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## **Complementarity and Rivalry in EU–China Economic Relations in the Twenty-First Century**

BERNADETTE ANDREOSSO-O'CALLAGHAN\* AND FRANÇOISE NICOLAS\*\*

*Economic dynamism in the People's Republic of China over the past two decades, in contrast with sluggish growth in an enlarged European Union, makes the examination of contemporary and future EU–China economic relations all the more relevant. This examination is done by highlighting complementary and opposing forces between the two regions. It underlines the asymmetry in the trade relationship – with a growing EU trade deficit – and a declining share of EU foreign direct investment since the peak years in the late 1990s.*

*In terms of trade patterns, a certain degree of complementarity still exists between the two regions, with China relatively engaged in low-knowledge-intensive industries (such as office machinery and computers), although the move up the value chain is rapid. This still leaves scope for a manufacturing–services complementarity. Areas of possible rivalry include the perception, by the EU, of an 'unfair' Chinese competition, the opacity of the Chinese market, and allegations of dumping by Chinese firms, an issue related to its non-market economy status.*

*In the future, the fifth enlargement may lessen the complementarity (and therefore increase the level of competition), thus generating another challenge. Faced with these numerous challenges, a number of solutions are proffered, among which are multilateralism and cooperation on energy issues.*

### **I Introduction**

Despite some periods of tensions, the EU has been maintaining tight economic relations with the People's Republic of China (PRC) since it opened up in the 1970s. Over the past decades, the two regions have recorded contrasted performances, with China boasting strong and sustained growth rates while the EU records persistently sluggish growth. China is thus perceived by the EU both positively as a major engine of growth, and negatively as a likely competitor in a number of markets and sectors where the EU used to have a comparative advantage. At the same time, China's sustained economic

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growth raises new challenges, such as its increasing bargaining power. As a result, China is now perceived as an economic partner that can no longer be ignored or underestimated. The role of the EU as the third pole of economic activity next to North America and Asia implies that the partnership cannot be neglected by China either. More specifically, the EU is seen as being in a position to balance the weight of the USA.<sup>1</sup>

Major changes have been affecting the relationship over the past few years and are likely to have a long-lasting impact. These are: i) the fifth enlargement of the EU, ii) China's rising economic clout both globally and in East Asia, iii) the deepening of economic relations (hence the change in trade-offs and perceptions – in particular on the part of the EU, which now perceives China increasingly as a potential economic threat and no longer as a developing or less developed country). These changes are likely to shape the EU–China economic relationship in the coming years.

The objective of the paper is to examine the EU–China economic relationship from a prospective point of view. Its purpose is twofold. First, it will briefly take stock of the existing economic relations between the EU and the PRC, highlighting in particular both the positive sides and the areas of friction. Second, it will sketch the possible evolution of the relationship, by emphasizing the most likely bones of contention and areas of cooperation; it will then suggest ways and means of sustaining and perhaps enhancing the relationship (by improving the quality of the partnership and by soothing the possible tensions).

Obviously political considerations weigh quite heavily on the development of trade, and more generally on the economic relations between China and the EU, although ultimately the economic interests of both parties seem to be the main drivers of the relationship.<sup>2</sup> Finally, it should be borne in mind that the different interests and attitudes of the individual EU Member States may hamper the emergence of a common EU position vis-à-vis China.

## II EU–China Relations in Retrospect

A brief account of past relations is useful in highlighting the issues at stake. After a concise account of the EU policy towards China over the years, this section will depict the trade and investment relations between the two regions, before engaging in a discussion on the areas of contention and cooperation.

<sup>1</sup> An over-reliance on the USA for exports is no doubt a risky stance, as exemplified by the case of Wal-Mart which succeeds in bargaining with Chinese suppliers thanks to its position as a quasi-monopsonist. As a result, the EU may be perceived as a counterweight by China.

<sup>2</sup> Note for example that ASEM, the major framework of EU–Asia relations, is over-reliant on the economic pillar.

### *1. The EU Policy towards China*

Much has been achieved since 1975, the year that marked the official establishment of EC relations with the PRC. This opened the door to the signing of an EC-China trade agreement in April 1978 and of a textile agreement in 1979.<sup>3</sup> In 1980, China became a beneficiary of the EU's GSP scheme (Generalised System of Preferences), allowing the country to increase its exports of industrial products to the EU.<sup>4</sup> China has indeed been the main beneficiary of the scheme, accounting for more than 30 per cent of all EU preferential imports under GSP. The 1978 Agreement was replaced by the 1985 Trade and Economic Co-operation Agreement,<sup>5</sup> where the emphasis was placed on a broad economic cooperation and on investment. This *rapprochement* between the two regions culminated with the setting up in 1988 of a delegation by the EC Commission in Beijing just before the relationship started to deteriorate, albeit over a rather short time span of 16 months, as a result of the June 1989 Tiananmen Square events. Despite persistent tensions on human rights issues, the EU's relation with the PRC has continuously upgraded since October 1990.<sup>6</sup> The latest EU policy paper<sup>7</sup> stresses again the shared interest that the two parties have in working together, that is *inter alia*, in terms of the EU support to China's reform process and to political change, and of the necessity for the EU to raise its visibility in the PRC. These critical issues were reiterated in the 26-point statement released after the 8th EU–China Summit in September 2005.<sup>8</sup> The joint statement issued after the 9th EU–China Summit in September 2006 goes even further and calls for the launch of negotiations on a new Partnership and Co-operation Agreement which will update the 1985 Agreement.

<sup>3</sup> See OJ L123, 1978 for the Trade Agreement between the EEC and the PRC, and OJ L389, 31/12, 1986 on EEC/EC–China Agreements for the 1979 Textile Agreement. The 1978 agreement, which did not cover textile and clothing trade, accorded MFN treatment (most favoured nation).

<sup>4</sup> Quantitative restrictions (QRs) on all imports from China were gradually being phased out, so that by 1993, less than 6 per cent of all Chinese exports to the EU were subject to QRs.

<sup>5</sup> Available at <[ec.europa.eu/comm/external\\_relations/china/intro/1985\\_trade\\_agreement.htm](http://ec.europa.eu/comm/external_relations/china/intro/1985_trade_agreement.htm)>.

<sup>6</sup> The official line taken by the EU in its political involvement with China is one of 'constructive engagement'. This implies economic cooperation and support for the transition of the PRC to an open society based on the rule of law and the respect of human rights.

<sup>7</sup> CEC (2003) Commission's Policy Paper on China: *A Maturing partnership: shared interests and challenges in EU–China relations?* Commission of European Communities, Brussels, COM (2003) 533/final.

<sup>8</sup> See 'Joint Statement of the 8th EU–China Summit', Brussels, 5 September 2005, IP/05/1091.

Outside the EU spheres, the evolving relationship has been either praised as showing 'an extremely positive momentum'<sup>9</sup> and a fruitful convergence between the EU and major EU states policies,<sup>10</sup> or criticized as exacerbating the problem of lack of consistency in EU external relations.<sup>11</sup>

## 2. *The Pattern of EU–China Trade*

*a) Main features.* The first salient feature of EU–China trade relations is its dynamism. Since 1978, EU–China trade has increased more than 30-fold, reaching more than EUR209 billion in 2005. The expansion of EU–China trade has nevertheless not been perfectly smooth, with setbacks at some points related to political tensions. Yet the overall trend has clearly been on the ascending path. Over the period 1999–2003, trade between the EU-25 and China has more than doubled, with EU exports to China rising from USD19.6 billion to USD41.2 billion. The penetration of Chinese products in EU markets has been facilitated by the EU GSP scheme. As a result, China is today the EU's second biggest trading partner (after the USA) while the EU-25 is China's first export market.

