The seminar series Critical Issues Confronting China turned its attention to European Union (EU)-China relations at the beginning of this spring semester. François Godement, Senior Policy Fellow and Director of the Asia & China Program of the European Council on Foreign Relations, Professor of Political Science at Sciences Po, Paris Institute of Political Studies, gives an up-to-date depiction of the multifaceted economic and political relations between EU and China.

By looking underneath the aggregate picture and into individual bilateral relations between EU member countries and China, he tries to fill the gap between the public perception of the overall picture and what he sees as reality. He also puts these relations in a comparative perspective with US-China relations. Some obstacles that are absent in US-China relations are present in EU-China relations, and visa versa.

Viewing EU-China relations from the perspective of the EU, Godement says that these relations tell as much about the EU as about China. The EU's bureaucracy is much more fragmented than that of the US. China's decision makers often ask who in the EU are making decisions and how. While it is good in some respects to keep the Chinese wondering since this fragmentation reduces pressure on the relevant decision making units inside the EU, it allows the Chinese to use its advantage of size in bilateral negotiations with individual EU member countries.

Godement traces EU's dynamic and expanding economic relations with China back to the 1980s. In 1985, the president of the European Commission, Jacques Delors, signed a commercial treaty with China, which helped correct the trade imbalance between the two sides (the EU was running a large trade surplus with China). The EU aid program was designed to benefit China, not the EU. The Europeans set up teaching facilities in Beijing and Shanghai to train Chinese managers. Among the member states, the Czech even helped the Chinese to upgrade their shoe manufacturing processes. Needless to say that this mission was more than accomplished. China has become the world's capital for shoe manufacturing. In addition to much financial and technical assistance, the EU gave China much freedom to pick projects and choose how to spend the money. Among many endeavors, EU's money was used to help alleviate pockets of poverty, build irrigation projects, and help dairy farms in China.

In terms of overall trade relations with China, the EU has been running a large trade deficit, on the same scale as the US in recent years. Yet the EU has never called China a currency manipulator, and never put as much pressure on China as the US Treasury did. However, if we only look at EU's aggregate trade with China, China's influence on Europe is under estimated. The trade picture at sub-EU level is very different. Although
all EU member states have a trade deficit with China, northern European countries generally run overall trade surpluses, whereas southern European countries run trade deficits. In this respect, France is more like a southern country; Germany also fears losing its edge over China. New EU-level negotiations didn't really take off until very recently.

Investment flow between EU as a whole and China is not a problem. The problem captured by the term "Lucas Paradox", in which a developed country, against the prediction of standard economic theory¹, imports capital from a developing country, is an issue for the US (China holds about two-thirds of its foreign reserves in the form of dollar denominated securities, largely in the form of U.S. treasuries), but not for the EU. China is not exporting capital to Europe at the EU level. The EU generally runs a large current account surplus, except briefly in 2009 and 2010 when it ran a small overall deficit.

But for individual EU member countries, the direction of net investment flow is very different. China is not as open to foreign investments as Europe is. This is demonstrated by reports from the European Chamber of Commerce in China. The main message in these reports is similar to that of American Chamber of Commerce in China. EU member countries, wishing to get a foothold in China, almost always lose out when they negotiate individually with China, simply because of China's dominating economies of scale. Even German officials and business leaders don't feel secure when dealing with the Chinese. On the other hand, Germany has qualms about forming a united front with other EU member countries.

The European sovereign debt crisis since 2009 has made it more difficult for EU member countries to unite. Eager to find foreign buyers for their sovereign debt, southern European countries have been courting the Chinese to alleviate their crisis. In this regard, France is also more like a southern European country. The European Central Bank cannot stop this trend, nor does it have the necessary knowledge about the identities of the holders of the sovereign debt of member states. As Mrs. Clinton once said when she was Secretary of the State, if China is your biggest creditor, there is a limit to what you can say to China. Hungary, headed by a far right prime minister, has changed its stand from criticizing China to pro-China, viewing China as a successful authoritarian country. Poland and Romania have all given in to some extent in an effort to attract Chinese investments. While there is a need for bilateral investment treaties to offset these countries' trade deficits with China, such bilateral attempts undermine EU’s capacity to negotiate with Beijing.

The extent of Chinese investments in the EU is often underestimated. Some small

¹ According to standard economic models, developed country has relative abundance of capital and scarcity of labor, whereas developing country has relative abundance of labor and scarcity of capital, so the marginal productivity of capital in the developing country is higher than that in the developed country. Therefore capital should and will flow from developed country into developing country. But this is the opposite of what is happening between the US and China. This apparent paradox is called Lucas Paradox.
member countries like Cyprus are basically selling EU residence and citizenship in order to bring in Chinese investment. While the EU is moving toward more integration, some member countries, facing with domestic challenges, have new economic incentives to cause disarray within the EU, creating an impression for China that it can always hold out and wait for a better deal.

China has mixed views about having European-wide treaties. On the one hand, Chinese business people would love to have a uniform playing field and investment protections throughout Europe, just like the U.S. and Canada do. On the other hand, China knows well that if the EU is more integrated, its advantageous negotiating ability will be impaired. In fact, the EU is more open to foreign investments than the U.S. and Canada, with essentially no formal barriers, except the U.K. There are some informal barriers, which member countries try to use to get reciprocity from China.

On the political front, there are difficulties related to China's expectations. Receiving Dalai Lama is not as a big deal in the US as it is in the EU. Even though China and the EU in 2003 agreed to build a strategic relationship between them, there has been a general failure on the part of the Europeans when member countries run individual diplomacy with China. Angela Merkel of Germany, Nicolas Sarkozy of France, David Cameron of the U.K. all invariably got cold feet either when they met with Dalai Lama or questioned Tibet's sovereignty, all of which angered Beijing and cooled down bilateral relations for at least several months each time. So since 2009, the EU tries to run its China policy at the EU level. According to Godement, enhancing integration within the EU is the only way to negotiate more effectively with China.

Unlike the US, the EU does not have a hard power relationship with China, since it does not have military assets in east Asia. With arms embargo still in place, the EU does not sell weapons to China. France and the UK recently agreed with Japan to discuss dual use technology transfers, including to China.

In Godement's view, EU's public cooperation agreements with foreign countries always try to shape values and norms around the world, as though every country were a candidate for EU expansion. But China's mission has always been to improve and upgrade its economy without regime change. In fact, China is happy with the 1985 trade agreement, and sees no need to improve. China prefers to call high-level interaction with the EU a dialogue rather than a mechanism.

During the Q and A session, Godement describes four waves in China's initiative of "going abroad" (走出去). The first wave was to export consumer products. The second wave was to import energy and raw materials from resource-rich countries such as Australia. The third wave was to build transportation infrastructure, assembly lines, distribution hubs in developing countries. Now this wave has spread from Africa to the periphery of the EU. The fourth wave is overseas acquisitions by large Chinese state owned enterprises, mostly financed by public money. Although there is a question of
whether the Chinese overpaid for some of their acquisitions, and there may not be a master plan behind these waves, Godement sees some logic in this pattern.