OSW | COMMENTARY
Centre for Eastern Studies NUMBER 282 | 23.08.2018 www.osw.waw.pl

China's offer to the EU: tough negotiations or a coalition against Trump?

Jakub Jakóbowski, Konrad Popławski

Donald Trump's aggressive policy towards Beijing and the spectre of a trade war have served as a catalyst for the resumption of dialogue between China and the EU. Within a period of less than two weeks, the Chinese prime minister held three meetings with EU leaders: within the 16+1 framework, a German-Chinese intergovernmental consultation, and a China-EU summit. Beijing's diplomatic offensive was intended to show openness to the EU's demands to liberalise access to the Chinese market, and to neutralise allegations that China has been exploiting divisions between EU member states. Beijing hopes that improving the climate of the talks, together with making some small concessions to Brussels, and especially to Berlin, will allow it to bring the EU onto its side in its conflict with the United States at relatively little cost. This puts the EU in a dilemma. On the one hand, supporting the pressure Washington is currently putting on Beijing could lead to a real opening-up of the Chinese market, and also reduce the growing imbalance in international trade whose roots lie in China. However, this risks a collapse of economic growth in China, which would mean losses for many European companies. On the other hand, if the EU cooperated with Beijing on this matter, it could strengthen the multilateral trading system based on the WTO, and also help to defend the Iran agreement and the Paris agreement on climate change. However, if Brussels openly joins the Chinese coalition against Washington, that could cause serious divisions within the EU and in trans-Atlantic relations, and also limit Beijing's determination to undertake domestic reforms.

The economic conflict between China and the United States has revived the concepts China has operated under since the beginning of the 21st century, according to which the formation of an alliance with the EU would allow China to counteract the dominance of the United States. However, the series of internal crises the EU has undergone since 2010, including the debt crisis in the euro area, the migration crisis and Brexit, has disseminated the conviction within China that the community is suffering from internal weakness and diminished the belief that it could be helpful in balancing the power of the United States. Currently China mainly sees the EU as a sales market and a source of advanced technology. Beijing's policy is focused on maintaining the beneficial status quo of asymmetrically opening the EU up to Chinese exports and taking over European companies. This has manifested itself, on the one hand, in a reluctance to renegotiate the legal basis of the two sides' economic contacts (including bilateral investment treaties [BITs]), and on the other, in preventing European attempts to close their market, including during the dispute over granting China market economy status within the WTO[1].

[1] See J. Jakóbowski, M. Kaczmarski, *The EU on granting China market economy status: a compromise or a dodge?*, "OSW Commentary", 5 August 2016, https://www.osw.waw.pl/en/publikacje/osw-commentary/2016-08-05/eu-granting-china-market-economy-status-a-compromise-or-a-dodge

The primary instrument of Beijing's policy of 'divide and conquer' in the EU in recent years has been the implementation of bilateral relations, above all with the three member states considered to be regional powers (Germany, France, the United Kingdom), as well as within the regional 16+1 format.

Beijing's policy is focused on maintaining the asymmetrical openness of the EU to Chinese exports and investment.

For the EU, China has in recent years become an increasingly important economic partner, but also an increasingly dangerous competitor. The global financial crisis, followed by the euro-area crisis, has led to years of economic stagnation in many of the EU member states. The rapidly growing Chinese market has become a source of diversification[2] in revenue for major EU exporters, such as Germany. Over time, however, it has turned out that the intensification of the economic relationship with China has had a high price. The Chinese authorities, despite their promises, have not guaranteed European investors and exporters access to their market in a way comparable to the EU's openness, and have even imposed new restrictions in some branches[3]. At the same time, Chinese companies have begun to catch up technologically with some of the European champions. This has happened mainly because Beijing has been running its industrial policy on two different tracks. For certain branches, entry onto the lucrative Chinese market is conditional upon foreign investors creating joint ventures and transferring technology to their Chinese partners[4]. At the same time, Beijing provides almost unlimited funding for the foreign expansion of Chinese entities, which has opened up the way for many of them to buy up their European competitors and the attractive technologies they own. In accordance with the Chinese government's 'Made in China 2025' strategy, this support covers the most promising branches (including robotics, renewable energy, modern transport), on which the long-term competitiveness of the European economy is largely based.

