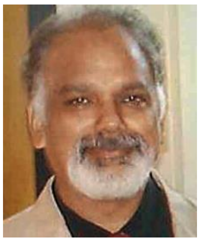

EU-China Powerful Equations - China's Emerging New Powerful Equations

Sourced & Compiled by Mr. Arvind Sinha - CEO

China's emerging new powerful equations

Throughout his campaign and from the start of his presidency, Donald Trump's blatant disdain for NATO and his open support for Brexit and populist, Euroskeptic parties across the continent have riled European leaders.

At the NATO and G7 summits in Brussels and Italy last week, Trump further poisoned transatlantic relations by refusing to support NATO's doctrine of collective defense and then signaling that he would withdraw from the Paris climate agreement, which he did on June 1.

As German Chancellor Angela Merkel balefully declared, "The times in which we could rely fully on others—they are somewhat over." She did not specifically mention the United States, but her message was clear.

As Trump alienates his Western allies, and the United Kingdom begins its departure from the EU, China has been quietly reaching out to Western nations. Both Beijing and Brussels hope to move ahead with economic globalization, and during the annual EU-China Summit held in Brussels on June 1–2, the two sides forged a new green alliance to combat global warming, a clear nose thumbing at Trump. With the EU and the United States increasingly divided, this moment may mark the beginning of a new China-EU axis in global politics.

A MONETARY AXIS?

One of the areas in which China and the EU have developed strong ties is in the monetary field. Beijing has traditionally supported the euro, which is the only serious alternative to the dollar, and has diversified its foreign exchange reserves—the world's largest—so that it now holds over one-third in euros and just slightly more than half in dollars, a decrease of around 30 percent since 1999, when the European common currency came into circulation. What this means is that in the last several years, Beijing has swapped dollars for euros, a trend that is likely to continue in future.

China's diversification of its foreign reserves has accelerated since August 2011, after Standard & Poor's downgraded the credit ratings of the U.S. federal government from AAA (outstanding) to AA+ (excellent). Sino-European financial and monetary links deepened as a result, because China began divesting away from dollar-denominated assets and purchased growing quantities of eurozone bonds, in particular German Bunds, which were perceived to be safer than U.S. Treasuries. This has come at the expense of the United States, which has had to raise the yields on its securities to attract investors. Moreover, China's diversification strategy signals that the dollar is no longer the world's only reserve currency, and this is important to Beijing, which is trying to internationalize its currency as it weans itself off of its dependency on the United States' economic cycle and monetary policy.

The reserve status of the dollar means that the world needs greenbacks for making payments, and this has allowed the U.S. government as well as Americans to borrow at lower costs. The fact that China supports the European common currency at the expense of the dollar has thus major geostrategic implications.

Europe has, in turn, supported many of China's monetary ambitions. The Europeans unanimously backed the decision by the International Monetary Fund (IMF) in December 2015 to include the renminbi in the basket of currencies making up the Special Drawing Right (SDR), an international reserve currency that includes the U.S. dollar, the euro, the British pound, and the Japanese yen. The decision was clearly political. The EU wanted to send a friendly message to China, the world's second-largest economy, as well as to recognize what Beijing had done to support the euro during the euro crisis of 2009–11, when the European common currency became the target of speculative attacks mainly stemming from Wall Street–based banks and hedge funds. At the time, Chinese leaders intervened on various occasions to reassure the financial markets by buying eurozone bonds.

Europe's decision to support the renminbi's inclusion in the IMF's currency basket was also taken in defiance of Washington, which had argued for years that the Chinese currency should be included in the SDR only if China opened its capital account, meaning it would allow companies, individuals, and banks to move money without overbearing rules and government approvals; let its currency float freely; and loosened government control over its central bank. None of this has happened. But Europe believed that including the renminbi would encourage China to liberalize its capital account further.

Today, the old continent is home to the largest number of renminbi bank clearings or offshore hubs where the Chinese currency can be traded. The fact that offshore renminbi hubs have also emerged in Budapest, Frankfurt, Luxembourg City, Madrid, Milan, Paris, and Prague indicates Europe's willingness to promote the use of the Chinese currency. In the same vein, most of Europe's central banks have accepted—or are considering accepting—China's currency as a viable reserve. Although London is currently the most important offshore market for renminbi trading, once the United Kingdom leaves EU, significant shares of renminbi trading in London will most likely move to the continent, in places such as Paris, Frankfurt, and Luxembourg, thus strengthening the China-EU monetary axis even more.

TRADE AND THE PROBLEM WITH RECIPROCITY

When it comes to trade, relations between China and the EU have been rockier, although Trump's derision of global trade certainly provides an opening. Between 2002 and 2016, total EU-China trade has risen dramatically, from 125 billion euros to roughly 515 billion euros. Today, China and the EU trade more than 1.5 billion euros in goods each day, and total bilateral trade in 2016 was 514.6 billion euros according to the European Commission—nearly equivalent to what China exchanges with the United States. In fact, the EU is now China's most important trading partner, although China ranks number two for the EU, after the United States.

