

American University of Central Asia

European Studies Department

Linking Two Growing Poles: European Union-China Relations

By

Aierken Ailifeire ES-106

Supervisor: Dr. Markus Kaiser

A thesis submitted to the European Studies Department of American University of Central Asia in partial fulfillment of the requirements for the degree of Bachelor of Arts

May 2011

Bishkek, Kyrgyz Republic

List of Abbreviations

ECIPE	European Center for International Political Economy
ECSC	European Coal and Steel Community
EEC	European Economic Community
EFTA	European Free Trade Agreement
EU	European Union
FASP	Foreign Affairs and Security Policy
IPR	Intellectual Property Rights
NBS	National Bureau of Statistics of China
PRC	People's Republic of China
RMB	Ren Min Bi
SOE	State Owned Enterprise

Abstract

Relations of European Union and People's Republic of China have made significant achievements in short historical period of time. Core of their relations has been mainly economic. In 1985, Trade and Economic Cooperation Agreement engaged them unconditionally. The suggestion of engagement was not to be conditional on specific Chinese behavior. Further they have signed several different agreements to develop their relations. However, first decade of EU-China trade relation was largely symbolic due to its insignificant trade volume. Chinese transition economy had much to approve in its strongly centralized economy in order to play the global economic game with the other economies on equal terms. While preparing itself for the membership status for WTO, EU was one of the parties that favored and help Chinese fulfillment of requirements of the WTO. EU had great expectations from this membership, as all the other members, since entrance into WTO meant having all the trading partners under common rules and obligations of WTO. However, EU's expectations were not met. EU-China relations still have problems on human rights issue, arms embargo lifting, transparency and easy access to Chinese market, anti-dumping and anti-subsidizing issues, copy-right and IPR protection issues and many other issues, which remain as source of misunderstanding and conflict among EU and China. Another source is the complex and not transparent governmental system of China and divided and not unified voice of EU. Researching all this problems and attitudes of EU on China as well as Chinese view of EU, paper highlights the main obstacles for further mutually beneficial relations. Weighting all the opportunities and threats of the relations I propose EU to rethink over its strategy toward China in a way that further relations with economic giant will not harm EU economically.

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Introduction

EU's approach toward China seemed to stuck in the last decade. China today is a global power. Decisions taken in China are central to almost all the EU's pressing global concerns, whether it is about climate change, nuclear proliferation, or rebuilding economic stability. Strongly controlled economic and industrial policies of China have affected the EU's economic wellbeing. Yet EU continues to treat China as the emerging power it was, rather than the global force it is.

China's dramatic rise sneak of EU's attention. Standing against such a giant some Member States are fascinated, however many feel more fearful than hopeful about the long-term relations. To what degree China will dominate the economic exchange in future is the main concern. EU leaders also share many of these worries, and are watching China more closely. I drew analogies between the EU-China relations and the story of Gulliver's Travel. Gulliver was washed ashore after a shipwreck and found himself as a prisoner of small people, who are inhabitants of the neighboring and rivaling countries. Just after being sure of his good behavior, he was given a residence in Lilliput and became a favorite of the court. Applying the same scenario to the EU-China relations we can see how giant China was washed ashore to the EU market after its remarkable economic reforms. Small EU neighboring and rivaling Member States greeted China with astonishment, fear and ambiguity. China was webbed by EU bilateral agreements, joint communiqués, memoranda of understanding, summits, ministerial visits and sector-specific dialogues that supposed to catch up China in rules and commitments, protecting the EU from bad Chinese behavior. Now EU is observing and assuring weather giant China is good enough to give a residence in EU market and become a favorite of the court.

This paper is structured in a way to see if the positive scenario in Gulliver's travel where he is released from the ties and have helped his small friends, is applicable for EU-China relations,

or there is another scenario where released Gulliver in our case China will harm and destroy the country of Lilliputs in our case EU.

First Chapter of the paper discusses the development of economies of EU and China since 1950. Deng Xiao Ping's economic reforms that resulted a shift from strongly centralized economy to more open and market economy. These reforms played major role in Chinese tremendous economic growth and in its global influence on international economy today. As well chapter discusses about the integration process of EU. First initiatives to form an economic and political union of European countries. Each step of economical integration has contributed its own benefits to the union. Passing through stages of forming: European Economic Community, European Free Trade Association, Customs Union, Single Market, Eurozone and European Monetary Union, EU today also became a global player in global market. Also China and EU was brought up together in this chapter, in order to see what are the bases for researching their relations today.

Second chapter mainly describes the history of relationship of EU and China. Starting with the Trade and Economic Cooperation Agreement between them signed in 1985 when they were engaged unconditionally. EU believed that this engagement would liberalize Chinese economy, improve the rule of law and democratize its politics. This unconditional engagement could be described as a policy that gave China an access to all the economic benefits of cooperation with Europe while asking for little in return. Since then different agreement were designed to improve and deepen the relations of EU and China. Celebration of 35th anniversary of their relations in 2010. Current EU-China strategy paper for 2007-2013 under which their work today. Moreover why their relations are far from being strategic.

Third chapter is mainly focuses on the entrance of China into WTO. China's membership to the WTO was seen as a favorable provision to improve the disputes between EU and China.

However, EU's hopes were not met. Oppositely China benefited from this membership more than other members including EU. China profited from fully accessible EU market and copied not only luxurious French bags, but also produced cars with the identical design to BMW and Mercedes. In contrary, China looked skeptical to the foreign companies entrance into their domestic market.

In forth chapter paper argues about the main problems of relations of EU and China. Divided EU, which does not speak by one single voice and which have diversified views on issues like human rights and arms embargo lifting. Rivalry of the "Big three", how UK, Germany and France prefer to have their own trade dialogues with China rather than a unified one. Therefore on occasion they are the main rivals of each other. Complexity of Chinese government system, lack of transparency in reporting and no clear division between state, province and local authorities is another source of problems. Renminbi (RMB) peg is one more issue of discussion. RMB was fixed till 2005 and undervalued, thus hurt the economies with flexible currency rates. Human rights disputes seem to be the endless problem of EU-China relations. Violations of human rights are strongly criticized in EU and discussed in every Human rights dialogues. However, changes after decades are not significant. Lastly discussed problem of relations is arms embargo lifting. EU has imposed sanctions on China after Tiananmen Square massacre in 1989, and since that time arms embargo remained in force. Chinese sees it as an obstacle of their relations; nonetheless EU countries have comparatively strong voice to keep arms embargo in force.

Fifth chapter is dedicated to Member States attitudes toward China. Here the results of the survey made by Fox and Godement senior policy fellows of European Council on Foreign relations are presented. By individual policies and actions of Member States, they are divided into four groups: Assertive Industrialists, Ideological Free-Traders, Accommodating

Mercantilists and European Followers. Chapter describes by which principle were these countries divided into that groups and what are their policies toward China.

Chapter sixth describes the European view of China. EU views China with a combination of different views. Many Commissioners are sent to Beijing to read the unreadable China. There is fear of China, when their relations are viewed from militaristic aspect, in zero-sum terms. EU does except their weakness in front of strong military power of China. EU thinks that China more or less knows how to deal with whom and what to get from the relationship thus is confident about how to manage the pressure from EU's side. It seems that EU honestly and faithfully believes in the "high merit" of their unconditional engagement, because EU fell in love with China more then China fell in love with EU.

Next chapter of the paper presents the Contemporary Chinese View of Europe by Karine Lisbonne-de Vergeron. Here, all the strengths and weaknesses of EU by eyes of China are described. How China sees its partner and what China wishes to improve in EU in order to have more close and strategic relations. Feeling of China is that EU's political significance has obviously decreased. Chinese vision is that Brussels significance in diminishing. "Brussels is losing importance: we must go back to the capitals, who make the decisions, speak to Member States, even on trade," said one influential Chinese analyst.

In chapter seven statistical records of EU-China economic relations are presented. Analyses of the dynamics of the economic relations during last years are included. Facts and figures show the huge trade deficit of EU with China. The biggest numbers are recorded on trade in goods. EU imports have dramatically exceeded its imports and figure of 170 billion Euros trade deficit was recorded by the end of 2008. Comparison of the trade deficit of EU with China with the trade deficit of EU with World was made. Also chapter includes the possible reasons causing such trade imbalance.

Last chapter discusses the topic whether China is opportunity or threat for EU and brings arguments to prove this point of view. Summing up the whole paper we can see how each chapter discusses traces of the relation of EU and China to help to conclude that China is a threat for EU.

In conclusion of the paper, applicability of the positive scenario of Gulliver's travel into EU- China relations will be discussed. Pointing out the main obstacles and give some suggestions for EU to change its policy toward China.

By analyzing the relations from economical and political aspects, stressing on complication of the relation and bringing facts of current economic conditions of both sides I would like to answer the question: Is EU-China relationship an opportunity or threat for EU? By analyzing the facts and figures I will prove my hypothesis that: China is an economic threat for EU. To answer the research question and test the hypothesis; descriptive analyses of economic data and indicators of European Union and China, comparison analyses of statistical data for EU and China, revision and analyses of relevant literature, analyses of content of primary documents such as agreements, reports, books, national strategies, and statistical books were used. Also Analyses of secondary sources as articles from research databases, newspaper articles and interviews were done.

Chapter 1. Economic systems of EU and China

1.1 China's economic reforms help China to reach a status of global player

Historical changes help to understand the development of economies and help to make scenarios for future relations of EU and China. It is hardly possible that successful models of democracy and governance of Western countries may suit Asian countries and visa versa, as communism may lead Western countries to precipice. Thus a novel form of accommodation needs to be sought in order to place Europe-China on a more equal ground. A brief overview of China's domestic changes and difficulties in economical transition may help to analyze economic prosperity of today's Chinese economy and have an outlook for future relations of EU-China counterparts.

China under rule of Mao Zedong's¹ Communist Party had socialist economic system. Political, economic and social powers were controlled by the state. All enterprises were controlled and managed by highly centralized planning system. In such political and economical system, state could not be separated from economy and society. This highly centralized economic system decreased productivity of people and depressed their political liberty, did not provide incentives to work harder, ultimately required essential changes in the system. Possibility to make change in the system came by the death of Ma Zedong in 1976, when Deng Xiao Ping² returned to power and made his tries to reform totalitarian state. China under rule of Deng began twenty years of reform. Goals of his economic reform were to separate economy and society from totalitarian state and establish a state-free economy and an economy-free state.

¹ Mao Zedong (Dec.26.1893-Sep.09.1976) was a Chinese statesman whose status as a revolutionary in world history is probably next only to that of Vladimir Lenin (1870–1924). More than anyone else in recent history, Mao Zedong helped to reshape the social and political structures of his ancient and heavily populated country.

² Deng Xiaoping (Aug.22.1904-Feb.19.1997) became the most powerful leader in the People's Republic of China (PRC) in the 1970s. He served as the chairman of the Communist Party's Military Commission and was the chief architect of China's economic improvements during the 1980s.

The Chinese economic reform was a process of marketization, but it did not lead to radical privatization of state-owned enterprises as happened in the Soviet Union and Eastern Europe in the late 1980s (Preston and Gilson 156). Such reforms are highly risky, but Chinese reforms chosen here easier path, they did not privatize state-owned enterprises, instead reform permitted the establishment of small personal, village and town enterprises and foreign capital-owned projects by introducing foreign capital into domestic market. Such reform soon caused increasing movement of capital and human resources to the private sector, since people were more motivated to work for themselves.