In the face of trade war with the United States, as well as growing risk of a revision of the WTO's rules, China is threatened not only with losing access to the American market and technology (which from the Chinese perspective increases the importance of the EU's openness), but also the dismantling of the multilateral global trading system which has underpinned China's economic success. The Chinese response to Trump's policy is an attempt to cast itself as the main defender of free trade, together with the creation of an international coalition for openness, of which the expanding Belt & Road Initiative (a.k.a. the New Silk Road) is the main platform among developing countries. To stand up to the US, however, Beijing needs partners from the EU, which have the appropriate economic power to shape the rules of global trade. During July's meetings with the prime ministers of Central and Eastern European countries, the bilateral Chinese-German consultations, and then the official China-EU summit held in Beijing, China put forward its offer of a new opening in its relations with Europe, in the hope of getting the EU's support for its trade policy.

[2] At this point we may even talk in terms of dependency, as the 30 biggest German listed companies receive 15% of their income from the Chinese market. Volkswagen sells 37% of its finished cars there, BMW 24% and Daimler 23%.

[3] This mainly applies to the high-tech sectors. The Chinese law on cyber-security introduced in 2017 increases German concerns regarding the leakage of knowledge from foreign companies operating on the Chinese market.

[4] In addition, foreign investors are exposed to technology theft by Chinese competitors due to the low level of intellectual property protection in China.

The 16+1 summit in Sofia: altering the format to suit Brussels and Berlin

Beijing's aim regarding the summit of the 16+1 format (gathering together China and sixteen countries from Central and Eastern Europe), which was held on 6-7 July in Sofia, was primarily to weaken the controversy which this grouping has caused among Western European countries. China moved this year's summit (which had previously been held in the last quarter of the year) to an earlier date to fit in with the timetable of its other meetings with the EU. Beijing also went one step further in the rhetoric it has employed over the past several years by presenting the 16+1 as an element of its cooperation with the EU, announcing that it would adapt its offers for financing infrastructure to EU regulations. This was done in order to calm the fears of EU institutions, which see the 16+1 format as crossing the line into areas reserved for formal EU-Chinese dialogue, and have criticised the Chinese offer of finance as failing to comply with EU regulations concerning tenders and state aid. Germany also has serious concerns that the frequent meetings of leaders within the 16+1 format represent an attempt to pull the Central and Eastern European region into the zone of China's political and economic influence, which would undermine the competitiveness of the German economy[5]. This format has been described in terms such as 'a dangerous parallel network of institutions' which undermines the coherence of the EU[6]. After a campaign in Chinese state media during 2017 criticising the German position[7], Beijing adopted a more conciliatory position in 2018, and has begun to deal with Germany's concerns directly. The future of the format has been discussed at meetings including the bilateral consultations held in May this year, when China invited German companies to participate in projects within the 16+1 format, and has also proposed Germany's formal inclusion in the 16+1 group.

The Chinese response to Trump's policy is an attempt to cast itself as the main defender of free trade and create an international coalition for openness.

At the Sofia summit, the Chinese also made an offer to the countries of Central and Eastern Europe in the hope that they would support their global agenda. Although some participants in the format (including Hungary) have adopted the strategy of promoting China's interests in anticipation of bilateral economic benefits, other countries are trying to use the 16+1 format to communicate to China the need to find solutions to the long-term problems in its relations with the region. In the document issued after the summit, Beijing's previous demand concerning the use of China's Exim Bank's line of credit, which most of the sixteen states did not consider to be sufficiently financially attractive, has been replaced by a passage on the need to look for 'innovations in the mode of investment and financing'. In Sofia a special research institute is to be set up, tasked with the mission of adapting the activities of Chinese companies to EU regulations. The region's key demands include expanding access to the Chinese market and reducing the trade deficit. In response to this, Beijing has proposed to the 16+1 states that it will create a set of instruments to promote exports of their foodstuffs to China (including the creation of exhibition centres for their food products in China), and that it will expand channels for e-commerce distribution.

