Hang Together! The Case for Unity in EU Trade Negotiations with China

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After 15 years of negotiations (including GATT), the People's Republic of China (PRC) joined the World Trade Organization (WTO), an intergovernmental organisation overseeing regulation of international trade between member nations. Following successful negotiations between China and the WTO working party for China's accession, the eventual agreement[1] included commitments to be undertaken by China to provide non-discriminatory treatment to all WTO members: all foreign individuals and enterprises must be accorded equal treatment to enterprises in China with respect to the right to trade. China will eliminate dual pricing practices as well as differences in treatment accorded to goods produced for sale in China in comparison to those produced for export. Price controls will not be used for purposes of affording protection to domestic industries or services providers. The new member's commitments are to apply equally to all WTO members under normal non-discrimination rules. However, the EU leaves no doubt as to its opinion that there has been a frustrating lack of progress in giving the market a more decisive role in key areas of the economy and that EU enterprises face new and ever tougher restrictions in China, which go against market opening and the principles of equal treatment and a level playing field.[2]

In late March this year (2019), on a working trip to Europe, PRC President Xi Jinping visited, inter alia, French President Emmanuel Macron in Paris. Whenever possible, Beijing prefers bi- over multilateral avenues and avoids third party participation, making the most of China's relative weight advantage vis-à-vis its international partners. This behaviour has been criticised often in Asia, where Beijing

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[1] World Trade Organization (11 December 2001), "Accessions: China", https://www.wto.org/english/thewto_e/acc_e/a1_chine_e.htm.

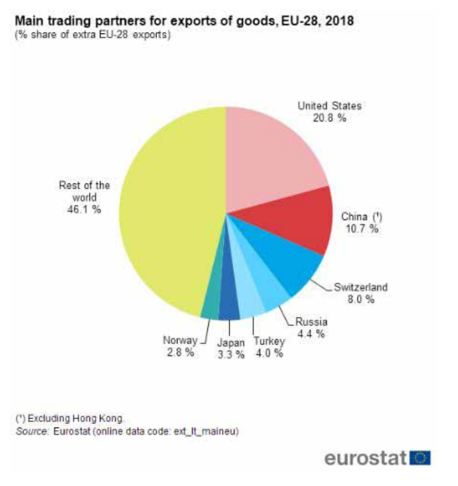
[2] E.g., EU Commission (2016), "Elements for a new EU strategy on China", http://eeas.europa.eu/archives/docs/china/docs/joint_communication_to_the_european_parliament_and_the_council_-_elements_for_a_new_eu_strategy_on_china.pdf.

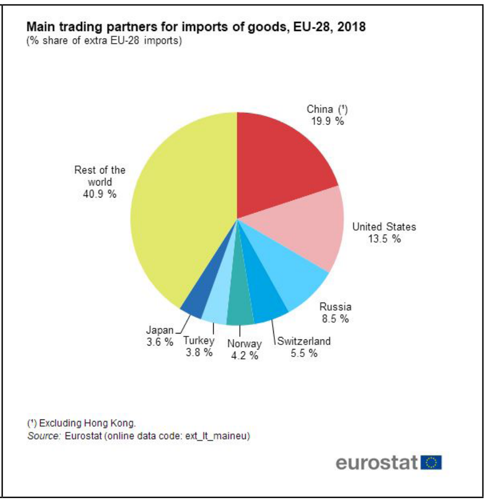
allegedly divides the Association of Southeast Asian Nations (ASEAN) by engaging the ten members of the organisation individually rather than as a united bloc. In Paris, however, two further invitees upset Xi's preference when Emmanuel Macron brought along his two strongest European allies: German Chancellor Angela Merkel and Jean-Claude Juncker, Chief of the European Commission. Whether or not Xi was disturbed by this remains speculation, of course, but what is evident is that this configuration is indicative of what Macron and other European leaders are working towards in their relations with China: a more coordinated European approach towards an awkward, but inevitable trading partner. EU leaders want to put multilateralism back on the menu and get tough on China, allegedly not complying with its commitments. Macron's effort also underscored division as the key weakness in the EU's external engagement process and symbolised the search for much-needed European unity at a time when Beijing is out to expand its global influence via its ambitious Belt and Road Initiative (BRI). In Europe, most EU nations, including Germany and France, willingly jump on the Chinese bandwagon at the expense of a united EU response.

