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Time to take Sino-EU relations to a new level

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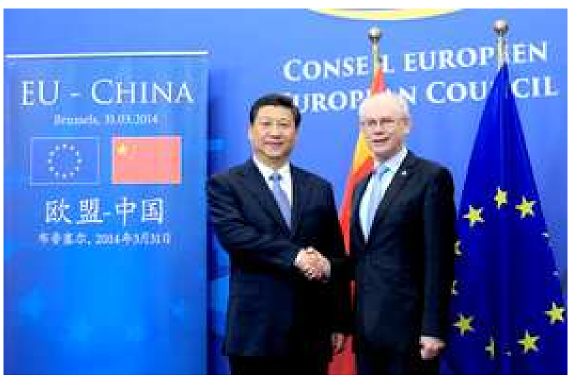
BRUSSELS - As the first Chinese leader to visit the EU headquarters, President Xi Jinping is seeking a new trade opening with Brussels, which needs deeper economic relations for its recovery agenda.



China's president Xi Jinping started his Europe tour in the Netherlands (Photo: Flicker/Dave de Vaal)

In China President Xi’s visit to the EU headquarters as well as the Netherlands, France, Germany, and Belgium, has attracted attention. Beijing hopes to soften European opposition to the free-trade deal.

This time stars may be aligned for improved bilateral relations, despite old weariness on both sides.

Today, both Brussels and Beijing have new incentives to move ahead in bilateral relations. As international multilateral trade talks continue to linger, the spotlight has shifted toward free trade agreements (FTAs).

In Asia, new trading blocs are emerging. Washington is pushing for the Trans-Pacific Partnership (TPP), in which Brussels plays no role and which Beijing is following from the sidelines. China has a role in the Regional Comprehensive Economic Partnership (RCEP), while the Association of Southeast Asian Nations (ASEAN) is pushing regional economic integration. In turn, Brussels seeks to secure its gateway to the region.

Securing a position in the Chinese marketplace

Meanwhile, Beijing is in talks on a China-US investment deal, while Brussels hopes to secure an EU-US FTA. To Brussels, the proposed trade pact with Beijing could ensure long-term positioning in the Chinese marketplace. To Beijing, it is a way to accelerate catch-up growth and to move from cost efficiencies to innovation.

In early 2013, the EU accused China of dumping solar panels on the European market and illegal subsidies, while threatening actions against Chinese telecoms equipment giants Huawei and ZTE. In turn, these moves were followed by tit-for-tat accusations from China that the EU had dumped wine on the Chinese market.

While trade tensions have often overshadowed the bilateral relations, the friction has decreased significantly since last year, when the European Commission threatened to impose duties on $28.9 billion of Chinese solar panels imports and Beijing retaliated with its own measures.

In the past weeks Beijing ended its subsidy and dumping complaints against imports of European wine and polysilicon used in solar panels. In turn, EU trade commissioner Karel De Gucht said he would no longer pursue an investigation into Chinese dumping of telecoms equipment.

For almost a decade, the EU has been China's biggest trade partner. Meanwhile, trade in goods between China and the EU grew four-fold, reaching €434 billion (US$597 billion) in 2012. China is the EU’s largest source of imports and one its fastest-growing export markets.

Moving toward investment and innovation

As China is moving higher in the value-added chain and as the economic reforms by President Xi and Premier Li Keqiang are expanding, investment and innovation are increasingly important to China. Yet, the bilateral investment landscape is lagging behind.

China accounts for barely 2-3 percent of total European investments abroad, whereas Chinese investments in Europe are rising fairly fast, but from a very low starting-point.

Each side would like to broaden and deepen access to the other's marketplace. Yet, until recently, bilateral trade in services amounted to only 10 percent of total trade in goods and only 20 percent of the EU's exports to China are in services.

If the talks are difficult for Beijing, they are also challenging to Brussels. On the one hand, all EU members hope to institute symmetric market relations with China. Yet, different countries have already negotiated different deals.

Then there is the issue of the Chinese yuan that is rapidly internationalising. In the 1990s, the euro still had aspirations to become a global currency. Today, it remains important, but mainly a regional currency. By contrast, China's currency is likely to have a global presence within the next two years. Consequently, several European financial centres would like to serve as the gateway for the Chinese yuan.

Race for the yuan

During his October visit to China, UK Chancellor George Osborne pledged to open the doors to inward investors, especially to Chinese banks that seek to open branches in London. The City sees itself as China's financial beachhead in Europe.

As reflected by China's nascent financial deregulation, Shanghai's free trade zone and the central government's impending reforms, Beijing seeks to build a more advanced financial system.

Resting on a fully convertible yuan, China needs a more advanced financial sector to support sustainable growth and a rudimentary social model for Chinese people. As the UK has offered to treat Chinese banks operating in Britain as branches, which are subject to Chinese regulation, rather than subsidiaries, which are subject to British regulation, both Chinese banks and UK economy can potentially reap great benefits.

However, critics argue that British policy-makers may be more eager to encourage Chinese banks' risk-taking, when it benefits the financial markets, than to protect Chinese financial flows, which should benefit Chinese savers.

Last week, the Bank of England and the People's Bank of China reached an agreement to allow the clearing and settlement of yuan trades in London, which UK Prime Minister David Cameron would like to see as the leading Western hub for Chinese trading.

But only days after, Germany’s Bundesbank and the PBoC agreed to cooperate in the clearing and settling of payments in yuan. This will allow Frankfurt to corner a share of the offshore market.

Right track, challenging terrain

In Beijing, the sense is that if the EU wants to take bilateral relations to the next level, the FTA would dramatically deepen ties between two of the world’s largest markets.

While Europe continues to suffer from low growth and stagnation, it is moving toward a fragile recovery. While China is no longer enjoying double-digit growth, the new leadership has initiated the most massive reforms in China since the Deng era.

An extensive trade pact would certainly increase the interdependence of the two blocs and potentially reduce the risk of new trade disputes.

The Sino-EU investment talks are not a sprint, but a marathon. They are moving towards the right track, but facing challenging terrain.

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