



The EU-China partnership: 10 years on

by Nicola Casarini

The year 2003 was one of many events for the European Union – both internal and external. Among them was the beginning of a more structured relationship with Beijing.

A flying start

The establishment of the EU-China ‘strategic partnership’ on 30 October 2003 came at a time of converging priorities between the two actors. It also coincided with one of the worst crises in transatlantic relations, mainly due to disagreements over the US-led war in Iraq and the foreign policy stance of the first Bush administration. As a result of the partnership, the then EU-15 and China adopted three initiatives which caught the attention of US policymakers.

First, the declaration inaugurating the strategic partnership included an agreement on the joint development of Galileo, the EU-led global navigation satellite system and a potential alternative to the hitherto dominant US Global Positioning System (GPS). At the time, the proposed amount of money to be invested and the number of projects to be launched would make China the most important non-EU partner in the project.

Second, the same EU member states that were keen on China’s participation in the Galileo project also proposed to initiate discussions on lifting the EU arms embargo imposed on China following the crackdown by the People’s Liberation Army (PLA) on students in Tiananmen Square in June 1989.

Apart from sending out a powerful political message, the repealing of the embargo would have made it easier for the two partners to develop space cooperation due to the dual-use nature of space technology, as well as the different interpretations that EU member states tend to give to it.

Third, as bilateral trade was booming, the People’s Bank of China (PBOC) made an informal commitment to further diversify its holdings of foreign currency reserves – away from the dollar and towards the euro.

Support for the European common currency and the Galileo satellite system in the context of the establishment of the EU-China strategic partnership can thus be seen as part of China’s traditional strategy of backing European integration in order to drive a wedge between the Western allies.



In the autumn of 2003, EU policymakers were genuinely convinced that such a broad policy of engagement would build trust between the two partners and encourage China to develop along Western lines. In the same vein, Beijing had high expectations of the EU, believing that a stronger and united Europe could work with China to establish a new multipolar world order and counter the 'hegemonic' status of the US. In years that followed, however, mutual disenchantment grew as a result of a series of disappointments on both sides.

Disenchantment (2003-2008)

Since 2003, the two partners have changed a lot – in particular with regard to their relative power, influence, and foreign policy preferences. One of the immediate consequences of the 2004 EU enlargement, which incorporated ten, marginally more 'Atlanticist' central and eastern European countries, was the Council Decision of summer 2005 to shelve the proposal to lift the EU arms embargo on China. As the proposal was strongly opposed by the US and its Asian allies, this move was well received in Washington but left Beijing disheartened, and Chinese leaders ceased to view the EU as a possible partner to counter American dominance. In order to move relations forward after the arms embargo impasse, the EU-25 and China subsequently established a Strategic Dialogue in December 2005.

The next round of EU enlargement occurred on 1 January 2007, with the entry of Romania and Bulgaria, and as the Union's size expanded, so did China's economy. Beijing's overall nominal GDP surpassed that of Germany in 2007, having overtaken Italy in 2000, France in 2002 and the United Kingdom in 2006. While Sino-European relations were growing in depth and width, however, serious misperceptions and differences on issues such as trade, technology transfers and human rights started to emerge. Europeans began to accuse Beijing of unfair trade practices, artificially maintaining a weak currency, and imposing political hurdles, while the Chinese criticised the EU for not granting Market Economy Status to Beijing in the WTO framework. To address these and other contentious issues, the EU-27 and China launched the High-Level Economic and Trade Dialogue (HED) in Beijing in April 2008.

In July 2008, another setback in relations occurred with the European Commission's decision to exclude Chinese contractors from the second phase of Galileo, a decision made following a Commission assessment alleging unfair competition, a lack of intellectual property rights enforcement and of reciprocity in public procurement by China. This then brought

to a halt what was possibly the most visible aspect of the 'strategic partnership' established in 2003.

Human rights concerns and the Tibetan question further marred the relationship. In March 2008, following the heavy-handed Chinese crackdown on riots which erupted in Lhasa, the President of the European Parliament, Hans-Gert Pöttering, called on EU leaders to consider boycotting the opening ceremony of the Beijing Olympic Games in August 2008 in protest against the continued violation of human rights and fundamental freedoms by the Chinese regime. Many major European leaders at the time (including Angela Merkel, Gordon Brown, Silvio Berlusconi and Donald Tusk) did not attend the opening ceremony. Both the Chinese government and the population at large perceived this as a disregard for the reform efforts undertaken by the country since the late 1970s. With the annual EU-China summit scheduled for November 2008 then postponed at the request of the Chinese, the Sino-European strategic partnership reached its lowest point.

