China and Europe to Set Their Relations on a Different Course?

By **Fredrik Erixon**

Stalling trade growth is a problem for both China and Europe. If it is desirable that the Sino-European relation deepens in several areas, the only force that in reality can drive better cooperation is economic integration.

President Xi's recent visit to Brussels has got some China observers in Europe thinking about rekindling the Sino-European relationship, and fusing it with other forces rather than buoyant mercantilism and tangential political squabbles—two defining characters of Sino-European relations in the past twenty years. Perhaps there are some merits to that hypothesis. Yet they are not obvious – and they do not help us to answer the most basic question: What is the strategic rationale for China and the EU to deepen their relationship? While diplomats on both sides miss no opportunity to talk up the importance of Sino-European relations and President Xi's visit, both sides remain uncertain about what they actually want to do with each other.

Europe and China's different trajectories

Europe, weakened by the crisis and long-term relative decline, is struggling to find its role in the new Asian century. It mixes free-trade optimism and grand aspirations with introverted protectionism and political grandstanding. The mercantilists are increasingly geared towards clinching deals with big economies and growth markets like China. Yet Europe's Dr Jekyll – worldly, cooperative and problem-solving – is all too often undermined by its Mr Hyde, a bureaucrat of primitive regulatory convictions whose mission is to expand Europe's regulatory dominion.

China, on the other hand, has not made up its mind if Europe fits into its map of global strategy, other than as a destination for Chinese goods. Europe has no real influence on China's regional strategy – and it offers little attraction for Beijing's grand ideas about new big-power relations in the world.

Yet Europe represents a philosophy of international law and cooperation that is both enticing and challenging for China. Even if the post-1945 institutions for global cooperation have a European colour, it is dawning on at least some of China's strategists that such institutions and international law are expedient, if not indispensible, tools for rising powers. Europe remains far too over-represented in bodies like the International Monetary Fund or the United Nation's Security Council – and if China's rise continues it will certainly be asked to take up a greater role in them. But Beijing is not very active canvassing a new leadership role for China in global institutions because it does not yet have an idea what it wants to use its leadership for. It still remains uncertain about how far it wants to be constrained by a rules-based world order, let alone how active China should be in international matters of peace, security and economic prosperity.

So the trajectories of China and Europe are not matching: China is on its way up while Europe's stocks in global power politics are falling. Inevitably, such diverging trends entail frictions. In the past decade China and Europe have soured over areas like trade policy, climate change, and the ousting of regimes in Northern Africa and the Middle East. As the their differences err on the fundamental rather than the marginal side, it is not obvious that there are gains to both sides from an attempt to charge the relation with new cooperative ambitions, going beyond the current arrangement.

Stalling trade growth: a problem for both China and Europe

Yet status quo is not an option either. Mercantilism – the desire to export more goods and services – is no longer the glue that can keep China-EU relation intimate. Trade between China and Europe is no longer growing at the high levels witnessed in the past decades. While China's annual growth in export to Europe used to be in the region of 15 percent, last year it grew by only 2 percent, according to preliminary statistics, and did not grow at all in the previous year.

Weak economic growth in Europe is indeed a key factor behind the slow growth of trade in the past years. But even if Europe's ailing economy is recovering, no one expects medium-term growth levels to be much higher because the continent is weighed down by high debts that will continue to mute demand and consumption for several years. And there is a structural dimension to the trade slowdown, too, that should worry leaders in Beijing and Brussels. Both Europe and China have problems of substantial overcapacity in several industrial sectors and both are in the process of adjusting to a world that is not going to grow as fast in

the next 15 years as it did in the past 15 years. That adjustment will eat itself into the trade relation.

Moreover, there are visible signs that a good part of the structural potential for trade growth between China and Europe has been exhausted. Trade will continue to follow cyclical trends, but the fast growth of bilateral trade in the past twenty years had less to do with cyclical trends and more to do with the fact that China had opened up and that Europe stood to benefit quite substantially from the new competition coming from China. But the windfall of China's entry to the world economy can no longer carry trade growth alone. Absent new reforms that open up for trade and investment, it is difficult to see how trade between China and Europe can climb much higher.

Stalling trade growth is a problem for both sides. In contrast to the United States, general economic growth in China and Europe are more dependent on trade than on innovation. While U.S. growth is historically a factor of the "perennial gale of creative destruction", to quote economist Joseph Schumpeter, growth in Europe and China has to a larger extent followed the model of Adam Smith: economic growth through specialisation and the exploitation of comparative advantages.

A "Smithian" model of economic growth depends on a continuing process of trade liberalisation and structural economic change. Neither China nor Europe has excelled in such reforms in recent years. China's economic attention has been focused on keeping up investments and monetary liquidity, in the past years by a sharp rise in credit. In Europe, harsh fiscal realities has pushed it to deal with apparent problems in taxes and expenditures, but little has actually happened in terms of general economic reforms to boost productivity and competition.

Rejuvenating the bilateral relations

So in an odd sort of way, the paths of China and Europe are crossing each other, even if the two are moving in different directions. This also presents opportunities for rejuvenating their bilateral relation. Even if it is desirable that the Sino-European relation deepens in several areas, the only force that in reality can drive better cooperation is economic integration. The main sentiment to help unlock necessary reforms to build closer cooperation is invariably about reaping bigger economic gains. There is an obvious reform agenda knocking at the doors of China and Europe. They can both empower that reform agenda with bilateral initiatives in the fields of trade and investment. Europe, like China, has a political structure that does not easily connect with economic reforms. Political tailwinds from international negotiations can help to push countries to actually pursue reforms more forcefully.

That will not happen by default. Both sides need to change the guiding principles for how they approach each other. China's leaders, to begin with, need to park its preferred strategy to deal with political capitals in Europe rather than the EU institutions in Brussels. That strategy has been vastly over-rated – Beijing's courting of Berlin never led to the withdrawal of the EU trade defence case against Chinese solar-panel producers – and it is not a strategy that will work if China wants Europe to open up more to China's commercial interests. Europe, on the other hand, needs to get away from the presumption that new cooperation with China is a one-way delivery of better market access for Europe's traders and investors. Europe needs to put something on the table, too.

China and the EU are currently negotiating a new Bilateral Investment Treaty, traditionally an accord to address investment protection but that now also includes measures to liberalize investments. This is a good start. Furthermore, leaders agreed during President Xi's visit to Brussels that a "Deep and Comprehensive Free Trade Agreement" could be envisioned in the future. It is less important now to spend time targeting the date for the start of such an agreement – senior trade officials on both sides agree they are far away from it –than to lay out the sequence of events that should trigger both sides to seriously consider an FTA. That sequence should include domestic economic reform measures as well as participation in new international accords such as the Trade in Services Agreement and the revision of the Information Technology Agreement, which are both in the process of being negotiated.

Finally, there has to be a more pragmatic and direct way for both sides to resolve trade frictions. A pragmatic deal on trade defence cases was cut shortly before President Xi arrived to Brussels. But it is just a question of time before there will be new flare-ups – and the way China and the EU will deal will them will define the scope for how much trade and economic cooperation can be deepened.

Insanity, said Albert Einstein, is doing the same thing over and over again and expecting different results. China and the EU now need to convince each other that they are not going to fall back on their well-rehearsed routine of trade frictions.

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