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EUROPEAN UNION - CHINA RELATIONS:

BUT WHOSE RULES?

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Universal consensus exists that China over the last 20-30 years has developed at an astonishing speed to become the second largest economy in the world that is headed towards becoming a global power. Already today, the world's power relations no longer reflect the West's, including America's, commanding place in the world's power hierarchy. It cannot be denied that China is committed to developing its economic potential in order to be on an equal footing with the United States, not to mention the European Union.

What is the Union's place in this new power arrangement? European countries, as others which have relations with China, face a strategic choice. What is to be the appropriate trade-off between relations that create mutual gain, against accepting China's rules that not always follow EU or WTO rules and principles? This is a challenging dilemma which if not handled right could mean, as French President Macron recently claimed, that Europe could be marginalized, against the backdrop of U.S.-China competition, and an assertive Russia. Like it or not, Europe has returned to the arena of power politics.[i]

EU'S REVISED VIEW OF CHINA

On March 12, 2019, the European Commission and the High Representative for Foreign Affairs and Security Policy issued a Joint Communication, outlook[ii] which can be characterized as the first serious EU strategy on China that does not hesitate to robustly criticize China, but, at the same time, looks forward to creating a sustainable partnership. The communication assumes that China, in possessing growing economic power, is creating a foreign policy based on power politics that will allow it to become a major global player. The EU notes that there now exist three leading world economic centers – the United States, China and the European Union.

In not trying to create a 'for or against' relationship in the future, the EU envisages that this relationship will be multifaceted; China will be a 'cooperative partner' on issues when ends align; and when interests do not align, the Union will enter in a 'partnership of dialogue'; and, finally, China is recognized as a 'systemic rival' given that the governing principles of each are opposed. To follow these precepts closely will require an adroit foreign policy and diplomatic touch, that will not come easily given the fragmentation of the Union's foreign policy remit, held hostage to the member states' national interests. Recognizing this predicament, the communication observes that it can only secure its interests and values if it is united, allowing the Union's various mechanisms to leverage its negotiating position. Of course, China's preferred negotiating stance is to deal with each member state individually, thereby increasing its leverage. Pushing back against China's approach, the communication reiterates that to be effective in negotiations, a united front must be maintained by individual members and by regional groupings, i.e. by the '17+1' format that includes Central and East European states and the Balkans.[iii]

As has been already recounted, this EU-China strategy has been the most critical to date; China has been called an economic competitor and systemic rival that seeks to popularize its governance model. The EU would appear to have lost its patience with China's one-way unbalanced economic relations: these have not been 'win-win' as advertised, but in China's favour. Promises that it would fulfill when it joined the World Trade Organization have not been met. In this context, the Union asks that China as a leading power has an obligation to maintain the existing ruled-based international order and to strengthen the mutually advantageous, non-discriminatory and open trading system.

CHINA'S DEMANDS FOR EUROPE

For its part, China has its own complaints against the European Union and its member states, which were expressed in its December 2018 official statement, the third on China's relations with the EU.[iv] Rejected was the Union's claim that China was seeking to acquire high tech companies and that China had a deteriorating human rights record. Against the Union's claims, China reminded the Europeans that it had adopted policies favourable to the EU as compared to the United States. Given the ongoing China-U.S. trade war finding an accommodative stance toward the EU is likely to be China's objective over the near and mid-term.

The statement was also quite explicit about the obligations the EU owes China. The Union must respect China's 'core interests' that relate to its sovereignty and territorial integrity, a reference to Taiwan's claim to independence which cannot be recognized, nor with whom can there be state to state relations. Moreover, EU member states are not to host the Dalai Lama, as this gesture questions China's territorial integrity. Nor can they support Uyghur human rights which fosters a separate eastern Turkmenistan. The Union should avoid getting involved in Hong Kong and Macao. The list of obligations the EU should take on board is long, but what can also be mentioned is China's call for the EU to lift the restrictions on the export of innovative technologies to China and open its investment market and that it follows WTO standards. Given that the EU is about to introduce a Europe-wide foreign investment screening procedure, this issue has a potential for trade tension.