[5] For Germany the Visegrad states themselves – taken in total – are the largest trading partner, with a turnover of €273 billion, while China, which ranks second, generates turnover amounting to 'only' €187 billion.

[6] W. Wu, *Berlin uneasy about Beijing's growing clout in eastern, southern Europe*, "South China Morning Post", 18 February 2017, https://www.scmp.com/news/china/diplomacy-defence/article/2072046/berlin-uneasy-about-beijings-growing-clout-eastern

[7] Cui Hongjian, *Dreams of 'one Europe' need the actions to match*, "The Global Times", 6 September 2017.

However, the Chinese offer to Central and Eastern Europe is still at the declarative stage, and during the course of the summit no bilateral agreements with the countries of the region which would have been relevant from the economic point of view were signed. China's position in Sofia should be seen as expressing a willingness to open dialogue on adapting the 16+1 to Brussels expectations, including greater flexibility in the financing and construction of infrastructure, as well as a to accommodate some of the interests of the Central and Eastern European states.

Beijing's aim regarding the 16+1 summit in Sofia was primarily to weaken the controversy which this grouping has caused among Western European countries.

This opens the way for institutional cooperation with the EU, including the creation of investment funds and credit lines aimed at the development of the region. The question remains as to whether the scope of the concessions provided by Beijing will satisfy the EU institutions and Germany. In March this year Brussels signalled that it expected a reduction in the frequency of 16+1 summits[8]; however, in Sofia, the Prime Minister of Croatia Andrej Plenković announced that his country had agreed to host the summit next year[9]. As was shown by the conference after the intergovernmental consultation in Berlin, during which China's prime minister defended the functioning of the 16+1, Beijing is not at present ready to make concessions or marginalise the format.

Berlin–Beijing: an offer to German companies

One of the most important events affecting the positive course of the EU-China summit was the German-Chinese intergovernmental consultations, which had been held a week before then. The meeting of both countries' governments, the fifth in the last eight years, saw the signing of 22 contracts worth US$30 billion. The atmosphere during these talks was significantly different from that prevailing in previous years[10]. After the initial enthusiasm that accompanied the meetings in this format, a sense of disappointment at them had prevailed in Germany in recent years.

During the last two years, an integral part of the talks was German government representatives' criticism of Beijing for its lack of reciprocity regarding market access, as well as its policy of buying up shares in German small and medium-sized enterprises in order to acquire their technology. This time, though, the Chinese government offered to take concrete steps towards liberalising access to their domestic market. In April the Chinese government promised that by 2022 it would abolish the requirement to create partnerships with at least 50% participation by a partner from China with regard to the activities of foreign investors in the automotive industry. According to the declaration in July by Prime Minister Li Keqiang, Germany's BMW will be the first foreign automotive company to obtain a majority stake (75%) in a joint venture created in China[11]. During the Chinese-German talks, an agreement was

[8] N. Barkin, R. Emott, T. Tsolova, *Exclusive: China may pare back 'divisive' eastern Europe summits*, Reuters, 12 March 2018, https://www.reuters.com/article/us-china-easteurope-exclusive/exclusive-china-may-pare-back-divisive-eastern-europe-summits-idUSKCN1GO1PI

[9] *Croatia to host 16+1 initiative summit next year*, https://vlada.gov.hr/news/croatia-to-host-16-1-initiative-summit-next-year/24118

[10] As a result of the Chinese-German talks, Liu Xia, the wife of the deceased Chinese dissident and Nobel Prize winner Liu Xiaobo, who had been held under house arrest, was released from China to Europe. Beijing's decision was a symbolic gesture towards Germany, which had hitherto belonged to the ranks of countries unsuccessfully demanding the release of Chinese prisoners.

