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After Brexit: Risks and Opportunities to EU-China Relations

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Abstract

As a result of the Brexit, China faces both enormous economic challenges and political uncertainties in future relations with its largest trading partner, the EU. But while the UK's vote to leave creates an unexpected dilemma for the Chinese leadership, whose EU policy focusses largely on gaining vast market access, it also presents a rare opportunity for China to harness its policy instruments and diversify its initiatives to pursue its economic goals with European partners. As a pre-condition to achieving the desired outcome, however, Beijing will need to untangle its foreign policy decision-making processes. Against this backdrop, the author will illuminate post-Brexit Sino-British relations and reflect on the possible impacts of Brexit upon future relations between Beijing and Brussels. A second section will analyse the very complex foreign policymaking mechanism in Beijing in terms of its economic policy goals with the EU.

Running Head: After Brexit

Key Words: European Union, Brexit, China, foreign policy, EU-China relations

Word count: 4502

Policy Implications

- In the process of developing their bilateral partnership, neither China nor the UK will use major infrastructure investments to reconcile the existing political and ideological divisions.
- The EU must enhance its understanding of the aspirations of the Chinese

government and the governing capacity of the Chinese Communist Party (CCP) in order to develop sustainable economic relations.

- It is crucial but impossible that the EU grant China 'market economy' status in order to signal political recognition of the CCP.
- China's current EU policy is expansive in scope and number of partnerships. As a result, some unexpected players have become involved in formulating foreign policy, which has produced less desirable outcomes in terms of China's long-term economic development goals and objectives.

The debate over Brexit has made history in international affairs. It is rare for China, Japan and the United States to agree with one another on issues of international politics. However, all three countries share the view that Britain's future is in the European Union. Notably, President Xi Jinping joined other major world leaders and openly voiced the preference that the UK remains in the EU. On 24th June 2016, the British vote to leave left the Chinese just as stunned as the rest of the world.

The Brexit poses a dilemma for Beijing and strikes a heavy blow to the tumbled Chinese economy. This move by its newly acquired 'best partner in the West' (BBC 2015b) also imminently challenges Beijing's foreign policy capability and calls into question President Xi's governing capacity as a steady leader (Yu, 2016b).

In an era when the Europeans seem incapable of resolving one severe crisis after another, Beijing will undoubtedly adjust its bilateral relations with the UK and reassess the value of its partnerships with other EU member states and Brussels. With respect to the emerging geo-political struggles in Asia, Europe remains disengaged. Nor has it shown any interest to get involved in the global power struggles between Beijing and Washington. Instead, China is seen almost exclusively in economic terms as an opportunity for European service-oriented economies and a threat to jobs in European manufacturing sectors. Thus, China's recent economic turbulences have served as a major source of conflict between Beijing and Brussels.

Despite the multiple ongoing crises in Europe, China's EU policy still focuses

on gaining access to the vast markets there in order to pursue its immediate economic activities. Beijing also continues to flex its economic muscles and apply the well-practiced ‘divide and rule’ strategy in its dealings with EU member states regardless of their sizes. In particular, Beijing puts strong emphasis on courting Central and Eastern European countries with its ‘16+1’ cooperation framework, which has shown significant potential for generating a strong pro-China lobby within the EU.

However, the European political elites must be aware that Beijing has devised several tactics to attain its economic diplomacy goals, which have also become more complex as a result of China’s ongoing and much-needed efforts to transform the domestic economy. In particular, the ambitious ‘Belt and Road’ initiative¹ under the aegis of President Xi Jinping is confusing and creates ambiguities rather than incentives for EU member states to engage in further collaborations. For instance, with a view towards revamping its EU policy agenda, Beijing has intertwined this initiative with domestic players, who, however, are little known to the European policymakers. This type of change in bureaucratic management will only exacerbate the already tenuous EU-China relations.

