CHINA AND THE EUROPEAN UNION: FROM STRATEGIC PARTNERS TO SYSTEMIC RIVALS

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Introduction

In 2003, the European Union and China signed a strategic partnership agreement. The Europeans believed that as China developed it would become more liberal and perhaps even more democratic. Two years earlier the Asian giant had joined the World Trade Organization (WTO), integrating itself into global economic structures and value chains, and it was hoped that within 15 years – as the accession treaty stipulated – China would became a market economy. It is crucial to understand the mindset of the time. The Berlin Wall had fallen just over a decade earlier, the Soviet Union had disappeared, and the central and eastern European countries of the former Warsaw Pact were engaged in democratic transition processes and on the verge of EU membership. In this context of democratisation, many assumed that China would follow a similar path. Hence the commitment to a strategic partnership.

Almost two decades on, the mental and geopolitical framework is very different. EU–China trade ties have strengthened, with goods and services worth €1bn exchanged every day. China is the EU's largest source of imports and second-largest export market. That makes China the EU's second-largest trading partner (after the US), while the EU is China's largest. But this extremely close economic relationship has not brought greater political understanding. On the contrary, the consolidation of Chinese state capitalism; the rise of Xi Jinping, a strong man, to power in 2012; the unexpected victory of Donald Trump, a major critic of China, in the 2016 US elections; and the origin of the coronavirus pandemic in the Chinese city of Wuhan this year have greatly strained relations between Brussels (and European national capitals) and Beijing. A strategic document published by the European Commission in 2019 (i.e. before the pandemic) reflected this. For the first time China was called a systemic rival, and an unprecedented ratification of this new conceptual framework by the European Council of heads of state and government followed.

Brussels's relationship with China has become multifaceted, as Josep Borrell, the EU's High Representative for Foreign Affairs, has said on several occasions. For the EU, China has four faces: strategic partner, negotiation counterpart, economic competitor and systemic rival. Each side of the rhombus of the new relationship merits analysis.

1. Strategic partner

China remains a Strategic partner, negotiation counterpart, economic competitor and systemic rival.

Its growing structural power means China remains a strategic partner for the European Union. Not only is the Asian giant home to almost a fifth of the world's population, it is the world's second-largest economy in nominal terms, and largest by purchasing power parity. For many years it has also contributed over twice as much as the US to the annual growth of the world economy. Despite its relative decline, the US can still be considered the world's indispensable power. But China is its inevitable power. Few of today's international relations matters can be resolved without involving China. Its help in stabilising the euro zone periphery in the debt crisis of 2010 to 2012 was perhaps the most palpable example from a European point of view, but the same is true of strategic issues as important as the fight against climate change, the preservation of the biosphere and water resources, global public health, the resolution of international conflicts (China contributes more UN peacekeeping troops than any other country) and the governance and stability of international economic and financial relations.

The environment is often given as an example of a field where cooperation with China is essential on several fronts. It is true that great potential exists for collaboration in this field, from smart cities to meeting the ambitious goal of carbon emissions neutrality set for the EU in 2050 and China in 2060. But that is just one of the big issues on the table. A better understanding with China is crucial to almost all the questions usually grouped within the concept of *multilateralism* (including, of course, the whole of the 2030 Agenda). And that understanding will be all the more necessary in the future, because China is no longer the somewhat passive actor in international institutions of the past, but has become more proactive and assertive. This much is evident from its activism in shaping the human rights debate at the UN, its stance in traditionally Western-dominated institutions like the International Monetary Fund and the World Bank, and even from the creation of new organisations like the New Development Bank and the Asian Infrastructure Investment Bank, as well as its greater ambition in setting the rules and standards on 5G, the internet of things, facial recognition and artificial intelligence.

2. Negotiation counterpart

Logically, the divergence in interests and values in almost all these areas makes China a counterpart in negotiations for the EU and its member states. In economic matters, the dialogue occurs at the highest level. At the (informal) G20 forum of heads of state and government, for example, in multilateral institutions like the World Bank, IMF and WTO, and in the technical international agencies that oversee the architecture of globalisation, such as those concerned with internet governance. But it also includes all existing bilateral dialogues. As Figure 1 shows, the central pillar of the bilateral relationship may be economic, but it also takes in political or strategic dialogue (pillar 1) and people-to-people relations (pillar 3).

