Europe-China Relations: Trying to Reconcile Economic & Global Concerns in a Changing Bilateral Context

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Europe's relations with China have in the last few years moved from an almost single-minded focus on the huge economic relationship to one which pays increasing attention to the political and strategic implications of China's policies. This is not only due to China's translation of economic power into political and military power, but also the growing realisation on the European side that it must react to these implications to protect Europe's economic, political, and even security interests. Important drivers of this realisation are the European Union institutions like the European Commission and the European Parliament. Trade policies are now the prerogative of the European Commission. However, finding a consensus among the 27 member states with their divergent interests and perspectives is a hugely complicated endeavour. The fundamental dilemma is how to maintain a workable relationship with China for economic interests as well as for addressing global issues like climate change without alienating China by initiatives and policies like human rights criticism or countering China's Belt and Road Initiative (BRI) with Europe's Global Gateway project.

Deteriorating Mood Towards China

General feelings among Europeans towards China have taken a negative turn in the last few years for various political as well as economic reasons. China's non-cooperative stance on communicating with the rest of the world on the outbreak and later investigation of the origins of Covid-19 has alienated public opinion not only in Europe. China's radical Covid-19 restrictions and then their abrupt ending shocked people inside and outside of China. The more assertive rhetoric of Chinese officials, referred to as "Wolf Warrior Diplomacy", has also been directed against Europe: the Chinese ambassador to Sweden, Gui Congyou, has been called 40 times to the Swedish Foreign Ministry for his offensive statements. The Chinese side has been irate at EU sanctions against Chinese officials involved in human rights violations in Xinjiang and took reciprocal sanctions, including banning European China specialists from visiting China. Another example of Chinese coercion occurred when Lithuania changed the title of Taiwan's representation office in the capital Vilnius and China then tried to pressurize the Lithuanian government by cutting trade relations. As a member state of the EU, all member states had to support Lithuania and the European Commission launched a WTO dispute in 2022 against China.

The most sensitive political issue for Europeans has been China's indirect and direct support of Russia after its invasion of Ukraine in 2022 and its lack of condemnation. President Xi Jinping's "no-limits" relationship with Vladimir Putin is a direct threat to Europe's security interests. Xi's parting words to Putin during his visit to Russia – "Right now, there are changes, the likes of which we have not seen for 100 years. And we are the ones driving these changes together" – revealed China's intention of creating a new world order under Chinese domination. Moreover, Russia's invasion has woken up Europe to the dangers of a one-sided dependence on one country. Already in 2016 the Chinese acquisition of Kuka Robotics of Germany had a considerable impact on German public opinion and has led in several European countries to greater attention to supply chain issues and to the protection of intellectual property.

A specific issue in EU-China trade relations is the use of forced labor in Xinjiang. The EU (Ministerial Council and European Parliament) proposed a regulation in September 2022 that would prohibit the importation of goods made with forced labor into the EU. China vehemently denies the accusation and the regulatory costs for European companies are considerable. In any case it has been leading to some reduction of EU investment. The EU proposed in February 2024 a law which would require large companies to determine if their supply chains use forced labor or cause environmental damage. This proposal initially failed because Germany and Italy did not agree due to their concerns about the expected regulatory burden.

Against this overall background, the EU-China Comprehensive Agreement on Investment which is ready for signing has been stalled. The mood in the European Parliament has very much stiffened against China and would never allow the ratification of this agreement. In its 2019 Strategic Outlook, the European Commission had already described China as a "systemic rival". In March 2023 in a much-quoted speech, European Commission President Ursula von der Leyen spoke of "de-risking" as an EU compromise between "pro decoupling" and "pro engagement" and advised of the need of a new approach to counter Beijing's pursuit of "systemic change of the international order with China at its center".

This fine distinction between "decoupling" and "de-risking" trade relations (which may be difficult to operationalize in action) also illustrates the impact of US policies on Europe's relations with China. The administration of President Joe Biden is trying to influence the EU to take a stronger stance against China and concerns in some quarters over a second Donald Trump administration adds to this pressure. Although US official rhetoric has taken on the less radical European rhetoric of "de-risking" trade with China, its actions are more oriented towards “decoupling”. However, some US trade policies to counter China’s export surge, like the requirement of electric vehicles to be produced in the US, have also hit European car exports to the US.