Common interest (2009-2013)

The onset of the eurozone crisis, however, provided new impetus as well as new priorities for the bilateral partnership. In contrast to widespread scepticism *vis-à-vis* the euro (mainly stemming from Anglo-American banks and hedge funds), Chinese leaders have consistently been more optimistic, intervening on a number of occasions to reassure financial markets and European leaders that they would continue to buy eurozone bonds and support the common currency. This was and still is driven by the need to find new but safe investments for China's growing currency reserves, diversify risk away from the dollar, and sustain the economy of a region which had become Beijing's most important export market.

Chinese support for the euro is also motivated by political considerations with Chinese leaders having approached the eurozone's sovereign debt crisis through the lens of their longstanding desire for a stronger and more united EU that could work alongside Beijing to counterbalance American hegemony and, in this case, challenge the dominance of the dollar. In March 2009, at the height of the eurozone crisis, the PBOC governor explicitly called for the creation of a new international reserve currency while reiterating China's support for the euro. Since summer 2011, China has accelerated the diversification of its holdings of foreign reserves to such an extent that, today, euro-denominated assets represent around 30% of Beijing's total foreign currency reserves (which, at \$3.5 trillion, are the world's largest).



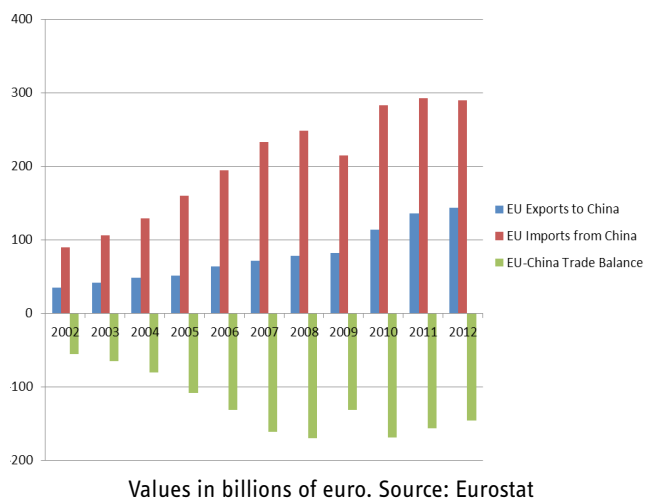
Far from being a one-sided process, some eurozone governments and EU institutions, in the face of mounting speculation, have courted and welcomed Chinese engagement, setting in motion an active monetary diplomacy. Since its establishment in May 2010, the European Financial Stability Facility (EFSF) – replaced in October 2012 by the European Stability Mechanism (ESM) – has actively sought Beijing’s support, obtaining concrete pledges for the purchase of Portuguese, Irish and Greek bailout bonds auctioned by the EFSF/ESM €440 billion rescue fund. Moreover, China has already showed an interest in investing in fully guaranteed and safe (i.e. AAA-rated) euro bonds – if and when they become a reality.

Although China’s intervention helped keep the eurozone afloat (a fact recognised by investors such as George Soros among others), its involvement has been rather selective. Beijing, has gradually reoriented its purchases of eurozone bonds away from the peripheral countries and towards the more secure core members, in particular Germany. Overall, however, China’s monetary activism has made the Sino-European strategic partnership stronger by identifying and pursuing a core common interest: the survival of the eurozone and its common currency.

2013: a mixed picture

Today, the two partners are highly interdependent. Between 2002 and 2012, total EU-China trade has risen from €125 billion to roughly €434 billion. However, such dramatic growth in EU-China commercial relations has also led to significant imbalances. The EU’s trade deficit with China for example, is the Union’s biggest bilateral deficit with any one country and over the same time period, has increased from €55 billion in 2002 to €146 billion.

Table 1 – EU-27 trade in goods with China (2002-2012)



Europe as a whole is losing competitiveness *vis-à-vis* China, as more and more Chinese products now directly compete with European ones. According to the Complementary Index for European and Chinese Exports, an economic indicator measuring relative competitiveness, the EU is now in direct competition with China on 35% of the 5,775 types of goods traded, compared to 15% in 2000. Yet, while some sectors suffer, others are growing, and the profits of European companies in China have risen steadily over the last decade, reaching around €16 billion in 2012.

The quantity and quality of two-way investment flows is also growing. China accounts for about 2-3% of overall European investments abroad, while Europe represents 5-6% of China’s outward foreign direct investment (FDI). Since the advent of the financial crisis, the eurozone has been experiencing a massive surge in outbound direct investment by Chinese firms – a trend that is likely to accelerate in the future, as the debt crisis provides big investors with lucrative opportunities. In March 2012, the Chinese government also injected \$30 billion into the China Investment Corporation (the Chinese sovereign wealth fund) to be used specifically for acquiring industrial and strategic assets in Europe.

