

critical hardware components cannot be manipulated. Similar programs are active within Russia and China, and to some extent are even more wide-spread than in those active in the US. While the US program is not without its critics, the current need of the EU and most EU Member States to depend on commercial off-the-shelf components even for its most critical information systems puts it at direct risk to serious cyberattacks.

A major difference between cybercrime and cyberwarfare is the applicability of criminal legislation versus national security legislation. This is especially acute as there are scenarios in which one Member State is subject to a critical cyberattack via another ('third party' or 'transit') Member State. To support the Member State under attack, the 'transit' Member State might have to take measures that can result in collateral damage to its own civilian systems – for instance, by disrupting the availability of crucial ITC services to its own private companies. However, under criminal legislation, most Member States might find it legally difficult to inflict this 'collateral damage' on its own citizens. Under national security legislation, however, measures like these are more likely to be legally possible.

European integration is not only achieved via EU institutions, but also by a number of bilateral initiatives and cooperative agreements between EU Member States. These initiatives can contribute greatly to European cybersecurity. Foremost among them is the European Government CERT Group (EGCG). The group sets its own membership standards (only a few Member States currently meet the requirements) and is not subordinate to any EU institution. This independence is strength rather than a weakness, and EU institutions should resist the temptation to try to regulate successful independent ventures. Cooperation between such groups and EU institutions, on the other hand, is a different matter, and should be encouraged, where viable.

Partners and Rivals: The EU and China

Hannes Hanso

China's role in global affairs is becoming increasingly important. This article offers an analysis of EU-China relations, including political and economic challenges that this relationship faces. Diplomatic relations between the EU and China were established 36 years ago in 1975. Both China and the EU have undergone profound changes since then. After decades of contact, cooperation and challenges, a new level of relationship was reached in 2003 in the form of a 'Strategic Partnership'. Attempts to take the next logical step in developing EU-China relations – signing a PCA (Partnership and Cooperation Agreement) – have stalled. Needless to say, the EU and China share numerous common interests, but there are also areas of conflict of interest. China, a rising power, views Europe as an important economic partner, but it also uses the latter to counterbalance the dominance of the US, whom China perceives as a strategic rival in global affairs. While China is becoming more assertive, it finds Europe a more convenient and less threatening partner than the US. Europe has some tough choices ahead: on the one hand, economic cooperation allows the two sides to work together for material benefit, but differences in political regimes and value beliefs and calculation of relative gains give rise to problems in bilateral relations.¹ This ques-

¹ Jing Men, 'EU-China Relations: Problems and Promises,' Jean Monnet and Robert Schuman Paper Series, Vol. 8, No. 13, June 2008, <http://aei.pitt.edu/9060/1/MenEUchinaLong08edi.pdf>.

tion is particularly acute now as Europe is struggling with a financial crisis and its relative bargaining power vis-à-vis China is seriously weakened. Europe needs to learn how to deal with the new role that China is taking in the 21st century.

Why would China be interested in engaging with the EU on resolving the current financial crisis?

China has turned into a country that can offer solutions to global problems or has a key role in finding them. This tendency has been accentuated since the financial crisis, with Europe suffering and urgently needing resources to maintain its credibility at least at a minimum level. In contrast to Europe and the USA, the key to China's economic success lies in its uncanny ability to earn more than it spends. Today's China is the world economy's no. 1 creditor nation.

The EU's efforts to solicit money from China for crisis management highlight the extent to which the situation has changed. In December 2008, French President Nicolas Sarkozy, who also held the EU Presidency at the time, met in Gdansk with the Dalai Lama. Without further ado, China postponed a planned EU-Chinese summit for an extended period of time and practically froze all high-level contacts with France. Since then, their relations have gradually improved, but this has only happened on China's terms. Today we live in a world where China is perceived as part of the solution to the financial crisis. It was none other than his Chinese colleague, Hu Jintao, to whom President Sarkozy rushed to call after the eurozone crisis summit on October 27, so that they could discuss this topic among others. In the last days of October, Klaus Regling, the head of the European Financial Stability Fund (EFSF), visited Beijing to promote EFSF bonds in China. In Regling's words, participation in the EFSF is simply a profitable investment opportunity for the Chinese and nothing more. The Europeans hope to raise 100 billion euros for the eurozone bailout

fund from China's foreign currency reserves. China has been very careful to date in making such financial commitments, preferring instead to emphasise the need for a European financial reform.

From China's perspective, there could be several compelling reasons for participation in Europe's financial schemes or investing in European companies. First, China holds the world's greatest foreign currency reserves, currently valued at approximately 3.2 trillion dollars in total with an accumulation rate of about 1.3 billion dollars daily. China simply has to invest its assets productively and to generate extra income from them. In the past, China has made several attempts at acquiring major strategic US companies or stakes therein. Chinalco's desire to invest in Rio Tinto, CNOOC's offer to buy Unocal or HUAWEI's proposed purchases of US telecom companies – all such attempts have always ended in disappointment for the Chinese. However, Europe does not view Chinese investments with the same level of suspicion as the US.

Second, the country makes efforts to gradually decrease the share of US bonds in its investment portfolio with the aim of not having all its eggs in one basket, but of reallocating them to several baskets. In recent years, China has regularly voiced strong criticism at bilateral summits with the USA, targeting its poor financial discipline and insecure investment environment. As of May 2011, China was the largest single holder of US government debt, with 26% of all foreign-held US Treasury securities (8% of total US public debt). China's holdings of government debt, as a percentage of all foreign-held government debt, have slightly decreased over the last year, but are up significantly since 2000 (when China held just 6% of all foreign-held US Treasury securities).² There have been times when China has held over 1 trillion dollars of US bonds. Now Beijing appears to think that this number

² http://en.wikipedia.org/wiki/United_States_public_debt.

is too high. China's stake in European debt is, however, at a much lower level. At the same time, constant pressure from the USA to revalue the yuan angers the Chinese.