While China poses significant challenges to international trade, competition and systemic differences do not equate to conflict. Cooperation between China and Europe and a healthy, market-driven competition on eye level is necessary. For this to be possible, though, Europe must "hang together". This article is about an unequal trade relationship that ought not to be unequal at all.

China and Europe need each other

The Chinese economic miracle is real. It began in the late 1970s under Deng Xiaoping, who led the People's Republic of China onto a path of successful economic reforms. Some four decades on, China has become the second largest economy in the world, growing dynamically year on year, and is the single most important cause and driver of global geopolitical and economic change. In spite of all the (often exaggerated) suspicion of, and problems with, China, the Chinese growth trajectory is a positive force for both domestic and global development. Not only have the last two decades of enormous growth propelled hundreds of millions of Chinese out of poverty and rapidly improved the socio-economic situation of the Chinese society at large, China's sustained growth has also benefited its European partners immensely, especially the strong export nations, Germany, France, Italy, Great Britain and the Netherlands. The European Union is one of the largest trading blocs in the world, its leading economies are significant exporting nations, and its financial centres are major hubs of capital exchange. As such, the PRC remains an important partner, and, to say that much upfront, neither the European Union nor any of its members can have any interest in a conflictual relationship with Beijing, least of all a Chinese containment strategy.





The Chinese market absorbs enormous exports and foreign direct investments (FDI) from Europe on the one hand, and feeds European markets with comparatively cheap consumer goods on the other. Both exchanges are particularly beneficial to the lower-middle income groups in Europe.

EU-China: Trade in goods

Trade in goods 2015-2017, € billions

Year	EU imports	EU exports	Balance
2015	351.0	170.4	-180.7
2016	345.1	169.7	-175.3
2017	374.8	198.2	-176.6

EU-China: Trade in services

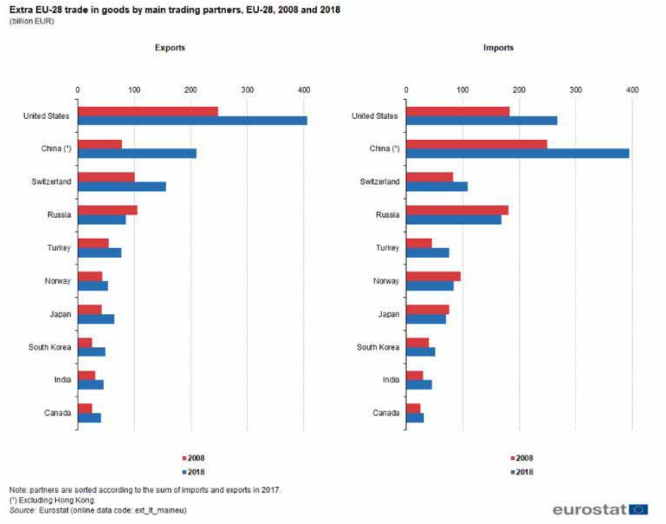
Trade in services 2014-2016, € billions

Year	EU imports	EU exports	Balance
2014	23.1	30.3	7.2
2015	28.7	38.3	9.7
2016	29.6	38.3	8.8