In 1992 Communist Party governed by Deng established socialist market economy and communist state abandoned direct control of production and trade. As a result state-owned enterprises (SOE) has decreased from 56% in 1978 to 40.8% in 1996, and non-SOEs sharply increased from 44% in 1978 to 59.2% in 1996 (Preston and Gilson 158). Thus non-state-owned economy has exceeded the state-owned sectors and became mainstream of the national economy of modern China. China could no more be recognized as a socialist state according to the definition of socialism when the means of production should be collectivized. In the adjustment of the Chinese Constitution in 1997, the legal position of the private sector in the national economy was included into the constitution. So we can clearly see the contributions and results of the reforms made by Deng. By this reforms China became a centralized planned economy to a free market economy. All these epic changes made a crucial influence upon both China and the world. Change in political system and especially in economic system laid down favorable ground for future relationships of China and EU.

Goals set by Deng were achieved and market reforms led the basis for China to become global player in the global economy. Today's China has ranked on place of top three countries

based on different aspects. Data stored in Central Intelligence Agency (CIA)³ shows that China is not only the most populated country with its population of 1.336.718.015 people by July 2010, but also is ranked as world's second large exporter in 2010 with export amount in \$1.506 trillion (CIA, World Factbook, "China"). Current account balance of the country was also ranked number one by estimations of 2010, which composed \$272.5 billion. Japan, standing on the second place, showed an account balance of \$166.5 billion. We can clearly see that China's balance is dominating with almost the same amount of account balance of Japan, which is a very strong indicator of their economic welfare. Consequently its economy plays a major role in the change and development of global economy. China's GDP purchasing power parity is \$9.854 trillion (2010 est.) and rebates just EU with its \$14.900 and US - \$14.720 (CIA, World Factbook, "China"). China still surprises the World by its impressive leap in its GDP-real growth rate which is in average 9.91%, which reached its historical high of 15.2% in 1984 and a record of low of 3.8% in 1990 ("Wikipedia The Free Encyclopedia"). In 2010 China's real growth rate reached 10.3%. By estimations of economists it will keep this rate in 2011 and further years. Chinese share of World GDP in percentages at Purchasing Power Parity⁴ will reach 17.7% in 2020 and 22.7% in 2030 (Grant and Barysch 3). It just remains to wait and observe how appropriate these prognoses were made about rise of Chinese economy.

1.2 Europe on its way toward economic integration

Europe had totally different scenario from China. Countries of Europe decided to share common future together. The idea behind the European integration was to create an institutional

³ The Central Intelligence Agency (CIA) is an independent US Government agency responsible for providing national security intelligence to senior US policymakers. CIA was created in 1947 with the signing of the National Security Act by President Harry S. Truman. The act also created a Director of Central Intelligence (DCI) to serve as head of the United States intelligence community; act as the principal adviser to the President for intelligence matters related to the national security; and serve as head of the Central Intelligence Agency.

⁴ In December 2007, the World Bank's International Comparison Program released new PPP calculations for 146 countries for 2005; China had fully participated in this survey for the first time. The new data suggest that the emerging economies are much smaller than previously assumed – and the new estimate for China is 40 per cent lower. The EIU's projections are based on the new estimates. Source: The Economist Intelligence Unit.

framework of shared sovereignty in different sectors of the economy and also to prevent the possibility of war. Europe decided to integrate by the model of Economic integration. Europe's first steps toward integration process have started in 1951 when initial six states: Federal Republic of Germany, France, Italy, Belgium, the Netherlands, and Luxemburg have signed the European Coal and Steel Community (ECSC) Treaty in Paris. Coal and Steel were major elements of war, and by controlling the resources of each other further war would be physically impossible. In year 1957 European Economic Community (EEC) or European Atomic Energy Community (EURATOM) was established. The Treaty of Rome signed on 25 March 1957, transferred sovereignty from the countries to the organization. In 1960 establishment of European Free Trade Association (EFTA). In 1968 the elimination of internal tariff barriers between European Economic Community member states was achieved. In 1992, 12 countries EEC decided to merge separate National markets into a single market that would ensure the free movement of goods, capital, people and services under a common economic policy and signed the Maastricht treaty to establish a Single Market. By implementing the Maastricht Treaty in 1993 the EC became the EU. In 1995 the Customs Union Decision was adopted that involved trading goods between countries without any customs duties and tariffs. Each and every step of economic integration in Europe gave Member States broader opportunities for trade among each other. Further stage was creation of European Economic and monetary Union, which helped to adopt euro as a single currency. Today there are 17 European Union states and 5 non-EU states using euro as their national currency. Economic integration of European Union smoothly passed through its different stages and reached the Complete Economic Integration by unifying the monetary, fiscal, social policies and finally binding supra-national organizations. As a result, today European Union composed of 27 countries is known as a hybrid intergovernmental and supranational organization that is based on representative democracy.

As CIA reports: 27 Member States of EU have population of 492.387.344 by July 2010. Its GDP is estimated \$14.9 trillion (2010 est.) ranking it at the first place among world. EU's GDP per capita estimated \$32.900 (2010 est.) that is total GDP divided by the population, and ranks EU on 41st place among the world. GDP real growth rate is 1.8% (2010 est.), which is very low in comparison to other countries and especially China thus places EU on 156th position. Estimations provided by CIA shows that EU's exports ranked as number one in 2007 with \$ 1.952 trillion, but export of Germany alone is estimated \$ 1.337 trillion (2010 est.). Making projections, CIA would rank EU as world number one exporter in 2010.

EU's economic integration brought to dramatically positive results. Member States once decided to bring their economies together made a right decision. Integration helped European countries successfully recover their economies after World War 2 and gave opportunity for prosperous development. As a result, we have a strong united economy of EU, which with dignity takes up its position on global economy and whose voice has certain weight in global decision.

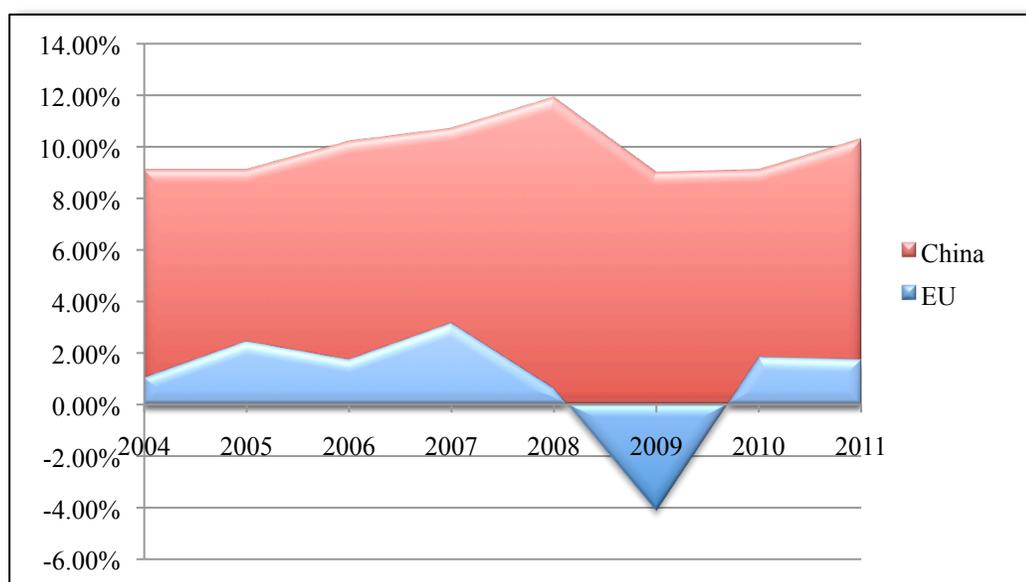
1.3 Bringing EU and China together

Today EU and China are the global players of the Global market. In areas such as export, import, GDP growth, they both compete for the first second and third places. GDP of the European Union is ranked number one among the world \$14.900 trillion 2010 est. and China stands on the third place with its GDP of \$ 9.872 trillion 2010 est. letting the second place to the United States \$ 14.720 trillion 2010 est. Yet, while calculating the GDP per capita we see the big difference between EU and China. GDP per capita of EU is estimated \$32.900 (2010 est.) and ranks it on the 41 position among world countries, China's GDP per capita is \$7.400 and ranked as 126th country. GDP per capita sharply falls when GDP is divided among 1.34 billion population of China. Even if Chinese GDP shows big numbers, life standards of population is not

that high. Population below poverty line is 2.8%. As CIA presents, 21.5 million rural population live below the official "absolute poverty" line (approximately \$90 per year); an additional 35.5 million rural population live above that level but below the official "low income" line (approximately \$125 per year) (2007). There is no combined data on population below poverty line for EU as a whole, but individually for separate countries, however it is obvious by the GDP per capita and population of EU that this number is much lower than Chinese data.

Comparing the economical development of China and EU in same period of time, we can see how China's GDP surpassed that of France in 2005 and that of Germany in 2007, before overtaking Japan in 2010, making China today the world's second largest economy after the United States and giving it all the grounds to become world's largest economy in close future. The main ground of these achievements is the extreme GDP growth rate of China all these years. Below, I have compared GDP growth rates of EU and China from 2004 to 2011;

Figure 1.



Source: "European Union GDP - real growth rate." *Index Mundi*. IndexMundi, 2010. Web. 2 Apr 2011. <http://www.indexmundi.com/european_union/gdp_real_growth_rate.html>.

From the graph we can see the enormous GDP growth of China, which is, estimated proximately 10% and GDP growth of EU, which is proximately 1% during last 8 years. Decline of GDP growth rate in 2008 and 2009 can be explained by the world crisis that did not over path EU by side. On contrary Chinese GDP growth shows its maximum at almost 12% growth in 2008. Which explains that world crisis did not hurt Chinese economy, but on contrary has left positive results afterwards. By projections of specialists, China with its extremely growing economy has potential to take the lead over the economies of EU and US by 2020 or even earlier.

Mainly GDP growth of EU and China, which rises and falls independently in their own economies, is not an aspect of problem in relations of EU and China. However, when we bring them together, and see the huge GDP growth of China, one questions rises; for how long will it continue to rise? By the projection of specialist future two decades promises to grant positive results of GDP growth in China. Then it will be a threat for EU which has much lower GDP growth and which will be harmed by steady GDP growth of China.

Understanding the economic developments of EU and China and analyzing their current situations in global market, I would suggest to observe, when and how have they tied each other by agreements on trade and cooperation. Also analyze how effectively their agreements worked for deepening their relations.

Chapter 2. History of relationship of EU-China

The intensified relationship of EU and China started back in 1985 when they have linked their relations by signing Trade and Economic Cooperation Agreement between the European Economic Community and the People's Republic of China (*EEC-China Trade and Economic Cooperation Agreement 2007*). Since that agreement Europe and China was engaged unconditionally. EU-China strategy was based on belief that China, under the influence of European engagement, will liberalize its economy, improve the rule of law and democratize its politics (Fox and Godement 1). The idea of engagement was positive in it and decided not to be conditional on specific Chinese behavior. On bases of this agreement web of bilateral agreements, joint communiqués, memoranda of understanding, summits, ministerial visits and sector-specific dialogues, all designed to draw China towards EU-friendly policies. This unconditional engagement could be simply described as a policy that gave China an access to all the economic and other benefits of cooperation with Europe while asking for little in return. However these are informal views of relations, in deed by the Trade and Economic Cooperation agreement they have granted each other most-favored nation treatment in all matters regarding: customs duties and charges of all kinds applied to the import, export, re-export, or transit of products; regulations, procedures and formalities concerning customs clearance, transit, warehousing and transshipment of products imported or exported; taxes and other internal charges levied directly or indirectly on products or services imported or exported; administrative formalities for the issue of import or export licenses (*EEC-China Trade and Economic Cooperation Agreement 2007*). It was the first piece laid for structuring the economic pathways between PRC and at that time EEC. First delegation of the European Commission in Beijing was opened in 1988 (*European Commission – External Relations 2010*). Such a good start of relations did not last for long and in June 1989 as a reaction to Tian An Men incidents of June 4; EC froze

its relations with China and imposed a number of economic sanctions, including an arms embargo with an aim of coercing China to accept Universal human rights conditions. However, here the existing two different values should be mentioned; European versus Asian that focuses on individual versus collective values. That is the source of conflicts in differences of values. The strategy of EEC neither survived for a long time, nor brought positive results. Germany proposed a milder approach while France was against and thought that actions should be stronger. Soon economic sanctions were made non-binding due to Germany's objections (Xiaoping, 2010). In a short one-year period the Italian government also started to lobby in favor of smoothing sanctions due to serious losses in country's exports to and investment in China. In 1990 economic sanctions were phased out, Council and European Parliament decided to re-establish bilateral relations again, so in 1992 EC-China relations returned back to normal without any effort from Chinese side to make changes in their human rights policy. However, arms embargo remained in place.

