

# **CHINA-EU TRADE DISPUTES AND THEIR MANAGEMENT**

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## **PREFACE**

Since China's accession to the WTO, China and the EU have witnessed dynamic growth in trade relations. The EU has become China's biggest trading partner and China, the EU's second biggest trading partner. Concurrently, bilateral trade relations with the two has emerged as a significant feature of the international trading system, with China being the world's most populous and second largest economy and the EU being the world's largest market. In the wake of the ongoing global financial crisis and against the backdrop of surging trade disputes between China and the EU, it is thus timely and useful to assess bilateral trade relations between these two powers, which are two very different types of international actors, with different economic and regulatory structures, and even value systems. This book is an attempt to identify the factors that are contributing to the trade disputes which have become part of, and have an immense impact on China-EU trade relations, and to address the issue of managing the surmounting trade disputes.

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## **CHAPTER 1**

# **TRADE BETWEEN CHINA AND THE EU: A HISTORICAL PERSPECTIVE**

This chapter attempts to review the history and the present status of the relationship between China and the European Union (EU)<sup>1</sup> and to examine the existing problems and issues, with a view to illuminating the context of the trade disputes between China and the EU.

### **I. A Retrospective Account of the China-Europe Relationship**

Trade between China and Europe began many centuries ago. Traditionally, while China exported silk, porcelain and other luxuries to Europe, little of what Europe could offer was acceptable in China, partly due to the tyranny of distance, as well as the self-sustaining economy of ancient China. The Opium War of 1840, which itself was a result of the greed for trade opportunities on the part of a European nation, i.e., England, ushered in a century of conflict between the two civilizations and a sense of humiliation on the part of the Chinese.

When the People's Republic of China was founded in 1949, the two powers did not grow closer. Their relationship was affected by their

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<sup>1</sup> The EU, an economic and political organization, is the progeny of the European Community (EC). On 18 April 1951, France, Germany, Italy, Netherlands, Belgium and Luxembourg signed the treaty of the European Community of Steel and Coal (ECSC), which entered into force on 25 July 1952. On 25 March 1957, the above-mentioned six countries established the European Economic Community and the European Atomic Energy Community. In 1965, the three communities merged into one European Community. The Maastricht Treaty entered into force on 1 November 1993, and the term 'the EU' was replaced progressively with the term 'the EC'. In this book, the use of the terms of 'the EU' and 'the EC' are not strictly distinguished, and the term 'the EU' is used most often.



respective relationships with the US and the Soviet Union. A cold relationship was observed between China and Western Europe before the Sino-American rapprochement took place. This alignment of China and the US in the early 1970s against the Soviet Union brought about a change in China's relations with Western Europe. It was not just Western European countries which individually established formal diplomatic relationships with China in the years after 1972, but also the European Economic Community as a whole.

The rest of this section reviews China-EC/EU relations in three distinguishable periods.

### ***The First Period: From 1975 to 1989***

In 1975, China and the European Economic Community reached an agreement on the establishment of formal relations. Initially, both sides did this in order to enhance their own international standing.<sup>2</sup> From the Chinese point of view, the partnership of Western Europe was a possible card to play in the geopolitical game to contain the Soviet Union. China's reform and opening up after the Third Plenary Session of the 11th Central Committee of the Communist Party of China further paved the way to reach other agreements with the EC; in 1985, both sides signed the EC-China Trade and Economic Cooperation Agreement.<sup>3</sup> The 1985 agreement remains the main legal framework for the relations between

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<sup>2</sup> Kay Möller puts it this way: "Beijing had entered into an anti-soviet partnership with Washington in 1971/1972 and the EC in 1970 had launched European Political Cooperation (EPC) as the point of departure for a future Common Foreign and Security Policy (CFSP). The role of the European Parliament (EP) had been strengthened in 1974 with the first direct elections scheduled for 1979. Also in 1974, EC heads of state and government had agreed henceforth to convene as the European Council, a *de facto* executive. The EC Commission was authorized to collect its own revenues and to advance into new areas of cooperation such as common trade policies." See Möller, K. (2002). Diplomatic relations and mutual strategic perceptions: China and the European Union. *China Quarterly*, No. 169, pp. 10–32.

