

China's Economic Diplomacy and Sino-EU Relations

La cooperación económica y las relaciones comerciales son la base en las relaciones UE-China. Desde hace varias décadas, su cooperación en la economía y en el comercio se desarrolló mucho más rápidamente que sus relaciones políticas. El diálogo a distintos niveles de una amplia gama de asuntos ayuda a institucionalizar las relaciones bilaterales, a regularizar el intercambio bilateral y a fortalecer la comunicación y el mutuo entendimiento. La UE se mantiene como primer socio comercial de China y a su vez China es el segundo de la UE. La diplomacia económica constituye una parte importante en las relaciones Sino-europeas. Sin embargo, en los últimos años, junto con el ascenso de China y la crisis del euro, hay nuevos retos para estas relaciones económicas bilaterales y comerciales. La diplomacia económica de China debe ser revisada para hacer frente a los cambios y a los desafíos. Este documento se compone de las siguientes partes: después de revisar las relaciones UE-China, se definirá la diplomacia económica de China y sus características y analizará cuatro casos de diplomacia económica de China en sus relaciones con la UE. En las conclusiones se analizarán los retos para esta colaboración.

Ekonomiako lankidetzeta eta merkataritza-harremana izan dira orain arte EB eta Txinaren arteko harremanen oinarriak. Hainbat hamarkadatan, askoz gehiago garatu izan da lankidetzeta ekonomikoa eta merkataritza bien artean, harreman politikoak baino. Hainbat gairen inguruko solasaldiek, maila ezberdinetako gaiak aztertuz, asko laguntzen dute aldebiko harremanak instituzionalizatzen, aldebiko merkataritza normalizatzen eta komunikazio eta elkarrekiko ulermena sendotzen. EBk Txinako merkataritza-kide handiena izaten jarraitzen du, eta Txina da bigarren kidea EBrako. Diplomazi ekonomikoa funtsezkoa da Txina eta Europaren arteko harremanetan. Nolanahi, azken urteotan, Txinak goraka egin duenez eta euroa krisian dagoenez, bestelako erronkak sortu dira aldebiko harreman ekonomiko eta komertzial honetarako. Txinako diplomazi ekonomikoari buelta eman beharko zaio, aldaketei eta erronkei aurre egiteko moduan egon dadin. Dokumentu honek zati hauek ditu: EB eta Txinaren arteko harremanen berrikuspena, Txinako ekonomia diplomaziaren definizioa eta bere ezaugarriak, eta Txinaren diplomazia ekonomikoaren lau kasuren azterketa, EBrekiko harremanetan. Ondorioetan elkarlan horren erronkak aztertuko dira.

Economic cooperation and trade relations are the cornerstones in EU-China relations. For several decades, their cooperation in economy and trade developed much more rapidly than their political relations. Dialogue at different levels covering a broad range of issues help institutionalize bilateral ties, regularize bilateral exchange and strengthen communication and mutual understanding. The EU stays as China's largest trading partner and China the EU's second largest trading partner. Economic diplomacy serves as an important part in Sino-EU relations. Yet, in recent years, along with China's rise and the euro crisis, there are new challenges to bilateral economic and trade relations. China's economic diplomacy needs to be revised in order to deal with the changes and meet the challenges. This paper will be composed of the following parts: after a review of EU-China relations, it will define China's economic diplomacy and its features and analyse four cases of China's economic diplomacy in its relations with the EU. In the conclusion, it will examine the challenges for the partnership.

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1. INTRODUCTION

As a result of more than 30 years of economic reform and dynamic growth, China's rise has been widely recognised in the first decade of the 21st century. It is currently the world's second largest economy and second largest trading power. It possesses the largest amount of foreign currency reserve and is turning from an eager recipient of foreign direct investment to an aggressive investor in the world. For China, the EU is an important partner. Since 1975 when the two sides established diplomatic relations, economic and trade cooperation serves as the cornerstone of the partnership. The EU stays as China's largest trading partner and China as the EU's second largest trading partner. The increasing degree of interdependence and the necessity of cooperation in strategically important

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international affairs require the EU and China to build a long-term partnership, but EU-China relations have experienced some difficulties since 2005.

Needless to say, economy is closely linked to politics and diplomacy—economic activities are closely related to political decision-making, and interstate economic relations can either promote or hamper the development of their political relations. Economic diplomacy serves as an important part in China's relations with the EU. Either by providing economic incentives or exerting pressure, China intends to protect and promote its national interests. Yet, a close examination of such practice by China reveals some existing problems in EU-China relations. The differences between the EU and China from economic development to political and normative issues hamper the establishment of a closer relationship and mutual understanding. While China's economic diplomacy is significant, it will not help solve the fundamental problems in bilateral relations. This paper will be composed of the following parts: after a review of EU-China relations, it will define China's economic diplomacy and its features and analyse four cases of China's economic diplomacy in its relations with the EU. In the conclusion, it will examine the challenges for the partnership.

2. A REVIEW OF EU-CHINA RELATIONS

The history of EU-China relations can be divided into the following phases: mutual disregard (1975-1994); mutual attraction (1995-2002); honeymoon (2003-2004); reflection and adjustment (2005-now). The bilateral official relationship was established in 1975, but the EU had not produced its first China policy paper until 1995. Before 1975, ideological differences kept the two away from each other. As Prof. Shambaugh pointed out, Brussels-Beijing relations were to a large degree derivative from their respective relations with Moscow and Washington (Shambaugh 2004, p. 245). The European Community established diplomatic relations with the People's Republic of China in 1975 after most of its members recognised Beijing. In the first two decades of bilateral relations, two important agreements were produced. 1978 witnessed the first bilateral trade agreement. Seven years later, in 1985, a new one was reached on trade and economic cooperation. Bilateral trade grew rapidly from \$2.4 billion in 1980 to \$33.97 billion in 1994 (Huang 2005, pp. 1-2).

