An Assessment of EU-China Relations in Global Governance Forums

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Executive Summary

China and the European Union are both confronting a critical transition, whose outcomes will affect the medium to long-term horizon of EU-China cooperation at the multilateral level. Beijing needs to reignite stalled political reforms at home, and strike a new balance between state intervention in the economy and market play to guarantee the sustainability of China’s development. In Europe, the outcome of the euro crisis will determine how the material constitution of an increasingly two-speed Union shapes up and whether the EU can emerge as a more cohesive multi-level actor, addressing China’s frustration with Brussels’s seeming inability to act as a more autonomous ‘pole’ in international affairs.

With the recent financial crisis marking a systemic watershed, the EU should aim to create strategic space for engaging China in the re-moulding of the institutional landscape of post-crisis global finance and trade. As the post-neoliberal era awaits defining, the Union has an opportunity to upgrade the profile of European discourses on economic governance and leverage Beijing’s manifest interest in reforming the international monetary and financial systems. This would anchor China to a more legitimate international order, and provide constructive exogenous pressure for Beijing to implement difficult domestic reforms which can have global implications, including on key European economic interests.

The G20 is regarded both by China and the EU as a critical platform to generate political momentum for more effective global governance. Beijing has actively raised its profile from peripheral to core actor within the G20, as the forum fits several of its foreign policy priorities, including the enhancement of China’s status, mitigation of external pressures, and trust generation. For the EU the G20 is instrumental to increase internal cohesion and ensure that newly-emerged and emerging countries perceive to have a stake in global governance. The EU and China share an ambition for the G20 to pursue sustainable global growth by encouraging diffuse domestic structural adjustments, fiscal consolidation in advanced economies, and the restructuring of China’s development paradigm to reduce global imbalances. Despite an apparent decline in effectiveness after 2009, the G20 has made progress in multilateral regulatory oversight through the Financial Stability Board. As the international financial system stabilises, it is now important for the EU to engage China in defining a post-emergency mission for the G20, and designing a new G20+ institutional formula with an agile permanent secretariat, coupled with a G20 advisory council of independent experts.

The EU can leverage the political capital arising from more robust leadership in the reform of Bretton Woods institutions to steer China’s manifest interest in a more level international monetary playing field through joint contingency planning in preparation for a multipolar phase, to be followed by a new multilateral regime. Monetary and financial stability can be strengthened by China diversifying its currency portfolio and spreading risk: the EU can build on a strategic convergence of interests with China in this field by positioning the Euro credibly as a global reserve currency and supporting the gradual internationalisation of the renmimbi.

The EU and China are active participants in the WTO legal framework, reinforcing the role of the WTO dispute settlement system as a stand-in for incremental trade regulation. Pursuing a
comprehensive negotiation of a Europe-wide agreement on investment with China, while deploying a comprehensive EU external public procurement policy would further encourage China to fulfil its obligations in the WTO and increase the staying power of free trade at a particularly critical juncture. This would create opportunities abroad and cut government costs at home both in Europe and in China and would be coherent with the EU’s 2020 Strategy and China’s 12th Five-Year Programme, which converge on the strategic pursuit of green and sustainable growth based on an innovative economy.

**Main points**

- Both the European Union and China are facing a phase of critical transition domestically, whose outcomes will bear significant consequences on the medium to long-term horizon of EU-China cooperation at the multilateral level.

- China has shown increasing frustration with the EU’s seeming inability to emerge as a more unified, autonomous ‘pole’ in international affairs, but in the aftermath of the recent systemic crisis the EU can aim to create new strategic space for engaging China in the remoulding of the institutional landscape of the global financial and monetary systems.

- China has grown to regard the G20 as the most important multilateral global governance platform for economic and financial matters, and one coherent with several of its foreign policy priorities, including status enhancement, mitigation of external pressures, trust generation, and access to opportunities to become better acquainted with multilateral governance practices.

- The EU and China support the G20 to pursue sustainable global growth by encouraging diffuse domestic structural adjustments, fiscal consolidation in advanced economies, and the restructuring of China’s development paradigm to reduce global imbalances.

- Despite an apparent decline in G20 performance since 2009, progress has been made in multilateral regulatory oversight through the Financial Stability Board; the EU should encourage China to support a more ambitious G20+ formula with an agile permanent secretariat, coupled with a G20 advisory council of independent experts.