<sup>3</sup> Agreement on Trade and Economic Cooperation between the European Economic Community and the People's Republic of China. The Agreement is composed of four chapters (Trade Cooperation, Economic Cooperation, Joint Committee and Final Provisions). See Appendix 1.

the two. In May 1988, the EC Council decided to establish a delegation to China.

The first period was a time when economic cooperation, though at a very low level, was the predominant focus (to a certain extent, it remains so). In this early period, China and Europe were not connected by any grand joint design, but rather by a peripheral consequence of the more central geopolitical phenomena.

### ***The Second Period: From 1989 to 1995***

The steady development of bilateral relations was interrupted by the 3–4 June 1989 Tiananmen Incident in Beijing, which saw the beginning of civilization conflicts and the second period in China-European relations, characterized by isolation. Europe, like other major international partners of China, reacted with a range of sanctions. On 7 June 1989, the twelve members of the EU at the time took the decision to suspend economic and cultural relations with China. Since 1990, the EU has sponsored resolutions critical of China at the United Nations Commission on Human Rights sessions held in Geneva. The ensuing end of the Cold War, marked by the collapse of communist regimes in Eastern Europe and the Soviet Union, strengthened this stance of the Europeans.

The second period was a time of transition. Both sides needed time to address and manage the consequences of the end of the Cold War and to formulate more defined policies. It must be noted that the Chinese launched decisive reforms to open up their economy to trade, as well as to restructure the industrial and agricultural sectors during this period. This was especially true from 1992 onwards, when China undertook enormous trade and foreign direct investment (FDI) liberalization — followed by another big dose of liberalization in line with its efforts to join the World Trade Organization (WTO). For the Europeans, however, the importance of China's unilateral liberalization was only to be realized at the end of this period.

### ***The Third Period: From 1995 Up to Now***

The third period is characterized by a common EU policy toward China. The EU, for the first time, published “A Long Term Policy for Europe-China Relations” in 1995. On the European side, this document saw the beginning of a real, concrete European policy toward China.

During this period, the EU has seen the opportunity to engage in a rising China for the purpose of realizing its dream of a wider Europe and, perhaps, of counterbalancing the US. In this respect, the EU promulgated strategic relations with China in 2003 with the issuance of the Communication “Building a Comprehensive Partnership with China”. The EU’s policy paper highlighted China as one of the EU’s major strategic partners and the EU-China relationship to be a maturing partnership.<sup>4</sup>

## II. Current Trade Relations between China and the EU

The EU and China have the world’s second most important trade-and-investment relationship (after the transatlantic relationship). The EU is China’s biggest trading partner, ahead of the US and Japan, accounting for 20% of Chinese exports. China is the EU’s second biggest trading partner and its biggest source of goods imports.<sup>5</sup> European multinationals have poured investments into China<sup>6</sup> and are prominent in East-Asian supply chains (in which China is usually the location of the last assembly stage before finished products are exported back to the West).

Recent years have seen a dramatic increase in trade between China and the EU, an increase of about 20% per annum in recent years (17% in 2007). This brings us to the question: what exactly is the driving force behind China-EU trade relations?

The most important factor for China-EU trade is the mutual benefits based on the economic complementarity, which serves as the foundation of the trade relation between China and the EU. Indeed, China-EU trade relations are determined by the relative economic performance of both sides, by the degree of complementarity and by mutual benefits. Undoubtedly, China and the EU are highly complementary in an economical sense.

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<sup>4</sup> EU (2003). *A Maturing Partnership — Shared Interests and Challenges in EU-China Relations*. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0533:FIN:EN:PDF> (last accessed September 30, 2011).

<sup>5</sup> EU goods imports from China in 2008: €247.6 billion and EU goods exports to China 2008: €78.4 billion, some way ahead of the US and with 16% of the EU market in 2007.

