

# **The Current Economic Crisis and Prospects for EU-China Commercial Negotiations**

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The politics of EU-China commercial relations hit a low in late 2008. The strongest moment in the rift was the Chinese cancellation of the EU-China Summit due to President Sarkozy’s decision to publicly meet the Dalai Lama. But now the tones have become less shrill on both sides, and there are signs that both wish to find a way back to dialogue since both rely on each other’s growth in order to prosper.

Both sides have started discussing their economic relationship within the framework of negotiations towards a Strategic Partnership Agreement to upgrade their 1985 Trade and Cooperation Agreement. When economic relationships started seriously deteriorating amidst rising protectionist rhetoric and economic policy discords, as well as rising China-bashing in the EU, a “High Level Economic Dialogue Mechanism” was set up. It met once, about one year ago, in April 2008. Drawing inspiration from the US-China Strategic Economic Dialogue put in place in late 2006, its aim was to avoid a slide into protectionism and to talk constructively about ways to open up each others’ economies in a balanced way. It was a shrewd move to insulate commercial matters from wider political discussions and discords between China and the EU.

Yet in 2009, the unfolding of the crisis will be a difficult moment for bringing talks further. Protectionist pressures are on the rise. Neither China nor the EU will want to give the impression to their audiences that they are making concessions to partners that are perceived as part of the problem of the current crisis.

More fundamentally, however, we are in an environment of disorientation in policy-making, which spills over into trade policy. The EU is split and weakened. On the one hand, EU economies' need for structural reform has been made itself felt more strongly than ever. On the other hand, those EU member countries that had been booming and thriving in the last strongly China-tainted wave of globalisation such as the United Kingdom are seeing their economic model strongly put into question. In China, the limits of its aggressive export-led model have clearly been reached. It leaves China with excessive dependence on the imports of the EU and the US, with 2 trillion dollar reserves that are underutilized and heavily exposed to others' public finances. China's recent policy developments have started going in the direction of raising domestic consumption levels. But these remain timid and will take time to materialize. Both are also haunted by their respective mercantilist demons: China announced it would reduce all export taxes and introduce value-added tax rebates to boost exports into a world where demand for China's exports has contracted. And the EU's fixation on its bilateral trade deficit with China is still alive.

What can we thus expect from commercial talks between China and the European Union this year? Expectations should better not be too high. This is why:

***First, there is clearly a loss of momentum and urgency.*** Confrontation is no longer the big order of the day as both sides are looking inward to try and fix their economies. With trade flows having plummeted

and a further decline of world trade of 9% (these are WTO figures) or more than 13% (these are OECD figures) to be expected in 2009, grounds for direct friction have moved a little bit into the background. There is also an issue of political timing. The EU Commission is set to change this year, and it is not taking any more bold steps before its new composition is known later this year. More broadly, trade and investment liberalization is not a very popular policy agenda these days.

***Second, there is a problem with setting priorities as both economies are hesitant about their economic strategies.*** Setting a date, and setting up an agenda for the Dialogue in April appears to have been a challenge. In January, during a meeting Commissioner Ashton and the Chinese Commerce Minister Chen, both sides decided that this year Doha and Small-and Medium enterprises would be on their broad agenda. For the Dialogue Mechanism, they would want to address “investment, market access and intellectual property rights”. They aim, they stated, to have it focused on “Improving business opportunities in times of crisis – openness in trade and investment as a catalyst to revive economic growth.” It is not unlikely that a strong environmental angle will be brought to the discussions. This problem of setting up an agenda is compounded by my third point.

***The third problem, indeed, is that the Dialogue framework that was set up lacks a structure that is focused on delivery.*** When the last US administration met with China for its Strategic Economic Dialogue in 2006, it set a clear agenda. Six months later, the agenda was gone through point by point, thoroughly prepared by a bilateral study group appointed to dedicate itself to the entire process. After each meeting the agenda for the next meeting was also agreed upon and then prepared in between meetings.

An EU-China Dialogue that would lead to effective results would entail not only clear agendas and priorities, but also room for bargaining, and flexibility to bring in new topics as events in the global economy unfold. Hank Paulson's Dialogue was able to do so. It helped bring down protectionist pressures in the US and avoid discussions on the exchange rate get out of hand. While these topics were discussed, concrete deals were done: China agreed to some piecemeal yet significant openings [LIST IN ANNEX] in its financial sector and to discuss further opening of that sector in the future. The US got a little bit its way in terms of yuan revaluation, and achieved agreements on food safety. The US on the other hand committed to maintaining an open regime for Chinese SWF and FDI investments in the US, a deal on civil aviation more flights from China to the US and better conditions for delivery of tourist visas to Chinese. The Dialogue gave also a framework for business on both sides to cooperate on environmentally-friendly technologies. The US and China are now talking of a bilateral investment treaty. The United States also publicly endorsed the idea of discussing China's recognition as a Market Economy. This cocktail of long-term discussion punctuated by individual deals is not easy to achieve with an EU framework. The EU Commission is generally focused on long term policies and is dependent on a mandate by powerful member states and requires their ratification after deals were done – its hands are tied. Furthermore, many of the sensitive topics both sides want to discuss, namely services and increasingly, investment, are an area where decision-making competencies are shared between Brussels and the member states. Making deals with China on such issues, which would, among others, include sensitive issues such as relaxing visa regimes for businessmen and workers, or avoiding FDI and portfolio investment protectionism, might be tricky. Investment is an area where EU members compete in China. They also have their own Bilateral Investment Treaties. The Lisbon Treaty is likely to centralize the EU's competencies in investment, but the Treaty's fate remains uncertain, as well as the exact terms under which the Commission will be able to strike deals on investment.

