



EPC WORKING PAPER

EU-China Relations Towards a Strategic Partnership

July 2005

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EU AND ASIA



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EU AND ASIA

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1. FOREWORD

Both the European Union and China are facing an uncertain world as a result of major changes to the global environment during the past 15 years: the collapse of the Soviet Union and communism as an ideology, the emergence of the US as the sole superpower; the events of 11 September; greater terrorist threats.

Other problems remain unresolved, including the Arab-Israeli conflict, the future of Russia and the ever-expanding gap between rich and poor. The last decade has also seen the EU and China grow in importance, with both undergoing processes of profound transformation such as EU enlargement and China's rapid economic development. This underpins the need for greater strategic cooperation between the EU and China.

The EU's overriding challenge for the next decade is to rekindle economic growth and stabilise its neighbourhood. China's overriding challenge for the next ten years is to continue to move its citizens out of poverty and maintain economic progress. Both partners have a shared interest in a strengthened rules-based international system of governance and in developing a real partnership between the world's largest market and the world's most populous and fastest-growing economy.

This paper is part of the European Policy Centre (EPC)'s EU and Asia Work Programme and the first in a series dealing with different aspects of China. 2005 marks the 30th anniversary of EU-China relations and this is an appropriate moment to take stock of the relationship. It is intended that the paper will be presented at the second EU-China Think Tank Roundtable taking place in Beijing in July 2005. A first roundtable, held in The Hague in December 2004 on the eve of the EU-China summit, was organised by the EPC and the Chinese Institute of International Studies. The Hague Roundtable was immediately followed by a presentation of its conclusions to, and an exchange of views with, Chinese Prime Minister Wen Jiabao.

The authors wish to thank those who gave us their time to discuss the many aspects of EU-China relations, and in particular EU officials. Their insight and day-to-day work experience was extremely useful in writing this paper. The opinions expressed here, however, are those of the authors alone.

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2. INTRODUCTION

There is a global fascination with China, mainly because of its high economic growth rates over recent decades and its increasing role on the world stage.

China is now playing a more confident and assertive role at the United Nations, World Trade Organization and other international bodies. It routinely sends high-level trade missions to all continents and has started to promote its culture abroad, aware of the need to advance its soft power. There is also huge interest in how the country with the world's largest population can transform itself into a modern economy, while retaining its current single-party political system. China's leaders appear rational, calculating and conscious of both China's strengths and weaknesses. However, the absence of western-style democracy and, therefore, transparency makes it difficult to understand the driving forces and political interests that guide China.

Given China's history, it is natural to assume that it would like to be regarded as the most important power in Asia, but this aim could conflict with the aims of other powers, including the US, Japan and India. Recently, due to China's rapid economic growth – and the decade-long Japanese economic recession – many Asians have begun to take Chinese economic and political leadership in Asia for granted. This is unlikely to change unless Japan can return to sustainable economic growth rates, enabling Tokyo to exert economic and political leadership in the region.¹ Unlike Japan, the Chinese leadership has always emphasised that China is an “Asian nation” (as opposed to belonging to the “West”), thus securing widespread support in the region. Consequently, China never had to “return” to Asia like Japan did in the 1990s.²

Over the past decade, the EU and China have become two of the most important global actors, with each steadily increasing its influence on the world stage. The European Security Strategy (ESS) agreed by the European Council in December 2003 proposed that the Union should look to develop strategic partnerships with China, Japan, Canada and India, as well as with all those who shared the EU's values and goals. The ESS also called for an effective and balanced partnership with the United States and described the transatlantic relationship as “irreplaceable”. Russia was also mentioned as another strategic partner, subject to respect for common values.³

The inclusion of China as a potential strategic partner was a recognition by the EU of the growing importance of China and, in particular, the prospect of the two actors working together in several important policy areas such as trade, energy, the environment and global governance. The Union is now China's main trading partner and for the EU, China ranks second to the US.

The objective of this paper is to put the EU-China relationship into historical perspective, analyse its workings and make recommendations for the establishment of the intended strategic partnership. It will also consider how the relationship might develop over the next decade.

There are many unknowns, not least with regard to internal events in China, but the thrust of the paper is that both the EU and China will be playing even more important roles on the world stage by 2015. The EU is set to enlarge further while strengthening its institutional structures. China is set to maintain its extraordinary growth record and has its eyes firmly set on the 2008 Beijing Olympics and the 2010 World Expo in Shanghai. It hopes to demonstrate its continuing "peaceful rise" through the successful holding of these two showcase events.

Interpreting Chinese policy is a challenging process. Chinese decision-making is not monolithic or centralised. The views of different interest groups have to be reconciled and regional influence should not be underestimated (seven provinces have populations greater than those of France, Italy and the UK). In many ways, the process is not dissimilar to EU decision-making, except that there is little transparency.

3. POLICY RECOMMENDATIONS

An EU-China strategic partnership should build on the experience of more than three decades of successful, but predominantly economic, cooperation. There needs to be a new, expanded agenda also dealing with global political and security issues, and a deeper dialogue on human rights and the rule of law. Above all, both sides need to develop the capability to conduct an ongoing strategic dialogue.

The principal aims of the strategic partnership should include:

- Promoting mutual understanding. This is arguably the most important long-term aim, and a 10-20 year plan is needed, beginning with schools

and universities. Exchange programmes should be promoted at all levels of society (see section 21).

■ Promoting respect for the rule of law, including human rights. The need for the strengthening of the rule of law has frequently been confirmed by Chinese leaders and it is necessary in order to comply with China's WTO obligations. Human rights are better looked at in this context (see Annex I, paragraph 6).

■ Increasing economic and social sustainability. This involves both environmental protection and human resource development, alongside economic progress (see sections 5-7).

■ Promoting regional and global security, and strengthening international cooperation and global governance. The biggest concern is the potential instability of the Asian region (see section 10). Other aspects of global security include strengthening the UN system, tackling poverty and combating international terrorism.

The authors further propose that:

■ A high-level group should be established to recommend to the 2006 summit the key elements for a strategic partnership. In the meantime, maximum use should be made of the EU-China high-level coordination mechanism

■ An ongoing strategic dialogue without any subjects being taboo is essential

■ All EU-China issue meetings should be rationalised into dialogues which would report to the Joint Ministerial Committee

■ A Legislative Dialogue should be established

■ A Judicial Reform Dialogue should be established

■ A China-Europe Law School should be established

■ An EU-China Business Dialogue should be established

■ A sophisticated website should be created to cover EU-China relations

■ The EU should increase its support for the network of EU Centres in China and promote Chinese studies in the EU

■ A Dialogue on the Rule of Law should be established to support and complement the existing EU-China Human Rights Dialogue

■ There should be regular consultation between Chinese and European monetary authorities

■ More attention should be paid to addressing trade restrictions and technical barriers

■ The EU should grant China full market-economy status when it fulfils the necessary requirements, including transparency and good governance

- A joint working party should be set up between the public and private sectors on common standards and regulatory convergence
- EU Member States should recognise the importance of speaking to China with a united voice on all issues.

Above all, any strategic partnership must promote mutual understanding, which requires the involvement, in addition to government, of business and civil society.

PART I: BACKGROUND

INTERNAL

4. China's "peaceful rise"

In 1800, China's share of global GDP was about 30%. Now it is about 6% and the target is 20% within the next decade. Since Deng Xiaoping opened the door to the outside world some 25 years ago, China has steadily increased its political and economic influence. Within a single generation, per capita income has increased eightfold and more than 300 million people have been lifted out of poverty. Over the past two decades, China has transformed itself from one of the world's most backward- and inward-looking countries to become its largest consumer of natural resources and an export powerhouse.

Since 1985, China's foreign trade has increased by an annual average of 15% and now exceeds €1 trillion. It also has the world's second largest foreign exchange reserves, at over €600 billion, much of it in US Treasury bills, technically leaving the US in debt to China.

Compared with Japan and Korea, which have often been criticised for their numerous market-access barriers, protectionism and highly regulated economies, China is already an open market providing a business-friendly environment.⁴ Total exports as a percentage of GDP have leapt to around 70%, which is unusual for countries of continental size and/or large populations: India, Brazil, Japan and the US do not even reach 30%. Measured on a purchasing power parity (PPP) basis, China was the second-largest economy in the world after the US in 2003, although in per capita terms it amounts to a modest \$1,000. China is the top destination in the world for foreign direct investment (FDI), with more than \$500 billion so far.

Mainland factories are not subject to the wage, safety and environmental standards of the EU or US. China did not participate in drawing up the WTO rules, but argues that it has kept to them since joining. Responding to criticism of the surge in Chinese textile imports to Europe, Beijing points out that Europe had ten years to prepare for the abolition of quotas. Further, it argues, China needs to export 800 million shirts to buy just one Airbus.

Although full exposure to foreign competition also carries serious risks for various sectors in China, its export performance has remained impressively

robust and the pace of its growth in GDP has been maintained at around 9% per annum since WTO accession, despite recent government efforts to cool the economy. China's booming trade has had a global impact, as evidenced by the furore in the EU and US over textile exports in the first few months of 2005. The composition of China's exports, however, has changed beyond recognition. In the early 1990s, textiles and light manufacturing still made up more than 40% of its export portfolio; today, machinery, transport and electronics account for the same proportion (up from 17% in 1993). China accounted for 3.3% of EU exports and for 6.9% of its imports (adjusted for intra-EU trade flows) in 2003.