European Countermeasures & Their Limits

The European Commission has been trying to unite the member states around an economic security package which would contain measures to protect supply chains and vet inward as well as outward FDI. But these countermeasures and protective policies are hampered by the vital importance of trade with China and the divergent interests and concerns of EU member states. According to EU statistics, China accounts for 9% of EU goods exports and more than 20% of EU goods imports. These figures hide the dependence of Europe on many Chinese goods, like batteries and their components for automobiles, chemical components for medicines or rare earths. Moreover, dependence on trade with China varies according to individual member states of the EU.

For Germany, the EU’s largest economy and trading nation, China is the biggest trading partner. In 2022 the trade volume between China and Germany increased by 21% year on year to 191 billion euro (US$214.5 billion) despite mounting tensions. The value of Germany’s imports from China increased by around 30%, although the value of its exports to China rose by only 3.1%. The rise of German investments in China is even more impressive: a record 10 billion euro was added in 2021, followed by another record of 11.5 billion euro invested in 2022. China accounted for 16.4% of total German direct investments abroad. Between 2016-2023, Germany’s share of total EU FDI in China averaged 58%, up from an average of 38% in the previous decade. What explains this rise of trade and FDI is the fact that 88% of EU FDI in China is done by 10 big companies, half of which are from Germany (VW, BMW, Daimler, BASF, Siemens). These big European companies have sizable manufacturing sites in China and are well established. Both the German and Chinese economies have been so far very complementary, despite Chinese discrimination against foreign companies and unfair Chinese competition due to dumping, cheaper labor, and preferential treatment of Chinese companies. Their dependence on the Chinese market is very considerable. In the case of VW, China remains the single most important country market and it had a market share in 2022 of 15.1% in China. This explains the German government’s restraint towards tougher countermeasures against China which – in addition to the differences between German Chancellor Olaf Scholz’s party (SPD) and his Green Party coalition partner – delayed the publication of the government’s new China policy paper. Whereas the German Federation of Industry (BDI) which regroups Germany’s biggest companies could publish in 2019 a China-critical paper with 54 demands to China, titled “Partner and Systemic Competitor”, this would not be possible today because of big industry’s concern for its commercial interests in China, as I was told by a representative of the BDI in September 2023. When the European Commission proposed in 2023 at the initiative of France an investigation of Chinese subsidising of electric vehicles exported to the EU market, the German car industry was opposed to it, fearing Chinese retribution against German car exports to China and German car production there. This may, however, be changing in the near future: whereas the big companies can still compete in China despite narrowing profit margins, it is much tougher for small and medium-sized companies. The growing competition with Chinese companies is forcing even big German companies to cut their German labor force, which is particularly hitting the automobile industry because of China’s advance in producing electric vehicles. In 2023 total exports and imports have been declining.

Other major European countries with considerable interest in economic relations with China are Italy and France. Italy is the third-largest importer from China in the EU and the fourth-largest EU exporter to China. Dissatisfaction with the EU, populist grandstanding and exaggerated hopes for Chinese trade and investment were the motives for signing an MOU to join the BRI. However, with the new right-wing government under Prime Minister Giorgia Meloni, Italy decided in December 2023 to withdraw from the BRI agreement as expectations of more trade and investment from China did not materialise. From 2018 to 2022 Chinese FDI into Italy dropped by 81% and during the same period Italy’s trade deficit with China expanded by 55%. Other reasons were US pressure, and improved political and economic relations with Taiwan.

China is France’s seventh-largest customer and second-largest supplier, but the trade balance is very much in favor of China. Major French exports are aircraft (Airbus, whose co-producers include Germany, Spain, China, and the United States), apparel and fashion. Apart from economic interests, France’s China policy is influenced by its desire for strategic autonomy where relations with China are instrumentalized to counterbalance the influence of the US which is, however, France’s major partner outside of the EU. France has been cultivating high-level consultations with Chinese leaders and in April 2023 President Emmanuel Macron de-emphasized French interest in the future of Taiwan, which was greatly welcomed by the Chinese government. The EU is a useful tool to talk tough on economic issues with China as was demonstrated by France pushing for an investigation of Chinese subsidies of Chinese exports of electric vehicles.

