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**POLICY**  
**BRIEF**

# A GLOBAL CHINA POLICY

FRANÇOIS GODEMENT

## SUMMARY

China now affects every global issue from trade and the economy to climate change and nuclear proliferation, as well as every region from Africa to the Middle East. Europe therefore needs to reframe its China policy in global terms. Instead of thinking of their relationship with China in bilateral terms, EU member states need to take into account China's impact across all of the issues in European foreign policy and in relations with all other countries and regions. Europe needs to co-ordinate its own policy more effectively, preferably at EU level, and to co-operate with other countries to increase its limited leverage over China. In short, Europe needs a global China policy. At the same time, many of the key decisions in China's foreign policy are now taken by domestic actors who are largely unknown to foreigners. Europe needs to identify and engage with these actors.

In the past, EU member states have struggled to co-ordinate even their own policy toward China, let alone co-operate with other countries. But although China now feels more powerful than ever, especially after the global economic crisis, greater tension between China and both its neighbours and the US offers new opportunities for Europe to form new coalitions and to increase its leverage over China. Europe should also reach out to the new actors in the Chinese system with whom it may share interests. To make this global China policy work, however, Europe will need to focus on a limited number of priorities. In particular, the EU should focus its relationship with China on five issues: trade and investment policy; industry and technology; climate change; nuclear proliferation and Iran; and human rights.

## Introduction

China feels more powerful than ever. Chinese foreign policy experts saw the collapse of Lehman Brothers in September 2008 not as a one-off crisis but as a structural change in the global distribution of power. Since then, China has become assertive across a range of foreign policy issues. China has repeatedly snubbed Europeans in response to their support for the Dalai Lama and Tibet. At the same time, it has become even less apologetic about its own human rights violations. China has deepened economic ties with North Korea and put minimal pressure on Pyongyang after it crossed the nuclear threshold and even after it torpedoed a South Korean navy vessel in May. China has also slowed down progress on international efforts to impose new sanctions on Iran while benefitting from a burgeoning economic relationship with Tehran. Finally, at the Copenhagen climate conference – a wake-up call for many in the West in general and in Europe in particular – China used tough tactics to achieve its objective of preventing an agreement on a binding commitment for developing countries (although, in this case, it may have overplayed its hand). In short, China has frustrated hopes for increased global responsibility sharing while pursuing its own economic and strategic interests through international institutions and stalling when such institutions challenge its own positions.

These developments vindicate the findings of ECFR's Power Audit of EU-China relations, published in April 2009, which

argued that Europe's approach toward China was failing<sup>1</sup>. The report argued that Europe's policy of "unconditional engagement" with China was based on an assumption that, as China integrated into the global economic system, it would slowly but inexorably converge with European values and interests. But, we argued, rather than becoming a "responsible stakeholder" as the West hoped, China was taking advantage of the policy of "unconditional engagement" to take the benefits of the international system while resisting international requests in key areas. In doing so, it was having the effect of "hollowing out" the international system.

In the report, we also argued that divisions between EU member states have weakened Europe collectively and each member state individually when they have faced difficulties in their bilateral relations with China. We showed how Europe was divided along two fault lines within Europe: firstly, a divide between free traders and protectionists; and, secondly, a divide between those who were more interested in applying political conditionality and those who were more accommodationist. Since the publication of the report, these divisions have led to a series of further embarrassing failures by member states. For example, China has successively isolated the governments of Denmark, France and Germany because of their support for the Dalai Lama. Conversely, China did not reward the UK for moving to recognise China's sovereignty over Tibet in 2008. Instead, China made a point of ignoring repeated pleas by the UK government and executed Akmal Shaikh, a British citizen who was mentally ill, in December 2009.

The lack of European unity is compounded by the inconsistencies that exist between different dialogues and agreements in different sectors at the EU level, and between trade and economic policy on the one hand and foreign policy and governance issues on the other. To make matters even worse, the EU has often changed its positions on China (including at EU-China summits) and has thus struggled to use even the limited leverage it has. China, meanwhile, has been consistent in demanding that the EU lift the arms embargo imposed in 1989, grant China market economy status, and limit contacts with Taiwanese and Tibetan leaders. In the report, we recommended moving from unconditional engagement to a policy that we called "reciprocal engagement" – in other words, a shift from a foreign policy predicated on an assumption of shared values and naturally converging interests to a relationship in which bargaining and trade-offs would become the norm.