China's economic rise has largely replicated that of other Asian countries. Its leadership has been firmly committed to the development of the country as a top priority and its growth has been based on high savings, massive investment in infrastructure, universal basic education, rapid industrialisation, an increasingly deregulated labour market, and an internationally open and competitive economy. At more than 40% of its GDP, China's fixed investment is probably the highest ever achieved by a large economy. However, economists point out that China's economic growth should be even higher given its fixed investment rate, which suggests that large amounts of capital are being misallocated.⁵

According to the National Intelligence Council (NIC)'s December 2004 report, "Mapping the Global Future", China is already the world's largest producer of manufactured goods, having increased its global share to 12%. The NIC predicts that China's share of global manufacturing, as well as its exports, will surpass those of Japan within a few years.⁶ China's consumer economy is also booming: sales of almost everything from electronic goods to automobiles are soaring. In 1996, China had seven million cell phones and the EU 44 million. By 2003, China had rocketed to 269 million compared with 159 million in the EU. The number of personal computers is doubling every 28 months. China has long since moved ahead of the EU and US in household appliances such as television sets and refrigerators. The moment when China overtook the US as a consumer nation should be seen as another milestone along the path of its evolution as a world economic leader. Its record-high domestic savings and its huge trade surplus with the US are but two of the more visible manifestations of its economic strength.

This remarkable economic growth has helped China promote its foreign policy interests in Asia and elsewhere. Although relations with Japan remain troubled, China has pursued a moderate policy in its relations with, and support for,

ASEAN and the Shanghai Cooperation Organisation.⁷ It has also agreed a strategic partnership with India, exercised a moderating influence in the Six Party talks on North Korea, sent troops to participate in UN peacekeeping missions and accepted the main thrust of the UN High-level Panel's report, including endorsement of the "responsibility to protect" principle. But its principal preoccupation remains Taiwan: the future of cross-straits relations is unpredictable, although the outlook is currently optimistic.

5. Economic problems

Despite its astonishing growth rates, China faces huge economic problems. Some 800 million people still live in the countryside, mainly in poverty, and China's economic growth is unevenly distributed. It also faces many other challenges, including rising unemployment, massively indebted and unreformed firms in key sectors, an inefficient banking system and emergent social unrest.

In the not-too-distant future, China could be confronted with serious internal strains due to increasing income disparities, continuing authoritarian rule, ethnic tensions and environmental pollution. It is not yet clear how and to what extent these factors will lead to upheaval, or how the leadership will cope with these strains.⁸ Pessimistic analysts conclude that, despite its impressive economic growth and development, China still risks instability. In order to overcome this, it is widely acknowledged that the Chinese leadership needs to ensure that economic growth and increasing prosperity are accompanied by some democratisation at the local, regional and national levels.

China's accession to the WTO will continue to help strengthen its ability to maintain strong growth rates, but, at the same time, puts additional pressure on the hybrid system of strong political controls and growing market influences.⁹

There are 750 million people in the labour market and China needs to create at least 25 million new jobs annually to keep the unemployment rate from rising.¹⁰ Over the past two decades, the profitability of China's state-owned companies has declined from around 25% of assets to about 5%.¹¹ Reform of these enterprises is very difficult, but essential, if China is to continue its progress towards becoming a modern economy.¹²

Chinese banks suffer from financial fragility, manifested by high proportions of non-performing loans and low capital-adequacy ratios. Economists

estimate that more than 30% of bank loans are not being repaid and the credit-rating agency Standard & Poor's has warned that 50% of bank loans can be rated as non-performing.¹³ If China does not address this problem, it will be confronted with a Japanese-style banking crisis sooner rather than later.

China also has huge regional imbalances. While its coastal regions have experienced rapid economic development and growth, its rural areas are still severely underdeveloped. On China's eastern coast, where most of the country's growth is concentrated, the GDP per capita amounts to \$3,000, whereas in western and rural regions, the GDP per capita is a modest \$300. China has identified regional policy and rural development as areas where the EU can provide valuable advice, and initial exchanges of experience have already taken place.

China (like Europe) is confronted with a rapidly ageing society, which will have significant implications for the country's economic and social development.¹⁴ In 1999, those aged 45 or more accounted for 24% of the active labour force, up from 19% in 1990, and it is projected that this figure will rise to around 37% by 2040. Currently, there are roughly 135 million people aged over 60 in China and forecasts suggest that by 2050, this will rise to 400 million: approximately one-quarter of China's total population.

6. Environmental problems

China's rapid growth has also led to severe environmental problems. The long list includes air pollution, bio-diversity losses, desertification, loss of wetlands, river-flow cessation, soil erosion and water pollution.

The enormity of these problems means that the entire planet is affected. China is a major emitter of ozone-depleting substances and the second largest importer of tropical timber from rainforest regions. Three-quarters of China's energy consumption depends on coal, the main cause of its air pollution and acid rain. The construction of the Three Gorges Dam and the South to North Water Diversion project is also likely to cause major environmental problems, and China's drive to achieve higher standards of living for its huge population can only make matters worse.

In a recent report,¹⁵ WWF made a number of clear and practical recommendations which should be carefully examined by the China-EU

Environment Dialogue. The idea is that Chinese companies which want to contribute to sustainability could work with government and non-governmental organisations (NGOs) to ensure that an overarching investment and export framework is developed which supports sustainable development.

Companies with sustainable goods and services for export could collaborate with the government and NGOs to develop export strategies, starting with a limited number of sectors. Progressive companies could choose a limited number of concrete projects for potential use in China and abroad, implement these and communicate the results to key stakeholders. Any such projects should be linked to the core business of the company and not be philanthropic. Firms which want to contribute to sustainable development could use important forums to highlight key areas and ways of moving forward within them. In China, bodies like the BOAO Forum for Asia provide opportunities to communicate new ideas and make concrete proposals for measures to achieve sustainable development.

The Chinese government and authorities could initiate a process to support proactive companies and ensure that the rest do not lower environmental standards and give Chinese products a bad name on the international market. This process could involve incentives, including financial ones. Companies which go beyond the existing regulations should be rewarded accordingly. Basic environmental information should be disclosed, preferably in line with international standards such as global reporting. Existing laws must also be complied with. Progressive companies must be given the opportunity to clarify where reporting needs are most acute and companies which do not follow the rules could be exposed on a national website.

The Chinese government could encourage partnerships between Chinese companies and NGOs to support the export of sustainable goods and services. A work programme with clear targets could be explored and implemented during 2006. This would examine the role of procurement in the importing countries of the EU, the US and Japan. The Chinese government could explore how relevant Chinese concepts can be incorporated into the regulatory framework. As China grows and Chinese companies invest abroad and increase exports, there is a need to involve indigenous thinking on sustainability.

Government, business and NGOs should ensure that polarisation on the environmental issue does not get worse. Companies which drag their feet

cannot be allowed to disrupt sustainable development. The definition and promotion of sustainable investments must be explored. This could be linked to work with green GDP. Green investments are a prerequisite for green GDP.

EU governments and their companies could support Chinese firms in taking the lead on sustainable development. Regulations could be amended to support the import from China of sustainable goods and services. Public procurement rules could also support sustainable development in China. European companies could investigate their supply chains and their Chinese customers to ensure that they are supporting progressive actors in the country.

WWF has been operating in China for 25 years and the government works extensively with it. To its credit, the Chinese leadership has identified this as an area where the EU could provide a valuable input on issues such as environmental legislation and management, climate change, bio-diversity protection, bio-safety management, and trade and the environment. The EU needs to make this a priority given the size of the environmental problems facing China.¹⁶ The recent meeting between the Chinese Environment Minister Xie Zhenhua and EU Environment Commissioner Stavros Dimas was to be welcomed and closer cooperation on climate change with development countries is very important.

7. China's hunger for energy and natural resources

China's spectacular economic growth has greatly fuelled its appetite for energy and natural resources. Among the five basic food, energy and industrial commodities – grain, meat, oil, coal and steel – Chinese consumption has already eclipsed that of the EU and US in all but oil.

Today, China accounts for 12.1% of the world's energy consumption, second only to the US (24%). China was, until recently, an oil exporter, but now imports more than one-third of its needs and became the world's second largest consumer of petroleum products in 2003, surpassing Japan for the first time, with total demand of 5.56 million barrels per day.¹⁷ China's oil demand is projected to reach 12.8 million barrels per day by 2020, with net imports of 9.4 million per day.¹⁸

In order to meet the rapidly growing demand for crude oil, Chinese state-controlled oil companies have recently sought to acquire foreign oil companies abroad, in the US, Russia and Iran.¹⁹

Furthermore, China is seeking to quadruple its output of nuclear-generated electricity over the next ten years in order, eventually, to reduce its oil dependency on the Middle East.

In view of China's rising energy consumption, it is faced with the challenge – like India, which is experiencing a similar growth in energy consumption – of improving energy efficiency. The consumption of fuel could be decreased dramatically if Chinese cars and factories became more energy-efficient. Although high oil prices have negative economic effects, they encourage greater efforts to reduce consumption.