[11] D. Ren, *China makes the BMW the envy of foreign carmakers, giving it green light to raise its venture stake*, South China Morning Post, 16 July 2018, https://www.scmp.com/business/companies/article/2155528/china-makes-bmw-envy-foreign-carmakers-giving-it-green-light

also signed under which BASF will be able to build a production plant in China valued at US$10 billion without the need for cooperation with a Chinese partner (the German company had previously operated a joint venture with the Chinese company Sinopec). These steps by Beijing are clearly a nod towards German business, and represent one of the first real signals of changes in the long-term policy of the Chinese government, which accepted the entry of foreign companies in strategic sectors provided they shared their technology with their partners in China. Representatives of the German Chamber of Commerce and Industry welcomed the steps taken by the government in Beijing to open up its domestic market, especially in the areas of financial services, the automotive, aerospace and shipbuilding industries. However, they emphasised that this is just the beginning of the journey to the destination, that is, equality of conditions for EU companies operating in China with the terms the European market offers to Chinese companies.

A new element in the relationship may come from technological cooperation in the development of the automotive industry. German companies have had problems with mastering key new technologies, such as the production of batteries for electric cars, as well as software for self-driving vehicles. During the intergovernmental consultations, the construction of a Chinese battery factory in Thuringia for BMW cars was announced. As Chancellor Angela Merkel stated, German manufacturers must make use of deliveries of electric car batteries from Asian companies, because they themselves are unable to produce them at a competitive price. In addition, the two countries' ministers of economy signed an agreement on cooperation in the development of self-driving vehicle technology. It was announced that BMW will join the work by the Chinese company Baidu on software to drive self-driving cars, namely the Apollo system, which is the main competitor to the Waymo system currently being developed by Google.

Many important issues have been pushed into the background, including in particular the question of the transferral of German technology[12]. Attempts to stop this trend by tightening the law on takeovers of companies which are essential for German security have been only partially successful. Chinese investors' interest in taking over German companies has continued, although the expansion of capital from China has fallen off in other EU countries.

Beijing's main aims were to ease the criticism levelled against it by Berlin, and to get a signal from Germany that it was opposed to Trump's trade policy.

In the first half of this year, Chinese companies acquired shares in EU businesses to the tune of €15 billion (a decrease of 47%), of which €10 billion was accounted for by Germany (an increase of 47%). It has been difficult for the German government to draw up regulations protecting its strategic interests while at the same time not limiting the rules on the free movement of capital within the EU. This year, the acquisition of a 20% stake in the energy infrastructure operator 50Hertz by a company from China only failed to go through due to the reluctance of one of the private company's owners to resell the shares[13]. In February this year, Li Shufu, the founder and chairman of the leading Chinese automotive company Geely (which controls Sweden's Volvo) became one of the main shareholders in Daimler (taking almost 10% of the shares).

[12] This problem was noted in Germany in 2015, when despite opposition from German politicians the Chinese took over Kuka, the German leader in robotics. See K. Popławski, *Capital does have nationality: Germany's fears of Chinese investments*, "OSW Commentary", 25 January 2017, https://www.osw.waw.pl/en/publikacje/osw-commentary/2017-01-25/capital-does-have-nationality-germanys-fears-chinese

[13] K. Popławski, *Germany: new barriers for Chinese capital,* "OSW Analyses", 8 August 2018, https://www.osw.waw.pl/en/publikacje/analyses/2018-08-08/germany-new-barriers-chinese-capital

The Chinese company carried out the transaction by exploiting legal and financial loopholes, circumventing German law imposing the obligation to publish information about its assets,

China may be continuing its tactic of 'divide and conquer' in Europe, in an attempt to use bilateral dialogue with Germany as the main instrument to influence the EU's policy on trade.

and it also failed to inform the management of Daimler of this fact[14]. These acquisitions have caused concerns in Germany within the context of the Chinese government's 'Made in China 2025' strategy, which assumes that manufacturers from China will achieve leading positions in many industries where Germany is currently the world leader. Moreover, the law introduced by China in 2017 on cyber-security may lead to an increase in leakages of data and technology from German companies, including highly advanced technology, from their production plants located in China. These concerns are all the more justified in that the most important German companies have been considering the construction of R&D centres in China.