Post Brexit UK-China relations: crisis and opportunities

The British vote to exit has indeed diminished Beijing’s hopes to have the UK as a strong China advocate in the debate on ‘market economy’ status (EP, 2016). For the same reason, the UK has also lost some of its attractiveness as a ‘gateway’ for Chinese investors to enter the European market and reach its population of over 500 million consumers (Yu, 2016a).

From the perspective of the ancient Chinese philosophical approach, a crisis (*wei*) is synonymous with an opportunity (*ji*), as reflected in the Chinese term for crisis (*weiji*). Accordingly, a pending Brexit will likely provide Beijing with other windows of opportunity to adjust its plans for an economic partnership with London and reflect more fundamentally on its foreign policy practices. The stakeholders should not rely

on 'Hinkley Point C' and its outcome as the sole benchmark to measure the success and maturity of post-Brexit UK-China relations (UK Gov, 2016b).

1) The Hinkley Point C deal

The delayed approval of the Hinkley Point C nuclear project is an immediate consequence of changes in the British government after the Brexit referendum. However, for Chinese decision-makers, who see it as 'a test of mutual trust' in the so-called 'Golden Era' of Sino-Britain relations (BBC, 2015b; Liu, 2016), the project overhaul came unexpectedly and generated confusion.

While an initial frustration is understandable, Beijing should not overreact. Hinkley Point C is a unique and intricate project that will demonstrate new ways of collaboration among stakeholders in three national governments, the industry sectors, trade unions and civil society. Due to its commercial and political complexity and for plenty of reasons that have little to do with China, the project remains the subject of heated debates. For domestic considerations alone, May's government was justified in seeking a comprehensive review and adding 'extra strings' for future infrastructure projects on UK soil (UK Gov, 2016a). Beyond that, the deal also involves delicate diplomatic relations between the UK and France. Therefore, the new Prime Minister has a difficult task to strike the right balance on the Hinkley deal against the background of France's position on the upcoming Brexit negotiation.

2) Chinese investments in a post-Brexit UK

The wish to forge stronger economic and trade ties with non-EU member states was a key argument on the agenda of those who voted to leave the EU. Post Brexit, a robust commercial relationship with China is indispensable. Further engaging with China economically should therefore feature on the very top of the new government's 'to do' list. In return, Beijing should seize the opportunity to negotiate an advantageous bilateral trade agreement with London to take effect once the Brexit is completed.

The service-oriented economy of the UK will not pose a great challenge for the Chinese manufacturing sector. In contrast, the complementarities of the bilateral trade ties are positive enough for the two sides to reach a new trade agreement when the conditions are right. However, the UK's successful Brexit negotiation with Brussels is a prerequisite for the success of a bilateral free trade agreement.

Another post-Brexit opportunity for China and Chinese companies is to learn how to deal with political risks associated with dramatic shifts in democratic governments in a mature free market environment. Mitigating non-market related risks is *de rigueur* for their business strategy planning, if they want to fulfil their ambitions to become leading players in world economic affairs.

The close association and somewhat submissive relationship of Chinese companies with the Chinese government has largely impeded their overseas business plans. In particular, the Chinese state-owned enterprises (SOEs), such as China General Nuclear Group (CGN), China National Offshore Oil Company (CNOOC) and China International Investment Corps (CIC), have long favoured investments in major infrastructure projects in the UK and worldwide. Their close links with the state are a double-edged sword for most Chinese firms, providing support for overseas expansion but also hindering growth and profit making in foreign markets, where their direct links with Beijing have often provoked suspicions and hostility.

Chinese SOEs often lack a transparent corporate governance framework and have little experience in explaining the purpose of their investments to the British public and policy elites. Unlike Western multinational companies, their non-state shareholders play only a small role in determining their corporate strategies and overseas investments plans. Instead, some party secretaries of the SOEs possess final decision-making power with regard to corporate strategies. Given their direct ties to the government, it is difficult to judge whether the overseas investments plans of Chinese SOEs are politically motivated or based purely on their commercial merit.