China is the leading producer and consumer of coal. The use of steel, a key indicator of industrial development, has soared and is now more than double that of the EU or US. China is also a world leader in the use of other metals such as aluminium and copper, as well as fertilisers. It is now importing vast quantities of grain, soybeans, iron ore, aluminium, copper, platinum, phosphates, potash, oil and natural gas, forest products for lumber and paper, and the cotton needed for its world-dominating textile industry. These massive imports have put China at the centre of the world raw materials economy. Its voracious appetite for materials is driving up not only commodity prices but also ocean shipping rates.

China's need for access to raw materials and energy is partly shaping its foreign policy and security planning. Strategic relationships with resource-rich countries such as Brazil, Kazakhstan, Russia, Indonesia, and Australia are built around long-term supply contracts for products such as oil, natural gas, iron ore, bauxite, and timber.

It is in everyone's interests that China diversifies its dependency on oil and that there be closer cooperation in building strategic oil reserves. Climate change is a global challenge, and energy production and consumption is responsible for more than 80% of the problem. EU-China dialogue and cooperation on appropriate energy policy strategies to combat global warming could help to achieve acceptable solutions in a global context. There is a particular opportunity for EU-China cooperation on energy, as there is a potentially strong alignment between the choices both actors face. What we say to each other about energy and climate will be one of the key global conversations in the coming years. Of course, as Wen Jiabao warned in 1999, the very "survival of the Chinese nation" was threatened – and continues to be threatened – by looming water shortages. "Clean water for the people" is a government priority but drought, rising demand and pollution make this an uphill task.

The resource issue naturally has political implications and contributes to external tensions, as it has with Japan. The Union must invest political, diplomatic and financial capital in the transition towards greater resource efficiency. Arguably, China is the ideal place in which to develop and prove new technology, which could help make Europe's own economy more resource-efficient.

EXTERNAL

8. EU-China relations – historical background

When seeking to understand the Chinese, it is essential to remember 4,000-plus years of history and the tumultuous internal events of the last two centuries, including foreign invasions and internal strife.

In the 18th century, when Europe “discovered China” – especially its tea, silk and porcelain – there was little China wanted in return. This unfavourable balance of trade led to European pressure on China, resulting in the Opium Wars of 1839-42. The Treaty of Nanjing (1842) was the first in a series of agreements with the western trading nations later described by the Chinese as the “unequal treaties”. China was forced to cede the island of Hong Kong to the British (in whose hands it remained until it was returned in 1997) and this set the scope and character of an unequal relationship for the ensuing century of what the Chinese still regard as national humiliations.

After two decades of war, both civil and against Japan, the People's Republic of China (PRC) was formally established on 1 October 1949. There followed three tumultuous decades as the communist leadership pursued a ziz-zag course of political and economic development. Diplomatic relations were established with the US and Japan in 1972, and with the EU (then the European Community) in 1975. Following the signing of the 1978 Trade Agreement, the China-Europe Trade and Economic Cooperation Agreement – the basis for the current relationship between the EU and China – was agreed in 1985.

For the decade after that, EU-China relations were coloured, on the one hand, by growing trade relations and, on the other, by the impact of the events in Tiananmen Square in 1989, when the Chinese authorities shot many peaceful pro-democracy demonstrators. This led the EU to impose an arms embargo on China and heightened public concern about the country's human right situation.

9. The arms embargo, Taiwan and the US dimension

Any assessment of EU-China relations must take into account its effect on other relationships, the most significant for both parties being that with the United States. Both share an interest in being partners, and not rivals, to an increasingly powerful nation.

George W. Bush's administration came into office regarding China as a strategic competitor, but after 9/11, Washington's attitude changed, and it saw China as an important ally in the war on terrorism. However, this rhetoric, like the rhetoric about China as a strategic competitor, was never backed up by substance and China can hardly be described as an ally of the US-led war against terrorism. More recently, there has been increasing criticism of China in Washington, with US Secretary of State Condoleezza Rice making clear to the media in Japan that the US was keeping its troops in Okinawa to balance China.

Some American neoconservatives view China as a threat to free trade and security, and have been pushing Japan and Taiwan to adopt a tougher stance towards China. But Beijing has countered US attempts to contain it by signing agreements with India, Pakistan and the Philippines, and it has spun an extensive web of multilateral arrangements in the region.

A hostile US attitude is likely to be counter-productive and will also encourage China to increase further its military expenditure. Donald Rumsfeld, speaking on 4 June 2005 in Singapore, questioned the degree of China's military build-up "at a time when it faces no threat from any other nation". But he did not explain the threat faced by the US which justifies it spending many times more than the Chinese on armaments.

There has been a remarkable expansion of US-China trade in the past decade, resulting in a massive trade imbalance. This, allied to the reluctance of the Chinese to revalue their currency, has led to increased protectionist voices in the US. At the same time, their growing economic interdependency acts as a powerful stabilising factor in Sino-US relations.

The public debate over whether or not the EU should lift its arms embargo on China has generated more heat than light, and seems largely to have been conducted without full knowledge of the facts. The ban was imposed following the Tiananmen Square massacre in 1989. Human rights in China

have steadily improved since then, but are by no means satisfactory from an EU standpoint. The lifting of the ban is controversial and impacts on transatlantic relations as the US is strongly opposed to ending the embargo.²⁰

The joint EU-China summit declaration in The Hague on 8 December 2004 stated that the Union “confirmed its political will to continue to work towards lifting the arms embargo”. The end of the ban was to be preceded by an improved EU code of conduct for arms exports and improvements in China in the field of human rights. No date was set for lifting the embargo, although Javier Solana, the EU’s High Representative for the EU Common Foreign and Security Policy, stated then that this might be done in the first six months of 2005.

The ban is not legally binding and the only countries to which it applies are Bosnia-Herzegovina, China, Congo, Iraq, Ivory Coast, Liberia, Myanmar, Sierra Leone, Somalia, Sudan and Zimbabwe. Effectively, arms exports to China are controlled by the 1998 EU code of conduct on arms exports.

US President George W. Bush appeared resigned to the likely EU decision to lift the embargo during his February 2005 visit to Brussels, leaving it to the US Congress to threaten retaliatory measures. However, after he returned to Washington, pressure on the Union from the administration increased and Congress threatened an arms technology ban on the EU. The issue is particularly sensitive in the US because of its commitment to Taiwan and Washington’s fears that the balance of forces between China and Taiwan will be upset if the Chinese acquire sophisticated arms. At present, the prospect of an early lifting of the ban has receded.

There is an overall lack of consistency in the US strategy towards China which reflects two schools of thought: one believing that China should be helped to progress and should be integrated into the international community; the other preferring to contain China militarily and slow its economic growth.

Both Europe and America share an interest in being partners with, not rivals to, the biggest nation in the world. Both pursue a “One China” policy and recognise Beijing as the sole legal government of China. However, both also have significant economic and commercial relations with Taiwan, and the US also has a defence commitment to the island. Both the EU and US support the peaceful resolution of the differences between China and Taiwan, rejecting the use or threat of force. However, China does not

exclude the use of force towards Taiwan should it unilaterally change the current status quo and declare independence.²¹ In March 2005, the National People's Congress passed the so-called Anti-Secession Law authorising China to use military force against Taiwan if Taiwan declared independence, a move which was criticised in Europe and the US.

It was, however, followed in April by visits by the two Taiwanese opposition leaders to the mainland for the first time since the establishment of the PRC. There has also been a subtle change in China's diplomatic language. President Hu Jintao and James Soong of the Taiwan "People Fits Party" endorsed a new formulation of the mainland government's long-standing position that cross-straits negotiations can only begin after Taiwan acknowledges that it is part of "One China". In the new terminology, Hu effectively agreed to open talks if Taiwan accepted the principal of "two sides, one China", while acknowledging that the two sides may differ on precisely what this means. This change may seem arcane, but it appears to be significant. China is now pushing for the opening up of travel across the straits, hitherto resisted by Taipei.

The enormous volume of China-Taiwan trade and the importance of Taiwanese investments in China suggest that Taipei is unlikely to declare independence unilaterally and, therefore, a military conflict is improbable,²² although miscalculations cannot be excluded. The US has made it clear to Taiwan that it is opposed to a declaration of independence, but the EU is unlikely to become directly embroiled in any China-US dispute and its role in helping both sides to manage cross-straits relations peacefully is very limited.²³

There are also misgivings within the Union about ending the arms embargo. Agreement on amendments to the Code of Conduct is clearly a prerequisite. China has still not ratified the UN Covenant on Civil and Political Rights, and continues to commit human rights abuses. The EU is expected to insist on a commitment to ratification of the covenant as a condition for lifting the ban.

The issue of the imprisoned demonstrators who peacefully challenged China's authorities on Tiananmen Square in 1989 will also remain on the agenda of EU-China relations. The EU continues to urge Beijing to free them after 16 years in prison. So far, however, the Chinese leadership has insisted that the prisoners are a "threat to China's national security" and it remains unwilling to consider releasing them.²³

It is hardly conceivable that the EU can maintain a ban and at the same time engage in a strategic partnership with China. But, as has been well articulated by EU Trade Commissioner Peter Mandelson, China needs to help the Union to lift the embargo. “A modern Europe and a modern China need a modern basis for their relationship – permitting broad, open and honest debate and negotiations,” he has said. “I accept that there has to be give and take on both sides. We in Europe are preparing to move forward to lift the arms embargo. But if and when we do, we shall find the step easier if we can point to clear evidence that China is taking account of our concerns in other areas of policy, which, in turn, will allow us in Europe to feel confident about our next move.”²⁴

10. Sino-Japanese relations

The recently renewed Sino-Japanese animosity gives cause for concern as to the potential instability of the East Asian region. Nearly 60 years after the end of World War II, there has been no true reconciliation between the two peoples and there is no early prospect of a change.

