Transcript Q&A

China–EU Relations: Moving Beyond Trade

Professor Kerry Brown
Associate Fellow, Asia Programme, Chatham House

Guy de Jonquières
Senior Fellow, ECIPE

Bernice Lee
Research Director, Energy, Environment and Resources, Chatham House

Chair: Jonathan Fenby CBE
China Director, Trusted Sources

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**Question 1:**

Would the panel members like to say a little bit about finance which is the basis of all this trade? What is the trend in China regarding the loosening of their finance?

**Guy de Jonquières:**

Well there’s an external side to this and a domestic side and they’re very closely linked. The external aspect is the question, the vexed question of the renminbi – there’s not been so much in the news recently – and the exchange rate, and capital controls. The domestic side is an extremely rigid and rather primitive financial system that operates through preferential credit, administered interest rates and so forth. This has been something of a running battle inside Beijing. The reformers, led particularly by the central bank, have been making some progress bit by bit in easing up at the edges. I mean it’s been fairly small scale stuff, I think you’d agree Jonathan, very much piecemeal but it’s been moving in the same direction. We’ve also seen a push to internationalize the renminbi and, of course, that was one of the issues in the discussions that Osborne had when he was in Beijing. He obviously is expecting that to move forward.

There are several problems, the first one – this is where you get the link between the domestic and the international. If you start really changing the domestic system fundamentally you run into the famous vested interests, in other words all the people who profit from the status quo, the local governments, the state banks, the people – to be honest, it is a considerable source of corruption, and this is an unresolved battle, we’ll see next month between them how far or how much progress they have made, so there’s that side. The other problem is that sequencing the removal of capital controls is an immensely delicate and potentially enormously hazardous task. If you get it wrong you could get enormous flows of capital in or out of China playing havoc with the domestic financial system, with the exchange rate and having considerable knock-on effects on the rest of the world. So I mean there is a good reason for going cautiously and a bad reason for going cautiously, and I think maybe we’ll get some hints at next month’s plenum of how much further they’re going to go with this, although I think all the expectation is that while we may see some broad parameters set out we are unlikely to see a great deal on what really matters, which is the implementation.
Bernice Lee:

Well I was going to pick up on the domestic finance question if that's interesting, I mean with the freezing of a lot of local government spending and further loans, obviously there is at the moment a big discussion about where the next stage of growth will come from and on our part – I mean we have been talking to quite a lot of people and concluded that actually The Economist just writing that China is continuing to be addicted to investment or was in the FT today, it's clearly true – and then the question becomes whether or not the next phase could be done better if indeed there will be another round of infrastructure and investment, and I think a lot of that would indeed depend on the extent to which they could attract sustainable investments of the type that is clean, green and obviously building infrastructure that would last. And that is exactly, I believe, where the European Union or the UK have potentially a stronghold to help shape and play.

Kerry Brown:

Could I just add a four letter word that I didn’t mention, which is debt. But that’s a whole chapter on its own.

Jonathan Fenby:

And if I might take the chairman’s prerogative, the other thing was reform and change, which this is part of a whole series, I mean we can draw up a list of at least half a dozen and probably a dozen things that China should do if you’re writing headlines to it. We all think that reform is wonderful, like motherhood and apple pie and so on, but actually if you did it in China, serious structural reform notably of the financial system, you’d cut one or two points off GDP growth and add two to three points to inflation for four years. So this is a pretty big regime question as well as the specific economic question, which we will always tend to overlook and, therefore, the dynamic for conservatism, as Guy was saying, certainly in implementation is pretty huge I think.

Question 2:

Sorry to be a bit political about this one, but aside from the sort of tributary-state type relationship that the UK seems determined to put itself at the
moment, so aside from Boris Johnson and the trip to China recently, isn't the UK referendum on EU membership stabbing UK and EU trade relations with China in the foot, and isn't actually what's needed more integration on the EU side both politically and trade for better relationships between China and the EU?