This policy brief, which is intended to launch ECFR's China programme, explains in more detail what the key elements of such an approach should be. It argues that Europe needs to reframe its China policy in global terms. Instead of thinking of its relationship with China in bilateral and traditional foreign policy terms, Europe needs to take into account China's impact across a range of policy issues and

in relations with all other countries and regions. The brief argues that Europe needs to co-ordinate its own policy more effectively and to co-operate with other countries to increase its limited leverage over China. Finally, it shows how Europe might begin to develop such a global China policy in five priority areas: trade and investment policy; industry and technology; climate change; nuclear proliferation and Iran; and human rights.

## A new China?

China has undoubtedly become economically more powerful in the last 12 months, at least in the short term. Its sound budgetary situation at the beginning of the global economic crisis enabled it to launch a stimulus-and-loan package, which, at around two trillion dollars including bank loans, is on a par with the Federal Reserve's quantitative easing or the European Central Bank's provision of bank liquidity. Thanks to its competitive costs, China's exports have suffered less than those of its competitors: its exports of goods and services decreased by 10.6 percent while global exports without China decreased by 16 percent. There is no doubt that China's policies since late 2008 have created a giant infrastructure, lending and real-estate bubble in the domestic economy. But China's currency reserves and near-zero interest rates for the US dollar mean that even when this bubble bursts it is likely to create an international deflationary effect rather than a catastrophe for China's economy. China has increased the uses of its reserves for direct investment abroad, has taken a share of new currency swap agreements (as yet untested) in Asia, but remains far more cautious than is generally believed in undertaking new financial responsibilities.

As China has become economically more powerful, we are seeing a newly assertive approach in a range of spheres: economic, diplomatic, military, and that of human rights. Although China regularly reaffirms the importance it attaches to Europe, the process of moving toward a partnership and co-operation agreement between the EU and China has stalled. Even the new US administration, which made an unprecedented attempt to engage with China and accommodate its strategic interests and requirements, has been increasingly frustrated by China's reluctance to co-operate on issues of importance to the US such as North Korea and Iran. Meanwhile, China is steadily expanding its relationships with developing countries, including Iran, Myanmar, North Korea, Sudan and Turkmenistan. Its share of direct investment abroad is rapidly involving major commodity producers, especially in western Africa, and its state firms are also financing infrastructure projects such as high-speed rail in Saudi Arabia. China has also become more loudly protective of its sovereignty. It has always been sensitive about US arms sales to Taiwan, but now openly threatens to sanction US firms involved in arms sales in the same way that it previously threatened European companies.

China has also raised its own military profile without, however, co-operating with the West or accommodating its

<sup>1</sup> John Fox & François Godement, *A Power Audit of EU-China Relations* (European Council on Foreign Relations, 2009), available at [http://ecfr.3cdn.net/532cd91d0b5c9699ad\\_ozm6b9bz4.pdf](http://ecfr.3cdn.net/532cd91d0b5c9699ad_ozm6b9bz4.pdf).

close neighbours – for example, India, Japan and Taiwan – on strategic issues. China has had double-digit growth in military expenditure for all but one of the past 30 years. This means that although military parity with the United States is a long way off, China may be able to put pressure on other countries. In January 2010, China succeeded in the difficult feat of intercepting a ballistic missile during its final atmospheric re-entry phase – the latest development in an unbroken and accelerating trend toward military modernisation. It now challenges US ships that enter its maritime Exclusive Economic Zone (EEZ) while its own ships enter its neighbours' EEZs. It is also becoming increasingly ready to assert its jurisdiction over the north-eastern Indian state of Arunachal Pradesh, and has expanded military bases along the border with India. (It is worth remembering, however, that China has only used significant force abroad twice in the last 60 years – during the short war with India in 1962 and the equally short campaign against Vietnam in 1979.)

China has also become more open in rejecting western human rights standards and is, on occasion, now even willing to show disregard for its own law. For example, in January 2010, a Chinese foreign ministry spokesman responded to a question about the whereabouts of a well-known dissident, Gao Zhisheng, who had been missing for almost a year, by saying that “he is where he should be”. (After briefly reappearing under police control after more than a year, Mr. Gao disappeared again.) This disregard represents a significant change and may create splits within China's political elite and in public opinion. China has also become more aggressive toward foreign critics. For example, in 2009 it boycotted the Danish government, which for decades had pursued a dual strategy of positive co-operation on the one hand and criticism of China over human rights and its treatment of the Dalai Lama on the other.

As a result of these events, there has been a shift in expert analysis and media opinion in Europe – and, in fact, throughout the West – on relations with China. In a remarkably short space of time, complacency has been replaced to a large extent by anxiety. Even business seems less sanguine about the Chinese market. Google's threat to leave China unless the security of its users is ensured suggests companies are no longer prepared to do business in China at any price. Accusations about unfair competition, dumping and monetary manipulation have also been getting louder. In fact, fuelled by indignation, many analysts are now calling for the West to take a more confrontational stance toward China. However, these calls for a strategic challenge are as unrealistic as the earlier consensus on unconditional engagement. The West and China are simply too interdependent for us to replace blind engagement with blind confrontation.