While one cannot compare this with the Franco-German reconciliation which began soon after the end of the Second World War, there may be important lessons for both China and Japan to learn from this experience. German Chancellor Gerhard Schröder said only recently that the memory of the Nazi era had become part, not just of German history, but also of “German identity”. Reconciliation is, however, a two-way process. China must ask itself whether its own conduct falls short of the forgiving attitude shown by the European victims of Nazi Germany.

What can Europeans do to help? They certainly cannot tell China and Japan what to do, nor can they advise them without a deep understanding of the two cultures and the fact that both peoples find it much more difficult than Europeans to apologise and forgive. However, by working closely with China in a strategic partnership, Europe’s own post-war experience could be helpful. An examination of what Europeans might do in similar circumstances could be helpful, to see whether such solutions are adaptable to the region’s culture.

Sino-Japanese reconciliation is imperative for a stable Asia, as well as for prospects of further economic and political integration in East and South-East Asia. If political integration in Asia is to be meaningful, China

and Japan need to take a joint leadership role and coordinate initiatives and strategies.

China and Japan are the political and economic core of East Asia. However, instead of fully welcoming China's economic rise as an opportunity, Japan's political leadership at times perceives Chinese economic growth as a threat and is concerned about Beijing's numerous free-trade initiatives (above all the China-ASEAN Free Trade Agreement, which is due to be fully implemented by 2010). Whereas for China it is a "peaceful rise", Japan (and, to a lesser extent, South Korea) is concerned that these initiatives are an expression of Beijing's ambitions to dominate the region economically and politically.

By seeking to implement bilateral and multilateral free-trade agreements with Asian and non-Asian countries, China is only doing what Tokyo should have done long ago. However, Japan's protectionist instincts and its influential agricultural lobby, which strongly opposes free-trade agreements which would include the farm sector, have made this impossible.

China's economic rise is irreversible and Japan's leadership needs to acknowledge that there is no alternative to engaging with China economically and politically unless Tokyo is prepared to see its political and economic influence further reduced.

Unlike in Europe, the legacy of World War II has not been overcome in Asia and, thanks to Japanese Prime Minister Koizumi's decision to continue visiting the infamous Yasukuni Shrine in Tokyo (the last resting-place for Japanese war dead, including a number of convicted A-class war criminals), Sino-Japanese reconciliation remains a distant goal. Japan's political leadership and Prime Minister Koizumi himself seem unwilling to acknowledge that the Yasukuni Shrine is a symbol of Japan's World War II militarism and imperialism, and its inability to come to terms with its militarist past.

Japan's mention of China as "potential military threat" in the latest version of its White Book for Defence²⁵ is equally unhelpful for Sino-Japanese reconciliation and caused additional diplomatic friction between the two countries earlier this year. The recent strengthening of Japan's military alliance with the US and the explicit statement, for the first time, that stability in the Taiwan Straits was of "common interest" to the US and Japan, has provoked further tensions in Sino-Japanese relations.

The current unstable political relationship contrasts with strong economic and trade relations. Sino-Japanese trade is booming and the number of joint ventures is growing steadily. Japan is an important investor in China and is by far the biggest donor of overseas development aid to China (amounting to \$1 billion per year).

US pressure, encouragement and generous assistance immediately after World War II ensured the early reconstruction of Europe and enabled it to end the era of balance-of-power politics. Without the role played by the US, there would be no EU today. But Washington seems temporarily to have forgotten the basis of its success in bringing peace to Europe. It sees Asia through different eyes. A fundamental change of attitude would therefore be required in Washington, as its current policies are counterproductive.

The recent joint US-Japan declaration that Taiwan is a mutual security concern inflamed emotions in China and was generally not well-received in the region. Appearing to regard someone as your enemy can easily make them your enemy.

There is no agreement among observers as to who organised the recent demonstrations against Japan, but there is no doubt that the feelings expressed run deep. The Chinese leadership's current preoccupation is to meet huge economic, social and political challenges. War with Taiwan would destroy most of the progress made since Deng Xiaoping opened up the country. Recent events have been bad for both countries, the region and the world. There is little doubt that, in the short term, China and Japan will repair their relations – economic considerations will see to that. But without true reconciliation, there can be no guarantee of long-term regional stability. The only way to be liberated from the past is to have a vision of the future.

PART II: EU-CHINA: THE CURRENT RELATIONSHIP

11. Importance of China and the EU to each other

China and the European Union are polities at the extremities of the same land mass: Asia and Europe are no longer separate, far-away continents. It is in their shared interest to build a common zone of peace, prosperity and stability.

The EU is the only lasting case in history of independent states pooling their sovereignty by creating supranational institutions within a polity addressing political, economic and social issues. The values underpinning the Union, and the manner in which it operates, make it a magnet for countries in the region and a potential model for other regions in the world. The EU economy is the world's biggest, supporting a population of 456 million which is due to rise to 486 million in 2007 and likely to exceed 550 million by 2020. The EU plays an increasingly important role as a global actor, exerting its influence in the UN, WTO, Kyoto and the International Criminal Court. It is also the world's largest provider of development aid and technical assistance.

There is no basic conflict of interest between China and the EU, and neither represents a threat to the other, although their views sometimes diverge, which is understandable given their historical, cultural, political and economic differences. Europeans and the Chinese share an attachment to a solid social fabric where talents flourish but where individuals show responsibility towards each other. They both believe in human dignity, equality and the rule of law. However, there is a serious divergence in their interpretation of the rule of law – in particular in relation to human rights, personal liberty and democracy. The most obvious difference is that the EU is composed of democratic nation states, while China is not a democracy. If the EU is serious about implementing a strategic partnership with China, it needs to encourage and support Beijing's democratisation process and the rule of law.

Political relations between the EU and China have intensified in recent years, with an emphasis on global issues. There is some concern in the US that the expansion of Sino-European political relations reflects a hidden agenda to create a multipolar world to counter US influence. Certainly,

there is some evidence that the Chinese hope for this. However, the intensification of bilateral ties between the EU and China – as well as between China and individual EU Member States – need not mean either the weakening of EU-US relations or a move to establish a multipolar world (although some European capitals may harbour such thoughts).

In 1998, the European Commission published a Communication on “Building a Comprehensive Partnership with China” which proposed engaging China through an upgraded political dialogue; supporting its transition to an open society based upon the rule of law and respect for human rights; integrating it further into the world economy; encouraging China’s interest in regional cooperation; supporting economic and social reform as well as sustainable development; and raising the EU’s profile in China.

In 2001, the Commission published a further Communication on “EU strategy towards China: Implementation of the 1998 Communication and future steps for a more effective EU Policy.”²⁶ This was followed two years later by another policy paper entitled “A Maturing Partnership – Shared Interests and Challenges in EU-China Relations”²⁷, which continued to support the transition process and the sustainability of the economic and social reforms while integrating China further into the international community and world economy. The paper called for cooperation between the EU and China on global governance issues, and the promotion of sustainable development, global peace and stability, and other issues of high politics.

In 2003, the Chinese Ministry of Foreign Affairs also produced a policy paper stating that “China was committed to a long-term, stable and full partnership with the EU”. Its policy objectives were to deepen China-EU cooperation in the political, economic, trade and cultural fields.²⁸ The Chinese paper acknowledges that “the European integration process is irreversible and the EU will play an increasingly important role in both regional and international affairs”, and maintains that there are no fundamental conflicts of interest between the EU and China. The paper does not mention possible “strategic rivalry” or “strategic competition” with the Union, but instead envisages a strategic partnership with Brussels.

Beijing’s EU policy paper was the first of its kind and aimed to highlight the objectives of China’s EU policy, outlining the areas of Sino-European cooperation over the next five years. It covers a wide range of issues and

areas, including economic cooperation, the strengthening of EU-China trade and political relations, and scientific, cultural and educational exchanges etc. Furthermore, Beijing wants to increase the number of EU-China high-level meetings and make ministerial meetings between the two sides more policy-oriented. Since 1998, EU-China relations have greatly intensified. The first annual summits in 1998 and 1999 laid the groundwork for a more broadly based political dialogue. At the same time, an increasing number of meetings and dialogues at all levels and covering numerous areas of concern to both sides have helped promote mutual understanding.

In December 2004, several new agreements were signed at the EU-China summit²⁹ on enhancing cooperation in various fields, including customs, peaceful use of nuclear energy, financing, science and technology, social security reform and personal exchanges. Before the summit, European Commission President José Manuel Barroso stated that the EU was at a dynamic moment in its relationship with China and that developing this relationship would be one of the Union's top foreign policy objectives. It was agreed that China and the EU would actively explore the feasibility of concluding a new EU-China framework agreement.

This wish to move forward was partly a recognition of the limitations of the 1985 Agreement and partly a desire to establish a new framework which would benefit "strategic partners". The European Security Strategy did not explain how and in what areas the envisioned strategic partnership should be implemented. The EU must now define the term "strategic partnership" and explain how it plans to implement such a partnership between democratic European nations and a non-democratic China.

