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Sino-European Economic Interdependence and the Economic Crisis

Behind the headlines of quotas, antidumping measures and other trade conflicts, China and the EU are key to each others' economic survival being each other's first and second trade partner respectively, especially within the current environment where policy-makers across the world propose exporting their way of the crisis (particularly in high-value technological and knowledge based products and services). Drawing on official policy documents and material from open-ended personal interviews with policy-makers and diplomats, this paper presents an overview of the current Sino-European economic relationship. The narrative focuses on current policies pinning hopes of economic recovery on increased high-technology development and export, and investigates the likelihood of achieving this by focusing on specific cases (telecommunications and green energy technologies) which reveal the high level of complexity and interdependence that has developed between the EU and Chinese economies. The cases reveal the underlying paradox of how both parties need to display a more flexible approach to one another in order to benefit from these policies, and crucially also reveal the weakness on the European front caused by the different economic preferences of its Member States. These intra-EU tensions resulting from the intricacies of global production lines and international private investment opportunities and choices, complicate the realization of the policy-makers' future development plans. Moreover, these tensions, aggravated by the financial crisis, are preventing the development of a more synergetic economic relationship with China.

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

1. Introduction

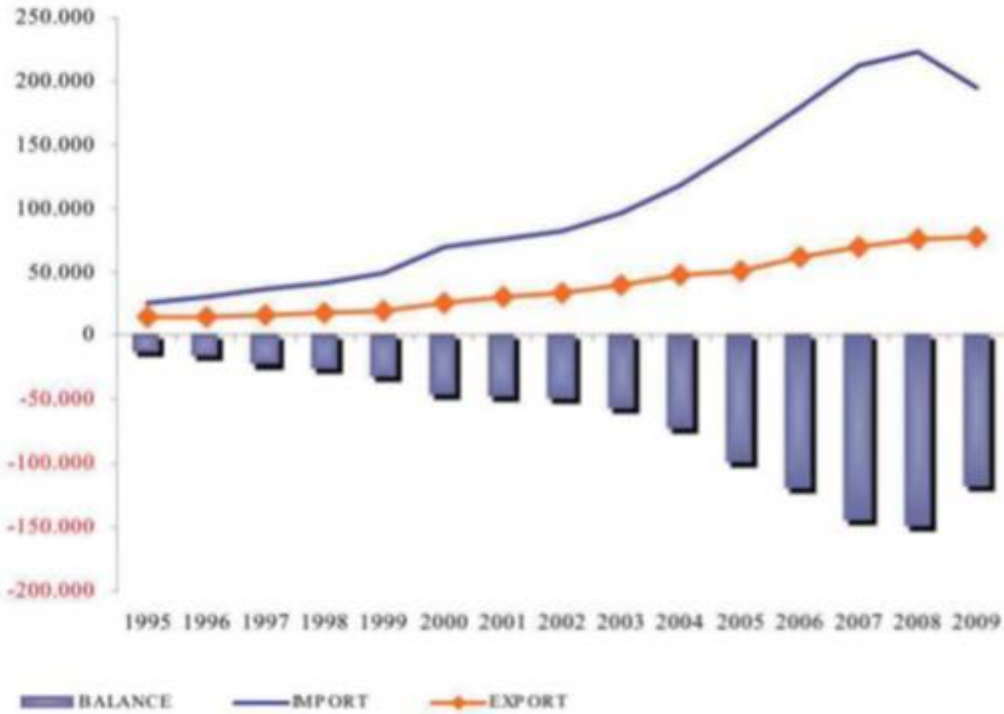
Behind the headlines of quotas, antidumping measures and other trade conflicts, China and the EU are key to each others' economic survival being each other's first and second trade partner respectively, especially within the current environment where policy-makers across the world propose exporting their way of the crisis (particularly in high-value technological and knowledge based products and services). Drawing on official policy documents and material from open-ended personal interviews with policy-makers and diplomats, this article presents an overview of the current Sino-European economic relationship. The narrative questions the wisdom of current policies pinning hopes of economic recovery on increased high-technology, arguing that with both the EU and China seeking to further their future development in the same way, it becomes increasingly difficult for the strategy to succeed and suggests that these incompatibilities may have already begun. The narrative points to recent and ongoing trade conflicts to highlight how the intricacies of global production lines and international investment opportunities and choices, complicate the realization of the policy-makers future development plans. The article is organized as follows: Section two offers an overview of EU-China economic relations focusing on trade, investment and the institutional relationship. Section Three discusses current plans to export out of the crisis, particularly the EU's 2020 Strategy and China's internal development plans whilst highlighting how these two interact. A final section concludes that this complex relationship will flourish but in a different guise.

2. **EU-China Economic Relations**

2.1 Trade Relationship

China's economic transformation into a market socialist economy and its consistent economic growth have been the focus of a wide body of literature and analysis (Blecher 2010; Bramall 2000; Breslin 2009; Naughton 2007). This unprecedented transformation initially focused on exports and the incorporation into global markets. Crucial to this was the accession of China into the WTO in late 2001, in spite of internal conflict regarding the desirability of opening up the Chinese economy to foreign competition (Blecher 2010). China's dramatic rise in share of global trade and magnified significance in global markets since its accession to the WTO has meant that its trade with the European Union has increased sharply (see Figure 1), in terms both of imports and exports, to the extent that in 2012 it is the world's second largest economic relation. The EU represents the largest market for Chinese goods accounting for almost 20 percent of all Chinese exports, and is the first source of imports for China. For the EU, China is its main supplier accounting for 17.1 percent of imports, and its third market purchasing 8.7 percent of all EU exports (behind the USA's 16.9 percent and Switzerland's 9 percent) in 2012 (DG Trade 2013).