Moreover, the dramatic shift in perceptions of China reflects a change of mood among the West's opinion leaders rather than a sudden aggressive turn in Chinese policy. In fact, there appear to be several trends occurring simultaneously in China. For example, there were some signs of a more

moderate trend in Chinese policy recently. Chinese officials met again with the Dalai Lama's representatives in Beijing. After an acute phase of political repression, governance is also improving in Xinjiang. Several semi-official spokesmen have also recently suggested that China may make further key concessions on global issues, for example by re-evaluating the currency and co-operating with the US on sanctions against Iran. But these developments were followed by signs of Chinese intransigence. For example, China has reaffirmed the monetary peg to the dollar despite calls for revaluation, and there is even a possibility that the renminbi will be pushed lower.

These apparently contradictory developments suggest that there are genuine differences within the Chinese political elite. In particular, there are signs of a high-level debate between exponents of a more nationalist policy and advocates of international co-operation. Chinese foreign policy appears to be in flux, influenced by several factors including the transition to a new leadership in 2012. However, the state of relations among top leaders has never been as well protected from outside scrutiny since the founding years of the People's Republic of China. The Chinese diplomats to whom the West has access tend to explain, mitigate or deny. Meanwhile, many of the key decisions in China's foreign policy are now taken by domestic actors within the army, major state companies and the party who are largely unknown to foreigners. Understanding these new actors and their interests is a prerequisite for an effective foreign policy toward China.

## China's increasing leverage

Alongside the changes that have taken place within China, its position in the world has also shifted as a result of global shifts. China is currently reaping the benefits of several converging factors: a long period of favourable demography and steady macro-economic policies; its classification as a developing country when it is actually the world's first trading nation and second-largest economy; and its skilful and pragmatic diplomacy, which has combined lip service to global integration and international institutions with lavish care for bilateral relations. The strategy of divide-and-rule is far from new. In fact, China has played foreigners off against each other at least since the Qing emperor Qianlong fought the last Mongol empire. Similarly, the nationalist Chiang Kai-shek advocated pushing back the West by “playing barbarian against barbarian”. Republican China led – and in 1942 finally won – a struggle to end all Western extra-territorial privileges. In fact, whether it was strong or weak and whether it had allies or was strategically isolated, China has consistently had a hyper-realist strategic culture. What has changed is simply that its leverage has kept increasing.

In the past, when China had less leverage than it does now, it made several long-term international concessions. It signed arms-control agreements between 1992 and 1998 and took steps to join the World Trade Organization between 1999

and 2001. During the same period, China also formed a new security concept that highlighted mutual trust and shared interests. Within three years, from 1996 to 1998, it also established partnerships with all of its key partners, including a “long-term and stable constructive partnership” with the EU that was agreed in April 1998. China also considered confidence-building measures with the Association of Southeast Asian Nations (ASEAN) in 1997 and proceeded to build up the Shanghai Cooperation Organization with a first meeting in 1996.

These steps toward integration into the international system prompted optimism that China as a joiner and learner would soon become a contributor and eventually a “responsible stakeholder”. But as China’s leverage has increased during the last decade, it has become more and more reluctant to sign new agreements that would have integrated it further into the international system. What was thought in the late 1990s to be a floor for further Chinese engagement in several key areas has, in fact, turned out to be a ceiling. A particularly good example is climate change policy, in which China has consistently rejected legally binding agreements since the Kyoto Protocol in 1997. In that sense, its attitude at the Copenhagen climate conference in December 2009 should have been no surprise.

China’s forward-looking diplomacy has become increasingly focused on sub-regional or even bilateral rather than multilateral agreements. China’s relations with South-East Asia are the best illustration of this. In 2001 – the year it joined the WTO – China offered an innovative free trade pact to ASEAN. In 2002, it signed a (non-binding) declaration of conduct with ASEAN states to resolve peacefully maritime issues. In 2003, it signed the (also non-binding) ASEAN Treaty of Amity and Co-operation, which commits signatories to the peaceful resolution of disputes. These days, however, China holds only bilateral negotiations to deal with the delimitation of maritime borders in the South China Sea. China abides by the terms of treaties it has already signed, but it is no longer willing to undertake new legal commitments.

