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Trading out of the Crisis: Sino-European dependence and competition

VERY FIRST DRAFT-NOT FOR CITATION

Behind the headlines of quotas, antidumping measures and other trade conflicts, China and the EU are key to each others' economic survival being each other's first and second trade partner respectively, especially within the current environment where policy-makers across the world propose exporting their way of the crisis (particularly in high-value technological and knowledge based products and services). The free trade agreement policies of these players in the Asian region belie a desire to diversify their markets and reduce dependence on one another (and the USA). This paper analyses similarities and differences in the EU's and China's approaches to free trade agreements in East Asia based on official documents and interview materials. It focuses on the idea of competitive diffusion of said policies. The paper shows how the economic interests of China and Europe as exemplified by their free trade agreements largely coincide in East Asia. It proposes that a more coordinated policy amongst them could result in more similar (and compatible) free trade agreements for third parties, which are essentially mapping out a new economic governance outside the WTO and its public scrutiny. More coordination in this would also result in a less conflictive relationship between the two, where some of the contentious issues discussed in the 26 dialogues of the strategic partnership (market economy status, market access and regulations) could also be defused and resolved.

Keywords: Trade policy, competition, free trade agreements, policy emulation, power balancing

Discipline: International Relations- International Political Economy

Theme: Foreign economic policy

Introduction

EU-China Economic Relations

Trade Relationship

China's economic transformation into a market socialist economy and its consistent economic growth have been the focus of a wide body of literature and analysis.¹ This unprecedented transformation initially focused on exports and the incorporation into global markets. Crucial to this was the accession of China into the WTO in late 2001. Despite internal conflict regarding the desirability of opening up the Chinese economy to foreign competition prior to accession, since joining the WTO, China's trade increased by 28 per cent yearly and FDI rose 7.5 per cent annually in the first five years following membership.² China's increased significance in global markets has meant that its trade with the European Union has gradually increased (see Figure 1), in terms both of imports and exports, to the extent that in 2012 it is the world's second largest economic relation. The EU represents the largest market for Chinese goods accounting for 20 percent of all Chinese exports, and is the second source of imports for China. For the EU, China

¹ See *inter alia*: Blecher, M., *China against the Tides: Restructuring through Revolution, Radicalism and Reform*. London: Continuum, 2010

Bramall, C., *Sources of Chinese Economic Growth 1978-1996*. Oxford: Oxford University Press, 2000

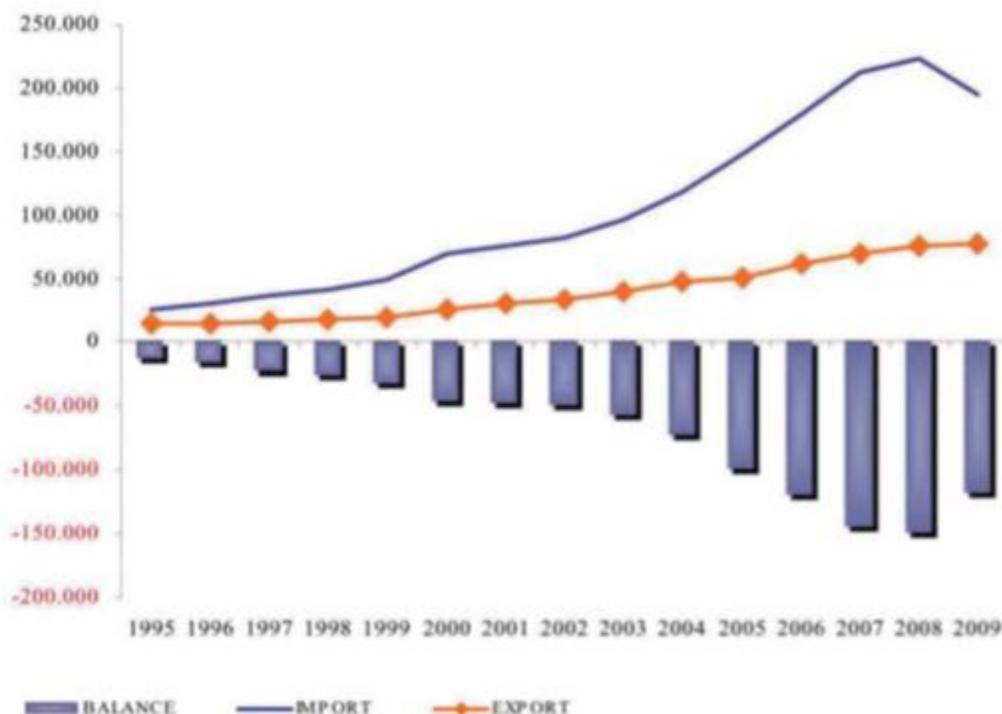
Breslin, S., 'Understanding China's Regional Rise: Interpretations, Identities and Implications', *International Affairs*, 85/4, 2009, pp. 817-835.

