"Sino-European Economic Relations"

by
Richard N. Cooper

Paper No. 05-03

June 2005

Contact:
Richard N. Cooper is a faculty associate and executive committee member of the Weatherhead Center for International Affairs and the Maurits C. Boas Professor of International Economics in the Economics Department at Harvard University.
rcooper@wcfia.harvard.edu

Published by the Weatherhead Center for International Affairs, Harvard University.

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WEATHERHEAD CENTER FOR INTERNATIONAL AFFAIRS
HARVARD UNIVERSITY
1033 MASSACHUSETTS AVENUE
CAMBRIDGE, MA 02138
TEL: 617-495-4420
FAX: 617-495-8292
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ABSTRACT

This paper addresses the evolution of economic relations between Europe, especially the European Union, and China over the past two decades, since the emergence of China as a significant player in the world economy. Data on the dramatic increases in trade and financial flows are presented, and comparisons made with the United States. Official dialogue between the EU and China is also addressed. In the economic realm, the parallel between Chinese-EU developments and Chinese-American developments is remarkable, both in trade and in foreign direct investment. Both bargained hard to gain market access from China on the latter's accession to the WTO and share similar concerns with the trade and economic policies of contemporary China. While official contact between the EU and China is extensive, China remains relatively low in EU priorities, which are heavily focused on the evolution of the EU itself and on its immediate neighborhood. Europe lacks the security commitment to East Asia of the United States, and that lends a remoteness to China, which growing economic relations may eventually overcome.

Introduction

How has Europe responded to China's emergence from an inconsequential position two decades ago to a major participant in the world economy? This paper will address that question. First, it will present some of the basic facts and recent trends of growing economic interaction between China and Europe: merchandise exports and imports, FDI, foreign loans (especially aid and commercial credits), services, tourism, students. Then it will take up some issues where economic developments in China raise concerns in Europe: energy, environment, macroeconomic and exchange rate policies, WTO membership, and other current economic issues of contention. Finally, it will take up the evolution of official dialogue between Europe and China in the economic arena, including institutionalization of such dialogue. Europe's position with respect to Taiwan will be briefly sketched. Comparisons will be made with the United States.

My key finding, addressed further in the final paragraph, is how China's emergence on the world scene is affecting the economies of both Europe and the United States in similar ways. Much of the political talk coming from Europe and China currently stresses friendship and opportunity, but just below the surface, the issues and challenges being addressed across Eurasia are remarkably similar to those being addressed across the Pacific. Differences that exist are largely in terms of magnitude as opposed to matters of principle. This in fact is probably good news for Beijing, as it illustrates the strong degree to which China is becoming integrated into the entire world economy, not just an old world or new world portion of it.

The first step in making such broad comparisons is to appreciate both the different sizes of these economies, and the sharply different degrees of integration within each of them. China, Europe, and the United States are each continental sized economies and are thus useful comparison points. Individual states in Europe, however, are more open and more specialized than either China or the United States, and thus are problematic in making direct comparisons. Yet much of our economic information is still individual state based. Degrees of integration are quite different also — with the United States a highly integrated economy, with Europe becoming more integrated across the EU member states, and with China in some ways highly integrated with a strong central government yet in other ways still highly provincial in terms of the ability of resources to move within the country. These all make for important distinctions in how trade and other economic data can be utilized, and in interpreting how economic policy is made at each level of government. We start by noting the many differences between the economies of Europe and the United States, but also the remarkable similarities. For one, they are roughly the same size, when allowance is made for the fact that the European Union (EU-15 throughout, including the enlargements of the 1980s and 1990s, but before the enlargement of 2004) is not only a customs union, but by now largely a single market in both capital and most services and labor, as well as in goods. The EU-15 has a GDP about the same as that of the United States, while that of Euroland (the twelve countries that have adopted a common currency, the euro) is smaller than the USA. [i]The enlargement of the European Union by the addition of 10 countries in 2004 of course alters these figures in Europe's favor, by adding 75 million people and increasing GDP by about five percent, but these new additions will not be fully integrated into the EU for at least a decade.

By global standards Europeans, like Americans, are very rich, and like Americans they do not typically appreciate this fact. In purchasing power parity (ppp) terms, their average income is about 70 percent that of Americans (enlargement will lower this ratio somewhat).