At present, there are more than 100 EU officials in several different services dealing with an ever-increasing number of meetings, dialogues, agreements, committees, working groups and "cooperation". These take place in different formats, with different frequencies, different methodologies and different reporting systems. Issues addressed in one area frequently interact with those in another area. Order, consistency, coordination and an effective overall reporting system are all needed.

A brief overview of the regular meetings within the 'EU-China Dialogue' is set out later in this paper. Both sides take a practical approach to all these issues, beginning with an exchange of experience. Cooperation will be further addressed in the EU-China Framework Agreement and a forthcoming EU-China policy paper being drafted by the Commission. Progress varies,

but a mutually constructive approach pervades. However, it is clear that the institutional structure and organisation need a thorough overhaul.

12. Common interests

There are a number of questions about global governance which both the EU and China are facing, including reform of the United Nations, the WTO and the Bretton Woods institutions.

Neither the EU nor China have found it easy to define how such reforms should be implemented. China is jealous of its permanent seat on the UN Security Council (UNSC) and seems adamantly opposed to Japan obtaining one too. The EU finds reform of the Security Council an equally difficult issue because of rivalries between Member States. But the EU and China both welcomed the High-level Panel's report and there is a wealth of proposals for the two sides to discuss. A further issue is whether the G8 should be abolished or reformed to reflect new global economic realities.

The two parties have somewhat different views of threat perception. China's focus is on threats to sovereignty and the nation state, while the EU's emphasis is on conflict prevention and developing a security community. Both take the threat of international terrorism seriously, but they do not necessarily agree with the US strategy for responding to this threat. They also have different attitudes towards sovereignty. China tends to see it as absolute and a means of protecting the state from outside intervention, and would resist any interference in domestic preoccupations such as Xinjiang. Europeans, on the other hand, believe that in an increasingly interdependent world, absolute sovereignty no longer exists.

The Union's success has been built on its Member States pooling their sovereignty, which necessarily involves some intervention in domestic policies. EU countries therefore have little difficulty in pooling sovereignty in the pursuit of fair and effective global governance. This means accepting limited internal intervention in another country, if approved by the UN and subject to stringent conditions. Indeed, there is a widespread belief that the international community has a duty to intervene if genocide is to be eliminated and international terrorism contained.

China, like the US, strenuously opposes any encroachment on its sovereignty and any form of intervention in its domestic affairs. It is regrettable that

China, like the US, has not signed up to the International Criminal Court. The EU and China have a major interest in a successful conclusion to the Doha Development Round, given the importance of trade liberalisation in combating global poverty and economic growth. Both should also promote efforts to strengthen the WTO because they have a common interest in developing strong and impartial international organisations. Their responses to future social, environmental and even geopolitical challenges are likely to be comparable as their long-term interests coincide in many areas, such as global warming.

13. Trade relations

EU-China trade more than doubled between 1999 and 2003, with exports rising from €19.6 billion to €41.2 billion and imports growing from €52.4 billion to €105.3 billion. In 2004, China became the EU's second biggest trading partner (after the US) and, according to its statistics, the EU became China's biggest trading partner (ahead of the US as well as Japan).³¹ Since 1978, EU-China trade has increased more than 30-fold to reach around €175 billion in 2004.³²

If China's economy continues to grow at the current rate (8.5-9%), its GDP is forecast to overtake that of the EU and the US some time between 2030 and 2050. However, this does not mean that China's GDP per capita will come anywhere near that of the EU (or US) in the same period.

China's trade imbalances are increasingly creating problems both with the EU and the US. The Union's trade deficit with China rose from €32.8 billion in 1999 to €64.2 billion in 2003. In 2004, it rose still further to around €78.5 billion.³³ This is the EU's largest bilateral trade deficit and it has doubled over the last four years.³⁴ In contrast, total extra-EU trade with China grew by just over a quarter between 1999 and 2003.³⁵ Furthermore, China is the main beneficiary of the EU's Generalised System of Preferences (GSP) scheme, which grants autonomous trade preferences to China.

The main items which EU countries sell to China are manufactured goods, such as automobiles and aircraft. China, in turn, ships mostly computer equipment, mobile phones, digital cameras and textiles to the Union.³⁶ The EU is the leading supplier of technology in China and Beijing is contributing €200 million to the development of the Galileo navigation satellite system, an alternative to the US Global Positioning System (GPS).³⁷

EU foreign direct investment in China amounts to €27 billion annually and European companies are expected to increase their investments in China significantly in the coming years.³⁸

The larger the trading relationship, the greater the number of trade disputes that will arise. The transatlantic relationship is never free of trade disputes, and some of them are very substantial and acrimonious. However, such disputes do not usually exceed 1-2% of overall trade, and they rarely spill over into political or personal relations. Western culture helps to prevent this happening. It is very important that the Chinese appreciate that disputes and tough negotiations are inevitable in trade matters and must be contained within the “trade box”.

14. Human rights and the rule of law

One of the most difficult and sensitive areas in EU-China relations concerns differing interpretations of human rights. In an interview in November 2004, Prime Minister Wen Jiabao stated that China should develop democracy to safeguard people’s rights and to respect and protect their human rights. He acknowledged the need to improve China’s legal system through better legislation, better administration and greater judicial reform. He also stressed the importance of the rule of law and developing democracy to ensure that the government is placed under the supervision of the people.³⁹

It is essential that the Union treats the human rights dialogue as an ongoing priority, but uses old-fashioned discreet diplomacy rather than the media-driven version: a good starting point might be press freedom, access for the Red Cross to prisons and accurate information on the application of the death penalty.

With these objectives in mind, the following actions are suggested:

- The establishment of a Rule of Law Dialogue, bringing the present Human Rights Dialogue within its structure
- The establishment of a Better Regulation and Regulatory Convergence Dialogue
- The establishment of a Judicial Reform Dialogue, involving both the EU and Member State judiciaries, including the setting up of a speedy and effective redress system for commercial disputes, arbitration and mediation
- The establishment of a China-Europe Law School to be run jointly by a Chinese and a European NGO, benefiting from the experience of the

successful China-Europe International Business School (CEIBS) in Shanghai set up by the Commission and the Chinese Foreign Trade Ministry in 1994.

15. Sectoral dialogues

The numerous EU-China sectoral dialogues reflect the growing importance of the relationship and the attempt to provide some structure. These dialogues have flourished in recent years and now cover more than 20 different areas, ranging from environmental protection to science and technology and from industrial policy to education and culture (see Annex II for overview of sectoral dialogues).

Competition policy, internal market, regional policies and trade policy are areas in which substantial mutual effort is being, and must continue to be, made. These exchanges are either referred to as “dialogues”, “regular exchanges” or “cooperation”, and take place at various levels, from working to ministerial level, often involving business representatives. Proceedings take the form of working groups, conferences, annual formal meetings or informal exchanges, and they involve officials from all the relevant Commission Directorates-General and Chinese Ministries.

These dialogues play a useful function in increasing mutual understanding and helping to overcome obstacles and coordinate policies. They are an essential element of the overall EU-China relationship.

16. China and the WTO

China has benefited from globalisation and WTO membership more than any other country. Yet WTO membership poses serious problems for Beijing in terms of compliance with rules on state aid and intellectual property rights (see section 17).⁴⁰

Although China has undertaken significant efforts to improve its law-enforcement mechanisms and to make its customs and distribution system WTO-compliant, the EU is still concerned about some aspects of its distribution system. European carmakers complain about China’s dual distribution system, with one for domestic and one for foreign car manufacturers.⁴¹ Furthermore, access for foreign construction companies,

including European firms, to China is still significantly limited. It remains very difficult for foreign banks to enter the Chinese market and foreign penetration of China's banking sector amounts to just 1.5%.

China is committed to complying with its WTO obligations and this is of great importance to the EU. Reinforced monitoring is essential, involving individual Member States as well as the Commission. Both the EU and China seek a successful conclusion to the Doha Development Round. An ongoing exchange of views on – and greater coordination of – the individual agenda dialogues is highly desirable.

17. Intellectual property protection

Intellectual property rights (IPR) protection remains an area of serious concern for the EU. Official statistics indicate that between 50% and 60% of counterfeit products imported into the Union originate from China.

Since the late 1990s, the Chinese government has developed copyright laws modelled on international standards aimed at the effective protection of IPR, but the EU (and US) complain that the Chinese authorities lack the political will and law-enforcement mechanisms to tackle the problem of counterfeits effectively.⁴²

The main problem areas are pharmaceuticals, automotive, electronics, telecommunications, software and audio-visual products. In order to address these IPR and IPR-related issues, the EU and China have established a working group on IPR which includes representatives of European and Chinese companies. The Commission emphasises that business participation will ensure the relevance of the working group for EU-China business and trade relations.⁴³

18. Better regulation and regulatory convergence

Divergences in legislation, regulation and practice can be obstacles to trade and inward investment and lead to trade disputes. Efforts to agree common standards and to promote convergence are being addressed through 13 EU-China working groups. A joint working party involving the public and private sectors should be established to analyse and evaluate the ongoing work on common standards and regulatory convergence, with a view to

exploring new areas in which it would make commercial sense and is practicable to agree, and also where it is in China's interests to reform its rules and practices in line with European and international norms.

