



Defend, Engage, Maximise:

A progressive agenda for EU–China relations

Nicola Casarini,

Senior Fellow, Istituto Affari Internazionali

Abstract

This paper examines the current state of play in EU–China relations and the future prospects for them. It proposes a progressive framework to be applied to a select list of issues of strategic importance for the next five years. Built around three key words — Defend, Engage, Maximise — the progressive agenda recommends the following: (i) **Defend**: Europe’s jobs, competitiveness, and technological sovereignty from China’s state-controlled economy and unfair trade practices; EU fundamental values from Chinese authoritarianism; (ii) **Engage** China to: meet the targets of the Paris Agreement on climate change; strengthen the multilateral trading system; address global security challenges; (iii) **Maximise** EU–China relations to: save the Iran nuclear deal; reform the international monetary system and put limits on the dollar’s exorbitant privilege.

FOUNDATION FOR EUROPEAN
PROGRESSIVE STUDIES
FONDATION EUROPÉENNE
D'ÉTUDES PROGRESSISTES



FEPS
Policy Paper

October
2019

Table of Contents

EXECUTIVE SUMMARY	3
1. INTRODUCTION	4
EU China policy: three main problems	5
2. A PROGRESSIVE AGENDA	7
3. EU–CHINA RELATIONS IN PERSPECTIVE	8
Key features	8
4. CURRENT STATE OF PLAY AND OPEN ISSUES	10
Trade and investment.....	10
The Belt and Road reaches Europe	12
Europe’s connectivity plan.....	13
Screening Chinese investments	14
Fostering European champions	15
US-China rivalry	15
Political values	16
Global issues	17
Maximising EU–China relations	21
5. POLICY RECOMMENDATIONS	23
DEFEND	23
ENGAGE	24
MAXIMISE	25
6. CONCLUSION	25
REFERENCES	27
ABOUT THE AUTHOR	28

EXECUTIVE SUMMARY

This paper examines the current state of play in EU–China relations and the future prospects for them. It proposes a progressive framework to be undertaken at EU level for the next five years. Built around three key words — Defend, Engage, Maximise (DEM) — it combines both elements of containment, as well as of engagement, towards China.

This progressive EU China policy aims to achieve three overarching objectives: (i) Promote a strong and united EU; (ii) Protect Europe’s socio-economic well-being and way of life; (iii) Advance EU fundamental values and principles, and foster an international order based on effective multilateralism and the rule of law.

It invites the EU to focus on a select list of issues of strategic importance in its relations with Beijing so as to achieve maximum impact. The progressive agenda for EU–China relations would unfold along the following lines:

DEFEND

- European jobs, industrial competitiveness and technological sovereignty from China’s state-controlled economy and unfair trade practices.
- EU fundamental values and principles from the Chinese authoritarian political system.

ENGAGE China to:

- Meet the targets of the Paris Agreement on climate change.
- Strengthen the multilateral trading system.
- Address global security challenges, including ways to find a solution to North Korea’s nuclear threat and support for a rules-based order in the South China Sea.

MAXIMISE EU–China relations to:

- Save the Iran nuclear deal.
- Reform the international monetary system and put limits on the dollar’s exorbitant privilege.

This progressive framework allows EU policymakers to identify and distinguish between those issues where China is a challenge — and thus needs to be contained — and those policy areas where Beijing can become a partner — and even a temporary ally — to advance EU interests and fundamental values. If used wisely, the China card could become the ace up the EU’s sleeve to advance a strong and united Europe, as well as promote a set of values and principles dear to the majority of Europeans.

1. INTRODUCTION

Should the European Union (EU) enforce a containment policy towards the People's Republic of China (PRC – or simply China), joining efforts undertaken by the President of the United States (US) Donald Trump, who has unleashed a trade and technological war against Beijing with the aim of permanently subordinating the Asian giant to the West? Or should the EU continue its engagement policy towards Beijing – and even seek to maximise Sino-European ties to put limits on those US unilateral policies that are detrimental to Europe's interests and fundamental values? What would be the best policy mix of engagement and containment for EU-China relations? And to what extent should the EU align its China policy with that of the US? Those are possibly some of the EU's greatest foreign policy challenges.

The West and China continue to have very different economic and socio-political systems and a different understanding of the rules-based international order. Therefore, transatlantic cooperation must be a key element of EU relations with Beijing. The EU and the US are committed to promoting an open society based on market economy and the respect of human rights, fundamental freedoms, good governance, and the rule of law in China. Moreover, both hope that Beijing will be a responsible stakeholder in the global system and that the Asian giant will not upend the rules-based order.

Alongside many similarities and a natural tendency to align their China policy, the transatlantic allies' relations with Beijing show some important differences, not to mention the existence of EU-US diverging interests and competition for China's market shares. Going forward, the EU should make the most of the opportunity provided by the renewal of institutional leadership in Brussels to devise a distinctive EU China policy which, on the one hand, builds on the transatlantic allies' commonalities vis-à-vis Beijing and, on the other, defends those EU interests and fundamental values under attack not only by an authoritarian China, but also by the America First policies of US President Donald Trump.

A rich debate has emerged in Europe on these topics. In January 2019, the Federation of German Industries (BDI) issued the policy paper *China – Partner and Systemic Competitor*, arguing in favour of a more assertive position vis-à-vis China on trade and investment. In March 2019, the European Commission and the High Representative of the Union for Foreign Affairs and Security Policy published the document *EU-China – a strategic outlook* which puts forward an approach towards China based on cooperation and rivalry. Think tanks and universities across Europe have also entered the debate through dedicated publications, conferences and workshops. Political parties, however, have tended to shy away from articulating their standpoint on EU-China relations, even though China has become a topic of discussion in electoral campaigns in many EU member states.

This paper intends to contribute to the debate by presenting the contours of a progressive agenda for EU-China relations, including discussion of the differences between a European progressive standpoint on China and that of conservative, hard right, sovereignist and populist forces. Hopefully, this exercise will help clarifying how different political sensitivities can approach the EU-China relationship.

The first part of this study introduces the reader to the main problems that the EU encounters when it attempts to develop a unitary and coherent EU policy towards China. It subsequently presents the contours of a progressive approach to EU-China relations and its merits compared to other standpoints. The following section sets the context by providing an overview of the key features and

major turning points of EU–China relations in recent decades, before moving to the examination of the current state of play in the relationship and its most controversial issues. The concluding section offers policymakers ideas and recommendations to be considered by the EU for the next five years.

EU China policy: three main problems

Developing a coherent and unitary policy towards China is a major challenge for the EU for three reasons: (i) China is both a boon, as well as a threat, to Europe; (ii) EU member states are divided over China, which in turn exploits their division; (iii) There are differences between the various political families within the European Parliament.

1) China is both a boon, as well as a threat, to Europe

Beijing represents a serious economic and trade challenge, due to its state-dominated economy and its unfair trade practices, which have contributed to de-industrialisation and a declining standard of living across some parts of the old continent — a situation that European countries share with other developed nations, including the United States. At the same time, China's huge domestic market and its expanding middle class represent a formidable opportunity for many European companies, some of which have shifted production to China to take advantage of lower production costs and global supply chains.

The Belt and Road Initiative (BRI — also known as the New Silk Road) — China's massive infrastructure and connectivity project launched by Chinese President Xi Jinping in late 2013 — is set to mobilise significant financial sums that are expected to surpass \$1 trillion over the next two decades. Europe stands to profit from the BRI, since the old continent sits at the end point of it. However, Chinese investments made in the framework of the BRI rarely uphold Western standards and principles. There is a risk that some of these projects become 'debt-traps', helping Beijing gain political influence in the old continent. The BRI is thus both an opportunity, and a challenge, for Europe.

Due to its non-democratic nature, the Chinese regime continues to be viewed with suspicion by European public opinion, which raises questions as to what use Beijing leaders will make of their country's increased capabilities. Yet, it is precisely this authoritarian Communist China, informed by values and principles quite different from those of the EU and its member states, that has come to support the EU's integration process, including key initiatives such as the European common currency.

China has become an important partner of the EU for addressing regional and global issues, including support for initiatives such as the Paris Agreement on climate change and the Joint Comprehensive Plan of Action (JCPOA) for Iran — also known as the Iran nuclear deal. Cooperation with China is essential for advancing effective multilateralism, although China's engagement towards it is sometimes selective and based on a different understanding of the rules-based international order.