Hence, the most important negotiation currently underway between the EU and China is the bilateral investment agreement, negotiations on which began in 2014. Over time, this has become an attempt at a comprehensive investment agreement that goes beyond its initially narrow scope to become a negotiation over how much market and how much state the bilateral relationship should contain. In other words, it is essentially a negotiation of a different social relationship. The EU seeks to achieve a series of objectives with this agreement that are worth recapping. First, it wants greater access to the Chinese market, and calls for the removal of quantitative restrictions, limits on ownership of Chinese companies and joint venture requirements. Second, it seeks equal treatment with Chinese companies, to prevent, for example, technology transfers and public procurement difficulties. Third, it wants greater transparency and predictability from Beijing in terms of legislation, regulations and obtaining licences. The fourth goal relates to greater market discipline and transparency on aid to state companies. The fifth objective is to establish minimum environmental and working conditions in China. The sixth is to get Beijing to accept the European dispute resolution mechanism between states and companies. And, finally, the seventh objective is for the agreement to include an instrument for resolving disputes between the two parties: the EU and its member states and the Chinese state.

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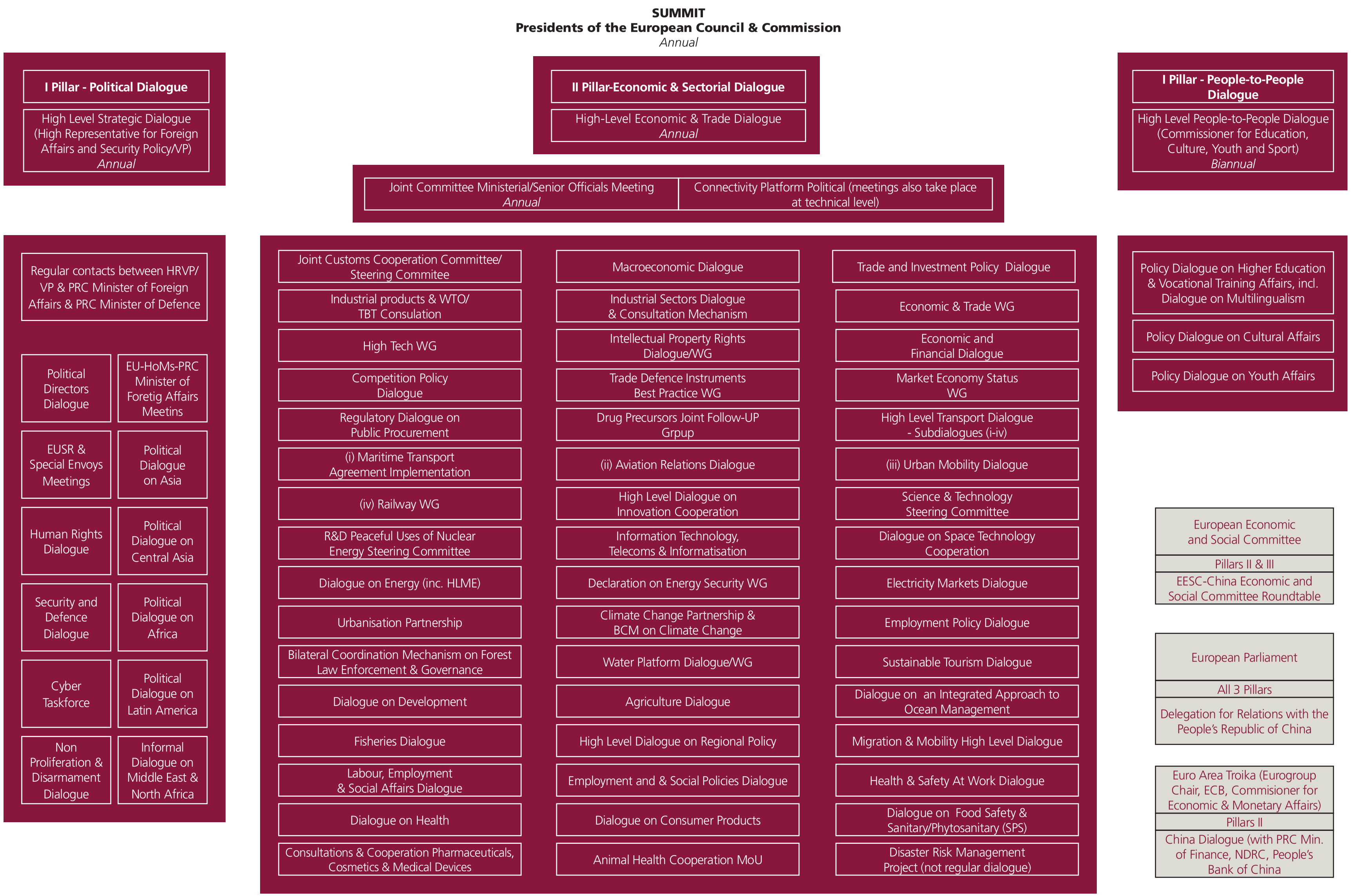
Clearly, these goals are not easy to achieve – they go right to the heart of the organisation of Chinese state capitalism. In general terms, both the EU and US – whose parallel negotiation is notable for a much more aggressive and coercive attitude – are asking China to change its model. Chinese Communist Party leaders, meanwhile, are increasingly convinced that its model is at least as valid as the one proposed by the West, if not superior. The handling of the pandemic has only reinforced this. Certain advances can be achieved: Beijing has recently accepted a hundred European denominations of origin, for example. And it is even possible that China will open up certain sectors to European investments and more harshly pursue intellectual property theft. But Beijing's commitment to state-owned companies and state aid is a red line of *national interest*, among other reasons because in the Chinese culture of *guanxi* (contact networks) a strict division between the public and private is oxymoronic. This also complicates any agreement within the WTO framework.