Alignment with EU standards can improve the quality and safety of Chinese goods. This work should be carried out under the umbrella of a new Better Regulation and Regulatory Convergence Dialogue.

Currently, the Chinese approach varies according to subject area. In some cases, it is developing its own standards in order to protect domestic industry or to avoid paying royalties to foreign rights-holders; in others, it is happy to take on board EU or US standards. While it is recognised that essentially technical issues are involved in agreeing standards, there are occasions when political considerations should prevail on both sides, in the interests of the strategic relationship.

There are industrial policy and regulation exchanges covering conformity assessment, standardisation, technical regulation, technical barriers to trade, electrical safety, toys, textiles, lighters, medical devices, pressure equipment, automobile standards, cosmetics and mobile phones.

PART III: STRATEGIC PARTNERSHIP

19. Who wants what?

In contrast with its relations with the US, China acknowledges that its relationship with the Union is free of strategic competition and rivalry. As far as Beijing is concerned, EU-China relations are characterised by “steadiness” and “pragmatism”.⁴⁴

From the Chinese perspective, the strategic partnership should be comprehensive, comprising cooperation in the field of traditional security (terrorism, the joint fight against illegal immigration and the proliferation of weapons of mass destruction) as well as non-traditional security (energy security, environmental security and economic security).⁴⁵ According to China, cooperation in jointly developing the Galileo satellite navigation system also falls under the strategic partnership. Many Chinese authors and the Chinese government maintain that the partnership should also serve to promote “global multilateralism”, the “democratisation of international relations” and what is being referred to as “global multipolarisation”.⁴⁶

China appreciates Europe’s achievements with regard to political and economic integration, and acknowledges that some elements of EU-style integration, policies and strategies could be applicable in the Chinese and Asian context. Judging by China’s rhetoric and its official policy papers, European approaches to international politics and security are preferred to those of the US. The tolerance, diversity and sustainable development embodied in the integration of the EU and its efforts to establish a “global consensus” are more suitable than the American model.⁴⁷ In fact, China compares its own “peaceful rise” with the peaceful rise of the Union, maintaining that the EU and China will become “global balancing forces” pursuing similar international policy strategies.

China is also keen to secure market-economy status from the Union, arguing that the rising number of anti-dumping charges and cases against Chinese companies stands in the way of implementing a strategic partnership. The EU maintains that China has a number of requirements to fulfil.⁴⁸ One of these is governance, where the EU can help at village, local and regional levels.

Recently, some US commentators – as well as the US administration itself – have warned that Beijing might be seeking to limit American global influence through the establishment of a strategic partnership with the Union.⁴⁹ However, the leadership in Beijing is aware of the close cultural, historical ties between the EU and the US, and the argument (voiced by a number of right-leaning US think tanks close to the government) that China is seeking to play off the EU and US against each other is overstating the case. China seems to view the EU as an important friend and partner in the international arena.

As for the EU, no serious bodies argue that it should seek to replace its transatlantic alliance with a strategic partnership with China. Rather, there is a consensus that the strategic partnership seeks to build on the current economic and trade relationship with a country whose global political and economic influence and power have grown substantially and will inevitably grow further in the future. The apparent interest of some Chinese opinion-formers in raising the country's regional and global security profile so as to compete with increased US military expenditure and missile build-ups may be linked to this.

20. Defining and implementing the strategic partnership

As EU External Relations Commissioner Benita Ferrero-Waldner said on 10 May 2005: “Both the EU and China have changed beyond recognition in 30 years and so has our relationship. Our existing Trade and Economic Cooperation Agreement simply doesn’t live up to the dynamism of today’s partnership. It’s time to reflect the vibrancy of our relations with an ambitious new agreement that will help us move to a fully-fledged strategic partnership.”

The term “strategic partnership” has not been defined by the Union and there is little that the countries identified in the European Security Strategy have in common apart from their size. Yet few have questioned the decision to include China as a strategic partner.

First and foremost, the parties must be clear about their objectives. A single, common objective is not essential, but the overarching objectives cannot be in conflict with each other. The EU’s objective is, or should be, to help China to be a peaceful, stable, democratic (although not necessarily in the full western sense), internationally responsible country, internally consensus-seeking and externally multilateral, sharing broadly similar

values and goals. A similar objective is in China's interests. The two parties should expressly define their strategic objectives in any agreement.

Within the overarching objectives of the strategic partnership, the main goals should be:

- To promote mutual understanding
- To promote respect for the rule of law, including human rights
- To increase economic and social sustainability
- To promote regional and global security
- To strengthen international cooperation and global governance.

This is an ambitious agenda, and the EU and China should be required to state how they intend to achieve these goals. Any such strategic partnership must be based on equality, mutual trust, respect and understanding. It must also be comprehensive, holistic and long-term, and there must be an intensive, ongoing and stable commitment to it. Ideally, the broad, underlying values of the two parties should be similar, or at least compatible. Annex I contains recommendations on the political structure of the strategic partnership.

21. Towards mutual understanding

As a strategic partnership has to be built on the basis of mutual trust, respect and understanding, the most important challenge is how to build such elements to provide a solid foundation for the relationship.

Despite all their differences, China and Europe have enjoyed uninterrupted contact, from the ancient Silk Road to today's high-tech communication revolution. Nevertheless, understanding between the two sides needs to be increased: many Chinese know little about Europe and Europeans do not have enough appreciation of China's history, current state and culture either. This understanding has to be increased through exchanges on the ground. EU Member States are highly integrated politically and economically, but maintain their cultural independence. Knowledge about China in Europe and about EU Member States in China needs to be transmitted in both multilateral and bilateral frameworks.

A pooling of Chinese expertise in the elaboration of a compendium of Chinese history, culture and politics could serve as a basic tool for experts in Europe working on Chinese affairs, in an effort to spread greater knowledge of the country in the EU. Increased people-to-people contacts through science and

research, academic exchanges and tourism are important. It is estimated that up to 600,000 Chinese will visit Europe in 2005, and an increasing number of Chinese travel agencies and tour operators are offering ten-day package tours in Europe.⁵⁰ More than 100,000 Chinese students studied at European universities in 2003 and 2004. In comparison, there are currently only 60,000 Chinese students registered at American universities and one expert has suggested that increasingly tight US visa restrictions will encourage more of them to study in Europe rather than in the US. Close to 5,500 European students studied in China in 2003 and 2004, and more European universities now offer Chinese languages courses and Chinese studies programmes.

While the Sino-European partnership has to be forged government-to-government, it needs to be supported by all elements of civil society. In particular, think tanks, academics, the media, business and NGOs should be directly involved. The creation of a strong civil society is in China's long-term interest because of its participatory nature and its stabilising influence. The dialogue between the European Economic & Social Committee and the China Economic & Social Council is to be encouraged. Journalistic exchanges are also an important way to promote mutual understanding.

Proposals have already been made to promote European studies in China at a joint research centre. The Ministry of Education has given a positive response to this idea and has also asked leading Chinese universities to set up Chinese language training programmes throughout Europe.

Twinning between Chinese and European towns should be encouraged. These are still very limited compared with the links established with many other countries, with just a handful in Austria, France, Germany and the UK. All such efforts would enhance mutual trust and understanding.

Contacts between Chinese and European industry need to be intensified. The EU Chamber of Commerce in China (EUCCC) has forged its own network, but there are insufficient links between EU and Chinese multisectoral and sectoral business organisations. Eventually, a EU-Chinese Business Dialogue might be established along the lines of the TransAtlantic Business Dialogue (TABD), but, in the meantime, it is important that common positions be fed into the official channels.

The long-term objective of increasing mutual understanding is arguably the most important of all. Many of the current misunderstandings between Europe and the US could well have been avoided if Jean Monnet's proposal

to establish a high-level Transatlantic Committee of Understanding had been taken up in the early Sixties. He rightly argued that important relationships need to be nurtured when they are in good shape, rather than waiting until they deteriorate.

A China-EU Committee of Understanding should therefore be set up, composed of representatives of government, legislators, think tanks and academia, business and NGOs, who should direct the implementation of a long-term (10-20 year) plan, beginning with schools and universities, including the promotion of exchange programmes covering numerous areas such as culture, language, technology, social sciences, natural sciences etc. at all levels. The first EU film festival was held in Beijing in May 2005 and a cultural festival will be held there in September 2005. The more people travel between China and the Union, the more mutual understanding grows. This flow has been helped by the 2004 Tourism and Approved Destination Agreements, and the number of Chinese students in the EU has risen to 160,000.

A dedicated EU-China website is needed to provide information and a mechanism for exchanges of views, as well as to facilitate networking contacts. Distance-learning techniques should be exploited.

22. Bilateral relations

The Chinese have only comparatively recently begun to appreciate the relationship between the Union and its Member States, and how that affects with whom they should be dealing. Indeed, deciding when to address the EU and/or individual governments is not easy for third countries, which struggle to find the right balance in their relations between the Union and its Member States.⁵¹

China needs to pursue bilateral relations when it comes to promoting trade and investment, but must deal with the Union in relation to trade policy, such as the textiles issue, which is an exclusive EU competence. However, the lifting of the arms embargo requires unanimity in the EU's Council of Ministers and the main players are the Member States.

China has, in the past, chosen to address the Union as an institution when this approach is likely to result (at least from a Chinese perspective) in a joint EU-China position on a particular issue. It should continue to deal with Europe in a multilateral framework as well as fostering

bilateral relations with the Member States. This should be a mutually reinforcing process.