China has taken the same approach to negotiations about nuclear proliferation issues. It took part in four-party talks on North Korea in New York between 1997 and 2000, and set up the six-party talks in 2003, but it has never gone beyond its limited role as a facilitator, let alone put pressure on North Korea. China has also made it clear that it is unwilling to contemplate any binding commitment to international sanctions, apart from narrowly defined sanctions against targeted individuals. As a result, resolutions 1718 and 1874 on North Korea and resolutions 1737 and 1803 on Iran have been far less effective than they could have been. There is little evidence that China will change its approach. The most one can realistically hope for is negative consent at the UN in cases in which China does not think its own “core interests” are at stake. For example, China made it clear to the US as early as October 2002 that it would not veto the use of force against Iraq.

## China and the international system

China’s strategy should not be seen as a revisionist challenge to the international system and its rules. In fact, China often acts as an upholder of existing international law and sovereignty. At the same time, however, it builds negative coalitions to restrain any new international norm-building. Furthermore, it builds these coalitions on the basis of tactics rather than principle. For example, in October 2009, China and India signed a climate pact to deflect any pressure on the two countries to set legally binding emissions targets. One month later, China unilaterally announced its own target on emission reductions, leaving a surprised India without its own face-saving proposal. China appeared to be making a contribution to action on climate change while it had, in fact, with India’s help, already blocked any binding agreement.

China has become very skilful at building these coalitions. It lobbies and entices partners; rewards those who co-operate and threatens those who do not; forms coalitions around issues such as sovereignty and trade; and occasionally brushes off, intimidates or isolates reticent partners. It claims in public that it is acting on principle, but in reality these principles are largely a formal and quasi-ritual form of public diplomacy. China always presents what in reality is offensive as defensive and castigates opponents as either troublemakers or consensus- or rule-breakers. As a result, China’s partners are often reluctant even to admit publicly that they have fallen out with China. For example, the US envoy to China defended the success of President Obama’s visit to China in November 2009, even after it became clear that it was a failure, and has recently accused his own administration of “trampling on China’s core interests”. Similarly, the EU presented the EU-China summit in Nanjing in December 2009 as a success even though it had not achieved any tangible result. Such is China’s skill that to have a public row with it becomes a sign of one’s own failure.

China is, of course, not the only scheming actor in the international system. Neither does it exhibit openly hegemonic tendencies – except of course in its (growing) neighbourhood where its “core interests” seem to be expanding. Indifference, passivity, abstention and defensive behaviour remain the preferred tools of China’s international action, albeit based on greater knowledge from better diplomats and analysts than at any previous time in its history. Nevertheless, China is ready to form alliances with states that seek to limit the reach of the international system in any given area. It has co-operated with India and to a lesser extent the US to prevent binding international agreements on climate change, with Russia to scupper international sanctions against countries such as Iran, and with emerging or developing countries to protect national sovereignty on issues that range from trade to human rights.

In the short term, China is likely to continue to block new international commitments and expand its influence on the margins of the international system. Other traditionally internationalist states meet the costs of maintaining peace,

of insuring the financial system and of preserving the environment, while China derives the benefit. For example, carbon trading has become a cash machine for Chinese companies. Similarly, NATO forces protect the Aynak copper mine in Afghanistan. China has also so far limited its participation in anti-piracy efforts to helping its own citizens. The stability of the international financial system may well become another case of widely diverging contributions. China's external capital flows largely go through offshore markets, a persistent anomaly which is a bigger issue when these flows become huge. In the first quarter of 2010, while observers were hoping for the decline of China's foreign-trade surplus, a total inflow of 95 billion dollars came more from inward capital flows than from the current account surplus: in effect, a non-convertible currency is serving as a magnet for capital.

In the longer term, however, we seem to be moving toward a completely scaled-down model of the international system based on nation states and a system of rules that functions merely as a way to prevent interference between them. At best, this is a norm-free order, in which only infringements on sovereignty justify international involvement. At worst, it could be a world defined by anarchy. While Chinese military spending is rising quickly, the Chinese contribution to actual enforcement of the international order is minimal, and it is therefore unlikely to replace the US in enforcing the UN system. Therefore, as Europeans and Americans debate their different values, they would do well to take notice that China is tempted by a normless foreign policy – the 21st century equivalent of what the historian Akira Iriye has termed the “ideal-less” foreign policy of Japan in the 1920s.

For this reason, China is becoming a huge test for EU foreign policy, which has been predicated on the principle of global norms and values. China's policy choices no longer affect only its neighbourhood but every issue from trade and the global economy to climate change and nuclear proliferation, as well as every region from Africa to the Middle East. EU member states therefore need to take into account China's impact across a range of policy issues and in relations with other countries and regions. Therefore, instead of thinking of its relationship with China in bilateral terms, Europe thus needs to reframe its policy on China in global terms. In other words, Europe needs a global China policy.