Attracted by dynamic economic development in Asia, the European Commission developed in 1994 a paper entitled «Towards a New Asia Strategy». Located at the centre of the EU's Asia strategy, China was given substantial attention. Marked by the first strategically-influential document produced by the European Commission in 1995, «A long term policy for China-Europe relations», EU-China relations embarked on a fast track of development. From 1995 to 2003,

bilateral relations were upgraded in an all-round way. Bilateral trade reached \$100 billion in 2003, two times more than that of 1995. In 2003, China overtook Switzerland to become the EU's second largest trading partner behind the US. Till then, about twenty sectoral dialogues and cooperative programs were set up to further bilateral communication and exchange. In the meantime, political cooperation has been strengthened due to close economic relations. Political dialogue on sensitive regional and international affairs and human rights has been established since 1994. The summit meeting mechanism between the political leaders of China and Europe was created in 1998. During this period, bilateral relations had been gradually institutionalised, widened and deepened.

Enhanced cooperation in economic, political and other fields encouraged the two sides to upgrade bilateral relations. In 2003, the consensus to establish a «strategic partnership» symbolised the climax in the development of EU-China relations. The strategic partnership brought the two into a honeymoon period between 2003 and 2004. Exchanges of visits by top leaders on both sides became more frequent. For example, EU officials paid 206 visits to China in 2004, on average four such visits a week (Waldner 2005). The Chinese Premier, Wen Jiabao, was the first foreign leader to pay an official visit to the EU after its historically important eastward enlargement in May 2004. The partnership demonstrated the EU's new ambition in international diplomacy. In the same vein, China sought to readjust its external relations. By forging partnerships widely with other influential powers apart from the United States, China wishes to wield more influence in international politics.

A strategic partnership should be «long-term and stable,» transcend «the differences in ideology and social system» and «not subjected to the impacts of individual events that occur from time to time» (Wen 2004). However, the developments in EU-China relations in the years after 2004 seem to indicate that such expectations are too high. Without a solid basis of shared values and norms, with many differences in history, culture and political beliefs, and, in particular, with rising problems in economic cooperation and trade relations, the strategic partnership faces challenges.

For three decades since the economic and reform policy was implemented in late 1978, China has been keeping an average annual increase rate of more than 9 percent in its GDP. The rapid Chinese economic development is in contrast with the unsatisfying economic performance inside the EU. Compared to the dynamic economic development in China, the economic growth rate in the EU has not been so impressive in recent years. The growth rate of the fifteen Member States was down to 0.8 percent in 2003, and the growth rate of the twelve euro countries dropped to 0.4 percent (Yang and Sun 2005, p. 21). Although the economic growth rate of the euro zone has been improving from 1.4 percent in 2005 to more than 2 percent in 2006, Europe was hit by the world-wide financial and economic crisis in 2008 and the

European governments face a formidable problem in reducing unemployment and encouraging sustainable development. How to effectively explore external markets in order to revitalise economy is an important concern for the EU countries.

Before 1996, the European Community enjoyed trade surplus but after 1996, the EU has been in an increasingly uncomfortable position in its trade relations with China. While China's exports to the EU grew from €4 billion in 2000 to €92.1 billion in 2011, China's imports from the EU increased from €5 billion to €36.2 billion in the same period.² Although the two-way trade with China has been growing impressively during these years, and China is the fastest growing export market for the EU, the trade deficit for the EU has also been rising rapidly.

As the EU-China partnership has been encountering increasing difficulty, the initial enthusiasm about the partnership has been gradually replaced by disappointment. Both Brussels and Beijing have become more realistic. While cautiously optimistic about the future of the partnership, both sides have come to recognise the existence of misunderstandings, disputes, and frictions. Three years after the strategic partnership had been established with China, the Commission tried to summarise developments in bilateral relations in its China policy paper in 2006. While confirming the rising influence of China, it emphasised the shared responsibility between China and the EU for maintaining global peace and stability. The EU repeated its engagement policy towards China and its commitment to support China's transition towards an open society. Meanwhile, it also realised that «Europe needs to respond effectively to China's renewed strength. To tackle the key challenges facing Europe today –including climate change, employment, migration, security– we need to leverage the potential of a dynamic relationship with China based on our values» (European Commission 2006). Unlike the earlier policy papers, this latest policy paper issued by the Commission includes two separate documents. The growing deficits in the EU's trade with China, increasing complaints from European investors about copyright issues, and the non-transparent market access conditions obliged the Europeans to re-evaluate their cooperation with the Chinese. While emphasising the importance of the partnership with China, the EU requested China to compete in a fairer way by further opening up its market and levelling the playing field particularly for copyrights of high-tech products.

In order to find solutions to existed problems, the EU and China widely expanded and strengthened their trade and economic dialogues at all levels covering trade policy, textile trade dialogue, competition policy, customs cooperation, intellectual property rights, regulatory and industrial policy. The EU-China High

² Due to financial crisis started in 2008, EU-China trade was seriously affected in late 2008 and 2009. As a consequence, the EU's deficit with China was decreasing due to its shrinking capacity of import from China. However, the trade deficit has been slightly rising since 2009 from €31.8 billion in 2009 to €55.9 billion in 2011.