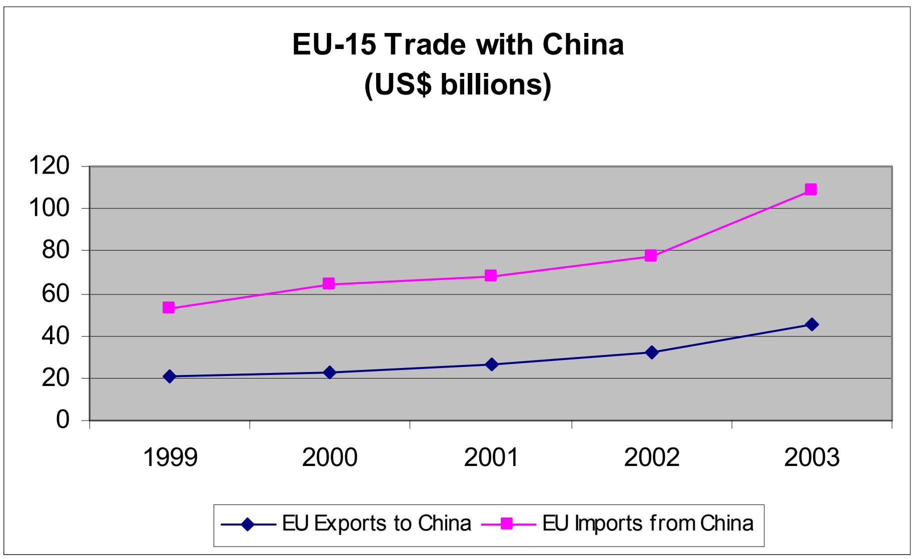
If trade among EU members is excluded on grounds of being internal to the EU, Europe's ratio of (external) imports to GDP is also similar to that of the United States — 13.4 percent, compared to 14.5 percent for US in 2002. This ratio will actually fall somewhat following enlargement, as most trade of the new members is with the EU. The EU ratio of (external) exports to GDP is slightly higher than that of the United States. Individual European countries are of course much more open than these figures suggest, but then so are American states. An important difference is that Europeans are much more conscious of their dependence on foreign trade than are Americans, because the EU is much newer than the United States, and for many Europeans, internal EU trade remains external to their countries. Both economies have a similar well-diversified structure in that they are simultaneously large exporters, but also large importers, of manufactured goods. Furthermore they are both large exporters, but also large importers, of agricultural products. Both are net importers of raw materials, particularly petroleum and its products, and natural gas.

China has three times the population of the EU before enlargement and is four times as large as the United States. Its GDP, however, is only about a tenth as large as either, with highly imprecise aggregate data. China entered the world economy from its period of Maoist autarky in the late 1970s, at first tentatively, then with gradually increasing commitment, to the point at which in 2003, a boom year in China, it became the third largest trading entity in the world. Still far behind the EU and the USA, it had surpassed Japan in imports and came close in terms of exports. The rapid growth of the Chinese economy, seven percent a year for over two decades, even at conservative estimates,[ii] led by a 14 percent annual average growth in exports, inevitably has had a major impact on the world economy, including Europe. European (= EU-15 throughout, except where noted) merchandise imports from China were $2.6 billion in 1982; by 2003 they had grown to $108 billion, a growth of 20 percent a year. The corresponding figures for the USA are not that different, $2.5 billion and $133 billion, 21 percent a year. European exports to China increased from $2.3 billion to $45 billion over the same period, exhibiting a slower growth than European imports but faster growth than US exports to China. China's share of world value-added in manufacturing rose from 1.5 percent in 1980 to 7.1 percent in 2000, by the latter year exceeding all European economies except Germany at 8.5 percent. The share of the five largest European economies together fell from 29.4 percent in 1980 to 23.1 percent in 2000. China's share in world exports of manufactured goods rose from 1.0 percent in 1981 to 6.5 percent in 2000 (Unido 2004, pp.151, 183).

As with the United States, leading European firms have invested heavily in China. Unlike the typical foreign direct investment (FDI) from China's neighbors in East Asia, aimed at building a platform for labor-intensive exports to the rest of the world, the European and American FDI is mainly aimed at serving China's huge domestic market. Since most of the growth of Chinese exports has derived from foreign firms or joint ventures between Chinese and foreign firms (China's preferred mode during the 1980s), this difference has affected the patterns of trade. China is a large importer of components, especially from other East Asian economies, which are assembled into finished products, mainly consumer goods, for sale in the USA or

Europe. Thus China tends to run trade deficits with other East Asian countries (except Hong Kong, the major entrepot for Chinese trade), as well as with oil exporting countries, but significant trade surpluses with Europe, and especially the United States. Taken altogether, China has produced modest overall trade surpluses in recent years, although it grew rapidly in 2004.

Recent Economic Trends



From Europe's perspective (which in general will be adopted here), merchandise trade between China and Europe has grown rapidly in both exports and especially imports. By 2003 China was the second most important origin of Europe's imports, after the United States, and the third most important destination for Europe's exports, after the United States and Switzerland. But as a market, China remained only one-fifth as important as the United States ($45 billion versus $247 billion). Europe's trade with China is diversified in terms of commodity composition, although machinery and transport equipment account for two-thirds of European exports with non-electrical machinery being the dominant category, and accounting alone for 31 percent of European exports of $32 billion in 2002. Office and telecommunications products (24%), clothing (13%), electrical products (9%), and toys and games (8%) were Europe's main imports from China, which totaled $77 billion in 2002 (WTO 2003, pp.90-91). There was however extensive two-way trade in chemical products, semi-manufactures, and miscellaneous consumer goods.

China's rapid growth and changing trade structure taken together led to the result that by 2003, China accounted for 8.9 percent of EU-15 imports (excluding intra-EU trade), up from 0.7 percent in 1980 and 2.0 percent in 1990. These figures reflect a slightly less important role by China in the European economy than it has in the US economy where the corresponding import shares were 12.5 percent in 2003, 0.5 percent in 1980, and 3.2 percent in 1990) (Prasad 2004, p.6).

Over this same 23-year period, the European share of China's imports actually <u>fell</u> from 15.8 percent to 12.9 percent (the US decline was even more pronounced, from 19.6 to 8.2 percent), although the actual sales of course increased dramatically.