EU-China: Foreign direct investment

Foreign direct investment 2016, € billions

Year	Inward stocks	Outward stocks	Balance
2016	45.1	177.7	132.6



Between 2008 and 2018, the EU exports of goods recorded the highest growth rate for exports to China, which almost trebled over this ten-year period. China is the EU's second-biggest trading partner behind the US and the EU is China's biggest trading partner. China is the EU's biggest source of imports and its second-biggest export market. Europe's main imports from China are industrial and consumer goods, machinery and equipment, and footwear and clothing, while the EU exports mostly machinery and equipment, motor vehicles, aircraft, and chemicals.[3] Particularly Germany, Europe's leading economy and by far the largest net contributor to the EU budget, benefits from China's positive development trajectory. European companies have had an extensive role in facilitating Chinese development over the past decades. There have been significant transfers of technology and know-how, necessary for much of China's infrastructure and other development and Europe has been instrumental in creating a skilled Chinese domestic labour market. Mutual investment is significant and the European consumer benefited from comparatively cheap Chinese manufacturing, whilst the European labour market benefited from an increasingly strong Chinese consumer base. China is an important production base, consumer market, import source as well as one of the largest research and development (R&D) hubs in the world. The EU and China have the potential for mutually beneficial trade relations, spurring each other's further development.

[3] European Union, DG Trade (March 2019), "European Union Trade with China", https://webgate.ec.europa.eu/isdb_results/factsheets/country/details_china_en.pdf.

China remains an awkward partner

Having said this, the alluring Chinese market and inevitable and desirable cooperation should not obscure the fact that China is not an easy partner and there is an urgent need to recalibrate relations – not an easy ask from a major trading partner in an interdependent global economy. Slowly, the realisation has sunk in in Europe that China has been a living falsification of the largely western belief in a path-dependency that leads from decades of growth, socio-economic progress and the development of a significant middle-class to inevitable democratisation and market liberalisation. Despite, or rather because of, stunningly rapid Chinese growth and development, the Communist Party of China (CPC) has stayed in power and solidified its control over the economy, polity, and society. China has not moved towards more market orientation, liberalism, and democracy, but has instead realised its very own model of political and economic governance. The Chinese model combines characteristics of a market-driven economy with substantial state intervention policies and centralised control and oversight. There are some market economy elements, driven by economic liberal supply and demand and price competition dynamics, mostly in the domestic market. However, especially when it comes to global trade, China remains a tightly centrally controlled economy. Through significant state intervention, tightly controlled resource allocation, and the dominance of state-owned enterprises (SOE), market distortion characterises the domestic market as well as much of China's international trade and investment and favours Chinese enterprises. Moreover, in addition to those operational disadvantages, there are also structural disadvantages European enterprises suffer from. While Chinese companies enjoy relatively unrestricted market access in the EU, this is not the case for European competitors in a highly protected Chinese investment environment. Many EU economies are increasingly frustrated that their businesses more often than not are excluded from realising or investing in infrastructure projects in China, while the domestic EU markets are open to PRC bidders in most public tenders. This applies to general market access as well as public tender contracts and FDI in specific sectors. According to the European Commission, financial services are a sector in which the lack of reciprocal market access is particularly severe. While Chinese fintech companies, banks and insurers are expanding their presence in the EU, their European counterparts are denied access to the Chinese market.

There is also a clear trend in China away from the private sector towards state control and management of the market. Lardy has for example pointed to a decline in private investment in favour of state investment, facilitated by easy access to credit and diversion of resources towards Chinese SOEs, and evidently away from the private sector.[4] In Europe, this has clear implications for economic security. A study by the German Bertelsmann Stiftung found that between 2014 and 2017, 64% of Chinese investments above a 10% stake in German companies were in sectors prioritised by the “Made in China 2025” campaign,[5] a central initiative to make China a leader of the fourth industrial revolution. Foreign acquisitions are an evident tool to acquire know-how and to realise “Made in China 2025”. Simplified, China is buying up European, and global, companies to acquire the technology and know-how gained elsewhere to rapidly further its own development and leapfrog the rest of the world.

