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The EU's Strategic Economic Dialogue with China

A New Chance for European Trade Policy

Hanns Günther Hilpert

With the rise of the European trade deficit the tone of European trade policy towards China has become noticeably more irritated. At the same time a protectionist attitude motivated by nationalist sentiments has taken hold in China. Nevertheless, rather than engaging in confrontation the two sides would like in future to resolve their trade disputes through dialogue. Hence the EU and China conducted their first High Level Economic and Trade Dialogue (HLM) in Peking at the end of April as they had resolved to do at the last bilateral summit. The European Commission hopes that this new forum will lead to closer co-operation on various issues, to the commitment of the Chinese state leadership in trade matters and ultimately to the Chinese taking greater account of European interests. The fact that the new forum was established on Peking's initiative has given rise to hopes that from now on Europe will have a better chance of influencing how China shapes its trade and economic policy. The new body will, however, only be able to help reduce tensions in relations between Europe and China if the talks yield substantial results.

There is clearly no shortage of controversies with China over economic policy. An explosion in the volume of imports from the People's Republic has put European Industry under considerable pressure, and the affected sectors are loudly demanding protective measures. Since 2006 China has become the EU's main source of imports. Last year the European Union's trade deficit with China amounted to 159 billion euros. While the goods the EU imported from China were worth 231 billion euros, the value of European exports to China was

only 72 billion. Nevertheless, Peking regards the anti-dumping measures introduced by the EU as illegal protectionism. At the same time European exporters are complaining about Chinese import tariffs, largely closed service markets, discrimination by the authorities, technical barriers to trade, a forced technology transfer and the violation of intellectual property rights. The EU Commission estimates that problems of this kind are costing Europe 20 billion euros a year in lost sales revenues. In this context European mistrust of China

has grown considerably, quite apart from the already widespread European criticism of social and humanitarian conditions in China. However, before bilateral relations go completely awry, it makes sense to address the conflicts through negotiations. What is more, there are many issues such as energy, the environment and climate protection which require joint action if sustainable long-term solutions are to be found. Bilateral and global interdependencies between Europe and China have grown sharply, so closer co-operation would be politically advisable and economically beneficial for both sides.

Motivated by these considerations the EU Commission and China agreed to establish a High Level Economic and Trade Dialogue Mechanism, which was officially launched by EU Commission President José Manuel Barroso and Chinese Prime Minister Wen Jiabao on 25 April 2008. The mechanism provides for meetings to be held every six months attended by eight EU commissioners and ten Chinese ministers. The chairmen of the dialogue body are Chinese Deputy Prime Minister Wang Qishan and EU Foreign Trade Commissioner Peter Mandelson, the latter as the personal representative of the Commission President. To no other meeting to date has the European Commission sent such a large delegation. Even the Transatlantic Economic Council between the EU and the United States is smaller.

In their first round of discussions the EU and China agreed on general goals for a harmonious and expanding trading relationship, sustainable economic development, improved energy efficiency, better product safety and more extensive dialogue over Africa. On the issue of climate protection China declared itself willing to work together with the EU on implementing the Bali Roadmap. In the field of science and technology the two sides signed an agreement on the peaceful use of atomic energy and a declaration of intent on the establishment of a European-Chinese research institute for renewable energy. The two sides declared that they considered the

protection of intellectual property a matter of strategic importance and agreed on specific steps to address legal violations in this area. They also agreed to try to counter the problems of product safety and brand-name piracy through closer co-operation between their customs authorities. Trade barriers in the fields of the environment, energy and high technology were also discussed. All in all, this first meeting may be evaluated as successful, if unspectacular. The dialogue testifies to the political will of both sides to engage in an objective discussion of bilateral problems and to refrain from verbal confrontation.

Why a Trade and Economic Dialogue with China?

Nevertheless, the question arises whether the enormous expense of the structured inter-ministerial dialogue and negotiation process is justified. The reasons that speak in favour are primarily institutional. The newly established body gives the Europeans the opportunity to have an impact in a privileged form on the formation of Chinese trade and economic policy in areas that affect European interests.

1. The otherwise well-constructed architecture of bilateral European-Chinese relations has so far lacked a level of discussion and negotiation commensurate with the importance of trade and economic ties. The annual prime ministers' summits held between the EU and China and the dialogue between the deputy foreign ministers have been largely devoted to political issues, with an emphasis on foreign policy. Little time has been devoted to addressing trade and economic problems in a thorough or purposeful manner. In the bilateral talks between the two countries' trade ministers current conflicts have been discussed, but the larger economic and political context has been ignored. What is more the trade ministers have no mandate to discuss issues with wider implications, such as structural change, the macro-economy, development policy, energy, and so on. This is one of the

reasons why talks on issues so crucial for Europe like market access, investment, subsidies, social standards, intellectual property, certification and standards have generally been so disappointing for the Europeans. It seems likely that in the course of the current renegotiation of the Framework Agreement of 1985 this institutional deficit will be remedied in the medium term. But given the explosive nature of current conflicts neither the private sector nor politicians can afford to wait until these negotiations are concluded. Given the fundamental importance of trade for bilateral relations, this issue needs to be addressed in a more substantive way and accorded greater diplomatic significance.