China's importance as a destination for European exports has also grown over time, although much less dramatically, from 0.8 percent of European exports to the world in 1980, and 1.2 percent in 1990 to 4.2 percent in 2003. This again illustrates the faster development of European exports to China than of US exports, where the corresponding figures are 1.7, 1.2, and 3.9 percent of worldwide US exports. But this is much less than the spectacular growth in importance to China's neighbors. China's share of South Korea's exports rose from nothing in

1980 to 20.5 percent in 2003, and from 3.9 to 13.6 percent of Japan's exports (Prasad 2004, p.8).

Germany is far and away Europe's largest exporter to China, accounting for about 46 percent of China's imports from Europe, with France and Italy together accounting for 21 percent (World Trade Atlas). Germany is also the largest national importer from China, but the Netherlands and Britain are not far behind, followed at some distance by Italy and France.

Trade grew significantly further in 2004, imports more than exports, resulting in a further increase in Europe's deficit with China, to 78 billion euros (IHT, 4/14/05, p.2).

These data generally come from European and US sources and it should be noted here that China's own trade data show significantly smaller exports to Europe ($72 billion vs. $108 billion), and somewhat larger imports from Europe ($53 billion vs. $45 billion in 2003), than do European data. Trade comparisons are complicated by the fact that Hong Kong is a significant entrepot for trade with China (and China's second largest trading partner, after the United States), especially for China's exports. The Netherlands plays an analogous role in continental Europe, especially with respect to Germany, although proportionately the impact on data is less significant. Customs authorities adopt somewhat different principles of attribution of origin. A similar discrepancy between US and China trade data became a source of bilateral dispute and examination. Over half of the difference in US import data can be attributed to Chinese data that show its exports (US imports) ending up in Hong Kong whereas US data show these products as continuing on in their export journey to the United States.

Foreign Direct Investment

Some European firms have shown an interest in investing in the Chinese market since it began to open in 1979; Volkswagen entered in the early 1980s, and by 2003 European brands accounted for 40 percent of the three million automobiles sold in China. By the end of 2002, the total stock of European FDI in China reached $34 billion, accounting for 7.6 percent of all FDI in China, a slightly larger share than that of the United States. Again, such numbers must be interpreted with caution. Nearly half of the $448 billion in FDI in China is registered in Hong Kong.[iii] A substantial fraction of this is thought to originate in China itself, round-tripping through Hong Kong to take advantage of the tax and foreign exchange privileges, not available to domestic firms, that were afforded to foreign enterprises.

During the period 1998-2002, European firms newly invested roughly $4 billion a year in China, about the same magnitude as US firms during the same period of time, demonstrating a continuing, if not an accelerating, interest.

FDI in China has two substantially different motivations. One is to take advantage of inexpensive and abundant Chinese labor to produce for export, and indeed it is such investment that China initially desired to attract, through establishment of the Special Economic Zones in the 1980s. Foreign investment in the SEZs got special tax privileges and infra-structure support, and in effect operated outside the customs and foreign exchange area of China, in that imports for processing for re-export, and the capital equipment needed, could enter free of import duties; and foreign exchange regulations were considerably more generous than they were for domestic firms.

Over time the rest of the economy has been significantly liberalized, and the geographic domain of the SEZ privileges extended, so the discrepancy in treatment between domestic and foreign firms (including foreign firms in joint ventures, the officially favored mode in the 1980s) has diminished over time. Under the accession agreement for membership in the World Trade Organization (WTO), China committed to eliminating quantitative restrictions on imports and to significant reductions in import tariffs by 2006. However, China's domestic market is still afforded significant protection against imports (the average unweighted tariff for all products was 12.4 percent in 2002, low by comparison with many other developing countries, and scheduled to fall further by 2006, but higher than Europe's 4.4 percent or the US 3.9 percent (WTO 2003, p.208).

The other motivation for FDI in China is to produce for sale in the large and rapidly growing domestic market, sometimes because of cost advantages for doing so, but sometimes to take advantage of the protection provided by Chinese policy. The latter condition is especially true for automobiles and automotive components, and both European firms (VW, Mercedes, Citroen, Peugeot) and US firms (GM, Ford, Chrysler's Jeep, now DaimlerChrysler) have responded by investing in automotive production in China, as have several Japanese firms.

As it happens, most Asian direct investment in China is export-oriented, while most European and American FDI in China is oriented toward the domestic market — with significant exceptions to both generalizations.

Several European firms are investing in China to provide services, such as HSBC, a British-owned London-based bank, formerly of Hong Kong, and the super-market chain Carrefour of France.

It is noteworthy that Chinese firms have begun to invest abroad, by 2002 amounting to a cumulative $36 billion, and growing rapidly. Some of these investments are in Europe and in the United States, overwhelmingly in the form of joint ventures with local firms.

Aid Flows

European countries have provided significant foreign assistance to China, although in value it has declined markedly in recent years. Britain, France, Germany, Italy, and Spain all had programs in China in 1995, totaling $885 million, of which Germany alone accounted for 77 percent; by 2001 foreign assistance from these five countries had fallen to $258 million, Germany remaining by far the largest source. In addition, the European Union had many ongoing aid projects, and in 2002 approved 250 million euros in further aid for the planning period 2002-2006, 50 million euros a year. A third of existing EU cooperation funds were devoted to environmental issues, followed by over a quarter to education and training programs, with the remainder spread over such topics as rule of law, governance, rural development, economic and social reform, and support to NGOs, mainly for improved health conditions. In contrast, the United States, constrained by laws limiting aid activities in Communist nations, has provided very little official aid to China.