Third, China's investments in the eurozone bailout fund will probably come with certain political strings attached. For years, the Chinese have tried to drive a wedge between the USA and the EU in order to secure the lifting of an arms embargo imposed on China in 1989 following the Tiananmen massacre. This has been a topic for discussion in the EU since late 2003. The Chinese have been quite close to achieving their objective at least once – Germany and France, two big EU member states, have sent positive signals to China. Under their leadership, the EU agreed that a new code of conduct regulating deliveries of European weapons to Beijing should be prepared to replace the arms embargo. The discussions between the leaders of the leading member states of the EU and China in 2004 seemed to lead to a sooner lifting. The European leaders gave an oral promise to the Chinese that this bilateral problem would probably be solved by June 2005.³ Back then, it took a decisive intervention by the USA to straighten things out.

Rather than being a bilateral issue, the arms embargo turned out to be an important concern for three parties. The EU faces a difficult situation due to pressure from the US and its commitment to the Chinese on the ban-lifting. Washington urged the EU to maintain the embargo and threatened to cut off American transfers of military technology to Europe. US Deputy Secretary of State Robert Zoellick warned EU officials that if ever “European equipment helped kill American men and women in conflict that would not be good for the [transatlantic] relationship.”⁴ Six years

³ This information was revealed by a Chinese diplomat, who said that due to the European promise, the Chinese leadership believed that the issue could be solved without much problem in the first half of 2005.

⁴ Sebastian Alison, ‘US Warns EU over Lifting China Arms Ban,’ *Reuters*, April 5, 2005.

ago, in April 2005, the European Parliament voted 431 to 85, with 31 abstentions, in favour of a resolution urging the EU to keep the weapons embargo.⁵ Today we are in a situation where China could, once again, try to find out how far the Europeans are willing to go on this issue. Major arms procurement and sales to a new cash-rich country such as China would probably delight many a nation with the necessary production capacity. Nevertheless, there seems to be a tacit agreement between the EU and China that this issue is not allowed to disturb bilateral relations.⁶

Fourth, despite years of focus on gaining official recognition to its full market economy status (MES) from the EU, China has failed to achieve it. Granting the MES for China by the EU has been an issue that China is increasingly vocal about. This topic has been included in the talking points of every major EU-China summit. It was mentioned most recently by Chinese Premier Wen Jiabao at the World Economic Forum in September 2011. The MES status would considerably increase the immunity of Chinese companies from Europe's accusations concerning limited market access, entry restrictions on the Chinese market and anti-dumping measures. The Chinese accuse Europe – and not without good reason – of double standards over the issue as the same status has been given to Russia and Ukraine where the state plays in both cases an equally large role in economic affairs. Anyhow, the EU is playing a losing battle over the issue. If the EU does not grant this status to China by 2016, then the WTO agreement to the same effect will come into force automatically. The fact remains, of course, that the role of the state in the economy in China is still much bigger than in the US or in Europe.

In addition, it would clearly be in China's interest to make Europe less vocal about the human rights situation

⁵ Jing Men, ‘EU-China Relations.’

⁶ *Ibid.*

in the country. When Klaus Regling, the head of the European Financial Stability Fund, had arrived in Beijing trying to raise billions of euros of Chinese bailout money for struggling European economies, human rights campaigners spoke out. They fear EU negotiators will cave in to Chinese demands to tone down criticism of the regime's human rights record.⁷

It is also clear that China is interested in isolating the Tibetan movement even further. European heads of state have been meeting the spiritual leader of the Tibetan movement, the Dalai Lama, quite regularly. This never fails to irritate China, often provoking a temporary backlash in relations such as cancellation of visits, planned events and government contracts. This approach has been partially successful with a number of countries now surrendering to Chinese demands to avoid contact with the Dalai Lama, at least at official level. China would like to see a 100% success rate in this process. Offering to bail out Europe might add an extra layer of influence over the issue.

Fifth, China must also consider the scenario that Europe, which is in recession, will not be able to buy Chinese goods in the same volumes as it has done in the past. Production for European markets affords employment to a sizeable proportion of the Chinese population, especially in the coastal industrial regions such as Shanghai, Guangdong and Fujian. If a drawn-out crisis in Europe leads to the shutdown of, or the reduction of workloads in, hundreds of factories in China, it will certainly not benefit the Chinese. A fall in the consumption levels in Europe and elsewhere, brought on by the 2008 financial crisis, left several millions of migrant workers unemployed in China – Beijing would definitely not like to see this scenario repeated. China does not have

⁷ Jason Groves, 'Silence on Human Rights... The Price Europe Must Pay for China's Billions,' *Daily Mail Online*, October 29, 2011, <http://www.dailymail.co.uk/news/article-2054929/EU-debt-deal-China-buys-Europes-silence-human-rights.html>.

a modern social security network to compensate for the loss of employment and income. These kinds of fears have been fuelled in recent months by statistics showing that the demand for Chinese goods has indeed declined. Maintaining the level of economic growth is thought to guarantee the preservation of domestic stability, often referred to as 'social harmony' in China. An annual economic growth rate above 8% has been mentioned repeatedly by the Chinese top leadership as the prerequisite for maintaining domestic stability. The legitimacy of the Chinese Communist Party, the dominant political power in China, has been built on its capacity to deliver economically. Europe as the second largest market for Chinese exports plays an important role in maintaining employment at a level acceptable to Beijing.

What are the possible implications of China's engagement in coming to Europe's rescue?