<sup>6</sup> EU FDI stock in China was €32.7 billion in 2006, representing 8% of total FDI stock in China. EU FDI to China was €6 billion in 2006, compared with €2.1 billion of Chinese FDI to the EU. [http://ec.europa.eu/trade/issues/bilateral/countries/china/index\\_en.html](http://ec.europa.eu/trade/issues/bilateral/countries/china/index_en.html). (last accessed September 30, 2011)

China, with a large population, has an abundant and cheap workforce. The Chinese economy has developed rapidly and steadily as witnessed by the world, and its market potential is enormous. However, China lags far behind the EU in terms of the levels of economic and technological development. China's competitive advantage, therefore, rests on labor-intensive products; while the EU's competitive advantage rests on technology-intensive and capital-intensive products. China is mainly exporting light industry goods with low technological content to the EU, and importing machines, equipment, and so on from the EU. Both China and the EU can gain by strengthening this sort of trade linkage. China's rapid economic development in the past thirty years has provided an impetus for and has had a significant impact upon China-EU trade relations. Moreover, the export-oriented strategy that China has pursued for its economic development, which has been given top priority and has preoccupied the leadership since 1978, has reinforced trade relations between China and the EU.

As China and the EU's preferences and interests in developing their bilateral trade relations are part of the broader picture of bilateral relations which integrate security concerns, political strategy, cultural interests and economic gains, China-EU trade relations are set within a favorable political environment. Yet there are some obstacles to the bilateral trade relation that cannot be overlooked.

In fact, it should be noted that such deep trade relations have also led inexorably to commercial and political tensions between the two sides in the new global economic landscape.

### **III. China and the EU in the New Global Economic Landscape**

Any portrait of the global economic landscape cannot be true without a focus on the EU. For hundreds of years, it has occupied the centre stage of the world alone or with the United States. There is no denying that the EU is a highly developed industrialized region, with hundreds of years of industrialization history. The EU is currently the world's second largest single market and accounts for 40% of international trade (including the trade among EU member states).<sup>7</sup> The EU is the world's prime source of FDI outflows as well.

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<sup>7</sup> EC Delegation in Beijing. [http://www.delchn.cec.eu.int/cn/eu\\_guide/Trade\\_Relations\\_Multilateral.htm](http://www.delchn.cec.eu.int/cn/eu_guide/Trade_Relations_Multilateral.htm) (last accessed June 30, 2008).

However, the new economic landscape of the globe is also characterized by the rise of China. Since the start of economic reform 30 years ago, the Chinese economy has indeed achieved spectacular performance, growing at an average annual rate of 9.6%. Converted into US dollars at the current exchange rate, China's total GDP in 2010 reached US\$5.87 trillion, making it the world's second largest economy after the US.<sup>8</sup> In terms of purchasing power parity (PPP) GDP, China had already been the world's second largest economy after the US for many years.

During the past three decades, the Chinese economy has also been radically transformed from a closed system based on self-reliance to one that is actively participating in the global economic system by way of trade and investment. China's exports have indeed been growing very rapidly, averaging 16% a year since 1978 and over 20% since 2001, rising from US\$9.8 billion in 1978 to US\$1.2 trillion in 2009, i.e., a 120-fold increase. Since 2009, China has become the world's largest exporting country,<sup>9</sup> and has been the world's second largest recipient of FDI since the early 1990s. By the end of 2007, China had attracted a total of US\$7,000 billion in FDI. Not surprisingly, over 80% of the world's largest Fortune 500 companies have established offices in China. Although its trade proportion in international trade currently lags behind that of the EU as a whole, China is already the world's largest trading country and the second largest recipient of FDI after the US.<sup>10</sup>

China's growing political and economic weight has increased its importance in the international arena. By its sheer size, China's level of production, consumption, imports and exports carry significant worldwide ramifications. China's large-scale manufacturing of a wide range of industrial products, as well as its huge labor supply, has substantially brought down the world prices of these products, thus bringing tremendous benefits to consumers globally and competition pressure to the domestic producers of these products. Meanwhile, on account of its massive industrialization, China has become the world's largest consumer of a wide

<sup>8</sup> See <http://www.bloomberg.com/.../2010.../china-economy-passes-japan-s-in-second-quarter-capping-three-decade-rise.html> (last accessed June 30, 2008).

<sup>9</sup> See <http://www.cbsnews.com/.../main6078497.shtml> (last accessed June 30, 2008).

<sup>10</sup> EU (2001). *EU Strategy towards China: Implementation of the 1998 Communication and Future Steps for a more Effective EU Policy*. [http://europa.eu.int/comm/external\\_relations/china/com01\\_265.pdf](http://europa.eu.int/comm/external_relations/china/com01_265.pdf) (last accessed June 30, 2008).

range of natural resources and primary commodities from iron cores and aluminum to oil and gas. The rising demand for these resources in recent years has driven up the world's market prices.