In addition to buoyant commercial relations, Beijing is trying to charm Europe through investments. Europe is now the top destination for Chinese foreign investments, surpassing the United States. According to the China Global Investment Tracker, a joint project of the American Enterprise Institute and the Heritage Foundation, China invested nearly $164 billion in Europe between 2005 and 2016. During that same period, it invested $103 billion in the United States.

That said, the European Parliament and a number of EU member states have increased their criticisms of China's lack of reciprocity. China restricts foreign investment in its domestic market for almost all sectors, with limited openings in banking and finance. European businesses consistently face difficulties in entering the market, while Chinese companies often receive help from the government, through subsidies or simpler procedures, for example. Big government contracts are routinely awarded to Chinese companies. Foreign companies, meanwhile, particularly those with recognized brands and technologically advanced products, are required to share their expertise before they are allowed into the market at all.

This has triggered a debate about the growing imbalances between Europe and China. In February, France, Germany, and Italy asked the European Commission to rethink the rules on foreign investment in the European Union. It was a message to Beijing about opening up access to its markets, at the time when the two sides are negotiating a bilateral investment treaty, which is meant to address the question of reciprocity.

Progress on the treaty has stalled, however, owing to China's reluctance to remove nontariff barriers in a range of sectors that are of interest to European businesses. Furthermore, the EU is unwilling to grant market economy status to China. Should they reach an agreement on these issues, however, there would be a significant boost to Sino-European trade and investment at the expense of other important players, most notably the United States, which would likely receive less inbound investments from China.

At the EU-China Summit, leaders of the two sides failed to deliver a final joint communiqué because of a disagreement over reducing global steel production. China's annual steel output is almost double the EU's, and the European Commission maintains that Chinese steel exports are damaging Europe's steel sector by putting tens of thousands of jobs at risk. Consequently, the EU denied China's request to be granted market economy status, which also strained relations at the summit.

INCREASED SECURITY COOPERATION

Still, as the summit revealed, there are a number of issues on which China and the EU agreed. Both pledged to continue efforts to reduce pollution and combat rising sea levels even without the United States. Donald Tusk, the president of the European Council, made clear that “the decision by the United States to leave the Paris agreement is a big mistake,” adding that “the fight against climate change, and all the research, innovation, and technological progress it will bring, will continue.” China and the EU agreed to cut back on fossil fuels, develop more green technology, and raise funds to help poorer countries, particularly in Africa, cut their emissions.

The two sides also discussed the problem of a belligerent North Korea, advocating for a peaceful resolution through increased dialogue at the multilateral level. The statement was in direct contrast to Trump, who has responded to Pyongyang’s recent missile launches with belligerence, an attitude that both Brussels and Beijing saw as troubling for regional peace. Shared opposition to Trump’s diplomatic style first surfaced at the last China-EU Strategic Dialogue, which was held in Beijing on April 19, when the two sides agreed on a common vision of international affairs and global governance, with the United Nations at the center. It is clear that the relations between the EU and China will continue to strengthen as their concerns with Trump’s unilateral attitude toward global issues grow.

Under such circumstances, it is likely that the EU and China will foster ties on security and defense as well. The EU and China already work together on conflict prevention, crisis management, and postconflict stabilization. EU NAVFOR, the EU-led antipiracy operation off the coast of Somalia, has already tested naval cooperation between some EU member states and China. Peacekeepers from both China and EU member states operate under the UN flag in Lebanon as well as in other UN-EU operations, such as Congo, Mali, and South Sudan.

Future China-EU security cooperation might involve China’s participation in the EU’s Common Security and Defence Policy or peacekeeping missions, particularly in African territories and seas, as well as targeted joint military activities, such as counterpiracy drills and humanitarian rescue exercises and operations. Moreover, Brexit will facilitate the establishment of a structured dialogue mechanism between the EU Military Committee and the Chinese People’s Liberation Army, including the appointment of a defense and security adviser to the EU Delegation in Beijing. London consistently opposed the creation of such a position for fear that this move would send the wrong message to Washington and undermine their special relationship.

That is because the United Kingdom has always wanted the EU to remain a trading bloc and has traditionally refused to give EU institutions the powers and capabilities necessary to transform the union into a global power. For decades, the United Kingdom rallied for Europe to stay firmly embedded within the Western alliance, a task made easy by Washington’s commitment to its European partners. Today, this configuration is fading away, with London leaving the EU and Trump alienating his Western allies. This will make it easier for Brussels to further ties with China on a whole range of issues that have the potential to challenge the United States’ global primacy.

Make no mistake, however. A China-EU alliance would be more a marriage of convenience than a solid partnership—one that is facilitated by Brexit and that revolves around a shared antagonism for Trump. We must wait and see whether the new dynamics within both the United Kingdom and the United States transform this axis into a more permanent one as new possibilities for China-EU relations open up, unthinkable only a few months ago.

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