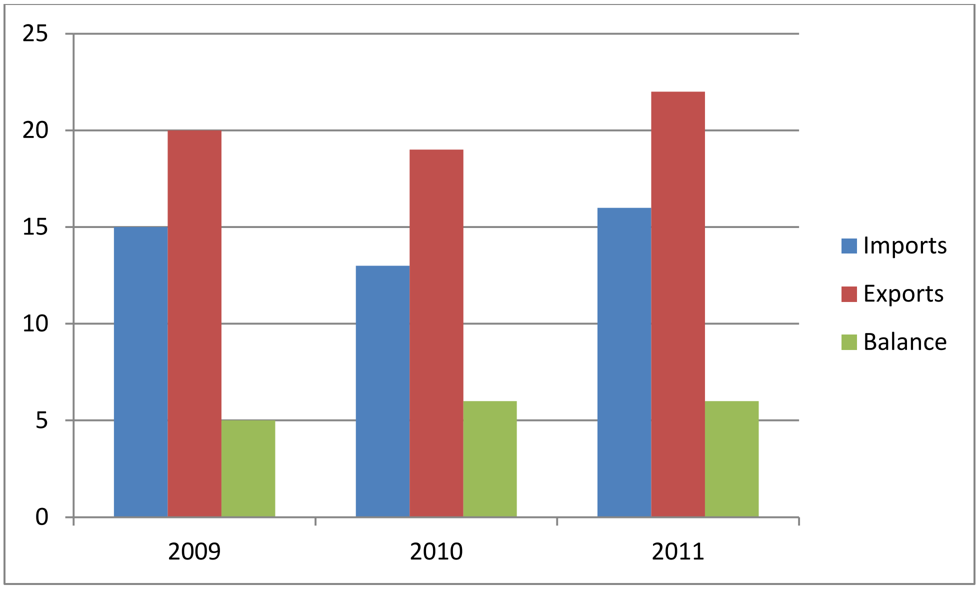
Figure 1: Evolution of EU27-China Imports and Exports



Source: EUROSTAT Comtext Data in Beneyto et al. 2011, 10

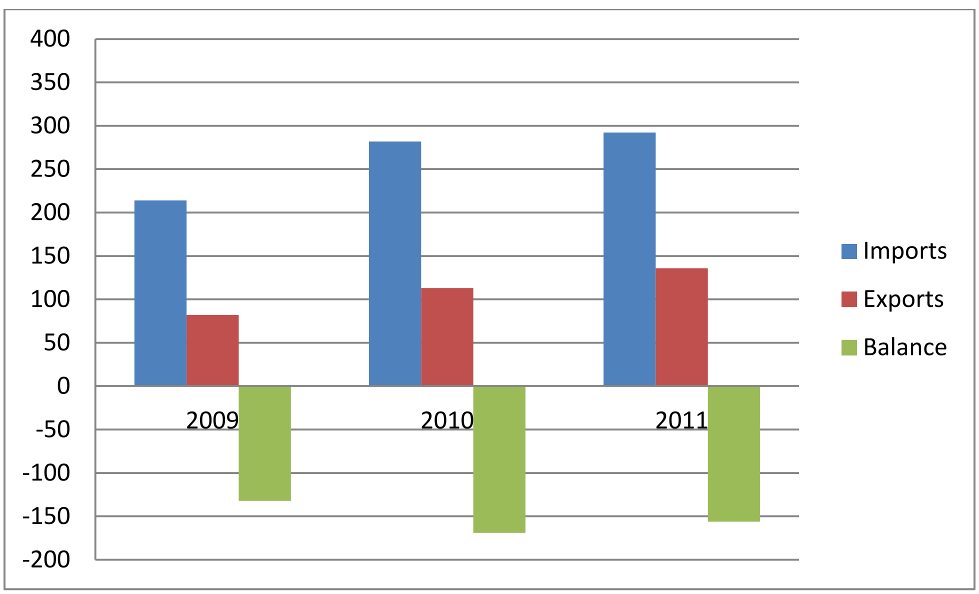
Whilst the EU runs a small trade surplus in commercial services with China, this is dwarfed by the deficit in trade in goods. Despite an initial drop in the EU of Chinese imports of 13.6 percent in 2009, and a siginificant rise in EU exports to China of 37.6 percent in 2010 and 20.3 percent in 2011 (DG Trade 2012), the financial and economic crisis that has so harshly affected Europe and the USA since 2008, has not, thus far, dramatically altered the economic relationship between the EU and China (see Figures 2 and 3). The EU still runs a trade deficit with China. Reducing this deficit has been a longstanding aim of the EU's trade policy towards China.