Carrots are also offered by China that it hopes will lead to greater cooperation between the two trading partners. On offer is closer cooperation on counter-terrorism, police coordination, and with respect to cross-border judicial cooperation. The sub-text for this offer of cooperation would appear to be obvious; implicit is the prospect of extending the extra-territoriality of Chinese law. Optimal relations with the EU would include a free trade arrangement that would open the Union's common market without restrictions, something the EU is not prepared to consider, lest that could open the EU to Chinese goods, and runs the risk of China 'dumping' its excess capacity in Europe. Nor is the Union prepared to open the energy sector to Chinese buyouts. What the EU is prepared to consider is an investment treaty protecting the investments in each other's jurisdiction.

2019 CHINA-EU SUMMIT

Whether China would take the Union's concerns seriously was to be tested at the EU-China Summit in April 2019.[v] A joint communique was issued that according to press reports was cause for serious wrangling, but which resulted in a commitment by China to introduce measures that would lead to a more balanced economic relationship based on transparency, open procurement processes and generally creating a level playing field for European businesses.[vi] One can speculate that with the on-going trade dispute with the United States China wished to avoid aggravating relations with the European Union, China's major trading partner. It will be interesting to see if the new European Commission led by Ursula von der Leyen will ensure the fulfilment of China's promises, given that she claims the Commission will be a 'geopolitical' one. Both sides agreed on creating a monitoring mechanism to oversee how the agreements are implemented.

CHINA'S ECONOMIC POSSIBILITIES

China's economy is made up of a mixture of private and public sector companies under supervision or control of the Chinese Communist Party.[vii] While overall this economic model has been quite successful since its introduction in the 1970's, it, nevertheless, has serious structural problems, viewed from a western economic perspective,[viii] and which creates 'instability, imbalances, uncoordinated and unsustainable development' as admitted by Wen Jiabao in 2007 when he was the premier.[ix] There is a growing literature on the economic difficulties facing China, that deals with its growing credit bubble, with public sector firms that are 'non-viable zombie firms', and with the likelihood that China has entered what is called the 'middle income trap', that indicates that China is not likely to grow as fast as it has done in the past.[x] China's prime minister Li Keqiang recently stated China's GDP in 2018 was 6.6% or worth 13.6 trillion U.S. dollars, but that in 2019 the percentage will drop to between 6% to 6.5%.[xi] Only a few years ago China's GDP was consistently above 8% and often 10%. As now often mentioned in the press, China's economy over the last few years has slowed down, which has required that the government initiate some stimulation, but moderate compared to what the U.S. did in 2018. Li has committed China to introduce 'supply side reforms' and will advance the expansion of the private sector by among other things reducing their tax burden. At the same time, China will not increase its deficit ceiling and thus increase its debt load, but, instead, will ask all state enterprises to reduce their spending. This could affect negatively outbound investment rates. But, to attract inbound investment, in January 2020 a revised foreign investment law will come into force which will be more open to foreign investors.

China is in for a period of macro-economic balancing between exports and internal consumption, avoiding over stimulation of the economy, but by using various economic levers maintain GDP growth at or above 6%. This will be even more challenging in light of the U.S.-China trade war and in the aftermath of COVID-19.

CHINA'S BELT AND ROAD INITIATIVE

As the Chinese economy has begun to slow down over the last few years, Xi Jinping has looked globally for economic opportunities, whether in terms of trade, resources or investment, using as its global vehicle what is called the 'Belt and Road Initiative' (BRI), or sometimes labelled the 'New Silk Road'. Since the introduction of the BRI in 2013 China has expanded its global reach, including in Europe.[xii] It has done so using three principal methods: through trade interconnections using transport networks, both land and maritime;[xiii] through direct foreign investment; and through infrastructure projects. Looking at transport networks, principally rail, we see that there has been an increase in the tempo of block train movement to Europe, with an expected value of U.S.$ 76.5 billion in 2020, as compared to U.S.$ 26.7 billion in 2016. However, two thirds of all trains return to China empty. Overall, 90% of goods arriving in Europe come by sea. The principal destination of these block trains is Duisburg in Germany, though over the past years such trains have arrived in London, Madrid and Riga among other cities.