A second characteristic of EU–China trade is the domination of manufacturing products. As shown in Table 1, more than 93 per cent of total EU trade with China was still in manufactures in the early 2000s, a feature which nevertheless is bound to change in the foreseeable future.

A third element to note is the increasing asymmetry existing between the two regions. Since 1990, China's exports to the EU have risen by more than 800 per cent, while EU sales to China have jumped by 600 per cent only. Over the period 1995–2002, EU imports from China have been sustained at a high annual growth rate (14.4 per cent), whereas EU exports to China have only risen by 9 per cent. Consequently and inevitably, there has been a shift from a traditional trade surplus in favour of the EU to a chronic and widening trade deficit since the 1990s. The deficit reached more than EUR106 billion in 2005 (Figure 1 and Table A1 in the Appendix), representing thereby the EU largest trade deficit with any partner. Moreover, every single Member State of the EU-25 now has a deficit with China (Table A1). The magnitude of the

<sup>9</sup> A. Pastor and D. Gosset, 'The EU-China Relationship: A Key to 21<sup>st</sup> Century Order', *CEIBS Research Paper*, No. 142/2005, November.

<sup>10</sup> R. Wong, 'Towards a Common European Policy on China? – Economic, Diplomatic and Human Rights Trends since 1985' (Mimeo, National University of Singapore, 2005).

<sup>11</sup> Gordon Crawford, 'European Union development co-operation and the promotion of democracy' in Peter Brunel (ed.), *Democracy Assistance: International Cooperation for Democratisation* (Frank Cass, London, 2000), pp. 90–127; C. Santiso, 'Promoting Democracy by Conditioning Aid?' (2002) 3 *International Politics and Society*, pp. 107–133.

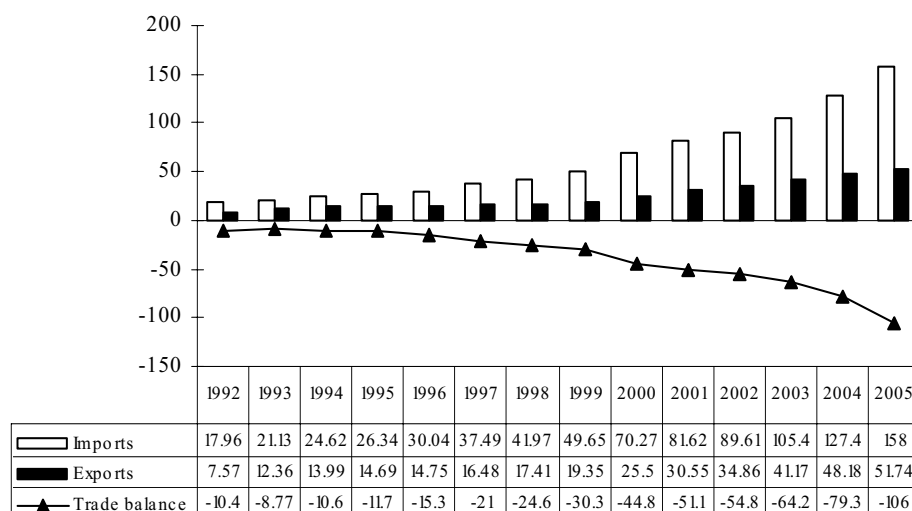
Table 1. EU trade with China in services and manufactured products, 1999–2003  
(USD billion)

	1999	2000	2001	2002	2003
Total trade in service	5.978	6.422	7.269	9.277	11.468
Total trade in goods	75.02088	83.85074	92.63038	106.7001	156.672685
Total trade	80.99888	90.27274	99.89938	115.9771	168.140685
Percentage of trade in services to total trade	7.38	7.11	7.28	8.00	6.82

Source: OECD Statistics on International Trade in Service, Volume II (2000–2003)–2005 Edition; OECD, International Trade by Commodity Statistics 1999–2004, Volume 2005/5.

imbalance is thought to reflect the persistence of market access obstacles in China (see below).

Figure 1. EU-15 manufacturing trade with China, 1992–2005 (ECU/EUR billion)

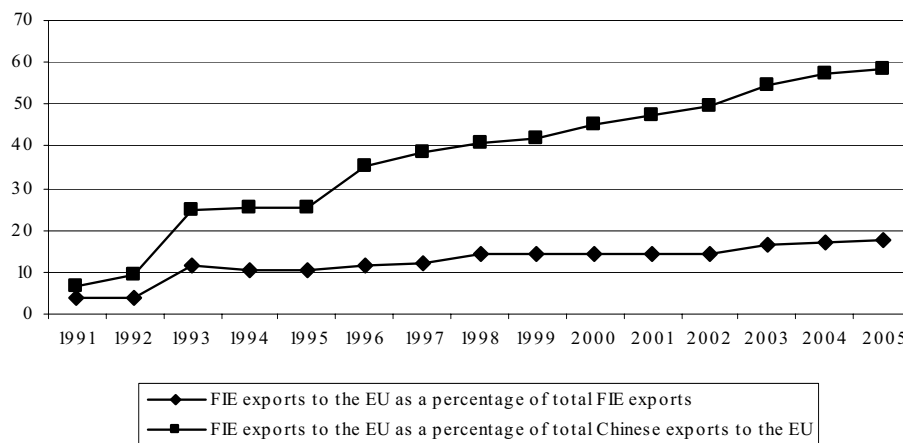


Source: EUROSTAT.

An important tempered argument in the analysis of the growing trade deficit with China is the amount of the EU trade deficit that can actually be imputed to Foreign Invested Enterprises (FIEs) operating in China. As shown in Figure

2, nearly 60 per cent of total manufacturing exports from China to the EU originated from FIEs in 2005. Also, about 20 per cent of all exports from FIEs based in China went to the EU in 2005. Since some of these FIEs are EU-invested firms, it can be argued that a non-negligible share of the growing manufacturing trade deficit of the EU vis-à-vis China is in fact a direct measure of its successful foreign direct investment (FDI) policy in this country.<sup>12</sup> A fair share of EU imports from Chinese FIEs concerns European Original Equipment Manufacturers (OEM) which have relocated their manufacturing units from a third country (in Southeast Asia or Eastern Europe) to China in order to take advantage of lower production costs.<sup>13</sup> Moreover, as explained below, the high import intensity of China's exports may actually contribute to boosting EU exports of intermediate goods to China.

Figure 2. Exports by FIEs from China to the EU, 1991–2005



Source: Ministry of Commerce, Chinese Customs Statistics, PRC.

Another important qualification is in order at this stage. When EU–China trade is broken down into ordinary and processing trade, China is found to record a surplus with the EU in ‘processing trade’ but a deficit in ‘ordinary’ trade.<sup>14</sup> This finding suggests that the major reason why China manages to record a surplus with the EU is because it is used as a processing platform by a number of (primarily foreign, namely Asian) firms. In other words, the EU trade deficit is actually a deficit vis-à-vis the whole of East Asia rather than vis-à-vis China.

<sup>12</sup> Bearing in mind the fact that the EU is still a marginal investor in China (see below).

<sup>13</sup> European Commission, *European Competitiveness Report*, Commission Staff working document, Sec (2004) 1397.

<sup>14</sup> Guillaume Gaulier, Françoise Lemoine and Deniz Unal-Kesenci, ‘China’s Integration in East Asia: Production Sharing, FDI and High-Tech Trade’ (2005) *CEPII Working Paper*, No. 2005-09, Paris, France.

