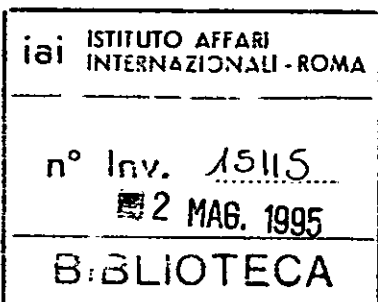


**THE EUROPEAN UNION AND CHINA:
A EUROPEAN STRATEGY FOR THE 21ST CENTURY**

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Kay Möller

Chinese Risks: Nationalism versus Integration in Peking's Foreign Relations¹

Free from a vital Soviet threat and expanding economically, the People's Republic of China remains a Leninist state with an uncertain domestic future and an unfulfilled national agenda. The latter includes not only reunification with Hong Kong, Macao and Taiwan, but also territorial claims to the East and South, the largest being the one on the South China Sea down to the coast of Borneo.

At a global level, China has been reluctant to accept as binding international norms in areas such as human rights, arms control and strategic arms exports.

Neighbouring countries, foremostly in Southeast Asia, and the US as the only remaining superpower have tried different approaches to the inherent uncertainties. Whereas the smaller regional actors have emphasized Peking's growing economic and other interdependencies through involvement in an open, non-controversial and ongoing dialogue, Washington applied a "carrots and stick" approach, depending on the impact at different times of relevant domestic lobbies. Both strategies share the conviction that the extent to which China might be willing to gradually move from purely nationalistic/great power-concerns towards more integration, cooperation and responsibility should be tested for want of prognostics and better alternatives.

This paper attempts to determine to what extent hopes in a "peaceful evolution" of China's external relations are either

1 Paper presented at the workshop on "The European Union and China: A European Strategy for the 21st Century", London, the Royal Institute of International Affairs, 28 March 1995.

justified or neutralized by more atavistic manifestations of nationalism and hegemonism. In doing so, it will first analyse Peking's own threat perceptions and foreign policy statements since the end of the Cold War and then proceed to an interpretation of China's aspirations and capabilities.

I. Perceptions and Rhetorics

In November 1990, Peking abstained in the UN Security Council's vote on the use of military force against Iraq, thus freeing the way for "Operation Desert Storm". President Bush in return met the Chinese foreign minister for the first time since the 1989 Tiananmen massacre and signalled more flexibility on the granting of World Bank credits to the PRC. The Peking leadership had obviously not expected a quick allied victory in the Gulf and increasingly perceived the campaign as a first step towards US hegemony in a unipolar world.² China has since emphasized the desirability and likely emergence of a multipolar community of sovereign nations mutually respecting the principle of non-interference.³

2 Harlan W. Jencks, Chinese Evaluation of "Desert Storm": Implications for PRC Security, in: *The Journal of East Asian Affairs*, 6 (summer/fall 1992) 2, pp. 447-476.

3 A typical example is an interview with Major General Wang Pufeng, Deputy Director of the Chinese Military Academy's Department on Strategic Studies, published in *Beijing Rundschau*, 28 (November 1991) 47, pp. 7-9. The General argues the emergence or reemergence of a multipolar structure in citing the important military role still played by Moscow, US dependence on others to finance "Operation Desert Storm", the unsolved Middle East problem, growing (economic) competition among Western powers, the emergence of regional economic blocs and China, Japan and Germany increasingly being "poles" in their own right. He concludes by emphasizing the role played by "hightech-weapons" in the Gulf and the necessity for China's military leadership to draw consequences from this fact.

Concern about the Gulf War and its outcome would have been less marked without the simultaneous breakup of the Soviet bloc and the earlier dissolution of China's "strategic partnership" with Washington. When this process culminated one year later in the disappearance of the USSR, Peking obviously found itself free from its most vital security concern since the 1960s and could confront its own people with a vision of glasnost resulting in "chaos, ethnical conflict and economic crisis".⁴ On the other hand, China foresaw Washington making use of such predicaments and encouraging destabilizing forces along the Chinese periphery.⁵ Peking had started its détente with the Soviet Union as early as 1987/88 and would have preferred this process to continue in a tripolar framework.⁶ In December 1991, Foreign Minister Qian Qichen suggested that Europe's stability was threatened because of the demise of the Soviet Union

4 Beijing Rundschau, 29 (7 January 1992) 1, pp. 12/13.

5 In December 1991, hardliner ideologue Deng Liqun predicted the advance of the "epic conflict" between capitalism and socialism into Asia and called on the Chinese "to learn from Mao and to be steadfast revolutionaries". The Times, 28 December 1991. Back in 1989, Deng Xiaoping had blamed Tiananmen on "Western subversion" and efforts to undermine China's socialism by a strategy of peaceful evolution. Beijing Rundschau, 26 (11 July 1989) 28, pp. 16-20. Chinese politicians and political analysts have since then accused the CIA of destabilizing activities in Sinkiang, Inner Mongolia, Tibet and Hong Kong. Defense News, 14-20 March 1994, pp. 1/2..

6 Reacting to the attempted Moscow coup in August 1991, the Chinese foreign ministry had predicted "uninterrupted progress" in bilateral relations and called upon the international community to "respect the decisions of the people of all countries". Xinhua News Agency (XNA) in English, 20 August 1991, quoted in Summary of World Broadcasts (SWB), FE/1156/A2/1, 21 August 1991. Three months earlier, CPC-President Jiang Zemin had visited Moscow and offered Gorbachev a relationship coming close to the alliance of the 1950s. Cf. China Daily, 8 June 1991.

whereas Asia was "relatively stable", mainly because China stood firm and had cultivated peaceful relations with its immediate neighbours. His implication was that destabilization might spill over from the West.⁷ Since then, Peking has tried to cultivate Russian and CIS military and civil elites sceptical of "Westernization" and holding vested interests in trade and the status quo. Chinese leaders have occasionally considered encouraging Russian nationalism in an anti-American sense.⁸ Peking has stayed mute, however, on Russian proposals for multilateral security mechanisms in Northeast Asia. For the time being, the PRC has no interest in helping Moscow to gain diplomatic ground, especially not in what it considers its own sphere of influence. Overall, though, punctual Russian weaknesses have not been exploited to an extent that might have endangered the process of détente launched in the late 1980s.

Peking had indeed mended its fences not only with Moscow, but tentatively also with Mongolia, both Koreas, Vietnam, Laos and India since the time when Gorbachev's foreign policy had made such flexibility possible and isolation from the West gave it some urgency. Relations with ASEAN countries had been good since Hanoi's invasion of Cambodia in 1978, and Burma had started leaning heavily on China since 1988, when the crushing of its own democracy-movement had earned it the condemnation of the West. Apart from the PRC's economic attraction, most Eastern and Southern neighbours shared Peking's apprehensions about Western demands for global standards and were themselves interested in a formula combining authoritarian government with economic success. This culminated in the 1993 UN conference on

7 Beijing Rundschau, 28 (31 December 1991) 52, pp. 9-13.

8 Lien Ho Pao (Hong Kong), 21 October 1994, as quoted in SWB, FE/2141 F/2-3, 1 November 1994.

human rights held in Vienna, when an almost comprehensive Asian bloc successfully refuted attempts at a greater degree of state accountability in this field.

China, of course, realized that its sheer size, past record and territorial claims threatened to undermine such cordiality and has since tried to reassure its neighbours of its own requirement for a "permanently peaceful and stable environment" necessary for modernization.⁹ In 1991, China joined the Asia-Pacific Economic Cooperation (APEC), and in 1994 it became a founding member of the ASEAN Regional Forum (ARF).

While the regional discourse at least at the rhetorical level continued to improve, relations with the remaining global power deteriorated in spite of damage-limiting efforts by both the Bush and Clinton administrations. The dispute focussed on bilateral trade, human rights, Taiwan, arms control and arms exports with the Chinese side accusing the US of double standards and an intention to prevent the PRC from taking its place as an equal great power.¹⁰ The loss of Peking's 2000 Olympics bid was attributed to "Western meddling",¹¹ and the inability

9 See for example President Yang Shangkun during a state visit to Singapore in January 1992 as quoted in Beijing Rundschau, 29 (21 January 1992) 3, p. 4. Yang suggested that regional confrontation during the Cold War should mainly be attributed to activities of non-Asian great powers.

10 After the so-called "Yinhe-affair" (the forced inspection of a Chinese freighter suspected of carrying chemical agents) in August 1993, "new and veteran Chinese generals" were reported to have petitioned President Jiang Zemin to "adopt appropriate measures against hegemonist behaviour of US authorities, which severely violated international law and China's national dignity and sovereignty". Ching Pao (Hong Kong), 5 October 1993, as quoted in SWB, FE/1817/G1, 12 October 1993.

11 Far Eastern Economic Review (FEER), 7 October 1993, pp. 12/13.

to join the World Trade Organization as a founding member was understood as another humiliation in the same vein.¹² China had tried to dispel international concern with its nuclear and missile proliferation by joining the Non-Proliferation Treaty (NPT) and declaring its readiness to "respect" the Missile Technology Control Regime (MTCR) in 1992. (Such flexibility was facilitated by the fact that after the disappearance of the USSR few motives remained to assist one's enemy's enemy in building a nuclear weapon of his own). As this did not prevent Washington, however, from authorizing fighter sales to Taiwan later that year or forcing inspection of a Chinese freighter suspected of transporting chemical agents to Iran in August 1993, the leadership of the People's Liberation Army (PLA) demanded a harder line which the politburo subsequently conceded.¹³ Clinton's unconditional and unlimited extension of most-favoured nation status for China in May 1993 appeared to vindicate this approach.

China believes time is on its side in this still difficult relationship. Its dependency on the American market is lessening, while the US is becoming more dependent on East Asian economies. Increasingly, Washington administrations are seen as being unable to convincingly act as world policemen.¹⁴

This became visible during the Korean nuclear crisis where the US had to renounce Security Council action in favour of "discrete diplomacy" and to probably concede the decisive part

12 Beijing Rundschau, 32 (3 January 1995) 1, p. 7.

13 FEER, 7 October 1993, pp. 12/13.

14 See for example a comment by a member of the executive board of the Chinese Centre for International Studies as quoted in Beijing Rundschau, 32 (January 1995) 4, p. 11.

to the PRC.¹⁵ Among China's motives for exerting pressure on Pyongyang, fears of Japan feeling compelled to unilaterally improve its security certainly played a role. On the other hand, the proposed solution might not be sufficient to terminate the debate in Japan. If China sees Korean unification as inevitable in the medium-term, it will wish to influence the process in the framework of its own regional ambitions. At least parts of the PLA-leadership have spoken up against a continued US military presence in Northeast Asia, which hitherto had been welcomed as a restraint on Japan.¹⁶ In the meantime, and playing on regional apprehensions about Tokyo, Chinese "experts" have been discussing the prospect of Japan at the turn of the century becoming a military power that might threaten China and other regional actors.¹⁷

Outside the Asia-Pacific, China's diplomatic impact remains uncertain: efforts to carry "Eastern values" into South and West Asia have mostly been inconclusive.¹⁸ Peking is irritated

15 According to Hong Kong's Ching Pao, Peking succeeded in making Pyongyang accept the 1994 nuclear deal by reaffirming its security commitment to North Korea and underlining it with large-scale manoeuvres conducted on the Liadong peninsula in August that year. The US, in return, granted China unconditional and unlimited extension of MFN. Ching Pao, 5 October 1994, as quoted in SWB, FE/2122/D7, 10 October 1994.

16 Author's information.

17 Bonnie S. Glaser, China's Security Perceptions. Interests and Ambitions, in: Asian Survey, 23 (March 1993) 3, pp. 252-271 (258).

18 In December 1992, China and Iran discussed the setting-up of an "Organization of Asian States" to jointly analyse and deter Western "interference". India, Pakistan and Central Asian republics were considered potential partners. In 1993, a high-ranking Iranian officer agreed on an exchange of defence related experiences with Peking and Pyongyang, the objective being prevention of "super-power-adventurism". Briefly before the US secretary of state's

with Islam's potential for anarchy and fragmentation. On the other hand, the vision of an "Islamistic arch" stretching from Central Asia to Northern Africa is seen with apprehension as it provides the US with a pretext to intensify its "meddling" in areas closer to China.¹⁹

Western Europe is probably not seen as an important actor, let alone as a threat in the Pacific by Chinese policy-makers. Too often have governments in question allowed their economic interests to be played out against the US or one another.

If the rest of the world is of any interest at all, then only as far as Taiwan's capacity for gaining diplomatic ground is concerned. China may have a policy towards Africa or Latin America, but it is probably confined to the foreign ministry desks concerned.

Not unlike Germany at the turn of the century, China is not quite a nation-state yet, but professes a strong sense of having been unfairly held down and denied its rightful status by outside great powers. Rather like early 20th century Germany, China is aspiring to a superior civilization with a regional sense of mission, derived from a mythological past and often explained with such "secondary virtues" as self-discipline and the respect for authority. The question here is,

visit to Peking, foreign ministers of China, Iran and India met in Tehran in March 1994 to discuss common approaches towards US "hegemonism" and the human rights problem. IRNA news agency in English, 18 December 1992, as quoted in Deutsche Welle Monitoring Service (Asia), 22 December 1992; Iranian Television in Persian, 14 January 1993, as quoted in *ibid.*, 19 January 1993; FEER, 24 March 1994, p. 16.

19 Cf. Zhao Guozhong, *The Middle East in Review*, in: *Foreign Affairs Journal* (Peking), (March 1994) 31, pp. 42-49.

whether this kind of vision can translate into actual changes in the existing balance of powers.

II. Objectives and Means

The People's Republic of China not only has certain attributes of a great power such as a permanent seat on the UN Security Council and nuclear arms, its candidacy for great power status is also derived from its size, wealth in resources and cultural tradition. Furthermore, China's economy has grown by about 9% annually over the last sixteen years, which means that it is four times larger today than it was in 1978. On a purchase power-basis, its share of global economic output was 6% in 1990 as compared with 22% for the US.²⁰ Extrapolating from such data, China would become the world's largest economy in the first half of the 21st century.

On the other hand, a gerontocratic one-party-dictatorship presides over an indebted and largely obsolete state sector, more than 200 million unemployed, many of them homeless, almost 30% inflation, an income gap of approximately 20:1 between coastal provinces in the Southeast and the northern interior, restless farmers and ethnic minorities, sectoral Manchester capitalism and de facto autonomous provinces such as Canton and Fukien. At home, the state felt compelled to resort to force in 1989, when its legitimacy was challenged by its own urban society and with no alternative vertical channels of communication available. In its external relations, the insistence on absolute state sovereignty and non interference was "more appropriate to the late sixteenth, rather than late twentieth, century...This Westphalian (sic) definition of international affairs grows out of China's modern historical and revolutionary experience. Mao's revolution was intended to restore China's dig-

20 World Economic Outlook (IMF), May 1993, pp. 116-119.

nity and place in the world by unifying the territory of greater China, expelling neocolonial influences and transforming China into a modern socialist country."²¹

Which meant in practice: reunification with Hong Kong, Macao and Taiwan, reestablishment of a hegemonial role in Southeast Asia by enforcing territorial claims in the South China Sea, cultivating special relationships with Burma and Thailand and enlisting the support of overseas Chinese communities. Furthermore, it meant securing influence regarding the process of Korean reunification and thus on the rearranging of the Northeast Asian power balance as well as neutralising remaining risks and/or filling vacua along its land borders. Peking's stance within the United Nations shows that China, much more than the US, derives its great power role from its regional standing. Disarmament, peacekeeping/peacemaking or protection of the global environment are even less genuine goals of Chinese foreign policies than is the case with other powers. They are exclusively defined in categories of national interest, and movement can only be expected in exchange for others' concessions.

During the Cold War, China's regional pretensions could only remain theoretical: in the North and Northwest, the Soviet army tied up about two thirds of the People's Liberation Army's potential, and both came close to the brink of war in 1969. To the South, Vietnam and India acted as Moscow's allies. After the 1989 Tiananmen massacre, the US once again became the potential principal enemy.

Since the end of the Cold War, Russia's Pacific Fleet has withdrawn to Vladivostok, the US has abandoned its Philippine

21 David Shambaugh, "China's Security Policy in the Post Cold War Era", in: *Survival*, 34 (summer 1992) 2, pp. 88-106 (92).

bases and has reduced its Western Pacific military presence by about 20%.²² Japan's defence perimeter is explicitly limited to one thousand nautical miles around Tokyo.

According to official statistics, China has doubled its defence spending since 1988. And even when allowing for 20-25% annual inflation, the actual budget could be as much as six times higher, thus bringing it close to Japanese defence spending.²³ The PRC has been building a blue water navy, developing an aircraft carrier²⁴ and modernising its nuclear forces and has signed arms deals with Russia worth five to six billion US\$. Among these imports are 72 long-distance bombers of the Su-27-Fencer type, permitting power projection in maritime areas far away from the Chinese mainland.²⁵

It was not by accident that the "Deng Xiaoping era" began with a war in 1979, the "punitive expedition" against Vietnam. Following decades of mostly declamatory foreign politics, the new leadership had to prove that China counts and that China "means what it says". Today, sixteen years later, the PRC has

22 According to IISS data, some 87 000 US troops remain stationed in the Western Pacific. The Military Balance 1993/94, London, 1993.

23 The 1994 official budget was 52.5 billion yuan or about 12 billion US\$. The SIPRI 1994 Yearbook states 37 billions in real spending for 1993. The amount could be even higher, depending on the calculation of profits made by PLA-run enterprises, indirect allocations to the military-industrial complex, R&D outside the regular budget, revenues from arms sales, expenses for the People's Armed Police and militia, provincial allocations to regional forces, the PLA's agricultural sector, other commercial investment and pension and demobilisation costs accounted for in the civil affairs budget. David Shambaugh, *Growing Strong: China's Challenge to Asian Security*, in: *Survival* 36 (summer 1994) 2, pp. 43-59.

24 South China Morning Post, 3 March 1993.

25 Ibid.

to defuse misgivings among neighbouring countries of its regional ambitions and to demonstrate the defensive character of its national development. Does Peking today mean what it says?

÷ In 1987 and 1988, China delivered battle tanks, air defence systems and other heavy equipment to Thailand at prices less than ten per cent of world market value.²⁶ The quasi-alliance resulting from Bangkok's support for the Khmer Rouge and cessation of Chinese support for the Communist Party of Thailand not only worried Vietnam, but also Bangkok's ASEAN partners, unwilling to see either Peking or the Khmer Rouge play a lasting important role in the region.²⁷ The military component in Chinese-Thai relations has lost some of its importance in the 1990s, and Bangkok's own ambitions in Indochina have been observed rather critically in Peking,²⁸ but links between the armed forces and military-industrial complexes have been maintained. Taking into account the continuing role of the Thai military in domestic politics, they could be reactivated at short notice.

÷ In 1988, the Burmese leadership forcibly crushed a democracy movement, thus creating a precedence for Tiananmen. Faced with international isolation, both regimes started to cooperate more closely. In December 1989, they

26 The Nation (Bangkok), 3 May 1987, Bangkok Post, 24 April 1988.

27 International Herald Tribune (IHT), 28 October 1988.

28 When Thailand's premier Chatichai Choonhavan in 1989 tried to win over the Chinese leadership to his formula for transforming Indochinese battlefields into "market places", his counterparts warned him not to stabilize the Phnom Penh government supported by Vietnam. XNA in English, 15 March 1989, as quoted in SWB, FE/0411/A3/3, 17 March 1989.

signed an agreement on economic cooperation and the building of bridges in their border areas. In November 1990, an agreement on the delivery of Chinese fighter aircraft, air defence weapons, patrol boats, etc. became public.²⁹ In 1991, Chinese military advisers started arriving in Rangoon.³⁰ Officers of the Burmese navy and air force have been trained in China.³¹ In 1992, Chinese arms were employed against the Karen guerilla army along the border with Thailand and Burmese Muslims along the border with Bangladesh. In April that year, there were reports on active logistical support by China for a Burmese army operation against the Kachin Independence Army.³² China has been helping with the construction of naval bases in the Andaman Sea, has installed electronic monitoring equipment and is likely to demand anchoring rights for the PLA navy.³³

÷ Also in the context of the 1989 massacre, China began its rapprochement with Vietnam. In early 1990, both sides discussed partial replacement of Soviet economic aid by the PRC. In June 1991, Vietnam's foreign minister, who had argued for opening up to the West, lost his positions in party and government due to Chinese pressure.³⁴ In October that year, both sides formally normalized their relations, thereby professing identical views on the question of a New World Order.³⁵ Three months earlier, ASEAN foreign

29 The Nation, 21 November 1990.

30 Jane's Defence Weekly, 15 June 1991, p. 1053.

31 FEER, 3 October 1991, pp. 24-25.

32 FEER, 24 April 1992, p. 9.

33 The Economist, 13 January 1991.

34 Author's information.

35 According to the Sino-Vietnamese communiqué of 10 November 1991, no country should "force its ideology, its values or ways of development" on others in the framework of this

ministers, commenting on this rapprochement, had voiced their concern on the perspective of a "red solution" for Cambodia.³⁶ Vietnam will become a member of ASEAN in 1995, thus trying to take one step out of the "Chinese orbit". The perspective of political opening up is more realistic there than in China itself. Conservative factions in party and government, however, are likely to build on their links with China to counter such tendencies.

- ÷ China had reestablished relations with Laos as early as 1987 with a view to offer the landlocked country an alternative to Vietnamese influence. After Tiananmen, party-relations were reactivated. In late 1990, both sides agreed on extending their economic cooperation. A border treaty was signed in October 1991. In early 1994, China set up three electronic monitoring stations in southern Laos.³⁷
- ÷ A potentially explosive issue in Sino-Vietnamese relations and Peking's relations with ASEAN and Japan is the PRC's territorial claim to almost the entire South China Sea down to the coast of Borneo. In 1974, the PLA navy drove the South Vietnamese out of the Paracel Islands, in March 1988 Chinese and Vietnamese ships clashed in the Spratly Archipelago, after which Peking occupied seven islands. In February 1992, Peking, in a law on its territorial waters, defined both archipelagoes as Chinese territory and thus points of departure for the delimitation of twelve-mile-zones and adjacent zones, where the passage of third coun-

order. XNA in English, 10 November 1991, as quoted in SWB, FE/1227/A3/1-2, 12 November 1991.