Debtors cannot protest too loudly

Leaving aside the financial implications of China's participation in rescuing Europe, it is clear that the continuation of financial difficulties in Europe and in the United States will leave the Chinese Communists holding all the ideological aces. As a result of frenzied over-borrowing, developed countries – which used to be patronising 'lecturers' of developing nations on politics and economics, but are now burdened with debts – have squandered a large share of their moral capital that previously gave them the edge over countries such as the People's Republic of China. At home, the Chinese Communist Party can look its people straight into the eye and say: "You see, comrades, we were right. Europe now stands begging at our door. Our social and economic model is superior to theirs." The latter political

argument will not only serve domestic purposes. China's development is followed closely – and with admiration – in many countries in Africa, Central Asia and South America. They will also learn their lesson and get guidance on how to proceed. Economic conditions and politics inevitably go hand in hand. A crisis in the Western world allows China to justify its non-democratic political system not only at home, but much farther too. This will further undermine the West's values-based approach. Despite its former weaknesses, China has managed to play its hand with remarkable sophistication and come up trumps. In the future, this process might constitute a key element in the emergence of a new international system, especially if Western nations will also 'Sinicise' their foreign relations, i.e. give up their values-based approach in dealing with non-Western states.

In defence of its political system, China's puts forward a two-fold counter-argument that is applicable to the non-Western world. First, China argues that economic improvement and the reduction of the poverty level of its citizens take priority over political liberalisation. Second, the Chinese ask why the Europeans insist on accepting cultural diversity while not accepting political diversity. China has always viewed human rights issues as an anti-China instrument or a tool for humiliating and pressuring China. Exactly the same could be applied to many other states outside Europe and North America. Europe does not include issues like the right to development, the right to stability and the right to peace in its human rights package. In the light of economic recession in Europe, China's arguments are gaining validity. Thirty Human Rights Dialogues between the European Union and China have been held so far. Attending those used to be a humiliation for the Chinese. In the future, the Chinese might start to like attending these events. EU countries have been feeling the consequences of China's new diplomacy at institutions like the UN, where it

has become much harder for the EU to muster coalitions on issues such as human rights.⁸ Strong statements by the EU towards China on sensitive issues are increasingly unlikely as China is successfully pursuing its strategy of placating Europe by putting economic interests above political ones.

What are the opportunities and challenges in the relationship between the EU and China?

China did not know for a very long time to whom to speak in Europe. Parallel diplomatic structures were developed, so that China's diplomatic representations were not cut down in size despite the new role the EU was supposed to play after the adoption of the Lisbon Treaty and the creation of the European External Action Service. Europe with its 27 member states finds it hard to formulate strong common positions towards China as the members have a wide range of differing interests in China. This applies to political issues, development cooperation and economic relations. The first comprehensive study of EU-China relations that was undertaken in 2009 identified four types of attitudes by EU member states towards China.⁹ These were Assertive Industrialists (the Czech Republic, Germany and Poland); Ideological Free-Traders (Denmark, the Netherlands, Sweden and the UK); Accommodating Mercantilists (Bulgaria, Cyprus, Finland, Greece, Hungary, Italy, Malta, Portugal, Romania, Slovakia, Slovenia and Spain) and European Followers (Austria, Belgium, Estonia, Ireland, Latvia, Lithuania and Luxembourg). The same study argues that the already modest leverage that EU member states have over China,

⁸ Bates Gill & Melissa Murphy, *China-Europe Relations: Implications and Policy Responses for the United States*, CSIS, May 2008, <http://csis.org/files/media/csis/pubs/080507-gill-chinaeuropereleations-web.pdf>.

⁹ John Fox & François Godement, 'A Power Audit of EU-China Relations,' 2009, http://ecfr.eu/page/-/documents/A_Power_Audit_of_EU_China_Relations.pdf.

collectively and individually, is weakened further by the disunity in their individual approaches. The result is an EU policy towards China that can be described as ‘unconditional engagement’: a policy that gives China access to all the economic and other benefits of cooperation with Europe while asking for little in return. Any attempt to strengthen the European position must start with an acknowledgment that no member state is big enough to sway China on its own.¹⁰ One can only agree with this analysis. Furthermore, there is an obvious competition going on between the national economic interests of each member state and any kind of common interest. It is clearly seen in the struggle between national economic and commercial representatives of larger European countries and the EU. The EU Chamber of Commerce competes for positions with the national representatives of France, Germany, Spain, Sweden, the UK, Denmark, Italy, Finland, the Benelux countries, etc. Some of the EU member states maintain Beijing embassies that are many times larger than the EU delegation. Smaller EU member states such as Estonia like to argue that the EU will further their interests in countries like China, but also in Asia overall. Regrettably, this is a rather naïve expectation. EU member states are first and foremost defending their own national interests, especially when it comes to economic cooperation even within EU structures.

The EU’s neglect of its foreign policy as the multipolar world continues to take shape means that, for now, as the euro crisis evolves, the Asian century (including in that the US) has arrived rather earlier than expected, with a much more rapid decline in European relevance or influence which will continue unless the EU changes course. The EU’s leaders and foreign ministers should be looking at the global context, and positioning the EU strategically. Yet there is no sign of Van Rompuy or Ashton or any of the EU’s foreign

¹⁰ *Ibid.*

ministers, or leaders, setting out the geopolitical challenge and developing a real, high-level strategy to address it.¹¹

Due to very different approaches to China by EU member states, the EU paradoxically – especially in the light of recent developments – continues to finance assistance programmes in China with hundreds of millions of euros. The current 7-year assistance package that the EU has committed to China is 224 million euros. The EU maintains a large development section in its Beijing delegation, including dozens of officials and contract agents tasked with managing the assistance programmes there. It is certainly questionable whether it is wise to continue the programmes in China, especially at a time of financial crisis. The debate over this issue could be started by the European Parliament if there is resistance to challenging the current approach from other parties. China is by no means an ordinary developing country, even though the Chinese leadership often continues to emphasise this at international gatherings.