Other Financial Flows

China has drawn capital heavily from abroad during the past two decades, with total external debt standing at $168 billion at the end of 2002, up from $55 billion in 1990. Of this total, $47 billion was short-term (maturity under one year) and $120 billion was long-term, of which in turn $89 billion was public or publicly guaranteed debt and $32 billion was private debt. Of the total, $11 billion was in export credits, both short- and long-term, down from a peak of $32 billion in 1997.

Of the $89 billion in public debt, over half ($51 billion) was from official creditors – $27 billion from multilateral banks, mainly the World Bank (including the concessional International Development Agency, IDA) and the Asian Development Bank, and $23 billion from other countries. $38 billion was owed to private creditors, down from $73 billion in 1997, with $11 billion in bonds outstanding and the remainder to other creditors, including banks. Indeed, long-term public external debt is generally in decline, as repayments have exceeded new credits in recent years. Net inflows of these funds peaked in 1997, although outstanding official assistance, including borrowing from the World Bank (but not IDA) and the ADB, continues to rise; the drop in public liabilities has been wholly to private creditors. Private liabilities to foreigners, in contrast, have risen from nothing in 1990 and only $2.4 billion in 1997 to $32 billion in 2002 — mainly bank lending, but with small amounts of bonds. (All data from World Bank 2004, pp.136-139.)

China's long-term external debt is dominated overwhelmingly in US dollars, 73 percent at the end of 2002. Fifteen percent was in Japanese yen, and only 5.6 percent in euros. The USD share rose from 29 percent in 1990, while the yen share dropped from 30 percent and the share in sterling declined.

China floated nearly $2 billion a year in bonds on average, over the period 1999-2003, with no discernable trend, and, on a rising trend, borrowed $0.4 to $2.1 billion a year in syndicated bank loans. Equity flotations have been larger but more erratic, rising from $1.5 billion in 1999 to an astonishing $20 billion in 2000, the peak of dot.com IPOs, falling to $2.5 billion in 2002, and rising to $6.8 billion in 2003 and $3.7 billion in the first two months of 2004 (IMF 2004, pp.198-200).

It is generally not possible to trace the purchases of international issues of bonds or equity; the flotations are typically in London or New York (or, in China's case, in Hong Kong) and purchasers are from around the world.[iv] However, the Bank for International Settlements (BIS) reports bank credits by country. These show that the European banks are active in lending to China. At end-September 2003 China owed $61.5 billion to foreign banks that report to the BIS, $30.3 billion of which was short-term. ($6.9 billion was in Chinese currency, against $5.4 billion in RMB liabilities; the remainder was in foreign currencies.) China was the fifth largest developing country borrower, not counting offshore financial centers such as Cayman Islands, Hong Kong, and Singapore, after Mexico, Brazil, South Korea, and Poland, while Taiwan and Malaysia were not far behind.

Of the $61.5 billion, $10.2 billion was owed to Japanese banks, $9.5 billion to British banks, $21.1 billion to other European banks (excluding $2.1 billion to Swiss banks), and $6.9 billion to US banks (data from BIS 2004, Tables 9A&B). Thus European banks taken together are the predominant lenders to Chinese entities. These credits can take several different forms: export credits, direct bank loans, syndicated bank loans, and inter-bank loans to Chinese banks (the last typically being very short term).

At the same time, Chinese entities had claims of $86.3 billion on foreign banks, overwhelmingly inter-bank loans and deposits – much of this no doubt official foreign exchange reserves placed in foreign banks by the People's Bank of China (BIS 2004, Table 7).

Foreign Visitors

Foreign visitors to China have grown to over 13 million annually, for business and tourism, not counting visitors from Hong Kong and Taiwan. About ten percent come from Europe (excluding Russia), with the UK and Germany being the leading origins. On a per-capita basis, Swedes are the largest European travelers to China. Outbound Chinese tourism is also growing (400,000 to Europe, excluding Russia, in 2000), and one can now observe tour groups from Jiangsu and other well-to-do provinces visiting the Louvre in Paris and the Coliseum and Vatican in Rome. Direct scheduled air traffic between China and Europe continues to thicken.

Mainland Chinese students also attend European universities in growing numbers, rising in the United Kingdom from 2,368 in 1994/95 to 31,506 in 2002/03, plus an estimated 16,000 in other European countries in 2001, thus beginning to approach the estimated 65,000 Chinese students in the United States. Anecdotally, Chinese enrollments in Europe appear to be up appreciably since the post-9/11 visa tightening in the United States. They have become sufficiently numerous to lead some British analysts to suggest that the fees paid by Chinese may be the financial salvation of some cash-strapped British universities (Nania and Green, 2004).

Illegal migration from China into the EU has been on the European agenda at least since 1998. Numbers of illegal migrants from China are not known, but are thought to be only a small portion of illegals attempting to enter the EU. Nonetheless, China as a source was dramatized when 58 Chinese trying to enter Britain lost their lives near Dover in June 2000, and the EU has elicited the cooperation of China in putting a stop to such migration.

The Current Economic Agenda

When Prime Minister Wen Jiabao visited Europe in May 2004, he had two major requests: that China should be accorded market-economy status, a matter especially important for calculating anti-dumping duties (ADD); and that Europe should drop its embargo of arms sales to China, imposed following the June 1989 massacre of students at Tiananmen Square. He was denied both requests, although both France's Chirac and Germany's Schroeder have indicated their support for dropping the arms embargo. It would of course be of major concern to the United States if France, say, were to sell modern anti-ship missiles to China, or if Germany were to sell modern diesel submarines.