36 Asia-Pacific Defence Reporter, October 1991.

37 Jane's Defence Weekly, 19 November 1994.

try ships would require China's consent.³⁸ In May that year, Peking granted a drilling concession to a US oil-company west of the Spratlys, about 80 nautical miles off the southern Vietnamese coast. The PLA navy has been protecting exploration activities there.³⁹ In February 1995, China, for the first time, occupied an island claimed by the Philippines. The PRC's offer to Brunei, Malaysia, the Philippines and Vietnam, all of which have partial claims, to jointly exploit these maritime areas,⁴⁰ has not yet resulted in a compromise, as Peking has made it conditional on potential partners recognizing in principle its sovereignty.⁴¹ ASEAN security planners have located the "greatest threat to (regional) peace" in the Spratly Archipelago,⁴² and have declared their interest in the continued presence of the Seventh Fleet because of this threat.⁴³

- ÷ When in 1992/93 Hong Kong's Governor Chris Patten tried to improve the representative character of the colony's legislature, China threatened economic strangulation and the possibility of a takeover prior to 1997.⁴⁴ China will

38 XNA in Chinese, 25 February 1992, as quoted in SWB, FE/1316 C1/1, 28 February 1992.

39 IHT, 19 July 1994.

40 First made by Prime Minister Li Peng when visiting Singapore in August 1990; Agence-France-Presse, Hong Kong, in English, 12 August 1990 as quoted in SWB, FE/0842/A3/2, 14 August 1990.

41 Foreign Minister Qian Qichen as quoted in Beijing Rundschau, 9 April 1991, p. 12.

42 Conclusion of an intra-governmental security-conference in Manila; Financial Times, 10 June 1991.

43 Author's information.

44 FEER, 10 December 1992, pp. 8-9 and 7 January 1993, pp. 8-9.

dissolve Hong Kong's Legislative Council in 1997 regardless of earlier assurances.

- ÷ Since Taiwan de facto abandoned its claim to represent all of China around 1987/88 and legalised opposition parties working for independence, the option of reunification by force has once again been discussed in Peking. Repeated threats with military intervention in case of a Taiwanese declaration of independence were underlined in September 1994 with large-scale amphibious manoeuvres in the East China Sea.
- ÷ China decisively influenced the provisional solution of the North Korean nuclear problem, thereby reinforcing its role in Korean reunification and the shaping of the future balance of powers in Northeast Asia. Short of alternatives, the US had to accept a weakening of the nuclear non-proliferation regime and the part played by the UN Security Council in this context. Japan might be faced with a choice of more unilateral defence efforts against becoming the "Switzerland of China". Russia's diplomatic role in Northeast Asia has been further eroded.

On the "confidence building side", this can be contrasted with China

- ÷ terminating its material and moral support for communist guerillas in Burma, Malaysia and Thailand since the early 1980s,
- ÷ participating in negotiations for peace and peacekeeping in Cambodia,
- ÷ establishing diplomatic relations with Brunei, Indonesia and Singapore (1991/92) as well as South Korea (1992),

- ÷ agreeing on confidence and security-building measures along the borders with Central Asia, India, Russia and Vietnam,
- ÷ exerting pressure on North Korea with a view to reduce the prospect of conflict on the Korean peninsula.

Such cooperative action, however, can easily be interpreted in the framework of Chinese power- and interest politics: the termination of Peking's support for communist insurgencies in Southeast Asia had been instrumental in achieving a common approach to Cambodia with ASEAN members since Hanoi's 1978 invasion of the neighbouring country. The movements concerned had by then run into an existential crisis, anyway, because of China's renunciation of Marxism and open hostility with Vietnam.⁴⁵ The subsequent normalization of relations with Indonesia suffered a setback in April 1994, when Peking called on Jakarta to improve the protection of Indonesia's Chinese minority, thus reviving the spectre of overseas Chinese functioning as a "fifth column".⁴⁶ Almost all ASEAN governments have been worried of late about local overseas Chinese preferring to invest in China rather than in their host countries.⁴⁷

If China has played a constructive role in the Cambodian peace process since about 1990 and even insisted on implementing the Paris Agreements of October 1991 at the expense of the Khmer Rouge, it did so because the ruling terminates third party influence in Cambodia and reestablishes

45 Kay Möller, *The Thai Communist Movement and China-Vietnam Competition in Southeast Asia*, Cologne (Berichte des Bundesinstituts für Ostwissenschaftliche und Internationale Studien), August 1981.

46 Rizal Sukma, *Recent Developments in Sino-Indonesian Relations: An Indonesian View*, in: *Contemporary Southeast Asia*, 16 (June 1994) 1, pp. 35-45.

47 Author's information.

an intra regional balance of powers. An independent and neutral Cambodia, sandwiched between Thailand and Vietnam, will automatically reorient its diplomatic relations northward.

This means that China's relations with Southeast Asia, while having been formalized through a temporary identity of interests in Cambodia, may deteriorate again because of the successful translation of such interests into policy.

In Northeast Asia, the mere geographic proximity of Japan, Russia, and the US and the continued presence of US troops in Japan and South Korea present more formidable obstacles to further expansion of China's influence. If, in this case, Peking has opposed institutionalized and multilateral processes as a means to solve the North Korean problem, calling instead for bilateral secret diplomacy, then because China's influence, under these circumstances, would not have been maximised along the lines of a "Cambodian formula". However, the results are comparable.

From these cases, one would not so much conclude that "China means what it says", but that China is trying to establish bridgeheads both in Northeast and Southeast Asia wherever it can. A final delimitation of borders has only been agreed upon with those northern neighbours which China itself sees as a potential threat. In dealing with India, Vietnam and parts of Central Asia, the PRC can afford to keep the question open and on the backburner. For the time being, Chinese interests towards the East and Southeast are perceived as more urgent.

Conclusion

An evaluation of this juxtaposition of China's subjective perceptions and comments on the one hand and my attempt at a more distanced assessment of policy goals and capacities on the other might read as follows:

China is a non status quo power, which for the first time since the Opium Wars is approaching a position to influence changes in the regional power balance. This is no threat to the US and Russia as yet, but already the main motive for national and multilateral security debates initiated all across the Asia-Pacific.

For the time being, any preventive containment of China would certainly come as diplomatic overkill and prematurely destroy the hopes that third parties have set in China's internal evolution and external interdependencies. Such hopes imply that Peking, in accepting an economic opening up, embarks on a path of development that would be suicidal to abandon again. Japan, South Korea and the US have recently decided to test this theory in bilateral security dialogues with the PRC. Other neighbours have been experimenting with CSBMs in their border areas or comprehensive forums for "open dialogue".

On the other hand, new interdependencies in themselves are no guarantee for the peaceful solution of conflicts, the contrary might be the case.⁴⁸ For the time being, they rather appear to accentuate the domestic cleavage between rich and poor and international competition with Southeast Asian producers for global markets. Caught in the "no-man's land" between economic

48 Dieter Senghaas distinguishes symmetrical and asymmetrical, cooperative and confrontative interdependencies. Cf. Dieter Senghaas, *Internationale Politik jenseits des Ost-West-Konflikts*, in: *Leviathan*, (1991) 19, pp. 491-520.

and security considerations, the Taiwanese government has determined a critical dependency on developments on the Chinese mainland.⁴⁹

Peking has spoken in favour of regional economic cooperation, was a founding member in 1980 of the informal Pacific Economic Cooperation Conference (PECC) and joined the Asia-Pacific Economic Cooperation (APEC) in 1991. Interest in APEC has at least a very strong political component, though: it was in this framework that, for the first time since Tiananmen, the Chinese president met his US counterpart and that the Taiwanese president was prevented from taking part as an equal. Peking has been reluctant to develop APEC into a free trade area. As an alternative, Malaysia's concept of an East Asian Economic Caucus (EAEC) excluding Australia, New Zealand and North America and furthering the "eastern values community" has been supported.

China has been even more reticent whenever multilateral security cooperation was suggested. Beyond agreement in principle,⁵⁰ there has been no commitment to the ASEAN concept of a Nuclear Weapons Free Zone in Southeast Asia (SEANWFZ; the same applies to South Asia, and Northeast Asia is an exception only insofar as in this case the US is required to make the essential concessions). China has joined others in rejecting proposals for transferring the CSCE-model to parts of Asia and refuses the multilateralisation of problems involving its self-defined sovereignty (Hong Kong, Taiwan, the South China Sea).

49 Radio Taipei in English, 10 May 1992, as quoted by Deutsche Welle Monitoring Service (Asia), 25 May 1992.

50 See for example President Jiang Zemin during an official visit to Malaysia, 11 November 1994, as quoted in Beijing Rundschau, 3 (29 November 1994) 31, p. 28.

As a consequence, Peking, while participating in the 1994 inaugural meeting of the ASEAN Regional Forum, prevented the Spratlys issue from entering the agenda.

Still more disturbing is the fact, that China under Deng Xiaoping as well as under Mao, has, in cases of doubt, tended to give priority to self-defined national interests over the "economic imperative" (see as Vietnam in 1979 or Tiananmen in 1989).

The sheer multitude of domestic and external problems would justify the question whether China and its neighbours will have enough time for a gradual process of peaceful evolution. In any case, a Chinese Gorbachev has not been identified. One might of course ask why the greatest East Asian country, with one quarter of the world's population and enormous economic potential should be prevented from taking decisive influence in a region, where third-party intervention has often caused destabilization and human suffering. From a western, but probably also regional, point of view, the answer might be the following: if China's vision of reestablishing traditional hegemony in East Asia becomes political reality, not only would successful regional examples of evolution towards civil society suffer (the Philippines, South Korea, Thailand, Taiwan), but the few existing onsets for global political culture might witness even greater setbacks. Furthermore, China being a nuclear power is no longer imperial China, which, most of the time, had been able to realize its regional vision at a symbolic level and with a minimum of actual force. Today's PRC, because of its own armament, is at the origin of a regional arms race. In the 1980s, Peking played a part in the development of nuclear arms in Pakistan, as well as possibly in

Irak and Iran. China has been exporting conventional weapons and ballistic missiles and might have proliferated components for the production of chemical weapons. If the original motives had been both commercial and political, it has recently become clear that the offer to renounce such exports is now part of a negotiation strategy vis-à-vis the US. Until today, concessions have been limited to the American side.

Washington certainly need not fear Peking, even if the PRC is the last state worldwide to have programmed its nuclear missiles on targets in the US. Russia, too, is still a power formidable enough to control security risks along its borders.⁵¹ Japan, however, perceives China to be a potential threat, not mentioning Peking's smaller neighbours. If the survival of one-party-dictatorship and China's national cohesion were not in question themselves, the region would have little choice but to prepare itself for a new pax sinica. The breakup of the PRC would be as catastrophic for both China and the region. Such processes, however, can hardly be influenced from the outside.

51 Another aspect is Chinese migration to Siberia - at present estimated to involve 1-2 million people - possibly aggravating Russia's own internal fragmentation. ITAR-TASS in English, 28 October 1994, as wquoted in SWB, FE/2142/G/1, 2 November 1994.

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THE EU AND THE PRC: DIPLOMATIC AND ECONOMIC INTERACTIONS

Peter Ferdinand
Warwick University

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THE EU AND PRC: DIPLOMATIC AND ECONOMIC INTERACTIONS

Introduction

In general relations between European states and the PRC have been getting both better and worse since 1991. It is likely that this contradictory process will continue.

They are getting better in terms of economics. Once Western governments and companies had decided that China was not going to fall into civil war or chaos in the aftermath of the Tiananmen Square events, and that the time for sanctions or withholding economic cooperation was over, then companies in particular became fixated on the possibilities of the Chinese market as the economy began to speed up.

They are getting worse in terms of politics. Public opinion and the media in West European countries have become more aware and more critical of the authoritarian nature of the Chinese state. The Tiananmen Square events highlighted that, but it is not that alone. Thus individual issues concerning European citizens and involving some criticism of China are likely to recur. This will make more difficult the task of devising a European policy which will be able to give due weight to these criticisms whilst at the same time enhancing cooperation with the Chinese authorities.

This paper will focus firstly upon the state of economic relations between EU countries and the PRC. It will then turn to the political and diplomatic disputes between EU countries and the PRC, as well as the underlying trends which will probably cause them to recur. Finally there will be a Conclusion.

Recent Economic Interactions

Firstly, let us begin with evidence of how far the European Community's foreign trade relations with the greater Chinese economic space have evolved since the introduction of economic reforms by the PRC at the end of 1978.

Table 1: Percentage of Total EC Exports Going to Greater China

<u>Destination</u>	<u>1978</u>	<u>1983</u>	<u>1988</u>	<u>1993</u>
PRC	0.4	0.4	0.6	1
Hong Kong	0.5	0.5	0.6	1
<u>Taiwan</u>	<u>N/A</u>	<u>0.2</u>	<u>0.5</u>	<u>0.7</u>
Greater China	0.9	1.1	1.7	2.7

Source: IMF Direction of Trade Statistics Yearbook (various years)

Table 2: Percentage of Total EC Imports Coming From Greater China

<u>Source</u>	<u>1978</u>	<u>1983</u>	<u>1988</u>	<u>1993</u>
PRC	0.3	0.4	0.7	1.6
Hong Kong	0.6	0.7	0.8	0.9
<u>Taiwan</u>	<u>N/A</u>	<u>0.5</u>	<u>0.9</u>	<u>1</u>
Greater China	0.9	1.6	2.4	3.5

Source: IMF Direction of Trade Statistics Yearbook (various years)

These figures indicate a steady increase in the importance of the Greater Chinese region in the EC's imports and exports, with the most dramatic increase coming in the share of EC imports originating in the PRC.

Now let us consider changes in the significance of trade with the EC in the PRC's overall foreign trade.

Table 3: Percentage of Total PRC Exports Going to Various Destinations

<u>Destination</u>	<u>1978</u>	<u>1983</u>	<u>1988</u>	<u>1993</u>
US	2.8	7.8	6.4	18.5
Japan	17.6	20.4	16.9	17.2
EC	12.3	11.2	10	12.8

Source: IMF Direction of Trade Statistics Yearbook (various years)

Table 4: Percentage of Total PRC Imports Coming From Various Sources

<u>Source</u>	<u>1978</u>	<u>1983</u>	<u>1988</u>	<u>1993</u>
US	6.6	12.9	12	10.3
Japan	28.4	25.8	20	22.5
EC	18.5	15.8	14.8	13.9

Source: IMF Direction of Trade Statistics Yearbook (various issues)

What will be seen from this is the relative stability of the EC as a destination for PRC exports over this period, but the relative decline of the EC (and also Japan) as a source of PRC imports, which have been partly replaced by the US.

Now let us turn to more detailed consideration of the performance of individual EU member countries in terms of trade with the PRC, Hong Kong and Taiwan (Appendices 1-10).

As far as exports to the PRC are concerned over this period (Appendix 1), we can note the gradually improving relative performance of France and Italy, and the relative decline of Germany - at least until 1992-3.

As for imports from the PRC (Appendix 2), Germany has become increasingly important, whilst the UK has become less so.

For exports to Hong Kong (Appendix 3), Italy's share has increased, whilst that of the UK has steadily declined since the

early 1980s, i.e. ironically before the agreement with the mainland over Hong Kong's future.

Imports from Hong Kong (Appendix 4) have primarily gone to the UK, but the share has fluctuated over these 15 years, whilst in the 1990s the Netherlands have taken an increasing share.

Exports to Taiwan (Appendix 5) have continued to be dominated by Germany, whilst Italy and Belgium increased their share, as did France until, surprisingly, the year after the agreement to sell arms.

Imports from Taiwan (Appendix 6) show a 16-year cycle for Germany, with relative decline being followed by an increase, and, until 1993, an increasing penetration of the Spanish market.

As for the trade balance between the EC and the PRC (Appendix 7), this has fluctuated quite sharply over the 16-year period, with an EU surplus in seven years, and a deficit in nine. Ironically since 1989, when Western companies and governments began to shun the PRC as a result of the Tiananmen Square massacre, the EU's deficit consistently and dramatically worsened, to the extent that Belgium and Luxembourg were the only EU states registering a trade surplus, as in fact they did for 14 out of the 16 years.

The trade balance with Hong Kong (Appendix 8) has consistently been in deficit for the first 14 years, only turning into surplus in 1992 and 1993. Here the best performer by far has been Italy, which since its one deficit in 1980 has shown a steadily increasing surplus, becoming by far the largest in 1992-3. Belgium and Luxembourg have consistently turned in a surplus, whilst France's has grown steadily since 1984. Germany's deficit has been second only to that of the UK.

The trade balance with Taiwan (Appendix 9) has been uniformly in deficit, with all states except, again, Belgium and Luxembourg showing unbroken losses.

Lastly, as far as the trading balance with the Greater China is concerned (Appendix 10), something which will become increasingly important to Europe as economic integration in the region develops, this has consistently been in deficit with the exception of 1985. Only Belgium and Luxembourg have shown a surplus in all 12 years since the IMF began publishing statistics on trade with Taiwan, whilst Italy has shown a surplus in six out of the twelve. Clearly in the earlier years surpluses with the PRC could be said to have compensated sometimes for losses in trading with Hong Kong and Taiwan. The dramatic increases in PRC exports to Europe in the early 1990s, however, have meant that the European deficit with the region grew 935% between 1986 and 1991.

The implication of this story, therefore, is that if Europe wishes to redress the balance of trade with the region, history suggests that it ought to be the PRC which would be most likely to bring results. Certainly, in addition, various European companies have focused upon the PRC in the 1990s as a vital element in their plans for global expansion, whether it be chemicals, or cars, or services. On the other hand, the achievements of the PRC in dramatically increasing their surpluses in the early 1990s suggest that the task for the Europeans may be greater now than it would have been a few years ago.

Of course, trade with China is only part of the picture of economic interactions. FDI is another important element, but

here figures are more sketchy. Nevertheless the next table should give an idea of the relative importance of the largest European investors on mainland China.

Table 5: Foreign Investments in China 1979-93

	<u>No. of Projects</u>	<u>Contracted Investment (US \$bn)</u>
Hong Kong	114,147	150.9
US	5269	78.47
Taiwan	20982	18.4
Japan	7180	8.9
France	242	6.84
Singapore	3122	4.8
Britain	616	3
Thailand	1399	2.1
Canada	1540	1.8
Germany	569	1.5

Source: Chinese Ministry of foreign trade and Economic Cooperation, cited in The Financial Times, 31 August 1994.

These figures suggest that European investment overall is significantly greater than that of Japan.

Diplomatic interactions with the PRC

So far what has been suggested is that economic relations between EU states and the PRC since 1978 have been relatively successful and cooperative. Though there has not been any dramatic enhancement of the role which EU countries have played in China's economic transformation as compared with the US and Japan, European states have at least maintained their relative position. And insofar as EU states pursued a less aggressive negotiating strategy than the US towards China over her admission to GATT, then they will have benefitted in Chinese eyes. On the other hand, it also became clear that the EU was unable to make the US administration significantly shift its negotiating stance over GATT, and as a result the gratitude of the PRC will likely

be muted. Nevertheless the task for the EU is to build upon that success.

On the other hand, along most other dimensions, relations between China and its European partners are likely to be more strained than in the 1980s. This can already be seen from the disputes with the British over Hong Kong, with the French and the Dutch over arms for Taiwan, over the role of the Security Council at the UN in peace-keeping operations, not to mention the legacy of the shootings around Tiananmen Square.

Partly this stems from the end of the Cold War and the collapse of the Soviet Union. As has often been emphasised, the West no longer needs China as a counterbalance for the Soviet Union. Even in a worst case scenario of some kind of 'clash of civilisations' in the future, where conceivably 'Christian' Europe could be set against a 'Muslim' Middle East, it is unlikely that China would be prepared to side consistently with the West, not least because of the great efforts which she has made over past decades to establish good relations with Middle Eastern states and because of the need for her to preserve good relations with her own Muslim minority.

Thus disputes which previously were mitigated by the sense of the overall need to keep on the same side can now be pursued more openly. And democratic governments will be more reluctant to spend political capital in discouraging their citizens, and their press, from uncovering the less attractive sides of Chinese reality for the sake of maintaining good commercial relations with the PRC.

On the other hand, on the Chinese side, the legacy of the Tiananmen Square events is suspicion of interference by foreign

powers and forces in China's internal affairs. It raised again for them the possibility of foreign governments aiming at the dismemberment of China and heightened the concern of the Chinese government about sovereignty. Though Europe was not perceived to be the prime mover in this respect, it nonetheless readily associated itself with the movement for imposing sanctions on Beijing's leaders as a mark of disapproval, and President Mitterand went out of his way to welcome Chinese dissidents to Paris. That too is likely to be a lasting element in China's attitude towards relations with outside world, including Europe.

Let us turn firstly to various international disputes and tensions between West European governments and the PRC since 1989, before discussing issues in domestic Chinese politics which will cause problems. Here let us focus upon four issues: a) Hong Kong; b) relations with Taiwan, including arms sales by Western governments; c) the role of China in the UN Security Council; d) China's role in the Asia-Pacific region.

a) Hong Kong

The disputes which have broken out between the British and Chinese governments since 1992 have raised the issue of the importance of economic rationality and calculation in its foreign-policy priorities, as compared with non-economic interests such as sovereignty.

Until the appointment of Governor Patten, it seemed as though both the British and Chinese governments would succeed in cooperating to ensure the smooth ride of the 'through train' up to and beyond 1997. Since then relations have been, to put it mildly, stormy.

The Chinese response was revealing. It showed how suspicious the Chinese leaders were over British motives, despite the achievements of the Joint Declaration and the relatively harmonious next seven years of cooperation. The British were condemned for having aimed at undermining the PRC by turning Hong Kong into a kind of Trojan horse of westernisation. A straight line was drawn linking the Governor's proposals with the Opium Wars, and all the nefarious deeds which had been done to China by the British ever since. The Jardine Matheson company was singled out for attack since some of its directors ventured to express support for the Governor's proposals - and the role of the founders of the company in trying to impose the opium habit upon the Chinese people was repeatedly mentioned. And once again suspicions were aired about the British plan to smuggle most of Hong Kong's wealth out of the colony and back to the UK before 1997.

Three conclusions follow from this experience. The first is the continuing importance of history in the conduct of China's foreign relations today. In particular there remains the sense of past injustices inflicted upon China and the need, at the very least, for permanent vigilance on the part of her leaders to ensure that this is not repeated. Insofar as other European countries were associated with the past injustices, then that is an attitude which can still be revived in Chinese relations with Europe, even though for the moment the United States is more prominently connected with attempts to undermine the PRC.

Secondly there is the reminder that considerations of sovereignty and honour/face may still outweigh the importance of economic pragmatism in the eyes of Chinese leaders. Because the

British government had not, as the Chinese saw it, seen fit to 'consult' the Chinese in ways to which the latter had become accustomed, and because the Governor had not personally gone to Beijing to establish personal relations with the leadership in Beijing before announcing his proposals, the Chinese believed that he was deliberately attempting to shame them.

Thirdly, there was the uniformly negative response from Beijing to any British proposals for change which did not involve tearing up the Patten proposals and starting again. The Chinese argument was to keep asserting that the proposals contravened the 'spirit' of the accords, but could not come up with specific examples of ways in which this occurred, except to say that the agreements included the principle that the two sides would consult more intensively as 1997 drew nearer, and that the two sides were committed to the 'through train' transition. This blanket hostility took aback even the British government's own most outspoken critics, such as Sir Percy Craddock. He confessed to surprise at the refusal of the Chinese government to offer even the slightest concession in the endless rounds of talks which took place in 1993-4.