Kerry Brown:

I mean to be honest the best negotiating position that we have for getting access to the enormous potential consumption market in China that's only going to go up, because you've got potentially 600 million customers, and Li Keqiang – I mean he's said a lot about increasing consumption – so for UK companies to have as good a chance as possible well then they'll have to do that in alliance with the European partners. Bilateral agreement between the UK and China will be not so important to China, and bilateral market access agreement between the EU and China is a big deal. As Guy said, we have our market, that's all we've got, really the Chinese are still interested in this market and we do want now multinationals to be allies of those who want to produce growth in China, and that's the Chinese government, of course, because growth is now not so big as it was before, so really we have to think of smart ways of tactically kind of plotting our way into getting entry to that market, and I would have thought EU strategies are the best option.

The problem really is it is absolutely understandable that China would become irritated by multinationals making fat profits in China, and that's probably why GlaxoSmithKline had issues, and it was remarkable that their senior leaders within three days admitted all guilt, I mean you would say very quick. In Europe they wouldn't admit these things for many, many years – you'd want to go through some process. So I guess that that shows that multinationals that are conspicuously in sensitive sectors like pharmaceuticals or energy or other sectors making big profits are going to have a tough time and the European Union must protect our interests there. It's going to be tough for multinationals to really kind of get into this market, but they had many, many great assets and great things the Chinese want and so I think within the EU the smarter and better deals we do to get access to that market the better it is, and I don't think the UK would be very easy to do that on its own.
Guy de Jonquières:

Can I just say that when the United States, within Britain prides itself on having special relationships, warns that withdrawal from the EU would marginalize the UK in American eyes, just think what it would do in not only Chinese eyes but the eyes of multinational business everywhere. They’ve been speaking more and more loudly about it.

Bernice Lee:

Well I was just thinking about what Guy and Kerry said and sort of want to say it slightly differently, which is when you think about it it’s obvious isn’t it that the EU together is a stronger partner and the divide and rule only happens because Europeans allow them to. But then the question is whether we can iron out the differences, and I don’t know what will come out in the wash in the final analysis, but I presume on the whole we all benefit, that the individual member of states probably will still, but I haven’t seen any numbers that talk about how collective bargaining vis-à-vis individual bargaining would yield different results.

Kerry Brown:

But I mean we’ve camped out on the World Trade Organization agreement, but it’s such a vague agreement – I mean so in retrospect when we were so excited 10 years ago, 12 years ago when it was done, and the EU negotiated for years with that deal. In fact it’s really proved a bit flimsy. I mean our companies have had a tough time using this really to get the kinds of access they want, and where the EU needs to sort of be very sophisticated in its battleground in China, and I would have thought Shanghai as a finance centre and its aspirations. Aspirations are important. In any area we have to kind of use whatever we can to have access to the consumers that might use services to increase service sector as part of GDP through the gate of Shanghai, and a better deal than the one we got through the WTO is obviously necessary.

Jonathan Fenby:

Could I just come in on that? I don’t think that it’s because the WTO accession terms are vague, they’re not, they’re extremely specific and
precise. Yes, they don’t cover the areas where more and more of the opportunities are arising. I mean one particular case was insurance where the US and the EU completely messed it up in the negotiations, they should have got a much better deal. They were so tired at the end that they didn’t push for it. If I may just make a related point, Bernice asked why not put TTIP on the table in an EU negotiation with China? Can you imagine what Washington’s response would be if that idea was raised?

Bernice Lee:
Well I can.

Jonathan Fenby:
But you couldn’t do that without in some way affecting US trade, and whether or not it’s true that the US is looking at the Trans-Pacific Partnership as a lockout strategy to China, and they deny it, the Chinese don’t believe it, I think one has to recognize that the Americans would consider that they had a very large stake in that and a big say in it.

Bernice Lee:
Well if I may in that case, I mean looking at the numbers for TTIP, the actual trade gain is small. Most of it is about regulatory change and, therefore, all I’m arguing is that the type of issues that are being discussed in TTIP context could be the type that is also discussed, and I’m not suggesting one another, that that becomes a trilateral by any measure.

Jonathan Fenby:
Right, just on a piecemeal basis, yes.

Bernice Lee:
But my point is the TTIP is political as it is economic in any case.
Jonathan Fenby:

Yeah, it is.