Naughton, B., *The Chinese Economy: Transitions and Growth*. Cambridge, MA: MIT Press, 2007

² Blecher, M., *China against the Tides: Restructuring through Revolution, Radicalism and Reform*. London: Continuum, 2010

is its main supplier accounting for 17.3 percent of all imports, and its second market representing 8.9 percent of all EU exports (behind the USA's 17 percent) in 2011.³

Figure 1: Evolution of EU27-China Imports and Exports



Source: EUROSTAT Comtext Data⁴

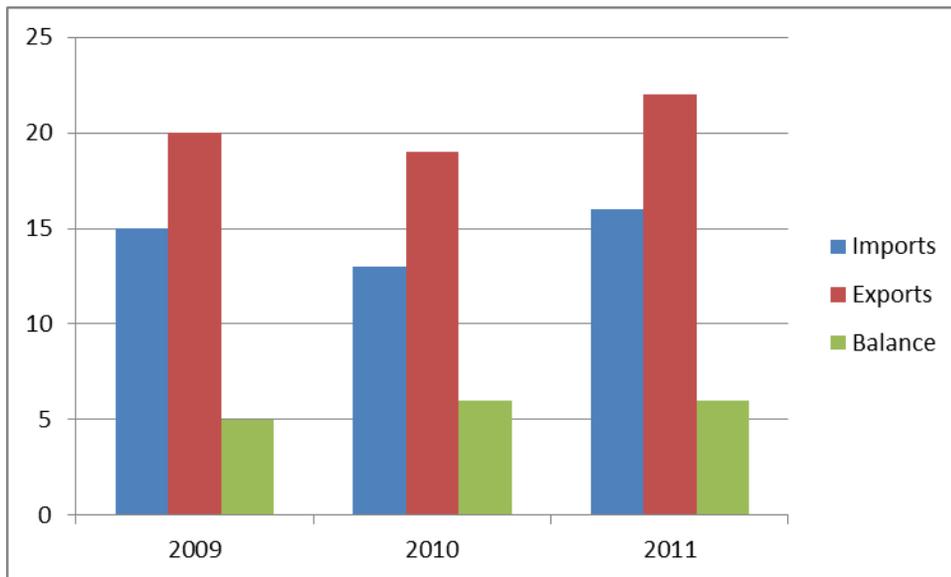
Whilst the EU runs a small trade surplus in commercial services with China, this is dwarfed by the deficit in trade in goods. Despite an initial drop in EU Chinese imports of 13.6 percent in 2009, and a significant rise in EU exports to China of 37.6 percent in 2010 and 20.3 percent in

³ Data from EUROSTAT in the EU's Trade Website, 'EU-China Trade Relations' , 2012 <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/china/>, last accessed 20.08.2012

⁴ In Beneyto, J.M., Soroza, A., Hurtado, I., Corti, J. 'Political Dialogue in EU-China Relations' *Documento de Trabajo Serie Unión Europea*, No. 50/2011, CEU Instituto Universitario de Estudios Europeos, 2011, p. 10

2011,⁵ the financial and economic crisis that has so harshly affected Europe and the USA since 2008, has not, thus far, dramatically altered the economic relationship between the EU and China (see Figures 2 and 3).

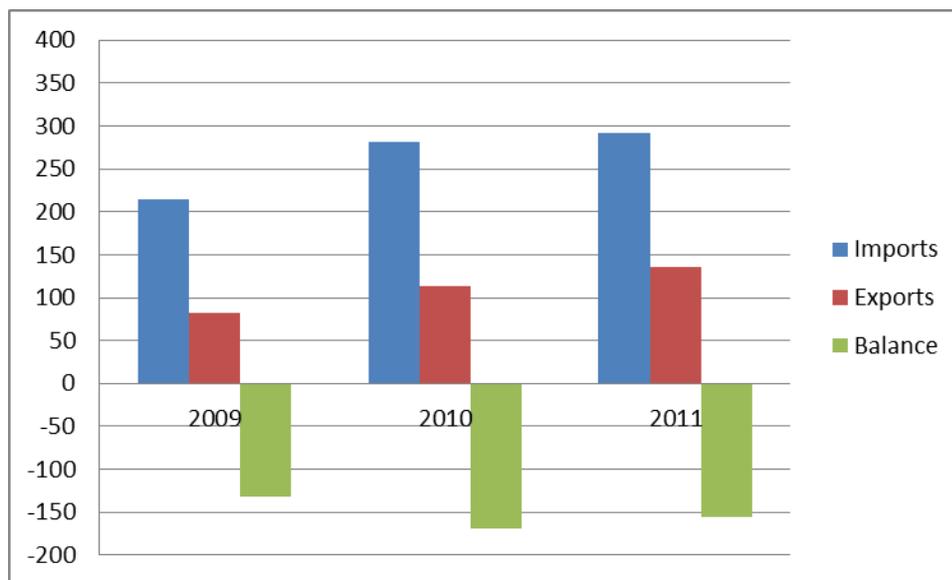
Figure 2: EU27-China Trade in Commercial Services (EUR Billion)



Source: EUROSTAT Comtext Data in EU Trade Website 2012

⁵Data from EUROSTAT in the EU's Trade Website, 'EU-China Trade Relations' , 2012 <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/china/>, last accessed 20.08.2012

Figure 3: EU27-China Trade in Goods (EUR Billion)



Source: EUROSTAT Comtext Data in EU Trade Website 2012

China's export capacity has continued to spur complications with other partners. Cases of antidumping measures, quota restrictions and others have been brought up against it by its key trade partners, the USA and the EU.⁶ What makes the particular case of the EU even more complicated is the fact that such actions must be undertaken by the EU as a whole, as the

⁶ See *inter alia*: Comino, A., 'A Dragon in Cheap Clothing: What Lessons can be Learned from the EU-China Textile Dispute', *European Law Journal*, 23/6, 2007, pp. 818-838.

Brown, C., 'China's WTO entry: Anti-dumping, Safeguards and Dispute Settlement', NBER Working Paper 13349. Cambridge, MA., 2007

Hufbauer, G., Wong, Y and Sheth, K., 'US-China Trade Disputes: Rising Tide, Rising Stakes'. Washington, DC: Institute for International Economics, 2006

Moller, J. and Kutkowski, A., 'The EU Anti-Dumping Policy Towards Russia and China: Product Quality and the Choice of an Analogue Country', *The World Economy*, 28/1, 2005, pp. 103-136.