Beijing's main aims were to ease the criticism levelled against it by Berlin, and to get a signal from Germany that the latter was opposed to Trump's trade policy. These aims had only partial success because Germany only agreed to a general statement of both countries' commitment to multilateralism and the rules of the World Trade Organisation. At the same time, by removing the requirement to create a joint venture for the individual German companies, China has neutralised the criticism from Germany of its lack of reciprocity in granting market access in EU-Chinese relations.

The EU-China summit: open dialogue without a common front

The EU-China summit on 16-17 July was a test of the effectiveness of China's new strategy of offering concessions to the EU. Beijing's relations with Brussels have cooled notably in recent years, mainly due to the lack of response from Beijing to European expectations of reciprocity of access to the Chinese market through liberalisation[15]. In connection with this, Brussels has adopted a more assertive posture towards China, by undertaking activities such as:

- the imposition of duties on Chinese steel;
- refusing to grant China market economy status within the WTO (which would limit the EU's ability to impose anti-dumping duties on imports from China);
- starting the process of revising EU mechanisms to block direct foreign investments aimed at stemming the outflow of European technology to China;
- putting pressure on Beijing to apply European standards and norms for financing and constructing infrastructure within the framework of the Chinese Belt & Road Initiative, both in Central & Eastern Europe and the Eurasian states outside the EU[16].

The result of this year's EU-China summit was a resumption of dialogue. The meeting ended with a joint statement for the first time in two years; the two sides also moved closer together on global and sectoral issues. Support was declared for the maintenance of the nuclear agreement with Iran and the Paris climate

[14] A. Jourdan, N. Shirouzu, *How Geely's Li Shufu spent months stealthily building a $9 billion stake in Daimler*, Reuters, 1 March 2018, https://www.reuters.com/article/us-daimler-geely-shell-insight/how-geelys-li-shufu-spent-months-stealthily-building-a-9-billion-stake-in-daimler-idUSKCN1GD5ST

[15] The European demands, repeated for years, relate to the reduction of trade barriers (including numerous non-tariff barriers), reducing restrictions on foreign investors in China, and guaranteeing the protection of their intellectual property. In a number of strategic sectors, the acquisition of Chinese companies by foreign entities is impossible, and greenfield projects require the sharing of technology with the Chinese partner. The Chinese state also provides significant support to Chinese businesses in sectors considered as strategic.

[16] During the prestigious first Road & Belt Forum in May 2017, EC representatives were able to persuade most EU countries not to sign the joint declaration on the financing of infrastructure, citing a lack of transparency and attention to sustainable development in the Chinese credit model.

declaration, as well as cooperation on the denuclearisation of North Korea. A joint working group, led by the Chinese deputy prime minister Liu He and the Deputy Head of the EC Jyrki Katainen, will develop a common proposal for the reform of the World Trade Organisation. Progress was also announced in the negotiations concerning geographical indicators on products designed to provide better protection for European food producers in China, and on accelerating a bilateral investment agreement (BIT) between China and the EU. Of importance from the point of view of Central and Eastern Europe was the publication of a common list of projects within the framework of the EU-China Connectivity Platform, including 10 infrastructure projects in the region which would be carried out with the participation of China, under the auspices of and covered by EU law.

President Trump's trade policy is forcing Beijing to offer concessions to its main partners in Europe and undertake dialogue on matters which it finds inconvenient.