From the perspective of the European Union to leave to China the building of all forms of connectivity between Europe and China would largely shut it out from the economic opportunities and influence across Central Asia. The Union has in response created the EU-China Connectivity Platform[xiv] as part of its Strategy on Connecting Europe and Asia.[xv] The strategy envisages all forms of connectivity, including air, sea and land, as well as digital and energy connectivity, and there is an agreed EU-China Strategic Agenda for Cooperation.[xvi] Both sides have agreed to increase the synergy between the BRI and the EU's Trans-European Transport Network – TEN-T. At the 2018 EU-China Summit, participants in the two platforms agreed to pursue synergy between the two, and a number of TENT-T projects were put on the table[xvii] by various countries looking for financial support, which could come from European Investment Fund, i.e. the Juncker Plan, or from the European Investment Bank, the European Reconstruction and Development Bank or from China's Silk Road Fund. 18 projects were listed with the majority submitted by the Balkan countries and from Central Europe. Latvia was the only Northern European country to submit several projects.[xviii]

With respect to direct foreign investment, such investment grew rapidly after 2010 when it stood at 1.6 billion euros but jumped to 35 billion euros in 2016. On the other hand, EU investments in China grew to 168 billion euros by 2016.[xix] In 2018, in response to the slowdown in China's economy, and, perhaps, in response to criticism, both internal and external, that some of the invested sums were wasted on such things as sports clubs and in the hospitality sector, there was a drop in China's direct investment in Europe, to a more modest 17 billion euros. This figure was 40% less than in 2017, and 50% less than in 2016. In 2017, the Chinese government had directed that investments that cannot be strategically justified should be avoided or even abandoned.[xx]

The principal beneficiaries of Chinese investment in Europe have been the largest economies, that is, the United Kingdom, France and Germany, although in 2018 Sweden and Luxembourg appeared as significant beneficiaries. In relation to the total value of Chinese investments in Europe, the three main beneficiaries received 71% of those investments in 2017, but in 2018 this number had dropped to 45%. Investments dropped in such sectors as transport, electricity, infrastructure and real estate, while increased in such sectors as finance, health, biotechnology, consumer goods and car manufacturing. Investments in Eastern Europe also decreased and comprised only 1.5% of total Chinese investments.[xxi]

During the years of high investment in Europe, besides buying non-strategic firms, Chinese companies also bought high value high tech enterprises at the technological frontier, which aroused fears that China was acquiring such firms in order to transfer innovative technologies to further its own high-tech potential. In response, EU countries defended against such take-overs by introducing stricter investment screening procedures. In 2018, the European Commission introduced a new regulation for all member states that would ask them to follow stricter criteria in screening foreign direct investment, coming into force in October 2020.[xxii]

SECOND BRI FORUM 2019

In April 2019 in Beijing, the second BRI Forum was held with 5000 participants from 150 countries.[xxiii] It was a somewhat toned-down affair from the Chinese side, with Xi Jinping emphasizing that BRI projects needed to be 'high value'. He also repeated the mantra of western critics, that all sides involved need to respect openness, transparency and inclusiveness, and that cooperation must be 'open, green and clean', with a reference to fighting corruption in the implementation of such projects. He also recognized the need for a monitoring mechanism to oversee the completion of agreed projects.[xxiv] Noteworthy is IMF's Christine Lagarde's warning to China to limit its level of debt that is supporting its various projects, as it can have negative consequences for its economy.[xxv]

As reflected in the communique, it would appear that Xi Jinping had heard of the wide-spread criticism of the way that the BRI projects were being implemented. Nevertheless, he was able to show that the BRI was a success, noting that in 2019 agreements worth U.S. $64 billion were signed, and that the Silk Road Fund would make available 380 billion yuan or U.S $ 54 billion to Chinese banks for BRI projects. XI also promised to end state subsidies, limit non-tariff barriers, increase imports, protect intellectual property and not devalue China's currency. Of course, intent is one thing, implementation quite another.[xxvi]

17+1 FORMAT OF CENTRAL AND EAST EUROPEAN COUNTRIES

From a Latvian perspective, that part of the BRI that encompasses the '17+1' format,[xxvii] that is, Central and East European states and the Balkans, is of particular interest for comparative reasons. 12 of the 17 states are EU members. What is notable about this format is the fact that it exists at all. One can surmise that for the Chinese these countries, so recently having left the Soviet camp and seeking to catch up economically with their western neighbours, would have an extra incentive to welcome China's financial and economic engagement in their economies. From the EU perspective the 12 EU states, in this format, constitute a potential that they will align more closely with China's interests than with those of the Union.