Level Economic and Trade Dialogue (HED) was launched in Beijing in April 2008, serving as a platform for both sides to deal with problems in bilateral economic and trade relations. One of its important objectives of this annual dialogue is to deal with the imbalanced trade. However, after three years, there seems to be lack of incentive to continue this initiative. Without any official explanation, the HED was suspended last year and it is rather unlikely that there will be an HED in 2012 since both sides have much more important topics to talk about, such as market economy status, arms embargo lifting, eurozone crisis and the EU's aviation carbon tax (author's interview 24 July 2012).

The review of bilateral relations indicates the following points: first, bilateral economic relations have been changing in favour of China due to the fact that China's economic power has been growing continuously in the reform era. Secondly, China's rising economic influence, on the one hand, stimulates more cooperation and trade development between the EU and China; but on the other hand, does not make bilateral relations easier. After keeping bilateral exchanges and dialogue for more than three decades, mutual understanding has not been realised and the gap between the two sides on key issues has not been noticeably shortened. When dealing with differences between Brussels and Beijing, China often practises economic diplomacy. Yet, how effective such practice is needs to be examined carefully.

3. CHINA'S ECONOMIC DIPLOMACY AND ITS FEATURES

For Americans or Europeans, economic diplomacy is not new (see, for example, Parrini 1969; Trachtenberg 1980), but for China, the most striking rising power in the world, economic diplomacy only appears in the government document in the 21st century. As a result of deepened economic globalisation and the increase of China's economic power, economic diplomacy has gradually become an important component of China's overall diplomacy. It was first used by Chinese Premier at his meeting with the representatives from developing countries in August 2004. Several months later, the government report of 2005 stated that the government would overall strengthen economic diplomacy in order to promote Chinese national interest (Wen 2005).

While economic diplomacy appears more frequently in the official documents in China in recent years, Beijing has never defined what «economic diplomacy» is. More interestingly, although the Chinese government never stated openly their practice of economic diplomacy before 2004, Chinese scholars in general agree that the practice of economic diplomacy started as early as when the People's Republic of China was founded, although the resources mobilised and the influence were not so impressive and the approaches that could be used were rather limited (Ye and He

2004). Yet, they disagree on how to summarise the current stage of China's economic diplomacy. Dr. Ding from Development Research Center of the State Council (DRC), for example, argues that China's economic diplomacy has experienced two stages: the previous one was characterised by the fact that economy promoted diplomacy and the current one is that diplomacy promotes economy (See Ke 2011). Dr. Di from Renmin University maintains that China's economic diplomacy has passed the two stages which use economic means to realise political and diplomatic objectives and to pursue economic interest. Currently, China enters into the stage that economy and diplomacy mutually support each other, that is, economy, politics and diplomacy are more balanced (See Qiu 2009).

The differences in perceiving the role of economy and diplomacy in these discussions are in line with the two types of economic diplomacy defined by Yi Lu, a professor of China Foreign Affairs University. In his view, the first type is to use economic means to reach specific political objectives or diplomatic strategic intention; the second is to focus on economic relations in the state's external relations. Through developing its own economy and relying on diplomatic approaches, the state is to solve economic issues, rectify and coordinate economic policy, safeguard the state's rights in its external economic relations, and increase national economic interest (1997, pp. 153-154). In other words, economic diplomacy is not only aimed at promoting national economic interest, but also intended for political objectives and diplomatic strategy. In case of China, its rising economic power helps increase the influence of its economic diplomacy and allows it to take manoeuvre against the EU policies which are in conflict with its national interests.

Generally speaking, Chinese economic interests are closely intertwined into its political interests. For example, the issues of arms embargo lifting and market economy status between the EU and China are complicated in nature. One can hardly define its nature as purely political or economic when trying to find a solution to these issues. Therefore, economic diplomacy practised by China often targets at both political and economic interests.

China deems high the Taiwan issue and the Tibet issue in its foreign policy and regard them as its core national interests. Since the 1950s, the Five Principles of Peaceful Co-existence have become the basic starting point of Chinese foreign policy. In the field of external relations, Beijing always emphasises respect for sovereignty and territorial integrity as well as mutual non-interference in each other's domestic affairs. China attaches great importance to domestic stability, which serves as the foundation of the regime stability. In order to maintain the legitimacy of the Chinese Communist Party in China, the Chinese leadership needs to maintain reasonable economic growth rate. Only when development is guaranteed, can the employment rate be maintained. Only when the economic interest of the Chinese people is taken care, can the society remain stable. In this way, the leadership of the Chinese Communist Party will not be challenged. Therefore, the close relationship between stability and development

decides that China opposes any issue in interstate relations, jeopardising either its stability or development.

Although the EU still maintains technological advantage in certain fields, it is not as strong as it used to be in comparison with China –the relative decline of the EU and the rapid rise of China form sharp contrast– as the review of bilateral relations indicated, the power shift is plainly exemplified in their bilateral relations. In its relationship with the EU, China uses its economic power either as carrot or stick to facilitate its national interests. The following cases demonstrate a clear linkage between China's economic diplomacy and its defensive position for sovereignty and its efforts to maintain domestic stability and development. Economic diplomacy is often practised by China to solve some thorny issues with the EU. Although sometimes it seems that China reached its purpose, the long term effect is dubious.

4. TEXTILE DISPUTE

The textile dispute between the EU and China in 2005 was the consequence of the abolition of the 40-year-old quota regime and the rapid growth of Chinese exports to the European market. The sharp rise in Chinese textile exports to the EU in the first three months of 2005 led to vocal demands from about half of the 25 EU Member States to impose immediate limits on Chinese textile imports (people.com.cn 2005). According to the statistics of Chinese customs, Chinese textile exports to the EU-15 countries indicated a 78.4 percent increase compared to the same period of the previous year. Its exports to Germany, France, Italy, Spain and Belgium all increased by more than 80 percent (Cai 2005, p. 42). Among the nine categories of textile products under investigation by the EU, the volume of T-shirt imports from China into the EU went up by 187 percent, compared with the first quarter of the previous year (Meller 2005). When China joined the World Trade Organization (WTO) in 2001, the admission agreement included a clause that allowed other WTO members to safeguard their own textile industries with measures including quotas if they face a sustained surge in Chinese imports that cause irrevocable harm to their own producers. Nevertheless, the accession agreement required that all the safeguard measures against Chinese textiles must be removed by the end of 2008 (European Commission 2005).