China is thus many things to Europe, and this complicates the adoption of a clear-cut strategy towards the Asian giant. The EU's China policy thus needs to be multifaceted and flexible enough to include both elements of engagement as well as of containment, calling into question the capacity of the EU and its member states to work together in a unitary and coordinated way.



2) *EU member states are divided over China, which in turn exploits their division*

The EU is not always consistent in its China policy since a unified line is often undermined by EU member states, which continue to compete against each other in search of commercial advantages in the Chinese market as well as for attracting Chinese investment into their territories. Beijing continues to play into the bloc's divisions, often helped in this by national elites more eager to develop relations with Beijing on a bilateral basis than in the EU framework. An example of such an approach is the creation of the China-Central and Eastern European Countries (China-CEEC) grouping founded in Budapest in 2012 to push for China-CEEC cooperation outside the EU framework and to promote China's BRI. Since 2019 the grouping has comprised 17 European countries (including 12 EU member states) and China — it is thus commonly referred to as the 17+1. The European states are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia.

Another example of the tendency of EU member states to go it alone in their relations with Beijing was the decision of the previous Italian government — a populist coalition formed by the hard right League and the anti-establishment Five Star Movement which ruled Italy from June 2018 to August 2019 — to sign a Memorandum of Understanding on China's BRI. Italy's official endorsement of Chinese President Xi Jinping's signature foreign policy initiative in March 2019 was taken without consultation with EU partners — actually, in defiance of calls from Brussels and other European capitals not to sign up to the BRI. The move was intended to promote an 'Italy First' set of policies. By doing this, Italy's populist coalition clearly undermined EU efforts at finding a common stance vis-à-vis Beijing. It also showed that there are differences between the various political families within the European Parliament — a trend that has implications for EU relations with China.

3) *Differences between the various political families within the European Parliament*

On EU-China relations, there are commonalities, but also differences between the progressive camp and the other political families represented in the European Parliament. In this study, the progressive camp comprises forces that would traditionally sit on the centre-left of the political spectrum. This camp includes the group of Socialists and Democrats, but also the Greens and some forces such as La République en Marche of French President Emmanuel Macron.

Differences are evident between the progressive camp, on the one hand, and the hard right and sovereigntist forces — including France's National Rally (Rassemblement Nationale) led by Marine Le Pen and Italy's League led by Matteo Salvini — which seek to undermine the EU for ideological reasons and emphasise the national level in foreign policy. Their anti-EU stance hinders their capacity to extract meaningful concessions from Beijing as they lack the necessary clout that the Union would have when negotiating with the Asian giant. The China policy of hard right and sovereigntist forces is thus a lose-lose game for the national level (too weak in the face of the Asian giant) and for the EU which is often bypassed and thus undermined. The only winner is China — and this is quite remarkable for political forces that claim to put their countries' interest 'first'.

Differences also exist between the progressive camp and conservative forces with regard to the emphasis given to: (i) business vs. values; (ii) confrontation vs. engagement; (iii) allegiance to vs. independence from the US. In general, conservative parties tend to prioritise business interests over the defence of values, although conservative forces in the Nordic countries are traditionally principled.

Conservative forces tend to adopt a confrontational stance vis-à-vis China, while the progressive camp favours engagement. Finally, the conservatives tend to side with Washington as a matter of principle; the progressive camp recognises the invaluable role of the US and of NATO, but it can countenance siding with China on specific issues if that helps promote EU interests and fundamental values.

2. A PROGRESSIVE AGENDA

A progressive EU China policy exploits relations with Beijing to strengthen the EU, not the national level only. Consultation with the EU on what to do towards Beijing should come first, even in cases of disagreement between the national level and the EU.

Built around three key words — Defend, Engage, Maximise — the progressive agenda combines both elements of containment, as well as of engagement, towards China. It aims to attain three overarching objectives: (i) Promote a strong and united EU; (ii) Protect Europe's socio-economic well-being and way of life; (iii) Advance EU fundamental values and principles, and foster an international order based on effective multilateralism and the rule of law.

This progressive agenda recommends the EU to focus on a select list of issues of strategic importance in its relations with Beijing so as to achieve maximum impact. It invites the EU to do the following:

DEFEND European workers and companies from China's unfair trade and competition practices, in line with what was advocated by the Federation of German Industries in its January 2019 paper and by the European External Action Service (EEAS) in its last document on the EU and China issued in March 2019. A progressive agenda would also support a new version of state interventionism at EU level to counter China's state-backed companies, as proposed by French President Emmanuel Macron in his Manifesto of 4 March 2019. A progressive EU China policy must also defend the EU's fundamental values and principles from the Chinese authoritarian political system, denouncing labour and environmental conditions inside China, as well as violations of human rights — including those relating to minorities, gender and LGBTQI (lesbian, gay, bisexual, transgender, questioning or queer, and intersex) — by the Chinese regime. A progressive EU policy towards China is a principled one.

ENGAGE China to promote multilateralism and international institutions, in contrast with hard right and sovereigntist forces — both inside Europe and abroad — which tend to prioritise bilateral relations, often showing contempt for institutions and the rule of law. The focus of EU cooperation with China should be on a select number of policy areas where the two partners working together could make the difference, including on: (i) Climate change; (ii) Reform of the multilateral trading system; (iii) Security cooperation, in particular in Africa; (iv) North Korea's nuclear threat; (v) The South China Sea.

MAXIMISE EU-China relations to build a more balanced international system, placing limits on those unilateral attitudes of the US which are detrimental to EU interests and fundamental values. Two interrelated policy areas could be the initial testing ground for the maximisation of Sino-European relations in the next five years: (i) Saving the Iran nuclear deal; (ii) Reforming the international monetary system and putting limits on the US arbitrary imposition of sanctions and the weaponisation of the dollar. A progressive agenda for EU-China relations is thus one of independence — and of boldness when necessary.

The above framework identifies and distinguishes between issues where China is a challenge — and thus needs to be contained — and policy areas where Beijing can become a partner — and even a temporary ally — to advance EU interests and fundamental values. This progressive agenda builds upon the main achievements in Sino-European relations over the last three decades.

The following section presents an overview of the key features and major milestones of the relationship in order to provide the necessary context — and historical perspective — for the subsequent discussion of the current state of play in, and future prospects for, the Brussels–Beijing partnership.

3. EU–CHINA RELATIONS IN PERSPECTIVE

Key features

Economic considerations have traditionally been the main driving force of EU–China relations, although security and defence-related elements have been added in recent times. Since 2004 (after EU enlargement) China has become the EU’s second biggest trading partner and the EU has become China’s biggest trading partner. As of 2019, China and the EU have been trading more than €1.5 billion in goods each day — nearly equivalent to what China exchanges with the United States.

A large number of sectoral dialogues underpin the Sino-European partnership, which is characterised by a high degree of institutionalisation. Since 1998, there has been a yearly EU–China Summit complemented, since 2008, by an EU–China High-Level Trade and Economic Dialogue — which follows on the heels of the US-China Strategic and Economic Dialogue. In 2013, the two partners adopted the EU–China 2020 Strategic Agenda for Cooperation, which provides the framework of their relationship. The Strategic Agenda reaffirms the EU’s respect for China’s sovereignty and territorial integrity, while Beijing reiterates its support for a strong and united EU.

Since 2010, following the entry into force of the Lisbon Treaty and the creation of the EEAS, there has been a yearly EU–China High Level Strategic Dialogue between the High Representative of the Union for Foreign Affairs and Security Policy (HR) and the Chinese State Councillor responsible for foreign affairs — an opportunity for the two sides to discuss regional and global issues of common concern.

Since 2011, the EU’s HR has also met annually with the Chinese defence minister, while the head of the EU Military Committee has engaged in a parallel dialogue with her/his counterpart in the People’s Liberation Army (PLA). There is still an EU arms embargo in place on China, imposed by the European Community 30 years ago following the PLA’s crackdown on students in Tiananmen Square in June 1989.

There are no major conflict issues that could bring the two sides to a military confrontation — unlike the case of US-China relations, where the Taiwan factor and US commitment to Asia’s security may lead to a military stand-off. However, should tension in the South China Sea escalate due to China’s expansive territorial and maritime claims in the area, some EU member states may decide to intervene alongside the US and other like-minded partners to defend the region’s rules-based order.

