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EUROPE'S RELATIONS WITH CHINA: LOST IN FLIGHT?

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Executive Summary

Europe has undergone a painful policy re-evaluation of its long-standing approach to China. The premises of its China policy – engagement of a developing economy and a helping hand to a wider societal transition – were out of date. During the public diplomacy skirmishes of 2008-2009, a new realist mood set in at the level of the European Union. The larger member states had experienced the futility of a go-it-alone policy towards China, which only served the ability of China to divide-and-rule. But as this shift to realism was taking place, a new development intervened: with the global financial crisis of 2008, and the resulting stress on public debt in many European member states, China became, for the first time, a provider of commercial and financial opportunity to Europe. This is potentially creating some of the fabled synergy that has existed in the Sino-U.S. relationship. But Europe, unlike the United States, does not have a federal system. How Europe can achieve the level playing field it is seeking in its relationship with China is quickly moving beyond a European foreign policy issue – it is beginning to call into question the very construction of the European Union itself.

Sino-American relations are generally described in terms of a central “path” towards which they return and gravitate, albeit with political cycles. They are strategic in nature and content, given the defense postures of the two countries, their direct interaction, and the delicate balance of power in the Asia-Pacific. What’s more, these two countries have become entwined in a mutual economic embrace from which they find it hard to disengage. Whether we think the situation is really asymmetric, with an incumbent and a potential challenger, or whether we think it is the debtor, and not the creditor, who masters the economic relationship, the fact remains that the relationship is deeply anchored into realities. What will happen when the relationship reaches a tipping point – eg. if and when China matches the United States in different fields of achievement – remains anybody’s guess. But no one thinks the two countries might be one day gazing beyond each other.

Transatlantic relationships are generally taken for granted. The hub of financial, trade, and cultural relations is so dense that it dwarfs political initiatives and debates. True, a sense of divergent values has occasionally crept in, and some would say there is a permanent commercial competition between Europe and the United States. But by and large, relations have gone beyond the nurturing stage. They can withstand even the indifference of a new generation of politicians, on both sides of the Atlantic, to a shared history. In a world where “strategic relationships” are all too often hyped, the transatlantic relationship is beyond this adjective. In fact, America’s overextended commitments may be helping European foreign and security policy to mature. Just like the Balkan wars of the 1990s led to advances in European defense, the Libyan implosion has led to unprecedented initiatives by a large group of European nations: what we are seeing today is a “Suez in reverse,” 55 years after

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the United States put an end to an ill-conceived Franco-British adventure in Egypt. Although there remains a disproportion of military means between the United States and Europeans, there is no question today that the gap cannot be ascribed to a difference over hard vs. soft power, or to a conflict between “Mars and Venus,” as one observer famously put it in 2003. This is at least true of the national state level. As for the Union’s common foreign and security policy, things remain a bit more complicated. Catherine Ashton, the EU’s supremo on these issues, recently said: “the EU (...) cannot deploy gunboats or bombers (...) The strength of the EU lies, paradoxically, in its inability to throw its weight around. Its influence flows from the fact that it is disinterested (...) It can be an honest broker - but backed up by diplomacy, aid, and great expertise.” Made a few days before the Libyan intervention, the statement could be interpreted as a misreading of the trend. More accurately, it reflects modesty about the means available to the European Union as such.

By contrast, Sino-European relations are still in their infancy, and not rooted in any strong sense of strategic realities or even shared economic destiny. There are good reasons for that. Since Europe withdrew from Asia, and until the very recent and as yet limited appearance of China as a long-range power, there has been simply no direct strategic interaction between the two entities. There has been no shortage of debate between Chinese and Europeans on political or even strategic issues. The fate of Indochina between 1975 and 1993 (when the Paris agreements were finally implemented, ending the Cambodian conflict), human rights, governance, and other big ticket transversal issues have been animatedly debated. Europe has occasionally involved itself in conflict resolution in Asia (Cambodia of course, but also the post-1994 nuclear energy deal with North Korea, and the Timor and Aceh crises), without ever being a key

player. China has frowned on the Balkan wars and on Europe’s involvement in the responsibility to protect. None of this put Chinese or European lives directly at stake – an exception, largely unnoticed, may be a large Chinese participation to the United Nations Interim Force in Lebanon, where risks are shared to some extent, and perhaps also in Sudan as well. Of course, Europe has alliance commitments to the Atlantic alliance – but even that does not apply to the European Union as such, where there are neutral member states, while others have occasionally sought to reach out to China directly. In essence, there is a strategic detachment to the EU-China relationship.