In the mind-set of both the Chinese government and investors regardless their ownerships, investing in the UK will ultimately increase their exposure to mature

market economies, allowing them to learn sophisticated management skills and create long-lasting brand value for their products. These intangible assets are abundant in the UK but relatively scarce in China. This is one of the key reasons why the CGN and many other Chinese SOEs are enthusiastic to participate in infrastructure projects in the UK as a stepping stone to successful global entry into developed economies. In addition, those companies that take the opportunities to invest in the UK and elsewhere globally will reap the benefits of a competitive advantage over other Chinese firms both in the domestic market and abroad.

From the UK's perspective, attracting investments from China is a good way to create more employment opportunities at home. In the aftermath of Brexit, the British may therefore increase the pressure on the Chinese to fulfil this particular prerequisite. If they then do not deliver as promised, they may feel more backlash and hostility from both the British political elite and citizenry alike.

3) Post-Brexit: resetting UK-China relations

On the foreign policy front, the UK's pending exit from the EU is also an opportunity for Beijing to re-assess its own foreign economic policy. Without a doubt, China has flexed its muscles to pursue economic statecraft to attain its global political ambitions as well as to invigorate its domestic economy. However, this statecraft will probably require an update after the Brexit and other associated events. Chinese policymakers must be aware that simply shopping around the UK with grand infrastructure projects will not automatically generate sufficient financial returns on investments or accumulating stronger political capital for crafting its desired global leadership.

From an economical perspective, Beijing needs to calculate carefully the attainable commercial profitability of the planned infrastructure projects and analyse the real costs and benefits on an individual basis. Contrary to conventional wisdom, the State-owned banks can offer cheap credit to its SOEs. Financing the already committed GBP 6bn (USD 9bn) by CGN to the Hinkley project is a daunting task by

itself which involves careful financial due diligence and planning by China's state-owned banks and investors (Reuter, 2015).

On a related political front, both China and the UK are very different in their political systems and institutional establishments. Each has different interest groups advocating their preferences in the negotiation process of bilateral agreements between Beijing and London. It would not be constructive to use investments to conceal the key differences of each side over normative issues such as human rights and the rule of law. Nor can relying upon infrastructure investments alone eliminate existing historical prejudices against one other.

Instead, what is required is that both China and the UK offer clearer policy objectives, better articulate diplomatic efforts, achieve bureaucratic transparency and explain what kind of partnership they wish to forge in the aftermath of the Brexit referendum. Other areas such as international financial reform, with the UK being a founding member of China-led Asia Infrastructure Investment Bank (AIIB), climate change and innovation, are crucial for future fruitful collaboration, as it became evident during the recent G20 Summit in Hangzhou (G20,2016; UK Gov, 2015).

Post Brexit EU-China relations: old divisions and new challenges

Beijing's policy objective *vis-à-vis* the EU is representative of the fundamental characteristics of Chinese foreign policy. China is a country with 'dual identities', combining a developing country reality with the power ambitions of a great global power. Therefore, this particular identity has created 'issue-oriented national interests, which can easily conflict with the type of value-based relationship most preferred by the EU' (Zhang, 2009:123). These dual identities have influenced Beijing's foreign policy, which focus on satisfying immediate economic needs rather than attaining long-term strategic goals. Despite the UK's vote to exit, China's issue-oriented foreign policy agenda will remain unchanged when it engages in the future with an independent UK and the EU.

China and the EU differ fundamentally in their manner of organising international

affairs. The EU prefers that international politics be organised under a rule-based system, whereas China holds a Hobbesian view on power, which is all about absolute sovereignty, stability and control. It is therefore not surprising that Beijing's current EU policy has largely failed to overcome two of its biggest obstacles: obtaining market economy status (MES) and lifting the arms embargo. These two issues are as much about rules as well as about power. The strains show no sign of abating and illustrate that closer bilateral trade ties alone cannot achieve a political strategic partnership as both sides had originally hoped for.