## New opportunities

Given China's instrumental approach to the international system and its increasing leverage, the challenge is to identify what China needs that it cannot provide on its own. Firstly, despite its instrumental approach to multilateral institutions, China needs the international system itself. International monetary standards, the trading system, security and access to resources are all essential to China's development. One could also argue that, in the longer term, international agreements to control climate change and preserve water resources will also be important to China. Secondly, China needs tangible

assets such as raw materials including oil, technology, access to markets, and security at home and abroad, including security for China's financial assets. It is particularly vulnerable in Africa, where its assets are growing at a spectacular rate but it has little leverage in terms of hard security. Thirdly, China may have intangible needs such as international recognition. Just as the tributary system was once a key source of the Chinese celestial bureaucracy's self-esteem, so today's regime relies to some extent on international recognition as a sign of legitimacy to its own people.

Europe's basic problem is that it lacks leverage over China. It is neither part of China's neighbourhood nor does it have the strategic leverage of the US. Europe does have two specific levers: China wants to be granted market status and it wants the EU to lift its arms embargo. However, Europe should think carefully before making these two concessions, both of which, after all, can be made only once. Moreover, they could have wider repercussions – for example, lifting the arms embargo without tangible progress on human rights might demonstrate to China and the rest of the world that the EU was willing to compromise on its values for a price or in the face of intransigence. But, in any case, however these two levers are used, they will not be enough on their own. Europe must therefore think about how it can increase its limited leverage over China.

Although China appears to be more powerful than ever after the global economic crisis, the new situation in which China finds itself does in fact make it vulnerable in several respects. Firstly, there is greater tension between China and the US. China's blunt response to the Obama administration's unprecedented offer of strategic co-operation – symbolised by the treatment of President Obama at Copenhagen – makes a G2 duopoly less likely, at least for the time being. This could create an opportunity for greater transatlantic co-operation on policy toward China (although the US could also decide that reaching an understanding with China takes precedence over consultation with its allies). At the moment, the main barrier to this kind of transatlantic co-operation is not the US but Europe's own inability to act decisively, as ECFR showed in its power audit of EU-US relations.<sup>2</sup>

Secondly, China's relationship with its neighbours is also becoming more strained. China increasingly drives the agenda in the region by pressing issues or by letting them persist. Whether with India, Japan or Taiwan, the ball is now in Beijing's court – a major reversal from the Cold War era when China faced a range of difficult partners in its own neighbourhood. But this also means that China is coming under increasing pressure to use its new strategic freedom and to start signalling what its long-term options are. Otherwise, it risks creating a new coalition of countries anxious or frustrated by the opacity of Chinese intentions. China's systematic assertion of its sovereignty and its “core interests” looks very

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<sup>2</sup> Jeremy Shapiro & Nick Witney, *Towards a Post-American Europe. A Power Audit of EU-US Relations* (European Council on Foreign Relations, 2009), available at [http://ecfr.3cdn.net/cdb1do4be418dc49c\\_2em6b7a0.pdf](http://ecfr.3cdn.net/cdb1do4be418dc49c_2em6b7a0.pdf).

different to its partners now that it has become a rich and far-reaching state than it did when it was weak.

This situation may create new opportunities for Europe. After the ratification of the Lisbon Treaty and the creation of the European External Action Service (EEAS), the EU is in some ways in a stronger position than it was two years ago. China's difficulties with the US and with its allies may increase Europe's own direct leverage with China, which cannot afford conflict on too many fronts. At the same time, the strained relations between the US and China creates opportunities for discreet co-ordination of policy with Washington. Even for the US, the exertion of purely bilateral pressure on China – especially on multiple issues – has become harder. There may also be some scope for greater co-operation with Europe's allies in Asia – for example, by extending free-trade partnerships and by developing strategic relationships with countries such as India, Indonesia, Japan and South Korea.

The key to a global China policy is therefore to work with other countries to assemble coalitions to increase Europe's leverage over China. A good illustration of how this might work is recent international co-operation to put pressure on China to disengage from Iran. China's shift was prompted not so much by anything the US or Europe did but by the actions of other countries, in particular Russia's change of policy on sanctions and the growing involvement in the negotiations of the Gulf States – especially Saudi Arabia, on which China is already heavily dependent for energy imports and will be to an even greater degree in the future. In other words, Europe's best chance of getting China to move may often be through others.

## A European strategy

Europe needs a new approach to China that is global in two senses. Firstly, it should recognise that China is now a global challenge for Europe: its policy choices no longer affect only its neighbourhood but every global issue from trade and the economy to climate change and nuclear proliferation, as well as every region from Africa to the Middle East. Instead of thinking of its relationship with China in bilateral terms, Europe therefore needs to reframe its policy on China in global terms. Secondly, however, it should also develop a global response based on the recognition that Europe will be more effective if it is less Beijing-centric and more focused on co-ordinating with others to shape China's choices. It must also learn more about China's new foreign-policy decision-makers in each policy area and region around the world.