EU-China trade deficit

Europe also runs a large trade deficit with China. The issue has never been as prominent in internal political debates in the EU as it is, and has been, in the US. There have been attempts to raise this question at the European Parliament where MEPs on the International Trade Committee organised a public hearing to assess the situation before drafting a report on how to avoid such global trade imbalances. The issue should not be underestimated as China has become a sizable market for many European exporters. In 2010, they exported goods and services worth some 113.1 billion euros to China. Complaints by European companies active in China include unfair trade practices, an artificially low yuan and political hurdles. The advocates for stronger European

¹¹ Kirsty Hughes, ‘European Politics and the Euro Crisis: Ten Failures,’ Friends of Europe Policy Paper, November 2011.

policy argue that the results speak for themselves. The EU allows China to throw many more obstacles in the way of European companies that want to enter the Chinese market than Chinese companies face in the EU – one reason why the EU's trade deficit with China has swollen to a staggering 169 billion euros (see Annex 1), even as the EU has replaced the US as China's largest trading partner.¹²

The reversal of roles as Chinese investors take a larger interest in investing in Europe

What the Chinese need from Europe is technology transfer in those areas where their own domestic capabilities are still weak, such as telecommunications, high-tech industry, IT, etc. China is also interested in real estate, logistics and shipping. This is evident from the EU-China trade structure. Europe mainly exports machinery and transport equipment (more than 60% of EU exports in 2010), chemicals and raw materials. Imports from China are mostly consumer goods, including office and telecommunication devices and clothing. While China's exports are impressive, it is still stuck with producing and exporting low-level value added export articles. This is becoming a major concern from the Chinese perspective. China is losing its advantage as a country of cheap labour with the raising expectations of its domestic work force.¹³ China's problem is that its companies are big, but they are not global innovators. When the Chinese buy European companies, they buy core technology, which can give them that missing know-how in the global market. Now that Europe is in need of finance, it is a suitable time for China's state-

owned and private businesses to cash in. The eurozone crisis means it is cheaper than ever for Chinese investors to purchase European companies. Traditionally, Chinese involvement in overseas infrastructure projects has been as a contractor only. Now, Chinese investors also see a need to invest in, develop and operate projects.¹⁴

Recent examples of high-profile Chinese investments in Europe include:

Italy – in October 2010, China announced 10 commercial investment agreements worth \$2.5 billion, covering – among others – the solar energy sector. China's Cosco is engaged in expanding the port of Naples to be used by Chinese companies exporting to Europe, and HNA (a logistics, transportation and tourism group from China) is in negotiations for the construction of a giant air terminal north of Rome for cargo arriving from China.

France – in November 2010, China and France signed commercial agreements of \$22.8 billion in total value. They included: French nuclear power industrial giant Areva will provide \$3.5 billion worth of uranium to the Chinese company CNGPC; China will buy 102 Airbus airplanes; and a joint effort to cooperate in cellular telecommunication worth \$1.5 billion.

Portugal – in November 2010, Portugal and China signed commercial agreements including a joint construction of optical fiber networks by Huawei and Portugal Telekom and a banking cooperation between Millennium and ICBC.

Ireland – Ireland's business community is working on obtaining approval for a \$61 million project to create a Chinese manufacturing hub in Athlone, in central Ireland. The attractions for Chinese investors in the Athlone project are numerous; a manufacturing centre operated inside the euro zone will bypass a range of tariffs and quotas levied by the EU on imported Chinese goods while benefit-

¹² Fox & Godement, 'A Power Audit of EU-China Relations.'

¹³ Some of the industries are already shifting out of China to countries like Vietnam, Cambodia and Thailand.

¹⁴ Lou Jiwei, 'China Can Help West Build Economic Growth,' *The Financial Times*, November 27, 2011, <http://www.ft.com/intl/cms/s/0/e3c5aac-18ed-11e1-92d8-00144feabdc0.html#axzz1gbr97LJK>.

ing from a developed infrastructure network and low corporate tax rates.¹⁵

Sweden – the car-maker Volvo and possibly also the troubled car-maker Saab.

Greece – last year the Chinese port operator Cosco bought a 35-year lease for two container terminals in debt-struck Greece.

The UK – on November 28, 2011, the China Investment Corporation (CIC) announced that it was keen to invest in UK infrastructure projects using the Public Private Partnership (PPP) format. A new UK north-south railway project has been mentioned in this context.¹⁶ According to The Heritage Foundation's China Global Investment Tracker, China's non-bond investments in Europe have reached around 35 billion dollars, compared to 28 billion invested in the US. Due to the crisis, many European countries are willing to overlook earlier hesitations about Chinese investments.¹⁷

The Financial Times has come up with a different figure, arguing that China's total non-financial direct investment in the EU, despite accelerating growth, is still only around 15 billion dollars. This amounts to a tiny 0.2 per cent of all overseas investment in the EU. According to an FT article on the matter, the total Chinese investment in hard assets in Europe in recent decades is equivalent to the average weekly increase of its foreign exchange reserves in the first half of 2011. The EU and Beijing are considering opening negotiations on an investment treaty that would make it easier for Chinese companies to invest in Europe and would help counter possible protectionist sentiment in Europe. Although European officials insist the continent is open to all foreign investment, Chinese officials complain that their

¹⁵ Nasos Mihalakas, 'China's Investments in Europe – To Save or Not to Save the Euro?' *Exchange*, No. 3, March 2011, <http://www.ibde.org/component/content/article/99-chinas-investments-in-europe-to-save-or-not-to-save-the-euro.html>.

¹⁶ Andrew Rettman, 'China Looking to Snap Up EU Factories, Railways,' *EUobserver*, November 28, 2011, <http://euobserver.com/19/114416>.

¹⁷ Nasos Mihalakas, 'China's Investments in Europe.'

companies are treated unfairly and regarded as a threat, while investors from the US are welcomed.¹⁸

Asking China for assistance is not the way out of crisis in Europe. Assistance, as ever, would come with strings attached and this would not be in the long-term interests of Europe. The required reforms, including painful spending cuts, must be acted out in Europe. Inviting Chinese investments is, however, a completely different matter. Provided that Chinese companies in Europe follow proper procedures and comply with local legislation, they should be allowed to operate here. Europe should, of course, insist on reciprocity in treatment for European companies in China.

A Free Trade Agreement between Europe and China – where is it?