Meanwhile, China's rising international profile and relentless pursuits in its economic statecraft have further complicated its policy towards the EU at both levels of policymaking and policy implementation. The Union's timid response toward Beijing's grand OBOR initiative indicates well this lack of mutual trust and Europe's insufficient understanding of Beijing's foreign affairs practices. Without reforms and a changed mind-set on both sides, such policy-related complexities will continue to hamper China's relations with Brussels and the individual EU member states.

1) Persistent economic tensions between the European Union and China

For many years, China's engagements with the EU have largely reflected its rapid economic growth as well as its rising international profile on global affairs. Decision makers in Beijing are very clear on what China wants from the EU: (1.) free access to the European Single Market; (2.) a secure home for its investments in particular a willing partner for China's fast-growing acquisition of overseas assets; and (3.) a meaningful diplomatic alternative to its increasingly fractious relationship with the US.

China and the EU have long been at odds with each other over trade and MES issues. In particular, the MES has remained a permanent obstacle to further EU-China 'Comprehensive Strategic Partnership' (MFA, 2014). A full market access to the EU is vital to sustaining the 'L' shape of China's economic growth, as indicated in

Beijing by the so-called ‘authoritative insiders’ at the People’s Daily (People’s Daily, 2016).

In Beijing’s view, granting China the MES is not only a statement of political recognition by the EU. More importantly, it would bring certain relief to China in dealing with its long-standing issue of excessive industrial capacity. In the end, China will have to pay a hefty price, both economically and politically, for failing to address its industrial overcapacity in time. Laying-off a large number of workers in non-performing industries will surely be a source of social discontent, which in turn, could destabilise the ruling elites of the Chinese Communist Party.

Yet, the EU still perceives China’s relentless economic pursuits with mixed feelings as a further source to undermine the already fragile European economy as well as deep suspicion over China’s broader strategic agenda beyond commercial calculations. The latest ‘anti-dumping case over Chinese steel imports’ opened by the EU Commission has exacerbated the lingering mistrust from both sides (EC, 2016).

2) The continued division over normative values between Beijing and Brussels

On the political front, part of the EU’s approach to engage with China has remained rooted in a democratisation and human rights paradigm, which both the Chinese political elites and the public view with great suspicions. The EU-China 2020 Strategy also stated, ‘China and the EU share positive and common values’ (EEAs, 2013). However, this ‘commonality’ was a cognitive mistake from both sides as Beijing believed that no fundamental conflicts with the EU is equivalent to sharing common values.

The most obvious example of continuing differences in values between Europe and China is evident in their perceptions to ‘multilateralism’. Multilateralism, for Europeans, is a defining principle of organising world politics and a core element of constructing the ‘normative power’ of the EU. Multilateral cooperation should solve most transnational problems and even some hard security issues. For China, in contrast, multilateralism is ‘a continuation of Realpolitik by other means’ (Holslag,

2011:295). In the view of political elites in Beijing, encouraging China's participation in the Western-led multilateral institutions was in fact a trap to contain the rise of China. Investing in the West could undermine China's ambition to reclaim its own great power status. Therefore, from the Chinese perspective, it is unwise to use multilateralism as a regular mechanism to combat global challenges. These differing perceptions of 'common values' has caused more frustrations than further enhancement of their relations on several occasions.

For example, in the policy domain of tackling global climate change, the fundamental division on multilateralism between Beijing and Brussels was the driving force that caused China to oppose the EU's stance on a global climate regime. Chinese officials prefer that climate change and carbon emissions problems should be resolved by individual countries according to their different situations, whereas the EU contends that environmental issues are transnational in nature and should be resolved via binding rules from international organisations.

Chinese foreign policymakers have a long tradition of equating 'multilateralism' with 'multi-polarity'.² According to their perspective, the world consists of different poles under US hegemony. China's role must therefore be to forge partnerships with other poles and challenge the Americans' supremacy. Given the EU's rising profile in international politics, Chinese foreign policy makers assumed 'establishing an alliance with the EU could undermine US dominance, and was a viable option' (Wu, 2004).