It is true that Politburo Standing Committee member Li Ruihuan recently admitted to the National People's Congress that China had made mistakes in its handling of the Hong Kong issue, although he did not go into specifics. And there were signs earlier that the leadership was divided over its response to the British proposals. Nevertheless there have not yet been any signs of open disagreement in the current handling of relations. As much as anything, the reason for that is the continuing political succession struggle in Beijing, which discourages any

Chinese leader from wanting to appear 'soft' towards Britain and the West. Insofar as Western observers believe that no clear succession to Deng Xiaoping has been established, and that any post-Deng leadership is likely to be 'patriotic', if not nationalist, in ethos, then that climate of uncertainty and reluctance to initiate concessions will be likely to persist.

b) Taiwan-Mainland relations, and the effect of Western arms sales

The relationship between Taiwan and the mainland was quiescent from the 1970s until the late 1980s. That is unlikely to continue. The chief source of change has been Taiwan. The economic success of the Nationalist regime over the last 30 years, despite the increasing diplomatic isolation, has aroused both a self-confidence among the citizens of Taiwan as well as a frustration over the restrictions which they face whenever they have to travel abroad. This, coupled with the surfacing of resentments by native Taiwanese over their past treatment by mainlanders, has induced the Kuomintang leadership since the late 1980s to launch the country upon a round of political liberalisation and democratisation. In turn this has allowed the Democratic Progressive Party to emerge as the chief opposition to the KMT, and its chief political platform is independence for Taiwan, i.e. the abandonment of any claim to rule or represent the mainland.

The problem for Western governments is that if the DPP came to power and sought to implement this proposal, even if it first carried out a referendum to ensure that it had the support of the population, the PRC has declared that it would regard that as

grounds for invasion. The dilemma for Western governments, therefore, would be how to respond to a still-communist regime invading, or at least threatening, a democratic one.

In fact the opportunities for foreign governments to make a contribution by encouraging cross-Straits cooperation have increased with the opening up of business opportunities. Taiwan has become possibly the second largest trader with the mainland, and Western companies have begun to accept the encouragement of the Taiwanese government to develop operations on the island with the aim of serving factories on the mainland. VW, for example, recently opened a factory on Taiwan, part of whose rationale was to supply VW plants on the mainland in the foreseeable future.

Since the governments of the two Chinas are both encouraging economic links as a way of discouraging separatism on Taiwan, there is an opportunity for European governments and the EU to contribute to that process. This opportunity will increase once the two Chinas are admitted to the World Trade Organisation and each side will be under an obligation to treat the other as an equal. Indeed once that has actually taken place, there will be real opportunities to create the much-touted 'Greater Chinese Economic Space' and, were it to succeed, it would certainly be desirable for the EU to try to take advantage of it in its own interests, as well as for the sake of enhancing stability in the region.

The government of France, presumably, would be especially interested in encouraging this process to work, given the penalties which it suffered as a result of the decision in 1992 to sell fighters and frigates to Taiwan. Though the PRC at that time enjoyed a sizeable trade surplus with France already, and

though French exports to the PRC continued to rise in absolute terms in 1993, their share of EU exports to the PRC fell from 16 to 12 per cent. If France had maintained the figure of 16 per cent in 1993 (and the average for 1989-91 had been 21 per cent), then they would have gained a further \$550 million. Of course, the benefits of sales of weapons to Taiwan would far outweigh this disbenefit. Nevertheless the French government was under no illusions about the potential long-term impact of PRC displeasure and Prime Minister Balladur went to Beijing in 1994 to mend fences. This was a reminder of the extent to which the PRC, at least as long as it is not a member of the GATT/WTO, is capable of imposing sanctions upon countries which have seriously displeased it in some way.

c) China in the Security Council and the UN

Though the PRC has had serious disagreements with other permanent members of the Security Council over issues such as the response to the crisis in the former Yugoslavia, and though its government agencies have serious conflicts of interest with new policies introduced such as the missile technology control regime, by and large the PRC has been cooperative. For example, these are Chinese observers now in several UN peace-keeping operations.

It is true that in its initial stages peace-keeping in Yugoslavia and elsewhere was hobbled by the Chinese reluctance to concede too much authority to UN agencies which might lead to peace-making and thereby create a precedent that could lead to intervention in other countries' affairs, including China's own. Thus a conclusion from this is the reluctance of the Chinese

government to approve activist international organisations. The Chinese government is wedded to the principle that sovereignty is vital in the life of the nation - and it sees its own history in the 19th and 20th centuries as bearing that out. Thus it certainly is possible for other governments to work with the PRC, but it is more likely to be productive if things are conducted on a bilateral rather than a multilateral basis.

d) China's relations with its neighbours

One obvious consequence of an enhanced mission for the EU in East Asia will be that other countries too will seek to involve the EU in disputes and their resolution. One example recently was the attempt by President Ramos to mobilise support in other parts of the world, Europe included, for his claims about renewed expansion plans by China in the Spratly island group. It will be important to ensure that the EU does not become too preoccupied with China to prejudice its interests with other states in the region. And it will be particularly important to try to encourage processes which lead to China behaving as far as possible like a normal state power rather than seeking special treatment.

Where is China Going and the Challenges for EU Diplomacy

On the other hand, problems for European countries dealing with China will stem too from the nature of government in China, its increasing domestic fragility, and its attempts to compensate by force to maintain order. This is a 'problem' for the EU democracies, in that various issues in Chinese domestic and foreign policies will continue to arouse adverse comment from

human rights and other interest groups, especially at the time of meetings between Chinese and European leaders, and these will be highlighted by the media. These will necessarily make the task of forming a smooth relationship with the Chinese leadership more problematic. They will also cause arguments with business organisations in European countries which will wish to focus more upon the trade opportunities and complain about the financial and employment costs to European companies of arguments with China.

Let us first outline a few of the domestic issues which will recur, and cause problems. Most of them stem from the erosion of government control over society, and the state's attempts to maintain order and compensate by at times arbitrary and excessive punishments. The economic reforms since 1978 have had the effect of driving increasing numbers of people away from home and the place of their registration in search of work. This is the so-called 'floating population'. No-one can know their exact numbers, but estimates have put the figure at between 100 and 150 million. Mostly they are young people, i.e. those who are less concerned about the absence of welfare benefits and pensions for people not employed in state enterprises. They are not on the move all the time, but they have no stable roots. When times become harder, employment in private and collective enterprises has tended to be the first to suffer. This has had the result of throwing more people out of work, who may then resort to crime to make ends meet. China is in fact already suffering from an increasing crime wave, even in more prosperous Guangdong. If, after the death of Deng Xiaoping, the economy is forced to slow down because of overheating, the result will probably again be, as it was the last time this was attempted towards the end of

1989, a squeeze on private enterprise, with greater job losses in the private sector.

The response of the state has been to try to crack down harder to prevent chaos. China has been growing more 'legalistic' - in the Chinese rather than the Western sense. This means a reliance upon legal instruments simply to maintain order, rather than establish justice. Arbitrary and, by Western standards, excessive punishments may be used, even the death penalty, provided they restrain disorder, whether or not they conform to the principles of justice. These punishments can be imposed for 'economic crimes', as well as for extreme violence against the person.

In one sense of course, this is an issue for the Chinese government itself, rather than for foreign governments, although the PRC has signed the UN Convention on Human Rights and therefore other governments are entitled to consider China's performance in this respect as an indication of her more general readiness to comply with international agreements. If Henan province, for example, executes 240 people on one afternoon for economic crimes as it did in 1993 after finding them guilty the same morning, that could be said to be their affair.

To some extent, of course, these are issues which will be of greater significance for national governments rather than the EU, since it will be national domestic media and interest groups which will raise these kinds of issues. Insofar as the European Commission has focused more upon economic issues, it is not called upon to pass judgement in these matters. Nevertheless the European Parliament has commented on various aspects of China's human rights record, and no doubt the Commission cannot ignore

that. And perhaps some encouragement could be drawn from the success of the French government in increasing their share of EC exports to the PRC between 1989 and 1991, despite a much more openly critical stance towards the regime which had shot students around Tiananmen Square than some other European governments took.

It is important to try to establish fora for dialogue with Chinese officials where they can be helped to understand why such issues are a matter of legitimate concern for Western governments and citizens, and why Western governments cannot simply ignore them. And it is also important for the Chinese government to understand that these are concerns which will be shared by all European governments. It will not simply be the case that only the more 'antagonistic' towards China will allow them to be taken up, thus letting the PRC attempt to play off one country against another. At the same time, such fora could be an important channel for reassuring the Chinese leadership that the West is not aiming at sowing discord inside China, of deliberately and aggressively pursuing the 'peaceful evolution' of China as the PRC leadership sometimes presents it, or of promoting the disintegration of China, as allegedly some Western powers were trying in the early part of this century.

However, the issue will become more sensitive for European governments if and when their own citizens fall victims of arbitrary arrest and extreme punishment. For Britain and for Portugal, the issue is complicated by possible treatment of the inhabitants of Hong Kong and Macao both within the former territories and on the mainland after their reversion to the mainland. European governments will either have to protest about

inhuman treatment of their nationals, thereby reopening the arguments of the nineteenth century about special treatment for foreigners inside China and extra-territoriality. Or they will have to protest about the general practices of the Chinese government in law enforcement, which will arouse complaints from the Chinese side about interference in their internal affairs.

Another dimension of the human rights problem concerns religious believers. Whether it be underground Catholic or evangelical believers, or the Dalai Lama, or Muslims in the north and north-west, organisations in western Europe will increasingly take up their cause and expect official support. How far governments and other official organisations will be ready to respond to the pressure of citizens' groups take up the cause of forcible sterilisations and other inhumane practices, sometimes against religious believers or ethnic minorities, by a Chinese government which is faced by apparently insuperable problems in restraining its population growth will cause particular dilemmas.

The problem for EU governments, however, is compounded by the fact that chaos in China would certainly cause enormous difficulties for neighbouring states. Thus conniving with any attempts to undermine governmental authority in china would also cause enormous difficulties. The dilemma, therefore, is how to encourage and promote gradual change inside China, and strengthen certain functions of the Chinese government, without stimulating excessive violence, either from the government or the people.

Conclusion

The particular dilemma facing officials charged with devising a fuller and mutually beneficial relationship with the

PRC is that on the one hand the European partners wish to enhance economic cooperation and also smooth the transition to a different power configuration in world affairs as economic and political might develops in East Asia. Yet at the same time, it is very difficult to predict where the PRC is going over the long term, and so it is difficult to devise a strategy that would be best fitted for cooperation in that transition. And there are domestic issues inside Europe where the EU needs the cooperation of PRC officials in dealing with them, e.g. the increasing numbers of Chinese refugees who try to reach the EU across Eastern Europe (one estimate is that there are always 20,000 Chinese awaiting help to enter the EU illegally from Prague. Even more ironically for those with a sense of history, it is now Europe which needs the assistance of Beijing in trying to stem the influx of drugs.

Yet although the dilemmas are great, there is also a reassurance about this. In the absence of an 'obvious' future path for China, her partners can pay more attention to maintaining their own values and looking to the long term, i.e. 20-25 years.

In terms of economics, it is quite likely that the Chinese leadership will respond positively to overtures for a better working relationship with Europe, as a way of avoiding too great dependency upon the US markets and US pressure - as Taiwan has already begun to do. And if that is the time-scale which should be adopted, then a policy or set of policies directed at Chinese youth would seem particularly appropriate. After all educational opportunities in China for young people remain limited - more limited than in most of China's neighbours. And it is largely

thanks to the energies of young people that China's private sector has become as vigorous as it has. If that is where China's future lies, it would be as well for the EU to try to get close to them and establish a favourable image as widely as possible.

APPENDIX 1: NATIONAL SHARE OF EC TRADE WITH THE PRC (in %): EXPORTS

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Belgium/Luxembourg	10.7	4.5	4.3	5.4	10.2	8.7	8.9	4.9	5.6	4.3	5.1	5.1	5.2	7.1	5.1	6
Denmark	0.4	0.8	2	1.7	6.7	2.5	2.6	1.8	2	2.9	1.9	1.3	1.5	1.5	1.4	1.5
France	10.4	11.8	12.6	12.8	16.9	18.4	11.3	14.2	10.4	13.2	13.7	22.5	21	19.9	16.1	11.9
Germany	52.1	51.8	47.4	47.6	42.9	43.9	37.9	40.7	44.7	43.5	41.1	35.6	37.2	35.3	42.7	43
Greece	0.1	0.1	0.5	0.5	0.1	0.2	1.2	0.9	0.5	0.3	0.3	0.4	0.5	0.4	0.2	0.4
Ireland	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.2	0.1	0.3	0.3	0.2	0.1	0.1	0.2	0.2
Italy	9.8	9.6	10.5	15.5	10.6	10.8	16.2	14.5	15.8	17	19.2	17.9	14.5	18.1	17.1	18.3
Netherlands	7.1	5.5	6.1	4.6	3.3	5.4	6.1	4.4	3.2	2.8	3.8	3.4	2.9	4.3	5	5.2
Portugal	0.2	0	0.1	0.3	0.3	0.7	0.6	0.2	0.4	0.3	0.5	0.3	0.5	0.4	0.2	0.3
Spain	3.5	4.4	2.7	3.5	5.6	4.5	6.8	8.7	5	4.8	3.2	3.3	4.5	4.6	3.4	4.8
UK	9.2	15.7	16.3	11.8	9	10	15.5	9.4	12.3	10.6	10.8	9.9	12.1	8.2	8.6	8.3

APPENDIX 2: NATIONAL SHARE OF EC TRADE WITH THE PRC (in %): IMPORTS

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Belgium/Luxembourg	3.7	4.2	6.8	6.8	6	4.7	4.6	4.3	5.1	3.5	3.1	2.8	2.4	2	2	2.9
Denmark	2.6	2.4	2.5	2.5	2.5	4	4.1	3.7	4.7	4.1	4.1	3.4	2.6	2.9	2.9	1.1
France	18.6	17.7	17.8	19.9	18.8	18.1	17.5	16.8	17.3	18.5	18.7	18.8	18	17.8	18	17.7
Germany	30.2	28.9	30.7	30	30.2	32.1	33.8	29.3	30.5	32.4	31.9	33.7	39.5	41.3	38.5	40.1
Greece	0.2	0.5	1	0.8	0.9	1.1	0.8	0.7	0.7	0.7	0.9	0.9	1	1.1	1.2	1
Ireland	0.5	0.5	0.5	0.5	0.5	0.6	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.8	1.2
Italy	16.4	21.4	16.6	15.7	18.4	17.3	17.1	20	16.6	17.2	18.5	18.4	14.9	13.5	14.3	12.5
Netherlands	10.4	8.4	10.4	9.6	8.2	7.4	6.6	6.4	6.6	5.9	6	5.5	5.9	6.1	4.8	7.1
Portugal	0.2	0.2	0.3	0.4	0.4	0.3	0.3	0.3	0.4	0.7	0.8	0.5	0.6	0.5	0.6	0.4
Spain	5.6	7.2	4.5	4.3	4.3	3.5	4.5	4.6	5.9	5.5	5	5.8	6.1	6.8	8.3	6.5
UK	17.6	15.9	13.6	14.3	14.6	14.7	14.8	13.3	11.6	10.8	10.2	9.5	8.5	7.4	8.6	9.6

Source: International Monetary Fund Direction of Trade Statistics Yearbook (various years)

APPENDIX 3: NATIONAL SHARE OF EC EXPORTS TO HONG KONG (in %)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Belgium/Luxembourg	15.7	14.4	12.9	10.9	11.7	9.4	7.7	7.7	7.3	8.3	8	8.8	7.9	8	8.5	8.5
Denmark	1.8	1.6	1.5	1.6	1.7	4.2	3.4	2.3	2.7	3	2.1	2.3	1.9	2.3	2.1	1.5
France	10.6	10.5	9.2	10.5	9.8	10.7	12.4	12	12.5	14/4	15	14.8	14.1	13.5	14.9	14.9
Germany	23	21.4	19.6	19.7	19.1	19.9	19.7	21.3	22.5	22.3	23.6	24.6	23.4	23.2	19	22.6
Greece	0.1	0	0	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3
Ireland	0.2	0.3	0.2	0.4	0.4	0.5	0.8	0.7	0.5	0.7	0.8	0.7	0.9	0.8	1	0.9
Italy	9.2	9.9	8.9	10.1	10.7	11.3	11.7	13.4	13.9	14.4	15.8	17.6	17.8	17.2	19.5	18.8
Netherlands	6.3	5.5	4.5	4.5	3.8	4.8	5.1	4.7	4.8	4.1	4.9	4.1	4.9	5.1	5.6	5.5
Portugal	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.2	0.4	0.3	0.2	0.2	0.2	0.2	0.2
Spain	1.7	1.2	1.3	1.2	1.4	1.5	2.6	2.3	1.9	2.1	2.7	2	2.2	2.8	2.6	2.8
UK	33	36.4	43.3	42.2	42.7	39.3	39.1	35.2	33.6	30.2	26.8	24.8	26.5	26.8	26.5	24

APPENDIX 4: NATIONAL SHARE OF EC IMPORTS FROM HONG KONG (in %)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Belgium/Luxembourg	5.8	6.2	4.8	5.1	4.6	3.7	3.9	3.4	3.3	4.1	4.5	5.4	5.1	5.4	6.2	8.6
Denmark	2.6	2.3	1.9	1.9	2.2	1.9	2.1	2.1	2.2	2.3	2.2	2.1	1.7	1.6	1.6	3.9
France	5.8	6.9	7.4	7.9	8.4	7.4	7.9	8.1	8.3	9.7	9.2	8.3	7.7	7.3	7.2	5.2
Germany	37.9	35.7	34	32.4	34.1	32.6	32.8	31.7	32.8	32	29.7	28.8	32.5	32.2	23.2	22.3
Greece	0.6	0.5	0.5	0.4	0.5	0.3	0.4	0.4	0.4	0.5	0.8	0.7	0.7	0.7	0.6	1.3
Ireland	0.7	0.8	0.8	0.9	1	1.2	1.7	1.4	1.1	1	1.1	0.7	1	1.2	1.4	1.3
Italy	3.6	4.5	5.5	5	4.9	4.5	4.6	5	4.2	5	4.3	3.9	3.1	3.4	3.6	2.1
Netherlands	8.1	7.4	6.9	6.5	7	6.8	7.1	7.3	6.9	7.8	8.2	7.8	9.2	8.7	11.6	13.6
Portugal	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.2	0.3	0.3	0.2	0.3	0.4	0.4	1.7
Spain	1.7	2.1	2.4	2.5	2.6	2.3	2	2.5	2.9	3.3	3.4	3.2	2.3	2.9	3.1	1.7
UK	35	35.9	38.1	39.9	37.2	41.6	39.5	38	37.7	34.1	36.3	38.6	36.5	36.1	41.1	38.3

APPENDIX 5: NATIONAL SHARE OF EC EXPORTS TO TAIWAN (in %)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Belgium/Luxembourg					3.6	4.9	5.5	9.3	7.5	7.3	7	7.5	6.5	6.4	5.8	6.6
Denmark					2	2.4	2.6	2.6	2.3	1.8	1.9	1.8	1.8	2	1.8	1.6
France					21.9	17.8	12.9	11.9	12.7	12.3	12.6	16.4	14.6	14.7	15.3	11.6
Germany					38	38	41.1	41.1	41.7	40	34.5	37.3	39.6	39.5	40.2	39.9
Greece					0	0.1	0.2	0.1	0.2	0.2	0.4	0.4	0.2	0.2	0.3	0.2
Ireland					0.5	0.4	0.4	0.6	0.6	1	1.1	0.7	0.5	0.6	0.7	1
Italy					8.4	10.1	11.3	9.8	9	11	11.5	12.3	11.9	10.9	11.3	13.7
Netherlands					9	10.6	10.6	10	11.8	11	15.2	8.4	10	10.1	10.4	11.1
Portugal					0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.2	0.3
Spain					0.9	1.6	2.3	2.1	2.5	2.4	3.2	3.2	2.1	1.9	2.1	2.7
UK					15.5	13.8	13	12.2	11.6	12.9	12.3	11.8	12.5	13.6	12	11.4

APPENDIX 6: NATIONAL SHARE OF EC IMPORTS FROM TAIWAN (in %)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Belgium/Luxembourg					3.9	3.8	3.5	4.5	3.8	3.5	3.1	2.9	2.7	2.6	2.5	3.7
Denmark					1.7	1.8	2	2.1	2.4	2.3	2	1.8	1.7	1.7	1.9	1.3
France					14.2	12.4	12.2	12.5	14.9	15.6	15.8	16.1	15.6	15.6	15	15
Germany					34.5	35.3	33.4	31.9	31.6	30.2	28.9	28.7	32.5	34.7	33.2	34.8
Greece					1.2	1.2	0.9	1	0.9	1	1.3	1.6	1.4	1.2	1.2	1.1
Ireland					0.7	0.8	1.2	1.2	1.3	1.4	1.1	1.1	1.3	1	1.2	1.7
Italy					9.4	7.7	8.5	9.5	9	9.4	9.8	9.5	9.6	9	9.2	7.2
Netherlands					9.6	10.2	11.1	10.8	10.3	9.8	10.5	9.7	9.4	9.6	9.6	12.1
Portugal					0.5	0.5	0.5	0.4	0.6	0.7	0.6	0.8	0.9	0.9	1	0.9
Spain					2.7	2.1	2	2.5	3.9	5.1	6	6.5	6.8	7.6	8.1	5.5
UK					21.8	24.4	24.7	23.7	21.5	20.9	21	21.3	18.2	16	17.1	18.8

APPENDIX 7: EC BALANCE OF TRADE WITH THE PRC (in Millions of US \$)

EC	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
	694	1035	-216	-425	-341	54	218	2513
Belgium/Luxembourg	160	52	-76	-57	64	100	129	139
Denmark	-24	-21	-18	-27	75	-36	-31	-10
France	-27	12	-164	-236	-101	17	-130	282
Germany	628	959	337	248	151	307	187	1359
Greece	0	-7	-14	-11	-19	-22	11	25
Ireland	-5	-6	-10	-12	-8	-10	-10	-5
Italy	-12	-118	-183	-70	-218	-149	11	204
Netherlands	9	3	-126	-148	-126	-46	0	54
Portugal	2	-3	-4	-4	-3	10	7	3
Spain	-2	-5	-54	-36	-12	25	71	341
UK	-38	160	37	-113	-160	-107	52	119