Today, China and Europe are major pillars of the global economy. The two sides form the second-largest economic cooperation in the world with mutual trade in goods and services reaching 432 billion euros in 2010. The data for 2011 are not yet complete, but it may well be difficult to maintain the level of 2010. China's exports to the EU fell 9% in October 2011 versus a year ago (exports to the US fell 5%).¹⁹ A Europe-China Free Trade Agreement (FTA) would offer new stimulus in promoting trade.

China joined the WTO in 2001 and used the WTO membership preparations in the nineties to pursue challenging economic restructuring, often facing internal opposition to change. The country has used the first 10 years as a WTO member to increase trade and international economic integration, and to establish itself as a major international economy through trade and access to other members' markets.

¹⁸ Jamil Anderlini, 'Chinese Investment in Europe to Surge,' *The Financial Times*, October 26, 2011, <http://www.ft.com/intl/cms/s/0/44b70836-ffde-11e0-89ce-00144feabdc0.html#>.

¹⁹ 'China Warns of "Severe Challenges" to Exports to West,' *BBC News*, December 7, 2011, <http://www.bbc.co.uk/news/business-16065510>.

Some would argue that over the next 5–10 years China is projected to become the largest global economy. However, a number of problems regarding Chinese economic liberalisation and access to the Chinese market remain. European companies complain that they do not have a level playing field in China. As put forward by the EU Commissioner for Trade Karel De Gucht recently, Europe and China need more effective engagement on the following issues:

- **An open business climate:** There is a general feeling in Europe that economic openness in China is not improving. The recent annual report from the EU Chamber of Commerce in China seems to confirm that the business climate in China is getting worse, reflecting a severe imbalance in market access and significant behind-the-border issues.
- **Investments in China,** where key sectors remain closed or subject to ownership restrictions. This blocks significant economic gains on both sides from being realised. It erodes the platform for explorative talks on a possible investment agreement. It also plays into the hands of those in Europe who see Chinese investments as a threat. So far, we have kept this debate at bay by maintaining that Europe's open investment regime remains our strongest argument for others to grant us similar access.
- **Protection of Intellectual Property:** Significant infringements undermine not only European investments and technology transfer to China, but just as much China's ambitions to become an innovative economy.
- **Procurement:** We keep hearing complaints from European businesses that the Chinese procurement market is closed and lacks transparency and regularity. This has also spurred a debate in Europe to strengthen 'reciprocity' in our external economic relations.
- **Raw Materials:** Hopefully, the on-going WTO case

will contribute to undistorted access to raw materials in China. As a major importer of raw materials itself, China also has an interest in maintaining open and non-discriminatory global access to raw materials, including amongst others iron ore and cotton.

- **Subsidies and State Owned Enterprises:** These are issues which are rapidly rising in importance, and there are increasing calls in Europe to address them to restore more level playing field to our economic operators. To deal with this situation we need to engage in dialogue on these issues. More transparency on them would also be very helpful.²⁰

Dealing in part with the same issues, the Foreign Trade Association has put forward the following recommendations in its Position on EU-China Trade Relations:

Improvement of market access – The access of goods, services and investments to the Chinese market must be improved. This is why the EU should urge for a strict compliance with the relevant WTO rules. Apart from that, China should ensure the mutual recognition of testing results on the basis of well-established international standards, so that one-time testing of a product will be sufficient for the world market. Also on local and regional levels the consistent application of Chinese laws must be provided for in order to prevent them from being misused as subtle instruments for the limitation of an access to the market.

Protection of intellectual property rights – European companies are suffering sales losses in China, because copies of their products are being offered on the Chinese market. Moreover, both industry and trade have their images damaged due to the lower quality of the

²⁰ Karel De Gucht, 'Looking beyond the Crisis: Making the EU-China Trade Relations Work,' EU-China High Level Political Forum 2011, Brussels, November 8, 2011, <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/728&type=HTML>.

copied products. Action against product piracy must be facilitated and in any case the enforcement of claims for damages and default claims according to civil law must be ensured.

Liberalisation of the service sector – The proper functioning of the service sector is of growing importance for China. However, there are still many restrictions and burdensome requirements for foreign companies. Therefore, the EU should urge China to implement its WTO commitments to open the retail sector and wholesale services. Also the functioning of other service industries like insurance, banking and telecommunication must be secured as these sectors are important for commerce and industry.

Raising of awareness for WTO rules – The European Union should, as a matter of principle, raise the Chinese government's awareness for the possibility of dispute settlement on both WTO and bilateral levels. That way trade disputes could be settled without political or economic implications.

Support of certain branches of industry – The endeavours of certain branches of the European consumer goods industries to drive forward innovation, restructuring and an improved market access to China must be flanked by political support. The High Level Group on Textiles and Clothing established by the European Commission is an expedient example of such political support. Among other things it has worked out concrete recommendations for structural improvements in the textiles and clothing industries as well as in the field of research and development. This is not only benefiting the textiles industry but the whole sector, including the textile trade.

Development of an Asia strategy – The European Union should develop a strategic concept concerning its relations with Asian countries, covering not only China but also other Asian countries, in order to prevent too big a dependence on China as a supplier country. In doing so, the aspects of free trade should be given highest priority. As the case may be, bilateral free trade agreements could be concluded with certain Asian countries or regions.²¹

²¹ Foreign Trade Association, 'FTA Position on EU-China Trade Relations,' June 2006, http://www.fta-eu.org/doc/unp/opinion/en/eu_china_fta_position.pdf.

These issues are of serious concern with the sustainability of growing economic cooperation between the EU and China in question. European policy-makers must learn to be more insistent on protecting the interests of European businesses. This is particularly important as China has managed to sign FTAs with a number of partners such as Pakistan, New Zealand, Peru, Chile and ASEAN (Association of Southeast Asian Nations). The latter is a free trade area among ten Southeast Asian nations and the People's Republic of China. The FTA came into effect on January 1, 2010, and is today the largest FTA in the world in terms of population and the third largest in terms of nominal GDP.²² The EU has signed FTAs with South Korea and Singapore recently which, while being a step in the right direction, are not sufficient to satisfy the aspirations of European enterprises.