The EU’s China policy is predicated on a division of labour between Brussels and the member states: on the one hand, the EU traditionally adopts a tougher stance towards Beijing, in particular on trade and investment, while also engaging China in the international arena, acting as a norms entrepreneur

by funding a number of programmes, projects and dialogues across the board. At the same time, EU member states tend to maintain good political relations with Chinese leaders, shying away from a confrontational stance, in particular on sensitive issues pertaining to China's sovereignty (Tibet, Xinjiang, human rights, democratisation) and national pride (Taiwan). In recent years, however, some EU member states, in particular France and the United Kingdom, have sailed naval vessels in the South China Sea's international waters — a move viewed by Beijing as an infringement on its 'sovereignty rights' over large swaths of the Sea. Besides this and a few other exceptions, EU member states have, in general, adopted a non-confrontational approach towards China so as not to put at risk the award of lucrative contracts for their national companies. At the same time, the member states have also retained a certain degree of critical pressure on Beijing at EU level.

Major milestones

There are three major milestones in contemporary EU–China relations: 1995, 2003, and 2019.

1995: Constructive Engagement. In its first policy paper on China, the European Commission declared that 'relations with China are bound to be a cornerstone in Europe's external relations, both with Asia and globally' (EU, 1995). In the document, the term 'constructive engagement' was used to describe the EU's distinctive approach towards Beijing, combining economic engagement with critical pressure on human rights violations. Throughout the 1990s and early 2000s, the hope was that a firm engagement policy, coupled with globalisation, would unleash forces inside the country which would, in turn, transform China along liberal-democratic lines. It was this context — and hope — that convinced EU leaders to further develop relations with China through a strategic partnership.

2003: Strategic Partnership. In October 2003, Brussels and Beijing established a strategic partnership enlarging their cooperation to political and security-related fields of policy, including collaboration in big high-tech projects such as the joint development of Galileo, the EU-led global navigation satellite system alternative to the US-controlled Global Positioning System (GPS). Moreover, in Autumn 2003, the majority of EU member states, led by France and Germany, put forward a proposal to start discussions on lifting the arms embargo that had been imposed on China by the European Council of June 1989.

Autumn 2003 can rightly be considered the political heyday of EU–China relations, as it also coincided with one of the most serious transatlantic rifts, due to US President George W. Bush's unilateral policies and differences over the Iraq War. In 2005, EU member states decided to shelve the proposal to lift the arms ban on China, following internal criticism from the European Parliament and a number of national parliaments as well as strong opposition from the United States, which feared that such a move would put at risk Asian security and Washington's strategic interests in the area.

Since the late 2000s, EU–China political relations have deteriorated. The opening ceremony of the Beijing Olympic Games in August 2008 was boycotted by many European leaders. This mirrored growing negative perceptions by European public opinion vis-à-vis China, which were based on the idea that the Asian giant was invading European markets with cheap products, taking away jobs in manufacturing sectors, and accelerating the de-industrialisation of the old continent. The discourse on 'China's economic threat' has been strengthened in the last years, following publication of 'Made in China 2025', a document issued by the Chinese government in 2015 aimed at transforming the Asian giant from being the world's 'factory' into producing higher value products and services. In other

words, a strategy to upgrade China's manufacturing across the board – a move which directly challenges many industrial sectors across Europe.

2019: Cooperative Rivalry. In its last paper on China issued in March 2019, the EU makes a shift towards a more assertive – and defensive – approach, calling China an 'economic competitor' and a 'systemic rival promoting alternative models of governance'. In the document, the EU accuses China of withholding its domestic market for its national champions and restricting European companies' access to it; subsidising domestic competitors; and failing to protect intellectual property rights (EEAS, 2019). In the same vein, the European Council of 21-22 March 2019 voiced harsh criticism on issues ranging from the BRI and Chinese investments into the bloc, to the challenge posed by Beijing state-backed companies to Europe's competitiveness and prosperity.

4. CURRENT STATE OF PLAY AND OPEN ISSUES

The most recent EU policy paper on China — issued in March 2019 — contains a long list of topics and areas for cooperation between the two sides. For the next five years, the EU should instead focus on a select list of issues of strategic significance in order to attain the three overarching objectives of the progressive agenda, namely: i) Promote a strong and united EU; (ii) Protect Europe's socio-economic well-being and way of life; (iii) Advance EU fundamental values and principles, and foster an international order based on effective multilateralism and the rule of law.

Accordingly, the EU should focus on:

- (i) Trade, investment and technology, as well as democracy and human rights;
- (ii) Global issues, including climate change, reform of the multilateral trading system and international security issues;
- (iii) Iran nuclear deal and the reform of the international monetary system.

The remaining part of the paper examines these issues in more detail, beginning with trade and investment, which have traditionally been the backbone of the Sino-European partnership.

Trade and investment

In 2019, China and the EU traded more than €1.5 billion in goods each day. The EU is now China's most important trading partner, although China ranks number two for the EU, after the United States. Between 2007 and 2017, total EU–China trade rose dramatically, from around €306 billion to roughly €573 billion, according to the European Commission. In 2017, China had a share of 11 % in extra-EU exports of goods (€198 billion) and in extra-EU imports of goods China was the largest partner with a share of 20 % (€375 billion). The result was an EU trade deficit of €177 billion with China (Figure 1).

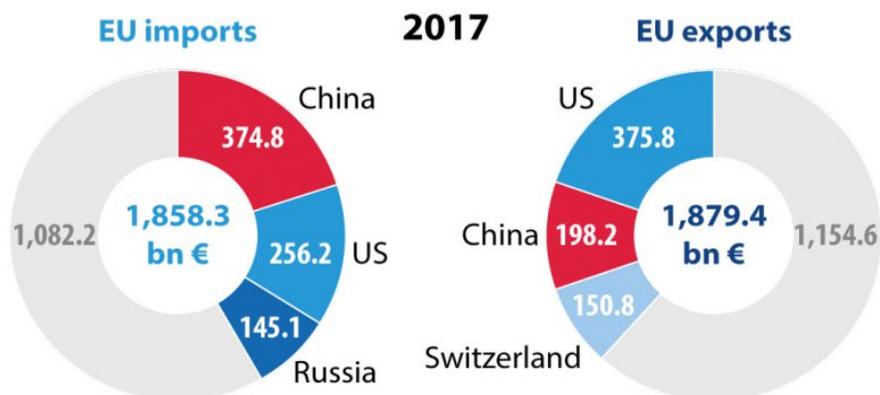
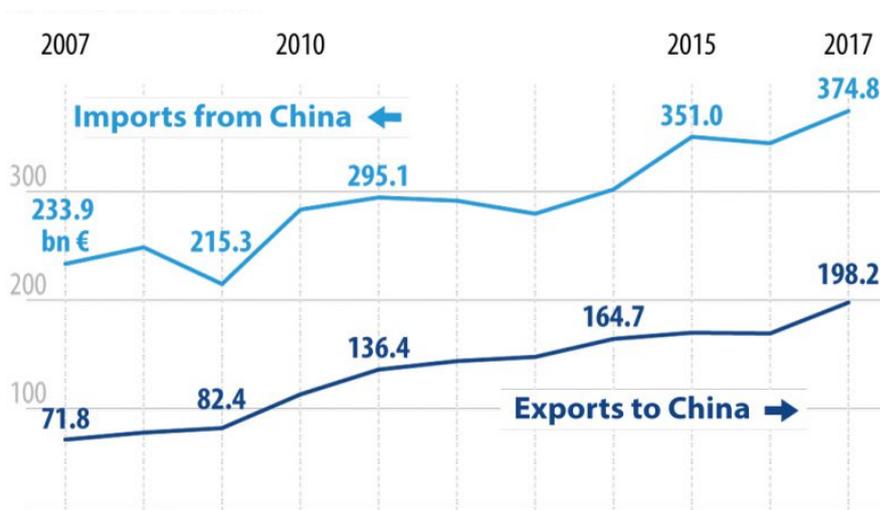
The surge in two-way trade has been accompanied by a growing number of European companies investing and relocating production in China, increasing the current stock of EU foreign direct investment (FDI) there. In recent years, investments have also begun flowing in the other direction, as Chinese financial institutions and companies increasingly acquire stakes of European assets.