European Commission's Trade Commissioner acts on behalf of all Member States. However, there is a great heterogeneity in the relations of EU member states with China. Germany, France, Italy, United Kingdom, Netherlands, Belgium, Sweden and Spain— account for more than 80% transactions. All of them display deficits with China, although the largest deficit relates to the Netherlands, the United Kingdom and Italy which represent over half of the entire deficit of the EU-27, amounting in 2009 to more than 69,000 million Euros.⁷ These countries' trade relations with China have increased rapidly, resulting in an increase in their trade deficit at rates above 10%, or higher as in Italy (20%), Spain (20.21%), Netherlands (25.90%) and Sweden (40.29%) from 1995 to 2009. The European Union is clearly concerned about the rapid growth of its external deficit. The disproportionate acceleration of imports and exports has taken the trade deficit to a cumulative growth rate of over 23 percent from 1995 until the onset of the international crisis. The European Commission argues that it is difficult to increase exports since China restricts the access to products with high added value or a high technological intensity.²⁰

In many cases, however, the increase in imports from China reflects the development of other sectors. For instance, Spain's multinational telecommunications company, *Telefónica*, is *Huawei's* (Chinese manufacturer of telecommunications equipment) largest client, reflecting growth in some sectors facilitated by the availability of competitively-priced equipment from China. This reveals the complexity of relations that underlie the official trade statistics, notwithstanding which the EU's trade deficits with China are a worrying sign of an unbalanced relationship, especially as almost half of all EU exports to China originate in one member state, Germany. Divergent interests of domestic constituencies, some of which specialize in exporting

⁷ Beneyto, J.M., Soroza, A., Hurtado, I., Corti, J. 'Political Dialogue in EU-China Relations' *Documento de Trabajo Serie Unión Europea*, No. 50/2011, CEU Instituto Universitario de Estudios Europeos, 2011, p. 16

parts for final production lines in China, others of which have invested in production facilities in China, and retailers who depend on Chinese imports, have led to complex and swaying EU responses to the rise of China.⁸

Complaints against the other party in this relationship, however, are not confined to Europe. On the Chinese part, anti-dumping measures and investigations have been a common cause for complaints. Indeed, in its 2008 China Trade Policy Review, the WTO expressed concern over complaints against China in breach of anti-dumping measures which indicates that in 2008 WTO Members initiated 93 anti-dumping, countervailing, safeguard, and product-specific safeguard investigations against Chinese exports, at a value of US\$6.1 billion, an annual increase of 69.4 per cent.⁹ To counter this situation, China had pressured its partners to grant it market economy status, which would enforce greater limits of the ability of parties to raise these cases at the WTO. In fact, in the free trade agreements (FTAs) that China has signed, the granting of market economy status has been a prerequisite and non-negotiable issue. However, new WTO rules place the onus of cases on a verification *in loco* which tightens procedures, combined with the fast approaching 2015 date for automatic market economy status at the WTO, have meant that this issue has practically vanished from China's economic dialogues with its partners.¹⁰ Recently, in reactions to the European Commission initiating an investigation at the WTO into Chinese subsidies to the photovoltaic and telecommunications industry, has sparked great concerns in China that if it were to go ahead it could create precedents for others to challenge its industrial policy, which until now has been a mainstay of the country's internal development policy. Insiders also report a deterioration of EU-China relations as a result of this incident and a strong

⁸ Shu, M., 'Dealing with an emerging economic power: The EU's trade policy towards China'. Paper presented at PSA 60th Annual Conference, Edinburgh, 30.03.2010.

⁹ [Retrieve the page reference from the report](#)

¹⁰ From interviews with European and Latin American diplomats, Beijing, August 2012

Chinese negative reaction to this, which has included threats to retaliate against European imports, specifically wine imports.¹¹ Other issues marring the relationship include many of the technical, sanitary and phytosanitary measures that have become obstacles to exports from China, affecting more than 15% of exporting firms, which highlights the need to adapt national legislation to the standards required by the vast majority of its trading partners.¹² Although, China too, has increasingly learnt from its WTO experience and has likewise increased its participation in the ‘nontariff barrier game’ as one European diplomat described it, but in ways that are compatible with its WTO membership.

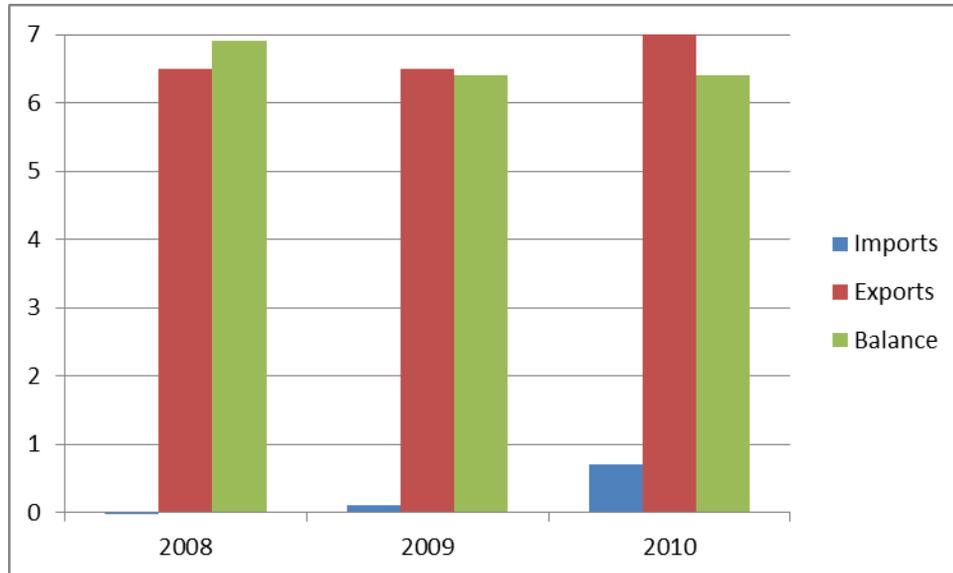
Investment Relationship

Although trade accounts for the more visible and substantial part of Sino-European economic relations, increasing investment flows are also gaining significance. Despite the financial and economic crisis, EU investment flows to China have continued, and perhaps because of the opportunities afforded by the EU’s need for liquidity, China’s foreign direct investment (FDI) flows into the European Union have increased to just under a billion Euro in 2010 (see Figure 4).