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



Source: EUROSTAT Comtext Data in EU Trade Website 2012

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



Source: EUROSTAT Comtext Data in EU Trade Website 2012

China's export capacity has spurred complications with the EU and other partners given these trade deficits. Cases of antidumping measures, quota restrictions and others have been brought up against it by its key trade partners, the USA and the EU (Comino 2007; Brown 2007; Hufbauer et al. 2006; Moller et al. 2005), as one measure to stem the deficits. What makes the particular case of the EU even more complicated is the fact that such actions must be undertaken by the EU as a whole, as the European Commission's Trade Commissioner acts on behalf of all Member States. The amalgamation of individual member state preferences as well as interest groups preferences is complex and at times opaque. A tendency towards consensual decision-making in the Council of the EU Trade Ministers' meetings dilutes the core objectives of individual member states in global trade relations.[1] EU-China economic relations display a large degree of heterogeneity amongst EU members states, which translates in divergent preferences that must be reconciled into one policy to be executed by the European Commission (DG Trade) on behalf of the Union.[2] However, there is a great heterogeneity in the relations of EU member states with China. Germany, France, Italy, United Kingdom, Netherlands, Belgium, Sweden and Spain– account for more than 80% of transactions. All of them display deficits with China, although the largest deficit relates to the Netherlands, the United Kingdom and Italy which represent over half of the entire deficit of the EU-27, amounting in 2009 to more than 69,000 million Euros (Beneyto et al. 2011: 16). These countries' trade relations with China have increased rapidly, resulting in an increase in their trade deficit at rates above 10%, or higher as in Italy (20%), Spain (20.21%), Netherlands (25.90%) and Sweden (40.29%) from 1995 to 2009. The European Union is clearly concerned about the rapid growth of its external deficit. The disproportionate acceleration of imports and exports has taken the trade deficit to a cumulative growth rate of over 23 percent from 1995 until the onset of the international crisis.

However, the overall trade deficit data disguises the complexity of international trade relations that underpin the data. Chinese imports into the EU include intra-firm import in cases where European firms have invested in production facilities in China (for instance Italian Targetti, Dutch Philips and to a lesser Extent German

[1] The complex interests at play in EU trade policy-making are highlighted in the concept of a 'conflicted trade power' as described in Meunier and Nicolaidis 2006. Meunier and Nicolaidis 1999, Meunier 2000 also describe EU trade policy-making in detail, and Dür 2008 focuses on the incorporation of interests into the policy.

[2] Literature describing the EU's trade policy mechanisms as a principal-agent relationship between the Council of the EU and the European Commission and the tensions within this relationship includes da Conceicao-Heldt 2011, Damro 2010.

Osram all make some of their lightbulbs in China, yet when these count as Chinese exports when brought into the European market). Increases in imports, which are implicitly understood as a negative development within the trade statistics, also reflect positive developments in other sectors. For instance, imports of Chinese commodities sustain certain parts of the European retail industry. In recent years, imports of competitively-priced Chinese photovoltaic PV) panels have reduced prices in Europe, encouraging a surge in their adoption by consumers (often further promoted through government subsidies) and in an industry specialized in their installation and maintenance. The European Union, and in particular Germany, have become the world's largest market for PV equipment, with Germany being the world leader in PV power generating capacity (10,000 MW) followed by Spain (3,400 MW) (Algieri et al. 2011, 7276). Similarly, Chinese exports of telecommunications equipment have benefitted European service providers, who can reduce costs with these devices. Thus, Spain's telecommunications provider *Telefónica* has become the largest external private client of China's *Huawei*, which in mid-2012 overtook Swedish *Ericsson* to become the world's largest telecoms-equipment-maker (*The Economist* 2012). Not only have *Huawei*'s more affordable devices enabled *Telefónica* to further its growth and leadership position in South American markets, but both companies have recently signed services contracts as well, with *Telefónica*'s UK section *O2* signing *Huawei* for a five year network service contract (Global Telecomm Business 2012). This reveals the complexity of relations that underlie the official trade statistics, notwithstanding which the EU's trade deficits with China are a worrying sign of an unbalanced relationship, especially as almost half of all EU exports to China originate in one member state, Germany. Divergent interests of domestic constituencies, some of which specialize in exporting parts for final production lines in China, others of which have invested in production facilities in China, and retailers who depend on Chinese imports, have led to complex and swaying EU responses to the rise of China (Shu 2010).