2016 was a record year for Chinese investment in the EU, reaching a record high of €35 billion, more than four times higher than the European FDI in China (€8 billion). According to the China Global Investment Tracker, a joint project between the American Enterprise Institute and the Heritage

Foundation, China invested nearly \$164 billion in Europe between 2005 and 2016. During that same period, it invested \$103 billion in the United States. According to the Rhodium Group, a New York-based consultancy, Chinese FDI in the EU has increased by almost 50 times in only eight years, from less than \$840 million in 2008 to a record high of \$42 billion (€35 billion) in 2016.

Europe is currently the top destination for Chinese foreign investments, surpassing the United States. However, in 2016 the share of Chinese FDI in Europe, at 2.2 %, remained low relative to the United States' market-leading 38 %. Similarly, the EU countries held only 4 % of the total FDI in China in 2016, versus 36 % of the total FDI in the United States. Although Chinese investments in the EU are still comparatively low, they have been evolving rapidly and increasing at unprecedented growth rates.

Figure 1 – EU trade with China 2007-2017 (billions of euros)



Source: European Commission.

China invests in Europe for several reasons: (i) Moving up the value chain by acquiring technology, know-how and brands in sectors where Europe has achieved global competitiveness; (ii) Acquiring

logistical bases and direct access to Europe's internal market for Chinese products; (iii) Gaining entrance to third markets (such as the United States) via European corporate networks; (iv) Enhancing Beijing's political and diplomatic influence in Europe — since investments are traditionally seen as beneficial for job creation, leading in turn to positive perceptions of China. The implementation of China's BRI has added an additional element to this picture, since Chinese investors are aware that outward investment in the BRI framework tends to receive smoother approvals, and finance, from Chinese authorities.

The EU has, however, repeatedly voiced its criticism of China's lack of reciprocity. Beijing restricts foreign investment in its domestic market for almost all sectors, with the exception of banking and finance. European businesses consistently face difficulties in entering the market, while Chinese companies often receive help from the government, through subsidies or simpler procedures, for example. Foreign companies, meanwhile, particularly those with recognised brands and technologically advanced products, are required to share their expertise before they are allowed into the market at all. European investors routinely point out the regulatory and administrative burden that foreign companies have to face in China. While the country is the EU's second largest trading partner, it also has the second most investment barriers in the world after Russia, including joint venture requirements, market entry restrictions, obligations of technology transfer as well as unjustifiable technical regulations.

Growing imbalances between Europe and China led France, Germany, and Italy to ask the European Commission, in February 2017, to rethink the rules on foreign investment in the EU. It was a message to Beijing about opening up access to its markets, at a time when the two sides were negotiating a bilateral investment treaty, which is meant to address the question of reciprocity. The EU–China 2020 Strategic Agenda for Cooperation puts an EU–China Investment Agreement as central to the EU's long-term bilateral relations with China. Negotiations for the Investment Agreement began in 2013, although progress on the treaty continues to stall, owing to China's reluctance to remove non-tariff barriers in a range of sectors that are of interest to European businesses.

According to a report by the Rhodium Group and the Berlin-based Mercator Institute for China Studies (MERICS) published in 2019, Chinese foreign direct investment in the EU fell 40 % to €17.3 billion in 2018. The report explains this decline by a tightening in China's capital outflows, but also by growing regulatory scrutiny in host European economies and mounting criticism vis-à-vis China's BRI, which today has become the main framework through which Chinese investments reach Europe (Hanemann, Huotari and Kratz 2019).

The Belt and Road reaches Europe

The Belt and Road Initiative is China's most ambitious geo-economic and foreign policy initiative in decades, combining a land-based Silk Road Economic Belt and a sea-based 21st Century Maritime Silk Road, which together connect China to Europe through South-East Asia, Central Asia, the Indian Ocean, the Middle East and Eastern Africa. The stated aim of this grandiose project is to boost connectivity and commerce between China and more than 70 countries traversed by the Belt and Road (Casarini, 2019).

China's total financial commitment to this initiative is expected to surpass \$1 trillion over the next three decades. Beijing has already committed around \$300 billion for infrastructural loans and trade

financing, a sum which includes a \$40 billion contribution to the Silk Road Fund for infrastructural development and the \$100 billion initial capital allocated to the China-initiated Asia Infrastructure Investment Bank (AIIB).

The BRI is presented to potential partners as an open and unconditional plan, with emphasis given to economic considerations and infrastructure. Unlike the US, which opposed it from the start, the Europeans have shown interest in China's initiative. All EU member states have joined the China-led AIIB, which is designed to lend financial support to BRI-related initiatives. Several projects supported by the AIIB are co-financed by the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD).

China's connectivity initiative has, however, attracted criticism from the EU. In April 2018, the German business newspaper *Handelsblatt* revealed that 27 of 28 ambassadors from the EU in Beijing compiled a report accusing the BRI of limiting free trade and providing subsidised Chinese companies with unfair advantages. The Hungarian ambassador in Beijing was the only one to refuse to sign the document (Heide, 2018), possibly due to two factors: (i) the high level of Chinese investments in Hungary (as a percentage of GDP); (ii) to send a message to Brussels, with which the Hungarian government at that time had a number of grievances.

The EU is concerned that through the BRI, China seeks to tackle industrial overcapacity at home by dumping goods priced below production cost, a strategy that could bring some industrial lines across Europe to their knees. Moreover, Brussels fears that Beijing wants to revise the global rules on commerce and investment, worrying that the Chinese initiative lacks transparency and that the opaque financing deals may threaten the competitiveness of European companies. It is increasingly evident that Chinese companies are awarded contracts with little respect for open procurement rules. This raises the question of reciprocity. While Chinese companies find an open-door environment in Europe, it is quite difficult – if not impossible – for a European company to succeed in winning a contract to build infrastructure projects in China.

Europe is also worried that through the BRI, China is encouraging indebtedness in various countries in order to gain control of strategic assets when debtors default on repayments, although Beijing denies this. Both the US and the EU have acted to respond to what they see are the negative aspect of China's BRI. Washington has created an agency, the US International Development Finance Corporation, which could invest up to \$60 billion to counter China's use of debt-trap projects to gain influence abroad. The EU has adopted its own connectivity strategy for the Euro-Asian region and an investment screening mechanism clearly aimed at Beijing.

Europe's connectivity plan

The 2016 Global Strategy committed the EU to strengthening relations with a 'connected Asia' and called for a 'coherent approach' to connectivity (EEAS, 2016). In this vein, on 19 September 2018 Federica Mogherini, High Representative for Foreign Affairs and Security Policy, and Cecilia Malmström, the European Commissioner for Trade, unveiled the EU's connectivity strategy. The initiative touches on all modes of transport links — land, sea and air — as well as digital and energy links in the Eurasian area (European Commission and EEAS, 2018).

The EU's plan seeks to promote a shared concept of connectivity that respects labour, social and environmental standards and follows the principles of sustainability, transparency, free market, open

procurement, and equal treatment and equal access — principles that Chinese companies investing in the framework of the BRI rarely uphold. This is particularly important in Central and Eastern Europe as well as in the Western Balkans (the countries forming the 17+1 grouping), where some EU member states — such as Hungary and the Czech Republic — and some accession countries — including Serbia and Montenegro — have received significant Chinese investments. There is a risk that some of the projects end up in ‘debt traps’, with implications for the financial stability of these countries that are either already members, or are in the process of becoming members, of the EU.

The EU’s connectivity strategy is linked to new legislation aimed at limiting China’s penetration into key industrial and strategic sectors in the bloc: the screening mechanism.

Screening Chinese investments

The European Commission first proposed to establish a framework for member states, and in certain cases the Commission itself, to screen foreign direct investment in the EU in September 2017 (European Commission, 2017). After 18 months of negotiations, the European Council of 21–22 March 2019 gave the green light to the screening mechanism. It is worth noting that during the vote on the draft text in the EU Council on 5 March 2019, 26 out of 28 EU members approved the screening mechanism. The two outliers were the United Kingdom, which is halfway out of the bloc, and Italy. Especially when it comes to the latter, the populist coalition in Rome at that time reversed the position of the previous centre-left Gentiloni government, which had joined Germany and France in sending a letter to the European Commission in February 2017 to back calls for an EU-wide investment screening mechanism.

The screening mechanism will help the European Commission and the EU member states to evaluate whether a foreign investor is in reality controlled by a third country government. This is clearly aimed at Chinese state-backed enterprises. The screening mechanism makes it more difficult for foreign investors to acquire expertise and technology that could be used to produce goods sold at lower prices.