China's Belt & Road Initiative & Its Impact on the EU

When it comes to Chinese policies on Eastern and Southeastern Europe, one has to mention the BRI. When Xi announced the BRI in 2013, Europe was astonished at the great ambition of this initiative (initially focused on connecting Asia to Europe) and the promise to invest $1 trillion by 2027 in infrastructure, mostly in the Global South. While the benefit of the reduction of transport costs (notably railroads and roads) was welcome, the impact on the EU's cohesiveness and Europe's competitiveness in third markets was all too obvious.

The most relevant EU member states in this context are Hungary and Greece. Hungary is probably the most pro-China EU state. Under its government led by Prime Minister Victor Orban, Hungary has become a major irritant for the EU's cohesiveness. In 2012 Hungary became one of the founding members of the China-inspired 16+1 group (1 being China) of Eastern and Southeastern European countries and in 2015 the first EU signatory of the BRI. A major motive for the 16+1 Group was the expectation of Chinese investment. In 2019, the 16+1 Group became the 17+1 Group with Greece joining it. Of these members, five are EU membership candidates (Albania, Bosnia and Herzegovina, Northern Macedonia, Montenegro and Serbia). However, four EU member states changed their minds in the meantime: Lithuania left the 17+1 Group in 2021 and after Russia's invasion of Ukraine the two other Baltic states, Latvia and Estonia, as well as the Czech Republic left the group. This grouping has been viewed by other EU member states with some concern as a Chinese attempt to influence these countries with promises of trade and FDI and thus harm the cohesiveness of the EU. In view of the BRI's focus on connectivity, these countries are important chain links for China's commercial penetration of the EU.

In 2016 the European Commission found that Hungary had breached EU laws on the procurement for the Budapest-Belgrade railway built by China as a BRI project. More recently, in December 2022, Hungary and China signed on the establishment of an intergovernmental cooperation committee for BRI. In 2021 Chinese exports to Hungary exceeded $10 billion and Hungarian exports to China were nearing $2.5 billion. After Germany, China has become Hungary's biggest trading partner. This pro-China position has also been shown by Orban being the only EU leader to support China's position paper for peace in the Ukraine war as well as halting weapon deliveries to Ukraine.

Greece has also become very involved with BRI projects related to transport infrastructure. During a visit by then-Chinese President Hu Jintao in November 2008, China's state-owned China Ocean Shipping Company Pacific (COSCO) signed a $1 billion deal for a 35-year concession to operate and manage two container terminals at the port of Piraeus. In 2016, COSCO acquired a controlling stake of the port. In 2019 COSCO bought a 60% majority stake of the Greek railway company Piraeus-Europe-Asia Rail Logistics and a minority stake in the Budapest train terminal in Hungary. Chinese state-owned enterprises (SOEs) also hold a minority stake in the Port of Thessaloniki in Greece. The Chinese investment has had a very positive effect on Piraeus harbor: it increased its throughput by 168% between 2007 and 2016. However, there have recently been protests by the Piraeus harbor workers because of safety and environmental issues.

The BRI has the potential to enhance China's competitiveness at the expense of the EU not just in the above-mentioned states, but in the Global South in general. The BRI could be problematic for European companies if it leads to Chinese companies in affected countries receiving preferential treatment. The same concern arises for China's FTAs with developing countries. BRI projects are removed from multilateral cooperation and there are many transparency issues which could give China commercial advantages. Other elements of the BRI which may provide Chinese enterprises an unfair advantage are the alleged disregard of labor rights and environmental protection, as well as the removal from open procurement rules. In its official rhetoric China is increasingly playing on a longstanding dissatisfaction in the Global South with the non-symmetric trade relationship it has with the West, conveniently passing over China's own non-symmetric trade relationship with the Global South. European countries are particularly concerned about China's advances into its "backyard" Africa and the Middle East. China has been strengthening its links with Saudi Arabia, Iran and the Gulf States, establishing them as a base for its BRI projects. As of 2020, Chinese entities had made direct investments of $43.39 billion in Africa. For example, China is building in Morocco a manufacturing and technology hub related to electric vehicles, benefiting from Morocco's relevant raw materials, cheap labor and easy export opportunities to Europe and the US thanks to an EU-Morocco and a US-Morocco FTA.

