Economic relations between China and the EU show promise but more should be done

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Since 2008, both China and the EU have each experienced their own set of economic problems. In this light, **John Farnell** *takes an in-depth look at how greater cooperation between the two might help to resolve their respective economic difficulties. He argues that the EU must work towards a more collaborative common economic strategy on China, and that China could do more to open up its domestic market to competition from Europe.*

After ten years of the EU-China Comprehensive Strategic Partnership, has it made any difference? Alas, the partnership has mainly delivered more meetings. In 2006 the two sides opened negotiations for a Partnership and Cooperation Agreement which are still on-going. But there are reasons to be optimistic, even though a more robust economic partnership would require a major change of approach by both sides. The political relationship between these two giant economies remains cool, while the economic one has been stress-tested by the post-2008 Eurozone crisis.

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Since 2008, China has continued to grow rapidly (nearly 8 per cent last year) despite the wobbly global recovery. During this time it became the world's number one exporter and second largest national economy, exercising global influence through its trade leverage and a growing capacity for foreign investment. But its formidable economic problems – a disappearing labour surplus, less price competitiveness, high pollution costs, bad bank loans and the need to improve state-funded social security – are worsening. Its main export markets remain volatile in the meantime. China only avoided a prolonged economic downturn in 2009 thanks to a massive public investment programme. This further distorted financial markets, increased local government debt, improved infrastructure rather than skills and delayed the growth of private domestic consumption, which everyone agrees must replace investment and exports as the driver of Chinese growth.

Meanwhile the malaise of the EU economy is well-documented. Steady but unspectacular economic growth pre-2008 has been replaced by widespread stagnation. Several Member States are suffering from a severe recession. Internal divisions over the management of the Eurozone banking and sovereign debt crisis and a four-year failure to regenerate economic growth have weakened the EU politically. Disagreement and disorder has undermined the push for closer integration following the 2010 Lisbon Treaty.

Yet despite these unpromising circumstances, the economic links between the EU and China have gone from strength to strength:

- Two-way trade, now standing at €450 billion (2012), has grown four times in the past decade and by 50 per cent since 2008.
- The EU remains China's biggest export market (17 per cent of its exports) and China is now the EU's second biggest (9 per cent).
- Two-way investment flows have increased in the past ten years (more than sevenfold in the China-EU direction) and are still growing.
- The two sides, each densely-populated and resource-poor, are starting to cooperate in areas where they face similar challenges, such as sustainable industrial production, climate change, energy and health.

There are still problems, of course. The EU is frustrated by the exclusion of foreign firms from China's services and government procurement markets, by restrictions on foreign investment and uncertainties about the rule of law. It is investigating alleged subsidies to major Chinese exporters. China, meanwhile, is pressing for looser visa restrictions, fairer treatment over EU trade defence measures and an end to the post-Tiananmen arms embargo. Nevertheless, economic interdependence has become a fact of life for both sides. The goal is to develop it, not limit it.

Where next?

What would do most to resolve each side's current economic difficulties? To begin, the EU and China need to live up to their commitment to open trade and investment. There also needs to be more cooperation in research and development in areas of common interest. Allowing more European competition and expertise into China's domestic market, particularly in the services sector, would boost its economic reform. Europe, too, would benefit from more direct investment from China and further efforts to open up the Chinese market. But such an economic deal faces political obstacles on both sides.

Economic reform in China, in the form of competition and the rule of law, means attacking important vested interests: the state-owned enterprises responsible for about 40 per cent of output, 82 million Party members and an army of bureaucrats at every level, many of whom benefit from corruption. They are likely to fight back. And mistrust of foreign influence in China's domestic economy tends to outweigh the advantages of importing the technology, know-how and skills which China needs.

The key problem on the EU side, apart from widespread mistrust of China as a partner, is the inability to agree on a common economic strategy towards China. The biggest Member States seem to prefer to compete rather than collaborate in this area, something China encourages. And issues such as common conditions for direct investment from China or the arms embargo are politically sensitive and divisive.

Making the next move

These problems are not going to be resolved quickly, and any signs of change seem to be coming from the Chinese side. At the recent National People's Congress the new Chinese leadership announced the need for radical economic change. There is at least declaratory commitment to reform. President Xi Jinping highlighted the fight against corruption as a political priority and Premier Li Keqiang said that China needed a bigger private sector. Tackling vested interests would be part of that process. Indeed, recent administrative decisions seem to confirm that China is taking steps to make the *remnimbi*convertible and it is opening up its stock markets. The pace of change remains uncertain but its direction is clear.

In the EU, though, signals of change are not yet visible. The recession may have strengthened the determination of bigger Member States to go their own way in relations with China, rather than agree and defend a common EU position.

This may seem preferable in the short term, but it could be risky. Cooperation at national level with China in the development of new technologies, for example, could affect future industrial competitiveness across the EU. If Member States avoid EU-level decisions about a common industrial strategy, the EU could be in trouble further down the road. Alas, the United Kingdom, already semi-detached, is likely to oppose any extension of the EU's role. It is probably not alone, especially as EU-China economic activity continues to grow under existing arrangements.

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About the author

John Farnell
John Farnell retired from the European Commission last year, where he had been Director responsible for international affairs in the Enterprise and Industry Directorate-General. He was the EU Visiting Fellow at St Antony's College, Oxford, in 2011-2012. He is currently working on a book on the politics of EU-China economic relations and is a Senior Advisor to the EU-Asia Centre, Brussels.