Bernice Lee:

The part that it's economic should be up for further discussion so that the EU can have its own strategy to actually strike a bargain for itself that it really wants with both sides, and I don't think that should be in question.

Question 3:

Just building on that previous conversation, in his evidence to the foreign affairs select committee a few days ago Dr Robin Niblett argued that strategically the US sees TTIP as principally a new forum to counterbalance the rise of the influence of China in multilateral trade fora and also mitigate the risk of other emerging markets pushing trade policy which is against their interests. So how do you think China is thinking about TTIP and what are they going to be concerned about on the forthcoming EU-China trade negotiations? How do you think it will influence issues beyond trade?

Guy de Jonquières:

Well to be honest I don't think they're thinking very much about TTIP. When it comes to large, these mega-regional projected deals, the Chinese are looking almost entirely at the Trans-Pacific Partnership (TPP). TTIP is still a long way away. Certainly on element, and I was part of a taskforce that prepared a preparatory report on TTIP, one element in the thinking is definitely that if the US and EU agree on a lot of these things then they can go to China and say look, we'd like you to sign up to these. Not sort of threatening to protection against China, but saying look, if you want some of the benefits of this you've got to meet high regulatory standards. From that point of view, I think that probably in parts of the Chinese government you would find people who are pretty positive about that. I mean this after all is a government that sees that China faces a problem known as the middle income gap. They're constantly talking about the need to move beyond basic – because they're not labour-intensive industries, they're capital-intensive industries and manufacturing industries - into higher value added. If you want to do that, if you want to be globally competitive then you've got to meet high standards. If the US and the
EU succeed in setting those standards in a non-discriminatory way one could see why China could be interested in discussing them. But I think frankly that TTIP is a second or third stage question from the Chinese standpoint as compared with TPP, which is obviously of some concern to them and that one hears them talking about quite a lot in Beijing and international meetings and so forth.

**Bernice Lee:**

Well if I may, and it scares me a little bit to be slightly diverging from your version, I have a slightly different impression but for different reasons. I think that they are indeed of different orders of magnitude of importance today, but the fact that TPP is likely to be finished soon – and this is at least what I heard recently that there will be announcement soon – implies that possibly it is more political gesture than substance. In other words, we can’t agree on trade amongst so many countries so quickly and therefore anything that could come to quick agreement probably isn’t that substantive. On the TTIP side I think that echoes a long-standing discussion one would have had with Chinese colleagues if one works on global public goods area, which is how much does China want to play in terms of crafting global rules on the next set of global rules. The fact of the matter is that the WTO with nothing really happening for so long, those who want to use liberalization or other means to advance trade and other interests have nowhere to go, so obviously they will have to go the bilateral route. And therefore, in some ways China’s response is a much larger question in my view, not just about TTIP but about the extent to which it actually wants to help the world, if that is what the world desires, advance to the next stage of negotiation and liberalization via institutions of the WTO and otherwise, and that to me is probably what I think the Chinese should be thinking about.

Now in terms of whether or not they’re treated with suspicion, I think the answer is definitely, but then they also treat most European policies with suspicion, unilateral policies. So anything that looks like it’s advancing global rules without the multilateral forum tends to be treated with suspicion, but these things won’t happen, i.e. bilateral or regional, unless it advances, right, from beyond? So in some ways I think the big question is whether or not China wants to be part of the global rules making at the next stage or not.
Jonathan Fenby:

Sure, I think that’s very important, I mean you’ve got China often understandably complaining that it has to play by rules set by others before it emerged from Maoism and so on, but it’s played, as far as I can gather, quite a small role in actually putting forward suggestions, financial system or whatever else it is.

Question 4:

The theme of the debate today was moving beyond trade and most of the conversation has been about trade. When the first EU- or EEC-China agreement was signed in the 1970s, China regarded the European Union as a possible counterweight to the Soviet Union and at that stage was encouraging Britain to take an active role in the European Union. From what I’ve heard today, China doesn’t regard the European Union as anything more than a series of individual markets. Do you think that China has any view of Europe as an entity? Does it have a strategic or a political value as a counterweight? Obviously no longer to the Soviet Union that’s been dealt with, that perhaps the United States.