The basis for the EU's unease with the 17+1 format reflects the asymmetric relationship between China and the 17, when China as the second largest economy has the investment capital and an expanding consumer market that draws these countries to China in the hope that it will favour them individually. This economic enticement has political consequences depending on the country. China has recognized the potential for such political influence by scheduling frequent meetings in this format at the level of experts, ministers, prime ministers and presidents. China is to be kept in constant focus. These meetings reiterate the gains from engagement with China, as stated by Chinese premier Li Keqiang at the Riga 16+1 Summit:

> *Principles of equal consultation, mutual respect and mutual assistance; of mutual benefit and win-win cooperation; of openness and inclusiveness; of inter-connected development; joint contribution and shared benefits.*[xxviii]

Unfortunately, these words do not reflect reality. In 2018 at the Sofia 16+1 Summit, the Central and East Europeans insisted on balanced trade, that is, not just in China's favour; that there be equivalent openness to each side's markets; and, open tenders for infrastructure projects that do not limit such tenders to Chinese firms. Such demands had been regularly made by the Union, but now also by the 17+1, bringing the countries in this format in closer alignment with the European Union. Even the designation of responsibility for coordinating different economic sectors among the 17 has not resulted in significant gain for these countries. Thus, for example, Poland is responsible for maritime issues, Romania for energy, Slovenia for forestry, Lithuania for financials and Latvia for logistics. The EU Parliament's research service could not attest to any empirical evidence that such coordinating functions have benefitted the coordinating country.[xxix] The reality, however, has not tempered, according to the EU study, enthusiasm for engagement with China. Nevertheless, in a number of these 17+1 format countries debate has begun on the issue of whether China exercises 'soft power' in advancing BRI projects: it would be naïve to presume that in utilizing its asymmetric economic power China does not seek political influence.[xxx]

When we look at some of the trade figures between the 17+1, actually when format was still 16+1, the turn-over has been relatively small; thus, in 2017 it was 57.3 billion euros, compared to 573 billion euros for trade turn-over at the total EU level. Among the Central and East European countries, the most trade occurred with the Visegrad four and with Romania.[xxxi] Detailed analysis of China's investments – greenfield, acquisitions and FDI with these countries cannot be entered here, save to say that it is a subject that has been extensively studied.[xxxii]

Given the reassessment that is taking place in some of the 17+1 countries, this format's future direction is not entirely clear; will China take into account the concerns of these countries, or will it continue as business as usual. In April 2019 in Dubrovnik, Croatia, the 8th China-CEE Summit took place, when Greece joined the group. Notable in the summit guidelines that detail achievements and challenges[xxxiii] was a reference to the format being part of the EU-China relationship and the EU-China Comprehensive Strategic Partnership. One can sense here an attempt by both sides to head-off any criticism made by the Union that this format hinders a united EU position on its relations with China, and calls on greater interaction with EU institutions, particularly on issues that are within EU competence – trade.[xxxiv]

For his part, China's prime minister Li Keqiang in Dubrovnik took the opportunity to put a positive gloss on the economic relations between China and the 17+1 countries, highlighting that trade turn-over had reached 82.2 billion dollars and that China's imports exceeded exports by 5%.[xxxv] Foreign direct investment had grown by 67%, particularly in the energy sector, mining and in consumer goods. Moreover, 6,000 block trains had travelled back and forth between China and Europe and promised that the 17+1 would play a greater role as gateways to Europe. He emphasized that this format was an essential element in China-EU relations. The prime minister also promised that China would build logistical centers or hubs, import more food products, including honey, fruit, milk and meat products. Coming from China would be electrical appliances and high-end consumer goods, including cars and household appliances. The trade-off here would appear to be between low value and high value goods that aid China's manufacturing sector while adding little to Europe's. In addition, he urged Chinese companies to create cross-border e-commerce warehouses and build stores in the 17 countries, and that they should invest in such sectors as farming, manufacturing, information and communication and create industrial clusters and logistical parks. 'Rule-based public tendering' would also be instituted.