This new global China policy should be based on the idea of “reciprocal engagement” that we outlined in our report a year ago. This means that Europe should be prepared to respond to China's interest-based approach with an interest-based approach of its own. This approach should be based on two principles: firstly, that Europe should focus the relationship with China on a limited number of policy areas; and, secondly, that Europe should be prepared to use incentives and leverage to ensure that China will reciprocate.

In other words, there should be political trade-offs between Europe and China. A consistent, persistent, well-coordinated European position must be able to exercise linkage on issues with China, something no single member state is any longer capable of obtaining.

As a first step toward developing such a global China policy, Europe needs to set clearer priorities. Important Chinese officials and experts constantly repeat the same question: What does Europe want? The EU should therefore identify a limited number of issues of strategic importance and be consistent in communicating to China what they are. In particular, the EU should focus its relationship with China on five issues: trade and investment policy; industry and technology; climate change; nuclear proliferation and Iran; and human rights. Several of these issues, such as investment, proliferation and human rights, are also short-term priorities, while others, such as industry and technology, are areas in which there is a need for a Europe-wide rethink in the longer term that goes beyond EU-China relations. But, in each case, Europe needs to co-ordinate policy more effectively, identify possible coalition partners and co-operate with them to increase leverage, and identify interest groups and constituencies within China with whom Europe may share interests.

### *Trade and investment policy*

On trade and investment policy, Europe is, in a sense, in a stronger position than the US in relation to China. The European market is as important to China as the North American market. But because private savings in Europe compensate for public debt, Europe's overall need for external capital is nowhere near as great as that of the US, and Europe is therefore not as dependent on China as the US is. Europe could therefore use the terms to access to its own market in order to win concessions from China, even if it would not always be in the best interests of European consumers. However, until now, Europe has not used the leverage it has to get what it wants from China. Europe should now aim to create more incentives for China to open its economy and diversify investment in Europe. As part of a global China policy, it should also consider whether it may have shared interests with emerging economies such as India and Brazil, which are increasingly competing with China on high technology exports.

Currently, China invests most in acquiring European high-tech companies, particularly smaller firms that create less controversy. This cautious but mercantilist approach must give way to investment that drives growth in Europe. The Chinese should be encouraged to invest in larger companies, in Europe's bond markets (and preferably an EU-level public bond system) and in structural infrastructure projects. Better participation by China in the regulation of offshore capital markets is also essential to a reciprocal relationship and to the potential role of the renminbi as a reserve currency. There remain many European loopholes on these issues, but none is so large as to match the opacity of China's external balance sheet.

There are a number of possible proposals on trade and investment policy that the EU could make. It could, for example, create a Eurobond instrument with a mandate for structural investment inside Europe; encourage large-scale projects with joint Chinese participation; ask China to open its infrastructure projects under stimulus spending to European firms; and open its public procurement. But whatever proposals the EU makes, it should be prepared to take action if China refuses to respond to them. While protectionism is both highly unlikely and undesirable, Europe could consider making full use of anti-dumping measures, cracking down on illegal imports (which are wildly underestimated), and taxing China's non-cooperation on emission reductions by a carbon tax that would be levied on European producers as well as imports. Europe has a need for fiscal revenue in lean economic years and China's exports have downward price flexibility thanks to China's union-less system. This means that such propositions, which would be compatible with WTO provisions if they were assessed fairly and levied across the board, could be effective if China keeps leading the global trend toward a low household revenue and consumption share of its GDP. Trade agreements with the key Asian economies could also increase European leverage over China.

#### *Industry and technology*

China's protective industrial policies, intellectual-property rights and the insecurity of web-based communications make it more difficult for European and American companies to do business in China. China is reluctant to liberalise its domestic policies in these areas because to do so would imply it was no longer a developing country under WTO rules. For example, in the lead-up to the Copenhagen climate conference, China campaigned to protect the existence of so-called Annex B countries under the 1997 Kyoto Convention. This group of countries, classified as developing even though it includes OECD member states such as South Korea, has far fewer obligations than developed countries. However, China's continuing status as a developing economy is a handicap for truly developing countries that are, in effect, trying to play catch-up. It also allows China to keep in place protective rules in many sectors of the Chinese economy that restrict opportunities for European and American firms. The United States could therefore be a potential coalition partner for Europe on industry and technology policy.