Facing a sharp increase in Chinese products in the European market, some of the Member States, particularly the southern European countries, exerted pressure on the Commission to adopt emergency measures against the huge quantity of Chinese imports coming into Europe. In order to ease the situation, Beijing introduced voluntarily export tariffs on 81 textile products to slow the surge in Chinese textile exports to the European market in the early 2005. When it was clear that the EU would impose restrictions on Chinese imports, Beijing became furious

and scrapped the voluntary export tariffs that it introduced earlier (*Economist* 2005). Although unhappy about the EU's idea of quota re-imposition, the then Chinese Minister of Commerce expressed that «We do not want to see a trade war.... I do not believe retaliation to be the only way (forward) for us. A healthy trade relationship is good for both sides» (*China Daily* 31 May 2005).

The rapid growth of Chinese economy, to a large extent, is supported by its robust foreign trade sector. The advantage of cheap land and labour made Chinese products relatively cheaper compared to products from other countries and Chinese products competitive in the international market. On top of that, Chinese textile industry was well prepared for the abolition of the quota system –it dramatically increased investment in 2004 to largely expand its productivity– the actual investment of the first season of 2004 reached Rmb10.319 billion, an increase of 100.7 percent compared to the same period of the previous year (ec.com.cn 2011). In contrast, many European producers were caught unexpected –they failed to make good use of the ten years of transitional period from 1995 to 2004– as a result, they required the EU to re-introduce quota system against Chinese imports. For Beijing, the article included in China's accession to the WTO obliged it to accept the re-imposed the quotas; but the need to maintain a relatively stable employment rate in the industry required that it should bargain hard with the European counterpart.

After several rounds of negotiations, the two sides reached an agreement in June 2005, introducing quotas on some of the categories of Chinese textile products. Rather than taking the Chinese imports of 2004 as the reference data for quota imposition, which was proposed by the Europeans, the agreement adopted the argument from the Chinese side to calculate the quotas on the basis of Chinese imports in 2005 (ec.com.cn 2011).

Unexpectedly, European importers took advantage of the month-long delay of the enforcement of the restrictions and placed huge orders in an attempt to get quota-free goods into Europe before the deadline arrived. The newly introduced quotas were rapidly exceeded. From July to early September 2005, about 80 millions of Chinese garments piled up at EU ports which forced the two to start a new round of negotiation. Agreement was finally reached in early September after hard bargaining between the two sides.

The textile dispute revealed some problems in bilateral economic relations. First, although the Member States have already transferred part of their sovereignty to European Community, and the latter has the right to make overall decisions concerning the economic and trade policies, the Community and the Member States differ about the trade relations with China. Different Member States have different interests in trade issues, with the countries in the north promoting market liberalisation and the countries in the south trying desperately to protect their markets. It is therefore difficult for the Community to speak with one voice.

Secondly, inside the Member States, different groups have different interests. Trading companies, wholesalers and consumers benefiting from the cheap products from China, are in favour of more imports from China. In contrast, European workers and textile enterprise owners, unable to compete with cheap labour in China, intend to exclude and limit Chinese imports. In this way, there is some space for China to manoeuvre in the negotiations with the EU. As an important trade partner for both the EU in general and the Member States in particular, China enjoys undeniable influence. Neither the EU, nor the Member States, would like to see that bilateral economic and trade relations were in recession due to conflicts in some of the fields. Although postponed for a month or more, the European governments finally gave green light to the stockpiles of Chinese textile products blocked in European harbours. While started with a crisis situation, both sides reacted in a relatively rational and reasonable way. On the other hand, as this is a quite technical issue, which is not so much related to more sensitive issues in bilateral relations, economic diplomacy seems to work well. The following cases are much more complicated and more difficult to find satisfying solutions.

5. MERKEL AND THE DALAI LAMA

After Angela Merkel became German Chancellor in late 2005, she decided in 2007 to meet the Dalai Lama, the political and spiritual leader of the Tibetans, despite Beijing's complaints. As she was the first German Chancellor to do so, Beijing was furious (Dempsey 2007). China cancelled a series of high-level meetings including the one on the protection of intellectual property rights with the German justice minister, the annual human rights dialogue with Germany, and a standing breakfast between the Chinese and German foreign ministers on the sidelines of the annual UN General Assembly in New York.

China's strong reaction initiated discussions inside Germany. In the opinion of Adrienne Woltersdorf, head of *Deutsche Welle's* Chinese service, «German politicians have always debated very intensely how to meet the Dalai Lama, whether to meet, on what level and even in which building. It's a difficult issue, especially because Germany is a very big export nation with strong economic ties to China.» She pointed out further that «We can't judge how far China is prepared to go in punishing foreign governments for meeting with the Dalai Lama» (Quoted in Lawton 2010).

One of the major reasons that the Germans were reluctant to upset the Chinese was because they were afraid that their economic and trade relations would be negatively affected. Two months after Merkel's meeting with the Dalai Lama, the newly elected French President Sarkozy paid his first state visit to China. In contrast to Merkel's criticism of China's human rights record and insufficient efforts on the

rule of law, He was more muted about these issues. And interestingly enough, he did not take his human rights minister with him at the visit. In exchange, he got contracts worth more than €0 billion from his Chinese counterpart, including a €2 billion order for 160 Airbus planes and an € billion deal to supply two third-generation nuclear reactors (Dempsey and Bennhold 2007).