¹¹ From interviews with European diplomats, Beijing August 2012

¹² Beneyto et al. 2011, p.

Figure 4: EU27-China FDI Flows (EUR Billion)



Source: EUROSTAT Comtext Data in EU Trade Website, 2012

Despite some high profile Chinese investments some the Eurozone struggling economies, for instance in Greek infrastructures (*Piraeus* port operations) and in a large exhibition centre in Ireland to showcase Chinese products, both of which are consistent with the bulk of Chinese overseas FDI which destined to reinforce China's own internal development, Chinese investment and support for the Euro has not been as strong as some might have hoped. Whilst the Chinese economic leadership might not wish for a collapse of the Euro (which it holds as foreign exchange currency, although not to the extent of the US dollar),¹³ and are clearly concerned about the decline in demand from their major market, their current attitude to Europe is marked

¹³ China has already started Exchange swap agreements with key trade partners (Russia, Japan) to pay in their own currencies or even to bypass currencies completely by bartering oil and commodities (with Russia), showing a clear desire by these other crucial actors to limit their exposures to volatile US dollars and Euros.

by a clear sense of business acumen. They will not support Europe at any cost, but rather are shopping around for the best business opportunities. For example, there have been several Chinese trips to Spain to scout investment opportunities, and although having shown a keen interest decisions are being delayed awaiting developments, and more importantly lower prices.¹⁴ These investments, thus far, also represent a small fraction of Chinese FDI abroad, which has been destined mostly to other securing resources in other resource-rich developing states.

Although important in absolute values, in 2009 FDI inflows into the EU from the whole of Asia represented just under 20 percent of total FDI inflows, compared to 47 originating in North America. More significant in value have been EU investments in Asia and China, yet even then, total EU FDI outward stocks in Asia accounted for 15 percent of total EU investments abroad compared to 58 percent represented by North America.¹⁵ In terms of FDI the relationship with North America remains crucial. This is, of course, partly motivated by tradition, (the accumulation of FDI stocks over decades), but also by more open investment environments in North America and Europe and more consistent legal frameworks. European (and other foreign) enterprises have experienced difficulties investing in China, which accounts for lower levels of investment than elsewhere.

Outright foreign ownership is not allowed and foreign partners must engage in joint ventures with local partners. Foreigners are also limited to minority shareholder status, and have restricted input into management decisions. Whilst this may not appear very attractive, the prospect of entering the growing and extremely populous market that is China has signified important European investments in China. For many companies it is also a way of gaining a presence in the

¹⁴ Interview with European diplomat, August 2012

¹⁵ Author's calculations based on EUROSTAT Data

market as well as the networks necessary to then introduce products produced in their home country into China. It is also a mechanism for obtaining leverage within China. In fact many large transnational corporations have opted for investments in China through which to lobby the Chinese government directly (for better market access) rather than just lobbying their own home governments or the European Commission to exercise pressure on the Chinese government.¹⁶

Other European concerns in this economic relationship regard frequent infringements of Intellectual Property (IP) by an industry specializing in forgeries of consumer goods, as well as resulting from technology and know-how transfers via investments and joint ventures. A European diplomat considered the difficulty in addressing this issue given entrenched and generalized perceptions that IP breaches are a ‘crime without victims’ even when over 80 percent of all IP infringement cases tried by Chinese courts actually involve one Chinese company against another.¹⁷ Difficulties for competitive European service companies bidding for public procurement contracts are another contentious issue, and the European Commission has recently suggested that it too will close the European public procurement market to companies from states that have closed public procurement markets.¹⁸ The European Commission’s Directorate General for trade has stressed all these aspects, as well as increased nontariff barrier obstacles for exports in its general trade policy papers, like ‘Global Europe’ (2006) and ‘Jobs, Growth and Trade’ (2010), with regards to all states.

DG Trade’s objectives are to upload and institutionalise its ‘deep trade’ agenda,¹⁹ acknowledging that: ‘many key issues, including investment, public procurement, competition, other regulatory issues and IPR enforcement, which remain outside the WTO at this time can be addressed

¹⁶ Get the reference from that paper on Firms’ FDI decisions!

¹⁷ Interview with European diplomat, August 2012

¹⁸ *EUObserver*, ‘EU to restrict foreign access to tenders’, 21.03.2012, <http://euobserver.com/news/115658>

¹⁹ Add Peterson & Youngs’s (2006) definition and also add reference to Lamy 2002 paper

through FTAs.²⁰ The EU stressed its wishes to open market and claims ‘most emerging countries combine high growth with unnecessarily high barriers to EU exports [and as] their role and the benefits they draw from the global trading system grow, so too do their responsibilities to play a full part in maintaining a global regime that favours openness.’²¹ It further stresses that in its view, ‘[t]he absence of competition and state aid rules in third countries limits market access as it raises new barriers to substitute for tariffs or traditional non-tariff barriers,’ and highlights as a strategic interests the development of international rules on competition policies ‘to ensure European firms do not suffer in third countries from unreasonable subsidisation of local companies or anti-competitive practices.’²² ‘Public procurement is an area of significant untapped potential for EU exporters’ according to the policy and the biggest sector outside of multilateral disciplines, and one where EU companies face discriminatory practices.²³