When China joined the WTO in December 2001, it was denied market-economy status by the United States, along with the European Union and other countries, due to internal prices that are seen as distorted in important ways, and thus not reflecting their scarcity value to the Chinese economy. This means that when dumping charges (= selling below fair market value) are brought against Chinese products, the actual costs of production in China are ignored in determining "fair market value." Instead, fair market value is constructed artificially, usually by drawing on cost information from some market economy (e.g., India is sometimes the proxy used for China) which is similarly situated with respect to the products in question. China claims (correctly) that this practice is grossly unfair, since the determination of fair market value for purposes of assessing anti-dumping duties is essentially an arbitrary construction. China also claims that in fact it is (nearly) a market economy, and that especially for exports, Chinese costs are fair and reasonable, not subsidized or otherwise badly distorted.

The EU examined the Chinese request, which was not new, having previously determined that a market economy had to meet five tests. The Commission in June 2004 found that China still did not meet four of its five tests. In particular, the role of the government in micro-managing the economy was still considerable, the country lacked transparent and non-discriminatory company law, property rights were not secure, a bankruptcy law was not effectively in place, the financial system did not operate independently of the state, and there were no standard accounting principles which firms were obliged to follow (making corporate accounts, where they exist, untrustworthy for determining Chinese costs) (Financial Times, June 28, 2004). The EU has 32 antidumping measures in force against Chinese products, covering about 0.5 percent of China's exports to Europe, and 22 investigations in process. The negative influence of the antidumping process is arguably far wider than the products actually covered, since the antidumping regime creates enormous uncertainty for Chinese firms wanting to export to the EU (a similar problem exists in the United States).

Anti-dumping is not a new issue for China. A Chinese Almanac (1999) covering Sino-EU issues in 1997 also prominently mentions European antidumping cases, along with quantitative restrictions on imports from China (presumably since removed on China's entry into WTO) and suspension of imports of poultry from China, allegedly on phyto-sanitary grounds, but with suspicions of protectionist motivation.

During his April 2004 visit to China, Commission President Romano Prodi identified several contemporary European concerns with China in the economic arena. Prodi first mentioned the fact that China's currency is linked to the US dollar, and observed that China had a significant trade surplus and simultaneously was experiencing domestic over-heating. "As an economist," and explicitly without offering advice to China, and in this regard disassociating himself from the United States, Prodi observed that an appreciation of the yuan might serve China's near-term as well as its long-term interests "to avoid bringing any major and long-term imbalances to bear on the delicate world equilibrium."

Second, the EU is concerned with Chinese sanitary standard linked bans on products of animal origin. Third, a "major EU priority" is to assure China's compliance with its WTO commitments. Under this heading Prodi identified several particular concerns: a) new Chinese rules that effectively close the construction sector to European companies; b) much higher hurdles for European banks and telecom operators than agreed at WTO accession; c) restrictions on exports of raw materials from China, especially coke, creating shortages in Europe; d) a continuing lack of overall transparency, and a tendency to erect new regulatory barriers as tariffs are lowered. Distinctive telecommunications standards were specifically mentioned, and the desirability of having worldwide technological standards (ironic, coming from Europe, which has specialized in separate technical standards, such as in TV broadcasting and mobile phones, not to mention foods).

Finally, Prodi expressed "ongoing anxieties in relation to China's approach to human rights, good governance, respect for the environment and rule of law."

Another recent source of European concern with economic developments in China can be found in Kaiser (2004), summarizing a task force assigned to prepare for an October 2004 summit meeting between the EU and ASEAN plus 3, which includes both China and Japan. Heavy weight is put on the need to strengthen the multilateral base for global governance, an important topic that will not be pursued further here.[v]

Within the narrower economic arena, three major areas calling for closer and more effective Asian-European collaboration are identified.

First, is the area of energy security. Growing demands in China and Southeast Asia for energy imply growing world dependence on oil from the Persian Gulf region, and the attendant uncertainties associated with such growing dependence. China's net imports of oil, for instance, have grown from nothing in 1994 to about 2.1 million barrels a day in 2003, and are expected to grow by a further 7 mb/d by 2020. Although European demand for energy is expected to grow only modestly in the coming decades, Europe too will become more dependent on imported oil and gas as production in the North Sea declines, and as coal use and nuclear power are phased down further. Thus Europe's energy future is closely intertwined with that of China, which so far has been unable to discover nearly enough new indigenous oil to cover its rapidly growing need for oil. With that in mind, at least some Europeans urge much closer energy cooperation with China and other Asian countries to strengthen short-term supply management through national oil stock-piles in Asia, something that Japan has and China is actively pursuing, and through associating China somehow with the oil-sharing scheme of the International Energy Agency in the event of a serious disturbance to the world's supply of oil. Europe should offer help in enhancing energy efficiency in China, for which there is much scope. China is encouraged to join the Energy Charter Treaty, or at least follow its prescriptions closely, with a view both to improving efficiency in the use of energy and to providing a more secure climate for energy investments and for cross-border infrastructure projects. European-Asian cooperation on research and development should be enhanced, again with a view to improving energy efficiency and reducing reliance on fossil fuels in the long run (Godement 2004, appendix).