**Fourth, the EU has a self-defeating one-way street approach.** The EU tends to want just about everything from China: open services, lower tariffs in some areas such as cars, harmonized standards, an open and safe investment regime, similar rules on intellectual property. It also has ambitions in the areas of competition or trade facilitation. That is what the EU likes to talk about. It does not like to or is not always able to reciprocate, though. Even less with China. Despite what is being said about China's export-led growth model, China continues to have a major comparative advantage in labour-intensive manufactures and will continue to be the world's major manufacturing power-house. But these manufactures are an area where the EU still remains comparatively protectionist. It is not recognizing China as a Market Economy and therefore has looser disciplines on anti-dumping. China is subject to one third of the EU's antidumping measures. Furthermore, the EU still has high tariffs in some areas of interest to China, such as textiles and consumer electronics. China will continue balking at EU attacks on its intellectual property record and other sensitive market opening issues if there is no effort on side of the EU to seriously consider Chinese concerns. These basic issues cannot be wished away, since it is the core business of the ongoing EU-China commercial relationship.

**In short:** We are in a situation in which the competencies of the EU would allow it to tackle head-on the immediate trade issues outstanding between the EU and China, namely tariffs, anti-dumping and EU market access issues of concern to the EU such as Chinese tariffs in automobiles or standards and certification procedures. But this is not what the EU, nor even China, seem to be envisaging. If other topics are put on the table in the coming Dialogue, given the institutional shortcomings of the EU, and the overall lack of policy priorities on both sides, the whole undertaking appears pre-programmed for a drift into insignificance. A final remark: When Commissioner Ashton and Minister Chen met in January and indicated that the Doha Round in the WTO should be put up on their mutual agenda, their instincts on what can be achieved bilaterally on trade were probably right. It might be more constructive to direct

energies towards reviving multilateralism in trade. Yet as long as both sides have not resolved to gear up in their action towards the next stage of reform and openness of their economies, one cannot expect much to happen, be it in the WTO or bilaterally.

## ANNEX

### Examples of negotiated outcomes in US-China Strategic Economic Dialogue – Financial Services

- NYSE and NASDAQ allowed to open a branch in China
- Investors in securities allowed to issue papers in local currency
- Foreign banks allowed to issue bank cards in local currency
- Easier branching for foreign insurance companies
- Licensing of international securities companies resumed
- Commitment by Chinese authorities to examine further opening of financial markets
- China will allow existing credit rating agency (CRA) joint ventures to apply to qualify for a securities-related credit rating business without a reduction in their existing percentage foreign equity stake.
- China allowed, on a pilot project basis, non-deposit taking foreign financial institutions to provide consumer finance to local retail customers in China;
- China will reduce the lockup period for the invested principal of Qualified Foreign Institutional Investors (QFII) to 3 months for insurance companies, government and monetary authorities, mutual funds, pension funds, charity funds, donations funds and open-end China funds established by QFIIs;
- China will allow qualified foreign companies to list on its stock exchanges through issuing shares or depository receipts
- China will allow qualified foreign incorporated banks to issue subordinated RMB-denominated bonds;
- China will allow foreign incorporated banks in China to trade bonds in the inter-bank market, both for their customers or their own accounts, on the same basis as Chinese-invested banks, and, in exceptional circumstances, allow qualified foreign banks to increase their liquidity either through guarantees or foreign currency loans from overseas affiliates on a temporary basis, notwithstanding short-term external debt quotas.

#### ***US statements following the last SED in December 2008:***

“The United States reaffirmed that it welcomes foreign investment, including in its financial sector and commercially-oriented investments made through China's foreign exchange reserves and sovereign wealth fund, and its commitments to: 1) the open and non-discriminatory principles for recipients of sovereign wealth fund investment identified by the Organization for Economic Cooperation and Development; 2) apply the same regulatory standards to all applications made by Chinese banks, securities and fund management companies, as they apply to U.S. or other foreign financial institutions in like circumstances; 3) process expeditiously Chinese financial institutions' applications and 4) ensure that the Committee on Foreign Investment in the United States (CFIUS) process accords consistent and fair treatment of all foreign investment without prejudice to the place of origin. “