The screening mechanism can also be used to safeguard the national interest, a question of growing importance with regard to 5G technology, the world leader of which is Huawei, a Chinese company. The Europeans have security concerns regarding Huawei, however the majority of EU member states seem oriented towards a softer line — compared to the United States which has banned the Chinese company — that would allow Huawei to continue operating inside their countries alongside other providers, including US-based Cisco and European companies such as Ericsson and Nokia. This would avoid giving the Chinese company a leading position in the national market. Regarding the security aspects of the 5G network, European policymakers are considering whether to grant security authorities the right to access the source code of Huawei, as well as that of the other operators, so as to safeguard the national interest.

The screening mechanism has been supported by many industrial associations across Europe, including the powerful German business federation which put forward a proposal in January 2019 aimed at limiting market access for Chinese companies that receive big subsidies, and at blocking their ability to buy European companies in key technological and strategic sectors (Federation of German Industries, 2019) — a stance that has found support from the French political elite.

Fostering European champions

In his Manifesto addressed to the ‘citizens of Europe’ on 4 March 2019, French President Emmanuel Macron puts forward plans to combat aggressive Chinese competition with new interventionism at the EU level. In particular, Macron believes that Europe needs to act by enforcing policies that allow the EU to defend its technological sovereignty and create European industrial champions (Macron, 2019).

A recent report by the European Political Strategy Centre (EPSC) — the European Commission’s in-house think tank — lends support to this revamped state interventionism, including plans to merge the rail assets of France’s Alstom and Germany’s Siemens to avoid being outcompeted by Beijing-backed China Railway Rolling Stock Corp (CRRC), a publicly traded rolling stock manufacturer, which is the world’s largest train maker (European Political Strategy Centre, 2019).

Behind this proposal, there is the idea — made clear in Macron’s Manifesto — that Europe is caught in great power rivalry between China and the United States and that should Europe fail to act, its industrial future — and jobs — would be at stake.

US-China rivalry

The EU and the values it stands for are currently under attack from both the US and China. Under Trump, the US has become a disrupter of the liberal international order, including the fundamental norms of a trading system based on multilateral agreement and binding rules, a system created after the end of the second world war and ever since led by the US. Moreover, the administration of US President Donald Trump is showing contempt for multilateralism and institutions, preferring bilateral bargaining and power relations instead. Concurrently, China’s rise has not brought about the domestic changes hoped for by the West. China’s state-controlled economy represents a serious challenge for Europe’s competitiveness and well-being, while the Chinese regime now presents itself as an alternative to liberal democracy.

US President Donald Trump has responded to an increasingly powerful China by unleashing a trade and technology war, seeking to subordinate Beijing to US interests. The US is asking the Asian giant to substantially cut its bilateral trade deficit, reduce tariffs on US goods and diminish subsidies for emerging industries. A study from the Peterson Institute for International Economics (PIIE) — a Washington-based think tank — published in May 2019 maintains that Trump has threatened tariffs on China that are not far from the average level of duties the US imposed with the Smoot-Hawley Tariff Act of 1930. PIIE experts argue that tariffs may even stay this high, because US negotiating demands are too humiliating for China to accept (Bown and Zhang, 2019).

The Trump administration has also decided to restrict China’s ability to invest in, or acquire, US companies and start-ups in sectors such as robotics, aerospace and artificial intelligence identified by Beijing in its so-called Made in China 2025 plan. China has responded by imposing tariffs on US products and by blacklisting some US companies from doing business in China.

Washington has adopted a tough approach vis-à-vis Beijing, seeking to change China’s practices in order to boost US exports, protect intellectual property and technological edge, and counter discrimination against overseas investors. The more hawkish elements inside the Trump administration want to decouple the US economy from China, through the imposition of tariffs,

barriers to cross-border investment and initiatives that would compel companies to break supply chains.

For instance, Washington has decided to blacklist Huawei — China's only world-leading advanced technology manufacturer — preventing US companies from buying its products, though in August 2019 Trump softened his stance, limiting the restriction to products that are considered significant for national security reasons. The source of friction is competition to build and deploy 5G architecture which will underpin a vast array of commercial and military technologies. Huawei has gained an undisputed edge in 5G technology over its Western competitors, attracting the ire of the US.

The Trump administration's tough approach towards China enjoys – to varying degrees – bipartisan support in Washington. It also goes hand in hand with a deepening hostility among ordinary citizens to a rising China which challenges US primacy.

The EU has quite explicitly said it does not agree with the confrontational methods employed by the Trump administration in its trade war with China, although many Europeans would agree with the substance of the accusations that the US makes of Beijing. Nevertheless, the EU and its member states have never confronted China as openly as the US.

There are also differences in how the EU and the US deal with Huawei and 5G technology. In fact, the Europeans have so far resisted pressure from Washington to ban the Chinese company from the development of 5G networks.

Notwithstanding divergences over trade and 5G, the EU and the US share the same political values and are committed to pushing for domestic change inside the Asian giant – by promoting the respect of human rights, fundamental freedoms, good governance, and the rule of law in China.

Political values

The EU was founded on the principles of human rights, democracy and the rule of law. Moreover, the Lisbon Treaty of 2007 stipulates that the EU and its member states should promote these values in their external relations. Since the Chinese government presents its authoritarian political system as an alternative to liberal democracy, friction over political models increasingly shapes the relationships between the EU and China. For instance, the two sides look at human rights from different perspectives: while for Europe all human rights are universal, indivisible, interdependent and interrelated, China on the other hand emphasises social and economic rights within the context of government action — but not the rights of the individual, which continue to be violated inside the country.

The picture is quite gloomy. An estimated one million Uyghurs and other Turkic Muslims are detained in political re-education camps. There is extensive abuse of surveillance technology and systematic targeting of human rights lawyers and civil society. Deep and persistent inequalities in access to quality healthcare and education continue. More recently, Beijing has adopted expansive cross-border law enforcement that catches non-nationals, including EU citizens, in its net. The future of Hong Kong remains in the balance, following a series of demonstrations in Hong Kong and solidarity protests in other cities abroad. These began in mid-2019 with the aim of withdrawing an extradition bill proposed by the Hong Kong government but that in reality was inspired by Beijing.

The future status of Taiwan - whose official name is the Republic of China - remains in the balance too. The 'one China policy' asserts that there is only one sovereign state under the name China, as opposed to the idea that there are two states, the People's Republic of China (PRC – or the mainland) and the Republic of China (ROC – or Taiwan). The EU and all its member states abide by the 'one China policy' – a necessary condition for entertaining official diplomatic relations with Beijing. However, Taiwan has gained 'de facto' statehood and the question of reunification with the mainland remains open. Taiwan is a fully-fledged democracy - but the EU has tended to shy away from showing support for the island, for fear of commercial reprisals from the mainland.

The EU is often unable to find the necessary cohesion to denounce China's human rights violations and aggressive behaviour towards the neighbouring countries — helped in this by Beijing, which continues to put pressure on member states so as to undermine EU principled positions. For instance, in June 2017 Greece succeeded in preventing the EU from taking a clear critical stance against China at the United Nations Human Rights Council in Geneva. Greece has received significant Chinese investments in recent years. For example, the majority of the Greek port of Piraeus in Athens is now owned by CISCO, a Chinese state-owned company.

Another example occurred in 2016, following the deliberation by the Permanent Court in The Hague on the Arbitration between the Philippines and China regarding the latter's extensive claims to maritime areas in the South China Sea. The Tribunal found the claims to be incompatible with the United Nations Convention on the Law of the Sea (UNCLOS) and therefore illegitimate. The EU issued a mild declaration in July 2016, stressing the need for the parties to resolve the dispute in accordance with international law. An earlier — and more principled — declaration, which clearly mentioned China, had been blocked by Greece, Hungary and Croatia in June 2016.

Differences of values have nevertheless not hindered EU–China dialogue and collaboration on global issues of common concern.

Global issues

This authoritarian China - whose values are often at loggerheads with those of Europe - can be a formidable partner of the EU to advance effective multilateralism and address global challenges, such as climate change and the reform of multilateral trading, although China's engagement towards multilateralism is sometimes selective and based on a different understanding of the rules-based international order.

Climate change

China and the EU are, respectively, the first and third greenhouse gas emitters and two of the three leading actors of the international climate change regime. While the EU has possibly developed some of the most ambitious climate and energy legislation to implement the Paris Agreement, China is developing a far-reaching climate and energy agenda and has become a global leader in renewable energies and reforestation.