A systemic rival as a most favoured partner

In Davos recently, Xi Jinping had juxtaposed himself to US President Trump and declared his interest in free trade and stand against protectionism.[6] In practice, however, European leaders had to conclude that the Chinese President seems to define free trade and multilateralism differently from them. The EU Commission recently named the PRC a “systemic rival and competitor”.[7] With this, China is not only a structurally difficult market itself, but also offers an alternative growth model to third parties, and thus, is in direct systemic competition with the European Union. Xi presents China increasingly as a global player, willing and able to shape the geopolitical and economic agenda. The Belt and Road Initiative makes China a most favoured partner in many countries around the world and maximises Beijing’s global influence. Since its inception in 2013, the BRI has become a defining feature of the global economy and provided oftentimes much needed infrastructure investment not only for Asian countries, but also across the globe. BRI critics argue that it is a Chinese effort to take aim at the post-WWII international order conceived and enforced by the United States, and that the BRI attempts to trap countries in unsustainable debt, perpetuating unequal relationships. While this so-

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4 Lardy, N. (2017), “State Resurgence in China”, in Adam/Jiming (eds.), *U.S.-China Cooperation in a Changing Global Economy*, PIIE Briefing, 17-1 June.

5 Jungbluth, C. (2018), “Kauft China systematisch Schlüsseltechnologien auf? Chinesische Firmenbeteiligungen”, in Deutschland im Kontext von, “Made in China 2025”, Bertelsmann Stiftung, Gütersloh, p. 22.

6 *Reuters*, “In Davos, Xi makes case for Chinese leadership role”, 17 January 2017, https://www.reuters.com/article/us-davos-meeting-china/in-davos-xi-makes-case-for-chinese-leadership-role-idUSKBN15118V.

7 European Commission (2019), “Contribution to the European Council. EU-China – A strategic outlook”, 12 March 2019.

called "debt-trap" argument is exaggerated, it is true that China increases its status and importance via specifically targeted FDI. New Chinese financing institutions, such as the Asian Infrastructure Investment Bank (AIIB), a Chinese development bank headquartered in Beijing and investing in infrastructure and other productive sectors in Asia, increasingly shape the international order and provide significant resources to developing countries. They are also a covert attempt by China to become a norm-entrepreneur itself, setting standards and practices according to its own preferences.

For the EU, this is both promising and worrying at the same time. While China's interest in international trade and its increasing investment in often less developed countries are generally positive, Chinese-style institutions and trade regimes do not satisfy European standards and aspirations at all. Moreover, Beijing knows how to use its thus-increased leverage economically and politically. Especially, since it does not stop outside of Europe's borders. Just like in Asia, in Europe, too, the enormous appeal of the Chinese market and Chinese investment monies has the potential to divide friends and partners and drive up competition. Other competitors have made advances towards individual European countries, exposing divisions among EU members; Russia for example. However, unlike with other competitors before, the EU can this time around not rely on its ace card of superior economic strength and investment power; China's pockets are deep. So it happened that in 2012, the Chinese Ministry of Foreign Affairs inaugurated the Cooperation between China and Central and Eastern European Countries (16+1, soon to be named 17+1 with Greece having joined the grouping) initiative to promote investment relations between China and 17 countries of Central, Southern, and Eastern Europe, most of them EU members. 17+1 serves to further the Chinese Belt and Road Initiative beyond Asia and 14 EU members have signed bilateral agreements with China, officially becoming members of the BRI. While the EU is still a far cry away from having anything resembling a coherent policy on China, Beijing is carefully targeting "softer" countries in Europe, expanding its influence and its bargaining power.