3. Economic competitor

The Chinese model of state capitalism is here to stay. Those who thought China would become more liberal and those who believed the Chinese model would fail because communism never works were wrong. In under 40 years, China has gone from being a poor country on the margins of global economic structures and value chains (willingly, in Mao's time) to become the world's second most powerful country, which in multiple economic sectors shapes trends and sets prices. Once Deng Xiaoping discovered in the 1980s that his country's competitive advantage was cheap labour, China became the world's factory. Joining the WTO was a key factor in further strengthening that advantage, but the rise of value chains has been of such magnitude that China can today be considered an innovation hub.

Figure 1: Architecture of the institutional dialogue between the EU and China



Source: https://eeas.europa.eu/

So sudden is the transformation that in a single generation, Chinese society has gone from doing business with bundles of banknotes to using mobile phones for around 80% of payments, leaving the credit card (still dominant in Europe) and cheques (still widely used in the US) as Western relics. Many young people who have studied in New York and London today visit Shanghai and Beijing and are fascinated by the dynamism and innovation shown by a country said to be unable to innovate due to its authoritarian political system.

Both the EU and US are asking China to change its model.

The Chinese strategy "Made in China 2025" encapsulates the challenge the country poses to Western economies. By the end of its next five-year plan China aims to be competing on an equal footing in multiple sectors of high technological and industrial value currently dominated by the advanced powers: automobiles, aviation, machinery, robotics, latest generation rail and shipping, low CO_2 vehicles, high-precision medical equipment and information and communication technologies, to name but a few. In all these key fields of future growth, Beijing is committed to "indigenous innovation" and "self-sufficiency" and establishes domestic component and material thresholds in various sectors. For example, semi-official documents estimate that 40% of all mobile phone chips, 70% of all robots and 80% of renewable energy generation equipment consumed in China by 2025 will be manufactured domestically.

We are therefore talking about a large-scale foreign technology substitution strategy that will affect European interests. It should not be forgotten that the trade deficit with China would be much higher were it not for the sales of Airbus aircraft to the Asian giant. Growing Chinese competition in high-tech sectors is already notable in the telecommunications field, with companies like Huawei and ZTE. It is not that European companies like Ericsson and Nokia cannot compete in cutting-edge technologies such as 5G, it is that Huawei's growth and market share projection is stunning. Thanks to very beneficial financing from China's policy banks, Huawei has emerged as a technological champion of such magnitude that the White House is seeking to halt its rise by any means, to the extent that it has even threatened to cut intelligence cooperation with European countries that use Huawei equipment at the core of their 5G networks. This has put countries like Germany and Spain in a bind, as at the time of writing they have yet to decide whether to accept Chinese technology in their networks or not.