Finally, despite an overall consistent trend, there are possible conflicting interests among EU Member States. Owing in particular to its size, Germany is by far the largest trading partner within the EU, accounting for 28 per cent of the EU-25 trade with China in 2004,<sup>15</sup> compared to 14 per cent for the United Kingdom, 12 per cent for the Netherlands, 10 per cent for France and 9 per cent for Italy. So far, there has been very little trade with the new Member States, with the exception of Poland whose trade with China represented in 2004 some 2 per cent of total EU trade. Moreover, Germany has improved its trade balance with China over the past couple of years, unlike France and the EU-15 as a whole. As a result, the stakes are perceived differently in each country and commercial self-interest is likely to be a source of intra-European disagreements.

*b) Complementarity.* Amongst the group of manufactured products, machinery, transport equipment and other so called ‘high-tech’ products such as office machinery and communication equipment accounted in 2005 for more than two thirds of the EU-15’s exports to China. Owing to a more liberal attitude towards technology transfer than, say, the one perceptible in the USA, the EU is the largest source of technology for China. Most of China’s imports of machinery, electrical machinery and vehicles have indeed come from the EU, and more than a third of China’s imports from the EU concern machinery and equipment goods. This phenomenon can be directly linked to FDI activities. As if to present a challenge to Ricardian-type comparative advantages, these very same categories account nevertheless for about half the EU-15’s imports from China. At a more disaggregated level, the EU-25 primarily exports automobiles and planes to China and imports computers and other office equipment. A dynamic analysis reveals that China’s relative trade specialization in ‘mature’ industries (i.e. clothing and textiles) is gradually giving way to a specialization in ‘sunrise’ industries. For example, Table 2 shows the extent to which the EU trade deficits in office machinery and computers, as well as in communication equipment, have grown over time. The increasing incidence of a two-way trade, or intra-industry trade (IIT), is best captured by static as well as by dynamic intra-industry trade indices (Table 3).

Table 3 shows that although intra-industry trade between the EU and China has declined overall between 1993 and 2005, the index has risen in a number of industries, be they mature (such as food or paper) or sunrise (such as machinery or scientific instruments).

<sup>15</sup> And 44 per cent of the EU-25’s exports to China, compared to 11 per cent for France, and 9 per cent for Italy (EUROSTAT Trade Statistics Figures). However, the mere size of the German economy cannot fully account for the country’s export performance in China; the specialization pattern is a further important factor.

Table 2. EU-25 Trade with China by Broad Product Group, 2000 and 2005 (USD million)

Product groups	Export		Import		Trade balance		
	2005	Export Annual Growth	2005	Import Annual Growth	2005	2000	Changes
		2000– 2005		2000– 2005			2000– 2005
<b>1: Beverages and tobacco</b>	199	21	68	6	131	36	95
<b>6: Manufactured goods classified chiefly by material, of which:</b>	6938	20	18689	17	-11750	-5989	-5762
61: Leather, leather manufactures, n.e.s., and dressed fur skins	255	4	334	17	-79	41	-120
65: Textile yarn, fabrics, made- up articles, n.e.s., and related products	525	12	3951	14	-3426	-1801	-1625
<b>7: Machinery and transport equipment, of which:</b>	31040	14	73770	22	-42731	-11164	-31567
75: Office machines and automatic data-processing machines	848	11	25481	26	-24633	-7662	-16970
76: Telecommunications and sound-recording and reproducing apparatus and equipment	1890	-10	21546	26	-19656	-3111	-16545
78: Road vehicles (including air-cushion vehicles)	2839	23	1829	19	1009	436	573
79: Other transport equipment	3698	28	1507	55	2191	807	1384
<b>8: Miscellaneous manufactured articles, of which:</b>	3235	18	54645	12	-51410	-29674	-21736
84: Articles of apparel and clothing accessories	133	22	18534	16	-18400	-9147	-9254
87: Professional, scientific and controlling instruments and apparatus, n.e.s.	1722	21	1749	19	-27	-114	87
88: Photographic apparatus, equipment and supplies and optical goods, n.e.s.; watches and clocks	313	23	1931	-2	-1618	-1922	305
89: Miscellaneous manufactured articles, n.e.s.	756	16	17457	9	-16700	-11260	-5441

Source: UN Commodity Trade Statistics Database (UN Comtrade).

Table 3. Grubel and Lloyd indices and contribution of IIT and NT growth to the growth in total trade between the EU and China, 1993–2005

Products	GL 1993	GL 2005	Cnt	Ciit	tt
0: Food and live animals	21.70	50.55	109.16	169.91	279.07
1: Beverages and tobacco	97.83	46.82	262.10	134.80	396.91
2: Crude materials, inedible, except fuels	74.32	71.57	148.45	364.05	512.50
3: Mineral fuels, lubricants and related materials	77.09	19.93	573.54	71.38	644.91
4: Animal and vegetable oils, fats and waxes	90.46	61.13	15.35	-51.32	-35.98
5: Chemicals and related products, n.e.s.	88.28	81.57	124.48	514.38	638.87
6: Manufactured goods classified chiefly by material	77.77	69.18	171.02	356.03	527.05
61: <i>Leather, leather manufactures, n.e.s., and dressed fur skins</i>	46.17	73.82	41.78	223.45	265.23
64: <i>Paper, paperboard and articles of paper pulp, of paper or of paperboard</i>	29.12	58.54	125.45	248.07	373.52
65: <i>Textile yarn, fabrics, made-up articles, n.e.s., and related products</i>	26.25	28.82	371.03	153.82	524.84
7: Machinery and transport equipment	34.90	73.38	187.89	662.38	850.27
75: <i>Office machines and automatic data-processing machines</i>	27.66	10.13	5732.96	626.80	6359.76
76: <i>Telecommunications and sound-recording and reproducing apparatus and equipment</i>	99.97	21.60	952.58	162.45	1115.03
78: <i>Road vehicles (including air-cushion vehicles)</i>	16.16	96.41	-65.65	471.69	406.04
8: Miscellaneous manufactured articles	16.02	25.52	429.30	159.87	589.18
87: <i>Professional, scientific and controlling instruments and apparatus, n.e.s.</i>	36.27	78.07	232.92	1019.65	1252.57
9: Commodities and transactions not classified elsewhere	23.72	79.86	-47.51	90.34	42.83
Total trade	87.99	67.70	241.06	442.52	683.57

Source: UN Commodity Trade Statistics Database (UN Comtrade).

Note that the method used to calculate NT (net trade) and IIT (intra-industry trade) follows that proposed by Menon. See J. Menon, 'The Dynamics of Intra-Industry Trade in ASEAN' (1996) 10/11 *Asian Economic Journal*, pp. 105–115.

Column 5 in Table 3 gives an indication of the evolving incidence of IIT over the time period. It can be seen that more than four-fifths of the increase in EU–China total trade in machinery and equipment is explained by intra-industry trade (the other fifth by net trade). Concomitantly, a very large share

of total trade in professional and scientific instruments is also attributed to IIT. Again, increasing IIT ratios between structurally dissimilar countries defies the post-Ricardian logic enshrined in Helpman's hypothesis.<sup>16</sup> As was already shown by Wakasugi,<sup>17</sup> FDI, the modern manifestation of globalization, allows structurally dissimilar economies, such as Japan and other Asian countries, to trade increasingly in the same types of industries, and in particular in parts and components, as well as in middle products or in fragments of final goods. This is to be related to the increasing spatial 'fragmentation' of the production process and to international outsourcing.<sup>18</sup> This implies that the issues of trade, FDI, IIT and intra-firm trade (IFT) cannot be disassociated.