Economically, the form of the EU-China relationship has also been until recently very different from the Sino-U.S. synergy, whether understood as a prime mover for globalization or as a “Chimerica.” The difference is not in numbers for trade or direct investment: they almost match, although the EU reaches an equivalent trade deficit with a higher level of exports to China – thanks to “Europe’s China,” e.g. Germany. It lies mainly in the structural relationship. While the imbalances in the Sino-U.S. relationship have come to define the global sense of crisis since 2007, there is no such imbalance between China and Europe: while China’s trade surplus is the same as with the United States, Europe’s large pool of private savings – and its structural barriers to faster economic growth – mean that until mid-2009 there was no structural need for Chinese capital in Europe. And therefore also, no synergy or automatic course correction by virtue of economic necessity. True, this equilibrium is only apparent. While Europe has paid for its imports from China with its savings, and not with IOUs, it is still living above its means since Europe’s savings are not going into investment for growth. And because China has pegged its currency to the dollar, even the most one-sided relation between Europe and China (with a huge

export surplus without any reverse capital flow) cannot bring about a re-evaluation of the renminbi vis-à-vis the euro. Like Japan, Europe is stuck in a private savings trap of its own making, which is creating the contemporary equivalent of stagflation: no growth and a high currency. As to China, it could be said to suffer, until very recently, from an unforeseen consequence of this apparently balanced relationship: it simply could not invest its currency reserves, the result of large export gains and of its own financial repression, into a European debt market that had simply not the required depth.

With these reservations in mind, the EU-China relationship has taken on unique characteristics in the past, marked by idealization on the part of Europe. Its foundation was an extended hand from Europe to help China towards an economic transition from underdevelopment – these are the very terms of the 1985 Trade and Cooperation agreement, which is still in force. There is debate whether this also represented unconditional engagement. Indeed, Europe criticized and sanctioned China after 1989 (pulling off concessionary loans and aid not aimed at poverty alleviation or policy improvements). Europe's policy process "by committee" (so much so that "comitology" is an accepted term in Brussels language) has created a flurry of sectoral relationships, ranging from high politics to the most mundane (food safety, civil aviation, etc), where bargaining and compromise have increasingly become the norm. But Europe's basic philosophy was that a convergence of goals, norms, and even values was unavoidable in the mid-term. The opening of the European market – vastly increased after 2001 and WTO accession – was going to draw China into a form of political convergence. Unencumbered in the main by strategic realities, European technocrats aimed for the core of the two societies, and they were willing to make unilateral concessions in any number of

areas. One aspect remains particularly striking: the EU delegation in Beijing maintains a large team administering aid programs in China, while there is not a single counterpart at the U.S. embassy to China. America's private model of cooperation – via private universities, NGOs, and foundations – was in fact more likely to break the barrier of China's public bureaucracy and reach to China's civil society. Europe's preference for public action matched exactly the preference of the Chinese Party-state, but it also stumbles on this formidable obstacle.

What exists at this level of sectoral relationships is of course subject to many interrogations. There are demonstrable results – and in fact at least one expert in Sino-American relations, David Shambaugh, has called for an institutional strengthening, sector by sector, in the U.S.-China field, taking a cue from EU-China relations. It is always in the political coordination of these sectoral relations with top level exchanges, as well as in the cooperation, redundancy, or absence of Europe's 27 member states, that the problems have laid. There are currently renewed interrogations about China's own policy processes – "stove-piping," "silos," interest groups," provincial vs. central decision-making are again in fashion, reminding us of Ken Lieberthal's definition of a "fragmented authoritarianism" formulated 23 years ago. But few people realize, outside the European policy sphere, how complicated the European external relations process is, beyond the obvious tension between member state and Union policy level. It is really fragmented, compartmentalized, and in fact resembles a set of side-by-side silos. The EU's main directorates each possess their own logic, and their impulse to craft a China policy in their own domain, while China is probably the most popular destination for EU parliamentary delegations, human rights critics notwithstanding. Although the Lisbon Treaty and reform of external relations

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will slowly achieve results, the fact is that an EU delegation does not resemble an embassy: much of its staff, outside then political service, answers directly to corresponding units in Brussels rather than through the ambassador.