4. Systemic rival

As a market, the European Union has always been relatively open to foreign products and investments. Huawei is a paradigmatic case. While the company was banned some time ago from the US market, in Europe Chinese companies were until very recently treated the same as Korean and Japanese: as long as they complied with European rules and standards they were welcome. But that is changing. The Chinese model of state capitalism is increasingly seen as incompatible with European norms and values. As such, since 2019 European leaders have considered China to be a systemic rival, as mentioned above. Not necessarily at strategic level, but in terms of having – and more often defending and promoting – a social and political system that is far removed from EU liberal and democratic values. This has led EU leaders to approve a series of defensive measures to better protect against competition (in certain cases unfair) from Chinese companies, such as creating an investment supervision instrument, reformulating trade defence mechanisms and adapting competition legislation to prevent companies from third countries receiving public aid that specifically violates the principle of free competition.

Beijing is committed to "indigenous innovation" and "self-sufficiency"

The European Union has generally taken a less aggressive stance towards China than the United States, which sees relations with its Asian rival as a zero-sum game. In other words, whatever is good for China is bad for the United States. In Europe, the prevailing view is still that a positive-sum game can be achieved, precisely because of the multidimensional relationship that exists with China. In contrast to the increasingly popular idea in Washington of "decoupling" the US economy from the Chinese to reduce (inter)dependencies, Brussels and the European capitals favour the diversification of value chains with China. The COVID-19 pandemic has shown that, as well its rare earth dependence, the EU is overly reliant on China for pharmaceutical products and medical and healthcare protective equipment. It hopes to reduce this dependence either through onshoring (attempting to bring some production to Europe), nearshoring, which would decrease vulnerability by shortening value chains to strengthen regionalisation, or by increasing the slack or stock of strategic reserves of material against any eventuality.

This leads us, logically, to the debate over the EU's strategic autonomy, conceived not just in military terms but more broadly to include economic sovereignty and, in turn, digital. Many European leaders have realised that if the EU wants to compete in the fourth (digital) industrial revolution, it cannot depend on third-country digital platforms and structures like clouds to manage its own data. Many future high added value sectors will incorporate artificial intelligence into their processes and key aspects such as big data, quantum computing, automation and the internet of things. If Europe is to compete with the US and China it will have to invest a great deal of resources and increase scale. This will also require the European Union to reform its social and economic model in order. The pandemic will increase inequalities and economic anxiety in many layers of society, and if the European model of capitalism, based on the social market economy, is not able to reduce them, Chinese techno-authoritarianism will look increasingly attractive.

Conclusion

The West, and Europe in particular, should be more self-critical in its relationship with China. Greater efforts should be made to understand what has worked in China to lift over 700 million people out of poverty and become the world's second superpower, and what has failed in Europe to produce levels of inequality and polarisation – as well as political radicalisation – not seen since the 1980s. Perhaps the insistence on hyperglobalisation and free trade and markets since the fall of the Berlin Wall and the neglect, or even elimination, of social and industrial policy have something to do with Europe's decline. From the embedded, inclusive liberalism of the Bretton

Woods system Europe shifted to a more laissez-faire liberalism from the 1990s to 2008, when the global financial crisis broke out. China, meanwhile, remained anchored to the Bretton Woods principles, with relatively fixed exchange rate policy, capital control, industrial policy and Keynesian macroeconomic control focused on full employment and the financial sector serving the real economy rather than the other way around. This is not to say that Europe should return to the Bretton Woods era or adopt Chinese techno-authoritarian state capitalism, but it should reflect on the relationship between the state and the market and the public and private sectors in our societies.

To imagine that over the coming years or even decades China will transform its socioeconomic model to make it more similar to ours is naïve – especially if it manages the pandemic crisis better than the West. More likely, it will consolidate its growth potential and the geostrategic rivalry with the US will continue, even after Joe Biden's arrival in the White House. This will present the EU with a serious challenge. It will have to decide between clearly aligning itself with Washington or sticking with its strategy of doing as much business as possible with Beijing as long as it does not irritate its US partner. At the global level there are also two options. Either the impossibility of Chinese and Western models operating under the same rules will give rise to a less integrated multilateralism of more or less peaceful multipolar (geo)economic coexistence; or attempts must be made to agree rules in the WTO that are acceptable to both Washington and Beijing. In the latter case, the EU would theoretically be in a mediating position, with its social market economy model including both collectivist and liberal elements. But to play this role it would have to propose a new embedded liberalism. In other words, a social liberalism for the 21st century, and it is far from clear that it can do that.

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