A second, separate but closely related, European concern is with greenhouse gas emissions and the prospects for global climate change. (Apart from objection to the idea of man-made climate change, Europe faces some small chance that the Gulf Stream will be deflected southward, or even disappear altogether, thus leaving Europe much colder than it is today.) China holds abundant coal reserves, in contrast to oil, and continued rapid economic growth implies growing demand inter alia for electricity. Despite the fact that new power plants in China are much more efficient than existing plants, China's already large consumption of coal is expected to double between 2001 and 2025, with an attendant increase in emissions of carbon dioxide, a major greenhouse gas (EIA 2004). Some Europeans therefore see a strong interest in engaging China actively in approaches to mitigating greenhouse gas emissions, something that China to date has considered low priority, although to reduce heavy local air pollution China would also like to improve greatly the efficiency of its use of coal, and where possible, substitute natural gas for coal, both of which would contribute to mitigating climate change. Europeans are pushing hard for greater use of renewable sources of energy, and have developed some useful technology for doing so, especially harnessing wind.

A third area for closer economic cooperation concerns pushing ahead with multilateral trade negotiations, currently the Doha Round, explicitly "to resist tendencies toward a US-centered system of trade bilateralism", which would undermine the multilateralism of the WTO and reduce the prospects for a successful Doha Round (Kaiser 2004, p.12).[vi]

While President Prodi touched only lightly on the question of China's exchange rate policy, Europe in fact has considerable interest in China's macroeconomic performance, hence its macroeconomic policy, including exchange rate policy. If, as many believe, the US current account deficit (at five percent of GDP) is unsustainably large, some adjustment in the dollar exchange rate will eventually be necessary (e.g., Goldstein 2004).[vii]

The alternative, a sharp slowdown in US growth, is neither in the interests of the United States nor of the rest of the world. Yet a significant depreciation of the dollar will create discomfort for all countries that rely heavily on export-led growth, including many European countries. To the extent large countries such as Japan and China inhibit or even prevent appreciation of their currencies against the dollar, the burden of adjustment is shifted to those countries not preventing such appreciation, most notably the European Community and especially the twelve members that have adopted the euro (= Euroland), whose central bank (ECB) is charged with maintaining price stability, not international competitiveness, and which by its charter can neither solicit nor receive guidance from member governments. Since the core economies of Euroland (Germany, France, Italy) are not performing well, bearing the main adjustment through appreciation of the euro against the dollar will aggravate their weak macroeconomic performance. Thus, as Prodi hinted, appreciation of the Chinese yuan against the dollar would not merely help China cool its over-heated economy, but would also distribute more widely the adjustment to an improved US current account position — especially since many other Asian currencies are implicitly tied to the dollar, and at least some of them would be more willing to entertain appreciation of their currencies against the dollar if the yuan were revalued, thus maintaining their competitiveness in US and European markets with respect to China. (Goldstein 2004 suggests the yuan should be revalued by 15-25 percent against the dollar, and that a number of other East Asian currencies would follow).

It is sometimes suggested that China should diversify its large and growing foreign exchange reserves out of dollars and into other currencies, notably the euro. Indeed, market rumor suggests that this is already happening to a modest degree. (China, like most countries, does not publish the currency composition of its reserves, although it presumably does report it to the IMF.) And no doubt some European chests would swell with pride in the knowledge that the People's Bank of China (PBOC) was investing significantly in euros. But in this regard China — and Europe — confronts a dilemma. China's reserves rise, not as a result of a decision to augment reserves, but as a by-product of China's exchange rate policy, which is to maintain the yuan at 8.28 per US dollar, at least for the time being. Chinese purchases of euros instead of dollars, even more a switch from dollars to euros, would appreciate both the yuan and the euro against the dollar, something that neither region desires in present circumstances. So, China's holdings of euros are likely for the time being to be small and experimental, exploring what euro-denominated securities can be purchased, in what volume, and how liquid they are. The PBOC allegedly keeps the ECB informed of its actions, but this delicate topic is not on the official agenda.

Official EU-Chinese Dialogue

In 1974 EC sent a letter to all non-market economies asking whether they would like to start discussions to establish normal trading relations. Only China even responded to the letter. Still under Mao's rule, China was interested in some counter-weight to its very uncomfortable relations with the USSR and its recently improved, but still touchy, relationship with the United States. A series of discussions began. Initially Chinese leaders tended to focus on strategic issues (e.g. how many hydrogen bombs does Europe have?), but by the early 1990s focus had shifted heavily to trade and investment.

Since that inquiry thirty years ago Europe — both the EC Commission and member states — has established extensive regular official contact with China on economic issues. A trade agreement was signed in 1978, a year before the 1979 trade agreement with the United States, and a considerably expanded trade and economic cooperation agreement came in 1985. By now, an extensive system of high- and mid-level Sino-European consultations has been established, capped at the political level by an annual summit, with once or twice a year ministerial meetings and annual meetings of the political directors. A joint economic committee has been established at the ministerial level, supported by an economic and trade working group. In addition, working groups exist on environmental issues, on energy, on the information society, on industrial policy and regulation, on maritime transport, and on science and technology. In the sights of the European Commission are further working groups on human resource development, competition policy, sanitary standards, intellectual property rights, customs cooperation, satellite navigation, and nuclear research cooperation (EC Commission 2003, pp.17, 27).