- While EU-China cooperation in the IMF is affected by the over-representation of Member States and the non-representation of the EU itself, the EU should leverage the political capital arising from more robust leadership in the reform of Bretton Woods institutions (including relinquishing traditional European prerogatives over the office of IMF director and unilaterally renouncing a potential eurozone veto power) to steer China’s interest in a more level international monetary playing field through joint contingency planning in preparation for a multipolar phase, to be followed by a new multilateral regime.

- Fundamentally aligned in support of free-trade, the EU and China are active participants in the WTO legal framework, reinforcing the role of the WTO dispute settlement system as a stand-in for incremental trade regulation, which helps to preserve the overall staying power of free trade at the current critical juncture.
Through an early concession of Market Economy Status and the de-linking of non-trade goals from trade negotiations, the EU should neutralise irritants with China and focus on an ambitious Europe-wide agreement on investment with China and on the development of a comprehensive EU external public procurement policy to induce the Chinese authorities to fulfil their obligations in the WTO by submitting a comprehensive Government Procurement Agreement, better aligning to international standards, and generally increasing market access for EU companies in China.
Introduction: Europe, China and Multilateralism

Both the European Union and China are facing a phase of critical transition domestically, whose outcomes will bear significant consequences on the medium to long-term horizon of EU-China cooperation at the multilateral level.

The EU’s profile as a global actor has been in a state of flux since 2009, when the coming into force of the Lisbon treaty coincided with the most severe financial crisis to hit Europe since 1929. The EU’s capacity to play a strategically meaningful role at the international level in the future is thus fundamentally a function of its ability to carry out effective reforms on the domestic front today. The outcome of the euro crisis will determine whether the European project retains legitimacy in the eyes of its own public and how the material constitution of an increasingly two-speed Union shapes up. Failure would invalidate ambitions to leverage Europe’s unique experience in sovereignty pooling to foster global governance practices based on legalised frameworks of multilateral interaction. Success would graduate the Union past its security-preserving, market-enhancing credentials into a more cohesive multi-level political actor, boosting its credibility and influence at the international level.

The People’s Republic of China (PRC) does not share the EU’s normative commitment to multilateralism. Rather than viewing it as a tool to foster governance, Beijing mostly conceives multilateralism as a way to reproduce sovereignty, steering international order in directions that better reflect China’s role and preferences, while constraining its foreign policy autonomy as little as possible. The Chinese notion of ‘harmony’ in international society is as much a rejection of conflicts that may derail China’s development, as a statement affirming the intrinsic legitimacy of political-economic models and values alternative to Western democratic liberalism. Having moved incrementally away from its non-aligned, sovereignist posture, the PRC today sees global challenges as becoming more prominent and security threats as increasingly integrated and volatile, in a context of global power diffusion. However, while the EU fears marginalisation in a world characterised by competitive multipolarity, Beijing favours the informal dynamics of great power concert diplomacy. Although the impending political transition in Beijing is unlikely to alter the course of China’s foreign policy in the short term, there is growing consensus both inside and outside China that the PRC’s political system is in urgent need of reform, while a new balance between state intervention in the economy and market play needs to be struck to guarantee the sustainability of China’s development.
The PRC’s frustration with the seeming inability of the EU to emerge as a more unified and autonomous ‘pole’ in international affairs, especially with regards to specific US desires, accounts for the relative loss of momentum in EU-China relations since the mid-2000. Today, however, just as the dynamics generated by the financial crisis risk further denting the Union’s profile as a meaningful partner at the multilateral level, the structural fragility of the global economic landscape offers strategic space for constructive engagement with China.

The G20: Catalysing Political Impulse to Enhance Global Governance

Established by the diplomacies of the US and major European countries, which remain the principal agenda setters, the G20 Leaders’ Summit is one of the few multilateral forums where China has actively raised its profile from peripheral to core actor. Beijing has grown to regard the G20 as the most important multilateral global governance platform for economic and financial matters. As a forum operating by consensus to reform the global regulatory system, enhance surveillance and improve cooperation among the world’s main advanced and emerging economies, the G20 fits several key foreign policy priorities of the Chinese government:

- it allows China to see its status as a newly-emerged global power entrenched without being associated with the ‘hegemonistic’ aura of the Western-dominated G8;
- it preserves the strategic ambiguity of the PRC’s profile as a world power that can choose to cast itself as merely the ‘largest developing country’ to mitigate external pressure and claim diplomatic affinity with developing nations;
- it reduces the risk of an undesired drift towards a G-2 or G-3 configuration of global governance practices, which would force China to abandon its cherished approach of ‘keeping a low profile and acting proactively in a prudent, parsimonious way’;
- it facilitates a relatively hands-off learning process in an informal context where Chinese leaders can present China’s positions and foster trust.