It is therefore hard to disentangle, in the EU's difficulties to craft an effective China policy, what should be ascribed to past idealism or naiveté about convergence of values and norms (which in fact often antagonized Chinese officials, since this belief came with lectures on the European, multilateral, or global way...), and what flows from an obvious but unspoken asymmetry. China is a top down, Leninist state with at best a trend towards "consultative Leninism."¹ The fact that top leaders don't control all issues all of the time doesn't mean they can't control some of these issues all of the time (such as perceived threats to regime security and legitimacy) or all issues for some of the time (such as trade issues when anti-dumping cases are raised, typically), when and if they choose to. By contrast, the EU operates with what one might call "fuzzy logic" – there are clusters of decision centers (probably not simplified at the top by the Lisbon Treaty framework), with consensus-forming statements and papers that define the public face of the EU, and a herd instinct at work on many issues. At the working level, the bureaucracy often knows the ropes, when it does not turn over too quickly. Unlike China, where bureaucratic experts pursued entire careers in the same administrative sector, and the United States, where they often alternate between public and private jobs involving the same competencies, European civil servants move from one job to another inside the Commission with no particular accent on geographical competence (again, the Lisbon treaty aims to change this

within the frame work of the new External Action Service).

This is why EU-China relations work within a paradox. Whereas in general China's officials and diplomats are thought to be reactive and passive more than proactive and ready to make propositions (for instance inside the UN system), with Europe it is largely China that defines the agenda with its own priorities and requests. The arms embargo, market economy status, and non-intervention in domestic affairs have defined the field for almost two decades. Beneath this mantra, China has actually few requests to make, and follows a typical path of avoiding to be in the asking position: for instance, it has not until now really jumped on Europe's proposal to upgrade the relationship from the 1985 aid and cooperation Treaty to a much broader Partnership and Cooperation Treaty, a much higher plane of relationship in the EU's self-defined lingo. Europeans, on the other hand come up with huge lists of complaints and requests as dictated by the closed nature of the Chinese system: from criticism of human rights policies to market access, intellectual property rights, ambitious transversal policies (climate change was a cardinal example) and even, quite plainly, access for European and member states representatives to their counterparts in China. The asymmetry is also there, in China's easy and open access to all European and member states in Europe, while the reverse does not hold: access to officials beyond a mid-level administration is jealously guarded.

The problem has been compounded by Europe's unilateral concessions in the vital trade and economic area. Even in the United States, federal bureaucracies, Congressional oversight, and the need to lobby both the Hill and the administration create a reciprocity of sorts. Ever since the 1980s, the United States has reinvented its own path for civilian technology and industry – from crucial

¹ Tsang, Steve. 2009. "Consultative Leninism: China's New Political Framework." *Journal of Contemporary China*. 18(62): 865-880.

regulation on technology transfer to the “Buy American” act. Not so for Europe –although some differences exist at the level of member states. Europe is often being singled out for “protectionism” when its anti-dumping actions actually concern less than 2 percent of China’s exports, with a steeply rising curve for these exports.

Europe’s wake-up call came in 2008-2009 with a triple whammy: a record trade deficit (briefly surpassing the U.S. figure with China), the slow-down resulting from the global economic crisis, and a political crisis of its own making with China over Tibet and human rights. Concerning the latter, it is often said that Europe acted in disunion and with a lack of consistency. That is not completely true. More fundamentally, Europe went further than the United States in the last stretch of the Bush administration, and also than the Asian democracies (Japan, India, South Korea) on the core value issues, while possessing less political leverage. The result was predictable: China countered by focusing on Europe’s weak points, and worked at exploiting the natural lack of a flowing response among 27 states. The lesson was sobering to Europeans, including the larger nation-states, which perceived the limits of their own foreign policy in relation to China.