In 1995 European Commission published its first communication: "A long-term policy for EU-China relations" where specific dialogue on human rights issues was launched (*A long-term policy for China-Europe relations* 1995). It seems that EU places hopes on this communication to make some changes in human rights policy of China. Nevertheless, EU-China human rights dialogs launched since that time till nowadays, with a micro change in the Human Rights policy of China. Finally happened the event which EU eagerly waited for so long, in November 11, 2001 China becomes the 143rd Member of the World Trade Organization (WTO) ("Members and Observers" 2008). Member States of WTO and EU looked at the membership as an end of disputes on tariffs and barriers between EU and China, however EU started to realize the wrongness of their expectation. Nature of these problems will be described more in details in next chapter. After a decade of linkage of EU and China in 2003 China released first ever policy paper on EU where they stresses on deepening China-EU economic cooperation and trade under the

principles of mutual benefit, reciprocity and consultation on an equal basis, and promote common development ("CHINA'S EU POLICY PAPER 2003/10/13"). Since then EU-China relations had new objectives to fulfill.

Since launching first EU-China Summit, London in 1998, representatives of both sides travel to visit each other every year. Besides some postpone, as a punishment for Sarkozy's acceptance to meet Dalai Lama, EU-China summits were and are held on a regular basis just changing its place randomly. At the same time Human Rights dialogues and seminars are organized even more often. 29th Human Rights Dialogue was held on June 29, 2010 ("EU-China Relations: Chronology."). On May 6, 2010 there was celebration of the 35th anniversary of the establishment of diplomatic relations between the EU and China.

Zhang Xiaotong has identified the relations between EU and China through different types of linkages. He recognized different types of linkage strategies that could have leveraging means that EU used to build its relations with China. By his division firstly a constrictive partnership was established in 1998, then a comprehensive partnership in 2001, finally upgraded to a comprehensive strategic one in 2003.

From the perspective of power relationship, he argues that the EU is a power through partnership during this period, the essence of which was a complex of different linkages, involving political-strategic issues and economic and human rights issues as well. Once partnership was established, old linkages were consolidated by new ones. Politically and strategically, there was a trade-off between China's search of multipolarity and the EU's search of multilateralism. Economically, there was a trade-off on the basis of mutual market opening. On human rights, what was behind the EU's new soft approach was its attempt to link this issue with China's overall economic and social opening up (an issue linkage), as well as putting the human rights issue in the overall EU-China partnership context (a contextual linkage) (Xiaoping

4). He argues that the EU's power through partnership was at its most effective for the whole period of 1975-2008, whereas the confrontational approach of sanctions had been much less effective. However, in 1989, the EC's political and economic interdependence with China was undermined and the bilateral institutionalized cooperation was compressed to the minimum as the European-Sino relationship was roughly hit. Such circumstances, he thinks created opportunities for issue linkages. The period from 2003 till today, EU and China is linked by comprehensive strategic partnership and accompanied by annual 'strategic dialogues' at vice foreign minister level since 2005.

In 2007 EU has released EU China Strategy Paper 2007-2013. In recognition of this 'duality' of character, the EC response strategy will be targeted at providing support for China's reform program in areas covered by sectoral dialogues; assisting China in tackling global concerns and challenges over the environment, energy and climate change; and supporting China's human resource development. Indicative funding for the seven-year period is €224 million ("Council on Foreign Relations"). We can follow the process of development of relations between EU and China and see how tighter they become by deepening the relations.

However, current partnership between EU and China cannot yet be described as strategic due the questions of political relationship, dialogues on subjects which range from human rights issues to science, and from migration to monetary policy still remains unsolved. Grant and Barysch argues that all their tries in developing "partnership and co-operation agreement", annual "strategic dialogues", "high-level mechanism" to discuss economic and trade issues do not add up to the "comprehensive strategic partnership" that the two sides committed themselves to in 2003 (Grant and Barysch 17). Chinese prime minister, Wen Jiabao also shares the idea that the partnership of China with EU is hard to be called as strategic. During his lecture in Brussels he explained what he thought a strategic partnership meant:

“ ‘Strategic’ means that the co-operation should be long-term and stable, bearing on the larger picture of China - EU relations. It transcends the differences in ideology and social systems and is not subjected to the impact of individual events that occur from time to time. ‘Partnership’ means that the cooperation should be equal, mutually beneficial and win-win. The two sides should base themselves on mutual respect and mutual trust, endeavor to expand converging interests and seek common ground on the major issues while shelving differences on the minor ones ” (Grant and Barysch 17).

Comparing the reality with what was expected from the relations we can see that EU China relations are far from strategic. Grant and Barysch brought examples to support this statement. First, the current relations are focused on short-term perspectives, dealing with such questions as whether to grant China market economy status or not, or should EU claim on the number of Chinese bras imported. Secondly, the relationship has so far focused largely on economics. Long-term economic trends evidently have strategic implications. However, until the EU and China think more about their common interests, and potential disagreements, on questions of global security, their partnership cannot be called truly strategic. Third, the EU-China relation is not focused. According to the Commission, there are now 27 separate sectoral agreements and dialogues, covering subjects like climate change, regional policy, maritime transport, tourism, space science, the EU’s research and development programs, the ITER nuclear fusion reactor, university links, social security reform and the convergence of product standards. (Grant and Barysch 18)

Despite the non-strategic character of relations, the willingness of both parties to support the further development of their relations to be more precise economic relations is growing every year. We can surely assume that they will interdependent on each other in near and far future. However, who will benefit the relations more is another topic of discussion of further chapters.

Chapter 3. China's membership in the WTO

China's entrance into WTO was a long and difficult process. Campaign for accession to the WTO was firstly launched in 1986 and it took China 15 years to completely join the WTO. Joining WTO meant complexities and that China would have to dramatically change their laws, trade policies, and domestic regulation of doing business according to the WTO rules. China however did understand how beneficial these changes could be as for themselves as for member countries of the WTO. Membership would grant China with more foreign investments, bring desired new technologies and help to enhance China's own capabilities for technological development (Prime 5). Foreign companies and banks would increase their presence in the Chinese market, setting examples and creating competition for the domestic system (Yang 11). Chinese exports would rise thus influence its economy positively. For rest of the world this entrance would mean 1.3 billion consumer market where they could sell their products benefiting the common tariffs under WTO requirements.

Conditions for China to enter WTO were 1) lowering tariffs for imports, 2) the permission of foreign firms to sell directly in the Chinese domestic markets and 3) the opening of the telecommunication and finance sectors to more foreign competition (Chow 3). To meet the conditions for entrance China agreed to lower its tariffs on agricultural products from 31.5% to 14.5% overall by 2004, tariffs of industrial products from 35% to 17% in a by 2006, foreign manufacturers, including automobile companies, would sell their products directly to domestic consumers, foreign investors would be able to own up to 40% of shares of commercial banks in China, and up to 48% of telecommunication firms. We can see that China made gradual change in their tariffs and market share to deserve the acceptance to WTO.

However, EU played its significant role in China's entrance into WTO. Unlike US, which opposed a quick and easy accession for China, EU took more positive position and was stressing

on support rather than opposition. The EU has advocated a flexible strategy aimed at easing China into the international political and economic system while paying due respect to the gradual pace of economic reform that has been chosen by the Chinese government (Eglin 495). EU tried to find ways to benefit their relations before China gets its membership status. EU trade commissioner, Sir Leon Brittan, argues that China should be given transitional membership status whereby both China and WTO members would be freed from some of the obligations under the WTO, thus enabling China to become a founding member and to complete its market reforms in line with WTO rules (Eglin 495). US agreed with EU's transitional solution and in March 1995, China and the US accomplished an 8-point agreement according to which the US approved to conduct talks with China on China's entry into the WTO in a flexible and pragmatic spirit and to realistically solve the question of China's entry as a developing country on the basis of the Uruguay Round ("Ministry of Foreign Affairs of People's Republic of China") The US bilateral agreement opened the way for the European Union to complete its own agreement, which almost assured that China would join the WTO.

The event for which both China and rest of the world including EU waited for so long finally happened. After 15 years of negotiations of China with WTO, trade ministers from almost all the 142 members of WTO met in the Gulf state of Qatar and unanimously voted in favor of China's entrance in 2001. On December 11, 2001 a market of 1.3 billion people joined into the global trading system. Membership in WTO expected to boost economic reforms of China, which started in 1980's and open the huge market to the rest of the world. The approval of once-isolated communist China was planned to give the WTO maximum publicity and ensure that some positive news would come out of the meeting, which has the main aim of launching a new round of trade liberalization negotiations ("CNN World"). World expected much from this membership, the head of the WTO, Mike Moore said "Of course China is going to be very competitive, but

having China competitive under rules, under a binding dispute mechanism, is, I would have thought, in the whole world's interests," ("BBC News"). China's entrance was an event of worldwide meaning. EU by its turn also placed its huge prospects on China's entrance. French Finance Minister Laurent Fabius said the WTO could not genuinely be called a "world" organization without the world's most populous nation and that "When a country as important as China decides to join the WTO, it means there is a new impetus toward the development of trade." ("CNN World").

China opened up its economy significantly in preparation for WTO accession, and in the following years. It has cut most import tariffs⁵ (Grant and Barysch 36). Also China has started to open up services markets such as banking, and brought many of its laws into line with WTO requirements. However, China's move towards economic openness has slowed since 2006. Non-tariff barriers to trade make it hard for foreign exporters and investors to make business in China. These include unclear or arbitrary health and safety requirements; licensing and registration rules that discriminate against foreign companies; subsidies for Chinese companies through direct cash payments, cheap energy or soft loans; public tenders that are opaque and inaccessible for foreign bidders; and the widespread violation of intellectual property rights (IPR) (Grant and Barysch 37). The main tools as abolishment of barriers and tariffs that supposed to benefit the relations have not approved the expectancies. Trade commissioner Peter Mandelson claims that non-tariff barriers and discriminatory rules cost European companies \$55 million a day in lost business opportunities (Grant and Barysch 37).

EU's hopes that China would continue opening up its economy following its accession to the WTO have been disappointed— the Chinese government has treated WTO membership as the end of the reform process rather than a beginning (Fox and Godement 20). EU and other member of

⁵ The average tariff in China is now below 10 per cent, and only three percentage points higher than the EU average, although China's 'peak' tariffs on individual items can be considerably higher.

the WTO were complaining about Chinese unfairness on issues like anti-dumping⁶, strengthening of informal barriers to foreign entry into the Chinese market. When these issues are brought onto round table of the WTO meetings, Chinese officials answer is that they are grappling with that issues. However, EU and US became less patient for Chinese actions and be more serious about implementing its membership obligations. The EU is now making ‘a level playing field’ a major issue in its economic relations with China. However, the EU Chamber of Commerce in Beijing concludes that although China is now an integral part of the world economy, “there is a long way to go before reaching a genuine level playing field, in terms of trade and foreign investment” (Grant and Barysch 37) China still has not provided equal ground for its partners to play the fair economic game, they fully benefitted their own rights under WTO, but not granting the other member with their own obligations.