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
EC	2297	485	-947	-2258	-5601	-9967	-10801	-7301
Belgium/Luxembourg	149	67	109	101	58	153	43	205
Denmark	-68	-60	-188	-227	-222	-385	-431	-13
France	-45	-252	-516	-164	-807	-1628	-2107	-2076
Germany	1612	869	323	-630	-2374	-4536	-3795	-2531
Greece	2	-18	-49	-62	-85	-166	-219	-145
Ireland	-16	-17	-40	-49	-77	-105	-132	-226
Italy	327	67	-126	-448	-858	-1019	-1307	-121
Netherlands	-62	-169	-204	-264	-532	-734	-500	-772
Portugal	7	-22	-33	-28	-33	-48	-91	-46
Spain	83	-18	-166	-303	-442	-823	-1327	-696
UK	3309	36	-57	-184	-229	-675	-933	-878

APPENDIX 8: EC BALANCE OF TRADE WITH HONG KONG (in mlns US \$)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
EC	-802	-1511	-2181	-1577	-1107	-1512	-1201	-514
Belgium/Luxembourg	165	119	135	91	161	105	67	130
Denmark	-36	-52	-53	-37	-40	35	14	-5
France	55	-9	-110	-47	-49	-22	45	93
Germany	-618	-910	-1177	-886	-830	-847	-793	-522
Greece	-16	-18	-26	-18	-17	-13	-15	-10
Ireland	-15	-25	-34	-29	-31	-39	-49	-29
Italy	89	74	-20	68	120	122	163	263
Netherlands	-103	-161	-221	-159	-175	-158	-146	-125
Portugal	2	2	0	-1	-2	-3	0	0
Spain	-12	-58	-54	-78	-64	-56	-9	-18
UK	-322	-529	-676	-560	-248	-693	-487	-291

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
EC	-1714	-1889	-1918	-1355	-1315	-1343	415	1555
Belgium/Luxembourg	111	151	148	179	171	159	280	112
Denmark	-18	-3	-43	-9	-5	36	60	251
France	34	77	222	359	431	469	848	1376
Germany	-992	-1143	-992	-700	-1184	-1259	-346	384
Greece	-17	-27	-60	-57	-60	-58	-47	-123
Ireland	-40	-35	-39	-31	-21	-50	-46	-34
Italy	336	427	702	950	1186	1213	1702	2258
Netherlands	-209	-351	-390	-382	-480	-444	-592	-864
Portugal	-7	-3	-2	-4	-13	-21	-21	-172
Spain	-89	-125	-109	-126	-31	-55	-37	170
UK	-820	-857	-1353	-1537	-1310	-1332	-1384	-1303

APPENDIX 10: BALANCE OF EC TRADE WITH GREATER CHINA

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
EC	-2729	-2897	-2590	570	-1790	-5602
Belgium/Luxembourg	172	167	169	289	262	213
Denmark	18	-18	-41	-37	-143	-179
France	-222	-106	-269	-370	-417	-955
Germany	-1073	-1009	-1025	-29	113	-1174
Greece	-68	-68	-30	-14	-52	-118
Ireland	-119	-67	-90	-62	-104	-129
Italy	-231	-105	81	337	450	156
Netherlands	-431	-344	-332	-125	-477	-890
Portugal	-17	-4	-5	-7	-23	-71
Spain	-136	-68	33	282	-131	-460
UK	-775	-1300	-933	-710	-1263	-1998

	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
EC	-7457	-7788	-12654	-18551	-16719	-9863
Belgium/Luxembourg	315	410	308	371	431	419
Denmark	-329	-320	-320	-452	-498	-297
France	-1181	-550	-1340	-1107	-2192	-1359
Germany	-1700	-2196	-4986	-7982	-5691	-3124
Greece	-210	-261	-299	-375	-419	-395
Ireland	-125	-154	-215	-263	-286	-392
Italy	212	55	-78	-330	-28	2415
Netherlands	-836	-1178	-1507	-1844	-1664	-2223
Portugal	-81	-97	-129	-179	-239	-305
Spain	-697	-929	-1154	-183	-2350	-994
UK	-2816	-3461	-2934	-3332	-3809	-3609

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BIBLIOTECA

The EU and China: towards the 21st Century
"A view from the private sector"
by Nicolas Maclean

Introduction

The attitude of European business towards China is generally very positive. Although clearly a keen competitor in many sectors, China is primarily viewed as an opportunity rather than a threat. A quarter of the world's population should not be ignored. In most fields the past seventeen years of reform and opening to the outside world have presented real opportunities for business partnership, sometimes through trade, sometimes through investment, sometimes through technology transfer and licensing, sometimes through co-operation in third countries.

There have also been significant changes in the degree of European corporate involvement. China's reputation as a difficult and relatively inaccessible market, where relationships had to be built up over many years and decisions were reached relatively slowly, used to act as a disincentive to involvement by all but very large groups or specialist trading companies.

However, although liberalisation and decentralisation have complicated some aspects of doing business with China, they have undoubtedly opened many more doors, and decisions are often taken much faster than in the pre-1978 period. The appeal of China has therefore widened to include SMEs as well as large companies, and at this stage of China's development most European companies are beginning to realise that the awakening of the sleeping giant has at the very least implications for them and possibly business.

Size and nature of market

It is not only that China's population has now grown to at least 1.2 billion. For many years old China hands pointed to the lack of purchasing power and the illusory nature of many so-called market prospects.

However, not only has the growth rate accelerated markedly during the past seventeen years, but a multitude of separate markets has opened up instead of the carefully controlled national market previously organised by the all-powerful state trading import and export corporations.

Foreign investment now plays an appreciable role in the Chinese economy. There is still a strong wish by the Chinese authorities to manufacture foreign brands under licence or through foreign direct investment but no doubting the taste for the best foreign brands. The inevitably uneven economic development has allowed economic "take-off" to be achieved in the parts of China with the highest economic potential, such as parts of Guangdong, Fujian, Jiangsu and Zhejiang Provinces. It is important to stress "parts of" since Fujian and Zhejiang offer particular examples of the localisation of economic growth. In Fujian there is great prosperity in Fuzhou and the SEZ at Xiamen but many districts of the mountainous, forested hinterland show few signs of a "trickle-down effect".

On the other hand, it is wrong to characterise growth as being focused exclusively in these best-performing areas. The great city of Shanghai, formerly sometimes seen as an example of inner city deprivation, industrial decay, and a hot-bed of revolution, is now at last on the move, helped by being allowed to retain a fairer balance of its net foreign exchange revenues and with strong backing from Beijing for the development of Pudong, (an idea on the drawing-board since the 1920s).

In addition, cities in the North such as Tianjin and Qingdao or the North-East such as Changchun and Dalian are also on the move. Dalian is nick-named the "Hong Kong of the North" or the "mouth of the dragon" of the three North-Eastern provincial economies, not only within its own urban perimeter or in the Liaoning provincial capital Shenyang, but also in Beijing.

Going inland along the Yangtse, Wuhan and Chongqing are also benefiting visibly from the new policies, as is Chengdu, the capital of China's largest province - Sichuan, (population over 120 million).

By contrast, there are other ways of looking at the market for exports to China. For instance, it was long seen as a market for plant and machinery or certain raw materials lacking in China such as copper. Now transportation equipment has risen greatly in the trade statistics, and there is even a growing market for luxury consumer goods to cater for the spending power of China's "new rich". At least 200m of the population are now considered "middle class or above " in terms of their spending capacity and tastes. Armani suits are being bought in Beijing and are freely on display, to take one visible example, another is the proliferation of "XO brandy" advertising on giant bill-boards in all the major cities.

The momentum of growth is such that the benefits seem to be reaching a wider and wider number, as witnessed by consumption of Wella hair products, manufactured locally. One enthusiastic businessman from a pharmaceutical company with a leading brand in its toothpaste division has spoken of his hopes for a market of "over 32 billion teeth", since prosperity and modernisation are leading to greater health consciousness even in more remote parts of the country.

Longer-term forecasts

With a continuation of political stability and commitment to the economic reform process, there is no reason why economic growth could not be sustained at high levels for many years to come. The OECD's forecast that China will become the largest world economy early in the 21st century seems feasible, though there are a number of significant constraints on growth of which Chinese policy-makers are already aware. These relate to population growth, food, energy, and the environment including, in particular, water.

Of great significance to existing and potential European traders and investors is the wish of the Chinese government to achieve full convertibility of the Renminbi as soon as it is safe to do so, possibly before the turn of the century. Convertibility would facilitate many forms of co-operation with China in the economic sphere, and significant steps to form a basis for convertibility have already been taken in the unification of the currency and the completion of price reform over a large proportion of the economy.

Hong Kong and Macau

Hong Kong and Macau are a reminder of Europe's long historical links with China. In 1997 and 1999 respectively they will revert to Chinese sovereignty, with clear commitments by China to their future stability and prosperity under the rule of law.

Hong Kong, in particular, now plays a major role in the world trading and financial system and constitutes a most valuable economic asset for China. There is considerable European, US, Japanese and other international investment in Hong Kong, and both Hong Kong and to a lesser extent Macau offer a gateway to the European business community seeking entry to China, especially in Guangdong Province where Hong Kong companies already employ over 3 million people. Of the

four original Special Economic Zones, three are in Guangdong Province, Shenzhen closely linked with Hong Kong, Zhuhai with Macau, and Shantou a more distant but nonetheless prosperous neighbour. However, economic development and foreign investment has now long since spread beyond the boundaries of the SEZs.

National efforts for trade and investment promotion

In most of the EU's fifteen Member States there are areas of special expertise on China and specific organisations and committees helping the business community develop a more effective partnership with China. In the United Kingdom there were until 1991 two organisations, the Sino-British Trade Council and the 48 Group. These have now combined as the China-Britain Trade Group, an area advisory group of the British Overseas Trade Board.

In France the equivalent body is the Comité France Chine, in Belgium the Belgian-Chinese Economic and Commercial Council, in Italy the Camera di Commercio Italo-Cinese and in Sweden the Sweden-China Trade Council. There seem to be two bodies in the Netherlands, the China Council of the Netherlands Council for Trade Promotion and the AMPEK Amsterdam-Beijing Association, also in Germany the Deutsch-Chinesische Wirtschaftsvereinigung in Köln and the Ostasiatischer Verein e.V.(OAV) in Hamburg. These national EU organisations, and the Wirtschaftskammer Schweiz-China in Zürich, came together in 1992 to form the Euro-China Business Association (ECBA) in an effort to liaise and co-operate more effectively.

ECBA aims to foster the exchange of economic information, to carry out occasional joint activities, and to co-ordinate activities on a European basis. Participation in ECBA does not involve any renunciation of the independence of national organisations, and membership is open to non-governmental organisations from European countries including those outside the EU. ECBA aims to co-ordinate the visits of delegations from China to EU Member States, to prepare and conduct joint

business delegations to China and to organise trade fairs and exhibitions there, and by representing the interests of ECBA members in contacts with Chinese and European authorities to help eliminate discrimination or trade barriers.

These aims are admirable, but it should be borne in mind that most trade and investment promotion is currently carried out at Member State level in accordance with the principle of subsidiarity. Consultation with the business federations of Member States has given evidence that this is how most companies would prefer to keep the position, though this does not preclude ECBA's valuable co-ordination work. Before 1989 an attempt was made in Beijing to establish a joint EU Chamber of Commerce, but the project failed for a variety of reasons. Under the right circumstances a renewed attempt might prove more successful, as has been the case with the highly productive and influential European Chamber in Manila. However, it could be wisest to proceed with caution and to examine in detail the reasons for the earlier failure in Beijing.

During the 1980s the European Commission organised several EC-China Business Weeks, and also a joint seminar in Beijing led by Commissioner Matutas. These events were reasonably successful but rather inchoate. Those companies and individuals best attuned to developing business opportunities in chaos produced practical results but those more used to order found frustration. The lesson is that small-scale seminars, both in the EU and China would be the most effective form of joint promotion in the future and should best be sector-focused. This will avoid many of the horrendous organisational problems which marred the Brussels Business Week jamborees.

EU competition for China business

A principal reason why EU companies still usually opt for promotion at national level is because of intra-European competition. However, the extent of such competition varies from sector to sector and in some such as for aerospace or for power generation cross-frontier co-operation is sometimes taking place.

There have always been problems about attempting to limit competition in project business via a "chosen instrument" approach, and market forces and market experience are in general the best determinants. However, a joint European bid for a major project is often harder to mount on a cross-frontier basis than it is for major competitors in single countries such as Japan or the USA. Greater export credit harmonisation is needed, new co-insurance instruments, or even a revival of the European Commission's 1976 proposal for a European Export Bank to help make Europe more competitive for major joint project bids.

A new factor which results from the growing integration of European economies is that increasing numbers of EU companies are forming joint ventures and alliances to promote third country business. At the same time, integration is reducing the possibility in some sectors of mounting a project bid based on the productive capacity of one Member State alone. This is a further pointer to the need for better support mechanisms on a pan-European or co-ordinated European basis.

In the end an effective EU approach to business in China will rely more on European Commission and Member State policies to promote global competitiveness than on any attempts to restrain competition between European companies in China. Substantial structural reforms are still needed within Europe to restore competitiveness on a durable basis. The excessive weight and cost of the State in national economies still needs to be scaled back, European labour markets made more flexible, and entrepreneurship promoted in SMEs and more generally.

Investment promotion and industrial co-operation

In terms of investment promotion, UNICE, as spokesman for European business, has stated that it sees benefit in the Commission's exploring with Member States the creation of a new scheme to provide overseas investment insurance against political risks when EU companies from more than one Member State plan joint investment in some Asian countries. Such a scheme could be helpful in China, and such a guarantee would complement existing national schemes and the limited private market.

The European Community Investment Partners scheme helps to promote the participation of European business in the world's emerging markets, and its continuation and financial strengthening has been called for by the European business community. Opportunities abound in China for using the support of the ECIP scheme, since there are many interesting investment projects and a willingness at EU Member State level to co-finance and act as channel for the ECIP scheme, unlike, for instance, the case of Mongolia where ECIP availability is hampered by lack of national partners. All Member States should be encouraged to follow the lead of official development finance bodies such as the Deutsche Entwicklungsgesellschaft in acting as catalyst and partner for investment in China.

As for industrial co-operation, it is primarily the responsibility of companies themselves. Company managers must make up their own minds whether or not it is in the interest of their company to associate with a Chinese company.

The EU's role in this area must therefore be limited to encouraging and stimulating contacts between companies, especially SMEs, for whom information flows on potential partners may be less readily accessible. Improved information flows on the strengths and characteristics of each partner can be most helpful in order to identify complementarities which can come into play in joint trade and investment projects.

Development assistance and economic co-operation

Successful economic development is seen as the most effective means to increase stability and prosperity and hence to achieve sustainable poverty alleviation. China provides many good examples of successful ODA projects at national and European Commission level, as well as where companies or individual consultants from Member States work through IFIs such as the World Bank, Asian Development Bank or UN agencies. Prosperity in China will offer more scope for European trade and investment.

ODA in the form of technical assistance to help the structural reform of the Chinese economy and institution-building in sectors where Europe has areas of special expertise such as financial markets is especially to be encouraged. Training schemes leading to professional qualifications in those professions where European standards provide a model of global validity, such as training in accountancy, law, and insurance, banking and securities markets skills should be a high priority. Wherever possible, European Commission ODA should complement and enhance Member State budgets. Good liaison on this should be maintained.

The China-Europe International Business School in Shanghai opened by Sir Leon Brittan in November 1994 is a good example of Europe making a positive contribution to the development of human resources in China and a reminder of the vital need for improved international business management skills. European Commission money has been added to by generous corporate donations from many parts of Europe.

In addition, European companies may be able to find ways to finance trade or investment in China, or technical assistance projects, through working with partners from other parts of the world involved in development assistance and economic co-operation with China, in particular Japan, with whom some European companies have already worked successfully and whose ODA budget for China is very significant. Opportunities should arise with some of the newly industrialising countries of Asia in a similar way, as they develop and expand their own national aid programmes.

Role for the European Commission

So far this paper has highlighted a number of areas where the principle of subsidiarity should apply, while a number of lower priority roles for Commission involvement have been mentioned in passing. However, the most important role for the Commission to represent all Member States on a joint basis in the economic arena has been left until this point.

This is in the crucial area of multilateral negotiations, as on China's accession to the World Trade Organisation or in bilateral dialogue and negotiations to obtain improved market access and to ensure national treatment and non-discrimination. European business fully subscribes to the wish to achieve "a level playing field" and welcomes China's long-standing belief in "Equality and Mutual Benefit".

European business shares the wish of the USA and Japan to see further liberalisation in China, not for ideological reasons but because this is considered the most likely path to help China raise its people's living standards and thereby enhance global prosperity and political stability. European business hopes that China can as quickly as possible be welcomed into the WTO and is closer to Japan than the USA on the question of transitional periods for adjustment in China. It is welcome news that the USA has dropped its insistence on China being considered "developed", which is patently not the case, though many Chinese industries are now of world standing and

strength, which should be taken into account in debates on subsidy reduction, and the principle of graduation should apply to China as much as to any other country in the world. Graduation is that much harder to define and per capita averages are that much less appropriate given the unevenness of development referred to earlier, a similar problem as in India and Indonesia.

One of the issues which affects the companies of all EU Member States is IPR, and it is vital that the EU's softer and less sabre-rattling stance than that of the USA does not give any undue advantage to US companies.

The MFN clause should apply in all cases, as also existing agreements between China and the European Union on non-discrimination. However, it was noteworthy that the USA signed an IPR agreement before the European Union, and that there has been some reticence in China on the equal applicability to the European Union of this February's IPR agreement between the USA and China.

The European Union also has an important role to play in questions relating to investment conditions in China for European companies, such as regarding transparency and consistency in the Chinese tax system at national and local level or regarding questions of employment practices and conditions.

One of the most crucial areas of unfinished business after the 2,500 days spent negotiating the Uruguay Round is the GATS, and the European Commission's role in negotiating a more open market for financial services and equal treatment for European companies cannot be over-emphasised. Space prevents giving a detailed analysis of issues, but one category of financial business which historically originated in Europe and still has its most significant international activities there is insurance. The Chinese Government has so far invited a leading US and a leading Japanese insurance company to start operating in China on an experimental basis. The US company has already been operational for over two years. It is to be hoped that the Chinese authorities will before too long decide to open the door to long-established

and reliable European partners in this field of business, since they could contribute much to the development of China's capital market and to the modernisation of the Chinese savings, social insurance and pensions sector.

The European Commission's negotiating team doubtless has these points well in mind, but it sometimes seems to the European business community that too much of the EU negotiating profile is "demanding a market share" rather than "offering co-operation and partnership in China's self-interest". Nor does the EU profile always seem as favourable to China as that of the USA in terms of market openness and hence potential reciprocity, whatever the realities of the case. Since perception is often as important as reality, the EU should examine how its image could be improved to reflect its true principles and stance.

A business view on political dialogue with China

A stronger and more positive European image will be enhanced by effective political dialogue and a better understanding in China of the nature and development of the EU. This will in turn help achieve an improved recognition of the dynamism of European business and the value of links with European companies in trade, investment and technology exchange.

Too often US companies have a head start in image terms, regardless of the relevance or competitiveness of particular goods or services, coming as they do from the world's largest and most powerful country.

Regular visits to China by the President of the European Commission, senior Commissioners and officials will all be helpful. In order to improve mutual understanding and promote greater EU-China co-operation, European business is ready to support the political dialogue by strengthening, at horizontal or sectoral level, its relationship with its Chinese counterparts.

Efforts should be made to lay to rest the myth that North America is "closer" to China than Europe. In a world of modern air transport and telecommunications, most European countries are closer to most parts of China than are most parts of North America. This is true in terms of time zones as well as transport time. Perceived "distance" is unhelpful in China's psychological response to Europe and vice versa. This has repercussions on the business community.

The Commission's political role as upholder or proponent of European values in its dialogue with the Chinese Government may not only carry more weight as the combined voice of Europe, it may also help to avoid discriminatory retaliation against any one Member State or its business community. However, Europe's voice will be listened to more attentively by the Chinese Government if it does not feel it is being hectored or forced to accept alien cultural and philosophical traditions or political models. In Asia, "face" and "tone" matter even more than in Europe, and the wrong "form" can vitiate the right "substance". For that reason, European business supports the EU's current co-operative approach towards China. However, if this approach were to lead to less favourable treatment of European business than that obtained by other approaches, the EU should draw the necessary conclusions. While courtesy is always essential vis-à-vis Asian partners, it should never denote a lack of firmness or resolve, or a lack of attention to economic or financial realities.

Science and Technology

The European Union's initiatives to promote science and technology also have a role in relations with China, both in terms of European competitiveness against a gradually more knowledge-intensive Chinese industrial base and in terms of Europe's attractiveness to Chinese companies for partnership, joint ventures or mutually beneficial technology transfer.

European technology centres could play a useful role in key sectors where Europe has a comparative advantage and could help to promote European technology and

services effectively in China. They would also contribute to a better dissemination of Chinese innovations and inventions in Europe and hence offer good scope for future co-operation, both in basic and applied science. It is over thirty years since Europe and the People's Republic of China began to co-operate successfully in science, for instance, in the synthesis of insulin.

Strong emphasis should be placed on fostering contact between young researchers, engineers and technicians in China and the EU as future leaders in economic and technological fields with good potential to improve mutual understanding and enhance mutual interests. However, the language dimension should be taken fully into account.

IPR issues which could have been addressed under this heading were covered under "Role for the European Commission".

Culture and Education

Cultural differences lie at the heart of many of the problems encountered by European companies in developing trade and investment with China. If ignored, the complexity of Chinese culture can seem the biggest non-tariff barrier of all. On the other hand, the most successful European companies have taken full account of Chinese cultural differences and tried to go with the grain of local culture and tradition. The Chinese have long memories for old friends and reliable products and services, but this form of traditional "quality control" also works in reverse!

At Member State level, there should be much greater effort to encourage and fund the study of China and Chinese languages from school level upwards. The European Commission could help direct attention to this issue. Unless work in schools is taken seriously in this respect a crucial opportunity will be missed to change attitudes and prepare Europe's young people for satisfactory contact with China on a broad front. The Chinese communities in Europe are also a valuable asset for building business links and sound relationships, as are the Chinese communities of North America, already mobilised to a greater degree. The Commission places major emphasis on raising the profile of Europe in Asia, but the value of doing much more in Europe first should also be stressed in order to strengthen our base for understanding Asia, its peoples and its markets and economies. Study of China would play a full part in such a focus on Asia.

The establishment of a major centre for the study of Asia, where business communities could meet not only for business and political contacts but also to participate in cultural events, such as has been proposed as "the Asia House Project", should be seriously examined by the Commission and supported if possible. In addition, European companies could benefit from more readily accessible comparative data relevant to decisions where to set up, (eg salary levels, land costs, and guidance on cultural and legal differences on how to recruit and manage local staff).