These so-called Singapore issues, market access facilitation, as well as ‘strengthen[ing] sustainable development through [...] bilateral trade relations [...] incorporating new cooperative provisions in areas relating to labour standards and environmental protection’²⁴ are thus the core strategic aims that the EU pursues in its relations with Asia, addressed via Dialogues with China, and in the case of some other Asian states via the negotiation of legally-binding free trade agreements (FTAs), but as subsequent sections will argue it is increasingly difficult for the EU to gain acquiescence from partners on these contentious matters. Given the importance of the Chinese market and the challenges it presents, these issues are even more forcefully portrayed in the DG’s policy papers specifically on economic relations with China

²⁰ EUROPEAN COMMISSION, *Global Europe. Competing in the World*, Brussels, 2006, p. 10

²¹ EUROPEAN COMMISSION, *Global Europe. Competing in the World*, Brussels, 2006, p. 8

²² EUROPEAN COMMISSION, *Global Europe. Competing in the World*, Brussels, 2006, p.8

²³ EUROPEAN COMMISSION, *Global Europe. Competing in the World*, Brussels, 2006, p.8

²⁴ EUROPEAN COMMISSION, *Global Europe. Competing in the World*, Brussels, 2006, p.12

which insist on the need to ‘get China right’ and to establish ‘fair trade’ practices between the two partners to redress the current unbalanced relationship.²⁵ These challenges on the European side are particularly pressing as these are the precisely the economic areas in which European companies are most competitive and which the EU has priorities in its trade policies.

Institutional Relationship

A complex institutional relationship has developed to address these, as well as other issues, especially through the creation of a Strategic Partnership since 2003. The Partnership which revolves around three pillars: a Strategic Dialogue, a Trade pillar, and a People-to-People pillar, has been criticized for lacking a strategic component.²⁶ In fact EU representatives have conceded that the Strategic Dialogue needs to be imbued with meaningful content.²⁷ According to Beneyto et al. the Strategic Partnership was, ‘clearly directed, first toward a political dimension’ including global issues like reduction of weapons of mass destruction, security of energy supply, and international terrorism, and on the other hand, an economic dimension. A key element of the Partnership is the upgrading of the current legal basis of the relationship (the outdated 1985 Trade and Economic Cooperation Agreement) for a Partnership Cooperation Agreement (PCA), which whilst not as inclusive in scope as the FTAs and Association Agreements the EU has subscribed with other partners, would create a clear legal framework for cooperation and especially for increased trade and investment. Indeed, the economic pillar is the one in which

²⁵ Get reference from 2006 DG Trade China paper

²⁶ See inter alia Smith, M. & Xie, H. *Journal of Contemporary European Research*, 2010; Taneja 2010; Holslag *Journal of Common Market Studies*, 2011 Get full references from file

²⁷ Interview with EU officials Beijing, August 2012

diplomats agree a greater effort has been vested thus far. However, negotiations have been ongoing since 2007 and are still far from resolution. Within the PCA negotiations the European Union initially resorted to linkage of issues (as it does in other negotiations) to leverage its market power. However, Chinese reluctance to negotiate anything other than economic matters, led to an eventual separation of the economic and political negotiations, regardless of which both are currently more or less stalled.

Whilst the economic aspect of the Dialogue is the area both parties are most interested in, and have been institutionalized along the lines started in April 2008: *High Level Economic and Trade Dialogue Mechanism*, it remains difficult, especially in view of recent escalation of protectionist measures.²⁸ Recent difficulties notwithstanding, through this Dialogue, and the more technical (and depoliticized ones) on customs procedures, nontariff barriers, and so on, there has been an emphasis on the importance of collaboration between the EU and China on customs matters for the treatment of goods moving between the two blocks which have the same accessibility. It is at this point that the EU is making a greater effort in terms of dialogue, especially as it affects the rights of intellectual property and the rapid growth of cases of counterfeiting and piracy of products from the EU market. It has highlighted the necessity of reaching a consensus on the harmonization of policies and regulations affecting such important issues as utility models and patents; ever more frequently, Chinese companies are making copies or slight modifications of European technology, giving rise to a number of complaints.²⁹ In this respect, through the High Level Economic Dialogue, the parties have expressed their desire to ‘create a favourable

²⁸ Interview European diplomat, Beijing, August 2012

²⁹ Beneyto, J.M., Soroza, A., Huratdo, I., Corti, J. ‘Political Dialogue in EU-China Relations’ *Documento de Trabajo Serie Unión Europea*, No. 50/2011, CEU Instituto Universitario de Estudios Europeos, 2011, p. 27

environment to promote innovation and protection IPR to ensure favourable and regulatory conditions',³⁰ but Europeans remain dissatisfied with progress in this area.

Other aspects highlighted in the bilateral political and trade dialogue directly affect environmental and social regulations. For this reason, the EU wants China to ratify the main conventions of the International Labour Organization, especially Conventions 29, 87, 98 and 105, that refer to trade union rights and forced labour.³¹ Although this remains a complicated area as many of the EU's Asian partners view the EU's labour and environmental standards as nontariff barriers designed to limit their competitive advantages. Beneyto et al. argue that this practice of obtaining legitimate comparative advantages should also be followed by firms in Chinese territory, demanding the best practices of corporate social responsibility as in the home countries of these European investments, in order that European direct investment in China will lead to a stream of good labour practices and promote social dialogue between both partners.³² Foreign companies in China are required to comply with standards of health and safety, and work conditions, however, these investors complain that Chinese competitors are not bound by those rules, therefore enabling cost savings that are impossible for foreign companies, and limiting the potential for the extension of higher European standards.³³

³⁰ EU-China High Level Economic Dialogue, 3rd Meeting Declaration, 21.12.2010, MEMO/10/698

³¹ Beneyto, J.M., Soroza, A., Huratdo, I., Corti, J. 'Political Dialogue in EU-China Relations' *Documento de Trabajo Serie Unión Europea*, No. 50/2011, CEU Instituto Universitario de Estudios Europeos, 2011, p. 27

³² Ibid.

