The EU and China: Redressing An Unbalanced Relationship

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Henry Kissinger famously once asked: “What number should I dial when I want to talk to Europe?” Beijing has the answer. It begins +4930, the code for Berlin. Last month, President Xi Jinping added two more numbers to his address book: those of Britain’s Prime Minister and Chancellor of the Exchequer, who accorded him a rapturous – some unkindly souls said sycophantic - welcome to London and declared Britain to be China’s “best partner in the west”.

When Mr Xi or his colleagues call Berlin or London, they can expect an enthusiastic response – especially if there is Chinese money in it. Beijing, however, guarantees European leaders no such reciprocity, especially if they dare step out of line by, for example, meeting the Dalai Lama. Then, they can expect a frosty reception, or none at all.

As that suggests, the relationship between China and Europe is unbalanced, with the scales weighted mostly, though not entirely, in China’s favour. I shall argue that that imbalance owes less to Chinese strength, which is often over-rated abroad, than to European weaknesses – mostly self-inflicted.

Beijing is pretty clear what it wants from Europe. Chiefly three things: free access to its single market; a secure home for its investments, particularly its fast-growing acquisitions of corporate assets; and a diplomatic foil in its increasingly fractious relationship with the United States.

Europe's position is both simpler and more complicated. Unlike the US, it has no strategic geopolitical or security stake in east Asia, no global power projection capacity and no unified foreign or defence policies. The European Union is a significant global force only in trade, to a lesser extent in the international financial system and perhaps a bit through soft power.

Europe's interests in China today are basically mercantilist. Its governments think of China primarily as a big and promising market and, more recently, as a source of otherwise scarce capital. Increasingly, they view China also as a rising global power with which to make their number in the hope of political, as well as economic, dividends in the future. This has translated into an undignified scramble by EU members to curry favour and preferment with Beijing at each others' expense.

In narrow national terms, such tactics may make sense, if cosying up to China earns rewards in export orders and inward investment. That means jobs in Europe and jobs mean votes for politicians who claim credit for creating them. Offending China, on the other hand, risks forgoing prizes in the great treasure hunt. Or so European politicians seem to believe.

However, they are engaged, at best, in a zero-sum game, because they are all fighting over shares of the same cake. And largely unnecessarily. There is little evidence that sucking up to Beijing actually wins big economic favours, or that standing up to it provokes much more than token economic retribution. Too few European policy makers seem ready to accept that, like Palmerston's Britain, China has no friends, only interests.

Chinese capital will come to Europe anyway. China's own economic needs and those of its companies dictate it: to diversify overseas assets, to acquire technology, expertise and brands and to build commercial and financial bridgeheads in the EU. Investment decisions are determined far more by prospective returns and commercial gains than by political calculations. China's direct investment flows to the EU doubled last year, according to Rhodium Group, exceeding both its flows to the US and EU flows to China.

Game theory holds that tactics that benefit individual players produce a collective loss when everyone employs them. Intra-European rivalry has opened the EU wide to divide-and-rule tactics that Beijing has proven adept at employing. Frustrated by Brussels' impenetrable bureaucratic labyrinth, it chose to bypass it and deal with the EU by cultivating Berlin. Beijing prizes power above all else in international relations and it sees that, in Europe, Germany possesses it.

Similarly, it seems more than coincidence that Britain is increasingly adopting positions in Brussels that suit China rather well. Beijing, meanwhile, has sought to use its chequebook to persuade poorer Eurozone members and countries in central and eastern Europe to side with it in EU decisions that affect China's interests.

Beijing's biggest coup has been to get EU members, led by Britain, to brush aside stubborn and ill-judged US objections and join the Asian Infrastructure Investment Bank - a move preceded by no EU-level consultation that has contrived to strain transatlantic relations. Whether China's One Belt One Road initiative will exercise similar pull in Europe it is too early to say, since the plan has yet to be fleshed out and is showing some signs of teething troubles.

Things have not all gone China's way. Its 16+1 dialogue with central European states has yielded few concrete outcomes, in part because Beijing has balked at its partners' demands for increased access to its market for farm products. Its attempts to buy its way into infrastructure projects have bumped up against EU competitive tendering rules, while its Polish motorway fiasco a few years ago is a case study in blundering incompetence.