Both jealous of the deals made by Sarkozy and worried about the potential trade losses, German business leaders tried to lobby their Chancellor to take active steps to improve relations with China (Buck 2007). In the government, officials including Merkel's foreign policy advisor Christoph Heusgen and Foreign Minister Frank-Walter Steinmeier took pains to repair the damaged ties with China. The bilateral relationship kept cool for about nine months until the visit of Frank-Walter Steinmeier to China in 2008.

This diplomatic episode between China and Germany demonstrates a commonly used method by Beijing in its economic diplomacy: play one off against the other. France and Germany, the two most important Member States of the EU, are also competitors in their economic and trade relations with China. Germany has been the number one trading partner of China inside the EU for some years. France's sales account for less than 1.5 percent of Chinese imports, compared with 5 percent for Germany in 2007 (Dempsey and Bennhold 2007). When upset by Angela Merkel, Beijing intended to woo Sarkozy by giving France an impressive amount of business deals. In Beijing's calculation, the German government would be under pressure when the business went to France and therefore, Germany would make some compromise on China's core national interest. The result was quite interesting and worth analysis.

Noticeably, when the Dalai Lama visited Germany again in May 2008, both German President Horst Köhler and Foreign Minister Steinmeier declined to meet him while Chancellor Merkel was out of the country. Mr Steinmeier, the second-most-powerful politician after Merkel, who comes from the Social Democratic Party, criticised Merkel's confrontational policy with China, and pledged that Germany would support fully the one-China policy (Dempsey 2008). The reason that the German government reassured China its respect for China's core interest was not merely out of fear of China's punishment in economic terms. It was, more importantly, due to the differences in foreign policy between the German leaders that led to the different voices on China policy. The Germany society attaches great importance on human rights and the rule of law. Although the previous German leaders never offended Chinese government openly, it did not imply at all that they endorsed the Chinese political system. As a matter of fact, due to shared economic and political interests, they tended to rely on «quiet diplomacy» –to exchange views with the Chinese leadership behind the scene– in this way, Beijing would not lose face and the two sides were able to conduct a good working relationship. Therefore, how Germany's China policy will evolve will depend on domestic political

competition in Germany as well as China's further development. Chancellor Merkel may have started a precedent, which would probably attract more followers if one of the two elements mentioned above went wrong.

Although Germans were concerned about the possible negative impact of Merkel's meeting with the Dalai Lama on the trade relations with China, data showed that there was no fallout. Moreover, the deals of Airbus that Sarkozy made with China would not only benefit France but also Germany, because the EADS, Airbus parent company, is a consortium dominated by both French and German shareholders. In other words, although China wanted to play France off against Germany, to give contracts to Airbus was not a politically wise choice. Nevertheless, intensive economic interdependence, both between the EU Member States and between China and the EU, decides that the necessity of economic cooperation facilitates strong connection as well as exposes weakness in their external relations. Strengthened cooperation could deepen bilateral ties whereas competition and conflicts could have a direct negative impact on bilateral relations.

6. SARKOZY AND THE CHINESE PURCHASING DELEGATIONS

As mentioned earlier, When Sarkozy visited China in late 2007, he pleased Beijing by publicly supporting the one-China policy. Yet, his «policies have proved as unpredictable and unreliable as the man himself» (*The Economist* 28 April 2012). In 2008, he annoyed the Chinese on several occasions. Due to problems of human rights in China, the European Parliament urged EU leaders to boycott the opening ceremony at the Beijing Olympics. Merkel stated that she would not attend the opening ceremony, whereas Sarkozy did not send a clear signal until early July—he decided to attend the Olympics. However, while he was in Beijing, he dispatched his wife to meet the Dalai Lama. The Chinese were certainly irritated, and the French media, «almost universally, interpreted the deployment of the First Lady to greet the Tibetan leader as a clumsy attempt to combine realpolitik and principle.» The then first secretary of the Socialist Party, François Hollande, sarcastically pointed out that «Nicolas Sarkozy has already won the gold medal for hypocrisy» (Lichfiel 2008). Several months later, when both the European and the Chinese diplomats were ready for the 11th EU-China summit scheduled for the beginning of December in Lyon, China got informed that Mr Sarkozy planned to meet the Dalai Lama in Gdansk, Poland on 6 December. Predictably, China reacted strongly against it and cancelled the summit meeting.

In the meantime, China postponed the finalisation of the deal for 150 Airbus passenger planes. Chinese Vice Foreign Minister He Yafei summoned French Ambassador to China and stated solemnly that Sarkozy's «wrong action damaged the hard-earned political mutual trust, comprehensive cooperation and favorable

prospect created since the establishment of China-France ties 45 years ago. It is the French side that shall be held accountable for all the serious consequences» (Chinese Foreign Ministry 7 December 2008).

Since the EU-China summit mechanism was established in 1998, it was held annually until 2008. How many tangible issues could be addressed and solved at the summit are not what this paper would analyse, but at least one can say that this is the highest level contact between the two sides. Before 2008, both Beijing and Brussels tended to respect this institutional arrangement. For the latter half of 2008, France presided over the EU. The policy and behaviour of Sarkozy had strong repercussions not only on Sino-France relations, but also on Sino-EU relations. Sarkozy's meeting with the Dalai Lama was interpreted by China as not only on behalf of France, but also on behalf of the EU. Yet, when China cancelled the summit meeting with the EU, the issue became more complicated.