As happens in EU public life, consensus shifts with few leaders, but many followers, at least for cut-and-paste statements and public diplomacy. The mood on China became sober – some would say it soured, indeed, with public opinion becoming particularly negative. Although Chinese officials and media often maintain this is a function of either media manipulation or defensive fear about China’s economic performance and global competition, Chinese leaders and think tanks have in fact understood they should address this particular problem. Their very perception of Europe’s own limitations – no clear decision-

making process, no guaranteed unity, policy shifts – has persuaded them to move their approach to new tactics: working on each member state within bilateral relations, and emphasizing mutual interest by hyping the potential advantages China can bring to the table. In part, this was, of course, designed to counter the specter of trade protectionism rising in Europe, and the shockingly high trade deficit figures.

But the fall-out from the global financial crisis for Europe – a sudden emergency for the sovereign debt of several European countries, resulting both from a downswing and from the potential impact of bank insolvencies – has changed the scenario, creating new opportunities for China. To use a metaphor, we have entered an era whereby there are “Chinese bearing gifts to the Greeks,” and through them to Europe. It is this new situation that is likely to define future EU-China relations, which would indeed become economically strategic for the first time.

Two trends have therefore coincided in the past two years. Europe has woken up to the lack of clear purpose and self-interest in many aspects of its China policy. Several member states have had the painful experience of being singled out by campaigns from China, or conversely – and almost as importantly – of not seeing any conciliatory gesture or concession they made reciprocated by China. France, the Czech Republic, and Denmark fall in the first category, the U.K. and probably Germany in the second. Overall, less than following a mischievous game plan, China was in fact applying a realist principle in its foreign policy: where there is no need to adjust, why make the effort? And beyond a diplomatic recognition of the European Union (symbolized by a ministry of foreign affairs position paper in October 2003), why should China struggle to create a more united and better coordinated Europe in the relationship, when the present situation suited

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China perfectly? At times, China may have done just that – befuddled by the confusion of messages and decisions from Europe, its second track experts and officials in private moments tend to say the relationship would work better if Europe had a clear set of priorities. One might almost establish a parallel with the simultaneous and benign neglect by the Obama administration of the European-level decision-making process. Again, Europeans deplore it, but acknowledge it is a deeply rooted possibility when they muse over the specter of a G2. “Getting serious” about China has been on the mind of European policymakers, who can note, for example, that Sri Lanka had been the object of more communications to the European Council than China itself in 2009. Throughout 2010 – a painful year of adjustment by various parties in Brussels and among member states to the revamped institutions, and in particular to the new External Action Service – there was an effort, led by the high representative and encouraged by several member states, to put China on the agenda for discussion at several high level meetings: the Gymnich semi-informal discussion among foreign affair ministers, and the Council itself in September 2010. Position papers were written by the Commission and by several member states. The effort has stopped short for a variety of reasons. First, Council meetings are very much dominated by the flow of urgencies, and in this case, the Roma issue, an internal EU matter, crowded out much of the other topics at the September meeting. Second, internal debate among various DGs – especially between Trade and the former External Relations – left a gap that could not be covered in time for the next event (an EU-China summit coming soon on the heels of the Council meeting, with PM Wen Jiabao in attendance in Brussels). Whether the Chinese chose to play a deaf ear, or whether they had in fact been inadequately prepared for a change of philosophy by the Europeans – with reciprocity, which had been mentioned in a joint

communiqué only once before (Prague, May 2009) – the meeting reportedly came close to a clash. On the surface, public stands by Europeans were contradictory: while a Eurofin communiqué issued before the meeting seemed uncritical of China, the European presidency asserted a move towards reciprocity at the beginning of the meeting, and made representations for a Chinese currency re-evaluation. China was not ready, it seems, to go beyond the set terms of discussion, again revolving around the favorite agenda of market economy status, and Premier Wen issued a furious tirade against currency re-evaluation on the heels of the meeting.

A third factor has come into play. Another large member state has asserted its own game plan with China, after the past examples of France and the United Kingdom. Angela Merkel's Germany has inaugurated, without fanfare, a dual policy. On the one hand, Chancellor Merkel comes down as a realist in the European context, backing a European-wide effort for economic reciprocity, particularly on issues of investment and public procurement, which are now sensitive for German industry. This would have a strong impact on China, since Germany is China's biggest partner in Europe (although the question remains whether selling to China creates leverage, or whether indeed a large trade deficit should create influence with the purveyor...). But whether German politicians, on this as on other issues, do not credit the European Union enough, or because there is a frequent disconnect between Mrs. Merkel and Guido Westerwelle, the foreign affairs minister and her coalition partner, the fact is that Germany hasn't really put its strength behind a European-level policy. German positions are actually quite consistent at the level of political and governance or human rights issues, but they are not expressed very forcefully either.