This is far from only being an issue with smaller European economies though, as just before the cited Paris meeting, Xi had been to Italy, where the government of the fourth largest European economy dealt a further blow to European coherence on China. The government in Rome had just signed up to the BRI, leaving those European leaders and officials scratching their heads, wary of this increasing Chinese influence in the EU. At a time when Europe was just about to get its act together on China (see below), the Italian newspaper *La Stampa* reported that Xi received the most lavish of receptions in Rome and was courted with all state honours.[8] Italy's Premier, Giuseppe Conte, then became the first and only G-7 leader to officially sign up to the BRI. Previously, Athens had ceded a 51% controlling stake in its key port of Piraeus to China's SOE COSCO, which also controls container ports in Spain. And many European economies from Germany to Portugal are in some way connected to the BRI. Even the cited Paris meeting was somewhat ambivalent and Macron's strong words and gestures would have been that much more credible had Paris not used the opportunity of Xi's visit to sign business and investment deals for French companies with China totalling EUR40bn.

This is significant, since Rome and other governments lend ever more credence to the BRI project itself and implicitly legitimise the Chinese macro-economic vision that underpins the controversial Belt and Road Initiative. Something that has not gone unnoticed in the White House, where the National Security Council reacted with concern and warned Rome not to give this "legitimacy to China's infrastructure vanity project".[9] At the same time, there is a risk of a future over-dependency on Chinese capital and the Chinese market. The ASEAN lesson should be valuable to Europe. Chinese investment is transforming smaller Southeast Asian countries significantly both in economic and social terms. Countries such as Cambodia and Laos are dependent on China to an extent that has them being accused of becoming Chinese proxies within ASEAN, where member states decide on the basis of unanimity and a veto by one country can hold up moving forward on issues, such as a coherent China approach. Of course, most ASEAN countries are significantly smaller and less diversified economies, hard to compare to the likes of Italy, or even to some the poorer of EU countries. Nonetheless, the ASEAN example should be studied more seriously in Europe.

Europe's getting tough(er)

The risk of increasing over-dependence on Chinese capital and market is exacerbated by the unclear future of trade ties with the traditional ally, the USA. Standing up to China may well please Washington – in fact, this is something Washington demands. However, the Europeans cannot do so assured that the Americans will have their back in terms of trade. On the contrary, Germany especially is worried

8 *La Stampa*, "Italy endorses China's Belt and Road plan under wary gaze of Western allies", 23 March 2019, https://www.lastampa.it/2019/03/23/esteri/italy-endorses-chinas-belt-and-road-plan-under-wary-gaze-of-western-allies-BTzx2SyRBAntxrzKZFNAGN/pagina.html.

9 *Reuters*, "China's Xi looks to strengthen Italian ties, evokes ancient trade routes", 22 March 2019, https://www.reuters.com/article/us-italy-china-president/china-italy-looking-to-strengthen-trade-infrastructure-ties-xi-idUSKCN1R318U.

about the spectre of a looming trade war with the US, or at least a skirmish, once US President Trump gets serious on tariffs on European key exports such as automobiles – this scenario is only one nightly tweet away.

For this reason and the fact that the EU usually struggles to produce coherent strong policy communiqués, not to mention strategy papers – often due to dissents among its ranks – it is somewhat surprisingly unusual that the EU presented the above-mentioned strategy paper on China, just weeks before Xi's visit to Europe. This time, the EU could agree on a new China strategy paper, calling the strategic partner a de facto competitor and systemic rival.[10] This is a radical change in rhetoric and strong language from Brussels. Brussels makes it abundantly clear that it no longer regards China as a developing country, but as a key technological power and competitor instead. The EU agrees to unite behind demands for clear policies and action from Beijing to ensure equal market access and fair regulations, transparency, and greater Chinese responsibility for upholding the rules-based international order. In sum, the Commission demands a more responsible China and an interaction based on reciprocity.