China was one of the main brokers of the Paris Agreement on climate change. The final declaration of the EU–China Summit in 2017 marked a key point in Brussels–Beijing cooperation on environmental issues, as it coincided with Trump's rejection of the Paris Agreement. The EU and China have pledged

to continue efforts to reduce pollution, combat rising sea levels, and bolster research, innovation, and technological progress, even without the US. Brussels and Beijing have also agreed to cut back on fossil fuels, develop more green technology, and raise funds to help poorer countries, particularly in Africa, cut their emissions.

While there continue to be differences, and conflicting interests, between the two parties, climate change is nevertheless an area where China can become a key partner of the EU. Likewise, collaboration with China can provide the EU with additional strength to save the multilateral trading system and reform the World Trade Organisation (WTO).

WTO reform

There is no denying that China challenges Western norms and principles. Yet, today it is the US under Trump that has become a disrupter of the fundamental norms of a trading system based on multilateral agreement and binding rules, which the US itself created in the wake of the Second World War. As a result, the EU and China have been forced to collaborate more closely within the WTO to save the multilateral system.

The EU has at various times indicated that it disagrees with US resort to tariffs — which are in clear violation of the rules of the WTO — in its trade dispute with China. The EU can thus find in China a partner to uphold the centrality of the WTO and the principles of the multilateral trading system. In 2018, the EU and China set up a working group to revamp the WTO in order to counter US unilateralism and send a positive signal to those who want to maintain the multilateral trading system. However, the two sides remain divided on thorny issues such as Beijing's industrial policies and market access.

Both Brussels and Beijing are committed to reforming the Appellate Body, a standing group of seven people that hears appeals from reports issued by panels in disputes brought by WTO members. The Appellate Body is central for the very survival of the WTO's dispute settlement mechanism. It is currently facing one of its most acute crises, due to the US blocking the appointments of Appellate Body members to replace those whose terms have expired. China can thus become a formidable partner of the EU to defend the norms and principles on which the multilateral trading system is based. Similarly, there is great potential for EU–China cooperation on global security issues, in particular in those parts of the world where collaboration with China can make a difference for promoting EU interests and values.

International security

Both the EU and China agree on a vision of international affairs and global governance that puts the United Nations at the centre. The two partners have been able to foster cooperation on issues ranging from peacekeeping operations and antipiracy missions to non-proliferation and disarmament, including the question of North Korea's nuclear threat. Differences remain, however, on how to address territorial and maritime disputes in the South China Sea.

Since the early 2000s, EU member states, including France, the United Kingdom, Germany, Italy and Spain, have each set up a 'strategic dialogue' with Beijing, complemented by the training of Chinese

military officers and exchanges of high-level visits. In 2015, Sino-French and Sino-British cooperation also included port calls and joint naval search and rescue exercises.

Since 2010, there has been a yearly EU–China High Level Strategic Dialogue between the High Representative of the Union for Foreign Affairs and Security Policy and the Chinese State Councillor responsible for foreign affairs. Furthermore, since 2011 there has also been a yearly meeting between the EU’s High Representative and the Chinese Defence Minister, paralleled by a dialogue on military affairs between the Chair of the EU Military Committee and his/her counterpart in the PLA.

The EU and China already work together on conflict prevention, crisis management, and post-conflict stabilisation. EU NAVFOR, the EU-led antipiracy operation off the coast of Somalia, has already tested naval cooperation between some EU member states and China. In October 2018, for the first time, EU military forces completed a combined exercise with the People’s Liberation Army Navy (PLAN) in the Gulf of Aden. Peacekeepers from both China and EU member states operate under the UN flag in Lebanon as well as in other UN-EU operations, such as in Congo, Mali, and South Sudan. There is potential for further EU–China security cooperation in Africa and the Middle East, as well as in those areas — such as Afghanistan — where US presence is retreating and closer EU–China collaboration may be needed to fill the void and support regional stability. Another area of great potential for Brussels–Beijing relations is North-East Asia.

North Korea

The EU and China regularly discuss the question of North Korea, advocating a peaceful resolution through increased dialogue at the multilateral level. This is in direct contrast to the Trump administration, whose hawks have tended to respond to Pyongyang’s missile launches with belligerence — an attitude that both Brussels and Beijing see as troubling for regional peace.

The EU and its member states are the biggest donors of development and humanitarian aid in the Democratic People’s Republic of Korea (DPRK) and have recently adopted harsher sanctions against Pyongyang — in line with the rest of the international community. Concurrent with sanctions, the EU continues to back diplomatic initiatives aimed at promoting regional cooperation, multilateralism and trust building — such as Republic of Korea President Moon Jae-in’s engagement policy with the North.

The question of North Korea is linked to the future of the Korean Peninsula and of the surrounding region — one of the most important for the EU from an economic perspective, since it includes some of Europe’s biggest trading partners — China and Japan — and countries with which Brussels has signed important Free Trade Agreements (FTAs) — South Korea and Japan. The EU has become the staunchest supporter of Trilateral Cooperation — a process that aims to foster dialogue and reconciliation among China, Japan and South Korea.

China supports the Trilateral Cooperation process since it is an ‘Asian only’ initiative marked by the absence of the US. The EU and China should work together to bolster Trilateral Cooperation efforts aimed at addressing North Korea’s nuclear threat — but also mounting nationalism which puts at risk North-East Asia’s peace and stability. Nationalism is also on the rise in South-East Asia, a region marred by territorial and maritime disputes among its resident countries.

South China Sea

If North-East Asia is home of some of the EU's biggest trading partners, the South China Sea is an area through which a large part of Europe's global trade passes. The security situation in the South China Sea has been deteriorating in recent years, mainly due to Beijing's decision to step up territorial and maritime claims over large areas of the Sea. These claims are based not only on economic and security considerations, but also on national identity and the renewal of China's past glories.

China continues to challenge the rules-based order in the area by building several artificial islands with military facilities and weapons systems, drilling for oil and gas, and chasing off its South-East Asian neighbours' fishing vessels from waters where they have the rights to fish in accordance with UNCLOS.

In recent years, some EU member states, in particular France and the United Kingdom, have stepped up their involvement in the area by sailing naval vessels in the South China Sea's international waters to send the message that Europe cares about the region's stability and the rules-based order.

France, Germany and the United Kingdom issued a statement on 29 August 2019 expressing the three countries' concern about the situation in the South China Sea and their support for the application of UNCLOS. EU member states continue, however, to sell military equipment in the region. French, German, British and Italian arms manufacturers have developed a strong market presence in South-East Asia, especially in sales of naval units (submarines, frigates, corvettes) and jet fighters.

European arms sales represent an excellent example of the dilemma facing EU policymakers. On the one hand, Europe's defence sector is the source of highly paid jobs, contributing to the bloc's competitiveness and international technological excellence. To survive, the sector needs market outlets. Yet, the sale of arms, weapons systems and dual-use goods has the potential to produce destabilising effects in a part of the world such as the South China Sea where tension between China and its smaller South-East Asian neighbours is increasing.

Alongside greater activism in the area by member states, the EU has also stepped up its involvement but more as a normative actor intent on finding a solution to the ongoing tensions in the area. In this context, the EU has made itself available to facilitate ASEAN–China dialogue on devising a code of conduct for the South China Sea. The EU has also given its support to EU member state naval operations that are aimed at reaffirming the rule of law. For instance, in June 2018 there was an official from COASI — the EU Council's Working Group on the Asia-Pacific — on board one of the French vessels that joined the US and other countries sailing through international waters in the South China Sea. The EU must continue to engage China on finding a multilateral solution for the South China Sea, including support for an ASEAN–China code of conduct, while retaining a level of critical pressure on Beijing through support for EU member states — in particular French — naval activities in international waters in the South China Sea.

In some parts of the world, China is a source of tension. But Beijing can also be an element of support for regional stability and international law, as in the case of the Middle East and the Iran nuclear deal.

Maximising EU–China relations

A progressive agenda should make the best use of EU–China relations to build a more balanced international system, placing limits on those unilateral attitudes of the US that are detrimental to EU interests and fundamental values. In this respect, the two interrelated policy areas to focus on for the next five years should be the Iran nuclear deal and the reform of the international monetary system.