EU from its side has not yet been awarded China by market economy status even 60 other countries including Russia have done it. The fact that the EU has not defined China as a market economy gives it more leeway in the use of anti-dumping duties against Chinese exports⁷ (Grant and Barysch 46) Chinese non-market economy status brings positive futures for China as it face more anti-dumping actions and anti-subsidy⁸ tariffs which are normally reserved for developed economies. Since 2001, the EU has brought two cases against China in the WTO: one on excessive tariffs on imported car parts, and another one on restrictive practices by providers of financial information (the likes of Reuters, Dow Jones and Bloomberg are not allowed to sell their services in China) (Grant and Barysch 54).

⁶ If a company exports a product at a price lower than the price it normally charges on its own home market, it is said to be “dumping” the product. Is this unfair competition? The WTO agreement does not pass judgment. Its focus is on how governments can or cannot react to dumping — it disciplines anti-dumping actions, and it is often called the “Anti-dumping Agreement”.

⁷ Usually, for anti-dumping tariffs to be WTO compatible, the EU needs to prove that the company in question sells goods abroad at a price that is lower than the cost of production. In non-market economies, prices are seen as so distorted that the EU can use reference prices from a third country, such as Taiwan or Brazil.

⁸ Anti-subsidy refers to not providing a financial support, income and price support provide by the government or public agency of the exporting country (region) that may bring benefits to the recipient of the support.

China's entrance did not warrant the high expectancies of EU in contrary it have hold away the Chinese market and made European market easy of access. At an international car fair in Hannover in September 2007, Chinese companies presented models that looked almost identical to certain BMW and A-class Mercedes models. Chinese companies have not only faked French luxury handbags and copied German cars, but also stolen industrial designs for machinery and technology on a grand scale (Grant and Barysch 37).

Summing up the impacts of Chinese entrance in to the WTO on other members and on EU, it is obvious that China have benefited its membership status more then any other country that ache to see China in the list of members of the WTO. Chinese exports to member states of WTO have grown dramatically. Also Chinese consumers benefited from entrance of machinery and technological good without tariffs. Foreign investment flow increased accordingly they served as models for domestic companies. From the other hand other members and also EU suffered from discriminatory treatment of domestic and foreign companies, dumping of the prices, cheap imports that hurt their domestic production, and copy-write issues. Some of this issues will remain as problem of discussion while according to WTO rules, China will acquire Market Economy Status (MES) in 15 years after entering the organization which means it would get that status by 2016 at the latest. And apparently China will favor its non-market economy status till that time.

Next chapter is specially organized to see in depth the major problems of EU-China relations. Here we discuss the major aspects as complicated governmental systems of both EU and China, divided views of EU member states on their trade policies with China, especially in case of "Big Three", under valuated Chinese currency matter, disputes on human rights issue, and weather to lift arms embargo or not?

Chapter 4. Problems of relationship

4.1 Divided Europe

Complex structures of governmental systems of EU and the Chinese are organized in such ways that make it hard for both sides to treat their relationship as strategic. The EU is an organization that does not act strategically in its foreign policy toward China. The Commission is in charge of the EU's trade policy and the overall economic relationship with China. In 2006, 19 of the 27 commissioners found a reason to visit China. However, none of them has had overall charge of the relationship, and commissioners and their officials have not always co-ordinated their trips or shared information. This fact directly stresses on separateness of views of commissioners on China and how they do not will to cooperate to have a common voice toward China. In 2008 Commission President José Manuel Barroso made an effort to ensure a more integrated approach, and in April he led a group of 9 in place of previous 19 commissioners to Beijing (Grant and Barysch 20).

Another problem is the lack of co-ordination between the Commission and the Council of Ministers, which is responsible for the political actions of the EU's external relations. The Commission officials are aware of the fact that negotiating with China on partnership and co-operation agreements is less possible without EU lifting its arms embargo. But the arms embargo is a matter for the officials working under High Representative Javier Solana in the Council of Ministers, and the two groups of officials, apparently, have had little contact (Grant and Barysch 21). One of the Commission officials says: "If there is ever a case for having a single EU 'foreign minister', to replace the jobs now done by Solana and Benita Ferrero-Waldner [the commissioner for external relations], it is the way the EU handles China (Grant and Barysch 21). Catherine Ashton replaced Javier Solana on December 1, 2009, but not lifting of the EU arms embargo of China off the agenda remained in force. Catherine Ashton aligned herself with

anti-embargo countries in a strategy paper on China delivered to EU leaders. ("Security & Defense Agenda")

The European Council on Foreign Relations also has problems with handling China. EU realized that it is short of senior officials that are experts on China and which know Chinese on a level to make deeper research on China. A bigger problem is that the 27 member states hardly agree on a common idea even those, which share quite similar interests on China. They all want it to run an economy that is open to trade and investment; to get serious about curbing carbon emissions; to respect human rights; to move towards a more pluralistic political system; to maintain friendly relations with its neighbors; to act cautiously on Taiwan; and to engage in dialogue with the Dalai Lama (Grant and Barysch 21) Member States wish to have relations with China, which would include whole specter of aspects form carbon emissions to human rights issues.

Except clear and unified position of EU to maintain the arms embargo, on other important questions, such as how to respond to the tensions between China and Taiwan, or to the protests in Tibet, EU member states could not manage to find common policies. The High Representative for Foreign Affairs and Security Policy of the European Union, being more precise Catherine Ashton can only speak of the EU when the 27 will agree on a single line. Other wise it is hard to represent EU on the global arena with 27 different opinions.

4.2 Rivalry between the “Big Three”

The biggest states of EU, Britain, France and Germany ‘the big three’, see each other as commercial rivals in China. They are confident in their importance to have their own bilateral relationships with China. Here we should mention that there are two levels of relations between EU and China: bilateral, separate EU countries having economic relationship with China and multilateral, 27 Member States having political relationship with China. Thus the “Big three” are

often reluctant to join with the other big Member States or the institutions of the EU on economic issues. A diplomat working for one of “Big Three” in Beijing said: “We each seek to undermine the other Member States in the hope of short-term commercial advantage, access to the key decision makers, and influence” (Grant and Barysch 22). Each of them understands how competition for their niche in the market manipulates their decisions and actions. Also he has added: “The Chinese are skilled at playing us off against each other.”

China takes advantage of these divisions and reward countries that it considers has good behavior and punishes those governments that do ‘wrong’ thing. In the early 1990s, after France had sold frigates to Taiwan, it lost many contracts and was banned from bidding for the construction of subway systems (Grant and Barysch 23). Any EU Member State that meets Taiwanese leaders or Dalai Lama informally is likely to be punished by China. In October 2007, Angela Merkel met the Dalai Lama in Berlin. As a result, Beijing delayed contracts due to be signed with Germany, and it cancelled a series of meetings with the German government (Grant and Barysch 23). The European partners of Germany did not support Merkel’s action. German government widely believed that, after Merkel’s meeting with the Tibetan leader, President Sarkozy had called the Chinese leadership to suggest that France could become China’s chief partner in Europe (Grant and Barysch 23). Here we can see how fragmented the big three in their decisions and actions are.

Another reason for lack of enthusiasm of “Big Three” to work through the EU is not only because they see each other as rivals, but also because they do not perceive EU as serious foreign policy actor. An example is that, senior officials from EU and China meet regularly to discuss subjects such as Africa, energy, human rights, illegal immigration and strategic issues. However, the British, French and Germans prefer having their own strategic dialogues with China, while the British and the French have their own, separate, Africa dialogues. When Charles Grant and

Katinka Barysch asked an official from the UK Department of International Development why the British needed their own Africa dialogue with China, she replied: “Because we don’t trust the EU, it doesn’t have the expertise.” Likewise, UK and France have their own dialogues with China on energy, human rights, Taiwan and North Korea. From the Chinese point of view, all these multiple dialogues can be a bother, wasting valuable time of senior officials.

4.3 Complex China

The Chinese feeling about the complexity and difficulty with dealing the institutions of EU is mutual. The Chinese government is even harder to deal than the bureaucracy in Brussels where it is not easily find out who is responsible for which decision. The Chinese system is less transparent for observers. EU often does not know who is taking the decisions on Chinese side. Political structure of China is highly centralized, thus more sensitive issues are often discussed near the top of the hierarchy. However, despite its centralization it is hard to define who is responsible for what? This usually leads to setbacks and annoyance. They have difficulties with protocol issues of China, they usually do not know until last minute who will represent the China on meeting and what will be the format of the meeting. On one hand such actions from Chinese side can be considered as actions to frustrate and sap their counterparts. Sometimes EU officials just do not simply know whom to deal with to discuss or solve some particular issues. They may meet the Chinese minister who would seem like the right person, but he or she may not have full authority over the matter under discussion.

Chinese system is even more complex due to ministries, agencies and party bodies that use much influence on it. Perfect example is when Peter Mandelson went to Beijing before EU has opened a case against China in the WTO, considering excessive duties on imported car parts. Mandelson wanted to show his willingness to solve the problem by avoiding the formal procedure. But nobody seemed to be engaged seriously. His main interlocutor, the Ministry of

Commerce, had nothing to do with car industry, while the National Development and Reform Commission, which had, seemed apathetic for the deal. Such attitude forced EU to open a case in the WTO. Other examples of the WTO cases are discussed more in details in chapter devoted to Chinese membership into WTO.

China made major tries to open up the market, change its business environment and fulfill the WTO requirements, however it still remained very complex, highly centralized and closed. Lack of clear responsibility of state, region and local governments makes it very hard to solve the problems. The centralized Chinese system makes EU enterprises run through different levels without knowing exactly whom to deal with.

4.4 RMB⁹ peg begins to hurt

Only recently, Europeans were aware of the impact of China's currency policy on their competitiveness. US unlike had clear and immediate effect. In 1994, the Chinese pegged the RMB to the dollar at a rate of 8.28, and left it there for the next 11 years (Wibbelsman). Nevertheless, to catch up the price level with more developed countries, China with its open and fast-growing economy should have a rising exchange rate, not a stable one. Successive US Treasury Secretaries have pointed to the widening bilateral trade deficit, and China's ever-growing foreign exchange reserves, as evidence that the RMB peg undervalues the Chinese currency vis-à-vis the dollar, and thus makes Chinese goods unduly cheap in the American market (Grant and Barysch 40). US were unhappy with undervalued Chinese currency and decided to launch protectoral actions, they have called for a 27.5% across-the-board tariff on all Chinese imports unless Beijing allows the RMB to rise ("Forex Blog"). Such harsh conditions made China to rethink their currency policy, and soon China had more floating RMB.

⁹ The Renminbi (RMB) is the official currency of China meaning "people's currency".

For the EU, it is the euro's rate against the dollar that mattered and still matters. It did not bother Europeans much as long as euro was strong against the dollar and thus gave EU companies a natural cost advantage. However, since 2002 to 2007, the dollar fell by over 40 per cent against the euro, and it dragged the RMB down with it (Grant and Barysch 41). As a result European companies were squeezed in the American and Asian markets at the same time, while American and Asian producers gain a price advantage.

On July 21, 2005, the Chinese government scrapped the RMB's peg to the US dollar and at the same time left the RMB a little more room to move (Xu). Theoretically this new approach should benefit Europeans by allowing the RMB to rise against the euro. But in practice, the Chinese authorities have allowed only limited rise of the RMB, and it seemed that they were targeting only the RMB-dollar rate with their exchange rate involvement. As a result, the RMB rose by more than 10 per cent against the dollar between July 2005 and the end of 2007, and another 4 per cent in the 2008, accordingly RMB fell against euro, from 2005 to 2007 it fell by 7% and another 4% additionally in 2008 (Grant and Barysch 41). The fall of RMB against the euro, balanced its rise against the dollar, resulting the efficient exchange rate measures against all its major trading partners, which has changed little since 2005.