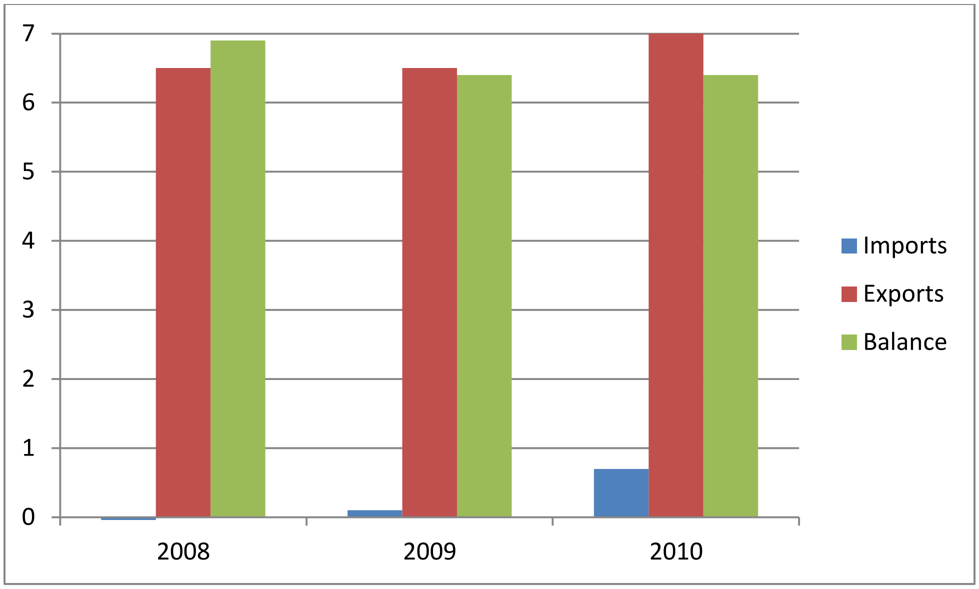
Complaints against the other party in this relationship, however, are not confined to Europe. On the Chinese part, anti-dumping measures and investigations have been a common cause for complaints. Indeed, in its 2010 China Trade Policy Review, the WTO (2010, 41) expressed concern over complaints against China in breach of anti-dumping measures which indicates that in 2008 WTO Members initiated 93 anti-dumping, countervailing, safeguard, and product-specific safeguard investigations against Chinese exports, at a value of US$6.1 billion, an annual increase of 69.4 per cent. To counter this situation, China had pressured its partners to grant it market economy status, which would enforce greater limits on the ability of parties to raise these cases at the WTO. In fact, in the free trade agreements (FTAs) that China has signed, the granting of market economy status has been a prerequisite and non-negotiable issue. However, new WTO rules placing the onus of cases on a verification *in loco* which tightens procedures, combined with the fast approaching 2016 date for automatic market economy status at the WTO, have meant that this issue has lost prominence in China's economic dialogues with its partners.[3] Other issues marring the relationship include many of the technical, sanitary and phytosanitary measures that have become obstacles to exports from China, affecting more than 15% of exporting firms, which highlights the need to adapt national legislation to the standards required by the vast majority of its trading partners Beneyto et al. 2011: 24). Although, China too, has increasingly learnt from its WTO experience and has likewise increased its participation in the 'nontariff barrier game' as one European diplomat described it, but in ways that are compatible with its WTO membership.

2.2 Investment Relationship

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

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

[3] From interviews with European and Latin American diplomats, Beijing, August 2012



Source: EUROSTAT Comtext Data in EU Trade Website, 2012

Chinese FDI in Europe increased by 337 percent between 2007 and 2010. Some high profile cases have included the purchase of car manufacturers Rover Group, *Saab* and *Volvo*, French wineries *Chateau de Viaud*, as well as recent acquisitions in the eurocrisis stricken countries. The latter include the lease of the operations of the Greek port *Piraeus*, showrooms in Ireland to exhibit Chinese exports, and a 21 percent participation by the Three Gorges Project Corporation in *Energias de Portugal* and a 25 percent stake in the Portuguese electricity network, and recently NHA Group acquired 20 percent of the Spanish NH hotel group. These investments are consistent with China's entering the second phase of its 'going out' strategy for investment abroad. If phase one focused on acquiring energy and raw materials (hence investments in extraction and infraestrustrure in Africa and Asia) to secure its own industrial growth, phase two targets entering into the developed markets and acquiring know-how, technologies and established brands. Invetsments in Europe, including the eurozone periphery , follow this business strategy. However, the eurocrisis has created additional opportunities for investment in the EU, as the declining value of the Euro has also cheapened the cost of these investments. Moreover with the currency losing value it seems sensible for Chinese companies to use some of the euros they have accumulated through their exports to the eurozone. Whilst the Chinese economic leadership might not wish for a collapse of the Euro (which it holds as foreign exchange currency, although not to the extent of the US dollar),[4] and are clearly concerned about the decline in demand from their major market, their current attitude to Europe is marked by a clear sense of business acumen. Although China's leadership has shown its commitment to Europe and the euro, not least through purchases of bonds at the height of the eurocrisis (see Otero-Iglesias 2013), China and its state and private enterprises will not support Europe at any cost, but rather are shopping around for the best business opportunities. For example, there have been several Chinese trips to Spain to scout investment opportunities, and although having shown a keen interest decisions are being delayed awaiting developments, and more importantly lower prices.[5] More significantly, investments in Europe, thus far, also represent a less than a fifith of Chinese FDI abroad, which has been destined mostly to securing resources in other resource-rich developing states.

From a European perspective, these FDI flows are also relatively minor. Although important in absolute values (€3.1 billion in 2011), FDI inflows into the EU from China accounted for just 1.4 percent of total FDI inflows, compared to 47 originating in North America. More significant in value have been EU investments in China (€617 billion representing 20 percent of Chinese FDI inflows), yet even then, total EU FDI outward stocks in Asia accounted for 15 percent of total EU investments abroad compared to 58 percent represented by North America.[6] In terms of FDI the relationship with North America remains crucial. This is, of course, partly motivated by tradition, (the accumulation of FDI stocks over decades), but also by more open investment environments in North America and Europe and more consistent legal frameworks, which are likely to be further harmonised if the Transatlantic Trade and Investment Partnership (TTIP) negotiations succeed. By contrast, European (and other foreign) enterprises have experienced difficulties investing in China, which accounts for lower levels of investment than elsewhere. To bolster investments in both direction, the European Commission's DG Trade is now prioritising the negotiation of an Investment Agreement with China, using the competence over investment that it was granted in the Lisbon Treaty.