The EU strategy paper was a solid first step to kick-start a process of reversing the unequal access of Chinese companies in the European market, while China is failing to reciprocate. But the litmus test is if Brussels bureaucrats and EU leaders manage to translate "talk into walk", tougher rhetoric into more concrete, biting policies based on that reciprocity they demand. For this to happen and to have any effect, member states need to be behind this; Europe needs an effective common response, which begins with a diplomatic show of force. The unusual format in Paris was, therefore, a further laudable step. Hidden in diplomatic niceties was an obvious attempt by major EU leaders to get two European messages across: The European market is not a free for all and we will stand united if we must. Or as Macron bluntly put it later in Brussels after a joint meeting of European leaders: "The time of European naiveté ended. [...] For many years we had an uncoordinated approach and China took advantage of our divisions."[11] Macron, Merkel and Juncker have diagnosed that the unfair advantage rests with Asia and the Europeans are more determined than ever to level the playing field.

In concrete terms, this means that the European Commission, together with the External Action Service, the EU's diplomatic service, aim to tighten the rules for Chinese FDI in Europe, especially mergers and acquisitions in sensitive and security-relevant areas. Earlier in the year, the EU member states had passed new

[10] EU Commission (2019), cited above.

[11] *FT Weekend,* "Naivety on China is over, says Macron", p. 2, 23/24 March, 2019.

EU regulation to screen foreign takeovers in strategic sectors in response to concerns that foreign firms – many of them Chinese – were buying up key technologies. German Chancellor Angela Merkel said that Europeans had to make sure that there is no unilateral protectionism, but reciprocity instead in world trade. "Germany is a country that is in favour of open trade, but we also want to guard our interests. That is why, together with France, we will put forward ever more proposals to that effect."[12]

European Union leaders and China then met on 9 April 2019 in Brussels for their annual EU-China Summit, usually an outcome-deprived affair, and achieved a further milestone on the reciprocity journey. Although not quite the "breakthrough" European Council President Donald Tusk called it,[13] the summit produced a joint statement. In fact, the Europeans put on a show of unity and strength, even threatening to leave the summit without any communiqué at all. The tough approach worked, with China making last-minute concessions to secure a meaningful declaration.[14] Leaders agreed to include a commitment "to build their economic relationship on openness, non-discrimination, and fair competition, ensuring a level playing field and transparency". The two sides also committed "to achieve in the course of 2019 the decisive progress required, notably with regard to the liberalisation commitments" as well as "broader and non-discriminatory market access". Chinese negotiators reaffirmed support for the rules-based trading system and included a reference to "forced transfers of technology", a staggeringly unique implicit acknowledgement by China of this transfer even being an issue.

Such Chinese pledges are no major change in Beijing's economic policy. During the press conference following the summit, Premier Li Keqiang reiterated the standard Chinese position that its opening is an ongoing process.[15] And yet, even minor results are significant, for they demonstrate how the EU can successfully pressure China, negotiate on eye level, and achieve results, if its leaders act in unison and refrain from the aggressive and destructive attitude displayed by the

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[12] Angela Merkel, "Regierungserklärung der Kanzlerin zum Europäischen Rat", https://www.bundeskanzlerin.de/bkin-de/mediathek/videos/regierungserklaerung-zum-europaeischen-rat-1592474!mediathek?query=.

[13] *Deutsche Welle*, "EU announces 'breakthrough' on trade with China", https://www.dw.com/en/eu-announces-breakthrough-on-trade-with-china/a-48269078.

[14] Delegation of the EU to China, "Joint statement of the 21st EU-China summit", https://eeas.europa.eu/delegations/china_en/60836/Joint%20statement%20of%20the%2021st%20EU-China%20summit.

[15] *South China Morning Post*, "As China-EU summit ends, Premier Li Keqiang vows reforms: 'When we say it, we have got to do it'", 10 April 2019, https://www.scmp.com/news/china/article/3005462/china-eu-summit-ends-premier-li-keqiang-vows-reforms-when-we-say-it-we.