Several steps were made from EU' side to stress on China to have more flexible RMB. A trio of eurozone officials – Jean-Claude Trichet, the ECB's president, Jean-Claude Juncker, the Luxembourg prime minister and president of the Euro Group, and Joaquin Almunia, the commissioner for economic and monetary affairs – travelled to Beijing to make the case for more RMB flexibility in November 2007 (Grant and Barysch 48). After the meeting, the Chinese central bank promised “comprehensive measures ... to avoid big swings in currency movements and make respective contributions to an orderly adjustment of global imbalances”, and have established working group of officials from the two central banks. However, results of 2008

showed that RMB was still falling against euro but the Europeans believed that their first attack into an external euro exchange rate policy would prove a success. Chinese reaction on EU's and US's suggestions to have currency reforms is really fast, however their actions are slow. Their slow reaction is also understandable, because they fear that a large and rapid rise of their currency would price Chinese exports out of world markets, thus strangling growth, endangering jobs and potentially undermining the legitimacy of the Communist Party (Grant and Barysch 48). Therefore they claim for gradual change of exchange rate at a speed compatible to continue strong economic growth.

4.5 Human Rights issue

From history of relations of EU and China we can observe that human rights issue was and still remains as most punctilious topic of discussion. European governments realize how less they can do to enhance political freedom in China. Volker Stanzel, a German diplomat, recalls that when he was stationed in Beijing in the 1990s, nobody in the government would talk about human rights (Grant and Barysch 28). He mentions the time just after the Tiananmen Square massacre happened. China was very skeptical to bring up the human rights issue to discuss.

Most of the Member States do not stress much about the human rights situation in China most of the time; although some Nordic countries are often voice their opinion openly. EU understands that it is much easier to get tough on human rights issues with small countries such as Burma, or Central Asian countries, but not with a country with a great economic importance such as China. Usually EU does not stress much on the issue of human rights, even if it is seen as the most problematic topic of their relations. However it also depends on how strongly one wishes to deal with an issue. Sometimes the Europeans' soft-spoken approach to human rights in China reflects more as recognition of their inability to change its internal politics, or the desire to

maximize commercial gains (Grant and Barysch 28). Even if EU has priority for its human rights dialogues with China, it does not want to put them before economic interests.

In human rights dialogues between EU and China, the Europeans usually complain about general problems, and sometimes emphasize individual cases. EU leaders always bring up human rights issues when they meet their Chinese officials. Chinese are good listeners and they always politely listen to what EU says in all meetings, but rarely give EU what they are asking for. Grant and Barysch described such meetings, a chance for EU officials to let off steam over issues that trouble them, without spoiling the overall relationship (Grant and Barysch 29). It seems to me that EU officials mention human rights issues on their meeting not because they really want to make a contribution to the violation of the rights of Chinese people, but to put a tick on their meeting agenda and to render an account for European states and mass media.

From the other hand human rights issues always have the means to distract EU-China relations. The unrest in Tibet, and China's attack in that region, loud protests against the Chinese government in many western countries, created pressure on relationship in 2008. Member States were not pleased by the crack down and imprisoning of thousands of not guilty Uyghur youth after uprising in June 2009. A heavy-handed response of EU on these issues may result damage on China's foreign relations with EU. EU officials must urge the China to handle any such incidents without violating human rights.

However, for today we can see how limited are abilities of EU to ask China for more respectful human and civic rights of its citizens. A recent report to the European parliament, which starts with the unconditional-engagement premise that trade with China will lead to democracy in China, ends with the observation that the EU human rights dialogue with China "has not led to any significant results" (Rap, Section 60). EU parliament is more pragmatic about China's transformation into democracy rather than making change in their human rights policy.

These problems of relations of EU and China discussed above are lying as milestones for a better and mutually beneficial relations. Both sides should launch sufficient solutions of these problems if they wish to continue their relation in future. EU should think of more common foreign policy toward China, while China should be more transparent for its partners. The “Big Three” should build the platform to trust each other, and should keep in mind that it is impossible to fight China alone. So they should facilitate other Member States toward common view and voice against China. Human rights issue needs its time to be solved. EU should think how to eradicate massacres, and eliminate death penalty, where as primary rights of people should remain for China itself to establish and control. EU should not preach China how to govern its nation. Just leave it up to own choice of people, if they do not feel themselves aggrieved then it is their choice. They know better whether to claim for their rights or not.

4.6 Arms embargo

An “arms embargo” is an embargo that applies to weaponry. The EU imposed ban on arms sales to China on human rights grounds in 1989 following the Tiananmen Square massacre. On 26 June 1989, in Madrid, the European Council of Ministers agreed that the arms embargo would become part of a set of EU-wide diplomatic and economic sanctions intended to signal disapproval of Chinese actions ("Stockholm International Peace Research Institute"). In 1989 EU had no common position on which items should be covered under the term "arms embargo". Therefore, it was up to individual Member States how to interpret the embargo in the context of their national laws, regulations and decision-making processes. For the UK and France, it seems that the embargo on China has primarily been taken to cover lethal items and major weapon platforms ("Stockholm International Peace Research Institute"). However, imposing arms embargo in eyes of EU does not mean that no good that carried militaristic character could be sold to China, certain other goods and technologies with potential military applications were not

considered to fall under the embargo. UK and France have exported to China, UK Search water radar and the French AS-365N Dauphin-2 helicopter - in the period since the embargo was imposed. It shows that not all military equipments fall under the understanding of arms embargo.

Since 1989 there were initiatives and tries to lift the arms embargo from both sides. However, EU's arms embargo on China remains in force until today. China wants the embargo to be lifted for two reasons. First, the Chinese do not believe that as a major world power they should be held accountable for their internal policies. Second, by accessing European defense technologies and reverse engineering those products, Beijing can improve its technological expertise, expand its military capacity, and increase defense sales (McNamara, and Lohman). China is developing its armed forces rapidly, and it wishes not to dependent on foreign sources for key weapons in the long term.

Nevertheless, discussions about lifting the arms embargo are constantly held in EU. High Representative for Foreign Affairs and Security Policy (FASP) Catherine Ashton is in favor for the lifting the EU's arms embargo on China. However, EU leaders failed to reach an agreement on the issue at their summit in Brussels in December, 2010, but Lady Ashton is reported to be working closely with France and Spain to take the issue forward in 2011, describing the embargo as "a major impediment" to intensifying relations between Brussels and Beijing (McNamara, and Lohman). But, there are other Member States that oppose the view of Higher Representative for FASP. As British Prime Minister David Cameron rightly resist lifting the arms embargo on both security and human rights grounds. Cameron works closely with his allies - Poland and the Czech Republic not to favor Ashton's initiative. He also wants to let her know that he will use his veto power if necessary.

So, we can see the reasons why EU still keeps its arms embargo in force till nowadays. However, it remains as a black dot on EU-China relations, which have deepened and widened

since 1989. China claiming EU to lift the arms embargo searches for its own benefits to enrich their military equipment. EU keeping it in force stresses on its policy regarding human rights and security concerns. EU's disunited opinion on whether lift the arms embargo or not, still remains as dispute of their relations.

All the problems mentioned earlier, and some more in addition to them still remain as an obstacle for further deepening and widening of EU-China relations. Both have their own complexities with decision-making and with dealing each other. As China complains that there is no single voice in EU, EU complains for unclear division of Chinese government where no one knows who is responsible for what. Also the competition of the "Big Three" in Chinese market disunites EU even more in its decision making toward China. They do not believe each other thus prefer to have their own policies with China. Human rights issue was and remains as the sensitive subject of discussion. And mostly because of difference in European and Asian values. Finally arms embargo remains as a drop of distrust on their relations from the both sides.

Now it is time to observe the attitude of Member States toward China. How each Member State sees its own relations with China and how these visions are common or separate in their content? Observe each Member States economical and political relations with China and find out what priorities each state puts prior their relations.

Chapter 5. Member States attitudes toward China

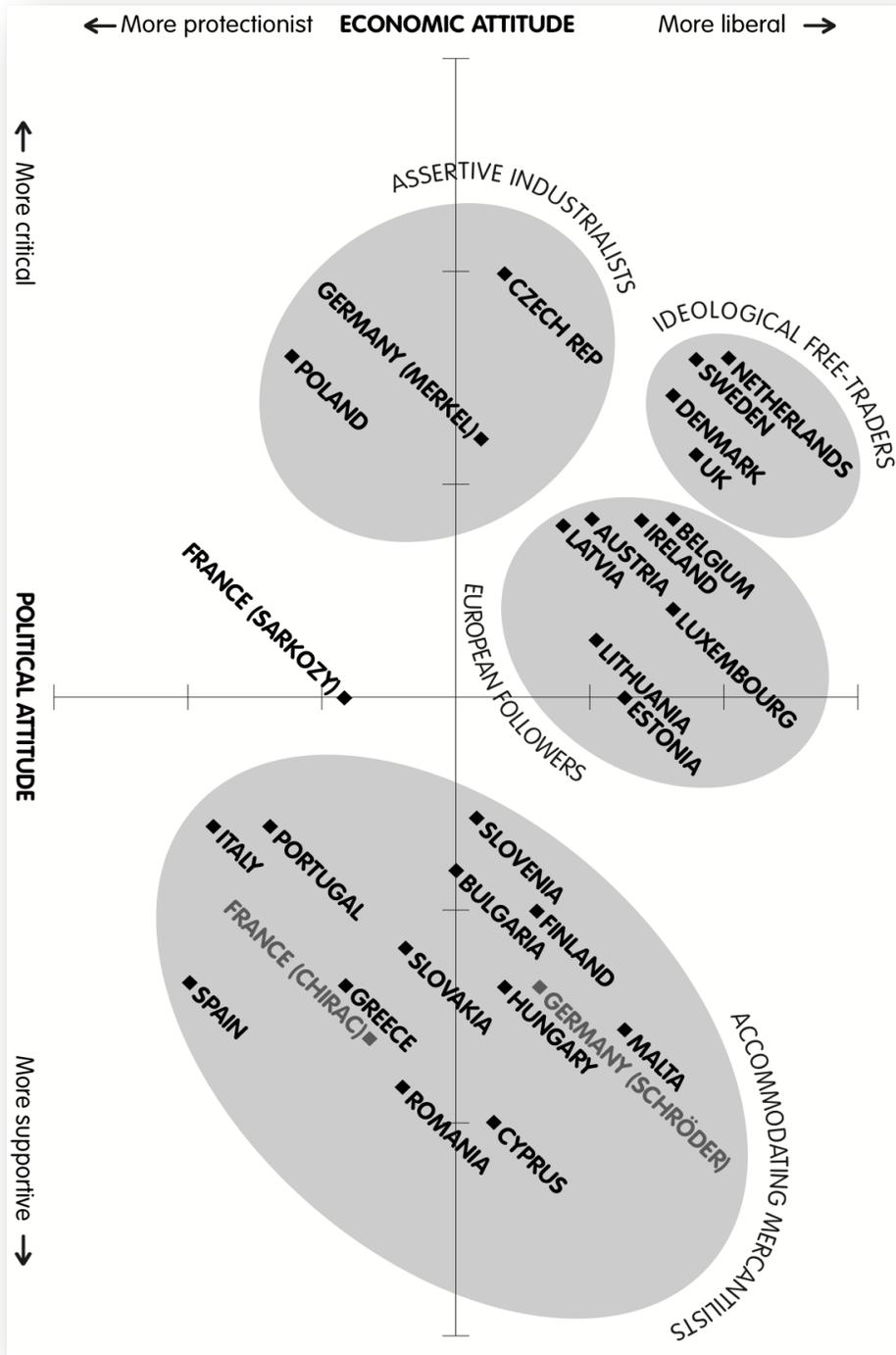
One of the major problems of EU-China relations is the division of attitudes among EU Member States (MS) towards China. China feeling the discrepancy between states noted it as a weak point of a strong union. John Fox and François Godement, senior policy fellows of European Council on Foreign Relations (ECFR) gave a good comparison for these relations: China treats its relationship with the EU as a game of chess, with 27 opponents crowding the other side of the board and power struggle about which piece to move (Fox and Godement 2009: 3). From this prospective there can be less doubt about the effectiveness of concrete moves made by one single body as China and divergent not unified moves of the EU.