The European Commission's wish to improve European expertise on China will best be achieved by encouraging the pooling of information and experience by existing academic and other organisations and by providing incentives for them to link up on a joint geographical basis, as is done by the European Association of Chinese Studies, or on a sectoral basis. This will enhance complementarity of research or training experience within Europe, for language and for other aspects. The European business community should benefit from this, though even more should be done to encourage synergy between the business and academic worlds.

EU programmes for enhancing exchanges should be developed on a wide basis, with the greatest emphasis on youth exchange in key business and related fields. In the long run, such programmes should prove even more rewarding and cost-effective than an enhanced "Distinguished Visitors' Programme", as mentioned in the Commission's Asia strategy document of 1994. It is important to make provision for short training courses as well as longer ones.

The Commission's Executive Training Programme in Japan could be extended to other countries of Asia, including China under the right circumstances, but it is most important that attempts should be made to find more cost-effective ways to achieve this, in consultation with the European business community which is sometimes aware of suitable alternative models. Pilot projects should be set up in the chosen countries to avoid expensive full-scale projects until appropriate formats have been found, suitable for each country's environment.

There is often a mismatch between Chinese long-termism and European short-termism. Focusing on the "Chinese boom" ignores the fact that even in China growth has been cyclical and that periods of down-turn in the Chinese economy have sometimes led to loss of interest from Europe rather than better opportunities being seized to establish long-term relations or a long-term presence. To counteract this approach, seminars should be organised at national level but with the backing of the Commission on the benefits of a contra-cyclical and long-term approach by European companies and policy-makers.

Conclusion

In this brief overview of EU relations with China an attempt has been made to make recommendations for the future, as well as to analyse the present position. It is much to be welcomed that the European Commission is seeking the views of practitioners from the business community with long experience of China.

Two thousand years ago intrepid travellers and merchants proved that silk could be transported under appalling conditions from China to Western Europe. In Rome Chinese silk was literally worth its weight in gold, which was then transported with European goods back to China. Thirteen hundred years later Marco Polo and his uncle Nicolo proved that the distance and stress of the overland route were not insurmountable. Now that it is less than ten hours flying time to China from most parts of Europe, how much easier it should be to develop full and mutually beneficial relations.

UK TRADE STATISTICS

	1990	1991	1992	1993	1994	1995 (Jan-Feb provisional)	1994 %
							Change
UK-China Trade (£ million)							
Exports	466	322	430	740	844.9	111.0	141.2 -21.4
Imports	583	707	954	1,327	1641.8	271.1	279.2 - 2.9
UK-Taiwan Trade (£ million)							
Exports	431	520	545	668	735.3	137.7	113.7 +21.1
Imports	1,212	1,272	1,394	1,617	1580.9	234.2	268.0 -12.5
UK-Hong Kong Trade (£ million)							
Exports	1,238	1,387	1,613	2,170	2297.6	357.1	319.0 +11.9
Imports	1,972	2,148	2,397	2,998	3079.6	505.4	491.4 + 2.3
UK-Korea Trade (£ million)							
Exports	621	786	654	796	971.0	183.4	136.4 +34.5
Imports	964	925	934	1,078	1095.2	195.9	187.9 + 4.3

Source: Overseas Statistics of the UK, CDO.

COMPARATIVE PERFORMANCE

Share of OECD exports to China

	1987	1988	1989	1990	1991	1992	1993
Germany	13.0	10.8	10.1	11.3	9.5	11.1	12.8
France	3.9	3.6	6.3	6.6	5.3	4.2	3.5
Italy	5.0	5.0	5.4	4.9	5.1	4.5	5.8
UK	3.2	2.8	2.8	3.9	2.2	2.3	2.5

Share of OECD exports to Taiwan

	1987	1988	1989	1990	1991	1992	1993
Germany	6.0	5.1	5.9	6.6	6.3	6.5	n.a
France	1.8	1.9	2.6	2.4	2.3	2.5	n.a
Italy	1.6	1.7	2.0	2.1	1.8	1.8	n.a
UK	1.9	1.8	1.8	2.1	2.2	2.0	n.a

Share of OECD exports to Hong Kong

	1987	1988	1989	1990	1991	1992	1993
Germany	5.7	5.7	6.1	6.0	5.6	5.9	5.8
France	3.7	3.6	3.7	3.6	3.3	3.4	3.8
Italy	3.8	3.8	4.6	4.9	4.3	4.5	4.7
UK	7.9	6.4	6.2	6.8	6.5	6.1	6.2

Share of OECD exports to Korea

	1987	1988	1989	1990	1991	1992	1993
Germany	5.5	5.2	5.5	6.5	6.1	6.7	7.1
France	2.8	2.6	2.3	2.9	2.8	2.6	2.5
Italy	1.5	1.5	2.0	2.6	2.6	2.5	2.6
UK	2.5	2.3	2.0	2.5	2.8	2.5	2.4

Source: OECD Series A

Exports 1993 (US \$m)

	China	Taiwan	Hong Kong	Korea
OECD	45,102	n.a	51,680	48,900
Germany	5,795	3,515*	3,010	3,448
France	1,599	1,105*	1,986	1,202
Italy	2,624	1,205*	2,433	1,263
UK	1,111	1,002*	3,196	1,195

Source: IMF Direction of Trade Statistics Quarterly, June 1994
* OECD Series A

EU-CHINA TRADE (Ecu, million)

	1992		1993		1994	
	Exp	Imp	Exp	Imp	Jan-March Exp	Imp
Germany	2,852	5,523	4,955	6,868	1,341	2,180
France	1,250	1,941	1,338	2,420	303	684
Italy	1,144	2,148	2,108	2,215	481	665
Netherlands	340	1,603	599	1,276	133	455
Bel/Lux	341	1,012	608	1,263	263	414
UK	578	2,672	946	3,509	269	1,052
Ireland	12	140	25	205	6	81
Denmark	98	545	114	502	39	145
Greece	14	184	36	248	1	60
Spain	209	1,031	544	875	149	256
Portugal	14	84	29	157	2	35

EUR 12 6,852 16,783 11,302 19,538 2,987 6,048

Source: Eurostat External Trade

RE-EXPORTS BETWEEN UK AND CHINA VIA HONG KONG

HK \$millions	1989	1990	1991	1992	1993	1994
UK Imports via Hong Kong	7,825	10,794	13,221	19,107	22,901	23,262
UK Exports via Hong Kong	1,945	2,027	2,397	3,321	7,781	5,056

Source: Hong Kong Census and Statistics Dept

China Desk
NORTHEAST ASIA TRADE UNIT
January 1995

**OVERSEAS INVESTMENT IN CHINA : 1979-1993
(TOP TEN INVESTORS WORLDWIDE)**

	Country	Projects	Pledged Investment (US\$m)	Utilised Investment (US\$m)
1.	Hong Kong/ Macao	114,147	150,932	-
2.	Taiwan	20,982	18,437	5,055
3.	USA	12,019	14,659	5,237
4.	Japan	7,812	8,935	5,203
5.	Singapore	3,122	4,847	931
6.	UK	616	3,013	578
7.	Thailand	-	-	-
8.	Canada	-	-	-
9.	Germany	553	1,453	527
10.	Australia	-	-	-

Source : MOFTEC Foreign Investment Administration

* Includes capital pledged in previous years.

INVESTMENT IN CHINA BY EUROPEAN UNION COUNTRIES : 1993

Country	Projects	Pledged Investment (US\$m)		Utilised Investment * (US\$m)	
		1993	% 93/92	1993	% 93/92
1. UK	388	1,988.52	+597.39	210.51	+467.15
2. Germany	320	249.88	+ 91.83	56.25	- 36.49
3. France	305	236.23	- 18.50	141.41	+214.48
4. Italy	241	233.68	+126.00	9.88	+742.91
5. Netherlands	109	151.69	+268.53	34.00	+195.35
6. Belgium	68	87.84	-	27.74	-
7. Luxembourg	6	13.11	-	1.50	-
8. Spain	107	5.90	-	9.60	-
9. Portugal	5	2.43	-	0.27	-
10. Ireland	3	2.15	-	-	-
11. Denmark	30	1.68	-	4.15	-
12. Greece	1	0.35	-	-	-
<hr/>					
Total EU	1,583	2,972.96	-	545.31	-
<hr/>					

Source : MOFTEC Foreign Investment Administration

* Includes capital pledged in previous years.

INVESTMENT IN CHINA BY EUROPEAN UNION COUNTRIES : 1979-1993

	Country	Projects	Pledged Investment (US\$m)	Utilised Investment * (US\$m)
1.	UK	616	3,013	578
2.	Germany	569	1,458	527
3.	France	547	920	602
4.	Italy	467	552	397
5.	Netherlands	191	406	176
6.	Spain	168	289	24
7.	Belgium	100	137	67
8.	Denmark	51	102	53
9.	Ireland	8	49	5
10.	Luxembourg	13	15	2.3
11.	Portugal	9	5	0.3
12.	Greece	2	0.5	—
<hr/>				
	Total EU	2,741	6947.5	2,441.6

Source : MOFTEC Foreign Investment Administration

* Includes capital pledged in previous years.

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BIBLIOTECA

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China and the WTO:
The Role of the European Union

Rohini Acharya
Royal Institute of International Affairs
March 1995

Introduction

The historical economic and political relationship between China and the European Union (EU) is long standing and has been less turbulent than recent Chinese relations with the United States. The Chinese leadership has tended to regard the European Economic Community and now the European Union, as less hostile towards China and in general as a positive influence (from the Chinese perspective) in the Western Hemisphere. It is therefore only natural that during this difficult period when China is making an important transition, both politically and economically, that the EU should play a major role in hastening China's entry onto the international stage. The prospect of accessing a market as large as that of China's is only one of the major challenges facing European companies today. The interest generated by the opening up of the Chinese market is evident from the number of European companies investing in China, a rate which may well rise with the participation of China in international trade agreements and the World Trade Organisation in particular.

Although China has had observer status at the General Agreement on Tariffs and Trade (GATT), since 1982 and is a signatory to the Multi-fibre arrangement, regulating trade in textiles and clothing, its application to become a contracting party to the GATT and later a founding member of the World Trade Organisation has created considerable problems for China and for the world community. It is after all in the interest of both that China joins the WTO. With an average growth in exports of around 13 percent during the last decade, China has become an important player in the international economy. Its expanding trade has however been a cause for concern among its trading partners, resulting often in the erection of a number of trade barriers especially against labour intensive goods such as clothing and footwear. The benefit to China of joining the WTO would therefore be a considerable reduction in both tariff and non-tariff

barriers¹, while for the world community allowing China entry to the WTO would to some extent regulate China's export expansion in a fair and orderly manner.

Despite these obvious benefits, talks between China and the WTO have been stalled until recently because of what China calls unfair demands, especially by the US. These include substantial changes in legal, institutional and economic arrangements covering a wide range of activities including trade and investment.

The central issue examined here, is that of China's entry into the World Trade Organisation, the major obstacles it faces and the role that the European Union can play in easing some of these obstacles. The problem appears to be less the apparent unwillingness of China to change its trade policies, but more a general difficulty faced by state trading nations to enter a forum which is in principle based on reciprocity and non discrimination. The paper therefore begins with a brief introduction of the problems faced by state trading nations such as China in entering the GATT and the WTO. Section II looks in brief at the changes that are required of China as a precondition to its entering the WTO and examines to what extent these conditions may or may not have been fulfilled to date. Section III then moves on to examining the relationship between the EU and China and suggests possible options for the EU *vis a vis* China's entry into the WTO. It is argued that China has liberalised both its trade and investment laws considerably in the last decade, and that although both the EU and the US maintain that China is pursuing a mercantilist policy by aggressively promoting exports and restricting imports, there is insufficient evidence to support this. If anything, the extent of quantitative restrictions placed on China's exports by its trading partners implies a high degree of protection against Chinese exports. In fact, trade with China should be promoted, not only by insisting on liberalisation of investment laws in

¹ Even if countries decided to raise trade barriers, the WTO process ensures that the country in question would have to consult with China or make use of the dispute settlement mechanism in the WTO. Whatever the route used, the benefit to China would be a fairer process before a decision is made to impose trade barriers.

China as is the EU's policy at present, but also by reducing the extent of quantitative restrictions on China's exports to the EU, especially manufactures. This is followed by conclusions and some thoughts on the negotiating process and prospects for China joining the WTO.

1. Reconciling Differences: State Trading Nations and the GATT

The GATT which was the precursor of the WTO was established in 1947 and in its subsequent multilateral trade negotiations, has succeeded in reducing tariff and non-tariff barriers, especially among the industrialized countries, significantly. The GATT and the WTO are clearly based upon the principles of fair and reciprocal trade. The rationale behind reducing trade barriers is the neo-classical principle that an economy free of distortions such as tariff or non-tariff barriers ensures an efficient allocation of resources based on comparative advantage. The principle of comparative advantage has remained a strong one despite new branches of economic thought which argue that in some cases it may not be in the best interest of a country to remove trade barriers ².

When the GATT was conceived, the major state trading nations such as the Soviet Union and China chose not to participate in the international economic market and the GATT. It was certainly hard to imagine then that China would become as dynamic a force as it is today. The principles of the GATT and those of state trading nations therefore remain considerably incompatible today. The basic differences lie in two principles of the GATT, those of Reciprocity and the Most Favoured Nation (MFN) clause. Both are important founding principles of the GATT.

² The new 'strategic trade theory' for example, which is often attributed to Brander and Spencer (in Krugman, 1986), argues that in some cases, especially in high technology sectors, where absolute rather than comparative advantages are more important, there *may be* a rationale for providing support through subsidies or taxes. A number of studies since then have argued against this, most notably Eaton and Grossman (also in Krugman, 1986), who have shown that a change in the assumptions made by Brander and Spencer would substantially change this result.

The principle of reciprocity argues that any tariff reductions offered by trading partners must be reciprocated in kind, i.e. by an equivalent tariff reduction which is offered to all contracting parties to the GATT (article I). The second problem is that of non-discrimination between contracting parties to the GATT. Any trade concessions granted to one country have to be extended to all other contracting parties to the GATT negotiations, again rather unclear within the framework of state trading nations.

The domination of the state in international trade in countries such as China basically implies that the government has a monopoly and uses quantitative restrictions to control the flow of imports, which is inconsistent with the principle of national treatment as outlined in article III of the GATT. This is also a violation of the GATT's article XI which forbids quantitative restrictions, although market-oriented economies, including the EU have used and continue to use quantitative restrictions fairly extensively. A related problem is the definition of tariff and non-tariff barriers where tariff barriers as defined by the GATT tend not to be widely present in state trading nations ³.

The problem in the past therefore, has been one of definitions and of reconciling the two systems. The original charter of the International Trade Organisation (ITO)⁴ however, does contain provisions for the accession of state trading countries, including the need for negotiating adequate equivalents for offered trade reductions to other members ⁵. This was indeed the case when Romania and Poland entered the GATT. Neither country had tariff barriers to imports and therefore could not be called upon to offer reciprocal tariff reductions. The special provisions that were therefore adopted, especially for Poland which was the first state trading nation to enter the GATT in 1967, included the country accepting a 7 percent increase in annual tariffs for an initial

³ Pisulla (1991), p 192.

⁴ Originally conceived after the second world war but was replaced by the GATT when the ITO agreement was not ratified by all member states.

⁵ Brabant (1988), p 14 quoted in Pissulla (1994).

three years after which the situation would be reviewed and changed accordingly. Similarly, provisions were made for protecting the economies of contracting parties in the case of non-tariff barriers. Of all the east European countries to enter the GATT before the collapse of the Berlin Wall and the Soviet Union, Hungary was the only one with a tariff system which was acceptable within the framework of the GATT.

Thus the problem for the GATT is not a new one and in fact, China has the added advantage that MFN treatment is granted to it by the US, when it was initially denied to previous state trading nations when they joined the GATT, with the exception of Poland and Yugoslavia ⁶. However, unlike Poland, which agreed to increase imports from GATT's contracting parties in return for membership, China has argued from the start that it would enter the negotiations on the basis of reductions in tariff levels, as with any other contracting party. The use of quantitative import commitments has also not proved very satisfactory as there are a number of problems associated with setting quotas based on current prices which often cannot be reconciled with a non-convertible currency.

These problems have thus placed pressure on the GATT to ensure that China's economy and especially its tariff barriers reflect a real level of protection, a pressure which has led them to urge China to implement and enforce both economic and legal reforms. The sheer size of the Chinese economy as well as its economic growth rates in the last decade or so, has increased this pressure somewhat, both in order to protect local markets and producers from cheap Chinese exports and also to ensure that the Chinese market is open to goods and services in which its trading partners have comparative advantage.

⁶ China's MFN position as is that of other state trading nations, is reviewed each year by the US because of the Jackson-Vanik Amendment which requires the Administration to consider the human rights and emigration records of countries before MFN treatment is granted.

The most visible push is for China to change its intellectual property rights regime and to enforce these changes, although there are a number of other reforms to the economy that are required by the US as a precondition to China entering the WTO. A first step has recently been taken in an agreement reached on copyright which gives the judicial authorities in China more power to enforce changes in copyright legislation and it is conceivable that enforcement of intellectual property rights will increase ⁷.

Intellectual property rights however are only one of the demands that are being made of China. The next section examines some of the other major requirements of the US and the EU and also lists the changes that have been made by China to date.

2. Preconditions for China's Entry into the WTO: A brief checklist

As mentioned, changes to intellectual property rights, which include copyright, trade marks and patents, are the most visible pressure placed on China by the US. This is however not the only requirement. The US Trade Representative, Mickey Kantor has listed four other main areas where the US would like to see China making rapid changes:

- a) Making more complete disclosures about quotas, procedures and other trade regulations. This would include far reaching structural change by the Central Government to ease imports, for example, the creation of an effective customs service and modifications in the Chinese legal system to facilitate this.

In anticipation of entering the WTO, the Chinese government increased its use of tariffs rather than quantitative restrictions on imports, beginning in the 1980s. By 1992, it was estimated that only about a quarter of total imports were covered by import licenses. In fact tariff exemptions for goods needed for the

⁷ Economist (1994)

high technology sectors in the economy as well as raw materials for the Special Economic Zones and the Economic and Technological Development Zones rose during this period and have formed a major part of the government's "export push" ⁸.

Tariff reduction exercises have also been carried out periodically, most notably in December 1992 when customs tariffs were reduced by an average of 7.3 percent on items representing 53 percent of dutiable goods⁹ and in January 1995 when it was announced that China was cutting quotas and import licences on 283 products and tariffs on a further 234 products¹⁰.

- b) Reforming the foreign exchange system to make the Chinese currency more freely convertible. This is also an important condition laid down by the EU. The Chinese Government in 1994 scrapped its system of dual currency rates to let the Yuan be traded in line with market forces at 8.7 yuan to the dollar, entailing a devaluation of 50% compared with the old official exchange rate of 5.8 yuan¹¹ and declared that the currency would be fully convertible on the foreign exchange market by the year 2000 ¹².
- c) Providing guarantees that Beijing will be able to enforce GATT regulations throughout China, not just at the Central govt level. This has been a major bone of contention between the US and China over intellectual property rights. The Chinese government has said that one of the main problems in enforcement of

⁸ Fukasaku and Wall (1994), pp 31-32.

⁹ Bell, Khor and Kochhar (1993), Footnote 49 on p 34.

¹⁰ "China's shifting wall of trade", *International Herald Tribune*, 3 Jan 1994

¹¹ "Unified yuan rate gets baptized in fire of market", *International Herald Tribune*, 3 January 1994.

¹² "Yuan to be Convertible by 2000", *International Herald Tribune*, 7 March 1994.

intellectual property rights across the country is that it is unable to control pirating activities at the Provincial levels very effectively. It is not clear whether the new agreement on copyright will demonstrate China's ability to enforce regulations at the local level. What is clear however, is that the deal goes some way in satisfying US demands to stop counterfeiting activities in China. Beijing has agreed to close two of the factories accused by the US of pirating software. The Chinese courts have also periodically ruled in favour of foreign companies filing cases of IPR violations in China.

- d) Offering assurances that foreign companies operating in China will receive the same treatment as domestic business. The EU has also insisted that China free up its foreign investment laws especially in key areas such as banking and telecommunications. In fact, foreign direct investment (FDI) regulations in China were eased at a much more rapid pace than in a number of other high-growth or previously high-growth countries including Japan and South Korea ¹³. The absolute magnitude of foreign direct investment in China moreover, exceeds that in Japan, Korea and Taiwan. The establishment of Special Economic Zones in the late 1970s and early 1980s has also enabled foreigners to invest more freely in certain parts of China and investment both by foreigners and by the Chinese has continued despite political upheavals in China in the late 1980s ¹⁴.

Recently, China agreed to resume implementation of its October 1992 market access agreement with the US which it had previously suspended in protest over

¹³ Lardy (1994) estimates that while in Japan, foreign investment was restricted to 49 percent upto 1973 when the Japanese allowed wholly-owned foreign firms in the country, in South Korea, foreign ownership was restricted to a maximum of 50% while a number of sectors were essentially closed to foreigners. South Korea in fact appears to have recently liberalised its FDI laws largely in response to growing FDI in China (see in particular, Chapters 3 and 5).

¹⁴ Fukasaku and Wall (1994)

what it perceived as a US blockade against China joining the WTO ¹⁵. The US has also agreed to consider China's bid for entry into the WTO as a developing country member on a sector by sector basis, i.e., accepting that while some sectors in China are equivalent to sectors in other industrialized countries, others are sufficiently underdeveloped to qualify for exemptions granted to developing countries under the WTO rules. Thus there is considerable flexibility and room for negotiation on this issue between the two trading partners.

It appears that the new agreement will make it easier for China to return to the negotiating table and may make it easier to exact further concessions from Beijing before it joins the WTO. A number of other issues most notably services such as telecommunications and insurance are still considered problematic by the US Trade Representative as well as by the European Union.

Thus on most of these fronts, China is moving gradually towards reform. In fact, observers of the economic reforms and of the changing relationship between China and the US argue, that in some respects China is more open than most other Asian countries even though by and large it continues to protect many of its domestic industries from full exposure to the international marketplace ¹⁶.

2.1. International Trade: China's Interaction with the Rest of the World

It is not just inward investment that has increased. China has used its economic liberalisation policies mainly as a tool to increase exports. As mentioned above, the reduction of trade barriers especially for imports related to high technology sectors and

¹⁵ "US Backs China as Trade Body Founder Member", *Financial Times*, March 13, 1995.

¹⁶ Lardy (1994) argues that if compared to other economies in the region, China is certainly more open at a comparable stage of economic development, and even in general is more open in some regards than they are at present (pp 126-127).

to raw materials destined for the export processing zones has also been used to boost China's exports to the rest of the world.