For the European Union, which has its own seat at the G20 in addition to the four attributed to its largest Member States, the visibility and political weight acquired by the forum shapes a de facto dual system of global governance. It raises questions about its representativeness and how informal multilateral political impulse is translated into verifiable binding commitments.
However, lack of consensus for substantial reform of the UN and other formal institutions, means that the G20 forum has become a critical proxy to ensure that newly-emerged and emerging countries perceive to have a stake in global governance. This is especially true for China, whose self-awareness as the linchpin of the global economy has been nurtured by its participation at G20 meetings, fostering a more assertive posture that eschews past behaviour as a rule-taker.

Both the EU and China have benefited domestically from participation in the G20. EU coordination ahead of summits has improved, increasing its credibility as the Union takes advantage of the G20 platform to protect the euro while advancing a wider reform agenda for the global financial architecture. China has found in the G20 an ideal forum to move past its tendency to passively adapt to international norms or engage in preventive revisionism, honing its understanding of global governance practices. G20 recommendations also serve as an expedient external pressure to enhance the domestic political momentum for Beijing’s economic reforms.

The performance of the G20 has appeared to suffer from a decline in effectiveness after the initial successes of 2009. Yet, although the realpolitik of national interests and significant industry resistance have slowed the pace of reforms, especially in the financial sector, substantial progress has been made in some areas of multilateral regulatory oversight through the efforts of the Financial Stability Board. The publication of the FSB’s traffic lights scoreboard to track progress in the implementation of financial reforms has been endorsed by the G20 and offers reason for cautious optimism, as the degree of Member States’ compliance with G20 recommendations has not been disappointing. The G20 decision at the recent Los Cabos summit to place the FSB on an enduring organisational footing, with legal personality, strengthened governance, greater financial autonomy, and enhanced capacity to coordinate the development and implementation of financial regulatory policies underlines the forum’s commitment to a consistent implementation of financial reforms, which is essential to avoid the fragmentation of global financial system.

The EU and China share an ambition for the G20 to pursue sustainable global growth by encouraging diffuse domestic structural adjustments. This approach, in partial contrast to the US policy of quantitative easing, calls for fiscal consolidation in G20 advanced economies and a
reduction of global imbalances through the restructuring of China’s investment/export-led development paradigm towards greater consumption. China’s decision at Los Cabos to inject USD 43bn USD (EUR 34 bn) in the IMF firewall set up to contain Europe’s debt crisis is as much a reflection of Beijing’s ambition to enhance its influence in Bretton Woods institutions, as it is proof of the stakes China sees for itself in the EU economy, in the euro as an alternative reserve currency to the dollar, and in the credibility of a (continental) European intellectual counterpoint to Anglo-Saxon neo-liberal economic thinking.

With polemics on China’s currency manipulation a politically-induced irritant, and debates on how to define and monitor global imbalances a case of European division, risks of divergence between the EU and China at the G20 remain, but appear manageable and not of strategic significance. The two sides have a fundamental interest in preserving the efficacy of this platform. While at the height of the 2008-09 crisis political momentum for enhancing the G20 hardly needed to be generated – as intense pressure was brought about by chaos in the financial markets and an immediate risk of systemic financial meltdown – with the global financial system now seemingly more stable, the urgency to define a post-emergency mission for the G20 has become apparent. This is a crucial debate in which the EU can leverage its unparalleled experience in multilateral governance to engage China in proposing that the G20 be cast – and reported about – as an incremental, drawn-out process with clearer medium-term ambitions.

**Bretton Woods: Reforming the IMF into a ‘barking watchdog’**

EU-China cooperation in the International Monetary Fund is fundamentally affected by the twin problems of the over-representation of Member States and the non-representation of the EU itself. These issues should be seen in the wider context of the forthcoming implementation of a quota revision that, despite lifting China to third largest shareholder, penalises developing economies, preserves the US veto power, and allows the sum of EU Member States’ quotas to far exceed that of BRIC countries. The Union’s role in the IMF is further complicated by the fact that the EU combines a major exclusive competence on monetary policy for the eurozone with shared competences on economic policy at the EU-27 level. Debate over structural reform of the Fund’s voting shares – affected by a potential voluntary consolidation of eurozone states’ quotas into a single seat – is thus a prime sphere for engagement between the EU and China.
If properly leveraged in the perspective of a more comprehensive revision of IMF governance mechanisms, the leadership shown by European Member States in quota distribution could constitute a positive background for further engaging China. Beijing has made its commitment to Bretton Woods institutions manifest by sending extremely capable officials to operate in them, but also by arguing for increased representation for new economic heavyweights, and by offering ambitious proposals for the reform of the international monetary system.