Outright foreign ownership in China is not allowed and foreign partners must engage in joint ventures with local partners. Foreigners are also limited to minority shareholder status, and have restricted input into management

[4] China has already started Exchange swap agreements with key trade partners (Russia, Japan) to pay in their own currencies or even to bypass currencies completely by bartering oil and commodities (with Russia), showing a clear desire by these other crucial actors to limit their exposures to volatile US dollars and Euros.
[5] Interview with European diplomat, August 2012
[6] Author's calculations based on EUROSTAT Data

decisions. Whilst this may not appear very attractive, the prospect of entering the growing and extremely populous market that is China has signified important European investments in China. For many companies it is also a way of gaining a presence in the market as well as the networks necessary to then introduce products produced in their home country into China. It is also a mechanism for obtaining leverage within China. In fact many large transnational corporations have opted for investments in China through which to lobby the Chinese government directly (for better market access) rather than just lobbying their own home governments or the European Commission to exercise pressure on the Chinese government.

Other European concerns in this economic relationship regard frequent infringements of Intellectual Property rights (IP)[7] by an industry specializing in forgeries of consumer goods, as well as resulting from technology and know-how transfers via investments and joint ventures. A European diplomat considered the difficulty in addressing this issue given entrenched and generalized perceptions that IP breaches are a 'crime without victims' even when over 80 percent of all IP infringement cases tried by Chinese courts actually involve one Chinese company against another.[8] Difficulties for competitive European service companies bidding for public procurement[9] contracts are another contentious issue, and the European Commission suggested in 2012 that it too will close the European public procurement market to companies from states that have closed public procurement markets (*EUObserver*, 2012a). However, threats of retaliation from China and the USA, and opposition from key EU member states (Germany, UK, Netherlands) meant that the Commission dropped the proposal.[10] Frederik Erixon and Razeen Sally (2010, 13) have documented some of these actions as part of the creeping protectionism that states across the world (including the EU) have enacted as part of their stimulus package policy responses to the economic and financial crisis. The European Commission's Directorate General for trade has stressed all these aspects, as well

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[7] Intellectual Property rights include copyright of creative works, geographic indicators of wines, spirits and agricultural and traditional goods, and innovation patents.

[8] Interview with European diplomat, August 2012

[9] Public procurement refers to the awarding of government contracts for infrastructure construction (roads, bridges, public works) to operation of ports and airports, to providing IT services to government-funded bodies or even contracts for security, catering and cleaning, amongst others.

[10] China is negotiating its entry into the WTO's Global Procurement Agreement (GPA) which binds signatories to more transparent procurement procedures. The USA is a member, yet European companies complain about 'Buy American' campaigns. Final adoption of an upgraded version of the GPA is still pending. Its adoption may resolve some of the procurement confrontations in the future.

as increased nontariff barrier obstacles for exports in its general trade policy papers, like 'Global Europe' (European Commission 2006a) and 'Jobs, Growth and Trade' (European Commission 2010), with regards to all states, and also in its specific policy papers on China (European Commission 2006b).

DG Trade's objectives are to upload and institutionalise what has been described as its 'deep trade' agenda (Peterson & Youngs 2006; Lamy 2002) through FTAs.[11] Deep trade refers to the incorporation of the so-called Singapore issues which were meant to be negotiated at the WTO: services, intellectual property rights, public procurement and competition policy, but which were diluted due to emerging states'. The European Commission (2006a, 10) acknowledges that: 'many key issues, including investment, public procurement, competition, other regulatory issues and IPR enforcement, which remain outside the WTO at this time can be addressed through FTAs'. Studies of potential effects of EU free trade agreements with other partners have all highlighted that unless these 'deep trade' issues are covered in the final agreements there is no scope for welfare gains for the EU (Decreux *et al.* 2010, ECORYS 2009, IBM Belgium 2008), as it is precisely in the area of services that its companies are more competitive internationally. The EU stressed its wishes to open markets abroad and claims 'most emerging countries combine high growth with unnecessarily high barriers to EU exports [and as] their role and the benefits they draw from the global trading system grow, so too do their responsibilities to play a full part in maintaining a global regime that favours openness'(European Commission 2006a: 8) It further stresses that in its view, '[t]he absence of competition and state aid rules in third countries limits market access as it raises new barriers to substitute for tariffs or traditional non-tariff barriers,' and highlights as a strategic interests the development of international rules on competition policies 'to ensure European firms do not suffer in third countries from unreasonable subsidisation of local companies or anti-competitive practices.' 'Public procurement is an area of significant untapped potential for EU exporters' according to the policy and the biggest sector outside of multilateral disciplines, and one where EU companies face discriminatory practices (European Commission 2006a: 8).