Diversified viewpoints of MS are the biggest obstacle for a better EU-China relation, if EU wants to improve the situation, it should find the ways to solve the problem. To see what exact differences MS have, “power audit” of each Member State’s policies towards China was conducted ECFR and observed how each country deals with the issues in relationship with China. Survey depends on data that shows MS’s view divided on two main issues: China’s economic impact on Europe, and China’s political and human rights record.

In the following paragraphs I will present the typology of different EU countries developed by ECFR senior policy fellows and present their findings. Analyses of the conducted survey were based primarily on two sources: first extensive interviews with Chinese and European officials and experts, and secondly commissioned for each MS about its relationship with China. As a result they have translated the answers of the political attitude and included them on horizontal axis and economic attitude on the vertical axis of the chart.¹⁰ Coincidence of views naturally formed different groups with different attitudes toward China.

¹⁰ The main policies/actions scored were: position on Taiwan, position on Tibet/willingness to meet the Dalai Lama, prominence of human rights issues, willingness to raise global issues with China (Iran, Sudan etc), voting on anti-dumping issues, position on trade deficit, attitude towards Chinese investment in Europe, and more broadly the nature of political statements on China.

Figure 2.



EU Member State attitudes towards China

Source: Fox John, Godement Francois. "A power audit of EU-China relations." *European Council on Foreign Relations*, April 2009. 23

Member States were scored to the right or left for actions that were respectively more supportive or critical of China, and to the top or bottom for actions that were more free trade or protectionist.

According to the results 27 MS were divided into four groups: **Assertive Industrialists**, **Ideological Free-Traders**, **Accommodating Mercantilists**, and **European Followers**. Authors also acknowledge that this division is neither absolute nor immutable and that their personality and political connection to EU and China both matter here. Another thing is that groups are neither perfectly divided nor perfectly homogeneous. Any change of government in MS can have impact on policy toward China and can easily shift a country from one group to another. As we can see it in example of Germany when Angela Merkel replaced Gerhard Schröder. Also as France under Sarkozy's Presidency does not easily fit into any group as the graph shows, that because of the flux strategy of France having toward China. However, establishing this typology and division into these groups are helpful to understand the sources of conflicts, which weakens the EU in dealings with China, and may somehow help to craft a new strategy toward China that would satisfy needs of four groups.

Assertive Industrialists

Assertive Industrialists are the smallest group among four consist of Germany under Angela Merkel, the Czech Republic and Poland. Authors opinion is that they uniquely placed to take on China, and could therefore form the core of a more rational and realist EU policy. Members of this group are ready to criticize Chinese politics and to defend their industrial interests and protect domestic production from Chinese competition. They act when they see that rules are in China's favor also they support anti-dumping actions and some trade measures when they see them as necessity. The Czech Republic and Poland just have few firms and sectors that are able to compete in the Chinese market, but their imports from China are rising rapidly (Fox and Godement 2009: 24). This means that they are less tempted comparing to other MS to ask the Chinese for favors for their national companies, and are less rendered to Chinese pressure. From the view of politics, Czech and Polish attitudes towards China are formed by the powerful

heritage of communist rules and their popular anti-communist movements. From Chinese view, the Czech Republic is identified as the EU member state that is most hostile towards them.

The biggest member of the group is Germany and it has vivid size of economic relationship with China. Debates concerning China on topics like: political parties, foundations and the media takes place in Germany more than in any other MS. The value of Germany's exports to China in 2007 – €29.9 billion – was more than three times that of France, almost five times that of Italy, and nearly six times that of the UK (Fox and Godement 2009: 24). Thus Germany should take into consideration their economical benefits from China while criticizing. Nevertheless, China also has strong demand for German machine tools and other technological equipments, which tends to pad Germany from long-term political revenge for its criticism. Though, Merkel has brought in a new focus on human rights issue, while former Chancellor Schröder competed with President Chirac for good relations with Beijing. So we see that Germany under Merkel's term placed in Assertive Industrialist group and under Schröder's term moved to group of Accommodating Mercantilists.

Ideological Free-Traders

The Ideological Free-Traders include -the Netherlands, Sweden Denmark, and the UK. These Member State are in favor of letting Chinese imports flow freely into the EU. They are ready to pressure on Chinese politics and oppose to restrict its trade. Their dislike to many forms of trade strategies makes it very tough for EU to develop an appropriate response to China's centralized and restricting trade policy. Economies of these countries are mostly oriented towards high technology and services, particularly finance. They hope to benefit from Chinese growth and are less threatened by cheap Chinese imports, comparing to other Member States. This group criticizes China on its market barriers, but at the same time they reserve their fiercest anger for those EU Member States who deploy import quotas and anti-dumping measures, who oppose

awarding China market economy status, or who dare even to mention about any protective measures. The Ideological Free-Traders will to raise human rights issues, and they will to meet the Dalai Lama¹¹, even if in a non-official capacity, although they know that China for sure will not be happy with it.

The UK holds a unique position in this group, as it clearly prioritizes its bilateral relationship with China over European channels. Their commercial interests have recently been overtaken their traditional focus on human rights and climate change. It also changed in 2008 a long-standing formal position on Tibet, finally recognizing full Chinese sovereignty over the territory (Fox and Godement 2009: 25). In case of UK we can see how commercial interest can change the principals of the country and shift issues like human rights, which had priority before to the second place.

As this survey was made in 2009 prime minister of UK was Gordon Brown. In May 11, 2010 UK elected a new prime minister and David Cameron came to position. Gordon Brown was from the Labor Party, which is a centre-left democratic socialist political party in the United Kingdom. We can see that shared socialist views could be the source of support of UK toward China. David Cameron is from the Conservative Party, which is a centre-right political party in the United Kingdom that adheres to the philosophies of conservatism and British unionism. During the trade mission trip to Beijing in November 2010, Cameron has raised the issue of human rights during talks. He stated, “There is no secret that we disagree on some issues, especially around human rights. We don’t raise these issues to make to us look good, or to flaunt publicly that we have done so. We raise them because the British people expect us to, and because we have sincere and deeply held concerns” (“The Heritage Foundation”). We can here

¹¹ The Dalai Lama (07.06.1935) is the fourteenth leader in a line of Buddhist spiritual and political leaders of Tibet. Buddhists are followers of Gautama Buddha (c. 563–c. 483 B.C.E.), who believed the troubles of this life can be overcome through moral and mental discipline. The Dalai Lama fled his country and took safety in India in 1959 during the revolt against Chinese control of Tibet. Since that time, while still in exile (a forced or a voluntary absence from one's country), he has promoted Tibetan religious and cultural traditions.

draw differences between Browns and Cameron's policy toward China. Even if Cameron favors and wishes deepening UK's economical relations with China, as he stated, "Britain is now open for business, has a very business-friendly government, and wants to have a much, much stronger relationship with China" (BBC news 2010) he still discusses the issues concerning human rights violations in China. Case of UK will join the cases of Germany and France when change in government shifted country from one group to another. UK under Cameron's policy toward China could also shift from group of Ideological Free-Traders to group of Assertive Industrialists.

All four countries are engaged politically and economically with China and do understand the importance of stable relations with it. Governments, businesses and media give priority on the long-term relationship with China. They tend to reach large diplomatic presences in capital of China (Beijing) as well as in other big cities such as Shanghai, Hong Kong and Guangzhou.

Accommodating Mercantilists

The Accommodating Mercantilists are the largest group among four, which consists of Bulgaria, Cyprus, Finland, Greece, Hungary, Italy, Malta, Portugal, Romania, Slovakia, Slovenia and Spain. Common believe that these countries share is that good political relationship with China will lead to a commercial benefit. These Member States feel that economic considerations must dominate the relationship with China; they see anti-dumping measures as a useful tool and oppose awarding China market economy status¹². Indeed, main reason to having a good political relationship with China is to make it easier for their own companies to get access to the Chinese market. They generally refuse to meet the Dalai Lama, loudly support China's position on Taiwan, and try to water down EU criticism on China's human rights issue and as well do not raise this issue themselves in meetings with China. Their actions do not seem very moral and

¹² Under article 15 of the protocol for China's accession to the World Trade Organization, signed in 2001, WTO members can use price comparisons with third countries to assess anti-dumping duties on imports from China. Granting China market economy status would remove the right to use such comparisons, which will expire by 2016 in any case. Individual Chinese firms or sectors can also be granted market status.

ethical, while actions are taken just in order not to make the other side unhappy. Chinese expert on European affairs Feng Zhongping, described Romania as an “all-season partner that will support China whatever happens” (Ibid. 26). That shows self-confidence of Chinese in whatever they do, because they know that there will be someone to support them. It already means that China has a great influence on EU Member States. One diplomat from a large EU Member State said his country “could not afford to be politically critical of China” because its trade was too dependent on these government decisions (Ibid.). Here we can see that countries, which have policies in favor of China doing so not only because they follow some commercial interest, but also because they are forced to do so by the great influence of imports from China.

Southern Europe whose economy mostly depends on production of textiles, shoes, consumer electronics and car parts are directly under threat from China. Spain has always followed a policy of good diplomatic relations with China, yet this has not prevented an unyielding growth in their trade deficit with China. France has another case: under Presidency of Jacques Chirac, France was one of the most important Mercantilists, but President Nicolas Sarkozy tried to use different approach, he publicly took critical position on Tibet and attempted to use the issue of his attendance at the Olympics Games to somehow influence Chinese behavior. As an outcome France, has been singled out for Chinese criticism – witnessed China’s cancellation of the annual EU-China summit – and took a role of swing state in the EU’s relationship with China. China has its own measures for the actions of MS that does not play in favor of them. China has its own rules for its own game.

European Followers

The fourth group, the European Followers, is made up of Austria, Belgium, Estonia, Ireland, Latvia, Lithuania and Luxembourg, who prefer to suspend to the EU decision while managing their relationship with China. Some members of the groups are too small to have their own

policies with China, so they simply have to follow the policies of stronger Member States. As such, Austria, Belgium, Estonia, Ireland, Latvia, Lithuania and Luxembourg are the most “European-spirited” of the four groups, but they are followers rather than leaders (Ibid. 7) These small countries do not have major trade and investment relationship with China, but still service providers as Luxemburg. Ireland and Belgium should be well set up in order to benefit from their relations with China. They are dependent on the EU to protect them from China when there is an issue concerning Tibet or Taiwan. One EU official noted “small EU Member States are always asking the Commission for the line to take when China bullies them” (Ibid. 27). These small countries feel really weak in front of giant economy of China, thus searches for shelter under EU Commission. These countries do not sees themselves defining the European policy toward China, many of them just do not consider their relationship with China having high political priority. This opinion is emerged due to low public and official interest of these countries in China.

