

Why it is dangerous for Europe to bash China

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By Patrick Messerlin and Razeen Sally

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European rhetoric aimed at China is becoming American in style: confrontational and shrill. Trade deficits and exchange rates are the lightning-rods. European Union threats of retaliation have become more frequent.

This new China-bashing is muddle-headed and dangerous. On deficits and exchange rates, the EU's diagnosis is nonsense. It is true the EU's trade deficit with China is soaring, hitting \$166.4bn in 2006. While that is still smaller than the US-China trade deficit, it has grown much faster. The Chinese renminbi has depreciated about 25 per cent against the euro since 2000, while it has appreciated about 10 per cent against the dollar.

However, the bilateral trade deficit is not a problem. The EU imports more from China, but correspondingly less from other east Asian countries: the EU's trade deficits have simply shifted from the latter to China. That is because China has become the final-assembly hub for goods exported to the rest of the world. Its corollary is increasing Chinese imports of parts and components from the west and east Asia. The trade deficit is a natural consequence of a massive global reshaping of trade and production.

This obsession with trade deficits also obscures phenomenally good news. Low-cost Chinese imports have been a boon to European consumers, retailers and producers. EU exports to China have more than doubled since 2000 and have grown faster than to any other export destination. European companies have invested over \$56bn in China and generated total sales of \$134bn in 2006. A big chunk of this was in the form of exports back to Europe. But Chinese domestic sales are growing too: European companies are targeting China's coastal provinces - a market of more than 400m people with explosive rates of growth and a middle class hungry for better-quality goods and services.

The EU has real commercial problems with China, notably the implementation of its World Trade Organisation obligations and domestic obstruction of foreign trade and investment. These are genuine, not bogus. But tit-for-tat protectionism from Brussels will make problems worse, not better. What should the EU do instead?

First, it should deal with its trade and non-trade objectives (such as democracy, human rights and climate change) on separate tracks. Linking them gets Chinese backs up and works against compromise. Far better to tackle commercial issues in a contained, businesslike setting.

Second, the EU should accord China "market-economy status" (MES). Its argument - that China does not yet meet specified market-economy criteria - is specious. These criteria are vague and arbitrary. China is now more market-oriented than Russia and most other developing countries. Yet the EU accords Russia and other developing countries MES, but not China.

Third, the EU and China could agree a series of reciprocal, mutually beneficial concessions as part of an improved bilateral co-operation outside the political theatre of trade negotiations.

In addition to granting China MES, the EU should agree to exercise restraint in using trade remedies generally, such as anti-dumping duties, China-specific "transitional safeguards" and countervailing duties. In return, it should ask China for better, targeted enforcement of intellectual property rights; further opening of China's services markets, especially by addressing domestic regulatory barriers; removal of foreign-investment restrictions in core services sectors; more transparency in subsidies to state-owned enterprises (SOEs); and higher transparency standards for Chinese SOEs and "sovereign wealth funds" that increasingly invest abroad.

These are measures that would contain protectionism on both sides and deepen commercial ties. They would also create political space for Beijing's leadership to continue structural

reforms to open its economy further.

Commercial relations between the EU and China could easily end up the other way around, with escalating tit-for-tat protectionism. The EU is the world's biggest trade and investment entity and has a key role to play in smoothing China's integration into the world economy. It should not undermine that chance by becoming increasingly shrill about bogus trade issues.

Razeen Sally is director of the European Centre for International Political Economy in Brussels. Patrick Messerlin is professor of economics at the Institut d'Etudes Politiques in Paris, and chairman of ECIPE's advisory board.

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