When Merkel met the Dalai Lama, China took measures solely against Germany, without involving other European countries. The problem China had with Merkel was purely bilateral. Yet, the French EU Presidency changed the nature of the problem and increased the difficulties for China to handle it. Understandably, Brussels was completely unprepared, «stunned» at China's decision, having no clear clue as to when the next summit would be held (*Euractiv* 27 November 2008). While targeting at France for retaliation, Beijing intended to send a clear message to the EU that the problem with France should not affect its relations with Brussels. In order to do so, Chinese Premier Wen visited Brussels after the Davos conference in Geneva at the end of January 2009, and met EU officials to reach an agreement that the 11th summit meeting would be held during the Czech EU Presidency. Wen also visited some other European countries and intentionally omitted France in his itinerary. When asked why doing so, he replied, «I looked at a map of Europe on the plane. My trip goes around France,... We all know why» (*China Daily* 3 February 2009).

The following February, after Premier Wen's trip to Europe, a large Chinese delegation visited Switzerland and several EU Member States, including Germany, the UK, and Spain, but pointedly excluded France. The Chinese business delegation signed a total of \$14 billion deals with German companies, \$2 billion deals with the UK, and \$320 million deals with Spain (*People's Daily* 2009). In March of that year, the second Chinese procurement delegation was sent to the above four countries to «explore investment opportunities on areas of automobile, machinery, textile, food, electronics and technologies relating to energy saving and environment protection» (*Xinhua News Agency* 2009a).

Similar as the previous case, China developed economic diplomacy in order to defend its core national interest. In contrast to China's dynamism and strong influence in the economic field, the EU started to suffer from the financial and

economic crisis since 2008. According to French Ministry of Economy, Industry and Employment, more than 2.57 million French lost their jobs in September 2009, up 25 percent from the previous year (Ding 29 October 2009). China's large scale purchases in other European countries constituted huge pressure to the French government, which reached a joint press communiqué with China during the G20 summit in London in April 2009 and stated that:

France fully recognizes the importance and sensitivity of the Tibet issue and reaffirms its adherence to the one-China policy and the position that Tibet is an integral part of the Chinese territory, in accordance with the decision made by General Charles de Gaulle, which has not changed and will remain unchanged (*Xinhua News Agency* 2009b).

After settling this political issue, China sent its third delegation to Europe, for a purchasing mission focused on France (Li 4 April 2009). Several months later, the fourth delegation was sent to Italy, Sweden, Finland, and Portugal to stimulate bilateral economic cooperation and trade relations (Xiaoyang July 2009). It was quite extraordinary that China sent four large-scale business delegations in one year to Europe on purchasing missions. Against the backdrop of euro crisis and the damaged EU-China relations, the Chinese delegations not only purchased the goods from EU Member States, but also helped stimulate local economy and improved economic cooperative relations with the EU.

While from appearance, the problem was solved, Sino-France relations were back to the right track and Sino-EU relations were repaired. Yet, an in-depth analysis indicates the limitedness of China's economic diplomacy. The ad-hoc purchasing missions could only help warm the relationship temporarily. As the differences in values and political interests between China and the EU have never been shortened, problems would certainly prop up again. As a matter of fact, after German Chancellor and French President, the British Prime Minister Cameron met the Dalai Lama in May 2012. China adopted similar retaliation methods by cancelling some high-level meetings, and exerting economic pressure to the UK, but predictably, it would not last long. As both the case of Germany and France demonstrated, after a certain period of time, Sino-UK bilateral relations would be normalised again. Therefore, either economic stick or economic carrot is not the optimal way for China to maintain a healthy relationship with the EU.

7. CHINA AND THE EMISSIONS TRADING SYSTEM

Different from the previous cases, this one covers problems China has with the EU on a multilateral basis. While there is no solution yet, it is quite clear that Beijing tends to pursue economic retaliation as a means to counter the EU's policy. Tension has been growing recently between Beijing and Brussels partly due to the EU's law

on the aviation carbon tax. Such an EU law came out against the background that the US is reluctant to cooperate with others to implement the Kyoto Protocol and there is no global agreement on how to effectively reduce aviation CO₂ emissions.

The EU established a scheme for greenhouse gas emission allowance trading for its own members in 2003 (Directive 2003/87/EC). Since 2005, the EU has launched the emissions trading system (ETS) which works on the «cap and trade» principle. In 2008, the EU further amended the directive by including «aviation activities in the scheme for greenhouse gas emission allowance trading within the Community» (Directive 2008/101/EC). Since 1 January 2012, greenhouse gas emissions from aviation activities have been regulated by the EU ETS and non-European airlines are requested to comply with the obligations imposed by the EU law, which says, «emissions from all flights arriving at and departing from Community aerodromes should be included» (Directive 2008/101/EC).

Although aware of the new EU law and its possible impact on Chinese airlines, China did not start negotiations with the EU until the beginning of 2011. During these months, no tangible results have been produced. Together with other countries, China strongly opposes the EU law, but compared with other countries, it is one of the most adamant in confronting the EU. Estimated by the European Commission, the ETS will cost Chinese airlines less than €5 million per year (Hale and Carrington 2012), but according to Chinese calculation, adopting the ETS standards will cost China's aviation industry Rmb790 million (\$124 million) in 2012 and an estimated Rmb3.7 billion in 2020 (Harris 2012).

On 7 July 2011, China and Russia jointly condemned the EU's decision and raised the possibility of pursuing retaliatory measures. One month later, 20 airlines had a meeting in Beijing and adopted the Beijing Common Declaration, protesting against the EU's Directive (Tunteng 2012, p. 118). As indicated earlier, economic deals are closely related to political objectives. Airbus, as one of the two largest plane manufacturers in the world, is often affected by political relations between the EU and China.