Our analysis of intra-industry trade is done at the two-digit level, smoothing thereby fundamental differences, and specialization patterns, between the EU and China. It is clear, obviously, that China and the EU would tend to be specialized in different stages of the same manufacturing process, with China being more involved at the lower end of the spectrum in, for example, the computer and office equipment industry.<sup>19</sup> This invites therefore further clarification into the issue of trade or production 'complementarity' between the two regions.

The precise analysis of intra-firm trade at a disaggregated level suffers nevertheless from a statistical gap. At the aggregate level, and as shown by Figure 3 (when assessed in tandem with Figure 2 above), the suspicion is that much of the activities of FIEs in China are enshrined in their global production networks

These figures imply that EU firms may to some extent engage in the spatial division of their activities in discrete manufacturing and distribution stages, and that China is an important step in the spatial organization of the production network. These activities are assigned, in a complementary way, to the host countries according to their specific advantages. At the moment, a low-knowledge intensive–high-knowledge intensive complementarity exists

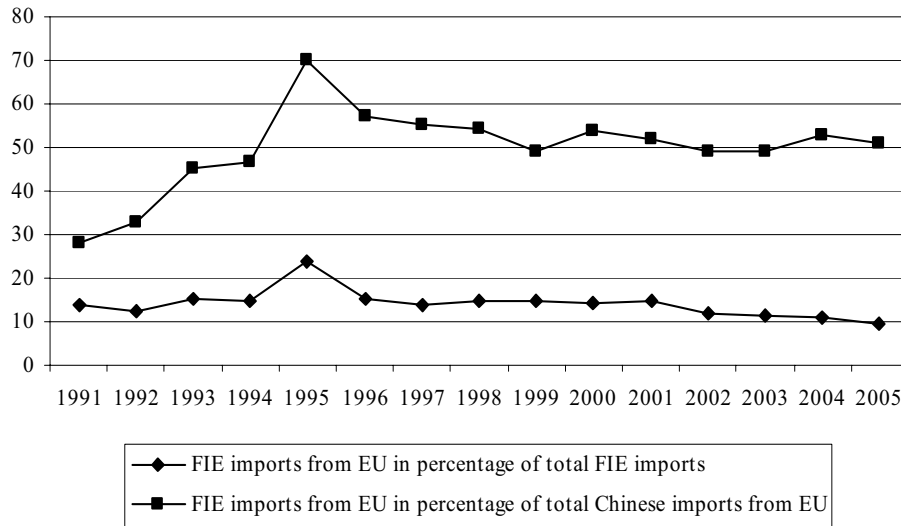
<sup>16</sup> This hypothesis states that intra-industry trade is more likely to occur between trading countries that present a small difference in their factor composition and size. See E. Helpman, 'Imperfect Competition and International Trade: Evidence from Fourteen Industrial Countries' (1987) 1 *Journal of the Japanese and International Economies*, pp. 62–81.

<sup>17</sup> R. Wakasugi, 'Missing Factors in Intra-industry Trade: Some Empirical Evidence based on Japan' (1997) 9 *Japan and the World Economy*, pp. 353–362

<sup>18</sup> Ronald Jones, Henryk Kierzkowski and Chen Lurong, 'What Does Evidence Tell Us About Fragmentation and Outsourcing?' (2005) 14/3 *International Review of Economics and Finance*, pp. 305–316. By contrast to 'standard' IIT, trade in middle products involves both developing and industrial economies. This is because developing countries can at a minimum capture production of certain segments and components, although they may not be in a position to supply competitively a whole product.

<sup>19</sup> Françoise Lemoine, 'FDI and the Opening-Up of China's Economy' (2000) *CEPII Working Paper*, No. 00-11, Paris, France.

Figure 3. Imports by FIEs from the EU to China, 1991–2005



Source: Ministry of Commerce, Chinese Custom Statistics, PRC.

between EU and Chinese manufacturing activities, although the Chinese shift to the higher end of the Value Added chain is rapid.

A further way in which the complementarity of manufacturing activities between China and the EU can be assessed is through the study of a number of relevant *filières*, defined as a chain of vertically connected economic activities. Earlier studies have found evidence of a manufacturing complementarity between the EU and China in terms of *filière*. For example, in the textile and clothing *filière*, it has been shown that China has been concentrating mostly on the low-end of the clothing industry, with the production of standardized products, and the EU on top-branded products and CAD-CAM textile machinery.<sup>20</sup>

Finally, the rapid technological catching-up of China in the manufacturing sector (viewed increasingly as the factory of the world) leaves still some scope for a EU–China complementarity of economic activities with a visible breakdown between manufacturing and service activities. As shown in Table 4, the EU has been able to consolidate a trade surplus in market-service activities in the early 2000s.

In this respect, China's accession to the WTO in 2001 and its commitment to open up to foreign competition one of its most protected and heavily regulated sectors, namely services, has no doubt generated significant opportunities

<sup>20</sup> B. Andreosso-O'Callaghan and W. Qian, 'EU-China Trade and Investment Relations: Complementarities in the Textile and Clothing *Filière*' (1997) 9/6 *International Journal of Clothing Science and Technology*, pp. 47–49.

Table 4. EU-15 China trade in services, 2000–2003 (USD million)

	Exports				Imports			
	2000	2001	2002	2003	2000	2001	2002	2003
Total Services	3182	3756	4952	6666	3240	3513	4325	4801
Transportation	1324	1556	2195	2575	1046	1079	1783	2104
Travel	494	471	685	749	744	867	1182	1022
Other Commercial Services	1337	1605	1925	3140	1401	1429	1224	1520
Government Services	27	27	55	97	51	53	37	50

Source: OECD Statistics on International Trade in Services: Detailed tables by Partner Country Volume 2006, release 02.

for foreign competitors. It remains to be seen, however, whether China will indeed allow full and fair competition in markets for services in China, since it may fear effective dominance by foreign competitors.

### 3. Foreign Direct Investment Flows

EU FDI in China has expanded recently with approximately USD4.2 billion per annum on average between 1999 and 2004. As a result, the stock stood at EUR35 billion as of July 2004. The EU's position in China's total FDI inflows improved continuously in the 1990s. However, the EU economies have allocated smaller shares of their FDI to China since the peak years in the late 1990s. The share in the total actual utilized value declined to 7.2 per cent in 2005 from 11 per cent in 1999.<sup>21</sup> The EU-15 remains thus a marginal foreign direct investor in China, when compared with ethnic Chinese and other Asian investors. Over the period 1991–2001, the EU accounted for less than 10 per cent of total inflows, a figure comparable to either the USA or Japanese performance, while Asian investors accounted for more than 60 per cent. Here again, however, the situation varies across countries, with the United Kingdom and Germany (with respectively 2.2 and 1.8 per cent of total FDI stocks in China) well ahead of France (with less than 1.2 per cent), for instance.

EU firms' strategies in China do not exhibit a clear-cut pattern. According to some analysts,<sup>22</sup> they tend to differ from their strategies in the Central and Eastern European Countries (CEECs), as well as from the aims of Asian firms

<sup>21</sup> By contrast, Central and East European countries (CEECs) have remained the primary destination of EU investment with the EU enlargement.