Kerry Brown:

Well I mean the problem with the 1975 diplomatic recognition and then what happened with the creation of the Union in 1992 is that the Maastricht Treaty obviously has quite a lot in it about values and about, I mean the social chapter, and that was contentious even in the UK. And so, in a sense, China could argue that they did a deal with one entity and as if by magic something else appeared with all of these issues of values and some of the dialogues they talked about, the 1980 dialogues, do address these issues of values, social values, social dialogue, people-to-people dialogue – I think that was last year there was a big people-to-people as opposed to people-to-thing dialogue, I don’t know what else is the alternative to people-to-people, but – so you do have an attempt to have a deeper values dialogue. I think the problem is that the articulations of European identity, particularly in the formal documents to the European Union produce, are for many Chinese lofty and pretty unappetizing and they feel a sort of European kind of sniffiness and lecturing, and it’s hard for them to take that when you think of the problems that the European Union has had over the last three or four years. And so when the Baroness Ashton, for instance, went to Beijing during the peak of
the eurozone crisis, she tried to have a security dialogue with Wen Jiabao as the state council head, and I mean really there was very little to talk about – I mean the security as a key issue beyond trade but what's really the content of our security dialogue – whereas of course America and their high levels of strategic and economic dialogue talk about security.

So I mean there are kind of immediate issues about a very tangible thing. About values it's even tougher, because I think the EU feels that it should promote governance. The first thing that I said in that flying sort of long list was the idea of creating a more plural society in China, and I mean that would again be antagonistic to the communist party in particular. I suppose we do have to have the values debate, I mean we shouldn't not have that debate, but I guess that we have to do it more equably. There are awful problems with the delivery of justice in China, with the issue of dealing with contention in society in China, huge issues of social cohesion. I mean these are things that I think we can have an equal policy dialogue about. Well in Australia where I’m based now, they produced a white paper in *Australia in the Asian Century* last year in October and that started to tackle the idea of a values dialogue. There was a group of nine Asian countries rather than just China, but I think at the heart of that is the idea of a policy serving an Asia savvy policy-making cadre, and I think we need to have very well informed politicians going to China, if that’s not a contradiction in terms, to basically have a decent debate with the Chinese about the justice agenda, civil society strengthening, issues of contention, all of these things are things we can talk about but we have to kind of strip out this idea that we have solutions that we can impose or give, because I don’t think there’s any appetite for that in China now.

**Bernice Lee:**

I agree completely with Kerry actually, that I think indeed the next generation of collaboration and mutual respect will have to come from joint problem solving, recognizing that both have something to bring, but neither party has the complete answer. But in terms of the extent to which China takes Europe seriously or not, my answer to that would be I think it does take the euro very seriously.

**Guy de Jonquières:**

The first point, I mean if you look back China has tended to use Europe as a foil to the United States, particularly on non-economic issues to do with things
like the arms embargo, and you only have to sort of look at the way - Boeing versus Airbus has been one of their favourite instruments, tactically placing orders with one or the other in order to curry favour. But I was going to mention the euro. China's got a very big stake in Europe, we don't know exactly how much but it's certainly probably about $600 billion to $700 billion worth of security holdings and small but rapidly growing direct investments. And they're really in a dilemma because, I mean they don't like their dependence on the US financially, they feel trapped by their treasury bond holdings. They've run down their treasury bill holdings, those are the short-term treasuries, with incredible speed over the last two or three weeks, but there aren't really any other places to put that amount of money than Europe. Europe is the only other place that has liquid markets, large markets where they can move their money in and out very easily without it losing value or pushing up prices, so they're locked in in that sense. I like to say they're trapped. I mean there's a lot of belief that somehow these $3.4 trillion give China power, they don't. China is trapped by the system. It's resolved this dilemma in Europe by dialling that Berlin telephone number and, if you remember, the Europeans after the first sort of blow-up over the euro sent off this poor chap to go with a begging bowl to China saying please give us capital, well Europe doesn't need capital, Europe has a capital surplus. The problem that Europe has is insolvent borrowers, sovereign borrowers, or near insolvent borrowers, and the Chinese quite understandably said well why should we lend them money when you won't?