These so-called Singapore issues, market access facilitation, as well as 'strengthen[ing] sustainable development through […] bilateral trade relations […] incorporating new co-operative provisions in areas relating to labour standards and environmental protection' are thus the core strategic aims that the EU pursues in its relations

[11] Young and Peterson (2006) explain the EU's deep trade agenda as a response to a new trade environment where behind-the-doors issues are more relevant, there are more actors (parliaments, NGOs) and EU and USA dominance is challenged by the newly industrialised and developing states.

with Asia (European Commission 2006a: 12). These are addressed via Dialogues with China, and in the case of some other Asian states via the negotiation of legally-binding free trade agreements (FTAs), but as subsequent sections will argue it is increasingly difficult for the EU to gain acquiescence from partners on these contentious matters. Given the importance of the Chinese market and the challenges it presents, these issues are even more forcefully portrayed in the DG's policy papers specifically on economic relations with China which insist on the need to 'get China right' and to establish 'fair trade' practices between the two partners to redress the current unbalanced relationship (European Commission 2006b). These challenges on the European side are particularly pressing as these are the precisely the economic areas in which European companies are most competitive and which the EU has priorities in its trade policies.

2.3 Institutional Relationship

A complex institutional relationship has developed to address these, as well as other issues, especially through the creation of a Strategic Partnership since 2003. The Partnership which revolves around three pillars: a Strategic Dialogue, a Trade pillar, and a People-to-People pillar, has been criticized for lacking a genuine strategic component (Smith & Xie 2010; Taneja 2010; Holslag 2011). In fact EU representatives have conceded that the Strategic Dialogue needs to be imbued with meaningful content.[12] According to Beneyto et al. (2011: 18) the Strategic Partnership was, 'clearly directed, first toward a political dimension' including global issues like reduction of weapons of mass destruction, security of energy supply, and international terrorism, and on the other hand, an economic dimension. A key element of the Partnership is the upgrading of the current legal basis of the relationship (the outdated 1985 Trade and Economic Cooperation Agreement) to a Partnership Cooperation Agreement (PCA), which whilst not as inclusive in scope as the FTAs and Association Agreements the EU has subscribed with other partners, would create a clear legal framework for cooperation and especially for increased trade and investment. Indeed, the economic pillar is the one in which diplomats agree a greater effort has been vested thus far. However, negotiations have been ongoing since 2007 and are still far from resolution. Within the PCA negotiations the European Union initially resorted to linkage of issues (as it does in other negotiations) to leverage its market

[12] Interview with EU officials Beijing, August 2012

power.[13] However, Chinese reluctance to negotiate anything other than economic matters, led to an eventual separation of the economic and political negotiations, regardless of which both are currently more or less stalled.

The economic aspect of the Dialogue is the area both parties are most interested in, and has been institutionalized since April 2008 through the High Level Economic and Trade Dialogue Mechanism. This Dialogue remains difficult, especially in view of recent escalation of protectionist measures. Recent difficulties notwithstanding, through this Dialogue, and the more technical (and depoliticized ones) on customs procedures, nontariff barriers, and so on, there has been an emphasis on the importance of collaboration between the EU and China on customs matters for the treatment of goods moving between the two blocks. It is at this point that the EU is making a greater effort in terms of dialogue, especially as it affects the rights of intellectual property and the rapid growth of cases of counterfeiting and piracy of products from the EU market. The EU has highlighted the necessity of reaching a consensus on the harmonization of policies and regulations affecting such important issues as utility models and patents; as ever more frequently, Chinese companies are making copies or slight modifications of European technology, giving rise to a number of complaints (Beneyto et al. 2011, 27). In this respect, through the High Level Economic Dialogue, the parties have expressed their desire to 'create a favourable environment to promote innovation and protection IPR to ensure favourable and regulatory conditions' (EU-China High Level Economic Dialogue 2010), but Europeans remain dissatisfied with progress in this area.

Other aspects highlighted in the bilateral political and trade dialogue directly affect environmental and social regulations. For this reason, the EU wants China to ratify the main conventions of the International Labour Organization, especially those that refer to trade union rights and forced labour. Although this remains a complicated area as many of the EU's Asian partners view the EU's labour and environmental standards as nontariff barriers designed to limit their competitive advantages. Beneyto et al. (2007, 27) argue that this practice of obtaining legitimate comparative advantages should also be followed by firms in Chinese territory, demanding the best practices of corporate social responsibility as in the home countries of these European investments, in order that European direct investment in China will lead to a stream of good labour practices and promote social dialogue between both partners. Foreign companies in China are, in fact, required to comply with standards of health and

[13] See García 2012, Damro 2012 *inter alia.*

safety, and work conditions. However, these investors complain that Chinese competitors are not bound by those rules, therefore enabling cost savings that are impossible for foreign companies, and limiting the potential for the extension of higher European standards beyond foreign-linked enterprises.[14]

3. **Exporting out of the crisis**

As already noted in section one, the economic and financial crisis that began in 2008, and has been particularly damaging to the USA and EU, has began to redress the EU's trade deficit with China, but only very slightly. The main impact has been in creating an even greater awareness within Chinese policy-making elites of the need to promote internal consumption and lessen dependence on the European and American markets, a political and developmental aim that precedes the onset of the crisis, but has gathered strength since. The new leadership team under Xi Jinping has shown commitment to this goal and to further the internal development of China in order to tackle the social inequality that has arisen form rapid development and industralisation. With the social and environmental consequences of China's rapid growth becoming more pressing, the new leadership is also keen to steer the country towards a more sustainable growth model. China's restriction on the export of rare earth minerals, crucial for the production of alternative energy generators as well as most high technology manufactures, has resulted in the EU asking the WTO to open two panels to investigate the matter. The first panel was presented by the EU, Japan and the USA in 2011 in a concerted effort to force China to continue supply of these minerals. China acocunts for 95 percent of the world's production of some of these minerals. For the EU, who currently is the world leader in alternative energy technology, and has committed itself to increased usage (up to 20 percent of energy form renewable sources) through the 20 20 by 2020 strategy, this presents a significant problem. From the Chinese perspective, itself now the largest producer of wind turbines, and in need to develop a 'cleaner development' model, this would be a way of encouraging more foreign investment in China to produce these goods, with the consequent technology transfer. This poses an interesting dilemma, as on the one hand over the past years European companies (and individuals) have been able to take advantage of lower priced photovoltaic equipment from China in their efforts to meet the EU's own renewable energy targets, whilst at the same time limiting the competitiveness of