According to estimates, China has been responsible for about 50% of the cumulative growth of these economically sensitive commodities. Whether in booms or busts, therefore, the movement of China's economic forces has become a significant factor in the global economy. Various terms, such as 'the world's powerhouse and workshop', have been coined to describe China's influence on the global economy. Despite all of the above, China's external economic impact can be best manifested in its unique pattern of trade balances with its major trade partners.

The EU and China play important roles in Europe and Asia respectively. As the largest developed economy and the fastest-growing developing economy respectively, the EU and China are nations with growing power and influence on international affairs. They are recognized as two important global leaders in today's world and positive participants in the processes of multi-polarizations and economic globalization.

Moreover, as far as bilateral relations are concerned, these two big powers provide mutual inspiration and mutual interaction by their very existence. The EU especially needs to expand and to enhance its presence, including the acquisition of access to more markets in the world, especially in Asia. The EC Communication "Europe and Asia: A Strategic Framework for Enhanced Partnerships" has made clear that "the EU is in need of other markets and China is potentially the biggest".<sup>11</sup> In all these aspects, it is necessary for the EU to obtain support and mutual cooperation from other regions and countries including Asia and China. As for China, the EU remains every bit an important partner and supporter for its ongoing reform process and its integration with the global economy. In short, both sides have a significant stake in each other's development.

#### **IV. The Evolving Bilateral Legal Framework for China-EU Trade Relations**

The conduct of trade relations raises many questions which involve legal as well as economic and political factors. When dealing with trade relations,

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<sup>11</sup> EU (2001). *Europe and Asia: A Strategic Framework for Enhanced Partnerships*. [http://ec.europa.eu/development/icenter/repository/strategy\\_asia\\_2001\\_en.pdf](http://ec.europa.eu/development/icenter/repository/strategy_asia_2001_en.pdf) (last accessed September 30, 2011).

one must bear in mind the interaction among these factors. While attention is focused on the economic and political factors, the legal aspects of trade relations are often overlooked. In fact, it is through the legal instrument that the trade-related economic and political policies are implemented, and perhaps more importantly, it is the legal instrument that creates a framework for trade policy formulation.

In theory, each state is free to adopt its own trade policy towards another state. In practice, the existing international obligations may place constraints on this otherwise unfettered freedom. Thus, in regulating trade relations with other states, governments are constrained in their policy choices by international rules.

There are currently only two categories of international rules on trade relations between China and the EU. In addition to the WTO agreements at the multinational level, there are the agreements at the bilateral level.

The EU does not have specific trade agreements with its major trading partners among the developed countries like the United States and Japan. Trade issues are handled through the WTO mechanisms, although the EU has many agreements in individual sectors with both countries. However, while the WTO framework also applies to trade between the EU and China, China and the EU have worked together in formulating a series of legal instruments for trade relations between China and the EU since 1975: in 1978, China and the EC signed the “China-EC Trade Agreement” to lay down an institutional framework for the bilateral economic and trade relationships, and the two sides put in place the Joint Committee on Trade Cooperation. This bilateral trade agreement marked a major step forward in China-EU trade relations. The 1978 agreement was replaced by the “Agreement on Trade and Economic Cooperation between the European Economic Community and the People’s Republic of China” in 1985. This cooperation agreement stressed mainly the cooperation in the areas of agriculture, energy, science and technology, and personal training.<sup>12</sup>

At the unilateral level, it was the EU that took the initiative in promoting China-EU trade relations. In 1994 the EU began to implement a “New Asia Strategy”, and in this context the EU later on formulated a

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<sup>12</sup> EU (1985). *Agreement on Trade and Economic Cooperation Between the European Economic Community and the People’s Republic of China—1985*. [http://europa.eu.int/comm/external\\_relations/china/intro/1985\\_trade\\_agreement.htm](http://europa.eu.int/comm/external_relations/china/intro/1985_trade_agreement.htm) (last accessed June 30, 2008). See Appendix 1.