<sup>22</sup> Frédérique Sachwald, 'The Integration of China and East European Countries in Global Production Networks' (2004) *Les Etudes de l'Ifri*, No. 2, Ifri, Paris.

investing in Asia. Surveys have indeed shown that Asian firms investing in China are mainly motivated by cost considerations and tend to invest more than others in export-oriented activities. Asian investments in China do correspond to the relocation of labour-intensive industries, which tend to lose competitiveness. By contrast, European investment (and to some extent American investment) in China is primarily market-seeking; in other words, it is driven by market expansion strategies rather than by cost considerations.<sup>23</sup> According to the European Commission, while early European FDI into China was primarily motivated by low costs and went into exporting industries, an increasing share is today motivated by the desire to produce for the growing Chinese market.<sup>24</sup> The examination of French IFT confirms for instance that European groups focus on the Chinese local market (while American and Japanese companies tend to be more involved in vertical trade with China). Some recent empirical evidence, however, suggests that cost-saving considerations are still important for EU FDI. As shown by Wei,<sup>25</sup> the empirical analysis of the locational determinants of EU FDI across Chinese provinces over the period 1996–2002 reveals that both provincial GDP, as a proxy for domestic market size, and revealed comparative export advantage are positively and significantly determining EU FDI.

These apparently contradictory pieces of evidence tend to suggest that FDI motivations are diverse and most certainly sector specific, as well as home-country specific.

An important characteristic of EU FDI in China is its focus on capital and technology-intensive manufacturing industries such as automotive, chemicals and pharmaceuticals, electronics, communication equipment and instruments. Being relatively capital intensive, EU FDI projects in these industries represent typically a large share of the total FDI realized value.<sup>26</sup> Another important EU FDI strength in China is the involvement in the nuclear energy sector, in which key technologies and equipment have originated from the EU.

#### *4. Current Areas of Tension and Collaborative Solutions*

In light of the previous discussion, it is possible to isolate the main areas of possible tension between the two regions.

First and foremost, the trade imbalance is perceived by EU actors as being partly the result of an ‘unfair’ Chinese competition in consumer goods industries

<sup>23</sup> Lemoine, note 19 above; Gaulier, Lemoine and Unal-Kesenci, note 14 above.

<sup>24</sup> European Commission, note 13 above.

<sup>25</sup> Xiaojung Wei, *EU FDI to China: Locational Determinants and Lessons from an Enlarged European Union*, PhD Thesis, University of Limerick, June 2006.

<sup>26</sup> Luolin Wang (ed.), *Report on Foreign Direct Investment in China* (China Finance and Economics Publishing House, Beijing, 2000).

such as clothing and textile. The allegation of social dumping (bordering on human rights issues), an undervalued exchange rate, the widespread practice of counterfeiting and the inadequate enforcement of intellectual property rights, are the ingredients of what has been perceived as being an 'unfair' competition from China. This may, however, be more a feature of past relations, given the non-compliance with WTO rules up to 2002. Nevertheless, counterfeiting can be expected to remain a major bone of contention between the two regions, at least for the foreseeable future. The same remark holds true for the exchange rate debate.<sup>27</sup>

Second, and as in the case of Japan in the past, the Chinese market is perceived as being sheltered behind many entry barriers, such as those represented by the industrial policies that discriminate against foreign companies, as in the case of the motor-vehicle industry.<sup>28</sup> Market-access obstacles include high tariffs, non-tariff barriers, non-transparent trade rules and regulations<sup>29</sup> and investment restrictions. Also, soft budget constraints of state-owned enterprises are a real issue and this is considered as distorting competition. Finally, barriers to market access have been identified in a number of service sectors (such as construction, banking and telecommunications). These barriers range from excessive regulation (in the telecommunication industry) to local content requirements, non-transparent bidding procedures, export obligations, an opaque legal system along with inconsistent enforcement of laws, etc. Access to raw materials has recently been identified as another major trade issue.

Another major area of friction between the two regions relates to the issue of selling below cost. In response to this alleged use of dumping, EU competitors have tended to resort to anti-dumping (AD) actions against Chinese products. By defining China as a non-market economy, the EU's AD policy does not acknowledge China's domestic costs of production but uses a third surrogate country to calculate the normal value of Chinese exports (see below). Be it as it may, China has become the EU's major anti-dumping target. According to Chinese sources, the EU has initiated 107 anti-dumping cases against China between 1979 and 2004, behind the USA. In 2004 alone, the number of cases climbed by nine, a 200 per cent jump over the previous year,<sup>30</sup> with a rise in cases involving electronics and mechanical goods (away from chemicals

<sup>27</sup> In spite of the Chinese Central Bank's decision on 21 July 2005 to abandon the eleven-year-old peg to the dollar and instead to link the renminbi to an undisclosed basket of currencies, leading to an appreciation vis-à-vis the euro.

<sup>28</sup> This type of dispute is quite comparable to the structural-impediments debate of the 1980s.

<sup>29</sup> 'China's trade laws and regulations are often secretly formulated, unpublished, unevenly enforced, and may vary across provinces', San Diego World Trade Center, available under <[www.sdwtc.org](http://www.sdwtc.org)>.

<sup>30</sup> *People's Daily Online*, 5 May 2005, available under <[english.people.com.cn/](http://english.people.com.cn/)>.

and ores). In 2000, the anti-dumping charges against China reached a peak of around 20 per cent of the EU's total annual anti-dumping procedures.<sup>31</sup> Over the period 1995–2006, China accounted for over 19 per cent of all EU AD initiations and actual measures. These actions are seen as being unfair by Chinese analysts who claim that the application of non-market economy treatment towards Chinese exporting companies is an arbitrary procedure and that China should be granted market economy status (MES) because about 70 per cent of China's economy is claimed to be market based.

One way in which the current tensions have started to be given a solution is through EU assistance in trade-related areas, so as to help China implement its obligations and commitments in the WTO. At this juncture, an interesting question is to investigate how the relationship is likely to evolve in the future, so that it can be profitable for both sides.

### **III EU–China Economic Relations in a Changing Environment**

#### *1. General Remarks*

Two major changes can be expected to impact upon the trade relations between China and the EU, namely the EU enlargement and the rise of China as an economic power and as a pivotal element in East Asian production networks as well as in a more institutionally based regional economic area. Because the EU is a major export destination for China, whether the accession of the CEECs to the EU will result in a reduction of its exports to the EU is a major concern for China. On the other hand, the development of trade and investment linkages in East Asia is also likely to change the characteristics of East Asia as a region. Competition is expected from China in a number of more highly skilled sectors, such as the automotive and electronic sectors.

#### *2. Implications of the Enlargement for the EU–China Partnership*

The fifth enlargement of the EU can be expected to have a substantial impact on the EU traditional trade partners. It will necessarily impact upon EU–China relations for a number of reasons.

First, the role of the CEECs as a destination for European FDI is increasing and the EU-15 is the most prominent source of FDI for this region. Note that before the fall of the Berlin wall, most of the relationship between the two 'Europes' took the form of outward processing trade (defined as transferring

<sup>31</sup> See <[www.wto.org](http://www.wto.org)>.

abroad segments of a previously integrated in-house production process and re-importing for final production), mostly in the Textile and Apparel industry. This has been shown to be one of the most important ways in which EU producers reacted to competitive pressures from low-wage competitors in labour-intensive industries.