The Iran nuclear deal

Saving the Iran nuclear deal – in its actual form or in an amended version following the return of the Trump administration to the negotiating table – is a strategic imperative for Europe. The EU invested considerable capital in support of the negotiations for the JCPOA, which was signed in 2015. Europe considers the accord as the best possible attempt to bring stability in an area – the Middle East – where competing nationalisms can trigger an arms race with significant destabilising effects for the region as well as for the old continent.

The future of the Iran nuclear deal remains uncertain following the unilateral withdrawal of the US and its reimposition of sanctions on Tehran – and on any companies from other countries that do business there – in May 2018. Trump walked out from the JCPOA accusing the previous administration of Barack Obama to have negotiated a ‘bad deal’. The Europeans acknowledge that the Iran’s nuclear deal is not perfect and that the Islamic Republic of Iran continues to support the Syrian regime as well as other forces that destabilise the region. However, for Europe the JCPOA – a multilateral accord incorporated in a resolution of the UN Security Council – remains the best diplomatic attempt, so far, to advance the non-proliferation regime in the Middle East and contribute to bring stability in a region marred by conflicts and competing nationalisms.

Europe is now working on a series of measures aimed at shielding EU companies involved in Iran from the threat of secondary US sanctions. The EU is committed to engaging Iran and the other signatories to the JCPOA – France, Germany, the UK plus Russia and China – to salvage the agreement. Tehran has agreed to consider remaining in the agreement if the other signatories offset the benefits lost due to US withdrawal. Should the deal fall through, there is the concrete possibility that Iran would resume developing its nuclear programme, with the risk of tempting other countries in the area to emulate it.

The three European signatories to the deal – France, the United Kingdom, and Germany – have formally registered a special purpose vehicle to help facilitate trade with Iran and thus save the JCPOA. This new mechanism is called the Instrument in Support of Trade Exchanges (INSTEX) and began operations in Spring 2019. However, trade is limited to humanitarian goods, and the effects on the Iranian economy have so far been quite limited. At the end of August 2019, France proposed establishing an international credit line worth US\$15 billion – guaranteed by Iranian oil sales and backed by France, Germany and the UK – in a bid to reduce tension between Iran and the West and to save the JCPOA. This may not suffice, however, as the credit line may encounter opposition from Washington, which maintains a ‘maximum pressure’ policy towards Tehran.

Saving the Iran nuclear deal is also a strategic imperative for China. Beijing is today Iran’s most important trading partner and the main buyer of Iranian oil. Moreover, Iran is a crucial country for the development of China’s BRI in Central Asia. China is the only signatory to the JCPOA which has the economic and political clout to effectively help the EU bypass US sanctions and thus save the deal.

The US administration of Donald Trump was able to reimpose sanctions against Tehran — and thus put at risk the JCPOA — because Washington has the power to cut off foreign companies' access to US capital markets and dollar transactions. This demonstrates how the US dollar — as a currency, together with the infrastructure of the global payments system — can be weaponised. It is in this context that EU–China collaboration on saving the Iran nuclear deal must go hand in hand with a reform of the international monetary system that would put limits on the dollar's exorbitant privilege.

Reform of the international monetary system

The dollar has been the world's reserve currency since the end of the Second World War. The reserve status of the dollar means that the world needs greenbacks for making payments, and this has allowed the US government as well as Americans to borrow at lower costs. This has also made possible US arbitrary imposition of sanctions and the weaponisation of the dollar.

Since 2010, following the crisis triggered by US sub-prime mortgages, there have been various attempts at reforming the international monetary system and create an independent global currency, including initiatives by some countries to promote their own currencies as an alternative to the dollar.

The EU has stepped up efforts to develop the global role of the European common currency, reflecting the euro area's economic and financial weight. In its Communication: *Towards a stronger international role of the euro*, the European Commission states that strengthening the international role of the euro would 'provide market operators across the globe with additional choice and making the international economy less vulnerable to shocks – and political decisions - linked to the strong reliance of many sectors on a single currency' (European Commission, 2018, p. 5). A similar discourse is put forward by China in relation to its currency, the renminbi.

China and the EU have developed strong ties in the monetary field. Beijing has traditionally supported the euro, which is the only serious alternative to the dollar, and has diversified its foreign exchange reserves — the world's largest — so that it now holds over one-third in euros and slightly more than half in dollars. This dollar reserve has decreased by around 30 % since 1999, when the European common currency came into circulation.

China's diversification of its foreign reserves has accelerated since August 2011, when Standard & Poor's downgraded the credit rating of the US federal government from AAA (outstanding) to AA+ (excellent). Sino-European financial and monetary links deepened as a result, because China began divesting away from dollar-denominated assets and purchased growing quantities of eurozone bonds, in particular German Bunds, which were perceived to be safer than US Treasuries.

China is trying to internationalise its currency as it weans itself off its dependency on the United States' economic cycle and monetary policy. The fact that China supports the European common currency at the expense of the dollar thus has major geostrategic implications.

China has traditionally backed the eurozone for reasons of national interest. By keeping the value of the currency of its first trade destination up, Beijing has benefited from the competitiveness of its products and further augmented the EU's trade deficit with China. Chinese support for the eurozone was particularly important during the euro crisis of 2009–11, when the European common currency became the target of speculative attacks mainly stemming from Wall Street-based banks and hedge funds. Chinese leaders intervened on various occasions at that time to reassure the financial markets by buying eurozone bonds.

Europe has, in turn, supported many of China's monetary ambitions. The Europeans unanimously backed the decision by the International Monetary Fund in December 2015 to include the renminbi in the basket of currencies making up the Special Drawing Right (SDR), an international reserve currency that includes the US dollar, the euro, the British pound, and the Japanese yen. The decision was clearly political, taken in defiance of Washington which had voted against the inclusion of the renminbi in the SDR basket. The decision of the Europeans to back China's monetary aspirations was also taken in recognition of what Beijing had done to support the euro during the euro crisis. Today, Europe is home to the largest number of renminbi bank clearings or offshore hubs where the Chinese currency can be traded. In the same vein, most of Europe's central banks have accepted — or are considering accepting — China's currency as a viable reserve.

Building upon well-established Europe–China monetary ties, the EU should further work on the reform of the international monetary system and place limits on the dollar's exorbitant privilege.

5. POLICY RECOMMENDATIONS

For the next five years, the EU should focus on the following issues:

- (i) Trade, investment and technology, as well as democracy and human rights — DEFEND
- (ii) Global issues, including climate change, reform of the multilateral trading system and international security issues — ENGAGE
- (iii) Iran nuclear deal and reform of the international monetary system — MAXIMISE.

DEFEND

Europe must stand up for its fundamental values by ensuring that its engagement with China remains principled. In the face of unfair competition from China, Europe needs to act by enforcing policies — including the creation of European industrial champions — that would allow the old continent to defend its jobs, competitiveness, technological sovereignty and way of life. The new EU leadership should also find ways to mitigate the most adverse effects of growing US–China rivalry on European interests and the broader international rules-based order. The EU should thus do the following:

- **Defend EU fundamental values and principles by adopting majority voting, and resist attempts by China to undermine EU unity.** Adopting Qualified Majority Voting on issues pertaining to human rights and international law would contribute to defending those principles on which the EU has been founded.
- **Defend Europe's jobs and industrial competitiveness by combating aggressive Chinese competition with new interventionism at the EU level.** A progressive EU China policy should seriously consider the idea of creating European champions able to compete on an equal footing with China's giant state-backed companies. This is essential for defending industrial jobs that could otherwise be at risk from China's unfair competition.
- **Defend Europe's technological sovereignty by fully endorsing legislation aimed at dissuading Chinese companies from the acquisition of strategic assets in Europe.** The adoption of the screening mechanism is a welcome addition to the instruments at the disposal of the EU to protect its industrial assets and limit China's attempts — today made through the BRI — to



acquire European technology and know-how and subsequently impose Chinese standards. This is particularly important in light of the development of 5G technology – an area where Chinese companies are world leaders. Close scrutiny of Chinese acquisitions should not be at the expense of good, greenfield investments that create jobs and economic growth.

- **Defend Europe’s well-being and the rules-based order from the US–China trade war by aligning temporarily — and depending on the issue — with either one or the other.** By doing so, the EU can defend its interests as well as the norms and principles on which the liberal international order, including the multilateral trading system, is based. In this regard, the EU should not support US attempts to thwart China, as this would put Europe in an open confrontation with Beijing and elicit a backlash that will likely be detrimental to EU interests. Instead, the EU should clearly indicate those issues on which it agrees with the US on trade and technology, seeking — when possible — to find a common position with Washington but without disrupting global norms.