EU-China *political* relations have been bolstered in recent years and now include interaction in the realms of foreign affairs, security matters and global challenges such as climate change and international economic governance. China’s growing role in the G-20 framework as well as inside the IMF (where Europe as a whole, by contrast, struggles to accept internal reforms that would help rebalance representation between the West and the ‘rest’) adds a further platform for dialogue within international fora. Meanwhile, the ‘strategic partnership’ launched in 2003 has also become highly institutionalised: alongside an annual EU-China summit and HED there is now an EU-China High-Level Strategic Dialogue. The issues that the partners discuss during their regular meetings are organised around ‘pillars’: political dialogues, economic and sectoral dialogues (of which there are now more than 80), and people-to-people dialogues.

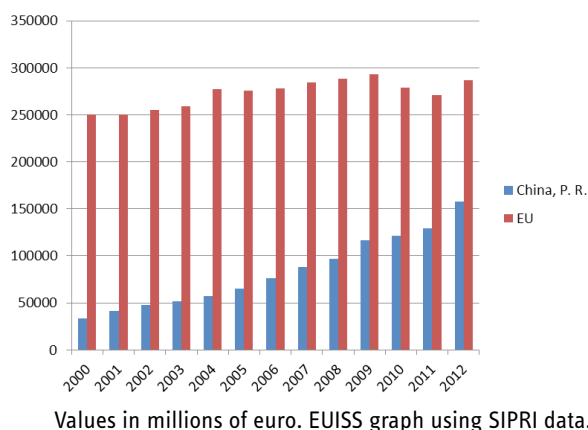
The next 10 years

Economic factors will continue to form the backbone of the EU-China relationship. A bilateral free trade agreement (FTA) could become reality in the next few years, leading to further economic growth and job creation. Yet it is in the domain of politico-

military affairs where there is the greatest potential to foster trust between the two sides. Although this dimension is still in its infancy, it nevertheless deserves serious consideration as a potentially defining element of the strategic partnership in the future, especially given the difference that such cooperation could make to global security.

It is true that the Union is still largely perceived as a mainly civilian power and doubts continue to exist regarding the capacity of the EU to become a fully-fledged player in politico-military affairs. And yet, according to SIPRI, the combined EU-27 defence expenditure for 2012 amounted to \$287 billion (1.7% of the EU's GDP), second only to the US. Although such aggregate figures do not tell the whole story (on either side), again according to SIPRI, China's defence budget for 2012 amounted to some \$158 billion – whereas the Chinese government claims it to be around \$106 billion – equivalent to 2% of GDP.

Table 2 – China and EU-27 defence spending (2002–2012)



If its member states so wished, the EU could engage China effectively on political and military affairs. Following the entry into force of the Lisbon Treaty and the establishment of the EEAS, a security dialogue with Beijing has been set in motion. Since 2011, HR/VP Catherine Ashton also meets regularly with the Chinese defence minister, while the head of the EU Military Committee engages in a parallel dialogue with his counterpart in the PLA.

The EU-China dialogue mirrors initiatives undertaken by some individual EU member states. France, the United Kingdom and Germany, for instance, have each set up a 'strategic dialogue' with Beijing, complemented by the training of Chinese military officers and reciprocal high-level visits. Sino-French and Sino-British cooperation also include port calls and joint naval search-and-rescue exercises.

The EU and China already work together in the areas of conflict prevention, crisis management and post-conflict stabilisation. EUNAVFOR Somalia off the coast of Somalia has already tested practical cooperation between the navies of some EU member states and China. Peacekeepers from the two sides operate under the UN flag in Lebanon as well as in other ongoing UN-EU operations (DRC, South Sudan, Mali).

Future cooperation could also include:

- (i) a structured dialogue mechanism between the EU Military Committee and the PLA, including the appointment of a defence and security advisor to the EU Delegation in Beijing;
- (ii) support for China's participation in CSDP missions, in particular those in African territories and seas;
- (iii) targeted joint military activities, including counter-piracy drills and humanitarian rescue exercises and operations.

There are currently no major contentious issues between China and the EU that could bring the two sides to a military confrontation. Unhindered by binding alliances in Asia, Europeans can engage Beijing in political and military affairs, while remaining loyal allies to the US and constructive partners to ASEAN. If the Union could manage to square this circle and advance cooperation with both its traditional American ally and a new Chinese partner, it would then have more opportunities (and leverage) to contribute to global security and play a constructive role (i.a. through mediation, dialogue and capacity-building) in reducing global as well as regional tensions, including between Washington and Beijing.

This would make the EU-China partnership truly 'strategic', preparing also the ground for a much-needed US-EU-China trilateral dialogue mechanism – and thereby cooperation – on the so-called 'global commons'.

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