A Partnership and Cooperation Agreement between Europe and China

The EU's principal aim in starting talks on a Partnership and Cooperation Agreement (PCA) with China is to make national laws in China to comply with international laws, rules and regulations. This is probably the reason why, despite rhetoric to the contrary, little real progress has been made. Some of China's neighbours, Mongolia for example, managed to conclude PCA talks with the EU within a year or two. Tangible progress has been made with Vietnam over the same issue.

Negotiations on a PCA with China started in early 2007, after being agreed upon at the 2006 EU-China Summit in Helsinki. The PCA will cover the political as well as the economic dimensions of EU-China relations and involve an upgrade of the 1985 Trade and Economic Cooperation Agreement. Trade and investment will form an important part of the negotiated agreement through the inclusion of TBT [Technical Barriers to Trade], SPS [Sanitary and Phy-

²² http://en.wikipedia.org/wiki/ASEAN%E2%80%93China_Free_Trade_Area.

tosanitary Standards], investment, competition, IPR [Intellectual Property Rights], and public procurement, among other issues. On sustainable development, the EU advocates *inter alia* the inclusion of commitments and cooperation on key issues with appropriate references to ILO core labour standards and Multilateral Environmental Agreements, coupled with commonly agreed monitoring mechanisms. A PCA is not a preferential trade agreement, but rather an instrument designed to create a framework for further liberalisation of trade and investment – in addition to the political part of the agreement.²³

Political topics – the environment, China's growing engagement in Africa, EU-US discrepancies on China

Climate change

Climate change has been established as a key topic in the EU-China relationship, and the EU has attempted to help to transform China's domestic policy in this area. China now recognises the threat of climate change and has made reducing the carbon and energy intensity of its economy a priority.²⁴

However, China is pursuing its own line over the environmental issues as was clearly seen during the Copenhagen Climate Summit in late 2009. The summit failed to commit countries to deep cuts in carbon emissions at least partly because of Chinese resistance against strong US pressure to submit to a regime of international monitoring. China took a leadership role advocating the position that developed countries have to make bigger cuts or to pay for the tech-

²³ European Commission Position Paper, 'Commission Position Paper on the Trade Sustainability Impact Assessment of the Negotiations of a Partnership and Cooperation Agreement between the EU and China,' February 2009, http://trade.ec.europa.eu/doclib/docs/2009/february/tradoc_142373.pdf.

²⁴ Fox & Godement, 'A Power Audit of EU-China Relations.'

nologies to cut carbon emissions in developed countries. China effectively rallied influential developing states such as India, Brazil, South Africa and others to support its approach. As a result, the conference where the EU wanted to achieve commitments to a 50% carbon emissions cut by 2050 ended in failure. In the end, a draft agreement put forward by China – and backed by Brazil, India and African nations – commits the world to the broad ambition of preventing global temperatures from rising above 2°C, but it does not force any nation to make specific cuts. "For the Chinese, this was our sovereignty and our national interest," said Xie Zhenhua, head of China's delegation.²⁵

China's primary goal is to ensure that the EU's engagement on climate change supports rather than hinders its economic development. It wants member states to provide the investments and technologies it needs for its continued development, and it wants EU funding to help those Chinese regions that will be hardest hit by climate change. The challenge now is for both the EU and China to combine the transition to low-carbon economies with measures designed to protect growth in the face of the global economic crisis.²⁶

China in Africa, the Middle East and Central Asia

The EU is, and should be, concerned about China's value-free approach to Africa, the Middle East and Central Asia. China's behaviour may fatally undermine Europe's attempts to achieve reforms and transparency in its partner countries as China makes deals with these states with no conditions attached. China's reluctance to support democratic processes and leadership transition in the Middle East is obvious. If anything, China seems to fear the fall of authoritar-

²⁵ Jonathan Watts, John Vidal, Robin McKie & Toby Helm., 'China Blamed as Anger Mounts over Climate Deal,' *The Observer*, December 20, 2009, <http://www.guardian.co.uk/environment/2009/dec/20/china-blamed-copenhagen-climate-failure?intcmp=239>.

²⁶ Fox & Godement, 'A Power Audit of EU-China Relations.'

ian regimes as an example to its own population. A similar attitude is apparent in China's policy towards Central Asian regimes. China is willing to barter natural resources for financial support that allows non-democratic regimes to maintain power.

While Europe has remained the primary foreign presence across most of the African continent, its influence is decreasing relative to China's. Chinese trade with Africa is expanding at about 33% a year against 6% for the EU. China sees Africa as a supplier of minerals and energy, and as a growing consumer goods market. China is increasingly effective in coupling its economic influence with its political aims that are not consistent with Europe's. China works hard to secure support in international organisations such as the UN from African countries on its so-called core interests, i.e. Taiwan, Tibet and human rights issues. China opposes EU efforts to halt human rights abuses in Africa as part of its policy of non-interference in the internal affairs of other countries.²⁷

China expects the same principle to be followed by other states regarding China's own human rights problems. China's growing influence undermines Europe's approach. Data from 2010 demonstrate how China's engagement on the African continent has overtaken even that of the World Bank.

Lending to Africa in 2010: World Bank versus China's Export Import Bank*

- Cameroon: WB \$30m; China \$743m
- Republic of Congo: WB \$25.5m; China \$75.8m
- Ghana: WB \$313m; China \$9.87bn
- Nigeria: WB \$890m; China \$900m
- Zambia: WB \$95m; China \$315m²⁸

²⁷ *Ibid.*

²⁸ Steven Duke, 'China's Global Reach: Lending More than the World Bank,' *BBC World Service*, December 9, 2011, <http://www.bbc.co.uk/news/business-16092634> (*data for Exim Bank are for specific reported loans; total amount of Chinese lending likely to be significantly higher).