³³ Interview with European diplomat, Beijing, August 2012

Exporting out of the crisis

As already noted in section one, the economic and financial crisis that began in 2008, and has been particularly damaging to the USA and EU, has begun to redress the EU's trade deficit with China, but only very slightly. The main impact has been in creating an even greater awareness within Chinese policy-making elites of the need to promote internal consumption and lessen dependence on the European and American markets, a political and developmental aim that precedes the onset of the crisis, but has gathered strength since. China's restriction on the export of rare earth minerals, crucial for the production of alternative energy generators, has resulted in the EU asking the WTO to open a panel to investigate the matter on June 27, 2012. For the EU, who currently is the world leader in alternative energy technology, and has committed itself to increased usage (up to 20 percent of energy from renewable sources) through the 2020 by 2020 strategy, this presents a significant problem. From the Chinese perspective, itself now the largest producer of wind turbines, and in need to develop a 'cleaner development' model, this would be a way of encouraging more foreign investment in China to produce these goods, with the consequent technology transfer. This poses an interesting dilemma, as on the one hand over the past years European companies (and individuals) have been able to take advantage of lower priced photovoltaic equipment from China in their efforts to meet the EU's own renewable energy targets, whilst at the same time limiting the competitiveness of European producers. The European Commission's recent request to the WTO to open an investigation into possible Chinese subsidies in this field, reflects this complex situation, and has also engendered a more tense relationship with China in the last year.

Europe 2020 is an overarching EU strategy that covers all areas of economic development, from economic governance (including fiscal oversight and constraints), to macroeconomic policies, social and employment policies as well as to external economic relations.³⁴ It focuses on a transformation into a low-carbon economy based on sustainability, on a clean and high-tech industry, in which training and technical and innovative training are key economic drivers. It aims to improve employment in Europe through the creation of jobs in these target sectors. Trade Commissioner De Gucht's 2010 'Trade, Growth and World Affairs' trade strategy put forward the external dimension of this strategy.³⁵ The policy paper claims a direct linkage between more open trade and GDP growth in Europe, greater consumer choice and lower prices, and more employment in Europe.³⁶ Indeed, some of the key aims of Europe 2020 rely on exporting high-technology, a carbon economy and innovations abroad. In this sense trade policy is a crucial factor in achieving the 2020 aims, and the difficulties that have marred the EU's external trade policy in recent years become more poignant in this light.

The core trade policy aims pursued by De Gucht's strategy follow on from those highlighted in the previous Commissioner's (Peter Mandelson) 2006 'Global Europe' trade strategy. Here the emphasis is on competitiveness, market access and creating a 'level playing field' more European exports of goods, and more importantly services, which make up 70 percent of EU GDP. Since the 1990s the EU's trade policy has focused on achieving a 'deep trade agenda'

³⁴ The different policy areas covered by the strategy and related documentation can be found at: http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/eu-tools-for-growth-and-jobs/index_en.htm

³⁵ European Commission (2010) *Trade, Growth and World Affairs. Trade Policy as a Key Component of the EU's 2020 Strategy*, Brussels

³⁶ Ibid. p. 5

revolving around the international acceptance of the so-called Singapore issues.³⁷ These include intellectual property rights, liberalization of services and public procurement markets, establishment of more harmonized international competition policies and dismantling nontariff barriers. The EU and USA tried to gain acquiescence for these at the WTO and failed on numerous occasions. As the WTO Doha Development Round dithered, the USA opted to simultaneously engage in bilateral free trade agreements (FTAs) with other partners in order to slowly gain binding agreements on the Singapore issues.³⁸ Whilst the USA, and other actors, were pursuing their trade preferences through FTAs (including establishing regulatory standards or gaining mutual recognitions for these, certain types of IP protection, etc.), the EU continued to hope for a resolution to the Doha Round and a multilateral adoption of ‘deep trade’. When Peter Mandelson took over DG Trade in late 2004, he and his team, concerned with the rise in USA and other FTAs,³⁹ changed their focus to the WTO *and* FTAs, and established an explicit EU FTA policy and laid out the economic rationale behind FTAs:

The key economic criteria for new FTA partners should be market potential (economic size and growth) and the level of protection against EU export interests (tariffs and non-

³⁷ The ‘deep trade’ agenda is described well in Lamy, P., ‘Stepping Stones or Stumbling Blocs: The EU’s Approach Towards the Problem of Multilateralism versus Regionalism in Trade Policy’, *The World Economy*, Vol. 25, N° 10, 2002, pp. 1399-1413; Young, A. R. and Peterson, J., ‘The EU and the New Trade Politics’, *Journal of European Public Policy*, Vol.13, N° 6, 2006, pp. 795-814

³⁸ On the USA’s multi-pronged approach to ‘competitive liberalisation’ see Schott, J., ‘Free Trade Agreements and US Trade Policy: A Comparative Analysis of US Initiatives in Latin America, the Asia-Pacific Region, and the Middle East and North Africa’ *The International Trade Journal*, Vol. 20, N° 2, pp. 95-138, p. 98