The June 2011 Paris Air Show became the first such show that no deals with China were achieved. Yet, in the meantime, Boeing received an order from China worth \$4.8 billion (Zhang 2011). If it was not due to Chinese Premier Wen's visit to Europe, China would not have even announced the purchase of 88 Airbus A320 two days after the Paris Air Show. Yet, in March 2012, Airbus said that China suspended the orders of ten Airbus A380 and 35 Airbus A330, which valued at \$12 billion. According to BBC environment correspondent Richard Black, this seems to be «the heaviest weapon yet deployed in the battle between the EU and its opponents over charging airlines for their global warming emissions» (BBC 8 March 2012).

On 6 February 2012, Beijing announced that its airlines may not participate in the ETS without authorisation from Chinese authority. About three months later, China

published a draft climate change law, which mentioned possible «retaliatory approaches» to dealing with the EU's inclusion of aviation within its ETS. Without specifying the EU, the draft law stated that «China objects to other countries and areas using climate change as an excuse to conduct protectionism in trade, or unilaterally levying carbon taxes or similar taxes on Chinese airlines, ships, etc» (Quoted in *Point Carbon* 14 May 2012). In view of Wei Zhenzhong, Director General of China Air Transport Association (CATA), «EU ETS is a unilateral action and lacks any basis to enforcement action and punishment» (Quoted in Cattle 2012).

While all the other airlines from outside the EU oppose to be included in the EU's ETS, they all submitted the required baseline emissions data for 2011 except eight Chinese airlines and two Indians, before the end of March 2012, the deadline requested by the EU. Instead of introducing punitive measures immediately, the EU extended the deadlines to mid-June, but the Chinese ignored the offered extension. At the International Air Transport Association (Iata) meeting in mid-June 2012, Air China Chairman Wang Changshun said that his airline would refuse to provide the relevant emission information for 2010 and 2011 (Harris 7 July 2012). As the tension increases between the EU and the international airlines, Europe's airline executives had a news conference in Brussels, condemning the EU's arrogant approach in unilaterally imposing the ETS on the world (*Euractiv* 2012a).

Eager to please Beijing and maintain its market share in China, Airbus supported China's refusal to accept the EU's position and started talks with China in mid-June 2012 to extend Tianjin assembly beyond 2016. Interestingly enough, if Airbus directed the work to its facility in Hamburg, it is cheaper and easily connected with its logistics setup. But the final assembly line in Tianjin is selected and kept by Airbus to improve its market access to China (Perrett 2012), especially against the moment of political crisis between Brussels and Beijing. It is predicted that «Chinese domestic air traffic is expected to grow by an average of 7.5 percent per year until 2030... China would need 5,000 commercial aircraft worth \$600 billion over the next 20 years» (*Reuters* 2012). Chinese market is undoubtedly attractive to aircraft manufacturers. As business deals are never purely commercial transactions, and it often happens that China selects European industries to retaliate whenever it has serious problem with some EU policies, Airbus does not want to be the victim in such conflict and tries to help itself by increasing cooperation with China.

The reasons for China to challenge the EU law are mainly out of the following considerations: first, the EU is a regional organisation. It has no right to implement a law which includes players outside the Union. In other words, the unilateral action taken by the EU infringes upon state sovereignty of those which are not member states of this organisation. Secondly, the EU made such policy without taking in the opinions of other countries. As a rising power which pays increasing attention to its right in the international arena, China feels upset to be put in the position of a rule-taker. In order to better protect both its political and economic interest, China

would like to be a rule maker. The conflict with the EU on the ETS is part of its struggle to gain equivalent influence relevant to its rising power in the world. Thirdly, due to this law, huge amount of cost will be inflicted upon Chinese airlines, which is deemed unacceptable by China. Most of the Chinese airlines argue that, «After buying planes made in the EU and flying with these planes to Europe, we are required to submit tax due to the CO₂ released by the planes produced by Europe, this is unfair. Why doesn't the EU levy directly tax from Airbus?» (Quoted in Zhang 2011). Fourthly, behind the debate on whether international airlines should be involved in the EU's ETS lies the core difference between the developed and the developing world on who should pay for the costs of mitigating climate change. Regarding itself as the representative of the developing countries, China emphasises times and again that the principle of «common but differentiated responsibilities» should be respected when considering efforts against climate change.

Obviously, the retaliatory measures that China took against Airbus would only be temporary. Yet, such practice may be necessary for China to exert economic pressure on the EU and to guard its interests before agreements can be found between the EU and China. Without acting tough, China would easily lose its negotiating ground. But without flexibility and wisdom to deal with these problems, conflicts will rise and the general atmosphere of EU-China relations will be affected negatively.

There may be two solutions for China to find. One is to make and implement an equivalent scheme of its own. Two Chinese institutes, the Beijing Energy and Environmental Exchange (CBEEEX) and Shenzhen Carbonneutral Bio-gas are currently working on blueprints for a Chinese carbon trading scheme (2012b). The draft law on climate change published in May 2012, to be taken up to three years to be implemented, will include «possible provisions for both a national emissions trading scheme (ETS) and for the introduction of a carbon tax» (*Point Carbon* 14 May 2012). However, although the EU said that it may exempt China if the latter develops such a scheme, it would likely impede China from introducing its own measures by claiming to avoid «double regulation in international aviation» and it would always be «in a position to unilaterally amend its legislation» (Tunteng 2012, pp. 14-15).