And finally, a major event has taken place. Quietly or not so quietly, China has become an influential partner with Europe's periphery – a geographical definition that can stretch as far as Iceland, but mainly applies to the indebted Southern member states, and to new member states looking for investment in their own economy. This is true at several levels. First, direct investment and mergers and acquisitions activity is rising quickly – particularly since the last quarter of 2010 and the first quarter of this year. Most of this increase in activity takes place in Mediterranean countries and among new member-states – justifying the notion that China has a peripheral and bilateral approach to the practical relationship. Some of it may also be dictated by the reluctance to confront and antagonize key interests in the core economies of the European Union. After all, China has also been very prudent, and with good cause, in its pattern of acquisition in the United States, and this is evidently dictated by political cautiousness. Some of the strategy is also driven by economic logic: a disproportionate share of China's new investments is made in infrastructure and transport logistics, particularly ports and airports. One can predict a wave of competition for land transport infrastructure – whether railroad tracks, rolling stock, or motorways. The first such contract, in Poland, has generated considerable controversy. The United Kingdom has become the first core country to openly declare its interest in infrastructure investment by China (rail). By contrast, acquisition of small and medium firms for their technology resources does not mobilize the same scale of funding. As to the stock market strategy of China's sovereign funds, it has up to now remained a strategy of maximum diversification with minimal risk-taking on single investments. Overall, these acquisitions raise the issue of reciprocity, since much of China's industry sectors remain closed to take over, and since greenfield investment is much more difficult.

But the most talked about development has undeniably been China's growing stake in European member state public debt, as well as the new bond issues raised by Europe's European Financial Stability Facility (EFSF), created in 2010. We cannot pretend to identify the true scale of this policy with good reason. There are no aggregated published statistics at the European-level for member state public debt, including by the European Central Bank (ECB). This makes sense since budget was not a shared competency under Maastricht rules. Even the United States, for that matter, has trouble gathering accurate statistics on the exact source of purchases of its massive public debt issues: to wit, in February 2011, the U.S. Treasury suddenly re-evaluated the stock of U.S. public debt owned by China by 32 percent, when it had earlier been said to be in a slow decline in 2010. Purchases via third countries and the general opacity of the system are responsible for this. But where the United States has what may be an inaccurate compass, the EU has no compass. The U.S. 2011 revision – so massive that is not believable that China's 32 percent rise in ownership took place solely in 2010 – at least kills a frequent misperception on the European side, endlessly recycled by the media, that China was cautiously beginning to shift its massive currency reserves into Euros. Some countries in distress from their public debt (notably Spain and Portugal, but not Greece), have hyped to a considerable extent the amount of public debt that China was purchasing, in the hope that China's magic wand would do wonders for public confidence. Indeed, a modest purchase by SAFE of new Spanish public debt in July 2010 stemmed the tide against that country's sovereign risk. More recently, China has gone to the extent of denying a massive purchase of Spanish public debt, announced as a fact by the Zapatero government after a visit to China. Inversely, British, French, and German treasury authorities are staying absolutely mum on the issue of Chinese purchases of their own paper. Yet these

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purchases make a great deal of sense for China's diversification of its portfolio.

We have therefore entered a scenario where core countries seek to deny a potential dependence towards Chinese investments, while peripheral countries tout these purchases. Fascinatingly, this development may throw a spanner in the works for EU-wide attempts at assessing reciprocity in part of the relationship – for FDI or public procurement. For those countries in need of Chinese FDI or debt purchases are also those least likely to benefit from a further opening up of China's own economy, and may see no reason to tie their boat to a European policy that requires some continuity and sense of purpose, yet does not benefit them in the short term.

Again, the temptation will be there to define China's tactics as one of "divide and rule," yet China is essentially working up an economic strategy while utilizing existing divisions, and seeking maximum gains in public diplomacy from its own contribution, however modest in reality.