³⁹ Much of the literature argues that fears of losses to others within an FTA arrangement encourages further FTAs. See inter alia Baldwin, R. ‘A Domino Theory of Regionalism’ Working paper 857, Centre for Economic Policy Research, London, 1993; Hallaert, J., ‘Proliferation of preferential trade agreements: Quantifying its welfare impact and preference erosion’ *Journal of World Trade*, Vol. 42, N° 5, 2008; Baldwin, R. and Venables, J. ‘Regional Economic Integration’ in *Handbook of International Economy*, Vol. 3, Elsevier, New York, 1995, pp. 1597-1644. Others also emphasise policy imitation and political balancing effects, see Solis, Mireya, Stallings, Barbara & Katada, Saori *Competitive Regionalism. FTA Diffusion in the Pacific Rim*, (Basingstoke, PalgraveMacmillan, 2009)

tariff barriers). We should also take account of our potential partners' negotiations with EU competitors, the likely impact of this on EU markets and economies...⁴⁰

The choice of immediate FTA partners reveals a balancing imperative, which is reiterated elsewhere in the policy: '[w]here our partners have signed FTAs with other countries that are competitors to the EU, we should seek full parity at least'.⁴¹ Relations with India, Russia, and of course, China, are also prioritised in this and subsequent policy papers, as the aim is to foster European competitiveness in services and high-tech by opening other markets (and it precisely these emerging economies that limit access to foreign enterprises). The 2010 Strategy reiterates the aim to complete the Doha Round in 2011,⁴² prioritises the continuation of competitiveness-driven FTA negotiations,⁴³ and continues to focus on achieving international liberalisation of public procurement and regulatory regimes.⁴⁴ Consistency with the 'deep trade' agenda, and pursuit of EU interests encompassed by it, has been reiterated by Commissioner De Gucht with respect to negotiations with Asia: 'We are not available to do shallow FTAs.'⁴⁵ The significance and stress that the EU attaches to 'deep trade' is precisely one of the components that has lengthened its FTA negotiations with Asian partners (Singapore, India, Vietnam, Malaysia) and which continues to hamper its economic relations with China. For whilst the EU wishes to secure public procurement possibilities in China, greater ease for service providers to offer their services in China, with the ability to invest in greater stakes of Chinese companies, or

⁴⁰ European Commission, *Global Europe. Competing in the World*, Brussels, 2006, p. 11

⁴¹ *Ibid.* p. 11

⁴² *Ibid.* p. 9

⁴³ *Ibid.* p. 10

⁴⁴ *Ibid.* p. 6

⁴⁵ K. De Gucht., 'Europe and Singapore: partners in trade, partners for growth', Speech delivered at Lee Kuan Yew School of Public Policy, Singapore, 3 March 2010

<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/58>

operate their own subsidiaries more freely, and to secure high levels of intellectual property protection (for European goods) and also for technological innovations, China's own strategy revolves around exploiting its own advantages by fostering technology transfers, and incentivating and supporting internal industrial development.

China's development policy

Increasingly affluent strata of Chinese society's penchant for luxury European consumer goods has meant that EU exports to China have been rising over the last decade. Food scares in China have also led to a greater demand for high quality foreign foodstuffs, and increasingly the Chinese are developing a taste for wine, much to the delight of European producers. However, as mentioned earlier, the EU's development strategy is based on technology and innovation, and high-technology exports and services, rather than these other products where Chinese demands remain strong. China *too* is aiming to further its own internal development along these lines, and the restriction on exports of rare earth minerals bears witness to that. Chinese authorities are well aware of the challenges their enormous and enormously diverse state faces. Growth rates continue strong, but have fallen from the pre-crisis levels, partly due to decreased demand for Chinese exports in the EU and USA. China wishes to reduce dependence on these markets by fostering internal consumption and the maturation of the Chinese internal market. Its rapid industrialization has brought with it negative environmental externalities, as well as rising social inequalities that the authorities are now keen to focus on. Plans to develop a lower carbon economy, towards which it is cooperating closely with the EU through the Strategic Partnership and joint development of carbon capture plants, lead it to engage in measures to encourage technology transfer and the manufacture of alternative energy devices within China, to the

chagrin of European producers. To secure future industrial independence, as well to guarantee jobs (and tackle social issues) Chinese authorities restrict foreign investment conditions, service provision and public procurement bids. Although Chinese authorities insist the failure to win contracts lies at the EU firms' door,⁴⁶ the EU is considering restricting access to its public procurement market to companies from emerging states (China, Brazil, Russia) where European companies encounter more obstacles to bidding.⁴⁷

China's own external economic policy, especially in terms of investments abroad (mostly in developing economies, and especially in the energy and extractive sectors) highlight the planned use of external economic policy to further the internal development of the Chinese economy.

Pragmatism has also been a core characteristic of China's FTA strategy, which has focused on economic goals of securing access to resources to further its own growth,⁴⁸ which builds upon the ever-closer intra-industry trade-and-investment linkages in East Asia that inform the economic logic of region-wide FTAs.⁴⁹ It is no coincidence that its key FTA partners, thus far, are its neighbouring states (ASEAN) which manufacture many of the component parts in the transnational manufacturing lines of East Asia. Given China's export-led economic growth strategy, it has also engaged in FTAs with partners further afield, such as Niger (2005), Chile (2006), New Zealand or Peru (2008), and negotiations are underway with Australia, Pakistan, the

⁴⁶ *EUObserver*, 'Failure to win contracts is EU companies' fault' 19.09.09 <http://euobserver.com/china/28658>

⁴⁷ *EUObserver*, 'EU to restrict public procurement market to foreign firms' 12.03.12 <http://euobserver.com/news/115658>