3) The power of the Chinese Communist Party and EU-China relations

Apart from their divergent views on multilateralism, China has been in dispute with the EU on other normative issues, such as China's human rights records and China's political reforms. This criticism was driven largely by several constant sources of Chinese foreign policy: the power of the Chinese Communist Party (CCP) and the safeguarding of territorial integrity and national sovereignty. These sources have profoundly shaped China's overall foreign policy and its international identity. Needless to say, the same sources have also profoundly influenced Beijing's EU

policy.

Surprisingly, the Europeans have largely overlooked the CCP's powerful role and seem to misunderstand its motivating force behind China's foreign policymaking. Any European complacency in seeking to facilitate China's domestic reform would only induce further disputes between Beijing and Brussels. Unlike the EU's neighbourhood policy, whereby democratisation processes through both economic and political reforms were seen as effective steps to re-integrate East European neighbours, such initiatives are seen in Beijing as posing a fundamental challenge to the CCP's legitimacy, which is based on absolute control of power, societal stability and governing capacity. In light of the above mentioned disputes between Beijing and Brussels, the EU needs to enhance its own understanding of the aspiration and governing capacity of the CCP and the Chinese government. The CCP has an omnipresent role in every aspect of policymaking in China and its ultimate aim is to retain its power.

The Europeans cannot afford to ignore the key interests of the CCP or to pretend that those conceptual differences on democracy and political freedoms do not exist. They should not remain idle under the false assumption that China will soon experience a sudden and unexpected political transition from an authoritarian regime to a democratically elected government.

4) Bureaucratic politics, Belt and Road Initiative and EU-China relations

Based on a conventional view from the West, China is a unitary and centralised power renowned for its long-term strategic planning and rational foreign policy agenda. Under the current Chinese government structure, this picture lost its validity. Almost all institutions in the central leadership and local governments are involved in foreign relations to different degrees, and it is almost impossible for these ministries and agencies to see China's national interests the same way or to speak with one voice. This failure to streamline confuses not only outsiders but also the Chinese people themselves.

The EU and its member states should also recognise that the scope and contents of Chinese foreign policies have expanded enormously since China joined the WTO. Certain policy domains, such as climate diplomacy, foreign aid and international financial governance, have only recently emerged as policy priorities for the CCP. However, since the top leadership does not have enough expertise on its own or sufficient time to make the ‘right’ decision on the individual items of its expanded foreign policy agenda, those agencies and organisations that already possess strong expertise in relevant areas have become prominent and influential by means of providing expert advice and policy recommendations.

Besides traditional foreign policy actors, such as the Ministry of Foreign Affairs (MFA) and the Ministry of Commerce (MOFCOM), the new experts include institutions like the People’s Bank of China and the National Reformation and Development Commission (NDRC). These experts in the background are either semi-autonomous or autonomous. They have built up their own centre of gravity in their attempts to shape Beijing’s EU policy agenda. On the international stage, they have become the de-facto decision-makers on behalf of the Party and the state. However, the flow of information derived from them creates a different set of problems for the CCP, as most of the new players have no vision of China’s foreign affairs and therefore send confusing signals to the outside world.

‘Belt and Road’ Initiative and EU-China relations

In September 2013, Chinese President Xi Jinping visited several Central Asian republics. He reiterated China’s intention of pursuing a policy of large-scale investments. He emphasised the revival of the economic and cultural ties that once characterised China’s relations with Eurasian countries during the past glory of the Silk Road and promoted the recreating the Silk Road Economic Belt in connection with the Maritime Silk Road (One Belt, One Road or OBOR).

This move caused a great deal of confusion for the EU member states and Brussels. Beyond the trade statistics and new rail connections, the role of the OBOR

initiative is not yet entirely clear for Europe. As an established journalist asserts, ‘OBOR is longer on sweeping vision than on nuts-and-bolts practicalities’ (De Jonquieres, 2015).