Second, the nature of the Single Market is bound to change with a much wider diversity in terms of specialization patterns. Even if, thanks to the Europe Agreements, economic integration through trade and FDI was already important in the 1990s between the EU-15 and the CEECs, the accession of the latter will further deepen and accelerate economic linkages. However, the production patterns of the EU-25 are rather different from the patterns of the EU-15, given the different levels of development and comparative advantages. Consequently, the pan-EU patterns of production may change compared to the pre-enlargement period, at least in the short to medium term. The division of labour may be characterized by a specialization of some of the 'older' Member States in knowledge-intensive activities, and a specialization of the new member countries into more labour-intensive activities. As a result, there may be less complementarity and more scope for competition between China – or rather some of its provinces therein – and the enlarged EU, and the EU may end up being more competitive and even less prone to use China as a production base for the production of its low-tech products.

It is this issue of a possibly increasing direct competition between the new Member States and some of the Chinese provinces that lies at the core of the FDI (and growth) debate in Europe. A rough glance at comparative figures published in the 2002 China Statistical Yearbook reveals that in 2001, GDP per capita in PPP terms for Shanghai municipality was 65 per cent of the EU-15 average; this was higher than that for the Czech Republic (at 57 per cent) one of the best performers of the CEECs.<sup>32</sup> A greater structural similarity between the more developed provinces of China and some of the EU countries implies a higher degree of competition between China and Europe for inward investment.

This leads to the issue of the hollowing out and relocation of low-skilled activities away from the EU-15, a feature of modern 'international business'.

According to some authors,<sup>33</sup> the risk of FDI diversion, however, should not be over-stated. As seen above, the motivation for investing in the CEECs and in China are not necessarily the same and the two regions, broadly speaking, are thus not necessarily in competition in this respect. However, as suggested earlier, this optimistic view seems to be less and less valid and is likely to become very soon a feature of the past.

<sup>32</sup> According to the same source, Guandong's ratio stood at 29 per cent, compared with 40 per cent for Poland.

<sup>33</sup> Sachwald, note 22 above.

Finally, the expansion of the EU market will offer further opportunities for Chinese firms, thus giving further scope for exchanges of all kinds. As a result of the EU enlargement, the EU market is likely to be as attractive for Chinese products as the US market.

### *3. The Emergence of a More Tightly Integrated East Asia and its Impact on the EU*

As far as East Asia is concerned, vertical integration is the key behind tighter economic integration, with China playing a pivotal role in the process. The emergence of China has helped further fuel the dynamics of private sector-led regionalization, which is a salient feature of East Asian economic integration. Following the normalization of its economic relations with a number of its Asian trading partners such as South Korea, China's trade with its neighbouring emerging Asian economies has intensified dramatically.<sup>34</sup> More importantly, about half of China's imports are for processing and re-exporting<sup>35</sup> and this holds particularly true for imports from the rest of Asia. The bulk of China's imports from neighbouring East Asia are made of parts, components and raw materials. The rise in East Asian intra-regional trade since the early 1990s has thus been largely driven by rapidly growing trade in parts, components and intermediate products that is a reflection of greater vertical specialization and the dispersion of production processes across borders. China is being used largely as an outward processing region for goods developed elsewhere in Asia.<sup>36</sup> This has been described as the 'Asian integrated circuit'. By contrast to what has been observed in the EU, the electronics sector has been (and still is) the driving force behind the segmentation of production throughout the region and the resulting regional economic integration.<sup>37</sup>

For the time being, economic integration in East Asia is based on intensive vertical intra-industry (even intra-product) trade. This type of integration is in contrast to what could be observed within the EU-15, where intra-industry trade primarily involved end-use products with minor differences, while it

<sup>34</sup> This is also reflected in the upward trend of trade intensity indices among the East Asian economies. See M. Ando and F. Kimura, 'The Formation of International Production and Distribution Networks in East Asia' (2003) *NBER Working Paper*, No. 10167, Cambridge, USA.

<sup>35</sup> On the export side, the so-called processing trade accounts for the bulk of China's trade. In the electronics and IT industry, processing trade has accounted for approximately 90 per cent of China's total exports since 1995. See T. Rumbaugh and N. Blancher, 'China: International Trade and WTO Accession' (2004) *IMF Working Paper*, No. 04/36, Washington, D.C., USA.

<sup>36</sup> As a result, China runs a trade surplus with East Asia in consumption goods and a deficit in intermediate goods.

<sup>37</sup> Sven Arndt and Henryk Kierkowski, *Fragmentation: New Production and Trade Patterns in the World Economy* (Oxford University Press, Oxford, 2001).

is closer to the new kind of economic integration prevailing within the EU-25.<sup>38</sup>

Although East Asia is likely to emerge in the near future as a consistent and better-structured area from the point of view of the private sector, it is unlikely to behave as a well-organized political entity. As a result, China will remain an isolated partner for the EU. Yet, it may be desirable for the EU to conduct parallel dialogues with East Asia and with China.

#### *4. A New China Challenge for the EU*

In the context of relocation to low-cost countries, a new fact is emerging gradually: while relocation until recently primarily involved unskilled employment, high-added-value jobs have also started to be impacted. Moreover, in contrast to what is often thought, relocation is not the exclusive privilege of large multinationals. According to a survey conducted by the French employers' union (MEDEF) with some 200 French SME leaders, relocation is also a common practice amongst SMEs. IT services and business process outsourcing (BPO) to developing countries, where wages are much lower, is increasingly frequent. Firms seem to focus increasingly their attention exclusively on cost minimization and profitability, and they seem to lose interest in industrial know-how ownership. Flat Panel Displays (FPDs) are a case in point: today, there is not a single company in Europe which is able to design and produce FPDs on a large scale. Because of the lack of domestic R&D investment, Europe runs the risk of falling behind in the R&D race, and in the long term of being unable to compete with Asian companies.

Before 2010, 25 per cent of all European information technology (IT) employment could be relocated in developing countries. Some 30 per cent of European IT companies have already started a process in this way. Be it through outsourcing, relocation, or offshoring, the transfer of European high-tech activity in developing countries seems unavoidable. Analysts do not really see how the trend could be reversed: in the year 2004, relocation in the European IT sector increased by 3.1 per cent. By 2007, its annual growth could reach 8 per cent. In 2005, 30 per cent of large European IT companies are deemed to have delocalized part of their activities. On the employment side, analysts estimate that in 2010 more than 25 per cent of jobs in the European

<sup>38</sup> With the enlargement to EU-25, the pattern of intra-industry trade is likely to evolve, with a rise in the fragmentation of the production process. As Arndt aptly puts it: 'the major gains from entry will not come from freer trade along established patterns but from the reorganization of production and the consequent integration of those economies into the production networks of the EU.' See S. Arndt, 'Regional Enterprise in Preference Areas' (2001) *Working Paper*, No. 02, Lowe Institute of Political Economy, Claremont McKenna College, p. 14.

high-tech sector will have been transferred towards emerging countries, in particular India, China and Russia.<sup>39</sup>

The rise of China is also likely to pose a major challenge to EU solidarity. Such may be the case because of the different perceptions of the China ‘threat’ throughout the EU. Leaving aside the potential old–new Member-State division, it is worth stressing that all European countries do not gauge the magnitude of the China challenge in the same way. Varying economic interests within the EU-15 may lead to varying stances. The textile issue was a case in point with the south European countries apparently more concerned than the north European ones. As a result, preserving EU solidarity may prove to be delicate.

Finally, the definition of some EU policies may also be made more difficult as a result of the rise of China. The signing of the Barcelona Declaration in 1995 between the EU and ten countries from the Mediterranean region, and the gradual completion of a Pan-Euro-Mediterranean Free Trade Zone, have been in some ways a strategic preparation for the China challenge. It is, however, unfortunate that there has not been enough attention, as well as financial resources, earmarked for structural change in these Mediterranean countries, given that their manufacturing specialization lies in the same area as China’s. In particular, the end of the MFA is an unprecedented challenge for these Mediterranean countries, and the fierce level of competition from China in the textile and clothing sector poses a major problem to the EU partnership with the Mediterranean countries.