Summing up the results of the survey we can see how different views and priorities EU countries have toward China. Some of them as Assertive Industrialists willing to stand up to China strongly on both political and economic issues. Seems that the balanced position of this group could build a stronger EU approach toward China, however Germany with its strongest trade relationship with China, has doubts about the success of an integrated European approach. They strongly believe that no relations should be shaped based on market forces, especially EU-China relationship. Thus Assertive Industrialists think that MS should pressure China on “anti-dumping” issues, sector specific demands in order to protect their markets. To my point of view EU policy toward China should take into consideration this realistic view of the group while crafting their integrated approach. However, Ideological Free-Traders would mostly oppose to restrict somehow the trade relations between China, cause they believe that EU countries are mostly benefited rather than threatened by cheap imports from China. For this group I would

suggest to reevaluate the benefits of cheap imports from China, they should clearly be aware of that this cheap imports are not harming their domestic production and not reflecting on the employment of workers working on the sectors producing same or similar products. The group of Accommodating Mercantilists that collected the biggest amount of MS in it shared the idea that economical considerations should dominate the relationship. Their refusal to pressure on political issues weakens main component of EU's policy toward China. This group often keep unfavorable stance when EU brings up issues related to human rights and Tibet. But, France under Sarkozy criticized China over human rights; Taiwan and Tibet thus shifted France from this group and made it an unpredictable partner for both China and other Member States. The last group of European Followers physically not strong enough to make changes in the policy of EU toward China, they are more followers rather than leaders. They are reluctant in more active participation in the debates on Chinese issues while they do not see China as a key priority of the EU. Such a pathetic attitude toward China also makes EU decisions more difficult and complicated.

Such divisions among Member States, not surprisingly gives China right to perceive the EU as disunited. That gives China more chance to ignore or not to take seriously the decisions of the EU. France, Germany and the UK carry exact responsibility for this situation. Each of these three has lobbied to become China's European partner of choice – although Beijing only grants preferred status for a limited period, offering its favors to the most flexible bidder. During the recent clashes with China over meetings with the Dalai Lama, British, French and German leaders refused to support each other, because no one wanted to respond other's misfortune.

Here we see how parts of a union stands against each other just to make sure that the economies of their countries will not be suffered from the decisions they are taken. Thus Member States should clearly understand that any effort to strengthen the European position must start with an admission that no Member State is big enough to sway China on its own. Neither

together nor separately, Member States can not benefit more from China except they find ways to overcome their divisions and put their combined weight into a strengthened bargaining position.

Chapter 6. European view of China

As we already have a more or less complete picture of Member States diverse attitude toward China, it is time to zoom out the picture and see the European view of China. EU views China with a combination of awe, ignorance, fear, confusion and ambition (Sally, ECIPE 2009). EU is awed by significant rise of China in such short period of time. Some countries of European Followers group are largely ignorant of China. According to Sally Razeen, real knowledge of China is pathetic in Brussels, as it is in all European capitals with the partial exception of London (Sally, ECIPE 2009). In comparison to United States universities and think tanks that strongly wish to know China more close and better, Europe looks at China with indifference. Then there is fear of China, when their relations are viewed from militaristic aspect, in zero-sum terms. EU does except their weakness in front of strong military power of China. Confusion over takes the EU as being a non-nation-state hybrid, that has no common foreign policy towards China and is often followed by the foreign policies of its “Big Three” UK, France and Germany. Eventually EU’s ambition is to be a privileged interlocutor and to be on the top list of partners of China.

The huge number of European delegation travels to China every year. There were 450 in 2007 – attests to this enormous interest (Fox and Godement 19). This numbers show how much MS are craving for closer acquaintance with China. Yet European policy accepted the reality of what China has become: the world’s first currency reserve holder, its second economic power and military spender, the EU’s second largest trade partner (Fox and Godement 19). National central bank’s figures showed that, China's foreign-exchange reserves exceeded \$3 trillion for the first time and bank lending accelerated, signaling an escalation in the global economic imbalances that Group of 20 finance chiefs are trying to rein in. China's currency holdings, the world's biggest, swelled by \$197 billion in the first quarter of 2011 (“Economic Times”). And they see these achievements hardly possible without China’s basically unconvertible currency, which isolated

China from many financial consequences of its global integration.

EU still treats China as if it were an emerging power as it was previously. An agreement concluded in 1985 – ironically designed in part to help Europe address the trade surplus with China – remains the legal basis for the relationship, and the attitude it enshrines still shapes the EU's approach (Fox and Godement 19). Despite not very fruitful European dialogues and agreements with China, EU still remains confident about their vision. Even with no conditions attached, EU engagement with China – so goes the optimistic assumption – will “Europeanize” China's behavior at home and abroad (Fox and Godement 20). This vision seems to be too optimistic and with obvious overconfidence of EU's transformational power while underestimates China's ability to use engagement with Europe to its own benefits. EU should keep in mind that their foreign policy is far from common.

Both China's and EU's policies against each other are built around their economic goals. From EU's prospective China wants wide access to EU markets and investment, it seeks technology transfers, and it wants the EU and other partners to bear the lion's share of the costs of the fight against climate change (Fox and Godement 32). Of course China would be happy if EU would not criticize on Taiwan and Tibet. Shi Yinhong, a leading Chinese international relations expert said that, “China's demands of the EU are feasible, limited and realistic” (Fox and Godement 32). China has clearly stated its demands from EU, but said no word about any returns for these demands. Maybe China thinks that EU themselves should craft their clear demands from China?

Fox and Godement during their report on power audit of EU-China relations have proposed China's three tactics in Europe. First, they think that China takes advantage of the mismatch between its own centralized authority and the EU's rules-based system of government. It helps China to fully use the openness of EU markets while using the fuzziness of its own administrative

channels to restrict access to its own markets. As one EU diplomat said, the party-government structure “can control anything it wants, but not everything; the party is good at choosing what to control” (Fox and Godement 34). Second, China channels EU pressure on specific issues, such as human rights, by accepting formal dialogues about them – which the EU hails as a great victory – and then turning them into inconclusive talking shops. And third tactic is that, China exploits and on occasion fosters the divisions between EU Member States. They think that China can individual Member States with punitive measures when national interests are at stake or short-term goals require it.

Also according to Fox and Godement’s division of Member States into groups, Accommodating Mercantilists are those whom China treats unkindly and sees as “friends” and therefore expects to follow established and approved scripts. With the Ideological Free-Traders and Assertive Industrialists, China seems to have difficult partnerships and therefore these groups have more leeway to oppose Beijing without incurring full revenge (Fox and Godement 20). China more or less knows how to deal with whom and what to get from the relationship thus is confident about how to manage the pressure from EU’s side.

EU has big demands, but small influence; China is visa versa, has less, but concrete demands and most of the power to say no. Honestly and faithfully EU still believes in the “high merit” of their unconditional engagement. It seems that EU fell in love with China more than China fell in love with EU. China dictates the terms of the relationship, turning it on and off as it pleases (Fox and Godement 37). It is just remains for EU to observe the mood of China and wait when it will reflect its love back.

Chapter 7. China's view of EU

Since 2003 as China released its first EU Policy Paper, China's official media spoke of a "honeymoon", and opinion polls found that ordinary Chinese were well disposed towards the EU (Fox and Godement 33). The policy paper was seen as a target in the Europe-China relationship, as it seemed to make a shift in EU's approach from state-to-state relations to the relations on European level. But today, feelings of China have changed and the EU's political significance has obviously decreased in Chinese eyes. Chinese vision is that Brussels is losing its importance. Citing an influential analyst Feng Zhongping: "Brussels is losing importance: we must go back to the capitals, who make the decisions, speak to Member States, even on trade" (Fox and Godement 33). China started to doubt about seriousness of EU policies. Thus China is approaching the EU not as a partner to be wooed, but as an economic space to be used for its own development (Fox and Godement 33). China is pragmatic on what they do. They like to be concrete, precise and on time, while considering their own businesses and own benefit.

China being a partner, at the same time rival and competitor of EU, stresses on EU's division and shares with their own vision on this aspect. As one leading Chinese expert puts it, "although we benefit from the current divisions, we anticipate the Europeans will increasingly understand that only if they are united will they be able, in the future, to retain a competitive position compared to China" (Lisbonne-de Vergeron 4). China highlighted that it needs more unified EU to work with. That it will be a positive effect of EU unified decisions not only on EU, but also on China.

Karine Lisbonne-de Vergeron reporting on Contemporary Chinese views of Europe emphasized three factors, which China think will be particularly important in determining their economic views of Europe. These are the evolution of their own domestic economy, the growth of their ties to the other major economies of Asia, the evolution of their commercial relationship

with the United States in ascending order of importance (Lisbonne-de Vergeron 5). From each of these three views we can see how egocentric China is, and how it sees Europe as tool to achieve their goals.

China thinks that, “the Europeans appear presently to be more fundamentally committed to free trade than the Americans”. On one hand, they believe that EU will surely take its lead from US. This statement is based on Chinese exports to EU that already have prevailed Chinese exports to US. On the other hand, China sees how Europe builds its trade policy copying the US’s, thus expects EU to act more protectionist ways as US does.

China perceives another clear problem on the EU side: the mismatch between the Commission, acting for all 27 Member States on trade, and the 17 countries of the Eurozone. The Chinese do not understand who really speaks for the euro. Is it the European Central Bank (ECB)? How does Jean-Claude Trichet, the ECB President, relate to Joaquín Aluminá, the Economic and Monetary Affairs Commissioner or to Jean-Claude Juncker, the President of the Eurogroup? What will be the role of Fernando Teixeira dos Santos, the Portuguese Finance Minister? What will be the position if the Presidency of the Union is held by a member state, which is not a member of the Eurozone? (Lisbonne-de Vergeron 8). China is puzzled in such complexity. In contrast they have simple dealing with US Treasury Secretary Henry Paulson and Federal Reserve Bank Governor Ben Bernanke to ask all their questions and solve their problems.

China believes that the stronger state assures more stability. For many Chinese, a stronger Eurozone entails a more stable world. They foresee that euro will become “a denominating currency for commodities’ and that ‘in thirty years, there will only be three major currencies in the world: the RMB, the Dollar and the Euro” (Lisbonne-de Vergeron 9). However, stronger Eurozone and stronger Euro cannot be achieved by current diverse fiscal policies of Member States. One Chinese specialist put it: “The Eurozone will not work if it does not address soon the

need for a greater integration of its members fiscal policy” (Lisbonne-de Vergeron 9). Furthermore, China sees the entrance of UK into the Eurozone as the most important boost to the euro’s strength, which would certainly be welcome from Chinese side also.

Karine Lisbonne-de Vergeron asked in her paper, weather China is optimistic or pessimistic about Europe’s economic prospects? The answer was both. China is much more willing than other observers of Europe, such as the Americans or the Indians, to credit the EU with “huge strengths” and admire the ‘uniquely rooted commercial and scientific base’ of Member States (Lisbonne-de Vergeron 18). Not only EU admires Chinas grand economic growth, but also China admires EU’s successful economic integration. In the outlook for continuing process of enlargement, and in prospect of euro, China believes that Europe has ‘unique instruments to correct its shortcomings and enhance its prosperity’, as well as ‘to adapt to some of the potential dangers to world growth such as greater protectionism (Lisbonne-de Vergeron 18). Even if China excepts EU’s shortcomings in borderless enlargement of EU and the euro which is not excepted yet as national currency of all 27 Member States, they believe that soon or late EU will overcome this problems and become more stronger as politically as well as economically.

Chapter 8. Economic imbalance

China is the most important challenge for EU trade policy. China is now the EU's 2nd trading partner after US and the EU's biggest source of imports by far. At the same time EU is China's biggest trading partner. Open market of EU has contributed much to China's export-led growth. EU also has benefited from the growth of the Chinese market and EU is committed to deepening their trade relations with China. However, EU wants China to be sure that it trades fairly, respects intellectual property rights of EU and meet WTO obligations.

EU's imports from China are mainly industrial goods: machinery and transport equipment and varied manufactured articles. EU's exports to China are also concentrated on industrial products: machinery & transport equipment, miscellaneous manufactured goods and chemicals. Below provided a chart by Eurostat on EU-China trade in goods:

Figure 3.



Source: "China." *Eurostat*. EUROSTAT, March 17, 2011. Web. 30 Mar 2011.

<http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113366.pdf>.