The US position in the EU-US-China triangle

Over time, the China question could emerge as an area of potential transatlantic disagreement. European perspectives might occasionally be very different from those of the US. There is basically no security dimension in EU-China relations. Europe has no strategic military commitments or alliances in the Asia Pacific, and it seems highly unlikely China would threaten the remaining small territorial outposts in the possession of European powers in the Asia Pacific.²⁹ Differences could be foreseen in areas concerning China, such as the arms embargo issue, its weapons trade, its currency manipulations, its support for authoritarian regimes, climate change, but also on broader concerns of global order, multipolarity, balancing US power, and economic competition.³⁰

China wants Europe to counterbalance American power. Europe is a softer partner than the US, as a prominent Chinese academic, Pan Wei, has put it: "The EU is weak, politically divided and militarily non-influential. Economically, it's a giant, but we no longer fear it because we know that the EU needs China more than China needs the EU."³¹ Europeans are wealthy but weak. They should be wooed for economic reasons, but ignored for strategic ones. Beijing treats the relationship like a game of chess 'with 27 opponents crowding the other side of the board and squabbling about which piece to move.'³²

Divisions over awarding support to the policies of the US have been visible before. For example, a number of EU member states have refused to take part in US-led operations in Iraq. Their approach of cautiousness is closer to that of China than the US. Many EU members prefer to take

²⁹ Gill & Murphy, *China-Europe Relations*.

³⁰ *Ibid.*

³¹ Fox & Godement, 'A Power Audit of EU-China Relations.'

³² Pramit Pal Chaudhuri, 'Against a Great Wall,' *Hindustan Times*, May 19, 2010, <http://www.hindustantimes.com/StoryPage/Print/545877.aspx>.

a pro-Palestinian position in the Middle East peace process. These are just a few examples of the differences.

There are signs that US attention has lately been shifting towards the Asia-Pacific region. US President Obama recently went to Australia where he promised to station troops in Northern Australia. US Defence Secretary Leon Panetta has recently issued statements about reorienting defence spending to deal with Pacific security while decreasing the overall defence budget. This will be a direct reaction to the Chinese aspiration to a more assertive approach to maritime boundary issues in the Asia-Pacific region, particularly in the seas east of Chinese mainland (conflict with Japan) and in the South China Sea (disputes with Vietnam, the Philippines, Brunei, Taiwan and Malaysia). The Chinese were more than just concerned this fall when they heard US Secretary of State Hillary Clinton say that the South China Sea issue was then viewed in Washington as part of US national interest.

The present situation in East Asia is in many ways a direct remnant of the Cold War. Current alliances between the US and Japan, the US and South Korea and the US and Taiwan all originate from that time. What we see today is a decline in US economic presence in the region. However, despite the decline in economic activity, its military presence in the region is on the rise. The rising regional dominance of China has started to concern many of China's South-east Asian neighbours. These concerns have forced them to start gravitating towards the US in order to counterbalance China's interests. So far, Europe has not been drawn into this game of playing for influence in the region. One could expect, however, that Europe will have to start taking positions on these issues at some point in the future.³³

³³ On October 25, 2011, the High Representative of the Union for Foreign Affairs and Security Policy Catherine Ashton met with China's Defence Minister Liang Guanglie to discuss how to enhance cooperation on defence and crisis response, in particular the fight against piracy and plans to establish a more regular dialogue between senior officials. Regional security issues, including the situation in the South

In addition to possible economic consequences, there are also security implications, which Europe has to take into account. As the Euro-Atlantic security partnership ceases to be a key area of interest for the US, Europe will have to fill the vacuum. Given the current crisis and the reluctance to increase defence spending in most EU countries, we might see an overall decline in the focus on security issues. Inevitably, sides will have to be taken if the conflict in the Asia-Pacific region intensifies.