#### **IV Enhancing an Economic Partnership**

Faced with the challenges reviewed in the previous sections, it is in the interest of both the EU and China to improve their economic relations so as to generate more FDI and to achieve more balanced trade and growth. Both sides can gain in collaborating more closely in a number of areas, which we have grouped into three subheadings: economic complementarity, multilateralism and sustainable development.

<sup>39</sup> This situation is not alarming per se. What is striking is that the EU suffers from a critical lack of adequate policies (such as training and R&D) that are necessary to accompany structural change and that are essential to smooth out the negative impact of relocation. See J.F. Kirkegaard, ‘Outsourcing and Offshoring: Pushing the European Model Over the Hill, Rather than Off the Cliff!’ (2005) *IIE Working Paper Series*, No. 05-1, Washington, D.C., USA.

### *1. Economic Complementarity and Attitudinal Change in China*

First of all, there are still many knowledge-intensive manufacturing and service activities in which the EU excels. As a result, there is scope for more diversified interactions between the two partners, particularly in the business services sector where the EU combines many strengths (such as in financial services, research, consultancy, etc.).

However, market access for foreign services providers in China remains restricted, and obviously China's WTO commitments are here of major relevance to the EU. For China, this implies a definite commitment to issues such as corporate governance, an adequate legal framework and judiciary system, accounting and auditing practices, etc. These represent undoubtedly major challenges to the Chinese Government, as well as its enterprises, workers and professionals, who will also have to adjust to the new economic circumstances.

The persistent disagreement between China and the EU on the MES issue constitutes a major stumbling block on the road to deeper cooperation and enhanced complementarity. The fact that China is not accorded market economy status by the EU through to 2016 has a number of implications.<sup>40</sup> In particular, in order to calculate dumping margins for a non-market economy, the prices and other information being used are not those from the country under investigation but those from a surrogate country that has a market economy. In the case of China, for instance, the US department of commerce uses production and price information from India or Singapore to determine a fair price in the case of an investigation relating to Chinese imports. It should be noted that China has agreements with a number of Asian neighbouring economies, in particular with the ASEAN countries, which extended market economy status to China in November 2004.

Actually, there seems to be a basic misunderstanding about the MES issue. Article 15 of the Chinese Protocol of Accession to the WTO permits the use of a special procedure for anti-dumping cases against China 'if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product'. While the accession of China to the WTO reflects an implicit acceptance of China's status as a market economy, the EU's refusal to grant officially this status to China is primarily related to specific trade disputes but it is perceived very negatively by China. A Market Economy Status dialogue is, however, underway between the two parties with

<sup>40</sup> Note that, according to figures published by *The Book on Chinese Reform* (Price Reform Volume, Beijing, 1997), more than 90 per cent of consumer goods prices were determined through the operation of the market at the end of 1992; this compares with less than 6 per cent in 1983.

a view to deepening the communication on the outstanding issues so as to help resolve the dispute.

## *2. Promoting Multilateralism*

Trade disputes are doomed to persist and even intensify in parallel to trade relations. Since such a development cannot be avoided, it is important for the EU and China to both engage in multilateral trade-dispute settlement mechanisms. The recent trade disputes about clothing and textile imports from China is undoubtedly due to a lack of transparency about the way in which the Chinese economy works. There are suspicions that a number of Chinese firms may have over-invested in order to flood the world market once the quota system was dismantled. Fair practices are the only possibility, and to that end, there is a need to push for multilateral rules. Yet the recent dispute has also shown that the bilateral dialogue is a better approach than the imposition of unilateral sanctions as chosen by the USA. By taking the unilateral route, the EU would have run the risk of further antagonizing China.

Further ‘normalization’ of the Chinese economy is desirable. For instance, the introduction of a streamlined visa-processing system in September 2004 has given rise to a dramatic inflow of Chinese tourists into the EU.

## *3. Enhancing Sustainable Development in China: The Role of Cooperation on Energy Issues<sup>41</sup>*

China’s performance in terms of energy efficiency is rather mixed, and there is scope to enhance energy efficiency in this country. In particular, the development of clean coal technology should be a priority.

It is undoubtedly in the EU’s interest to have China develop as a committed consumer and producer of energy. Because of the sheer size of the Chinese economy, promoting energy efficiency, developing cleaner technologies, as well as alternative energy sources, should rank high among the EU’s priorities. The EU is in a particularly good position to assist China in this endeavour. While existing signatories of the Kyoto protocol (which have taken on binding obligations) are expected to proceed with the implementation of the protocol, less developed economies with rapid rates of economic growth, and China in particular, should accept to be gradually phased in as a result of a renegotiated protocol. As there is shared concern on the need for environmental protection,

<sup>41</sup> This section draws on: Francois Godement, Francoise Nicolas and Taizo Yakushiji (eds), *Asia and Europe: Cooperating for Energy Security* (Japan Centre for International Exchange, Japan, 2004).

a common objective is to renew and expand the existing commitments to combat climate change and promote sustainable development (by reducing wasteful consumption of energy), and to help less advanced countries in this endeavour. In other words, sustainable development must be explicitly built into any energy policy.

The rise of China as one of the largest energy consumers in the world makes it all the more necessary to revamp the multilateral mechanisms which were designed at a time when industrial economies dominated the energy scene (see Figure A2 in the Appendix). In particular, it renders arrangements such as the IEA (International Energy Agency) far less relevant because the stabilization of the global energy market requires the participation of China. A challenge is thus to determine how China could be associated or could benefit from accumulated experience. Beyond such existing schemes, some degree of coordination may be warranted in the dialogue with oil producers for instance, or in the fora dealing with environmental issues. Again, as one of the major emitter of pollutants, China also should be associated as a participant with various schemes dealing with environmental aspects of energy security. Overall, it is in the interest of both China and Europe to strive to shape and improve global governance on energy-related issues and to help accommodate China in the appropriate mechanisms. As stressed in the joint statement released after the 9th EU–China Summit in September 2006, sustainable development is one of the major areas in EU–China cooperation.

Energy security concerns rank particularly high in China, since a sound energy security policy is clearly perceived as a precondition for big power status. An oil-focused energy strategy was proposed by the State Council in late November 2003, and a draft energy development programme for 2004–2020 was approved, calling in particular for a flexible strategic petroleum reserve system, a shortage-warning system, energy diversification and conservation, further exploration and cleaner energy technologies. In particular, in an effort to reverse the growth of its dependence on foreign oil, China is seeking to establish a 70–75 day strategic petroleum reserve in four locations, with the first phase scheduled to be completed in 2007. Additional measures are also envisaged, in particular encouraging a more effective development of domestic energy resources as well as intensive research into alternative fuels and resources to reduce reliance on petroleum and coal.

As far as the oil market is concerned, the rise of China poses a major challenge to existing emergency mechanisms. Helping in the establishment of oil stockpiling in countries such as China can certainly be seen as one of the few really valuable public investments for oil security. As a result, it would no doubt make a lot of sense to help (financially as well as technically) the development of such oil stocks in Asia.

Finally, another avenue for interregional cooperation should be stressed at this stage: while the emphasis is systematically placed today on the dramatic

impact of China's economic rise on the global demand for energy, it should not be overlooked that China may exert a comparable impact on energy supply, should this country manage to make major progress in the field of renewable energies in particular. Low production costs and relocation apply to energy-substitution machinery: batteries, micro-turbines and windmills could all be produced at substantially reduced cost in China, where they are also of major relevance given the country's growing and diversified energy needs. If such were the case, prospects for these alternative energy sources may be far less bleak than currently imagined and the whole energy balance can be substantially improved.