Table 1. China's foreign trade, 1978-1994
Billions of US dollars¹⁷

Year	Exports	Imports ^a	Trade Balance
1980	18.1	18.29	-0.2
1981	21.56	19.79	1.77
1982	21.9	17.35	4.55
1983	22.2	19.58	2.62
1984	24.98	24.3	0.68
1985	27.56	39.35	-11.79
1986	31.45	39.83	-8.38
1987	39.54	39.81	-0.27
1988	47.54	50.71	-3.17
1989	51.86	53.61	-1.75
1990	61.27	48.19	13.17
1991	70.45	57.40	13.05
1992	80.52	70.05	10.47
1993	90.97	94.58	-3.61
1994 ^b	108.0	116.0	-8.0

Source: International Financial Statistics (IMF)

^a free on board figures for imports

^b based on estimates in Lardy (1994)

¹⁷ Lardy (1994) shows somewhat different figures for the Chinese trade balance (see table 2.1 on p 30), although it is quite clear from both tables that the trade balance has been cyclical with recent years tending to register deficits with the rest of the world more than surpluses.

Chinese exports have risen from US\$ 2.3 billion in 1970 to US\$ 9.8 billion in 1978¹⁸ to over US\$ 100 billion by 1994¹⁹. Imports however have also continued to rise as Chinese demand for industrial raw material has expanded. With a few exceptions, notably 1990 to 1992, China in fact has had a deficit in visible trade in recent years with imports growing slightly faster than exports during the period 1980-93²⁰.

Although China maintains a trade deficit with the rest of the world, it has consistently had a trade surplus with the European Union, Japan and the US, placing successive US and European administrations under pressure to increase exports and market access to China. It has also led to accusations that China has pursued a mercantilist policy, aggressively promoting exports while restricting imports. China's global trade figures (table 1) clearly show that this is not the case and that the country has continued to import at the same or perhaps a greater rate as it has exported (see table 2).

Table 2. Growth of Chinese Trade (1980-1993)
Average annual percentage change

	Exports	Imports
1980-1993 ^a	13.42	15.01
1980-1993 ^b	13.3	13.5

^a Calculated from IMF statistics on trade

^b Calculated by Lardy (1994) based on China's General Administration of Customs Data

Source: Calculated from Table 1 above and Lardy (1994)

¹⁸ Perkins (1992), p 1

¹⁹ Lardy (1994), p 30

²⁰ Ibid, p 31

Nevertheless, the degree of protection in the US and in the European Community continues to be fairly high, especially through the use of non-tariff barriers. A World Bank estimate for example shows that European Union protection using non-tariff barriers such as quantitative restrictions and MFA quotas, covers about 30 percent of all Chinese imports, while protection against manufactures at 48 percent is even higher²¹. The European Union has also argued that it has a right to maintain quantitative restrictions against China even after the country joins the WTO²². Thus the level of restrictions facing Chinese exports to the European Union are unlikely to decline significantly in the future, especially in a situation of high unemployment and considerably overvalued exchange rates in the community.

Despite this, China's exports to countries of the OECD have continued to increase rapidly although there is some disagreement on the actual levels of these exports. Estimates range from Chinese statistics of 9 percent of total Chinese exports going to North America and 10 percent to Western Europe, to 25 percent and 19 percent respectively from alternative sources²³. The issue of China's trade, especially with the EU and with the US is enormously complicated by the presence of Hong Kong. It is estimated that as much as two-fifths of Chinese exports to Hong Kong are re-exported to these two parts of the world. However, because the Chinese trade and customs authorities have no record of what happens to goods after they have been exported, it is difficult to estimate what the true value of Chinese exports to the EU and to the US are. In the context of the European Community, the result is a considerable discrepancy in reported trade statistics. This is discussed in more detail in the next section below.

²¹ World Bank (1993), p 148

²² Lardy (1994), p 45.

²³ Finger (1992).

Nevertheless, despite these difficulties in measuring the actual size of exports, the numbers are clearly large and make it all the more obvious that a country as economically significant as China should indeed be part of the WTO. The next section examines the relationship that has developed between the EU and China and argues for the EU to increase its participation in the effort to integrate China into the world economy and the WTO.

3. The Relationship between the EU and China

The formation of the European Economic Community (EEC) came at an important time for China. In the years after China's break from the Soviet Union, China increasingly became isolated and came to regard the US and the Soviet Union as the two great polar powers in the world. Western Europe, along with other countries, especially among the developing world were perceived as being less extreme both politically and economically and the leadership could maintain relations with them without being seen to be making too many compromises.

In the years immediately following the Cultural Revolution, the first overtures were made to the European Economic Community when China extended an unofficial invitation to the Vice-President of the European Parliament. This was supported, although more cautiously, by a new relationship with the US which culminated in the visit later by US President Nixon to China in 1972. The relationship with the US has continued to be more volatile, especially as for many years the US's special relationship with Taiwan was considered to be a threat to China and appeared not to accept the idea of "one China".

It was felt by the Chinese authorities that the formation and strengthening of the EEC formed an important third power in a bi-polar world and they welcomed this

development. The formation and expansion²⁴ of the EEC was also seen as a weakening of US influence in this part of the world²⁵. It also meant that there was less chance of the Soviet Union exerting its influence on Western Europe. Thus, in general, the formation and expansion of a trading area in Western Europe was seen as a positive development internationally and more specifically, a good thing for China which was looking to expand economically.

The invitation to the Vice-President in charge of foreign affairs in the EEC was made in 1973 and began a series of contacts between the EEC and China, culminating in an agreement to negotiate a trade agreement with China. The path to establish economic relations with China had been eased by the Nixon visit to China which implied a warming in the relations between those two countries and the EEC was aided further by its new mandate which allowed it to negotiate commercial agreements on behalf of member countries from 1 January 1975. The prospect of a growing market in China which was increasingly dominated by the Japanese and the US was also a positive factor in increasing the interest both of the EEC and also of individual companies in EEC member states, in developing commercial relations with China. In early 1976 official talks between China and the EEC to conclude a trade agreement were initiated and in early 1978 the first trade agreement between the EEC and China was signed. At the time, the EEC was China's second largest trade partner, behind Japan. This is no longer the case.

3.1. Trade with China

Although trade between the two has expanded since then, the EU presently registers a trade deficit of approximately Ecu 10 million (1992 figures) with China. The deficit

²⁴ Most notably the successful entry of Great Britain into the EEC in 1971.

²⁵ Official Journal of the European Communities (1978), p 5.

has declined somewhat in 1993 although it is not clear whether this implies a continuing trend in this direction (see table 3 below).

Table 3. The EU's Trade with China (12 member countries)
(mil ECU)

Year	Imports	Exports	Trade Balance
1980	1,974	1,784	-90
1981	2,393	1,967	-426
1982	2,446	2,165	-281
1983	2,768	2,896	128
1984	3,323	3,765	442
1985	3,936	7,180	4,244
1986	4,223	6,533	2,310
1987	5,239	5,533	294
1988	7,005	5,802	-1,203
1989	9,149	6,369	-2,780
1990	10,603	5,318	-5,285
1991	14,937	5,605	-9,332
1992	16,781	6,848	-9,933
1993	19,538	11,302	-8,236

Source: Eurostat: External Trade Statistical Yearbook, Various Years

It does appear however, that while China's exports to the EU have continued to increase, EU exports have tended to remain stagnant in absolute terms with the exception of the last few years. It is not clear how much of this is due to non-tariff

restrictions on the part of China or simply reflects China's comparative advantage in labour intensive products ²⁶.

However, if one examines EU trade with "Greater China" which includes Taiwan and Hong Kong, the EU's trade deficit with China is not as large, since imports from Taiwan have actually declined while imports from Hong Kong have not grown at the same rate as exports to Hong Kong.

Table 4. The EU's Trade with Hong Kong and Taiwan
(1984-1993 million ECU)

Year	Imports	Exports	Trade Balance
1984	9,047	4,938	-4,109
1985	8,816	6,842	-1,974
1986	10,002	6,692	-3,310
1987	12,133	8,195	-3,938
1988	14,384	11,232	-3,152
1989	15,691	12,229	-3,462
1990	15,075	11,519	-3,556
1991	17,453	13,446	-4,007
1992	16,621	15,030	-1,591
1993	16,988	18,872	1,884

Source: Eurostat: External Trade Statistical Yearbook, 1994

The reason for this is probably because of declining production of labour intensive products in Taiwan and Hong Kong as companies from these two regions relocate or

²⁶ Lardy (1994) argues that the latter is more likely to be the case, especially in light of the degree of relocation of labour intensive industries in the region to China as the foreign investment regime in China becomes more liberal.

invest in China. Table 4 shows that the EU has had a relatively steady trade balance with Taiwan and Hong Kong, even registering a net surplus in 1993.

Thus, these two factors, first that Hong Kong plays a major role in trade between China and the EU, and second that firms in Hong Kong and Taiwan are increasingly relocating to China, considerably complicate the magnitude of trade imbalances between the two regions. It is likely therefore for the reasons mentioned above, that the EU's trade deficit with China is in fact smaller than actually reported in EU trade figures.

Table 5. The US's Trade with China
(US\$ million)

Year	Exports	Imports	Trade Balance
1980	3,754	1,058	2,696
1981	3,603	1,865	1,726
1982	2,912	2,284	628
1983	2,173	2,244	-68
1984	3,004	3,065	-61
1985	3,856	3,862	-10
1986	3,106	4,771	-1,665
1987	3,497	6,293	-2,776
1988	5,012	8,511	-3,490
1989	5,775	11,990	-6,235
1990	4,806	15,237	-10,431
1991	6,278	18,969	-12,691
1992	7,418	25,728	-18,309
1993	8,767	33,730	-24,963

Source: Lardy (1994) and Direction of Trade Statistics (IMF), 1994

In contrast, the trade figures between China and the US in table 5 show that trade between these two countries has expanded considerably and is much greater than trade between China and the EU.

Once again, the presence of Hong Kong as one of the main centres through which trade with China is channelled, complicates these figures considerably. Nevertheless, despite the EU being larger than the US in terms of GNP, its trade with and especially imports from China are considerably lower implying considerable room for change in the EU's external trade policy with China.

3.2. Foreign Investment in China

Since Deng Xiaoping's accession in 1977, the Chinese government has made a conscious decision to integrate the country more into the international economy. Two key methods appear to have been used in this. The first, already identified above, was a vigorous promotion of exports and trade links with other important parts of the world. The second was an experimental easing of government involvement in certain parts of the economy. The setting up of Special Economic Zones where foreign companies could invest relatively free of the restrictions that applied in the rest of China was a first step in this gradual opening, culminating finally in a unification of its dual exchange rate to a freely floating currency. China's plans to make the Yuan fully convertible by the year 2000 will considerably ease foreign investment in the country.

The changes to investment policy implemented over the years have found a lot of appeal among foreign investors although a further opening up is still desirable. Last year for instance, China recorded a net inflow of almost US \$ 26 billion in foreign investment in 1993. Investment by European companies has also risen considerably, although the US and Japan continue to be the leaders. Hence, it would be desirable for European companies to expand further into the growing Chinese market. Investment

therefore, as Sir Leon Brittan has made quite clear a number of times, is the key to improving economic relations with China and is being pursued quite seriously by the European Union ²⁷.

The European Union's position on China has been less openly aggressive than that of the US during the course of the debate on allowing China to join the WTO. While in the US there is, every year, a detailed debate about renewing China's Most Favoured Nation status, linking commerce with immigration policy, as required by the Jackson-Vanik amendment to the Trade Act of 1974, the European Union's Trade Commissioner has made it clear that human rights and other economic problems associated with China's entry into the WTO should be delinked. Sir Leon Brittan has gone on record as saying that the WTO issue should not be linked to human rights and that the European Union required China to make commitments to further liberalisation while recognising that China could not implement all these changes by the time it joined the WTO²⁸. Ensuring that China made these commitments when it became a member of the WTO would however be a first step in getting China to implement these reforms.

While the European Union has been willing to de-link China's record on human rights (although relations between the European Parliament and China were broken off for a period after the events in Tiananmen Square in 1989) with the question of its entry into the WTO, it is not clear that the EU's commercial policy toward China will be significantly liberalised. While it has been made clear to China that a substantial relaxation of investment restrictions is required before the EU agrees to China entering the WTO, the EU has also maintained the right to impose anti-dumping and other quantitative restrictions on China even after the country joins the WTO. In addition,

²⁷ The Trade Commissioner has made it clear during his frequent visits to China, that services and investment remain the two major stumbling blocks in an agreement with China (see for example his speech in Shanghai on 7 November 1994).

²⁸ "China may enter GATT this year", *Financial Times*, 2 March 1994.

the initial stage of phasing the MFA out shows that industrialized countries may still be relatively unwilling to reduce non-tariff barriers against developing countries²⁹. Anti-dumping and other quantitative restrictions as pointed out above also remain a problem for relations between the EU and China. There are therefore a number of problem areas in which the EU can take the initiative which would not only ease China's entry into the WTO but which may also result in greater concessions from China in the process.

4. China's Entry into the WTO

As the brief description of the relationship between the EU and China presented above has made clear, China has always appeared to desire a 'special relationship' with the European Union, although the question of Hong Kong and negotiations with the UK on its return to China have made for a relatively tense relationship in recent years. Trade with the US has also expanded at a faster rate than it has between the EU and China. Nevertheless, the combined GNP of the European Union as well as its enlargement continues to hold special interest for China which is one of the fastest growing economies in the world today.

With an economy the size of China's moreover, it is clear that it is not in the best interest of the other members of the world economy to exclude China from an organisation such as the WTO which would effectively ensure fair as well as free trade. Allowing China into the WTO without ensuring that it fulfils the requirements of all contracting parties to the Uruguay Round would however also not be realistic. The problems of reconciling the differences between state trading countries and the market, remain. It must however be remembered that this is not a new problem and that the contracting parties to the GATT have in the past allowed state trading countries entry

²⁹ There is some evidence to show that the Commission in fact would like to accelerate the pace of this phase-out although it probably faces a great deal of opposition from some member states on this.

into the GATT under specific circumstances, most of which have to do with lowering import barriers, both non-tariff as well as tariff.

There are two problems associated with the application of a similar requirement of China. First, China has foreclosed the option of using previous requirements of state trading nations, such as those used with Poland before, by declaring that it will only consider reducing tariff barriers. The GATT has therefore insisted on a number of changes to the Chinese economy which would ensure that prices reflect the market and that tariff barriers are realistic measures of the degree of import restriction. The second problem, which has complicated the first, is that of the insistence, notably by the US that China enters the WTO as an industrialized country although China insists that it should be granted the exceptions given to developing country contracting parties to the agreement. Not only would this give China GSP (Generalized System of Preferences) privileges as for other developing countries, it would also give the country a breathing space of at least 4 years and in some cases, 10 years to change its policies, instead of making immediate adjustments as is required of industrialized country signatories to the Uruguay Round.

On this latter point, as is the case with US trade negotiators, officials in the European Commission appear to take the position that China clearly falls somewhere in between these two extremes. Parts of the country have high levels of industrialization whereas other areas clearly register per capita income levels equivalent to those of least developed countries according to the World Bank's statistics. Thus, a realistic assumption is that China would be allowed to enter the WTO, and would be allowed a few years of delay to make changes required by the Uruguay Round, although not as much as granted to developing countries.

The EU has also made it clear that it regards currency convertibility as a litmus test for China's commitment to liberalisation which in turn is a condition for entry into the

World Trade Organisation. Furthermore, China's efforts to ease investment for foreigners, albeit in restricted areas, are also in keeping with European desires to increase investment in China. This is also one of the US conditions. Although the reforms implemented by China have been slow, there is no doubt that they have been consistently directed towards an opening of the economy. In fact, it has been argued that China's economic success, to a large degree, can be attributed to this consistency in policy, gradual though it may have been ³⁰. Current political speculation points to the dangers of this policy being halted in its tracks, as a new regime takes over in Beijing. This makes it all the more imperative for the European Union to express its support for the present liberalisation policy in China.

The fear that many have is that once China joins the WTO it will automatically be granted privileges such as MFA and GSP if it enters as a developing country, while reneging on its present commitments. This is largely unjustified and an insufficient reason for holding China back from joining the WTO. There are two reasons for this: first, the dispute settlement mechanism grants considerable power to the WTO to authorize trade sanctions against China if it violates any commitments. This is a far stronger instrument given to the WTO which was not available to the GATT. Second, the US in March 1994, obtained formal approval from the GATT for a strengthening of the non-application rule which allows members to deny access to the WTO to a new member state. Whereas the rule in the GATT only gave contracting parties this weapon before any tariff negotiations with the new member had begun, the new amendment to this rule allows countries to deny membership *even after* the negotiations have started. The two trade retaliation instruments, well within the rules of the WTO, basically ensure that China, or any other country, cannot get away with a violation of its commitments. Failing this, the US and the EU have also made it clear that they intend to continue using non-tariff barriers against Chinese goods that they believe are being dumped on their markets.

³⁰ Fukasaku and Wall (1994).

A number of problems also remain from the Chinese perspective, including the use of quantitative restrictions by the EU and the US, as well as the current debate on environmental and labour standards which is being introduced into the WTO by the industrialized countries ³¹. The methodology used by the EU to determine dumping has also been questioned in a number of cases especially against countries of east Asia, including China³².

Nevertheless, China's increasing pragmatism is evident from the number of recent concessions that have been granted bilaterally to the US. The EU to a large extent appears to have been left waiting in the wings as these bilateral agreements have been signed although this need not be the case if China signs a multilateral agreement under the auspices of the WTO.

Conclusions

The fact that China has, since 1977, continued to slowly liberalise and open its markets, although at a slower pace than the countries of the former east bloc, is surely evidence of its commitment to economic change.

The European Union, by accepting the commitment that China has made to opening up, would send a signal to the US and other members of the WTO, that the reforms made by China are a start, if not sufficient, and an acknowledgement of China's importance to the world economy, just as China's policy to a large extent has acknowledged the importance of the world economy to China.

³¹ Cable and Ferdinand (1994).

³² See for example, Hindley (1994) on this.

Now that the US has indicated that it may be willing to consider China's application in part as a developing country, there is even more reason to hasten the process. It is clearly unrealistic to expect China to make further changes within the time frame given to other industrialized country economies which require far less adjustment and change than in China. Continued quantitative restrictions as well as the potential use of labour and environmental standards also creates a danger of rising protectionism in industrialized countries against imports from developing and industrializing countries and the EU should work towards recognizing these dangers and reducing quantitative restrictions such as anti-dumping duties which were almost 50 percent on Chinese manufactures in the early 1990s. Finally, the EU's position in the negotiations which are scheduled to begin in April, should therefore be one of recognition of the changes made by the Chinese authorities, and an acceptance that China is perhaps less of a threat as it is perceived, inside, rather than outside the WTO.

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BIBLIOTECA

TOWARDS A COMMON EUROPEAN UNION POLICY IN RELATION TO CHINA
- A PORTUGUESE PERSPECTIVE

I.E.E.I. INSTITUTO DE ESTUDOS ESTRATÉGICOS INTERNACIONAIS , LISBOA

MIGUEL SANTOS NEVES

1. INTRODUCTION

The People's Republic of China (P.R.C.) initiated in 1978 a major process of economic reforms with a crucial political aim, to secure the regime's legitimacy basis. The economic reforms based on (i) the introduction of market mechanisms (ii) decentralization of economic management (iii) a gradual integration in the world economy through the promotion of exports and attraction of Foreign Direct Investment, were successfully implemented and led to an impressive economic growth rate during the 80's, around 9 per cent p.a., and the early 90's. The reforms created also some problems which threaten the future stability, mainly related to the recurrent inflation pressures, the infrastructural bottlenecks, the poor macroeconomic management, increasing tensions and inequalities between provinces and regions, and increasing pressure for political reforms as the power and autonomy of civil society grew.

The European Union (E.U.) relations with China have been dominated by economics and are characterized by the predominance of bilateral policies of individual Members States and a lack of a common strategy. The relations were negatively affected by the E.U. response to 1989 events which pushed China to reinforce its links to Southeast Asia in the early 90's.

For the E.U. the major challenge ahead consists in trying to revitalise E,U,-China relations and indeed to start building a common, more coherent and long term strategy towards China.

This paper is concerned with the question of knowing to what extent a common policy is possible and to what extent there is room for reconciling different economic and political Member States agendas.

It starts with a brief analysis of a specific Member case, the Portuguese policy towards China emphasising the specific relation which derives from the Macao process. The second chapter is concerned with the identification and interaction between the relevant conditioning factors which might constraint or facilitate the task of formulating and implementing a common policy.

Finally the last chapter addresses the question of guiding principles and priority issues to be considered in the formulation of an effective and pragmatic policy.

2. THE PORTUGUESE POLICY TOWARDS CHINA

2.1. The Portuguese foreign policy has been consistently based, since the democratic transition, on three basic pillars which include, in order of priority, Europe and the integration in the European Community, the Atlantic and Lusophone Africa. The relations with Asia are not recognised as a priority issue and there has been a lack of a clear policy and strategy towards the region.

This tendency seems to be a consequence not only of the overwhelming concentration of portuguese resources and attention

in the European process but also of factors related to the geographic and cultural distance and the fact that many Asian countries, in particular the Newly Industrialised Countries (Nic's) are perceived as direct and hostile economic competitors. China can be regarded as a relative exception to this tendency, in particular since Macao's process of transition began in 1987 following the signature of the Joint Declaration on the future of the Territory. In spite of that, bilateral relations with China, both political and economic, remain modest, relatively unbalanced as they tend to be dominated by political relations given the very low intensity of economic ones; and highly concentrated in the Macao negotiation process.

At the political level the present Government's foreign policy guidelines, as stated in the 1991 Government's programme approved by the Parliament, do not include either Asia or China among its major objectives, in contrast with the attention attached to Africa and Latin America.

However, the Programme makes a reference to the " specific relation which is to be maintained and developed with the People's Republic of China(PRC) with a view to the stability and development of the Macao Territory " ¹ thus recognizing the relevance of bilateral relations but simultaneously restricting its scope to the Macao process and the single objective of securing the stability and development of the Territory.

The economic relations between China and Portugal have been

¹Programa do Governo Constitucional, Novembro 1991, p:30-31.

traditionally very modest both in terms of trade and foreign direct investment (FDI) flows. This trend is not likely to be reversed in the near future considering that, like in the political sphere, the Asian region and China in particular, are not considered priorities in the context of the strategy to promote the internationalisation of the portuguese economy. In fact, in the "Programme of Support to the Internationalisation of Portuguese Firms"² there is not a single reference to Asia and the Asian markets which were surprisingly left out from the list of priority target markets, for the promotion of trade and portuguese direct investment, which includes the OECD, Eastern Europe, the Maghreb and Southern Africa.

In terms of trade the global level is relatively low reaching Ecu 173 millions in 1993. The recent evolution has been characterized both by an expansion of imports from China and the deepening of the portuguese trade deficit.