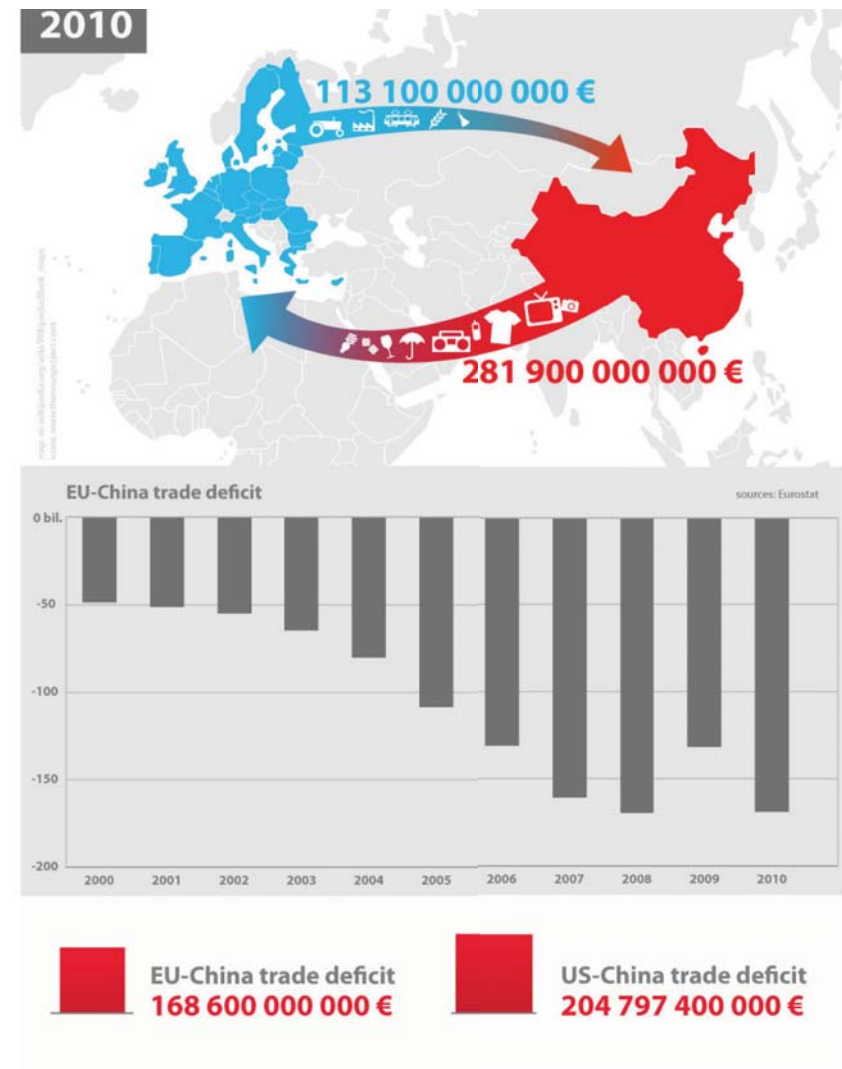
Conclusions

There is no doubt that economic partnership between the EU and China will continue to grow in the coming decades. The strength of this relationship will be tested by China's rapidly changing role and increased assertiveness in global affairs. This has already led to a number of disagreements over economic issues, investment climate, the environment, China's policy regarding developing countries, etc. However, this does not necessarily mean that the broader agreement on cooperation is weakening, i.e. the more issues are on the table, the more chances there are for disagreement. In a way, the number of problems may instead reflect their growing closeness and increased contact. Still, it is more difficult to see political closeness between the EU and China. China will soon enter the era of the fifth generation of leadership. There is now a fast emerging middle class of some 300 million people in China. The period of a unified voice has come to an end. There are now clearly multiple voices emanating from the country. Will the relations between Europe and China change as a result? The EU has invested

China Sea, were also discussed at the meeting – this is a sign for things to come. Non-committing statements such as the one following this meeting – “We agreed that different territorial claims should be dealt with through diplomatic channels” – sound rather placid.

heavily – politically, financially, and rhetorically – in assisting China in a wide range of reforms.³⁴ A self-confident China may no longer be interested in lessons from Europe. The challenge from the European perspective will certainly be to regard China as a global power with the biggest economy on the planet. Europe may also have to face tough balancing acts ahead as the rivalry between the US and China appears set to grow. It is clear now that we live in an era of mutual dependency, with China as an integral part of the global system. This was eloquently expressed by the former EU Trade Commissioner Peter Mandelson: “There is only one thing more frightening than China’s exponential growth. It is that growth suddenly stalling or crashing. [...] If we really want to shape the twenty-first century, we have to shape it with, not against, China.”³⁵

Annex 1

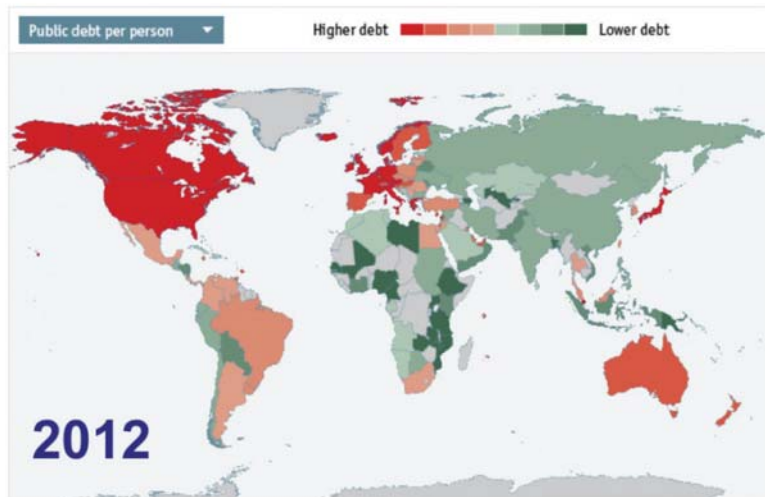


³⁴ David Shambaugh, ‘China-Europe Relations Get Complicated,’ Centre for Northeast Asian Policy Studies, May 2007, http://www.brookings.edu/opinions/2007/05china_shambaugh.aspx.

³⁵ Peter Mandelson, ‘Living with China,’ a speech at the China-Britain Business Council, April 15, 2008, http://trade.ec.europa.eu/doclib/docs/2008/april/tradoc_138549.pdf.

Annex 2

China In A World Of Debt (46 USD Tn)

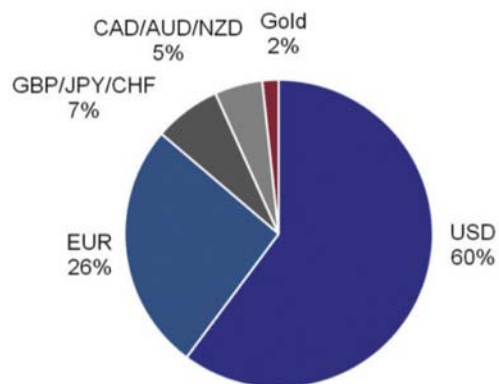


Source: Economist

A State Secret



China's Foreign Reserve Composition



Source: IMF, Woodsford

Changing realities in the EU's neighbourhoods

Elina Viilup

Introduction

Year 2011 has been far from boring, to say the least. The rollercoaster of events started with the outbreak of the Arab revolutions in January, continued with a nuclear catastrophe, floods, wars, more revolutions and then screeched to the halt with the sovereign debt crisis in the Euro zone. The latter is currently not only threatening the survival of the common currency but the very foundations of the European Union, making true the prophecies of some economists and die-hard federalists alike who predicted such a collapse, if the joint monetary policy is not backed up with common fiscal and economic policies. Although it is currently difficult to predict exactly what kind of perils the turmoil will entail both internally and on globally, it is clear that the consequences will be far-reaching and disastrous.

During 2011, the European Union has found itself split, unprepared and confused in the face of the popular uprisings and the collapse of some autocratic regimes in the Southern Mediterranean and on the Arab peninsula. Even more so as the Union has been in the midst of establishing its external relations machinery – a European External