

OPINION @EN

Alicia Garcia-Herrero: EU must end China schizophrenia

Alicia García-Herrero

This article was originally published in the Nikkei Asian Review

Europe's economic relationship with China is as vast as it is poorly understood. The European Union is China's main trading partner, with two-way trade valued at more than \$1.35 billion per day. However the U.S. still clearly dominates China's foreign economic relations.

The global media reports widely on summits between U.S. and Chinese leaders, but there is much less coverage of similar events involving European and Chinese leaders, except at the national level. Germany, for example, appears to be paying an increasing amount of sympathetic attention to China. At the EU level, though, the European approach is close to schizophrenic.

Costs and benefits

This became clear during the European sovereign debt crisis, when the EU begged China for financial assistance while simultaneously threatening to start a trade war. During the summer and autumn of 2011, when fears of a full-blown disintegration of the euro area were at their greatest, European authorities ranging from Nicolas Sarkozy, then President of France, to Klaus Regling, head of the European Financial Stability Facility, the euro area's bailout fund, made repeated attempts to persuade China to increase the proportion of southern European sovereign bonds in its reserves. At the same time, European Trade Commissioner Karel de Gucht decided to impose import duties on Chinese solar panels, acting on claims that Chinese manufacturers were benefiting from unfair state subsidies.

Chinese leaders, whose extremely centralized form of government is the antithesis of the EU's decentralized model, simply could not understand why Brussels would ask for financial assistance while at the same time attacking China over trade

issues, both directly and in complaints to the World Trade Organization. In Beijing's view, financial support for EU countries should have generated some compensation from the EU, such as support for greater Chinese representation at the International Monetary Fund, granting China market-economy status, or perhaps lifting the EU's arms embargo against China, which has become a matter of honor for the country's leaders.

The contrast between the EU approach to Beijing and that of Germany reflects differing perceptions of the potential costs and benefits of trading with China. While the EU as a whole has been accumulating an ever-growing trade deficit with China, Germany has increased its exports to China at a faster rate than its imports since 2012, and now accounts for more than 50% of Europe's total outbound trade with the People's Republic. This very different pattern helps to explain the German government's opposition to de Gucht's attempt to punish China over solar panels, which ended in a settlement seen by some European manufacturers as a capitulation.

However, this clear distinction between the German view of China and that of the rest of Europe may be about to change in response to Beijing's increasing foreign direct investment in the EU, the largest recipient of Chinese FDI in 2013. Southern European countries need this investment desperately, potentially making them more open to requests for support from China on other issues. For Germany, on the other hand, greater Chinese investment implies growing transfers of technology to China from its highly productive small and medium enterprises sector, which Germans call the *Mittelstand*. In addition, Germany's corporations are in direct competition

with China when it comes to acquiring quality takeover targets in southern Europe at good prices.

Easy target

Given this context, China may profit from the EU's contradictions in current negotiations for a bilateral investment agreement by seeking support from the weaker European countries, perhaps against Germany's interests. Given that the negotiations on a similar agreement between the U.S. and China seem to be stalled, and that China is no longer attracting FDI as easily as it once did, a deal with the EU could become more important than either China or Europe expected.

Chinese President Xi Jinping is especially adept at taking advantage of factional differences to buttress his own negotiating position, and the EU-China economic relationship, which suffers from many intrinsic contradictions, looks like an easy target. As the Chinese government becomes an increasingly assertive and sophisticated negotiator, the EU will need to overcome its schizophrenic tendencies or risk damaging its own interests.