What can we make of all this activity? Some of it, at the technical level, is designed to solve practical problems, e.g. of customs clearance procedures or product standards. Some of it, on the EU side, is simply and explicitly to raise the profile in Chinese consciousness of Europe, and especially of the European Union. Some of it, on both sides, is to establish and maintain a working relationship at several levels that can discuss, and perhaps even block, unacceptable moves by Russia, which stands physically between China and the EU, or by the United States. China in particular desires to diversify its international relations to provide a counter-weight to both Russia and the USA. China of course is also interested in trade access to Europe, inward investment, and European technology.

China has learned, however, that despite its extensive evolution the EU is not yet a sovereign entity that can deal with China on equal terms across a wide range of issues. China has, therefore, also maintained extensive contacts, even in the economic arena, directly with EU member states. The European Council, made up of state representatives, makes the policy decisions. And the member states have reciprocated. During 1997, for instance, the Presidents of France and Portugal visited China, as did the Prime Minister of Italy and many national ministers, in addition to VP Leon Brittan from the EC Commission. There were also nine bilateral high-level meetings with officials from EC members (Almanac...1998/99, pp.426-7).

The pace of bilateral meetings has continued, despite an extensive EU-wide agenda. For example, Premier Wen Jiabao visited Brussels in May 2004, but he also visited Berlin, Rome, Dublin, and London on the same trip. Also during 2004 the prime minister of Denmark visited China and President Hu Jintao visited France. Numerous visits at ministerial level also occurred between member states and Chinese ministers, both in Europe and in China.

Taiwan

Taiwan, a territory with 23 million inhabitants that China claims is a runaway province, developed much faster than China after 1950, and by 2002 was the 13th largest trading entity in the world with a GDP about one-fifth that of China and trade about one-third that of China, despite a population only 1/50 the size. Not surprisingly, European trade with Taiwan grew along with Taiwan's economy, and by 2002 amounted to 12 billion euros in exports and 21 billion euros in imports.

EU-15 - CHINA ECONOMIC AREA TRADE (US$ billions)

	EU-15 Exports			EU-15 Imports			EU-15 Balance		
Year	China	Hong Kong	Taiwan	China	Hong Kong	Taiwan	China	Hong Kong	Taiwan
2000	23.1	18.5	13.1	64.0	10.6	23.7	-41.0	7.9	-10.6
2001	26.6	18.9	11.3	67.6	9.0	21.2	-41.0	9.9	1.4
2002	32.2	18.6	10.9	77.5	9.1	19.9	-45.3	9.5	-9.1
2003	45.0	20.1	12.1	108.2	10.6	23.0	-63.2	9.6	-11.0

Source: World Trade Atlas

European countries try to maintain a finely balanced policy with respect to Taiwan, formally agreeing to China's assertion of "one China", but at the same time expressing the hope that unification of Taiwan with China would be peaceful. Europe has also placed increasing emphasis on human rights in its projections of its concerns, as reflected in its foreign policy statements.[viii] While denying diplomatic recognition, the EU has maintained annual consultations with Taiwan for some years, strongly supported Taiwan's membership in the WTO, and in 2003 opened a permanent economic and trade office in Taiwan under the guidance of EU Commission VP Chris Patten. France, like the United States, has from time to time incurred China's official displeasure by selling arms (e.g., fighter aircraft and frigates) to Taiwan.

However, EU and individual European countries lack the security connection to Taiwan that influences US policy toward Taiwan and China, and that makes China wary of US motives toward China.

Comparisons with the United States

There are many similarities between Europe and the United States in their economic relations with China. China has emerged as a major trading and investment partner of both, especially as a source for electronic products, clothing, and miscellaneous consumer products. Both run significant bilateral trade deficits with China, although the European deficit is substantially smaller than that of the United States (reflecting in large part the large US deficit with the entire world, in contrast with Europe's small surplus). On China's side, these imbalances arise in part as a result of China's emergence as the major manufacturing processing center, where many components are imported, especially from other Asian countries, and assembled for export to the world's two largest markets, Europe and the United States, and increasingly also to Japan. Both are concerned about a surge of clothing imports from China after the expiration, in 2005, of the Multi-fiber Agreement, under which bilateral textile and apparel trade have been under growth restraint on a product-by-product basis. Both are concerned about what is widely (but not necessarily correctly) considered an under-valued RMB. Both are concerned with continuing violations of intellectual property rights in China. Both are concerned with the absence of transparency in Chinese policy-making, promulgation of regulations, and general rule of law in China. On a broader scale, both are concerned with violations of human rights in China, a fact that occasionally intrudes into the economic arena. (Amnesty International and Transparency International are European, not American NGOs. Free Tibet sentiment is perhaps stronger in Europe, especially Germany, than in the United States.) Both are anxious about China's meeting the commitments it made on accession to the WTO.

On China's side, non-market status and its implications for the numerous anti-dumping cases are a concern with both Europe and the United States. And it would like to see a removal of the sanctions, mainly export controls on military equipment, which both areas imposed following the Tianamen uprising in June 1989. China especially pressed Europe on this point during 2004-2005, and received support from French President Chirac and German Chancellor Schroeder, but in mid-2005 it looked as though the removal of these sanctions would be postponed, partly on grounds that China had not responded sufficiently to Europe's concerns about human rights, partly because of recent Chinese legislation calling for (re)absorption of Taiwan by force if necessary, partly no doubt also because the American government protested strongly against such removal.