2. If Europe is to assert its interests vis-à-vis China, a long-term, structurally-based approach to negotiations would seem to be more promising than confrontation and certainly more useful than imposing sanctions. Europe's two major goals in its trade and economic policy towards China—to support China's attempt to bring about an enormous process of internal transformation while effectively asserting its own economic interests vis-à-vis China—can only be achieved through considerable patience and by paving the way for effective long-term institutional change. The establishment and consolidation of workable institutions of a state based on the rule of law and a market economy in China are tasks that will take generations to accomplish. Problems of trade policy like the EU's large and growing trade deficit, the undervaluation of the Yuan, the arbitrary practices of the Chinese bureaucracy and inadequate legal protection will scarcely be overcome in the short term. The agenda should therefore be determined not by frictions over trade policy but by a joint quest for solutions that are in tune with development policy in the medium term. Hence the main focus should be on fundamental structural problems. Such an approach would acknowledge that China's economic advancement and its integration in the global economy is a task of historic dimen-

sions in the success of which Europe should have a strong interest of its own.

3. In order to achieve market openings in China direct bilateral negotiations would seem to make more sense than a multilateral process. It is uncertain whether and when the Doha Round of WTO negotiations will be concluded. And in any case the economic liberalisation obligations that Peking entered into when it joined the WTO have been largely implemented. Only in exceptional cases, therefore, would it make sense to pursue the politically sensitive process of WTO dispute settlement in order to counter illegitimate obstacles to trade. The new dialogue mechanism, by contrast, allows negotiations to be conducted at the bilateral level in areas that are neither on the agenda of the WTO world trade talks nor indeed even part of trade policy. In the bilateral meetings the Commission can explicitly identify instances of discrimination and discuss possible political and administrative solutions together with the Chinese ministries involved. As China's largest export market the EU has a fair amount of leverage.

4. The fact that several EU Directorates General are participating in the trade and economic dialogue having reached agreement among themselves should bring about immediate improvements in the coherency and effectiveness of EU sectoral policy towards China. To date the Commission has conducted sectoral dialogue with China in more than twenty different areas, including science and technology, development cooperation, employment and social policy, environment, energy and customs cooperation, but the dialogues have always been specialised and scarcely linked with one another. All too often the implications for other areas or for more fundamental issues were ignored.

Prospects

The new format of the High-Level Economic and Trade Dialogue Mechanism provides the EU with a promising opportunity to

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have an impact on the Chinese reform process. The fact that China took the initiative here testifies to Peking's fundamental willingness to take more account of European interests in the future. There are, however, reasons not to be over-confident. First of all, experience has taught us that structural changes in China, as indeed the establishment of a state based on the rule of law and a market economy, cannot be accomplished from one day to the next. China has always taken a gradualist approach to economic and reform policy. Secondly, for Peking the High Level Dialogue is more than just a proven means of warding off the threat of protective measures being taken in trade policy. Rather China has its own catalogue of demands to make of the EU: it would, for example, like the EU to show restraint in introducing anti-dumping measures, reduce its high tariffs on textiles and clothing products, liberalise the strict regulation rules, give China open access to advanced technology and guarantees for its direct investments in Europe and grant it market economy status. Even if—as is to be expected—China makes more concessions to the EU during the negotiations than vice versa, Europe will also have to go some way to meeting China's demands.

The strategic economic dialogue that the United States and Japan have been conducting with China for some time now also illustrates that one should avoid being over-optimistic. Despite negotiations, the major bilateral disputes remain unresolved. The US trading deficit with China is continuing to grow, despite its revaluation the Yuan remains undervalued, and the gas fields in the South China Sea remained unexploited. The economic dialogue with China therefore continues to be a subject of controversy in the US Congress, although the United States is in a position to make good progress in fields like finance, air traffic, product safety, environmental protection and transparency. Ultimately the American experience shows how difficult but also how crucial to success the selection of the agenda is. On the one hand, it seems to make sense

to address the easier issues first. On the other, if the two sides fail to make progress on the most fundamental questions this will discredit the entire dialogue mechanism. This is a dilemma that the EU also faces and one which can only be resolved via a two-pronged approach which combines what is feasible in the short-term with what is desirable in the long-term. The Commission would also be well advised to give priority to those areas of trade policy where it is able to mobilise "allies" for its demands in China. For example, it is not only Chinese employees in local European subsidiaries but also Chinese consumers and industrial clients who would stand to gain from the larger choice, better products and lower prices that would result from an opening of the market. China would stand to gain particularly from the opening up of the service sector, for direct foreign investment in labour-intensive tertiary branches of the economy, such as transport, telecommunications, financial services, retail, engineering and environmental services would create many new jobs. Owing to the high growth potential here an increase in the number of foreign competitors would not necessarily squeeze out domestic companies. Indeed, as a result of the differentiation brought about by competition or through company alliances the latter might well count among the beneficiaries.