We arrive at the following situation. Europe has been going through a tough learning process about its relationship with China, and has belatedly adjusted its policies to a rising China, one which will not likely converge with Europe's expectations in key political and economic areas. The process has also involved, for member states including all but the number one European economy (Germany), becoming markedly more European. There are limits to this. The U.K. and some northern countries still have a marked interest in China's financial and service sector, while the Franco-German tandem might focus more easily on intellectual property rights issues and foreign direct investments. But this newfound realism is superannuated by China's new advances on the financial front within Europe. Although the figures may be nowhere near as large as the trade deficit is,

and also much lower than single investments made by China in countries with raw material resources, the trend exists, magnified by public diplomacy and by Europe's overall opacity in these matters.

On the surface, Europe has achieved "easy" successes of coordination on what were always thorny issues: taking a common stand on the Oslo ceremony for Nobel-prize winner Liu Xiaobo was one, handed to the Europeans on a platter by a Chinese foreign ministry spokesman who went so far as to wag a finger against European participation to an event on Europe's own turf. The protest against artist Ai Weiwei's recent disappearance is another case. But this unity does not extend much beyond symbolism. The Dalai Lama wasn't received officially in 2010 in Europe except by Slovenia: one might call this the unity-by-default option. In multilateral diplomacy within the UN system, another long-term trend is taking place. While cooperation is eagerly sought (and indeed more often these days obtained) on issues close to Europe, there is no question that the level of interest and activism on the part of Europe regarding Asian issues, closer to China, has abated. North Korea is an issue best left to the United States. Taiwan is not much heard about in Europe, in part with the assumption that the two sides of the straits are moving towards some form of settlement. Europe's involvement in Burma-Myanmar has also notably diminished. In short, Europe is moving towards greater focus on its regional interests, where China is indeed ready to take conciliatory attitudes. Europe is abstaining on global issues, except to throw lines to China (and other emerging countries) as happened recently in the G20 process with the acceptance of diminished European votes at the International Monetary Fund. Meanwhile, China is achieving a synergy of sorts within the European economy – something that has happened on a massive scale with the United States but was not a reality with Europe.

Lest we appear to focus critically on Europe, at this point we should throw in some comparisons between EU-China and U.S.-China relations. There remains a unique strategic deterrence and competition at work between the United States and China. But other trends may be pointing in the same direction as EU-China relations. For instance, the American Chamber of Commerce in Beijing and the European Union Chamber of Commerce in China are now, for the first time in their history, shooting in the same direction, largely because of complaints against the closure, informal or legal, that is happening again in some Chinese economic sectors at a time when the Chinese economy is strengthening. Even more so than the Bush administration, the Obama administration tried a strong engagement policy in its first year, only to backtrack in the face of unexpected difficulties. During the Obama visit to China in November 2009, the U.S.-China joint statement appeared for the first time to take on a European flavor. Potential achievements in a sector by sector approach were duly noted, while the statement took on board a key Chinese notion, that of “core interests,” however left it undefined. Statements by U.S. Secretary of State Hillary Clinton stressing America’s dependency on its creditor go further than any European statement in frankly acknowledging limits to U.S. policy freedom, although there remains a lot of controversy on just what level of dependency really exists. The fusion of the strategic dialogue with the economic dialogue, resulting in the U.S.-China Strategic and Economic Dialogue, has been an attempt to regain political control at the top of the entire relationship – but it is debatable that this actually has given the United States more leverage in its relationship with China. After the irritants of 2010, and in spite of the lull in incidents since December 2010 and since president Hu’s state visit to the United States, short term-ism and wait-and-see approaches seem to dominate U.S. policy towards China. The change of guard in

the administration’s Asia policy team (which had remained unchanged for two years when other portfolios were already changing hands) also lends credence to this trend. If China’s approach to Europe via the low-income periphery and through a set of bilateral relations follows a pattern set with the developing world, it also possible that as China closes the gap in influence with the United States, it is “Europeanizing the relationship” with the United States, helped in this direction by the overstretch of U.S. global responsibilities, and by an understandable search for accommodation with and by China. In this as in other Asian developments, the price to pay for this by China may be more coordination between Europe and the United States, as each side of the Atlantic finds it increasingly difficult to deal with China on its own terms.

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