Confusingly for the Chinese, individual EU Member States – particularly the big ones – promote their own political relationships with China, using this as leverage for trade deals. Thus, during their recent visits to Beijing, both French President Jacques Chirac and German Chancellor Gerhard Schröder strongly advocated the lifting of the arms ban and signed huge trade deals (Germany is easily the largest European exporter to China, followed by the Netherlands, the UK and France). The UK, which will hold the EU Presidency when the next China-EU summit takes place in Beijing in September 2005, is also holding a bilateral summit two days later. Historically, Germany has concentrated on trade and France on its political relationship (recognising the PRC as early as 1964), while the UK has been preoccupied with Hong Kong.

It is of paramount importance that the Member States agree common policies towards China and support, rather than undermine, the EU-China relationship. The goals recommended in this paper are not achievable unless the EU's Member States can agree a much stronger shared narrative on their collective interests in relation to China.

23. Conclusion

The future of China depends partly on how it is treated. If it is regarded as a threat, as many Americans see it, then this could turn out to be a self-fulfilling prophecy. Far better to engage China in developing a reformed international system which would place “effective multilateralism” at its core. This should be the central feature of any EU-China strategic partnership.

Without doubt, China has made tremendous progress in the past decade given its recent turbulent history and size. Its economic development has been staggering, although considerable regional imbalances remain.

The environment is a key issue, and here the EU and China should be able to make common cause. The social fabric of the country is still strong, but political change is slow. The Chinese argue that there must be slow and steady change to avoid upheavals (cf Russia).

The EU and China also have divergent views on democracy. Democracy, loosely defined as a form of government in which political control is exercised by the people either directly or through their elected representatives, took several centuries to take root in Europe. The Chinese Communist Party (CCP) appears to be inching towards more democracy, but in its own manner and at its own pace. It has a difficult balance to strike between full freedom and stability (akin to the West's problem in achieving a balance between freedom and terrorism), but the EU, while recognising the progress that has been made, should do all it can to encourage and assist the development of greater democracy in China.

China is still a developing country. However, it is also an emerging economic superpower; one that is writing economic history. It is less clear what kind of foreign policy China will pursue in the coming decades. If the last century was the American century, this one looks set to be the Chinese century. As Benita Ferrero-Waldner said on 22 February 2005: “There is no greater challenge for Europe than to understand the dramatic rise of China and to forge ties with it.” The EU and China have many areas of common interest, and a new strategic partnership could promote their bilateral relationship, and contribute to international peace and stability.

China fully appreciates the importance of ensuring the application of the rule of law both to comply with its WTO obligations and to

ensure continued inward investment. It is also broadly understood by many senior officials in Beijing that economic liberalisation is likely to lead to political reform and increasing democratisation. However, the Party clearly seeks to control its pace and manner, arguing that economic rights have priority over human rights, and economic and social freedom have priority over political and civil freedom/rights.

There will be other difficulties to resolve but, given a spirit of cooperation and compromise, there is no reason why the EU-China relationship should not develop gradually into a strategic partnership.

Above all, the strategic partnership must focus on promoting mutual understanding, be a partnership between all the constituents of society and ensure an ongoing strategic dialogue. It is particularly important to involve civil society if the strategic partnership is to take root among the peoples of Europe and China. There are many issues facing the two sides which require the actors in civil society to agree a much stronger narrative. A strategic partnership based on diplomacy alone will fail.

The Member States of the EU must also recognise the critical importance of speaking with one voice on China. Their habit of focusing on short-term, often illusory, commercial interests has to be broken. EU Member States, acting together, can play a vital role in allaying Chinese fears about global developments. The Union's soft-power "toolbox" (trade, finance, technical assistance, etc.) should be used to demonstrate to Beijing the importance of regional cooperation and the fact that a strategic partnership with the EU should be a clear "win-win" for both sides.

China presents an opportunity for the Union in its vital quest to understand and manage the forces that are shaping a globalising world, so as to deliver the outcomes which both the EU and China want; namely, peace, prosperity and progress. Our success in doing this will do much to determine whether we spend the rest of this century responding to events beyond our control or putting in place the conditions necessary to make interdependence work.

It is within this global context and with a sense of urgency that the EU and China must forge their strategic partnership. However, none of this is achievable without long-term regional stability and there is much that the Union can do to help China play a constructive role in ensuring this.

ANNEX I: Recommendations on the political structure of the strategic partnership

1. High-level group

A high-level group should be established at the September summit to recommend to the 2006 summit the key elements for a strategic partnership. The group should include a small number of officials from both sides as well as representatives of think tanks, business and NGOs.

2. Summits

The annual summits are important, but often largely symbolic. Although these are occasions to sign agreements and to publicise the relationship, there is limited time for in-depth discussion. Summits could be better prepared by sherpas building on the ministerial and sectoral dialogues. Summits could also usefully be flanked by business and think tank roundtables. The practice of holding back-to-back bilateral summits (e.g. the UK-China summit taking place in Beijing in September 2005 immediately after the EU-China summit) should be discontinued. It confuses the role of the Union and increases the difficulties in coordination.

3. Strategic dialogue

The strategic dialogue should be all-embracing and could be facilitated by a new troika of three Chinese ministers meeting twice a year with three Commissioners. Such a dialogue should facilitate the resolution of issues such as the lifting of the arms ban and the textiles dispute. The problems which arose in both cases were foreseeable and could have been better managed. Hitherto, European diplomacy towards China has focused too much on national commercial interests. An EU-China strategic dialogue can correct this failing. Ongoing contact at this level might help to ensure that trade disputes do not spill over into non-trade matters. We are used to this separation in the west, but it is not culturally natural for this to happen in China.

4. Troika and other ministerial meetings

Troika meetings take place once or twice per annum between the Chinese and EU Troika⁵² foreign ministers. In addition, there are ad hoc ministerials, for example, at the UN, and there are twice-yearly meetings between the EU Presidency and the Chinese Ambassador to the EU and between the Chinese Foreign Minister and the EU Heads of Mission in Beijing. These meetings vary in substance, but generally can be useful for continuity

and coordination. They should, however, be better focused on agreed priorities. There are also official meetings on regional and thematic issues.

5. Joint Ministerial Committee

The distinction between dialogues, working groups and committees should be abolished. They should all be rationalised into dialogues and report regularly to the Joint Ministerial Committee, which should issue a composite report on bilateral relations in advance of the annual summit.

6. Rule of Law Dialogue (see section II.14)

The Human Rights Dialogue currently meets twice a year, but does not seem to be effective. It is therefore recommended that a Rule of Law Dialogue be established, bringing the present Human Rights Dialogue within its structure. The Chinese government does not take seriously enough the emphasis placed on human rights not just by western governments, but also by the electorates who, in Europe, ultimately control their governments. Bread comes before freedom, but China needs to move steadily towards a freer society, so as to maximise the value of its highly intelligent and motivated young citizens.

7. Better Regulation and Regulatory Convergence Dialogue (see section II.18)

This new dialogue should be established to examine areas where agreement is possible on standardisation and to encourage regulatory convergence. The private sector should be included in its work.

8. Monetary cooperation

The US dollar has fallen very substantially against the euro, with a number of consequences. The renminbi is pegged to the dollar, which makes it considerably undervalued and gives China an unfair export advantage. Chinese currency reserves (including Hong Kong and Taiwan) substantially finance the US deficit. An adjustment to the renminbi and/or switching reserves from dollars to euros could have an extensive international impact. Regular consultation between Chinese and European monetary authorities is highly desirable so as to avoid, or at least minimise, serious monetary disruption. EU Trade Commissioner Peter Mandelson has floated the idea of a basket of Asian currencies which could be the basis for a stable currency regime for China and its neighbours.

9. Judicial Reform Dialogue

A dialogue involving both the EU and Member State judiciaries should be established. This dialogue would include helping to establish a speedy and

effective redress system for commercial disputes, including arbitration and mediation. A China-Europe Law School should be established, to be run jointly by a Chinese and a European non-governmental organisation, benefiting from the experience of the successful China-Europe International Business School in Shanghai set up by the Commission and the Chinese Foreign Trade Ministry in 1994.

10. Legislative Dialogue

A dialogue should be promoted between the National People's Congress and the European Parliament. The Chinese have not yet fully understood the European Parliament's growing powers and interest in China. Beijing has criticised its resolutions on China without attempting seriously to inform or influence the Parliament.

11. Committee of Understanding

A small high-level China-EU Committee of Understanding should be established, comprising one full and one alternate Chinese and one full and one alternate EU representative of government, parliament, think tanks, business and NGOs. The committee's objective would be to monitor developments in the strategic partnership and draw attention to potential problems areas and, where appropriate, make recommendations.

12. Business Dialogue

A high-level EU-China Business Dialogue should be set up (along the lines of the TransAtlantic Business Dialogue), bringing CEOs together and giving them the opportunity to meet with political leaders from time to time, including participating in one session of the annual summit.

13. Illegal immigration consultations

Consultations have taken place, but they have not as yet produced the results which had been anticipated.

14. Non-Proliferation Protocol

A Protocol on Nuclear Proliferation was signed in 2004, but it is too early to expect any results.