On each of these topics US concerns have been louder and more public than is the case for Europe, partly no doubt reflecting different magnitudes of the concerns, but partly also reflecting different styles of international diplomacy, which in turn reflect in part the parliamentary systems of government prevalent in Europe, as opposed to the US system in which the executive branch is in continual tension with the legislative branch.

Despite the extensive growth of economic ties between Europe and China, there is in Europe, compared with the United States, a sense of remoteness. China is not much interested in Europe, beyond its role as a market, as a source of technology, and as a partial counter-weight to the United States. Europe, while potentially interested in China, has an agenda filled with more pressing issues: making EU enlargement work, and deciding how much further to go; reforming domestic tax and social welfare systems; immigration; and in foreign relations, dealing with the United States and with Russia. Thus while China is of growing importance, and is of great interest to those European firms (e.g. Siemens, Alcatel, several auto firms) that have invested in China, it never quite reaches the top, or even the second level, of the European agenda — despite the large number of meetings.[ix]

This is perhaps in part because China has no natural patron in Europe. While some individual European leaders, e.g. Jacques Chirac and Carl Bildt, are apparently seriously interested in China, the external orientation of European countries is directed elsewhere, largely for historical and cultural reasons: Britain toward India and South Asia, France toward francophonie, mainly Africa, Germany toward eastern Europe and Russia, Spain increasingly toward Latin America — and above all inward toward building Europe. It is true that some leading European private but well-connected think tanks — Britain's Royal Institute of International Affairs, France's Ifri, Germany's Council on Foreign Relations — all have programs specifically on China, not only doing studies, but also engaging with Chinese counterparts and sponsoring meetings on various aspects of China.

While China borders Russia, it is physically remote; and Europe lacks the security engagement of the United States in East Asia, including with Taiwan. Moreover, Europe lacks the strong sentiment toward China that still resides in the United States, perhaps because of extensive American missionary activity in China in the late 19th century (some sons of whom became the leading American scholars and diplomats on China in the subsequent generation), the US role in inhibiting the political colonization of China through its "open door" policy, and direct US support for China against the Japanese during the Second World War.

Europe and China are however natural partners in holding in check the US superpower, with its inevitable tendencies toward unilateralism and the imposition of US preferences and priorities on the rest of the world. They are also natural partners in their wariness of Russia, with a shared desire to shape a benign future there.

Endnotes

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[i] These comparisons measured in US dollars of course depending on the exchange rate used between the dollar and the euro and other European currencies: $1.2/euro was used here, applied to 2003 data. Exports are remarkably similar, if intra-EU trade is excluded: the EU exported $940 billion to the rest of the world in 2002; US exports were $958 billion. The EU-15 is notably larger in population — 380 million as against the 291 million of the United States — but has a lower average per capita income.

[ii]. Official Chinese figures record average growth of over 9 percent a year, but most experts consider this too high. See, e.g., Angus Maddison, Chinese Economic Performance in the Long Run, OECD, 1998.

[iii]. Total FDI in China rose from an estimated $6 billion in 1980 and $25 billion in 1990 to $488 billion in 2002. Chinese FDI abroad reached $36 billion in 2002. UNCTAD 2003, pp.259, 264.

[iv]. The US Treasury, however, reports by country American purchases and sales of foreign securities made through US brokers and other reporting financial institutions in its quarterly Treasury Bulletin.

[v]. The scope of this topic includes the international economic financial institutions. Here Kaiser (2004, p.5) argues with respect to the IMF and the World Bank that given their "domination by the United States and the under-representation of Asia in its [sic] decision-making processes, both regions [EU and ASEAN+3] should make an effort to address this issue." There is no hint in this proposal that in fact the Executive Boards of the World Bank and the IMF are dominated by Europeans, who comprise 8 of the 24 Executive Directors (nine if Russia is counted as European) and collectively have much greater voting power than does the United States, even before EU enlargement. It is true that by (out-dated) tradition the World Bank has an American president (Australian born 1995-2005), but by the same tradition the Managing Director of the IMF has been European. Europe has demonstrated over the years a marked reluctance to give up either the MD position or the over-weighted position of especially the smaller European countries.

[vi]. This concern has considerable merit, although it is ironic coming from Europe, which aggressively pursued bilateral trade arrangements in previous decades, as part of its so-called Mediterranean policy and later its policy toward eastern Europe.

[vii]. I do not subscribe to the conventional wisdom that the US current account deficit is unsustainable, at least in the near future, resulting in the specific prediction that the United States will continue to have a multi-hundred billion dollar deficit five years from now. See Cooper (2005).

[viii]. For example, a background note for the Fourth EU-China Summit of September 2001, in Brussels, declared that "the EU remains much concerned at the lack of respect for fundamental freedoms in China, including the freedom of expression, religion and association, about the ongoing violations of human rights of pro-democracy activists, proponents of free trade unions and followers of other movements such as the Falun Gong, as well as the frequent use of the death penalty. The Council also stressed continued concern about restrictions against unofficial religious groups and the deprivation of religious and cultural right in Tibet and Xinjiang."

[ix] A European lament at the inadequate attention Europeans—for many of whom "Asia" still evokes recollections of Huns and Mongol barbarians—pay to the region can be found in the *Neue Zuricher Zeitung*, August 30, 2004.

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