policy document towards China,<sup>13</sup> that is, the “Long Term Policy for China-Europe Relations”, which was adopted by the European Commission in December 1995. This strategy paper built up the principles of the EU’s policy towards China and called on the EU to raise its profile in China.<sup>14</sup> In November 1996, the European Commission put forward “A New Strategy of the EU on China”; on 29 June 1998 the European Commission issued a policy paper on “Building a Comprehensive Partnership with China”. It proposed “to engage China further in the international community, to support China’s transition to an open society based on the rule of law and the respect for human rights, to integrate China further into the world economy, to make Europe’s funding go further and to raise the profile of the EU in China.”<sup>15</sup> This document elevated the EU’s relationship with China to the level of equal importance with the US, Japan and Russia, unveiling a mature and stable era in China-EU trade relations. On 10 September 2003, the EU published a new policy paper on China, “A Maturing Partnership — Shared Interests and Challenges in EU-China relations”. The EU stated in this paper that “both sides have to adapt to a fast moving international scene” and, against that background, “the EU and China have an ever-greater interest to work together as strategic partners to safeguard and promote sustainable development, peace and stability. Interests converge on many international governance issues, notably the importance that both attach to the role of the UN in physical and environmental security”.<sup>16</sup> Following this EU policy paper on China, China issued “China’s EU Policy paper” on 13 October 2003, which was the first strategic paper on the nation’s policy towards the EU. A number of measures for boosting China-EU economic cooperation in the subsequent five years were outlined in this policy paper. The paper also pointed out that “[to] strengthen China-EU relations is an important component of China’s foreign policy...China is committed to a long-term, stable and full partnership with the EU...

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<sup>13</sup> EU (1994). *Towards a New Asia Strategy*. [http://europa.eu.int/comm/external\\_relations/asem/asem\\_process/com94.htm](http://europa.eu.int/comm/external_relations/asem/asem_process/com94.htm) (last accessed June 30, 2008).

<sup>14</sup> EU (1995). *A Long Term Policy for China-Europe Relations*. [http://europa.eu.int/comm/external\\_relations/china/com\\_98/index.htm](http://europa.eu.int/comm/external_relations/china/com_98/index.htm) (last accessed June 30, 2008).

<sup>15</sup> EU (1998). *Building a Comprehensive Partnership with China*. [http://europa.eu.int/comm/external\\_relations/china/com\\_98/index.htm](http://europa.eu.int/comm/external_relations/china/com_98/index.htm) (last accessed June 30, 2008).

<sup>16</sup> See footnote 4.



China desires to promote a sound and steady development of China-EU political relations...deepen China-EU economic cooperation and trade.” The issuing of this paper was a further sign of the sound development of China and EU’s bilateral trade relations.<sup>17</sup>

The above-mentioned documents serve as the legal and policy framework for China-EU trade relations. The EU’s latest official Commission Communication marks something of a watershed. It officially boasted a strategic partnership for the first time.

Since 1995, successive policy declarations on the part of the EU attest to the growing importance of China as a trading partner. This process mirrors similar developments in the trade relations between China and the EU. To an extent, it has also eclipsed the developments in trade relations between either of the two sides and a third party, for the EU has become China’s largest trading partner, accounting for about a fifth of its external trade.

In a nutshell, the legal basis for bilateral relations has been the Trade and Cooperation Agreement of 1985, although there have been 7 formal agreements and 24 sectoral and regulatory dialogues on a wide range of issues.<sup>18</sup>

### ***Implications of the Legal Framework for Trade Relations***

A legal framework for trade, particularly the agreement that states conclude to regulate the bilateral trade, is generally trade-conducive. Moreover, bilateral agreements are generally in a better position than multilateral agreements to address the concerns of the states concerned.

However, with regard to the existing bilateral trade agreements between China and the EU, a close look at some of them, particularly the Agreement on Trade and Economic Cooperation of 1985, the founding stone of the bilateral trade relationship, will reveal that the trade agreements are not better equipped than multilateral agreements to promote trade liberalization. The Agreement is not yet in a position to constrain the trade policy options of either side, thus leading to prospective trade disputes between the two sides.

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<sup>17</sup> Ministry of Foreign Affairs of the People’s Republic of China (2003). China’s EU Policy Paper. <http://www.fmprc.gov.cn/eng/topics/ceupp/t27708.htm> (last accessed October 10, 2011). See also Appendix 2.

<sup>18</sup> [http://ec.europa.eu/external\\_relations/china/index\\_en.htm](http://ec.europa.eu/external_relations/china/index_en.htm) (last accessed September 30, 2011).