In order to face the challenge from China's industrial policies (and the production triangle it has formed with more advanced East Asian producers in some cases), Europe needs to take a radical step and create a federal industrial and technology policy for the first time. This means moving from simply unifying its domestic market to fostering industrial competitiveness, maintaining cutting-edge technology levels, and ensuring that its scientific and patent base is not raided under the pretext of an open market. This will enable Europe and China to move from an adversarial situation – in which the lack of a level playing field and of cross-ownership links

### How to improve the EU's internal coherence

In order to be able to develop such a global China policy based on greater co-operation with other countries and the idea of “reciprocal engagement”, Europe will first have to become more internally coherent. In particular, it will need to improve the co-ordination between member states and the European institutions. The EU should therefore launch a political review of EU-China policy that would look at the way both member states and the EU institutions approach China. It should examine the effectiveness of sectoral and strategic dialogues so that the process can be streamlined and preferably run at the level of the EU institutions. In particular, Europe should aim to be consistent in its policy statements from one summit to the next and co-ordinate its messages to China more effectively. Without such consistency, it will be impossible to develop a more coherent policy.

The review should address a number of specific problems with the European policymaking process toward China. Firstly, it should suggest an alternative to the twin-track approach that splits up trade and macro-economic issues on the one hand and foreign policy and governance on the other. This approach has allowed China to treat Europe simply as a market for its exports. Secondly, the review should suggest ways to take decisions on EU policy at a higher level, either by enlarging meetings of the Asia-Oceania Working Party (COASI) to bring in higher-level participants and key sectoral constituents, or by discussing China at meetings of COREPER and COPS, the main co-ordinating committees for member states under the European Council. Thirdly, it should use the creation of the EEAS as an opportunity to create a new role for EU diplomats, with requirements for language and area training, and to redefine co-ordination in China between the EU delegation and the embassies and consulates of member states. The EEAS will also need to involve European businesses and NGOs in order to gain political legitimacy and influence. Fourthly, the EU should clearly define a process for a calibrated EU-wide response to Chinese reprisals against member states on sensitive issues such as the Dalai Lama and Taiwan.

creates an incentive for preferential rules and intellectual-property theft – to greater interdependence. Such an industrial and technology policy could include technical co-operation on China-related issues of cyber-security; funding and technical support to enable European firms to assert their intellectual-property rights and patents in China, including redress against Chinese firms that used technologies leaked in third countries; the creation of a European funding agency to encourage cross-European co-operation on next-generation technologies; and a scheme to set up jointly-owned companies.

### *Climate change*

Europe's success in creating public momentum for a legally-binding treaty forced China to openly reject a deal with the other members of the BASIC group (Brazil, India and South Africa) and its traditional G77 partners at the Copenhagen climate conference in December 2009. China achieved its immediate goals but at a high price to its long-term diplomatic interests. China is now actively working to rebuild relations with key developing countries in Africa and the Small Island Developing States, but still feels bruised by the Copenhagen experience. Although it wants to project the image of being a proactive player on climate change, it is unlikely to agree to any stronger international commitments than contained in the Copenhagen Accord in the next two years unless the US commits to far more serious domestic action. However, China does believe a low carbon and resource-constrained global economy is inevitable and is planning a significant investment in decarbonisation and low carbon research and development.

Europe's strategy should be to leverage its lead on climate change to get Chinese compliance through reciprocal business deals and to work with countries like Japan which share Europe's objectives. It should restructure its engagement with China around a model of conditional and reciprocal co-operation. This will require a more coherent and co-ordinated approach in relationships at international, bilateral and UN levels. The EU could make agreement on climate finance conditional on developing countries agreeing a legally-binding system of monitoring, reporting and verification; make continued access to EU climate finance implicitly conditional on a more pro-active and balanced relationship on low carbon co-operation; and create a high-level panel including relevant officials and business leaders to discuss EU-China economic co-operation.

### *Nuclear proliferation and Iran*

Iran's nuclear policy is an immediate and urgent European strategic concern. Its attempt to develop nuclear weapons presents a direct threat to Europe and is a decisive test for the Non-Proliferation Treaty. However, Europe has not yet made Iran a strategic priority in its relationship with China. China opposes sanctions not only because it relies increasingly

on Iranian oil but also because it does not share the West's perception of the threat from Iran. Furthermore, China and Iran share resentment of perceived American meddling in their domestic politics. Beijing also suspects that sanctions are part of a wider plan to promote regime change in Iran – something it is loath to see anywhere. Beijing also does not believe sanctions will work. However, China wants to avoid a direct clash with the US over Iran and also to avoid compromising its relationship with Israel. Thus China has voted in favour of all four UN Security Council resolutions on sanctions against Iran since 2006, albeit after significant delays and restrictions.