ENGAGE

China, whose values are often at loggerheads with those of Europe, can however be a formidable partner of the EU to advance effective multilateralism and address global challenges, such as climate change and the reform of multilateral trading.

The EU should thus ENGAGE China to:

- **Fight climate change more effectively and meet the targets of the Paris Agreement.** While differences remain between the two sides, the EU should seek China’s commitment for the country’s emissions to peak before 2030, in line with the Paris Agreement. The EU should also foster cooperation on green energies.
- **Limit US attacks on the multilateral trading system and sustain liberal trade.** The EU should engage Beijing in upholding the centrality of the WTO and the principles of the multilateral trading system, including the reform of the Appellate Body, which is central for the very survival of the WTO’s dispute settlement mechanism.
- **Foster international security and promote the rule of law.** The EU should do the following: (i) Broaden and deepen security cooperation with China and consider involving Beijing in targeted joint military activities, such as counterpiracy drills and humanitarian rescue exercises and operations; (ii) Step up collaboration with China on finding a solution to North Korea’s nuclear threat and in support of the process of Trilateral Cooperation among North-East Asian countries; (iii) Engage Beijing in developing a multilateral solution for territorial and maritime disputes in the South China Sea — but also enforce a rules-based order in the region by supporting those EU member states that are willing to sail naval vessels in the South China Sea’s international waters. The EU should give more consideration to the region’s strategic balance, coordinating closely with those member states that sell arms in the area.



MAXIMISE

A progressive agenda should make the best use of EU–China relations to build a more balanced international system, placing limits on those unilateral attitudes of the US that are detrimental to EU interests and fundamental values.

The EU should thus MAXIMISE relations with China to:

- **Save the Iran nuclear deal.** Keeping the Iran deal alive is a strategic imperative for Europe and China. Brussels and Beijing should further their collaboration on this issue, using the full array of their bilateral partnership to keep the Iranian economy afloat and save the JCPOA. Initiatives could include using the euro and the renminbi for transactions with Iran, inviting China to become part of INSTEX, and having Chinese cargo ships transport Iranian oil to Europe.
- **Reform the international monetary system and put limits on the dollar’s exorbitant privilege.** Building on EU–China monetary ties and their past collaboration within the IMF, the two sides should work towards the creation of a more balanced monetary system.

6. CONCLUSION

This study has sought to answer the questions set out at the beginning: Should the EU enforce a containment policy towards China, joining Washington, which has unleashed a trade and technological war against Beijing with the aim of permanently subordinating the Asian giant to the West? Or should the EU not only engage with China, but even seek to maximise Sino-European ties to put limits on those US unilateral policies that are detrimental to Europe’s interests and fundamental values?

The progressive approach presented here and built around three key words — Defend, Engage, Maximise — provides an answer in the form of a policy mix of containment and engagement which, when applied to a select list of issues of strategic significance for EU–China relations, should guide EU policymakers in achieving three overarching objectives: (i) Promote a strong and united EU; (ii) Protect Europe’s socio-economic well-being and way of life; (iii) Advance EU fundamental values and principles and foster an international order based on effective multilateralism and the rule of law.

This progressive framework builds on the transatlantic allies’ commonalities vis-à-vis Beijing, including their commitment to promoting an open society based on market economy and the respect of human rights, fundamental freedoms, good governance, and the rule of law in China. However, a progressive agenda for EU-China relations recognise that EU interests and fundamental values are now under attack not only by an authoritarian Communist China, but also by the America First policies of US President Donald Trump.

To achieve maximum results in its approach towards China, this study invites the EU to focus on the following select list of issues for the next five years:

- (i) Trade, investment and technology, as well as democracy and human rights — DEFEND
- (ii) Global issues, including climate change, reform of the multilateral trading system and international security issues — ENGAGE
- (iii) Iran nuclear deal and reform of the international monetary system — MAXIMISE.

A progressive agenda for EU–China relations would thus unfold along the following lines:

DEFEND: European workers and companies from China’s unfair trade and competition practices; support a new version of state interventionism at EU level to counter China’s state-backed companies; protect the EU’s fundamental values and principles from the Chinese authoritarian political system.

ENGAGE China to promote multilateralism and international institutions, focusing on a select number of policy areas where Brussels and Beijing working together could make a difference.

MAXIMISE EU–China relations to build a more balanced international system, placing limits on those unilateral attitudes of the US which are detrimental to EU interests and fundamental values.

The progressive framework presented here allows EU policymakers to identify and distinguish between those issues where China is a challenge — and thus needs to be contained — and those policy areas where Beijing can become a partner — and even a temporary ally — to advance EU interests and fundamental values.

Hopefully, this exercise will help clarifying how different political sensitivities can approach the EU-China relationship. It is time, indeed, for political forces in Europe to step in and have their say on a topic of increasing importance for the future of the EU.

REFERENCES

[A Conversation with Spanish Foreign Minister Josep Borrell](#) (2019), Center for Strategic and International Studies, Washington DC, 1 April.

Bown C. and Zhang E. (2019), [Trump's 2019 Protection Could Push China Back to Smoot-Hawley Tariff Levels](#), Washington, Peterson Institute for International Economics, May.

Casarini N. (2016), "When All Roads Lead to Beijing. Assessing China's New Silk Road and its Implications for Europe", *The International Spectator*, Vol. 51, No. 4 (December 2016), p. 95-108.

E3 (France, Germany, UK), [Joint statement on the situation in the South China Sea](#) (2019), 29 August.

[EU–China 2020 Strategic Agenda for Cooperation](#) (2013), Brussels, 23 November.

European Commission and High Representative of the Union for Foreign Affairs and Security Policy (2019), ['EU–China — A strategic outlook'](#), JOIN (2019) 5 final.

European Commission (2018), [Towards a stronger international role of the euro](#) (COM/2018/796 final).

European Commission and EEAS (2018), [Connecting Europe and Asia — Building Blocks for an EU Strategy](#) (JOIN/2018/31).

European Commission (2017), [Proposal for a Regulation establishing a framework for screening of foreign direct investments into the European Union](#) (COM/2017/487).

European Commission (1995), [A Long-Term Policy for China–Europe Relations](#), COM (1995) 279 final.

European External Action Service (2016), [Shared Vision, Common Action: A Stronger Europe. A Global Strategy for the European Union's Foreign and Security Policy](#).

European Parliamentary Research Service (2019), [State of play of EU–China relations](#), Brussels, European Parliament, January.

European Political Strategy Centre (2019), [EU Industrial Policy After Siemens-Alstom. Finding a New Balance Between Openness and Protection](#), Brussels, 18 March.

European Think-Tank Network on China (2018), [Political values in Europe-China relations](#).

Federation of German Industries (2019), [China — Partner and Systemic Competitor](#), Berlin, January.

Hanemann T., Huotari M. and Kratz A. (2019), ["Chinese FDI in Europe: 2018 Trends and Impact of New Screening Policies"](#), MERICS *Papers on China*, Berlin, 6 March.

Heide D. et al. (2018), [EU Ambassadors Band Together Against Silk Road](#), in *Handelsblatt*, 17 April.

Holslag J. (2019), *The Silk Road Trap. How China's Trade Ambitions Challenge Europe*, Polity Press.

Le Corre P. and Sepulchre A. (2016), *China's Offensive in Europe*, Washington DC: Brookings.

Macron E. (2019), [For European renewal](#), Paris, 4 March.

Pirozzi N. and Ntousas V. (2019) [Walking the Strategic Talk. A Progressive EU Foreign Policy Agenda for the Future](#), IAI-FEPS Report, Brussels-Rome, May.

ABOUT THE AUTHOR



Nicola Casarini, Senior Fellow, Istituto Affari Internazionali, Rome

Nicola Casarini is Senior Fellow at the Istituto Affari Internazionali (IAI) in Rome. Prior to this, he was Visiting Professor at the Graduate Institute in Geneva; Public Policy Scholar at the Wilson Center, Washington DC; Senior Analyst at the EU Institute for Security Studies in Paris; Marie Curie Research Fellow and Jean Monnet Fellow at the European University Institute in Florence. He holds a PhD in international relations from the London School of Economics and Political Science. Dr. Casarini has published numerous works on EU–China relations, Chinese foreign policy, Asia’s security, and transatlantic relations. He has advised EU institutions and various European governments. Dr. Casarini is a regular media contributor.