This trade deficit caused much of complaint in Europe. The global economic crisis has hurried a process of reforming their relationship. Following the statistics on the graph, we can see the floating trade deficit of EU with China. In 2008 trade deficit of EU with China reached its maximum at 169.6 billions of Euros. It was mostly related to the outcomes of the world crisis. According to neurope.eu in 2009, EU imports from China fell by 13.4% and trade deficit with China decreased for 37.8 billion Euros. At the same time exports to China grew by 4% (Freeman). This seems not to be a major achievement, but China is was EU's third largest export market, and in 2009 shipments to every other important market fell significantly. The result was that the EU's trade deficit with China fell to 133 billion Euros. Andrew Willis explained one of the reasons of the decrease by the fall of Lehman Brothers bank in the US, that continued caution on the part of European consumers and retailers, which resulted in Chinese exports to the EU falling further than trade in the other direction (Willis). Rapid growth of trade deficit in 2010 is a result of increase in EU imports from China again. Imports of EU reached historical high of 281.9 billion Euros. Exports to China grew up as well, however not as significant as the imports. With the exports in amount of 113.1 billion Euros, EU's trade deficit calculated at 168.8 billion Euros. EU became more and more dependant on Chinese cheap exports that caused this huge gap between EU's exports and imports with China. Such a growing trade deficit through last years gives us ground to predict the further growth of EU trade deficit on goods with China in coming years.

If we take a bigger time period as between 2000 and 2010 we can see how the trade relations reached their today's position. As Eurostat News release reports, EU27 trade in goods with China tripled in value in that period. EU27 exports to China rose steadily from 26 billion euro in 2000 to 113.1 billion in 2010, while imports rose from 75 billion in 2000 to a peak of 281.9 billion in 2010. As a result, the EU27 trade deficit with China increased significantly, from

49 billion in 2000 to 168.8 billion in 2010. We can see how significantly trade volume changed since 2000 till 2010. How the relations that seemed as symbolic at the beginning turned into deep and wide web between EU and China. Moreover, EU that was pathetic about China becoming more and more dependent on cheap Chinese products.

To see even clearer picture of this deficit I suggest comparing EU deficit with China to its deficit with World. In 2010 EU imported goods from World in amount of 1.491.610 billion Euros from the World and its exports are estimated at 1.348.278 billion Euros, thus makes a trade deficit of 143.332 billion Euros. Imports of EU from China in year 2010 were in amount of 281.9 billion Euros. Exports composed amount of 113.1 billion Euros, thus trade deficit calculated at 168.8 billion Euros. Now we can see openly how indeed big is the number showed by trade deficit of EU with China.

Despite EU's trade deficit in goods, EU has some not very significant trade surplus in commercial services with China. According to the data of Eurostat taking the time period from 2008, 2009, 2010 trade surplus in commercial services increased by 2,5 billion, 4,9 billion and 5,3 billion respectively.

Foreign Direct Investments (FDI) of EU with China slightly fell comparing to 2007, but still remains with a positive balance for EU. Figures shows that outflow investment stocks estimated from EU toward China was 7.2 billion in 2007, 4.8 billion in 2008 and increased to 5.9 billion in 2009. In contrast inflows of FDI from China to EU was 0.8 billion in 2007, -0.2 billion in 2008 and only 0.1 billion Euros in 2009. This indicators show how eagerly EU invests in China and how pathetic is China in investing to EU. However, there are different problems, which cause this imbalance between EU-China trades.

European services companies find it very difficult to break into the Chinese market. Although China has signed agreements to open its market, since 2001 with its entrance into

WTO, it has granted 22000 telecoms licenses in China and only 12 have gone to foreign companies (Zuyderwijk). However, China maintains investment and ownership caps in different sectors such as banking, construction and telecommunications. Another example is that foreign law firms in China are not allowed to employ Chinese lawyers and are not permitted to participate in bar exams to gain Chinese qualifications. Moreover the public procurement market in China remains very difficult for foreign operators as well as for foreign owned companies in China to access ("Europa Press releases rapid"). Such a protectionist way of China puts it on a ground of unfair player regarding its partners including EU.

Protection of Intellectual Property Rights (IPR) still remains as a problem for European businesses in China. Seven in ten European businesses operating in China say that they have been the victims of IPR violations ("Europa Press releases rapid"). In 2007, European manufacturers estimated that IPR theft cost them 20% of their potential revenues in China and almost 60% of all counterfeit goods seized at European borders in 2007 came from China ("Europa Press releases rapid"). Chinese are skillful in copying the ideas of others and smartly selling their products to the owners of the idea.

As a result strongly protected China benefits from EU from every possible aspect: it exports tremendous amount of goods to EU, while imports much less, it strongly protects its domestic market from access of EU firm, at the same time as it profits from totally open market of EU, it invests nothing to EU market comparing to the investment of EU toward China, it violates IPR of EU firms and while their own firms are benefits form the protection of IPR in foreign markets. Ultimately, China benefiting from all these features gains their trade surpluses with help of foreign firms working on their territory.

Chapter 9. Is China, threat or opportunity for EU?

We have looked through the relations of EU and China during last two decades and can surely state that it is impossible to put an end for future relations of EU and China. China as being the biggest exporter of its goods to EU market wishes to tie their relation as tight as possible. EU is investing its money into Chinese market and benefits from cheap imports from China. The only problem is that to foresee the future possible outcomes of this game. Through the paper we have discussed all the obstacles, and difficulties as well as the growing trade deficit of EU with China. Thus I may conclude that staying at the same level, do not changing its strategy toward China, EU will be in a trouble. I have brought the examples how EU is loosing the game with China, but want to conclude with bringing opportunities and threats of the relations.

European public opinion became more hostile to China. According to a Financial Times/Harris Poll carried out in late March and early April 2008, China has replaced the US as “the biggest threat to global stability” in the eyes of Europeans. In Italy, 47 per cent thought China the biggest threat, up from 26 per cent in June 2007. In France, Germany and Britain, the figures were, respectively, 36 per cent, 35 per cent and 27 per cent (up from 22 percent, 18 per cent and 16 per cent) ("China Challenges"). EU fears that stronger China becomes, less it will be acting through slow moving international institutions, as opposed to unilateral.

However, in line of arguments brought for economic threat of China, there are some positive moments when China is seen as opportunity. One study from the Netherlands suggests that cheaper Chinese goods have saved the average European household around \$300 a year (Grant and Barysch 32). Most EU governments do not believe that China will develop in a scary direction. They believe that if Europeans engage China, they will increase the chances of it moving towards international co-operation and multilateralism (Grant and Barysch 14). This

report argues that Europeans have good reasons to be optimistic about China's future. We should remember that being optimistic about the positive economic growth of China doesn't necessarily mean that EU will share half of the benefit with it. Positive growth of China can cause some negative outcomes. Opinion of some EU member states on whether China is threat or opportunity is presented below.

Figure 4.

China: Economic threat or opportunity?

	Threat*	Opportunity**
France	70	26
Poland	67	18
Italy	66	28
Slovakia	65	22
Germany	53	43
UK	44	48
Europe***	59	34
US	59	33

Source: Grant, Charles, and Katinka Barysch. *Can Europe and China shape a new world order?* London: Centre for European Reform, May 2008. 45.

* "The Chinese economy represents a threat because low-cost Chinese products compete with our country's products and our country's companies can relocate to China."

** "The Chinese economy represents an opportunity because we can sell more of our country's products in China, purchase low cost Chinese goods, and our country's companies can invest in China."

*** Weighted average of the six European countries included in the survey.

Quoted after: German Marshall Fund, 'Perspectives on trade and poverty reduction', 2006; survey conducted among 1,000 random participants over 18 in selected countries.

Over half of the population of EU countries that took place in survey responded that China is a threat because of its low-cost products competes with the EU country's products thus can cause a relocation of domestic companies to China. It is true that many European firms have their factories in China, because the low purchase of the raw materials and low wages of Chinese workers. France was the country, which mostly believes that China is an economic threat. However, some of the participants see Chinese economy as an opportunity because they think that EU can sell more of its products in China, purchase low cost Chinese goods, and that EU companies can invest in China. Yet, just UK is more positive on this view rather than others.

China is threat because of its tremendous labor force, which is willing to work for a minimum wage. EU should accept that, it couldn't compete with China on this issue. The power of Chinese manufacturing machine is astonishing: in 2005, the Czech Republic was helping China with shoe-making technology; two years later, China flooded the Czech Republic with 11 pairs of shoes per Czech citizen (Fox and Godement 45). In Italy, a huge rise in fake goods from China has been accompanied by a large entry of Chinese small firms and huge amount of workers. Chinese illegal workers have filled a need in eastern European economies like Hungary and Romania.

China is threat because China is rich. China's foreign-exchange reserve is the world's largest. According to records of Central Bank China has \$2.82 trillion the biggest quarterly gain since Bloomberg data began in 1996 ("Bloomberg"). That is an incredible amount of money. During this year China plans to lend 7.95 trillion RMB (\$1.2 trillion) compared with a target of 7.5 trillion RMB ("Bloomberg"). China plans to lend its money in an amount, which is even hard to achieve as GDP or GNP by many countries. China lends money to EU as well.

For each indebted nation, the object is to secure a sufficient chunk of China's Himalaya of reserves (Godement). Ambitions of EU indebted countries are to bail out their banks without

huge liabilities, and a need for limitless money supply. This supply is not achieved so much by the Federal Reserve's printing presses as by China's reserves. Chinese Vice Premier Li Keqiang has said Beijing is willing to buy about 6 billion Euros worth of Spanish public debt. Which means that Spain being profited by covering its national debt will be dependent on Chinese demands from them. And China has same intentions to buy Greece and Portugal national debts.

China is threat for EU because of EU's rising trade deficit with China. Chinese economy is rising on yeast, and its countless small firms are working hard to produce the cheapest goods. EU members have already used to the prices and products imported from China, thus will not pay more for the same product produced in domestic firm. The more Member States used to cheap imported products the less they wish to produce them themselves. This leads to decrease in production of domestic products and to high dependence on Chinese goods. Accordingly to the rise in trade deficit.

EU should be very careful in its dealings with its giant partner. China is not anymore what it was 2 decades before. Today it is the largest foreign exchange reserve holder, which lends money and buys National debts of EU countries. Fastest growing economy, recording over 9% of GDP growth annually in comparison to 1% of GDP growth of the EU. Largest exporter of EU with record high exports in 2010 in amount of 281.9 billion Euros. Market with tremendous labor force which is willing to work for minimum wage. Thus a largest supplier of cheapest goods not only to EU, but as well to the World. Such an enormous partner not treated accurately and result in lost of the game.

Conclusion

Research showed us that positive scenario of Gulliver's travel is not applicable in case of EU-China relations. EU will certainly harm itself if decides to release China freely acting in its Market. No dream that they will benefit more from China is true. Causes of their conflict and misunderstanding are still not losing their actuality and make their relations more complex than before. EU's look at China as it is developing country is outdated. And their unconditional engagement of 1985 does not work any more. While future cooperation of EU and China is unavoidable EU should change its policy toward China by including all the weaknesses pointed by China as an observer at the same time by its own problems in complex system and diversified views. EU must develop a strategy for its relationship with China that is hard, rational and interest-based as China has it for dealing with Europe. EU should be more focused of its concerns toward China, not including range of concerns into one dialogue. EU should clearly structure its foreign policy mechanism in order not to make others confused with whom to deal. It should better have a single representative, which will be responsible for economic relations of EU with other countries. EU should try to find common view on China where the 27 can agree on a single line. As they did on imposing the arms embargo. Also I would suggest EU not to stress much on violation of human rights, while they should keep in mind that it is in their own interest if human rights will be violated, since that is the main reason of EU getting cheap imports from China. In addition I suggest EU to act in more protectionist way, as China does, it would reduce the cases of copy-write issues and violations of IPR brought to WTO. Finally I would suggest EU not to depend too much on Chinese purchase of governmental bonds and national debts of EU countries, in order not to be dependent on different wishes of China in return for these purchases.

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