[14] Interview with European diplomat, Beijing, August 2012

European producers. The European Commission's recent decision to open an investigation into possible Chinese dumping practices in this field at the behest of European solar panel makers (Bloomberg 2012, European Commission 2012), reflects this complex situation, and has also engendered a more tense relationship with China in the last year.[15] At the moment the European Commission is listing all PV equipment coming into the EU at the border as a first step to possible anti-dumping duties.[16] For its part, in 2012 China requested the opening of a panel at the WTO to investigate EU member states (specifically Greece and Italy) legislation on feed-in tariffs that require certain domestic manufacture components for the equipement as a breach of GATT 1994 (WTO 2013). On 27 April 2013, again under presseure from ProSun Glass, the European PV manufacturers association, the European Commisison launched an investigation into Chinese subsidies to the PV industry. This process will indeed be a challenging one for the EU-China relationship, as China has shown special sensitivity in the past on the issue of state subsidies.

In the summer of 2012, after pressure from European telecommunications devices manufacturers, the European Commission hinted that it might open an investigation into Chinese subsidies to *Huawei* and *ZTE* to enable them rapid market share capture (Reuters 2012). The mere suggestion of an investigation sparked great concerns in China that if it were to go ahead it could create precedents for others to challenge its industrial policy, which until now has been a mainstay of the country's internal development policy. [17] China immediately threatened to initiate its own investigations into alleged European subsidies in the agriculture, automotive, renewable and telecommunication sectors (Techeye 2012), a threat which has thus far prevented further European actions. Insiders report a deterioration of EU-China relations as a result of these incidents and a strong Chinese negative reaction to this, which has included threats to retaliate against European imports, specifically wine imports. Divergent structures of member states' economic relations with China further accentuate these tensions. Whilst any potential actions to defend EU telecommunications and solar panels manufacturers would be at the behest of manufacturers based in

[15] The European Commission is obliged to open an investigation if it receives a valid complaint from the industry, it will conduct its investigation for 15 months and then decide whether there is a case to impose counter-measures against Chinese imports, and whether the cost of this is not too high. In the meantime EU solar panel makers have made a second request for the imposition of tariffs on Chinese imports on 24.09.2012.

[16] Within the EU The Alliance for Affordable Solar Energy has been campaigning to put a stop to any possible duties.

[17] From interviews with European diplomats, Beijing August 2012

Northern EU member states, that are now adopting more protectionist stances, potential Chinese retaliation in wines would be to the detriment of Southern EU member state producers, which are now displaying attitudes in favour of trade liberalization. Whilst there is no evidence that China is manipulating these differences and the eurocrisis to gain leverage over the EU, a consequence of these different economic relations with China, result in some EU member states pushing views within the EU that coincide in some instances with Chinese preferences. These differences complicate a coherent European response and further exacerbate internal tensions resulting from the internal market and eurozone imbalances.

3.1 *2020 Strategy & EU Trade Strategies*

Europe 2020 is an overarching EU strategy that covers all areas of economic development, from economic governance (including fiscal oversight and constraints), to macroeconomic policies, social and employment policies as well as to external economic relations.[18] It focuses on a transformation into a low-carbon economy based on sustainability, on a clean and high-tech industry, in which training and technical and innovative training are key economic drivers. It aims to improve employment in Europe through the creation of jobs in these target sectors. Trade Commissioner De Gucht's 2010 'Trade, Growth and World Affairs' trade policy put forward the external dimension of this strategy (European Commission 2010). The policy paper claims a direct linkage between more open trade and GDP growth in Europe, greater consumer choice and lower prices, and more employment in Europe (European Commission 2010: 5). Indeed, some of the key aims of Europe 2020 rely on exporting high-technology, a carbon economy and innovations abroad. In this sense trade policy is a crucial factor in achieving the 2020 aims, and the difficulties that have marred the EU's external trade policy in recent years become more poignant in this light.