They've resolved this by first of all buying German bunds, which is why you now pay the German government money in order to lend it money, and secondly by hiding behind the IMF. And China has this wonderfully ambivalent attitude towards the IMF. On the one hand it says this is outrageous, we're not given our due weight, we don't have a big enough say in it, but at the first sign of trouble they scurry for shelter under the skirts of Madame [Christine] Lagarde and say please, please would you look after this problem for us? And they are in a little bit of a mess. So far it's worked, they manage somehow to hold it, but for all those reasons I think Europe is something that is pretty important to them, especially given the almost obsessive public interest in maintaining the value of China's foreign exchange reserves. You remember when some of them were badly invested there was, I don't know if it was a public outcry but it was certainly used by sections of the party to lambaste the leadership saying you are squandering our heritage, etc., etc.


**Jonathan Fenby:**

Although there is also the continual argument, particularly on Weibo and other sites, of why is all this money tied up in this form? Why can’t you work out a system where we can spend it at home? And we know the effect of that.

**Guy de Jonquières:**

Well it’s precisely because they’re not spending it at home that they’ve got all that external money.

**Jonathan Fenby:**

And they would like more German bonds, I’m sure if they can find them.

**Question 5:**

Just to follow exactly on that point, the surplus that China’s been running might encourage them given the kind of lack of reasonable assets to purchase with their excess cash flow, might encourage them actually to open their doors to productive services and products that might meaningfully drive growth but from foreign markets. Is there reasonable semblance that China might open up a little bit more to try and encourage lessening of that balance of payments problem?

**Kerry Brown:**

That comes back to the question of the vested interests. There’s an enormous amount of resistance built in to opening up services markets, because so many of those services markets are dominated by state-owned enterprises or the network industries, telecoms, airlines, energy, water, all of those. If the new leadership has the oomph, the bottle to take on the vested interests and beat them, yeah, but that’s really – it all comes down to politics.

**Bernice Lee:**

Well I hope so, and I think looking at the strategy, what looks likely to come out in the next big meeting, the infrastructural needs – whoever has a proposition to clean up cities in China should be doing very good business,
and I think the leadership obviously should make sure that that is indeed the case and we’ll see what is in the fine print down the line – but notwithstanding the political issues that are obviously clear and present.

**Kerry Brown:**

Well just finally, I mean I think Stephen King the chief economist of HSBC a couple of years wrote about a very competitive future and the heart of that is getting access to Indian and Chinese consumers. The Indian consumer is more in the distance, but I think Chinese consumption is coming into sight and if you want to see the future of Chinese consumption just go to Shanghai, an extraordinary kind of place at the forefront of the Chinese economy. So I think for UK companies the road to a market like China is through Shanghai and the road to Shanghai, alas or for good, is through Brussels.

**Question 6:**

Maybe the reflection or the question here is where is the limit? If we go beyond trades around energy interchange or technology you go onto politics too. So I mean how is there real necessity or importance to talk about the arms embargo between Europe and China?

**Guy de Jonquières:**

I mean a lot of politics is symbolic and so the three great sticking points of the embargo, of the trade disputes, the solar dispute in particular, and finally of market status, I mean they’re kind of symbolic. The embargo, it’s all dealt with by bilateral or kind of international law anyway, what you can and can’t sell, dual use stuff. I mean the problem is when we tried to shift it in 2004–05 the Americans didn’t like it, so symbolism of that for China is that we are close to the Americans and we therefore can’t really be depended upon. If we were politically ruthless we would be having an incredible time now being the biggest pals of China while America is closed for business, but we haven’t done that. If we’re ruthless we would let America kind of sign all these Mickey Mouse deals, TPP or whatever, and we would plot our way into the Chinese market by doing some big, big sort of friendly deal that said everything and meant nothing, but alas we don’t.
Jonathan Fenby:

On that note, thank you very much for coming, thank you to the three panellists.