Europe's aim should be to change this calculus of interests. Perceived costs to China's relationships with its most important energy providers in the Gulf are more likely to make a difference than anything Europe can do directly such as bilateral pressure or sharing intelligence. At the same time, the more solid and broad-based the international consensus that exists on sanctions, the higher the price China will pay for blocking them. Ultimately, if China finds itself facing unanimous support for sanctions, it will probably not use its veto but rather attempt to water down the resolution through a delay-and-weaken strategy that maximises concessions from both Iran and the West. The real risk is thus that China will only support sanctions that are effectively toothless.

Europe should make it clear to China that Europe's "core interests" are in play here and consider how it can give China positive and negative incentives either to accept tighter sanctions or to intervene with Iran directly. Positive incentives could include the sharing of advanced and dual-use technologies; co-operation with African countries and regional organisations to enhance the security of China's nationals and their interests in Africa; and an offer of an international commitment to abstain from the political use of energy in order to enhance China's own energy-security needs. Negative incentives could include obstacles for China on its imports of oil from the Middle East; an extension of controls on dual-use technologies to China; and a threat to develop anti-ballistic missiles with American, Japanese and South Korean partners.

### *Human rights*

Human rights is an important issue not just in its own right but also because Europe increasingly puts its credibility with China on the line when it defends human rights. Although Europe and most of its member states have criticised China on human rights issues, they have also frequently backed down. For example, France and Germany stopped voting for resolutions against Chinese human rights abuses at the United Nations Commission on Human Rights in 1997. However, this decision – justified as a switch to quiet diplomacy – divided Europe and did not result in any real progress in China. Moreover, by backing down and changing tack, Europe does not just fail to achieve results but also creates a perception of weaknesses that affects its ability to



win concessions from China on other issues. The apparent lack of any joint initiative with the US does little to enhance the West's credibility among the Chinese elite.

Criticism of Chinese human rights abuses is now increasingly made at the EU level, which leaves member states free to pursue their bilateral interests with China. If member states make high-profile gestures at all, they focus increasingly on popular issues such as Tibet and the Dalai Lama and ignore other political dissidents who are less well-known outside China. The primary goal of European policy on human rights in China should therefore be greater consistency and persistence. The danger that criticism of China and action on human rights is "kicked upstairs" to the EU institutions is now particularly acute because of the creation of the EEAS.

In order to avoid this, the EU should create a new mechanism to co-ordinate human rights policy more effectively. Firstly, the team within the European institutions that collects information on human rights violations in China (currently the human rights units in the Council Secretariat and the European Commission's China desk) should report to COASI and thus be integrated into wider regional policy. Secondly, decisions about which cases are going to be raised by European officials with their Chinese counterparts should be taken at COASI meetings. Thirdly, the European Council should decide whether and when to publicly criticise China and, crucially, whether it is willing to back up the criticism with action. This three-level mechanism would prevent individual member states (or the European Parliament) from raising other cases, but would make it more difficult for them to disassociate themselves from European human rights policy. Europe should agree a minimal code of conduct on key issues such as the treatment of the Dalai Lama.

Chinese public opinion does play a role in the effectiveness of external criticism. Therefore the EU should focus its criticism in particular on categories of human rights violations and governance issues that violate both international norms and China's own laws. These include administrative detention and sentencing, the lack of proper defence counsel, prosecution for non-violent religious and political beliefs, and torture and disappearances. The EU should also focus on human rights abuses under Chinese law where it has played a key role in defining international norms – for example, the death penalty. As with other issues that are important to Europe, member states should consider how they can give China positive and negative incentives to adhere to international human rights standards.

## Conclusion

China has evolved from a struggling developing country in transition from socialism to a rich and strong state protected by its status as a developing economy, buoyed by an ultra-competitive labour force and huge physical investment. Europeans realise that China is now more powerful than it was, but they do not yet recognise the extent to which its policy choices affect every global issue and every region around the world – in other words, the extent to which China has become a global problem for Europe. This requires a global response – in other words, a policy that takes into account China's role in global issues and in different regions around the world and that enhances European leverage by working with others around the world.

Such a global China policy will put far greater demands on Europe's foreign policy than the approach of "unconditional engagement" that Europe has followed until now. In particular, it will require Europe to become much better at co-ordinating its external relations than it has been so far. However, the Lisbon Treaty offers Europe new opportunities to do exactly this. The first step is to create the policymaking process and instruments that will enable Europe to craft a more coherent and consistent policy toward China. The second step is to identify policy goals and conceive bargains that can realistically be struck with China on some priority issues. China will no doubt put such an approach to the test. But if Europe is consistent in its demands, it will force China to refocus on Europe not just as its key international market but also as a competent negotiator and an upholder of the international system.

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