ANNEX II: Overview of EU-China Sectoral Dialogues⁵³

1. Trade Policy Dialogue

The high-level Trade Policy Dialogue includes both multilateral issues such as the Doha Development Round and regional issues such as integration and free-trade areas. Its first meeting took place in June 2004.

2. Environment Dialogue and Working Group

As a result of China's rapid economic growth, environmental protection has become an important issue. Exchanges between the Commission and the Chinese State Environmental Protection Agency (SEPA) have been intensified and issues such as sustainable development, climate change and renewable energy are being discussed at ministerial level. Environmental support programmes are heavily financed by the EU-China assistance cooperation budget. Cooperation and exchanges embrace many environmental issues, from bio-diversity, climate change, and waste management to water and air pollution, vehicle emissions, environmental indicators, sustainable consumption and production, and environmental impact assessments. China has ratified the Kyoto Protocol but, together with India, is not, as a "developing country", currently required to meet any emissions targets.

3. Energy Working Group

The Energy Working Group began in 1994. It includes nuclear energy and has annual working group meetings and a bi-annual conference on energy cooperation. Energy policy and development strategy, and the evolution of energy markets are under discussion. Specific action is planned on energy regulation, renewable energy, energy efficiency, natural gas and new technologies. The new EURATOM agreement, initialled at the 2004 summit, embraces research into the peaceful use of nuclear energy and allows researchers access to each other's facilities. European researchers are thus able to work in new state-of-the-art Chinese facilities on replacing the older European research reactors which will soon be phased out.

4. Space Cooperation Dialogue

The "Cooperation in space science, applications and technology" Dialogue was established in April 2004 with an inaugural workshop. The EU-China Space Coordination Group is analysing the current state of cooperation and seeking to eliminate obstacles. Inevitably, the problem of export controls arises.

5. Galileo global satellite navigation services

A joint agreement to develop the Galileo navigation satellite system was signed at the 2003 summit. China committed itself to contributing €200 million to the programme (overall costs are estimated to amount to €3-4 billion). A follow-up agreement between the EU and the Chinese Remote Sensing Centre signed in October 2004 constitutes the first full participation by a non-EU country in the Galileo project. Chinese participation in the programme paves the way for tangible scientific and industrial collaboration projects.

6. Information Society Working Group

The dialogue on information society was initiated in 1997 and all exchanges in this wide-ranging area have now been grouped under one umbrella dialogue, covering both research cooperation and policy discussions. It aims to promote collaboration between European and Chinese researchers and research teams, covering both information society and communications regulation. The dialogue is of considerable value for the competitiveness of European industry, and is of great interest to the Chinese government. Key policy issues include the respective developments in telecommunications policy and activities in areas such as e-government, the security of networks, and the promotion of e-commerce. The dialogue also offers the possibility for the EU side to pursue concerns such as the assignment of 3G licences (third-generation mobile communications) in China, delays in the emergence of a transparent regulatory framework for telecoms, difficulties in accessing telecoms services markets, and a range of standards issues. The dialogue is supported by a significant number of activities under the China-EU Information Society project, whose Financing Agreement was signed in December 2004. These issues are, of course, linked with regulatory convergence and harmonisation of standards.

7. Industrial Policy and Regulation Dialogue

Regulatory convergence between the EU and China is an important way to eliminate trade and investment obstacles. Promoting EU internal market rules in China is a step in this direction. The EU hopes that the quality and safety of Chinese goods sold in the Union and elsewhere will thereby improve. There are annual meetings of the dialogue, launched in 2003, and 13 horizontal and sectoral Working Groups addressing conformity assessment, standardisation, technical regulation, technical barriers to trade (TBT), electrical safety, toys, textiles, lighters, medical devices, pressure equipment, automobile standards, cosmetics and radiation from mobile phones.

8. Science and Technology Steering Committee

Cooperation has materially expanded within the Steering Committee under

the Science & Technology Agreement, which has operated since 1999 and was renewed in December 2004 in a wide range of areas, with increasing links between industry and researchers. China has joined the new European Hydrogen and Fuel Cells Technology Platform. The EU and China agree on the benefits of sharing knowledge on science and technology. China is becoming a centre for research and development in its own right, and many European firms have created, or are creating, R&D hubs in the country. Additionally, knowledge about international practices and research is flowing back to China through Chinese students educated abroad.

9. Maritime Transport Agreement

In 2002, the EU and China signed an agreement to improve conditions for maritime support undertaken by European and Chinese companies on journeys between the EU and China and to third countries. Mutual freedom to supply maritime services and have unrestricted port access is being promoted, and this cooperation now includes inland waterways.

10. Customs Cooperation Agreement

The EU-China customs agreement was signed in December 2004 to facilitate trade and support the fight against fraud and counterfeiting. The agreement established the practice of two-way inspections to support the enforcement of EU-China customs regulations. It appears to be working well.

11. Competition Policy Dialogue

The Chinese leadership realises that competition policy is essential to support Chinese efforts to restructure its economy. China's internal market clearly needs new and better regulation to implement market mechanisms and to support reform of largely inefficient state-owned enterprises. The EU's long experience in implementing the internal market could be of great value to Beijing. The Competition Policy Dialogue, formally set up in 2004, also addresses trade-dumping issues. China also recently implemented competition legislation which is similar to the EU system. This ongoing consultation is useful, not least in the fight against international cartels.

12. Sanitary and Phytosanitary Standards Working Group

An EU-China joint technical group was established in 2002 to address regulatory questions. EU and Chinese specialists discuss, among other issues, food safety and bilateral trade relations. Considerable progress has been made, leading to most of the remaining restrictions on exports to the Union of animal products being lifted.

13. Intellectual Property Rights (IPR) Dialogue

In recent years, China has made notable efforts to adapt its IPR legislation to the “Trade-Related Aspects of Intellectual Property Rights Agreement” (the so-called TRIPS Agreement, a central element of the WTO’s legal framework). There has been a formal dialogue since 2003. The Commission finances an IPR technical cooperation programme which supports law-enforcement mechanisms. However, Chinese enforcement of IPR protection still leaves much to be desired.⁵⁴ The 2005-06 China National Indicative Programme (NIP) for development cooperation includes a follow-up programme.

14. Tourism Agreement

The new Tourism Agreement (also known as the Approved Destination Status Agreement – ADS), intended to help promote people-to-people contact by making it easier for Chinese citizens to travel to EU destinations, is already showing results. It will, of course, further mutual understanding.

15. Textile Dialogue

This dialogue addresses the transition to quota-free textiles trade from 1 January 2005. The flood of Chinese imports on to European markets has already caused concern and the substantial increase in imports in 2005 sparked off some tough verbal exchanges. An agreement was reached in early June which allows reasonable growth in Chinese textile exports to the EU from 2005 to 2007, while giving time for Europe’s textile industry to adjust to the competition. This is another example of failure to consult strategically and manage a problem which had been known about for a long time.

16. Macroeconomics/Financial Services Dialogue

At the December 2004 EU-China summit, the two actors announced a dialogue process on macroeconomic and financial sector issues, to include regulators and central banks. Topical issues such as currency exchange and growth rates will be discussed, as will longer-term matters such as financial sector regulation and public procurement. The first session of the dialogue took place in February 2005 in Brussels. Another event is now being planned: a Financial Services Roundtable with the Chinese government and industries under the auspices of the EC-funded Financial Services cooperation project. Regular consultation between the Chinese and EU monetary authorities is highly desirable.

17. Balanced regional development – regional policy

China’s political leaders have, on several occasions, expressed concern over the income disparities which are emerging in the country, particularly in

relation to the urban/rural divide. Achieving “balanced development” is now an explicit goal of China’s economic policy. The EU, for its part, has a wealth of experience in regional and rural development policies which squarely address the issues related to disparities in regional growth, including income-redistribution mechanisms. Chinese and EU specialists have started exchanging experiences on these issues with the intention of intensifying cooperation.

18. Civil aviation

The first EU-China Civil Aviation Summit is taking place on 30 June-1 July 2005 in Beijing. A new framework has been needed for some time as the European Court of Justice ruled in 2002 that bilateral agreements between EU Member States and third countries are illegal if they discriminate against air carriers from other Member States, as the existing agreements between China and the Member States largely do. Strong interest has been shown by China in enhancing technical cooperation and assistance in a broad range of areas (e.g. aviation safety, security and air traffic management). There is already a successful cooperation project (financed with funds from the EU and both European and Chinese industries).

19. Education and Culture

The Dialogue on Education, Human Resource Development and Culture was launched in 2003. The EU’s Erasmus Mundus programme came into force in 2004, providing funding for third-country students to pursue postgraduate studies in the EU. Special ‘windows’ for China (as well as for other Asian countries) are being established to attract young people from China to study in Europe. Additional programmes promoting dialogue and cooperation in the field of education and culture are currently being explored.

20. Employment and Social Affairs

Social security, health and safety protection at the workplace, industrial relations and social dialogue represent major challenges for China’s future and continue to be important for Europe. A new cooperation in the area of employment and social affairs is being worked out. This should encompass health and safety at work, industrial relations and social dialogue. China will have huge problems overcoming the social and welfare policy challenges it faces. Different views on the best way forward are inevitable, given different societal values, but ongoing discussion is essential. Corporate social responsibility is a relatively new concept in China and needs addressing, alongside the promotion of economically and socially sustainable development.

FOOTNOTES

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