3	0.8	18
4Q	0.4	0	0
2009			
1Q	14.1	0	0
2Q	0.1	0	0
3Q	7.2	2.3	32
4Q	4.3	0.4	9
2010			
1Q	3.7	0.2	5
2Q	4.5	2.4	53
3Q	6.4	4.2	67
4Q	36.6	6.9	18
2011			
1Q	27.7	8.5	31
Total	120	26.2	22

Source: Grisons Peak Merchant Bank (2011).

Over the past few years China has focused on outbound investment into Asia and in other underdeveloped regions, like Africa and South America. Europe has hardly seen any activity, whether in mergers and acquisitions (M&A), bank loans or trade and cooperation agreements.

According to the data in Figure 1 above, the trend has clearly changed in the past few months. Chinese investment in Europe, and especially in the Mediterranean countries, has grown significantly. European Mediterranean countries were the recipients of numerous trade agreements, and this trend has continued throughout 2011. Mediterranean countries represent approximately 30% of China's total investments in Europe, a highly significant average considering the size of these economies.[7]

Despite the difficulties in comparing data on the real dimension of China's presence in Europe, it is possible to see a change in the Chinese approach to the EU and to certain European countries, especially in the eastern and southern peripheral regions. These countries, that until a couple of years ago had no relevant interests in China and few prospects of developing them at least in the short term, were willing to follow the lead of countries like the UK, Germany and France in the design of EU policies towards China.

More of these countries are now seeking to draw the attention of the Asian giant in terms of investment and the purchase of debt as a way to overcome the crisis, without making greater demands on human rights issues or in improving access to the Chinese markets.

[7] Grisons Peak Merchant Bank (2011), **China Outbound Investment Research Report**, Quarterly Feature, vol. 9 (Q1).

During the last few months, economic experts have warned that Chinese companies are preparing for a wave of new investments in Europe in the engineering and technology sector as part of an effort to find new markets and gain greater control over global supply chains.

As shown in Figure 1, the volume of Chinese investments in the last quarter of 2010 and the first quarter of 2011 add up to US$64.3 billion. This is more than double the figure for the previous 11 quarters. According to these banking experts, many Chinese companies see European deals as a 'short cut to a customer base'.[8] Businesses around the world might, for instance, be comfortable with buying high-tech equipment from a European supplier, whereas they would be less likely to do so if the supplier was Chinese and had a less established track record. In the context of the euro zone crisis, China has been buying bonds from southern member states such as Greece, Portugal and Spain, and also made promises to Ireland and Hungary. However, caution is called for regarding these figures, as China only publishes its total currency reserves, but not the breakdown by country. In addition, Europe does not publish aggregate data on foreign purchasers of public debt of its member states.[9]

This opacity and lack of transparency benefits China, whose intentions and potential capabilities are often overestimated, while it can also lead to competition between EU member states for attracting Chinese sovereign funds, making it more difficult to establish an EU policy towards China. Beyond the actual data (or lack of them) regarding bonds, China's strategy seems to be quite clear: it is gaining influence in Europe in order to strengthen its ties and have a greater interest in certain European countries and reduce its exposure to the US economy. The counterpart that China seeks, beyond the profits from its investments, is related to obtaining full market status, avoiding pressure on the appreciation of the renminbi, according to the Chinese authorities. The recent declarations (14/IX/2011) by the Chinese Premier, Wen Jiabao, indicate that China will continue to expand its investments in Europe but also that the EU should consider its relations with China from a strategic viewpoint, proving its sincerity and friendship by giving China full market status several years earlier than expected. However, for the EU, and despite economic concerns over the lack of transparency in several sectors of the Chinese market, access to the EU market is a tool for pressing the Chinese authorities to consider European claims for access to Chinese markets.

Conclusion: China has focused on Europe, and is using all the tools at its disposal to be more relevant to European eyes, and not just as a mere trading partner. This new Chinese approach (essentially bilateral) can positively influence the conviction of the European leaders of the main EU member states of the need to strengthen the EU dimension in their relationship with China. It is becoming clearer that without a coherent and consistent policy it will be very difficult to press China to improve conditions for market access, prevent dumping, etc. Therefore, the cancellation of the EU-China summit that was to take place in the Chinese city of Tianjin has come as a surprise.

However, in practical terms, the reality is that new interests and actors are now at the negotiating table, so an EU policy on this matter will be increasingly difficult.

[8] 'Focus on Deals High up Value Chain', *Financial Times*, 25/IV/2011.
[9] 'Chinese Investment in Europe: Streaks of Red, Capital and Companies from China are Sidling into Europe', *The Economist*, 30/VI/2011.

For some Chinese academics this is an opportunity to reinforce EU-China relations, based on a strong bilateral relationship. This is a possibility to be taken into account if the relationship is managed from a positive sum, not zero sum, viewpoint. But intentions are still unclear, both from the Chinese and European perspective.

Perhaps it is still too early to assess the more political implications of this new Chinese strategy towards the EU, and in this new scenario it is unclear the participation of China in the EFSF. However, it is likely that some sensitive issues for the Chinese authorities, including human rights and Tibet, will become even more marginal, if that is possible. And, furthermore, pressure will grow for the EU authorities to grant China full market status and lift the arms embargo. In this extremely complicated context, it seems unavoidable that the EEAS (in coordination with EU member states) will gain more prominence in the design and implementation of a real EU policy towards China, although the difficulties in developing the Van Rompuy/Ashton initiative with a Strategic Partnership make us very pessimistic. Time is not on our side.

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