In the latter realm, although European countries have long been tolerant of the ‘exorbitant privilege’ enjoyed by the US as the provider of global liquidity, concern has grown for the systemic distortions generated by Washington’s reliance on monetary short-cuts to exit a financial crisis provoked by its own institutional failures in the first place. Although China has publicly offered a proposal to mitigate dollar centrality by enhancing the global role of IMF Special Drawing Rights – a healthy indicator of Beijing’s willingness to stimulate rule-making – the EU has not been keen to confront its transatlantic ally on this key front as yet.

Chinese confidence in European leadership at the Fund, however, may be stimulated in other crucial areas. Given the euro’s role as the only alternative to the dollar for its capacity to absorb Chinese liquidity, the EU has a natural shared interest with China in cooperating with the Fund to strengthen the single currency, while at the same time, cooperating to facilitate the internationalisation of the Chinese renminbi beyond the current highly constrained set of purposes.

Secondly, both actors lament the IMF’s failure to act as a reliable watchdog ahead of the 2008 global financial crisis. While China’s rigidity on the definition and monitoring of global imbalances is matched by divisions within the EU on the same subject, both actors welcome greater institutional transparency at the Fund and an increase in its early warning and crisis-prevention capacity. The EU should further support China’s request that the Fund promote professional training for personnel from developing nations to increase their ability to participate in IMF technical mechanisms.

While that of transforming the Fund into a truly independent, ‘barking watchdog’ is a profoundly political issue, the current economic and intellectual milieu favours ambitious
structural reforms. Rather than witnessing the multiplication of veto power holders through a possible eurozone quota consolidation, the EU should publicly review the informal custom of having a European director of the IMF – a bargaining position unlikely to keep its salience for long – and invest its political capital to anchor both China and the US to a more level monetary playing field.

The WTO: Strengthening the Staying Power of Free Trade

A unique case among China’s main international partners, EU-China relations do not owe their relevance to strategic or geopolitical calculus, but essentially to bilateral and international trade. The EU remains the world’s largest exporter of manufactured goods and services, and the biggest export market for over one hundred countries, including China. China’s economic growth – and the overall stability of the Chinese polity – is in turn vitally dependent on exports (and imports, mostly from its own region). Brussels and Beijing thus fundamentally share a free-trade agenda, a commitment reflected in Europe’s leading role in GATT and WTO negotiations, and, more recently, in China’s seriousness about implementing the bulk of its WTO obligations in timely fashion.

In spite of this and the regularity of the dialogue between the two – during the annual EU-China Summit, EU-China High Level Economic and Trade Dialogue and sectoral dialogues – cooperation is declining, although by the law of unintended consequences this might work to the reinforcement of the WTO itself.

The weakening of political impetus for greater reduction of global trade barriers has become apparent in the continuing failure of the Doha round, but also in the perceived decline in support for free trade inside most advanced countries, most notably the United States. As Washington and Brussels become more concerned about their trade deficits with China and global trade recovers slowly after the sharp contraction of 2009, divergences and competing interests with China gain traction among publics and policymakers.

The EU is finding it increasingly difficult to induce China to open various spheres of its economy to foreign investment, starting with the service sector. Beijing’s peculiar national technical standards often function as non-tariff barriers further limiting access into the Chinese
market, while incomplete protection of intellectual property rights, preferential treatment of domestic (and especially state-owned) enterprises, bureaucratic hurdles and a still missing accession to the WTO Agreement on Government Procurement constitute severe obstacles to European business opportunities in the Chinese market.

Frustration with China’s lack of progress helps explain the growing recourse to the WTO’s dispute settlement system. After the initial grace period following China’s accession in 2001, the cases debated are moving progressively closer to the heart of Chinese industrial policies and related domestic regulation. While operating on opposing fronts, however, China and the EU effectively participate in the WTO legal framework, thus strengthening the credibility of the WTO dispute settlement system, reinforcing the role of WTO panels and the Appellate Body as stand-in ‘legislators’ for incremental trade regulation, and augmenting the overall staying power of free trade in the current critical juncture.

The EU has so far appeared to have little capacity to counter the deterioration of the business environment in China. An early concession of Market Economy Status to China and the delinking of normative, non-trade goals such as human rights, cultural diversity, and sustainable development from trade negotiations could be employed to extract a set of WTO-plus commitments to further open Chinese markets in investment and services.