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

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

Lamy 2002). These include intellectual property rights, liberalization of services and public procurement markets, establishment of more harmonized international competition policies and dismantling of nontariff barriers. The EU and USA tried to gain acquiescence for these at the WTO and failed on numerous occasions. As the WTO Doha Development Round dithered, the USA opted to simultaneously engage in bilateral free trade agreements (FTAs) with other partners in order to slowly gain binding agreements on the Singapore issues.[19] Whilst the USA, and other actors, were pursuing their trade preferences through FTAs (including establishing regulatory standards or gaining mutual recognitions for these, certain types of IP protection, etc.), the EU continued to hope for a resolution to the Doha Round and a multilateral adoption of 'deep trade'. When Peter Mandelson took over DG Trade in late 2004, he and his team, concerned with the rise in USA and other FTAs,[20] changed their focus to the WTO *and* FTAs, and established an explicit EU FTA policy and laid out the economic rationale behind FTAs:

> The key economic criteria for new FTA partners should be market potential (economic size and growth) and the level of protection against EU export interests (tariffs and non-tariff barriers). We should also take account of our potential partners' negotiations with EU competitors, the likely impact of this on EU markets and economies… (European Commission 2006a: 11)

The significance and stress that the EU attaches to 'deep trade' is precisely one of the components that has lengthened its FTA negotiations with Asian partners (Singapore, India, Vietnam, Malaysia) and which continues to hamper its economic relations with China. For whilst the EU wishes to secure public procurement possibilities in China, greater ease for service providers to offer their services in China, with the ability to invest in greater stakes of Chinese companies, or operate their own subsidiaries more freely, and to secure high levels of intellectual property protection (for European goods) and also for technological innovations, China's own strategy revolves around exploiting its own advantages by fostering technology transfers, and encouraging and supporting internal industrial development.

[19] On the USA's multi-progned approach to 'competitive liberalisation' see Schott 2006.

[20] Much of the literature argues that fears of losses to others within an FTA arrangement encourages further FTAs. See inter alia Baldwin1993; Hallaert 2008; Baldwin and Venables, 1995. Others also emphasise policy imitation and political balancing effects, see Solis, Stallings, and Katada 2009.

3.2 *China's development policy*

The penchant for luxury European consumer goods of increasingly affluent sectors of Chinese society has meant that EU exports to China have been rising over the last decade. Food scares in China have also lead to a greater demand for high quality foreign foodstuffs, and increasingly the Chinese are developing a taste for wine, much to the delight of European producers. However, as mentioned earlier, the EU's future development strategy is based on technology and innovation, and high-technology exports and services, rather than these other products were Chinese demands remains strong. China *too* is aiming to further its own internal development along technological lines, and the restriction on exports of rare earth minerals, which are necessary for the manufacture of solar panels and wind turbines, bears witness to that. Mining is polluting and the environmental crisis in China is now a government priority and sparking increased civil society activism. Chinese authorities are well aware of the challenges their vast and enormously diverse state faces. Growth rates continue strong, but have fallen from the pre-crisis levels, partly due to decreased demand for Chinese exports in the EU and USA. China wishes to reduce dependence on these markets by fostering internal consumption and the maturation of the Chinese internal market. Its rapid industrialization has brought with it negative environmental externalities, as well as rising social inequalities that the authorities are now keen to focus on. Plans to develop a lower carbon economy, towards which it is cooperating closely with the EU through the Strategic Partnership and joint development of carbon capture plants, lead it to engage in measures to encourage technology transfer and the manufacture of alternative energy devices within China, to the chagrin of European producers. To secure future industrial independence, as well to guarantee jobs (and tackle social issues) Chinese authorities restrict foreign investment conditions, service provision and public procurement bids. Although Chinese authorities insist the failure to win contracts lies at the EU firms' door (*EUObserver* 2009).

China's own external economic policy, especially in terms of investments abroad (mostly in developing economies, and especially in the energy and extractive sectors) highlight the planned use of external economic policy to further the internal development of the Chinese economy. Pragmatism has also been a core characteristic of China's FTA strategy, which has focused on economic goals of securing access to resources to further its own growth (Hai & Li 2003: Hufbauer & Wong 2005: Yan 2009), which builds upon the ever-closer intra-industry trade-and-investment linkages in East Asia that inform the economic logic of region-wide FTAs (Sally 2005: 42: Tay 2010: 35).

However, in the aftermath of the financial crisis that started in 2008, China's concerns over safeguarding its internal market from outside shocks has grown, and its ongoing negotiations have slowed down. The long duration of negotiations with Australia (a key supplier of raw materials to China) has actually soured relations between the two countries, and the comprehensiveness of the FTA New Zealand achieved with China is no longer on the cards for other partners. This is partly due to New Zealand's small economic size presenting no threat to China, but also to the fact that since the financial crisis China has become more internally focused and less pleased about additional external binding limitations,[21] as for example some of the clauses that New Zealand achieved that allow for environmental and labour issues to be obstacles to trade. The consequences of this are particularly poignant to the EU, as its own strategy is contingent on achieving progress on precisely these issues, and the Singapore issues, at a time when China appears to be more reluctant on these matters.

4. **Concluding remarks**

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

The problem with exporting your way of crisis assumes steady demand for your exports abroad. Furthermore, the exponential growth created by free trade, and even the existence of a genuinely free trade system,

[21] From interviews with diplomats in Beijing, August 2012

has been questioned.[22] Current FTAs, which are key parts of states' (especially the EU's) plans for diversification of economic relations and access to service and public procurement markets are not projected to produce significantly large economic welfare results, although they do gain acceptance of preferred rules (IPR, public procurement), and forge closer relationships, which gain greater economic significance in the future.[23] In this respect, developments within the TTIP negotatiations will be crucial and could be a 'game-changer' in terms of encouraging other states, including China, to adopt the Western approach or at least re-define their approach to non-traditional trade liberalisation.

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

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[22] Dunkley (2006) offers a thorough and enlightening challenge to common assumptions regarding the merits of free trade.

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

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