In terms of imports from China they have been growing constantly between 1987 - 1993 at an average rate of 35% p.a. with an important acceleration in the early 90's, increasing from ECU 50 million in 1990 to ECU 148 million in 1993. These imports, which are basically composed of raw materials (cotton), artificial flowers, toys and electrical products are marginal in the context of portuguese foreign trade accounting only for 0,3% of total imports in 1991 and 0,4% in 1992.³

²Council of Ministers resolution n° 27/92 of July 1992.

³Eurostat and Instituto de Estatística - Estatísticas Comércio Externo 1990,1991,1992.

As regards portuguese exports to China, the evolution has been less positive as there has been a declining trend between 1990 and 1994 with the exception of 1993 when they reached a total value of ECU 25 million. These exports are highly concentrated in a small number of products, in particular copper, wood products, cork and more recently transport vehicles, and its weight in total portuguese exports is negligible accounting for 0,2% of the total in 1991 and 0,1% in 1992.

In what concerns the global trade balance there has been a persistent trade deficit for Portugal which increased rapidly since 1990, in particular between 1992 and 1993, as a consequence of the joint effect of rapid growth of imports from China and the decline of the portuguese exports to China.

As regards foreign direct investment, the flows between the two countries are insignificant. The Chinese investment in Portugal is the dominant component but in spite of the recent increase in 1992 and 1993, represented less than ECU 1,7 million in 1993, accounting for less than 0,2% of total FDI in Portugal. As to the Portuguese direct investment in China, it has been almost inexistent between 1990 - 1993⁴.

In the last two years there have been visible efforts on the part of Portugal to strengthen political bilateral relations following an important change in the Portuguese strategy in two directions. Firstly, the investment in the improvement of political relations

⁴ICEP - Investimentos, Comércio e Turismo de Portugal 1994 (data on authorized FDI)

as a means of obtaining economic advantages and a better deal to Macao clearly demonstrated not only by the intensity of high level State visits on both sides since 1993 but also by the portuguese attitude within the Joint Liaison Group (J.L.G.) and the Macao Government Approach. Secondly, there is an attempt to delink the Macao and Hong Kong transition processes, through the adoption of a different negotiation strategy in contrast with the British line, motivated by two objectives: on the one hand gaining additional autonomy for Macao which remains highly dependent on Hong Kong, on the other, to limit the negative impact on Macao of a potential unsuccessful transition in Hong Kong.

Two crucial events favoured the emergence of the Portuguese line. Firstly the 1989 events and the E.U. response based on a policy of sanctions and political isolation of China was not entirely adopted by Portugal, on the grounds of the special relation the country maintained with China because of Macao.

In contrast, Portugal supported a more flexible approach, expressing some critical views regarding the use of sanctions⁵ and did not suspend J.L.G. contacts and work, thus keeping a door open in a context of considerable international isolation of China.

Secondly, the new British strategy in relation to H. K. negotiations and the conflict over democratic reforms contributed

⁵Reference is made to the Portuguese Prime Minister statement of April 1994 "At the moment the remaining E.U. sanctions to China are not justified". Newspaper Expresso.

to establish a contrast with Macao's negotiation process.

Portugal adopted a different and to some extent softer approach for objective reasons - the Macao system is more advanced and includes already an element of direct elections both for the Parliament and Local Governments - as well as for strategic reasons, given the small weight of Macao and Portugal's limited bargaining power. However, the Portuguese authorities have argued that a softer public approach does not mean larger concessions and more flexibility in relation to key issues at the level of J.L.G. negotiations.

2.2. MACAO'S TRANSITION PROCESS

Macao's transition process started in mid 1987 with the signature of the Chinese - Portuguese Joint Declaration and the institutionalisation of the Joint Liaison Group as the permanent negotiation structure responsible to prepare the transition due to last until 1999.

For obvious reasons Macao's transition has been genetically linked and strongly conditioned by the Hong Kong process, given the strategic weight and priority of the former and the fact it started earlier, in two different ways. Firstly, in what concerns the definition of the basic institutional framework and the key principles of the transition process the Joint Declaration on Hong Kong was used as a rigid model for setting up the Joint Declaration on Macao. Secondly, in what refers to the outcome of the negotiation process in relation to specific

topics, the fact that Hong Kong negotiations are 2 years ahead imply that the work of Macao's J.L.G. is considerably conditioned by the solutions previously adopted for Hong Kong, reducing the "room for manoeuvre" of portuguese negotiators.⁶

In spite of this high level of dependency it is possible to identify two different phases in Macao's process of transition.

The first phase which corresponds to the period 1987-1992 is characterized by a strong dependency on the evolution and contents of Hong Kong negotiations. Macao is basically perceived as a non-autonomous satellite of Hong Kong which in turn is regarded as the leading development pole in the Pearl River Delta. The Portuguese strategy was basically aimed at securing that it would not get a worse deal than Hong Kong while attempting to get some recognition and autonomous solutions for some specificities of Macao, namely issues relating to nationality, legal system and localization of high ranking officials.

The second phase beginning in 1992 has been characterized by the search for more autonomy for Macao and the attempt to delink Macao and Hong Kong processes. This tendency was facilitated by a set of favourable conditions. Firstly, the main obstacles to the construction of major infrastructures in Macao - in particular the international airport - were removed, thus

⁶Most information elements contained in this section were obtained from diplomatic sources, namely those working in the J.L.G., in the context of interviews conducted by the author in the Ministry of Foreign Affairs.

contributing to reduce the dependency on Hong Kong and to consolidate Macao's comparative advantages. Secondly, China initiated a strategy aimed at diversifying economic relations in order to reduce the dependency of its process of reforms on Hong Kong, a tendency which was clearly accelerated by the growing risks of an unsuccessful transition. As a result there has been an active policy to promote new development poles in different coastal areas. It is in this context that Macao starts to be referred to by Chinese authorities as a potential leading pole for the East Pearl River Delta and a crucial pillar of the triangle Macao-Canton-Zhanjiang and perhaps Hainan in the near future. Moreover, Macao is regarded as a privileged link with the E. U. taking into account the potential of the 1993 Cooperation Agreement between Macao and the E.U.⁷

In spite of these attempts to delink and to secure a smoother and more positive transition for Macao, it seems clear that they will have a very limited effectiveness. In fact, given the still high dependency ratio on Hong Kong and the fact that its negotiation process is already well advanced, a negative evolution of Hong Kong will inevitably have a very strong adverse impact on Macao even if it evolves positively.

The J.L.G. negotiations have been dominated by a set of fundamental topics the majority of which have a permanent nature: (i) Legal system translation into chinese, (ii) Pension Fund and financial reserves, (iii) Nationality issues, (iv) Localization

⁷ Please refer to statements of Zhuoyun Xu (Director of the Planning Commission of Guangdong Province) to the newspaper Expresso 24.12.1992 and Wang Dingchang to Expresso 23.4.1994.

of high-rank positions in Public Administration, (v) Macao's International Statute, (vi) Currency.

In addition specific topics such as those relating to Macao's International Airport and the Orient Foundation emerged from time to time.

The topics mentioned under (i), (ii), (iii), (iv) together with the International Airport and more recently the Orient Foundation have consistently been the most difficult issues in relation to which progress tended to be slower.

3. TOWARDS A COMMON E.U. STRATEGY

3.1. CURRENT E.U. - CHINA RELATIONS

The E.U. - China relations have been traditionally characterized by the predominance of economics and of the bilateral and autonomous policies of a few E.U. Member States. The absence of a common, or at least a coordinated approach, with the exception of the trade sector, was therefore a permanent feature.

More recently there has been a change in the picture. On the one hand the political dimension became more important as a result both of the 1989 events and decision of the Madrid Summit to impose economic and political sanctions, and the evolution of the negotiations on Hong Kong.

On the other hand there is an increasing recognition of the

limitations associated with an approach solely based on bilateral policies of individual State Members and the need for a common approach in order to strengthen the E.U. position in China. Thus, a need for a common approach became more evident as a consequence of: (i) the reinforcement of the regional blocs logic as a structuring principle of world economy future organization requiring a new and active E.U. strategy aimed at strengthening its position inside the other regional integration areas; (ii) China increasing potential role as a preferential E.U. partner in the region given its interest in limiting Japan's influence and maintaining an autonomous strategy; (iii) the increasing competition from U.S.A. and Japan for a strong position in China.

The economic, in particular commercial relations, have been the dominant dimension of E.U. - China relations. The basic framework for economic relations was in first place the 1978 Trade Agreement which was replaced in 1985 by the Commercial and Economic Cooperation Agreement. The former was restricted to trade relations and included both fundamental clauses namely most favoured nation, safeguards, balance of trade and prices clauses and specific provisions on the protection of intellectual property and trade promotion. The 1985 Agreement while retaining most of the contents of the 1978 Agreement, expanded the scope of relations to economic cooperation in almost all areas including industry, agriculture, energy, transport and communications, science and technology.

Under these two instruments there has been a positive evolution in the trade between the E.U. and China. In the period 1978-92

the volume of trade rose from ECU 2,5 billion to E.C.U. 23,6 billion. The E.U. became recently China's third trade partner behind Hong Kong and Japan but in front of the U.S.A..

In spite of this steady tendency for trade expansion the distribution of benefits has been uneven. Between 1979 and 1984 there was a balance in the trade between the two parties followed by a period characterized by China's trade deficit. This tendency was reversed since 1988 when a new period started characterized by a persistent E.U. deficit with China. The deficit has been increasing over the years, in particular in the early 90's, reaching nearly ECU 10 billion in 1992 and showing a slight tendency to decrease in 1993^a.

In fact imports from China mainly composed of textiles and clothing, have been growing very rapidly in contrast with E.U. exports to China, mainly composed of high-tech products and equipment, which tended to stabilise or even move downwards since 1985.

From China's perspective the importance of the E.U. as a market for its exports is somehow limited. However, there are important differences between Chinese statistics which estimate a share of 9 percent and E.U. statistics which estimate a share of almost 20 percent^a.

^aEurostat

^aSee Kichiro Kukasaku and Mingyuan Wu OCDE Technical Papers n°:89 China as a leading Pacific economy, 1993.

In spite of a general interest of E.U. Member States in the Chinese market -given its size, the high economic growth rates- the relative involvement in trade with China varies. Taking into account the data available for the period 1990-93¹⁰ it is possible to distinguish two different groups among E.U. Member States: major trading partners and medium trading partners. The first group includes 4 countries - Germany, France, Italy and the United Kingdom - which accounted together for 60 percent of total E.U. imports from China in 1992 and 85 per cent of total E.U. exports to China in the same year. Germany is by far the most important chinese trade partner followed by the U.K., France and Italy.

The second group has less intense trade relations and includes three countries - the Netherlands, Belgium and Spain, which accounted for 22 percent of total E.U. imports from China and around 13 percent of total exports to China in 1992.

In what regards F.D.I. which has been an important element for chinese economic reforms and economic success, the E.U. has a modest position behind Hong Kong and Macao, Taiwan, Japan and the U.S.A.. In 1992, the E.U. accounted for 1.7 percent of total F.D.I. inflows in China, a share which could be higher as the figures for H.K. include also investment from European countries, against 70 percent for Hong Kong and Macao, 6.4 percent for Japan and 4.6 percent for the U.S.A.¹¹

¹⁰Eurostat

¹¹China Statistical Yearbook and Intertrade Monthly (MOFTEC), n°4, 1993.

Among the E.U. Member States Germany is presently the most important investor in China in terms of flows while the U.K. has still a very prominent position in terms of stocks accounting in late 80's for 28 percent of total E.U. stock. The list of major E.U. investors, in a global context of a very modest level of European F.D.I. includes also France, Italy and Spain.

However it should be mentioned that, in spite of a limited quantitative weight, some E.U. Joint Ventures, namely German and French, are in a good position in strategic markets as the automobile market. In fact Shanghai Volkswagen corp. was identified in 1992 as the leading firm in terms of level of sales among the top 10 Joint Ventures in China which includes also in fourth place Guanzhou Peugeot Co.¹²

The basic framework for investment relations with China are the set of investment protection bilateral agreement concluded by Member States with China, basically inspired in the model provided by the agreement signed between Germany and China in 1983.

32. Conditioning Factors for the Definition of a E.U. Common Policy Towards China.

The definition of a coordinated E.U. strategy towards China has to start from the analysis of the conditioning factors some likely to facilitate the process and others to hinder it.

¹²Wall Street Journal 13th December 1993.

As regards the conditioning factors likely to help the formulation and implementation of a coordinated policy aimed at strengthening the relations with China, 3 major aspects should be mentioned. Firstly, on the E.U. front there is a clear consensus regarding the need to promote a transition from a traditional reactive to an active strategy in relation to other regional trade blocs namely Asia where the E.U. presence is less visible. In addition the new CFSP framework provides specific instruments to build that common approach. However, in this respect it should be considered at present that Asia and China are not included among CFSP priorities and might remain excluded in the near future. Moreover, the argument that the "common action" mechanism in its actual format could be more a mechanism to prevent rather than to promote action can also apply.

On the China front, the Chinese strategy of diversification of relations aimed at reducing the risk of becoming too much dependent on Japan's economic power or indeed on any of the 3 main external factors (Japan, USA and E.U.), favours the conditions for a successful expansion of European interests. Secondly the extremely positive economic performance and good perspectives for sustained economic growth in the future motivate European businessmen facilitates the task of conciliating different E.U. Members' interests as there will be more benefits to distribute.

In what concerns other external actors the very active strategies of Japan and USA in relation to China contribute to change the scope and level of complexity of the E.U. strategy which has to

take into account not only China's objectives but also the relative strategies of other major external actors. This circumstance presses for a more coherent coordinated and long term E.U. approach.

In what concerns the factors which are likely to create more obstacles to the formulation of a common policy the following aspects should be considered.

Firstly, the heterogeneous nature of E.U. Member States' interests as well as the various degrees of involvement in China are likely to create some obstacles. As mentioned earlier a variety of situations can be identified: (i) countries which have important economic interests but less important political motivations like Germany, France and Italy which dominate trade and investment flows with China; (ii) countries with both strong ^{economic} and political interests like the United Kingdom which has special responsibilities in relation to Hong Kong; (iii) countries with strong political interests and limited economic interests like Portugal which regards Macao as the core of its strategy; (iv) countries that have moderate economic interest like Spain and Belgium ; (v) countries with no specific relevant interest in China.

From the above account it is possible to foresee potential contradictions arising at 4 levels: a) between those with well established economic interests and those attempting to enter the market; b) between economic interests related to trade and those related to F.D.I.; c) between economic interests and the

political concerns of the 2 E.U. Members involved in the transition process of Macao and Hong Kong; d) between those driven by short-term pragmatic business interests and those more concerned with the support to the development process and to democratic transition.

The intensity of the conflict between these different perspectives tends to be attenuated by 2 basic factors thus facilitating the process of synthesis: on the one hand it is easier to conciliate divergent interests in a context of economic growth as the one that tends to prevail in China; on the other the fact that no single E.U. actor has a very strong position in absolute terms implies fewer risks and allows for more flexibility.

Secondly, following the Tiananmen crisis and the path of western reactions to it, there has been a fundamental policy change in China which tends to have a negative impact on E.U. interests: the decision to reinforce regional links and improve relations with East and Southeast Asian countries, as a way of reducing the risks of isolation and the dependency on western partners. As a consequence, in a short period China established or renewed relations with South Korea, Thailand, Indonesia, Singapore, Malaysia with a double objective: explore the complementarities between East Asian countries; reinforce the economic role of overseas chinese communities in those countries by promoting closer regional economic linkages. One of the direct effects of this change has been the growth of border trade between inland

provinces and neighbouring countries¹³.

Thirdly, the way in which the long-term chinese strategy has evolved seems to point to a relative marginalization of the relations with the E.U.. According to some observers China's strategy includes 3 types of triangular relationship between China and its partners: (i) the "small triangle" which includes China, in particular Guangdong, Hong Kong and Taiwan also known as Greater Hong Kong; (ii) the "middle triangle" including China, the four little dragons (H.K., Taiwan, Singapore and South Korea) and Southeast Asia; (iii) the "big triangle" involving China, Japan and the United States.

This system is supposed to work in an articulated and sequential manner in that each level prepares the following one be reinforcing the competitiveness and integration of the economy until the full integration in the world economy occurs at the level of the "big triangle". In this context the E.U. role seems to be uncertain in spite of the signs that some participation in the consolidation of the "small triangle" is likely to occur.

In sum, a careful analysis of the conditioning factors in order to identify both the opportunities and the constraints to the formulation and implementation of a common E.U. policy towards China is a necessary condition for the design of an adequate pragmatic and flexible policy. The following chapter addresses the question of the principles and guidelines which might be

¹³See Goodman, D. and Segal, G. (eds.) China Deconstructs: Politics, trade and regionalism pp:177-201.

considered in the formulation of such a policy.

4. PRINCIPLES AND GUIDELINES FOR A COMMON E.U. POLICY TOWARDS CHINA

The idea of developing a common E.U. policy towards China as a short term objective seems to be a rather ambitious proposition. A more realistic analysis suggests that a more gradual approach has to be followed and that, in the short term, it will only be feasible an improved coordination between Member State policies as a preliminary stage to the definition of a common policy. This coordination could be promoted through the definition of a set of long-term and broader objectives specific to China which would constitute the fundamental reference for decision-making. Simultaneously, coordination could also be stimulated through the promotion of the exchange of information and of co-financing.

In addition, the formulation of a common policy is not restricted to the reconciliation of interests but includes two different and complementary tasks: to identify and promote common interests; to harmonize contradictory interests;

The development of a common policy has to be based on the characteristics of the policy object , the other party and the prevailing environmental conditions which, in turn, determine the adoption of a specific set of principles that should guide policy formulation and implementation.

Firstly, given the heterogeneity of interests between Member

States it is necessary to start building on common interests. Under the present circumstances that could mean identifying a set of issues which all Member States could identify as a common problem such as the correction of the growing trade deficit with China or the support for China's adhesion to the G.A.T.T..

Secondly, the policy has to be built on the knowledge of the most experienced Member States in the region because of historical links, like in the case of Portugal, or an accumulated experience in the economic area. This option contributes to a more effective policy given the assets related to a better knowledge of (i) the market and local business culture;(ii) institutional and bureaucratic procedures;(iii) Chinese cultural values

Thirdly, the principle of division of labour between Member States, according to their respective comparative advantages, would contribute simultaneously to promote greater involvement and participation thus diminishing resistance and facilitating consensus, and to a more efficient management. One possibility would be to allocate to different Members the responsibility for the coordination of a specific sector of cooperation.

Fourthly, there is a need for a flexible approach and an open-ended strategy based on trial and error, for two basic reasons. On the one hand it provides a solution to accommodate very heterogeneous member States' interests, as mentioned earlier, and rapidly adapt to changing circumstances. On the other, such an approach is required to match and adapt to the open-ended nature of the Chinese reform process which was one of the keys for its

success. This is particularly important, from the perspective of a country like Portugal, which has to pursue specific objectives as a consequence of its responsibility to Macao.

As regards the definition of priorities in relation to basic policy contents the perspective of a small country like Portugal, speaking from Macao, can be summarized in 4 key ideas.

Firstly, right from the start E.U. policy has to take into account the chinese priorities and problems. As a consequence, it should attach priority to the second phase of economic reforms and contributing to attenuate the major bottlenecks of the chinese development process. In fact, and in spite of the extremely high growth rates registered since the early 80's, several tension points emerged which risk to weaken the process: (i) infrastructure including energy bottlenecks, (ii) increasing inequalities between inland areas and coastal areas which originated already considerable tension between provinces risk, and a potential risk of desintegration, (iii) reduced effectiveness of macro economic management instruments, (iv) unbalance between economic and political reforms, (v) fragility of financial sector, (vi) environmental degradation and increasing land shortages. In relation to some of these issues the E.U. could contribute to ease the pressure through its aid policy or F.D.I., by promoting investments in infrastructure, the modernization of the financial sector or the attenuation of environmental degradation, thus contributing to reduce the risk of slowdown in growth and inflationist pressures. By contributing to economic stability and expansion the E.U. will also be

promoting political stability in the chinese context, since the good economic performance is not only a key basis of the regime legitimacy but also an antidote to various tensions, including regional ones. This is certainly the easiest way to reconcile political and economic objectives of stability which are very closely related in China, provided the priority in the political sphere is not aimed at democratic reforms in the short term.¹⁴

Secondly, special attention should be paid to the regional integration processes. At present China cannot be regarded in isolation but in the context of its growing linkages with Southeast Asia. In this respect the E.U. could be directly involved in the "small" and "middle" triangle projects in particular the former, in the context of which Macao and Hong Kong can play a decisive role. For that purpose Portugal is presently seeking to coordinate efforts and resources with others E.U. partners.

Moreover the E.U. could also assist through technical cooperation the chinese regional processes, in what concerns the recent proposal in the creation of regional institutions.

In this field a potencial conflict between economic objectives and political objectives could emerge. In fact if it makes every sense from a strict economic perspective to invest in the most developed and rich coastal provinces, from a political point of

¹⁴Gordon White in his book Riding the Tiger (Macmillan, 1993) argues that the likely evolution of the chinese political regime will be, in the medium term, the transition from a totalitarian to an authoritarian state with some concessions to human rights.

view the increasing inequalities between rich and poor provinces leads to tension and to potencial desintegration . The regional diversification of the European Union F.D.I. could be a positive contribution, besides the mesures the chinese government is supposed to take, to attenuate the problem.

Thirdly, among the different vehicles of economic relations more priority should be attached to the promotion of F.D.I. in China, in particular directed to the above mentioned strategic sectors, since it secures a more effective presence in the chinese market than trade relations. Furthermore F.D.I. is more likely to offer opportunities to promote E.U. State Members coordination and cooperation.

Finally, a greater investment in economic cooperation seems to be required with priority to the science and technology sector which remains a key area for China's long term development in order to modernize and upgrade the technological level of its industry and to tackle increasing environmental problems through the use of Green technologies. Macao is paying particular attention to this sector and several cooperation actions took place under the U.E. - Macao 1993 Agreement, in the areas of human resources training and project development.

5.CONCLUSIONS

Portugal's strategic deficit, both at he political and economic levels, in relation to Asia in general and China in particular is a good illustration of a broader E.U. tendency. This contrast

with the specific responsibilities Portugal has in relation to Macao, a Territory integrated in one of the world's fast growing sub-regions.

The portuguese case clearly illustrates the need for a common E.U. strategy towards China able to explore the complementarities between Member States experiences, assets and resources.

However the near future it seems difficult to achieve a structured common policy and it is more likely that a less intense outcome such as an improved coordination of bilateral policies will emerge.

The development of a common policy has to take into consideration both opportunities and constraints. The new regionalism, the new C.F.S.P. framework and China's autonomous strategy and good economic performance tend to facilitate the process.

On the contrary the heterogeneous nature of E.U. Members States interests, together with the reaction to 1989 events and the sanctions policy adopted tend to create obstacles to the formulation of a common policy.