**Concluding Remarks and Policy Recommendations**

While management of expectations remains important to maximise the impact of the EU’s commitment to cooperating with China in global governance forums, it is essential that the Union upgrades the profile of European discourses on economic governance as we wait to define the post-neoliberal era. Depending on its future domestic developments, the EU can aim to create strategic space for engaging China in the re-moulding of the institutional landscape of post-crisis global finance and trade. This would both anchor China to a more representative and legitimate international order, and provide constructive exogenous pressure for Beijing to implement vital domestic reforms with systemic implications.

Europe’s experience in multilateral trust-building via the encapsulation of partners’ interests is a key asset. Its finalistic approach, however, is at odds with Chinese culture at large, and specifically with Beijing’s current perspective that an emerging power is best served by time-
biding, free-riding behaviour. Greater intra-EU solidarity, substantive and perceived EU loyalty to global governance, and a new capacity to bargain hard on a lean, cohesive portfolio of key desired outcomes will place the EU on a stronger footing in preventing global order erosion.

The G20 has to date been one of the most successful instances of China’s active participation in global governance forums. The European Union should resist the widening of the G20 mandate to include overly ambitious development and climate agendas, given that unhelpful normative abrasion is likely to occur with China in these fields. Rather, the Union should leverage common strategic interests to cooperate with China in focusing the G20 agenda on the reform of the international financial and monetary systems. New codes of conduct and regulatory regimes for sovereign rating agencies would be a substantial first step forward to create the momentum for more ambitious measures, including in the definition of a regime for managing hot capital flows that can be the cause of extreme market volatility.

While the intergovernmental nature of the G20 summits at head of state level is an asset to be preserved, at the institutional level, the EU should encourage China to support a more ambitious G20+ formula. Here, the limitations currently imposed by the rotating chair system could be tackled through the establishment of an agile permanent secretariat, coupled with a G20 advisory council. While the secretariat would serve as a tool to avert risks of fragmentation and short-termism in the definition and pursuit of the G20 agenda, independent experts making up the advisory council would be tasked with strengthening intra-G20 peer-review processes, preventing their deterioration into ‘peer protection’ dynamics – which, in an age of intense interdependence, would be lethal to the G20 and to global interest at large. The council ought to be afforded a degree of concurrent authority over the G20 agenda with the latitude to make recommendation proposals and it should be guaranteed adequate media visibility. Both entities should be based in Asia to balance the Western-centric arrangements of other global institutions, with Hong Kong a potential candidate as host city.

The European Union should further engage China’s manifest interest in reforming the international monetary system. By relinquishing traditional European prerogatives over the office of the IMF director and unilaterally renouncing a potential eurozone veto power, the EU would make a powerful contribution to the reform of the IMF into a more independent, veto-free ‘barking watchdog’. The Union should leverage the political capital arising from leadership in IMF reform to seek Chinese and US commitment to a more level monetary playing field in
view of the gradual, relative decline of the US economy and of the dollar as the sole reserve
currency. Specifically, the EU should engage China in contingency-planning for an impending
multipolar phase in the international monetary system, to be followed by a new multilateral
regime. The EU – and the Eurozone in particular – should take the necessary political steps to
position the Euro credibly as a global reserve currency, including governance reforms, the
streamlining of the Eurozone external representation, and the creation of a Eurobond market
to supply reserve assets. China’s efforts to progressively internationalise its currency through
the development of an offshore market and the stimulation of re-denomination of Chinese
trade should be supported.

Monetary and financial stability would be enhanced by increased Chinese investment in
Europe, enabling China to diversify its currency portfolio and spread risk. This dynamic should
be steered by the EU to translate into greater EU-China cooperation in bilateral trade and
investment. The EU should neutralise irritants through an early concession of Market Economy
Status to China and the de-linking of normative, non-trade goals from trade negotiations. It
should further pursue a comprehensive negotiation of a Europe-wide agreement on
investment with China, which would improve the current patchwork of bilateral agreements to
the benefit of both EU and Chinese investors. Contextually, it should finalise the development
of a comprehensive EU external public procurement policy that includes mechanisms to
encourage the EU’s trading partners to start market access discussions where necessary. The
objective should be to induce the Chinese authorities to fulfil their obligations in the WTO and
submit a comprehensive Government Procurement Agreement offer that reflects public
procurement realities (i.e. that a large proportion of China’s public procurement is carried out
at local levels and by state-owned enterprises). The EU should stress that GPA implementation
would create opportunities abroad and cut government costs at home for China, while an
agreement that encourages European investments into its economy would foster innovation
and competition in China, in line with its 12th Five-year programme.