However, China failed to obtain a clear statement from the EU within the context of a possible agreement regarding President Trump's policy. Both sides have declared their joint support for the WTO's multilateral trade rules and the containment of unilateralism, although EU officials sought to tone down the anti-American rhetoric, inviting the United States and Russia among others to cooperate. The WTO reform plan is still at a very general level, and during the summit the President of the European Council, Donald Tusk, said that such reform should proceed in the direction of regulating issues such as state subsidies, protecting intellectual property and transfers of technology by force. This indicates that the EU will continue to put pressure on China in terms of opening up its domestic market and creating equal conditions for competition; this position is also in line with the United States' principal demands regarding China.

Would the EU join China's coalition against Trump?

President Trump's trade policy is becoming a key condition defining the dynamics of the EU-China relationship. It is forcing Beijing to offer concessions to its main partners in Europe and to undertake dialogue on matters which it finds inconvenient. So far, the list of specific proposals China has offered is relatively small, and in reality July's diplomatic offensive in Europe was based on sounding out the expectations of its partners in the EU and opening up channels of dialogue. This may be connected with the current early stage of the Chinese-American trade war (which currently involves only a little over 10% of both countries' trade). If the US follows through on its threats (including the declared second round of tariffs on US$200 billion of Chinese exports), we should expect China to make further offers and express a greater willingness to deepen the dialogue. However, any systemic changes and a greater opening-up by China to European companies will depend on whether the EU can maintain a consistent position, and on individual member states not reducing the pressure on Beijing in exchange for bilateral privileges. So far, the largest number of China's specific concessions has been aimed at Berlin. This indicates that China may be continuing its tactic of 'divide and conquer' in Europe, in an attempt to use bilateral dialogue with Germany as the main instrument to influence the EU's policy on trade. This has been aided by a partial convergence of interests in relation to Trump's policy. Berlin, which has been the subject of criticism by the US President, is worried that if the US policy proves to be an effective mechanism to level off China's trade surplus, Germany, which also has a trade surplus with the United States, may become another victim of these methods.

If Trump's pressure on China rises, Beijing will expect more unambiguous support from Europe in its dispute with the United States. This puts the EU in a dilemma. Even if the spiral of imposing further tariffs only rises between China and the US alone, it is the production plants of European firms located in both countries which would lose out, no less than their American and Chinese partners. It would hit especially hard at the business models of the most globalised European companies, which have plants around the world. Another side-effect of high tariffs on China could be the flooding of the EU market with Chinese products, whose sales on the US market would cease to be viable, for example in the case of steel.

On the other hand, the EU member states share basically all the United States' demands concerning China's protectionist actions, as they can see that the policy of soft pressure on Beijing has not brought the desired results. Trump's increase of pressure on China has prompted the authorities in Beijing to make almost immediate concessions and declare their readiness to liberalise market access, which Brussels has been requesting for years. In addition, the EU will itself be looking for an agreement with Washington, especially on the issue of possible customs tariffs on cars, and so it does not want to give the impression of unambiguously supporting China's demands in a confrontation with the United States.

Colliding head-on with the United States would also risk a serious political crisis within the EU. The US is not only an important partner in the field of economy, but is also the guarantor of European security. The EU's interests are too divergent for it to be become a third geopolitical actor which could tip the balance in favour of one side in a dispute between Washington and Beijing. We should therefore expect that the EU will be unable to tip the scales in a possible trade conflict between the US and China, but will instead choose a path of slaloming between the two parties. One example of this is the EU's signing of an economic partnership agreement with Japan, whose details took six months to negotiate, even though previously the parties had been unable to reach an agreement for several years. However, if it becomes impossible to continue this strategy and it becomes necessary to choose one of the parties to the dispute, Brussels will rather support the interests of the US. Otherwise, the EU would be beset by very strong divisions which could threaten its coherence.

EDITORS: Adam Eberhardt,
Halina Kowalczyk, Katarzyna Kazimierska
TRANSLATION: Jim Todd
DTP: Bohdan Wędrychowski

Centre for Eastern Studies
Koszykowa 6a, 00-564 Warsaw
phone: +48 | 22 | 525 80 00
e-mail: info@osw.waw.pl

Visit our website: **www.osw.waw.pl**