A successful E.U. common approach to relations with China depends on the capacity to involve all interested Members States and to adapt to the other party's reality. It is then suggested that such a policy should be flexible and open-ended, implemented through a system of division of labour among E.U. Member States, and initially built upon the identified common interests.

Moreover it is argued that priorities should be set taking into account China's needs and conditions to secure political and economic stability.

In this regard the support to the second phase of reforms and to overcome the major bottlenecks in the Chinese Development process, as a means of maintaining the growth path and through it the country's political stability, by channeling investment and aid to critical sectors; together with the involvement in the various regional arrangements; the promotion of F.D.I. in China and the strengthening of bilateral cooperation in the science and technology sector seem to be of paramount importance.

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The European Union and China :
A European Strategy for the 21st CenturyBackground

As part of a broader effort to implement a new Asia strategy the European Commission has expressed an interest in building on its efforts to develop a closer and stronger relationship with China. Particular attention was asked to be given to the future directions that China may take and to possible responses from Europe to developments in China. A forward looking approach was desired, with a view to building a solid relationship between the European Union and China well into the next century. This paper is an initial effort to meet these objectives. Additional research will be commissioned for discussion at a one-day workshop on 28 March.

Introduction

China's foreign and security policies are driven by four primary considerations. First the need to ensure the country's territorial integrity. Second, the requirement to maintain the nation's defences. Third, the imperative to ensure the country's prosperity; and the final consideration is to secure China's influence internationally. Efforts to promote EU-China cooperation must be placed within this framework.

At the outset, it should be noted that within China there is little understanding of the European Union and how it operates. Most Chinese, including those at very senior levels, view the EU as a protectionist trade bloc, hostile to China's economic interests. The scope of the Union is probably incomprehensible to the Chinese given their highly developed sense of sovereignty. The idea that the EU may have a single policy approach that governs and is followed by all member states in any area of foreign affairs is simply inconceivable to most Chinese. The Chinese view the European Union as a collection of nation states, and do not understand the constraints that the Union can place on national sovereignty and decision-making.

The EU faces an additional drawback in its relations with China, namely the disinterest and distrust in China of Western policy initiatives. National governments also face this challenge. EU officials should bear this in mind and recognise from the outset that their ability to influence decision-makers in China is extremely limited. Chinese judgements over their own self-interest may not match European assessments of their interests. Goals and expectations should be modest. Over time, as the relationship develops more ambitious undertakings may be envisaged.

The existing framework for EU-China cooperation has several goals and operates at several levels. The maintenance of political dialogue is the task of the Commission and of member states. On issues that fall under the domain of the EU's Common Foreign and

Security Policy (CFSP), the Commission acts through the troika (current, past, next EC presidents). Member states can also act individually to implement agreed CFSP goals, or can act independently in other areas, such as British government policy on Hong Kong. Economic negotiations, particularly on trade fall are headed up by the Commission with member states supporting common trade policy. Cultural and educational exchanges are pursued both by the Commission and individual member states.

This multifaceted approach can be confusing to the EU's Chinese interlocutors. The troika mechanism is not understood in China (and elsewhere) and the Chinese do not see clear lines of authority from the troika into either the Commission or member states. Chinese officials are also unlikely to discern whether a member state is working to advance goals under the auspices of the CFSP and when it negotiating national priorities that are not included in the CFSP. Nor do the Chinese understand the role of the European Parliament, which is viewed as an integral part of the Commission rather than an independent body. In short when engaging the Chinese it is important for European officials, whether representing the Commission or national governments, to be clear about their mandate and the policy they are advancing.

In examining ways to advance EU-China cooperation it might be best to start at looking at China's priorities to see where opportunities and problems might emerge for Europe as China seeks to attain its goals. Over the course of the next ten years, at least, the enormous task of economic reform and maintaining

domestic political stability will ensure that China remains largely focused on internal matters and will continue to pursue a foreign policy that is reactive to world events rather than path breaking. This does not mean that China will be largely absent from the international stage; to the contrary she will vigorously defend her interests whenever she feels they are threatened and will participate in international affairs in ways that she feels will advance these interests. China is unlikely, however, to be a major catalyst in the international arena for the foreseeable future.

Territorial Integrity

China's sense of sovereignty has been described by some observers as "Victorian". Given the country's recent history, this is not surprising. China feels it has been badly treated in the past and is determined to eliminate any threats to its territorial integrity. Unfortunately many of the EU member states were prime violators of China's sovereignty in the 19th century, and this has not been forgotten by the Chinese. Evidence of China's bitterness over this legacy can readily be found in her attitude toward the United Kingdom and Hong Kong. It should be noted, in this context, that China in fact has yet to be fully unified. It will not recover Hong Kong for another 18 months and Macao until 1999. Reunification with Taiwan is a distant prospect at best. Much of China's ferocity over Hong Kong can be understood in this context. There is in short an "ideology of sovereignty" that holds sway in China today.

Implications for Hong Kong and Macao

It is now a certainty that China will interfere with Hong Kong's political arrangements after 1997. It is clear that the authorities in Beijing view the "one country, two systems" formula as an economic, rather than a political one. Hong Kong's political institutes, the Legislative Council, the Municipal Boards, and the District Boards will be dismantled and will be replaced at best with structures outlined in the Basic Law, which will serve as Hong Kong's constitution after 1997.

If China's interference is limited to these steps it may have little impact on the Hong Kong economy or way of life. The British government will be outraged, but cynics may be tempted to brush this away by pointing out that the Chinese are merely restoring to Hong Kong a system designed by the British and under which the people of Hong Kong prospered for decades.

The EU will have to decide how to react to Beijing's meddling in Hong Kong. The EU has an enormous economic stake in Hong Kong. This gives Europe an enormous stake in seeing Hong Kong remain intact and does provide leverage with the Chinese who welcome this investment and would like to see it grow as much of European business activity in Hong Kong is directed into other parts of China.

A major upheaval in Hong Kong is unlikely. In the early years following reversion, little in fact will change. What is

probable is that there will be a slow erosion of the Hong Kong way of life, with the sanctity of the rule of law and the independence of the civil service gradually undermined. Neither the European Commission nor individual member governments can do much to stop this from occurring; it will be up to individual companies to adjust their strategies accordingly.

In the lead up to 1997, officials of member governments on a national basis (not as part of the CFSP) should stress with Chinese counterparts the importance placed in Hong Kong continuing to flourish politically after 1997. Japan already does this as it underscores its significant economic stake in China. Beijing must understand that European business will cool toward China generally if Hong Kong is significantly weakened. It should be noted that this is most unlikely to stay China's hand.

Macao, which will revert to China in 1999, will be governed by arrangements almost identical to those set out in the Joint Declaration and the Basic Law which will govern Hong Kong. There have been no political rows between the Portuguese government and China and the transition to Chinese control is expected to be smoother in Macao than in Hong Kong.

A severe erosion of human rights in Hong Kong or Macao as a result of deliberate policy (as opposed to sloppiness or inattention) could lead to some form of economic or diplomatic sanctions on the part of the European Union, as was the case in

1989 after the suppression of the demonstrators in Tiananmen Square. This would be in line with the EU's general efforts to promote and protect human rights around the world.

China as a Regional Threat?

Time and time again, China has demonstrated its willingness to go to war when it feels its territorial integrity is threatened. China intervened in the Korean War not just because it wanted to help an ally, but because it also genuinely feared a US invasion of China itself. China has gone to war with the Soviet Union, Vietnam, and India to enforce its territorial claims. No one should underestimate China's readiness to do so again, whether it is in the South China Sea or across the Taiwan Straits.

The EU cannot rule out China as a source of conflict in the Asia-Pacific. Europe is unlikely to feel threatened should China enforce its claims to the Spratly Islands and occupy them militarily. A prolonged conflict in the South China Sea could be economically disadvantageous as shipping lanes could be disrupted. Any effort on the part of the EU to mediate such a conflict would in all probability be rebuffed by the Chinese as outside interference.

A Chinese military attack on Taiwan would be a severe challenge to the international community. Taiwan has moved from an authoritarian dictatorship to a liberal democracy; direct presidential elections will be held there for the first time in

1996. Although both Taipei and Beijing accept that there is but one China and matters concerning them are purely internal, the international community would have difficulty in accepting Taiwan's re-absorption into China by force.

A collective military response, similar to the one launched to repel Iraq from Kuwait, would be the preferred course of action; signs that such a coalition was forming could in fact halt Chinese military action against Taiwan. It would require US leadership, and if the US were unable or unwilling to take on this role it is unlikely that any other nation would wish to fill the gap.

European Union officials and member governments should actively discourage Taiwan from declaring independence unilaterally. The desire to see relations between Taipei and Beijing resolved at the negotiating table should be conveyed to officials in both capitals. Support for Taiwan's membership in the GATT as a customs union and observer status in the OECD should also be sought.

In light of the relative importance of China to the EU compared with Taiwan it is not advisable for the EU or member states to take a high profile stance on Taiwan. As appropriate, a higher international profile can be given to Taiwanese representatives, but a profile that is nonetheless consistent with Taiwan's political status.

Implications for Human Rights

China's highly developed sense of sovereignty and nation also make its officials resistant to criticism of what they view as purely internal matters, notably human rights. EU officials and member governments should not avoid raising human rights concerns with Chinese counterparts. Although they deny it, Chinese officials are sensitive to their international image and occasionally will make gestures in the human rights arena. Regular reminders from the EU that the respect of the UN Universal Declaration on Human Rights, to which China is a signatory, is important will have a healthy, if limited impact. Human rights issues in China should be discussed on their merit alone and not linked with Chinese behaviour in other areas.

The European Commission and member governments should expand training opportunities for judges and lawyers in China. There are currently on 75,000 judges in China, although the government would like to see this number grow to 150,000 by the year 2000. As China reforms its economy legislation and regulation proliferates. More intensive training of lawyers and judges will not only equip them to use these new economic laws effectively, but will also expose them to Western legal tradition and practice. This could, in the long run, create a more tolerant human rights environment in China.

If Beijing feels that political stability is at stake, however, human rights and civil liberties will not be respected as the authorities clamp down. It should be noted that the majority of the Chinese people probably favour this view; without question fear of social unrest is still powerful in the collective Chinese memory. The warlordism that emerged after the fall of the Qing dynasty, the Japanese occupation, the civil war between the communists and the nationalists, the chaos and starvation of the Great Leap Forward and of course the anarchy of the Cultural Revolution are potent reminders of the dangers of political instability and weak central government. This overriding consideration will guide the future of China's internal political development. It could in fact be the basis upon which the Peoples' Liberation Army (PLA) in China undertake a military coup.

There will not be another Tiananmen Square incident in China. There will certainly be protest marches and demonstrations in the coming years but they will be dealt with very differently than in 1989. The Peoples' Armed Police (PAP) have received riot control training and equipment. Future demonstrations in China will be handled very much like similar ones were in Tokyo in the 1960s and Seoul in the 1980s.

Prospects for Regional Autonomy

This emphasis on stability, China's strong sense of sovereignty, and the cement of the Communist Party will most likely prevent

China from breaking up. These forces will not stop China's provinces from resisting central control and operating independently from Beijing. In a sense China should be viewed as heading towards a de facto federalist state with provincial governors and their bureaucracies having much the same power as their equivalents in the United States.

Regional autonomy in China provides opportunities for the EU. Local ties in China are just as important (and in some cases more important) than relations in Beijing. The EU should consider therefore initiatives such as opening EU offices in Guangzhou and Shanghai. Contacts should be made in the provinces, not just Beijing, to open EU training programmes to qualified individuals. Provincial officials often have greater flexibility than do the bureaucrats in Beijing and are often willing to participate in initiatives that will bring direct advantage to their province, even if they fall outside Beijing's official policies. Furthermore it is rare for Beijing to over rule provincial authorities, at least on economic decisions, although this does happen occasionally.

Regional autonomy will also challenge the EU. Provincial authorities do ignore dictates from Beijing they do not like and on occasion ignore decisions from Beijing that the EU and others would like to see implemented. Respect for intellectual property rights and copy right protection are but two examples. Developing relations between EU officials can help. If provincial authorities are shown the benefits from the EU that

can accrue to provinces that respect international trade rules, they may be more willing to play ball. Such discussions will be easier if a relationship already exists and when provincial authorities have a firmer understanding of what the EU is about. Coupled with pressure from Beijing, such dialogue could tip the balance in right direction.

Maintaining the National Defences

If China is indeed to protect its territorial integrity, it will require a strong national defence establishment. This requires a professional military, and the depoliticisation of the armed forces was successfully achieved in the 1980s. These gains have survived Tiananmen and the actual size of the armed forces has been reduced by about 1,000,000 men. The military also needs to be well equipped; hence the current arms modernisation process under way in China. Given the poor quality of much of China's military equipment, a stark contrast to the proficiency demonstrated by Western armed forces in the Gulf War, this modernisation is neither surprising nor worrisome. Only if China were to acquire large numbers of sophisticated weapons that would profoundly alter the military balance in Asia, should one be concerned; China's modernisation programme at present shows no sign of destabilising the regional military balance.

The military is a potent force in China and greater contact should be established between its officers and European military officials. The United States has resumed military-to-military contact with the PLA and the EU should perhaps encourage its member states through the WEU or otherwise to follow suit. The Chinese military is an isolated one not sharing the European\Atlanticist history of alliances and multilateral defence arrangements. By fostering greater knowledge of the world and of Western military practices European military officers can help ensure that the Chinese military is more likely to behave responsibly. It might also make it easier for European concerns about weapons proliferation to be better understood and respected. Some percentage of China's military sales are conducted by the PLA itself with little or no reference to Beijing.

This latter point underscores another new and important dimension about the PLA in today's China; it has become a major force in the market place. It is estimated the PLA's private sector activity -- ranging from the manufacture of satellite dishes to a Baskin Robins franchise in Beijing to luxury hotels in Hong Kong generates as much money -- \$5 billion -- as the official defence budget. Some of this money enriches PLA officers but much of it goes to improves housing conditions on military bases and to supplement soldiers' pay.

As the EU looks at China, the new role played by the PLA should be re-assuring. The military in China now have a direct stake in continued economic reform and economic growth. Any attempt to turn back the clock (probably impossible anyway) would be resisted by the PLA; it is probable that the PLA leaders are on the side of those in China who want to accelerate economic reform. In a succession struggle, the conservatives might not obtain PLA support. A power struggle that led to a power vacuum could provoke a military coup.

The PLA's economic activities have made PLA entities valid economic partners in China. This is an additional reason to resume military-to-military contact with China. Not only does such contact provide a formula for addressing European security concerns it can also open the door for European business.

EU governments should take advantage of China's arms modernisation programme and assist European manufacturers in identifying potential sales areas. Although the Chinese want high-tech products they also want good value and have negotiated several very good deals with Russia which have included barter arrangements. Attractive financing will help sales.

Member governments will of course be sensitive to the transfer of certain technologies to China and will also want to ensure that weapons sold to China are not then re-sold to third countries. Governments will also not want to sell arms to China that would

destabilise the regional military balance, so the emphasis should be on weapons that are defensive in nature.

Chinese arms sales are of concern to the EU as it seeks to promote non-proliferation. To what extent the PLA acts as an independent operator rather than under direction from Beijing is not clear. EU member governments and the Commission should encourage China to implement the Military Critical Technology Regime, to which it is a signatory. The Commission and national governments should take Chinese arms sales into consideration when reviewing developmental assistance programmes to China. (As does Japan).

Ensuring Economic Prosperity as a Political Objective

Maintaining a professional, well equipped armed force is of course easier for a prosperous nation. Of course, China's drive for economic reform and growth is driven by more than a desire to have a first-class army. In walking down the path of reform in 1978 Deng Xiaoping had several goals : create an economic environment that offered the people of China equality of opportunity, not equality of wealth, the acquisition of foreign technology and capital to help modernise the economy, ensure that planning was guided by economic rationale and not political considerations by the introduction of market forces. China's economic policies since 1978 have had important international consequences. China has settled its age-old debate about how to deal with the rest of the world by resolutely opening its doors.

to outside investment and technology. As a consequence China has normalised its relations with every country in the world, including age-old enemies such as Russia and Vietnam. In fact, China today faces no direct threat to its security.

Deng and his colleagues took an incrementalist approach to reform. In the economic arena, reform was to be undertaken under Deng's four modernisations, with priority given first to the agriculture sector, followed by industry, science and technology, and the military. Reform was instituted first in rural areas, where the "household responsibility system" was introduced. Peasant farmers were given long-term leases on their land -- allowing for quasi-private ownership -- and were encouraged to establish light industrial enterprises.

The economic reform programme has an important political dimension. The Chinese leadership is betting that a prosperous China, in which peoples' income is rising steadily, will be a stable China. Importantly, a stable China is also one that will continue to accept rule by the Chinese Communist Party, which will be viewed (it is hoped) as the instrument of the country's new wealth. This explains why Chinese officials continue to emphasise Marxism, Leninism, and Mao Zhe Dong thought.

Eager to attract foreign investment and technology, the Chinese opened their economy to the outside world. Again, a gradualist approach was adopted. SEZ were created initially in the southern coastal area of Shenzhen and Guangdong. Western capital flowed

into these areas, 75% of which came through Hong Kong. Furthermore 70% of all foreign investment in China originates with the ethnic Chinese in Hong Kong and Taiwan and overseas Chinese in Southeast Asia. Hong Kong quickly became a significant force in China's economic growth; about 25% of China's GDP is the result of Hong Kong related business and Hong Kong companies employ over 3 million people in southern China.

China's tremendous growth is now entering its second decade; from 1981 to 1994 GDP grew at an average annual rate of 9-10%. Strains are beginning to show. Inflation is running at over 27%; there is a growing split in living standards and economic opportunities between rural and urban areas; a two track economy now exists in China with the state-subsidised sector operating along central planning guidelines while the private sector is governed by the forces of the market; there is an urgent need for price reform; corruption is widespread.

The primary economic challenge for China is reform of the state controlled sector. Many of these companies are sustaining huge losses which are being funded by loans from banks, loans that are unlikely to be repaid. Yet these enterprises also provide a social safety net to much of China's industrial workforce, that includes not only salary but also housing and medical benefits. Beijing cannot simply shut down the loss-making enterprises without putting into place a social welfare system.

The European Union and member states could provide important technical advice to the Chinese about how to create a social welfare system and -- equally important -- how to finance it. Helping China develop the tools to create an environment that would enable it to reform the state controlled enterprises would make an important contribution to China's economic reform programme.

A constant, permanent concern for the Chinese leadership is to ensure that China's population is adequately fed. China's population continues to rise by 15 million people each year, so the challenge is enormous. Not only is the population growing, but the amount of arable land is declining, due to industrialisation, pollution, and over-exploitation. The EU should explore ways of helping the Chinese improve their agricultural output through the use of new technologies. China should also be viewed as a market for European agricultural products; although the Chinese leadership plays great emphasis on food self sufficiency, they are unlikely to achieve it and will have to turn to world agricultural markets to meet total food needs.

On the positive side, the Chinese government recognises all these problems publicly; no attempt is made to sweep them under the rug as was the case in the former Soviet Union. On the negative side, there appears to be no agreement in Beijing on how these problems should be addressed and no action is taken.

For the European Union, China's economic contradictions should not scare officials from trying to build closer economic ties with the country. There are ways the EU can help China overcome its economic difficulties other than to step up its various training programmes and to make them available to as wide a range of individuals as possible. China desperately needs skilled managers, bankers, regulators, and analysts who can implement and supervise the rules and regulations China needs to develop if it is to manage its market economy. Emphasis should be placed by the European Commission on strengthening and enhancing existing training programmes for the Chinese; member governments should be encouraged to do the same at the national level.

As European Union officials encourage European business to exploit opportunities in China they should also paint a realistic picture of the economic and political environment there. Companies should understand that an incremental approach to China is best; that starting small and growing gradually is a better approach than making a massive initial investment in China. It should also be understood that initial investment in China generally does not turn a profit until eighteen months to two years after it is made. Finally, companies must realise that recession does and will occur in China and that when it does, it is not advisable to pull out.

In the end, the EU can help to influence the pace and course of economic reform in China. It can lend its support to those

forces in China that are committed to comprehensive reform via training across the broadest sector of Chinese society possible; it can encourage European investment in China, and, over time, Chinese investment in Europe thereby further strengthening the EU-China network. In the end how and when China moves on to the next level of economic reform will depend on events in Beijing and not Brussels (or Washington or Tokyo).

Joining the Global Community

China regards itself as a major power and as it continues to develop economically it will want to acquire the international attributes that are commensurate with its size and power. This trend is already evidenced by China's willingness to join international organisations such as APEC, the GATT, and even the ASEAN Regional Forum. China's partners and neighbours should take heart in this; the more engaged China is internationally, the less likely she is to behave aggressively. Nonetheless, there should be no doubt that if China feels her vital interests under threat she will respond, forcefully.

Here the EU can play a significant role. The European Union should argue forcefully for China's early entry into the World Trade Organisation. There is no question that at whatever moment China enters the WTO she will not be in compliance with all of its regulations. It is easier, however, for pressure to be brought to bear once China is within the organisation rather than as a negotiating tactic to try and secure her membership.

Secondly, WTO membership will help Beijing resolve some of the problems caused by provincial autonomy. By invoking not just national pressures but the full weight of the international community, Beijing will have greater clout to bring recalcitrant provinces into compliance with world trading standards. EU officials and member governments should try and secure agreement from the United States to bring China into the WTO now.

As China grows in confidence and strength the EU should support its entry into other relevant institutions such as the OECD. European officials should also give early consideration as to how China might be brought into the G-7 process. Although per capita income is low by G-7 standards and China is still a developing country, the sheer size of the Chinese economy is such that it has significant effects on global markets. As the Chinese economy grows, so will its demands for energy and food and so will its negative impact on the environment. Under the circumstances it would seem appropriate for China to play a role within the G-7.

The EU should also consider annual meetings with Chinese officials at the highest level. Such meetings should be modelled on the pattern established by the EU in its dealings with Japan and ASEAN. A commitment to such a process would demonstrate unequivocally Europe's commitment to building strong and lasting ties with China. Over time it would also provide Chinese

officials with a better understanding of the European Union and the opportunities it offers for China.

Conclusion

The good news is that the leadership in Beijing -- a leadership that is nonetheless paralysed as it awaits the death of Deng Xiaoping and the succession crisis that will follow his demise -- is committed to economic reform and admits to its problems. The key question remains whether Beijing has the ability to both find reasonable solutions and to implement them once they have been identified. If they don't or can't China will continue to experience cyclical growth, moving from periods of boom to moments of bust. China will still be a profitable place to do business, although it will continue to develop unevenly with greater disparities emerging among the provinces. From a long term perspective this type of growth will prove untenable. If China can successfully tackle its problems, then the future looks much brighter and China may well become the next Asian Dragon. Which ever scenario obtains China will be an important international focal point and one that should receive careful, constant attention from the European Union.

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