The second solution is to wait for the ICAO to produce a globally accepted emissions scheme. Despite the ongoing tension between Brussels and other countries including China, both sides seem to support a global emissions arrangement negotiated by the International Civil Aviation Organisation (ICAO). The working paper of the ICAO adopted on 2 November 2011 pointed out that the unilateral measure of including civil aviation in the EU ETS contravenes the articles of the Chicago Convention and its Preamble and it violates the principle of the UNFCCC as well as undermine ICAO's leading role in matters related to aviation and environment (Tunteng 2012, p. 15). Tony Tyler, chief executive

officer of IATA, commented that «Europe seems more committed to implementing its ETS unilaterally than to sincerely negotiating a multilateral agreement. For Europe's international counterparts, it's like being asked to negotiate with a gun to their head» (Harris 2012). Yet, it is easier to criticise others than to produce a workable arrangement. It is clear that the earliest solution from ICAO would only be out in November 2013. A lot of work still needs to be done before a global consensus can be reached. The question is: what will the EU do in the coming months? Will it wait till then or will it enforce its summer ETS deadline? For China in this case, while economic diplomacy may play somewhat a limited role, it will not help completely resolve the issue. Political wisdom and mutual understanding need to be found as the basis of successful negotiations.

8. CHALLENGES FOR EU-CHINA RELATIONS

As mentioned earlier, economic and trade relations are the cornerstone of EU-China relations. Close cooperation in this field stimulates further development of bilateral relations and makes each other attractive partners. Nevertheless, during the past 37 years, in particular in the 21st century, China is following a rapidly rising path while the EU is relatively declining. The euro crisis is lingering on, with no clear prospect of when the EU can be out of its shadow. Although the EU is the largest trading partner of China, its influence and power are often checked due to the fact that it is composed of 27 Member States. Germany, which enjoys the largest trading volume with China compared with other EU member states, is only number six among the top ten trading partners of China. Such a situation creates possibilities for China to play the economy card in its relations with the EU.

While the EU and China share a long-term interest in pursuing prosperity and influence, the two sides diverge on how to reach such a goal. The divergence is due to the fact that the EU and China are very different partners. First of all, they come from different ideological backgrounds. Such a difference is compounded by the fact that the EU and China are at different stages of development. The highly developed economy as a consequence of several hundred years of state building and capitalist development allows the EU to focus more on political freedom, and to attach great importance to the political and civil rights of its citizens. In contrast, China has only become independent at the end of the 1940s and still concentrates on solving economic problems so that all the Chinese can have enough to eat and wear. As a result, China stresses more the development rights of its citizens. This somehow fails to correspond to the EU's expectations. Proud of its own development path, the EU expects to exert its influence on China and to turn it into a liberal democratic regime based on the rule of law. Yet, the contact with China seems to tell the Europeans that it is not that easy to transform this huge authoritarian system. The EU's disappointment in China's political development

combines with the frustration caused by its trade deficit. In recent years, criticism on China's slow pace of political reform, on its human rights record, on its lack of transparency in military expenditure, and on its restriction on market access dominate the media in Europe which in one way or another reveals the problems of bilateral relations.

What makes bilateral cooperation more complicated is that unlike China, the EU is composed of 27 Member States and has difficulties to speak with one voice. As a supranational regional organisation, the EU has many different features from a sovereign state. For economic issues, the DG-Trade of the European Commission plays a leading role by working together with the Council and the European Parliament. But for political and military issues, the situation is more problematic. For example, the lifting of the arms embargo needs the approval of all of the Member States of the EU. Each individual Member State, no matter big or small, is important in the final decision of the Council of the European Union. Different Member States may have different national interests and different political positions concerning their China policy. When the embargo was introduced in 1989, the Community had only twelve members. Now with twenty-seven members, it will be an arduous task to achieve consensus on scrapping the ban among all the Member States.

In order to promote EU-China cooperation, China needs to work with both the European institutions and the Member States. Within the European institutions, however, the central concerns and interests are also different. The officials of the Commission are more concerned with tangible results in economic cooperation and pay less attention to the differences of norms and values between them and their partners, whereas the European Parliament counts on the public opinion in the Union and is very much concerned with the normative differences with its external partners. As the European Parliament is influential in the making of international agreements, China is obliged to establish a reasonable working relationship with it.

The normative, political, and economic differences between the EU and China limit the effects of China's economic diplomacy. While the short-term effect may be noticeable, the long-term effect may not be so impressive. Behind the Dalai Lama issue lies the fundamental difference in values and political system between Brussels and Beijing. The EU stresses respect for human rights and pluralism, whereas China focuses on stability and development. Even if compromise could be reached for the moment by the two sides, it is highly likely that the compromise would be broken on some other occasions since no mutual understanding has ever been reached.

Furthermore, some of the issues may be exchanged in deals of economic diplomacy, but some not. In recent years, Chinese Premier Wen expressed on several occasions that China would be willing to offer financial help to the debt-ridden EU Member States. But when he tried to make a linkage between Chinese

investment to the EU and the EU's recognition of China's market economy status, the European official excluded such possibility (author's interview 24 July 2012).

It is foreseeable that EU-China relations will be characterised by ups and downs in the coming years. As mentioned earlier, the EU-China summit is the highest institutional arrangement between the two sides. Yet, such institutional exchanges do not often work well. After China cancelled the 2008 summit due to Sarkozy's scheduled meeting with the Dalai Lama, the acute euro crisis served as an excuse for the Europeans to cancel the summit prepared in Tianjin in 2010. While the EU may not have done it out of tit-for-tat strategy, such practice seemed to indicate some problems that need to be addressed at the institutional level. As a result of economic and political developments of each side and changes in international relations in the 21st century, the two sides find both shared and conflicting interests on a wide range of issues. Such a partnership may not be exempted from difficulties and problems, but it conforms to their respective national interests to build a long-term partnership.

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