Nonetheless, China's preference for dealing with EU members bilaterally, often playing them off against each other, has clearly diminished the influence they could wield if they united behind a common stance. The only areas where they are obliged to act together are in trade and investment policy. However, recent efforts by Brussels to use its authority in those areas to gain leverage over Beijing – notably its ill-fated solar panels dumping case and aborted subsidies investigation into Chinese telecom equipment suppliers – have fallen flat.

Some are now urging Brussels to try a different tack by withholding the Market Economy Status that Beijing insists it is obliged by WTO rules to grant late next year. Such a gambit looks highly risky, however. Its legal basis appears less than solid and China would be bound to respond by bringing a WTO disputes case that the EU could not be sure of winning. If it lost, its authority in Beijing's eyes would be dealt a serious blow.

The EU is on firmer ground in its negotiations on a bilateral investment treaty or BIT with China, where both sides have something to gain. For China, it is security against a possible backlash against its investments in Europe. For the EU, it is improved market access and fairer treatment for European businesses and investors in China. The talks are progressing slowly, not least because China has only recently stopped balking at negotiating on the EU's demands on the former point.

China is also pressing the EU for a free trade agreement. That Xi Jinping spent a whole three days in Brussels last year – the first such visit by a Chinese president - suggests that this is a priority for Beijing. Its reasons are not entirely clear, though one is probably to signal to Washington that China has economic options if the US attempts to contain it economically. In any event, Beijing's *demandeur* status offers the EU an opportunity to gain leverage. After at first responding coolly to China's FTA overtures, Brussels has now opened the door a crack.

China's aims are essentially either pre-emptive or defensive: to forestall possible EU protectionism and to diminish US influence. The EU's are more offensive: to open up China's market and subject it to stronger rules. Brussels' hand will be strengthened if it can agree on the planned Transatlantic Trade and Investment Partnership with the US. That is still far from certain – but it would command Beijing's attention and respect by enabling Brussels and Washington to join forces in setting the global economic agenda. Conversely, failure would signal weak western commitment and resolve, from which Beijing would be quick to draw the consequences.

Whether the EU can realistically aspire to go further and develop a more comprehensive and coherent strategy for engaging with China is less clear.. The EU today is stumbling from crisis to crisis – over the euro, mass migration, possible UK withdrawal, the rise of fringe political movements and now, tragically, terrorist atrocities. All this is draining political energy and confidence, causing the EU increasingly to turn inwards and even calling into question its future institutional survival. The dread word "disintegration" is increasingly heard in EU discussions nowadays.

Nor do recent trends in China inspire optimism. Under President Xi, China has adopted a stridently nationalistic stance, which may intensify if its economic performance deteriorates further. Meanwhile, efforts to deepen engagement through the Strategic and Economic Dialogue have failed to contain rising tensions between an assertive Beijing and a Washington that seems increasingly confused and divided about how to respond to China's rise.

There is another factor, too. Europe's policy makers implicitly assume that China's continued rise will continue inexorably and are placing big bets on it. Nowhere perhaps more so than in Germany, for whose car industry – the engine of which about 12 per cent of GDP – China is now the single biggest source of profit.

While China was growing fast, that paid off handsomely. However, its slowing growth rate, rapidly rising debt, capital outflows and deep structural problems in its economy, which its promised reforms have yet to tackle effectively, all raise doubts about its future trajectory. If problems continue to mount, the path ahead could become a lot rockier.

That is not to say that the Chinese economy is destined to collapse. However, the assumption in many foreign capitals and boardrooms that it has only one way to go – ever onwards and upwards – and that they can all jump aboard for the ride, looks much more questionable than five or ten years ago. Such faith is likely to be tested further in the months and years ahead – and with it the spell that China casts on many observers abroad.

Those growing uncertainties call for more farsighted contingency planning, allowing for a range of different scenarios, than the EU has engaged in to date. The future is by definition unknowable, but rarely in peacetime has it appeared more so than today. In dealings with China, as in much else, we should hope and act for the best; but common prudence dictates preparing for the worst, just in case it happens.