Trump administration. With this communiqué, Europe begins to walk the talk of its earlier strategy paper and begins to implement the much-needed shift in the EU's approach towards China. The summit can – at least to some extent – be interpreted as a small victory for the EU, as China implicitly agreed to open up its economy, allow foreign investors and limit state subsidies for industries. It was certainly a further logical step in the right direction, building upon the strategy paper and efforts to present the EU as a coherent actor.

CONCLUSION AND RECOMMENDATIONS

Without a doubt, the EU and China, two of the largest markets in the world, need each other and trade between them is desirable. All of the above is not at all to discourage trade with China and there is nothing wrong with having good trading relationships with China per se, nor with signing up to the BRI. Increased trade volume and mutual FDI, even in critical infrastructure, is something to work towards and can be beneficial to both sides. However, this must be done according to WTO-agreed rules or possible future free trade agreements (FTAs), and must be completely transparent and reciprocal. If the major European trading nations and the EU as a whole want to have some credibility, they must stand up to Beijing's disregard of established trade practices and Europeans must address some of the major issues that still undermine a sound relationship. In particular, Europeans take issue with what they see as unfair trade practices on China's part, making this relationship essentially unequal. The EU's budget commissioner, Günther Oettinger, made a valuable proposal: Oettinger argued that the EU should have the right to deny Chinese-funded infrastructure deals in any EU member state if they do not serve the common EU interest. An EU Commission veto on Chinese infrastructure projects, in other words. Adding to this, companies from countries that do not allow for full EU bidding, first and foremost China, should reciprocally be banned from EU's own public tenders. This reciprocity must also apply to protectionist regulations on mergers and acquisitions with locals in such countries.

The EU should also work towards its key industries becoming more competitive. To this end, the EU needs a long-term strategy on how to maintain a leading position in technological R&D, and sustainable hard infrastructure and digital infrastructure development. Second, the EU needs competitive firms. Internal European mergers should be seen in this light first and foremost, not from a domestic cartel perspective only. The external environment, i.e., competition with mega conglomerates from China and the US, should be regarded as equally important to domestic market implications when weighing up intra-European mergers. Regretfully, EU anti-trust regulators recently rejected a rail industry merger deal between Alstom and Siemens' rail unit, on the basis of concerns over a lack of competition, leading to higher prices for consumers. However, the building of European champions, better equipped to compete globally, should be particularly encouraged. More than 15 years beyond China's accession into the WTO, it has become clear that China's SOEs are not going to disappear anytime soon and if Europeans want to compete, they must cooperate internally and draw on the full strength of its combined market.

Lastly, a competitive Europe, on par with China, needs European unity. Countries signing up to the BRI pose extraordinary frustrations and challenges to those Europeans who seek to sustain an open and equal trade and investment environment. But the fault also lies with the major European economies as well as with the United States. Instead of threatening and being frustrated with countries like Italy, Brussels (and Washington) should respect different positions across European capitals and discuss non-BRI alternatives in a constructive manner. Instead of prioritising national preferences, especially vis-à-vis China, the European common market should take priority and bilateral relations should be embedded in the European context. Macron's Paris meeting was laudable in this regard – despite the bilateral deals with China. Germany has also a lot to do in this regard, facing pressure from its domestic industry to cosy up to China. As critical of the EU as some in Europe may be, especially when it comes to trade and market regulations, the EU must hang together. What has happened in some ASEAN countries are warning signals, and even if these countries are not easily comparable to most EU economies, the case of smaller ASEAN countries should be studied well in Brussels and warnings should be communicated to EU capitals. If individual EU countries undermine a common EU approach in order to reap some benefits, they may soon find themselves overly dependent on China. It was a rare show of unity and resolve on the EU side, buoyed by the recent legislation on foreign investment and public procurement, that allowed the EU-China Summit to produce something it usually does not: deliverables in European priority areas. This resolve and a coherent China strategy in times of geopolitical and economic uncertainty, within Europe and vis-à-vis the USA and China, must become the norm guiding the EU's trade policy towards China.

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