Nevertheless, several EU member states have pledged their support for the initiative. Subsequently, in boasts picked up by the media and official papers, they spoke of their respective exclusive roles in the OBOR initiative. There was talk of German and Polish railway connections, a historical route linking Venice to the ancient Silk Road, and even China’s new plan to use the Piraeus port in Greece as the European receiving line of the 21st century Maritime Silk Road. But despite these reasonable expressions of enthusiasm, the overall European response has remained timid. Under the lens of bureaucratic politics, the ambitious initiative under the aegis of President Xi Jinping raises the following key questions that Beijing must answer to its potential partners: Which departments or ministries shall carry the overall responsibilities for OBOR? And what are the selection criteria for categorising infrastructure projects as parts of the initiative?

The bureaucratic opaqueness and overarching policy-related uncertainties of the OBOR initiative present a major obstacle in China’s efforts to convince the relevant European partners to make a monetary contribution to any infrastructure projects that would potentially mobilise their enormous financial resources without providing them with an ultimate underwriter to guarantee their investments.

Therefore, to engage with the EU on the OBOR initiative, China must actively promote a unified narrative of its vision and communicate the details of its plan on both a political and an entrepreneurial level. Beijing’s lack of a clearly defined set of guidelines for the OBOR development suits the Chinese pragmatic approach, which allows the Party simply to shift plans during the implementation process whenever new opportunities arise. However, this approach generates ambiguities for Europeans, who are their targeted partners amongst other continents. Therefore, Beijing’s lack of clarity regarding the OBOR initiative jeopardises any potential projects with the EU.

Conclusion

Overall, the UK's painful divorce from the EU is likely to generate tremendous economic and political uncertainties for China, calling the outcomes of Beijing's recent engagement efforts into doubt. There will be plenty of unexpected twists and turns in the coming Sino-British relations, similar to China's experiences with other advanced economies in Europe and elsewhere around the globe. A long-lasting and healthy diplomatic partnership is not only about the 'reddest red carpet' and 'investments' (BBC 2015a); it also requires measured calculations, grounded analyses and honest dialogues with one other. Both Beijing and London should 'Keep Calm and Carry On'.

Regarding the post-Brexit China-EU relations, Europe's political elite must remember that the people in charge of China's foreign affairs are groomed and trained within the system. It is therefore advisable to respect this continuity: the more the Europeans do today to engage the Chinese foreign policy elite in constructive debate, the greater their chances are for future policies that will reflect European interests. The EU needs to devote more resources to understanding China in its 'dual-identity' and offer a unified, less-value driven approach promoting European excellence in knowledge and the Union's strong mission as a global force for good.

It is also critical that the EU avoid meddling in China's internal political reform processes. The Europeans must practice restraint in this regard, as a brutal and unprepared political transition, like those seen in the Arab Spring, would be a recipe for disaster in China. A more turbulent China would not be an easier partner or a more benevolent great power than currently under the administration of Xi Jinping. Moreover, the EU has a profound interest in a stable and reform-oriented China that is economically successful and politically stable. If the Europeans continue to cultivate their old habit of advocating the process of democratisation to China, they will further alienate their biggest trade partner, which in turn will damage the EU's already fragile economy.

On the other side, China is in dire need of a sophisticated diplomacy and

communication strategy in order to keep pace with its own newly acquired global power status. It needs new rhetoric that clearly spells out its coordinated foreign policy and the way it streamlines proliferations of bureaucratic actors involved in policymaking.

Notes

1. The official Chinese name is ‘Belt and Road’ initiative. The West often refers to it alternatively as ‘One Belt and One Road’ (OBOR), the ‘Silk Road Economic Belt’ or the ‘21st Century Maritime Silk Road’.
2. Author interviews with a senior official at IDCPC, Sep 2012.

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