In response to BRI, the European Commission has been trying to develop a counter strategy, which became the "Global Gateway", launched in December 2021. However, this has not been a straightforward move and instead reflected the member states' dilemma of wanting workable relations with China despite growing concerns about its policies while fearing to alienate China by taking initiatives seen as confrontational by China. Von der Leyen said at its launch that "Global Gateway is this positive offer: Global Gateway is the European Union's plan, or you may call it a roadmap, for major investment in infrastructure development around the world." And in a clear critique of China's BRI, she said: "We want to take a different approach. We want to show that a democratic, value-driven approach can deliver on the most pressing challenges…We want to make Global Gateway a trusted brand that stands out because of high quality, reliable standards and high-level of transparency and good governance."

However, various financial and bureaucratic issues render the implementation of Global Gateway rather cumbersome. The main problem resides in the sheer bureaucratic complexity of implementing projects due the operational modus of the European Commission and related institutions. The budget is 300 billion euro for the period 2021-2027. This is not only much less than the BRI, but is to be funded by investments from member states, their development banks, the private sector, and EU financing bodies. It is obvious that even a big company interested in a Global Gateway project will face difficulties in making the right contact within the European Commission or finding the appropriate funding source, let alone small and medium-sized companies. Given China's different economic structure (SOEs, generous financial government support), its shorter decision-making process, less emphasis on sustainability, anti-corruption and environmental impacts, the EU will be less competitive than China's BRI. On the other hand, the EU will have advantages over the BRI because of better long-term perspectives: project quality, accompanying after-service, training, and affordability of debt-servicing.

During the launch of Global Gateway, the EU emphasized its commitment "to work together with like-minded partners to promote sustainable connectivity investments" and mentioned among other partners also Japan. Japan's Partnership for Quality Infrastructure has many overlapping aims with Global Gateway. As a result, in 2019 the European Investment Bank (EIB) signed an agreement with the Japan International Cooperation Agency (JICA) on cooperation on transport, quality infrastructure investment, microfinance and renewable energy resources, renewed in 2023. In October 2021 an extended MOU was signed between the EIB and the Japan Bank for International Cooperation (JBIC) to enhance co-financing opportunities for achieving the Sustainable Development Goals.

Outlook

The economic relationship between the EU and China will continue to be of major importance for most EU member states, but against the worsening international background – Russia's invasion of Ukraine, the regional implications of the war in Gaza, international terrorism – and also Europe's current economic difficulties, these economic links will weaken. This tendency is enhanced by China trying to pursue its "Made in China 2025" and "Circular Economy" goals to reduce dependence on foreign companies but also by its increasing international competitiveness in emerging markets. The EU's countermeasures of greater scrutiny of inward and outward investments, strengthening of supply chains or its counter project of Global Gateway to the BRI will have difficulty getting off the ground in time. China's hardening domestic political environment, which puts increasing emphasis on security and control rather than opening to outside influences, is making cooperation with China at all levels more difficult. Beijing's current rhetoric about an "open China" aims at appealing to foreign companies, but other signals are contradicting this. European companies are a particular target of China's more conciliatory rhetoric, particularly in view of US policies and the possibility of a sharpening of the US-China conflict in the event of a second Trump administration.

European nations, as well as other Western countries, have lost confidence that China's growing economic development will lead to more openness or democracy in China to enable both sides to compete and cooperate on an equal footing. The German motto *Wandel durch Handel* (change through trade) which worked between West and East Germany is not credible in China's case. Still, China is perceived not only as a "systemic competitor" but also a "partner" and that is valid for an economic relationship as well as for global issues like combating climate change or international security issues. In each case this will require tough negotiations and compromises.

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