⁴⁸ Hai, W. & H. Li, 'China's FTA Policy and Practice' in Y. Kim & CJ Lee (eds.) *Northeast Asian Economic Integration. Prospects for a Northeast Asian FTA*. (KIEP, Seoul, 2003); Hufbauer, G., & Y. Wong, 'Prospects for Regional Free Trade in Asia' Peterson-Institute Working Paper Series No. 05-12, 2005; J. Yan, 'China's competitive FTA strategy: Realism on a Liberal Slide' in M. Solis, B. Stallings & S. Katada, (eds.) *Competitive Regionalism. FTA Diffusion in the Pacific Rim*, (Basingstoke, PalgraveMacmillan, 2009) pp. 216-235

⁴⁹ R. Sally, 'China's Trade Policy in Wider Asian Perspective' Paper prepared for the LSE/CCER conference, Beijing, 22/23 August 2005, p. 42; S. Tay, *Asia Alone: The Dangerous Post-Crisis Divide from America* (Singapore: John Wiley & Sons, 2010) p. 35

Southern Africa Customs Union, Norway, the Gulf Cooperation Council,⁵⁰ all of which are on the one hand markets for Chinese mass-produced manufactures and purveyors of raw materials necessary for the continued development of China's economy. From this perspective the economic rationale for such FTAs seems straightforward, as indeed market access and securing commodity imports are key economic objectives of China-driven FTAs.⁵¹ There were, of course, also political considerations, like in the case of ASEAN, reassuring neighbours of its 'peaceful rise',⁵² gaining market economy status, and support for its one China policy towards Taiwan (FTA with Costa Rica).⁵³

However, in the aftermath of the financial crisis that started in 2008, China's concerns over safeguarding its internal market from outside shocks has grown, and its ongoing negotiations have slowed down. The long duration of negotiations with Australia (a key supplier of raw materials to China) has actually soured relations between the two countries, and the comprehensiveness of the FTA New Zealand achieved with China is no longer on the cards for other partners. This is partly due to New Zealand's small economic size presenting no threat to China, but also to the fact that since financial crisis China has become more internally focused and less pleased about extra external binding limitations,⁵⁴ as for example some of the clauses

⁵⁰ MOFCOM http://fta.mofcom.gov.cn/english/fta_qianshu.shtml last accessed 19.03.2012

⁵¹ Zerui, Yan 'China's FTA Strategy' Paper presented at the APEC Study Center/PECC Trade Forum Conference "The Challenges of APEC: Trade, Security and Capacity Building" May 26-29, 2004 Valparaiso, Chile

⁵² S. Lijun, 'China-ASEAN Free Trade Area: Origins, Developments and Strategic Motivations' *ISEAS Working Paper: International & Security Issues*, Series No. 1, 2003; S. Breslin, 'Understanding China's Regional Rise: Interpretations, Identities and Implications' *International Affairs*, Vol. 85, No. 4, 2009, pp. 817-835

⁵³ Zeng, K. (2010) 'Multilateral versus Bilateral and Regional Trade Liberalisation: Explaining China's pursuit of Free Trade Agreements', *Journal of Contemporary China*, Vol. 19, No. 66, pp. 635-652

⁵⁴ From interviews with diplomats in Beijing, August 2012

that New Zealand achieved that allow for environmental and labour issues to be obstacles to trade. The consequences of this are particularly poignant to the EU, as its own strategy is contingent on achieving progress on precisely these issues, and the Singapore issues, at a time when China appears to be more reluctant on these matters.

Preliminary Conclusions

In view of the EU's core Europe 2020 and trade policy paradigms, and China's own contrasting development policy it seems likely that difficulties in the relationship will continue into the future. However, as one diplomat put it, within this relationship, 'a lot of people have made and are still making a lot of money', and as long as those opportunities exist the relationship will continue. In the aftermath of the crisis, one interesting phenomenon has been the reshaping of EU member states' interest in China. Southern countries that had previously pushed the European Commission to take a more protectionist stance, are now looking to China's market to diversify their dependence on their European partners. As China's development drives its exports higher up the value chain and into high-technology exports, Northern member states are demanding more protectionist stances from the European Commission. These internal divisions (and the ones of the eurocrisis) have weakened the EU leveraging position with respect to China, and China (and other partners) can also take advantage as some EU member states will lobby the European Commission for a more open policy. The EU-China economic relationship will continue to be crucial to both partners, but will likely experience changes in the future.

The problem with exporting your way of crisis assumes steady demand for your goods abroad, as everyone tries to do this the demand side of the market will dry up. Furthermore, the exponential

growth created by free trade has been questioned (not to mention that a ‘free trade’ system hasn’t really existed). Current FTAs, which are key parts of states’ (especially the EU’s) plans for diversification of economic relations and access to service and public procurement markets are not projected to produce significantly large economic welfare results, although they do gain acceptance of preferred rules (IPR, public procurement), and forge closer relationships, which gain greater economic significance in the future.⁵⁵

Given EU-China disagreements in their relationship on definitions, trade ambitions and rules, it is unlikely that they can cooperate to co-create FTA templates and WTO rules. Even where cooperation appears to be more forthcoming (low carbon economy) China has voiced its opposition to French suggestions of a carbon-border tax and carbon taxes on flights to and from Europe have also been the focus of tensions. Notwithstanding this, within the Strategic Partnership, cooperation on the environment and peacekeeping is increasing, and the institutionalization of dialogues in itself is a success. China and the EU, do share a host of common interests globally (multipolarity, peacekeeping, low carbon economy, securing trade lanes, antiterrorism, development), and whilst complicated their maturing relationship increasingly bears resemblance with the EU-USA partnership, where trade and political tensions are frequent.

⁵⁵ A clear example of this would be the EU-India FTA, however negotiations are not progressing well and India has been very cautious in negotiating services, public procurement and other key interests for the EU.