## V Conclusions

The EU has no doubt a more straightforward relationship with China than the USA for instance. This is because the EU has no intention nor pretension to play a strategic role in the region, hence security considerations do not 'pollute' the relations.

Yet, the rise of China as a challenging economic power, in the eyes of the EU, is fraught with a number of inherent contradictions. China is not regarded by the EU (nor by the USA) as a fully-fledged market economy (although most of its consumer prices are market-based prices) and yet it is a member of the WTO. China has been a member of the WTO since 2001, and yet it has difficulty with implementing its WTO obligations and commitments. The EU trade deficit with China is increasingly perceived as being 'unfair' in the EU, and yet a large share of it is explained by the very successful investment strategies of EU and other (Asian) firms in China. These contradictions are the source of much new tension arising between the two parties, and it is only through their acknowledgement and through the recognition of shared interests that these tensions can abate in the future. The shared long-term interests are clear: continuous economic balanced growth, peace, security and sustainable development.

The emphasis in this article has been on the economic challenges posed to the EU by the fast economic development of China. Of particular importance is the evolving manufacturing specialization of China-based firms, in the context of an enlarged EU. Shared economic prosperity has been highlighted with due reference to the existence of two types of complementarity existing between the EU and Chinese productive systems. One at the level of the *filière*, with the EU supplying much needed technology and machinery to China, and China being involved in less technology intensive activities (in consumer goods for example). The second being a low-knowledge-intensive–high-knowledge-intensive complementarity taking place within the spatial

organization of global manufacturing systems. However, the complementarity in terms of *filière* is already a feature of the past, for the EU now has a trade deficit with China in machinery. More preoccupying, although the EU still combines many strengths in knowledge-intensive manufacturing activities (such as in the biotechnology area), the Chinese shift to the higher end of the VA chain in many of these industries is inexorably rapid. At this juncture, the only complementarity that the EU can best promote in the future seems to be more along the lines of a services–manufacturing complementarity.

In order for this to be realized, a key prerequisite must be fulfilled. The EU cannot maximize its benefits in knowledge intensive service (and also manufacturing) activities in the future if China does not implement the WTO commitments, in particular with regard to intellectual property rights. Moreover, the development of a service industry that can support and facilitate manufacturing is another condition for the emergence of this new form of complementarity.

This article has also shown that an area in which Sino-EU collaboration can lead to substantial and growing mutual benefits in the future is the energy sector. This is very much an untapped area and, given the strategic importance of energy in the economic–political sphere, EU-Sino collaboration can only contribute to stability at the world level.

More generally, the accelerating rise of the Chinese economy and the deepening of its relationship with the EU are likely to facilitate the change of forces in the international system and help promote multipolarization of international relations. Both China and the EU attach great importance to the international multilateral system. The two sides also share common interests in safeguarding world economic stability and sustainable development, and appreciate each other's rising role in international affairs. The need for multilateral cooperation between China and the EU has far outweighed the simple need for holding back the USA, although this objective may help maintain the cooperative momentum.

Finally, the rise of China poses another challenge for the definition of a EU policy, first because of the persistence of intra-European disagreements on China-related economic issues due to diverging commercial self-interest; and second, because the rise of China affects the relationship between the EU and some of its traditional economic partners, such as the North African economies, which happen to be in competition with China. This is all the more problematic since building a really solid partnership with China requires a more coherent policy on the EU side. This may therefore turn out to be the most difficult challenge faced by the EU as a result of the rise of the Chinese economy.

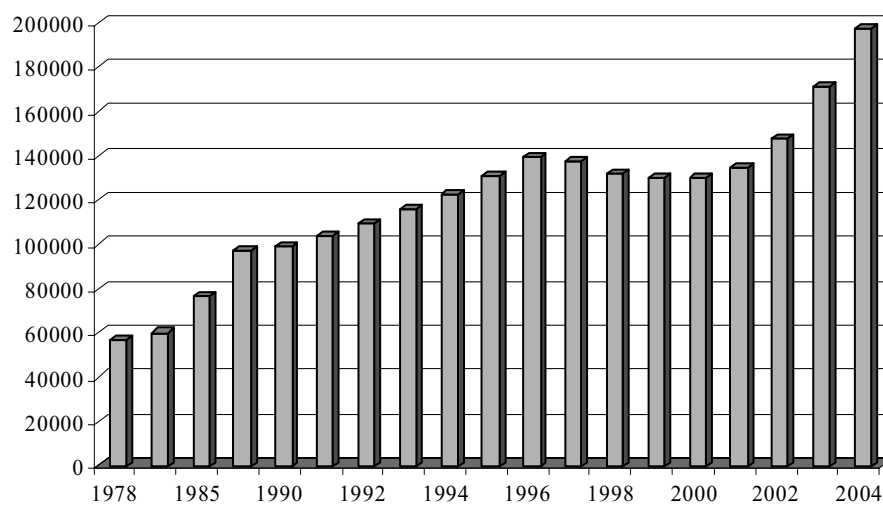
## Appendices

*Table A1.* EU-25 trade with mainland China, 2005 (Mio EURO), ranked by trade total

Country	Imports	% total	Exports	% total	Trade total	% total	Trade balance	% change
EU-25	157985	100	51842	100	209827	100	-106143	34
Germany	34721	22.0	21210	40.9	55931	26.7	-13512	79
UK	24667	15.6	4081	7.9	28748	13.7	-20585	21
Netherlands	25827	16.3	2626	5.1	28452	13.6	-23201	39
France	14466	9.2	6489	12.5	20955	10.0	-7976	27
Italy	14133	8.9	4605	8.9	18738	8.9	-9527	29
Belgium	8552	5.4	2711	5.2	11264	5.4	-5841	33
Spain	9705	6.1	1482	2.9	11187	5.3	-8223	37
Sweden	3198	2.0	2029	3.9	5227	2.5	-1169	141
Hungary	3816	2.4	332	0.6	4148	2.0	-3484	4
Denmark	2883	1.8	848	1.6	3731	1.8	-2035	50
Austria	2120	1.3	1592	3.1	3712	1.8	-527	44
Finland	1981	1.3	1605	3.1	3586	1.7	-376	-163
Poland	2606	1.6	476	0.9	3083	1.5	-2130	13
Ireland	1550	1.0	909	1.8	2459	1.2	-642	-2
Luxembourg	2233	1.4	129	0.2	2363	1.1	-2104	9
Czech Rep.	1676	1.1	240	0.5	1917	0.9	-1436	-14
Greece	1703	1.1	79	0.2	1781	0.8	-1624	19
Portugal	569	0.4	171	0.3	740	0.4	-398	11
Slovakia	414	0.3	102	0.2	516	0.2	-312	2
Estonia	304	0.2	33	0.1	337	0.2	-271	33
Lithuania	291	0.2	11	0.0	302	0.1	-280	23
Slovenia	213	0.1	43	0.1	257	0.1	-170	53
Cyprus	194	0.1	12	0.0	205	0.1	-182	2
Latvia	105	0.1	8	0.0	114	0.1	-97	54
Malta	58	0.0	18	0.0	75	0.0	-40	-21

Source: EUROSTAT, COMEXT.

Figure A2. Total consumption of energy in China, 1978–2004 (1 000 tons of SCE)



Source: China Statistical Yearbook, 2005.

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