To support the projects that Li Keqiang outlined the Chinese side would require a robust economy, and while economic growth has been significant, there have been indications that such growth is slowing. This was confirmed by Li Keqiang. In 2018 China's GDP had grown by 6.6% or 13 trillion dollars, in 2020 it will likely be between 6% and 6.5%. To ensure that economic growth does not fall below the targeted rate, some stimulation will be required, as well as structural reforms on the supply side as recommended by international organizations. The debt ceiling will not be raised, but the government will require that state entities and enterprises limit their expenditures. The private sector will be more actively supported and in January 2020 a new foreign investment law will be introduced that will open China's economy to greater foreign investment.

For Xi Jinping and the Chinese Communist Party the dilemma raised by greater responsiveness to the European Union's demands for greater openness to the Chinese economy turns on the party's ability to control China's economic development and, thus, maintaining its leading role in Chinese society. There is no evidence that Xi Jinping is ready to sacrifice that role to please its western trading partners. In making final determinations as to how far the Chinese economy should be opened to European investment and deeper economic cooperation, China will undoubtedly be guided by its own interests, particularly the interests of the CCP.

An assessment made by the European Council on Foreign Relations argues that in 2020 China will be more assertive in its relations with the European Union, given that the U.S.-China trade talks will complete 'phase one', and, thus, taking pressure off China to be more accommodative toward the EU. Some indications of a more assertive stance came from Chinese foreign minister Wang Yi in a speech in Brussels in late 2019. In effect, Yi warned the EU against following through on its new China strategy that had declared China a 'systemic rival', as well as against expecting greater reciprocity and the EU''s demand that China be more open economically. 2020 according to the ECFR could see little progress in resolving some of the outstanding complaints made by the EU against China, including China's leveraging the 17+1 format.[xxxvi]

From the European, and thus the Latvian, perspective, the geo-economic penetration by China of the EU's economic space raises a geo-strategic challenge. How over the coming years will the Union align its interests, when the U.S. intends to diminish China's ability to challenge it on multiple fronts, when Russia seeks to weaken the Union's already fragile cohesion, and when the U.S., at least under the present administration, signals its disinterest in supporting the European project in strengthening unity and the defensive alliance. If for Europe these are not abstract issues, as Nathalie Tocci has pointedly remarked,[xxxvii] they are no less for Latvia.

To what extent Europeans, aside from close observers of the global scene, are seized of the present and future challenges is not clear. Will they hunker down in their national politics, largely oblivious to the systemic shift in power relations in evidence today? Or, will they be led by political elites that understand that total preoccupation with national politics can lead to collective weakness, if not total powerlessness.

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ENDNOTES

[i] "The next decade will be defining for the future of Europe and Europe's role in the world. Seismic global power shifts; pressure on liberal democracies; challenges to global governance; the transformation of economic models and the very fabric of societies; new uses and misuses of technology; contrasting demographic patterns; and humanity's growing ecological footprint – the world is well on its way towards a new geopolitical, geo-economic and geo-technological order. What role will Europe play in this fast-changing world? How can the European Union ensure that it does not end up a middle power, caught between the United States and China? What will it take for Europe to hold its destiny in its own hands in 2030?" "Global Trends to 2030: Challenges and Choices for Europe," European Strategy and Policy Analysis, April 2019, https://espas.secure.europarl.europa.eu/orbis/sites/default/files/generated/document/en/ESPAS_Report2019.pdf

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[xi] "Chinese Premier Li Keqiang's speech at 9th China- CEEC Business Forum," Dubrovnik, 12 April 2019, https://www.ceec-china-croatia.org/files/Chinese-Premier-Li-Keqiang.pdf

[xii] Following are just some of the think-tanks that study China's developments: Rhodium Group; Mercator Institute for China Studies; LeidenAsia Centre, European Union Chamber of Commerce in China, ESADE (Escola Superior

d'Administracio i Direcció d'Empreses); Center for a New American Security. Some are part of European Think-tank Network on China (ETNC).

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[xxv] Tett, G., "China grapples with its BRI lending binge," The Financial Times, 3 May 2019.

[xxvi] Rosen, D.H., "The China Dashboard: Fall 2019 Edition," Rhodium Group, https://rhg.com/research/china-dashboard-fall-2019/

[xxvii] Originally there were 16 countries, but as of 2019, 17. They are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Chech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia. It should be noted also that Italy signed a memorandum of understanding with China on its participation in the BRI, against the objection of the EU.

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