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## *EUMA*

**The EU-China Trading-Economic Relationship is not a  
Zero-Sum Game**

**- Maria Lorca**



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***European Union Miami Analysis (EUMA)*** is a by-weekly service of analytical essays on current, trend setting issues and developing news about the European Union.

These short papers (between 2,000 and 2,500 words in length) will be produced by the Miami-Florida European Union Center of Excellence (a partnership of the University of Miami and Florida International University) as an outreach service for the academic, business and diplomatic communities.

Among the topics to be included in the series, the following are suggested:

- The collapse of the Constitution and its rescue
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These topics form part of the pressing agenda of the EU and represent the multifaceted and complex nature of the European integration process. These short papers also seek to highlight the internal and external dynamics which influence the workings of the EU and its relationship with the rest the world.

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# The EU-China Trading-Economic Relationship is not a Zero-Sum Game

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## Introduction

The European Union (EU) presented on Tuesday, October 24th, 2006, “EU-China: Closer partners, growing responsibilities”<sup>1</sup> which establishes the bases for a new, extended partnership and cooperation agreement with Beijing. This new agreement is necessary since the current 1985 “Trade and Co-operation Agreement” does not reflect the recent surge in trade between the two regions. Even though China has passed the first law targeting money-laundering, the EU keeps criticizing that China’s current market barriers, intellectual property violations, and continuous state intervention to maintain an undervalued currency are undermining the beginning of a prosperous new era of EU-China economic relations<sup>2</sup> -- especially, if the currency devaluation were to continue, even after being member of the World Trade Organization<sup>3</sup> (WTO). In fact, the International Monetary Fund (IMF) has said that despite China having allowed more movement in the currency since September, a faster appreciation of China’s currency, the renminbi, is required since the surge in China's net exports and increase in its foreign exchange reserves demonstrates that the currency remains extremely undervalued.<sup>4</sup>

Furthermore, China is also being heavily criticized for opening the market to foreign banks too slowly, stating that a “free for all” would “damage the system.”<sup>5</sup> This situation will be a truly devastating zero-sum game for Europe because the EU will be loosing jobs and reducing the living standard, while subsidizing China's poverty with European money. For this reason, EU has stated that “there is a growing risk that the EU-China trading relationship will not be seen as genuinely reciprocal. Political pressure in the EU to resist further openness to Chinese competition is likely to increase if these problems are not addressed.”<sup>6</sup>

## China reloaded: an impressive economic growth

China has become in the last decade the world’s fourth largest economy with a healthy economy led by an impressive Gross Domestic Product percentage growth in 2006 averaging 10.4 per cent and an inflation rate under control with the Consumer Price Index as low as 1.5 per cent. However, these figures are not sporadic since already in 2005 China enjoyed a nine per cent annual average growth and saw its share of world GDP expand tenfold to reach five per cent of

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<sup>1</sup> Commission of the European Communities. Communication from the Commission to the Council and the European Parliament. “EU-China: Closer partners, growing responsibilities.

<sup>2</sup> Yeh, Andrew. “China passes its first law targeting money-laundry.” Financial Times, Wednesday November 1, 2006

<sup>3</sup> China's five-year accession to the WTO will be complete on December 11.

<sup>4</sup> Guha, K. “IMF fears as China growth rate set to exceed 10.5%” Financial Times, Wednesday November 1, 2006

<sup>5</sup> McGregor R. “India and China acquisitions abroad ‘to explode’” Financial Times, Tuesday October 31, 2006

<sup>6</sup> Back, t. and Richard McGregor: “EU takes tough line with China on trade” Financial Times Wednesday October 25, 2006.

global GDP<sup>7</sup>. In fact, the IMF has reported that China's growth for 2006 is likely to exceed 10.5 per cent. This amazing growth is supported by the fact that China's exports will approach \$1,000bn by the end of 2006—twice what they were reporting in 2003—making China the third-largest base in the world.

Furthermore, China has a trade surplus that totaled US \$70 billion in the first six months of 2006 and it is expected to reach US \$120 billion or more by the end of 2006. In 2005 the surplus was US \$102 billion<sup>8</sup>. By the same token, this growth has resulted in an all time record drop in poverty in world history. The number of persons living in poverty in China was reduced from 250 million at the start of its reform process in 1978, to 80 million by the end of 1993 and to 29.27 million in 2001<sup>9</sup>. Furthermore, this economic boom has also raised the income level in the country; for instance, China has experienced the emergence of (a) a large educated middle class better with rising purchasing power, (b) a so-called “China's billionaire club” that has 15 new billionaires this year alone,<sup>10</sup> and (c) approximately 10,000 Chinese businessmen with more than \$10 million of personal wealth publicly reported<sup>11</sup>.

The miracle in China is not only economical, but primarily political. The political leaders are taking China for an interesting political ride, since they are moving away from a classical closed communist economy to a “capitalist-communism.” China's new political-economic ground is based on a dynamic revision of Marxists' theories that are peacefully transforming China. In fact, the political leaders seem to believe that first it is necessary to have a strong economic China, with solid socio-economic factors, in order to achieve a high quality democracy that would help to have, one day, a strong voice in world politics. Maybe they have learned from Russia's emergence from seventy years of Marxism, whose sudden adoption of democracy has economically destroyed the country, plunging it into major social inequalities, corruption, and economic instability. All this has led many to think that China could become an economic hegemon with the intention to play hardcore power politics in the world; however, Zheng Bijian, Executive Vice-President of the Party School of the CPC Central Committee<sup>12</sup>, has explained that “we did not seek hegemony in the past, do not seek hegemony now and will never seek hegemony in the future when we are developed”<sup>13</sup>. Furthermore, he said that China will “only export computers and will not export revolution.”

## **The beginning of a new relationship: Europe should not be scared**

Europe needs to respond effectively to China's renewed strength, keeping in mind that the EU offers the largest market in the world (the EU is China's largest trading partner, representing more than 19 per cent of China's external trade, and in 2006 the bilateral trade is expected to

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<sup>7</sup> McGregor, R. “China economy surges amid export boom” October 19, 2006. <http://www.ft.com/cms/s/ea7cc546-5f28-11db-afac-0000779e2340.html>

<sup>8</sup> Bustelo, Pablo. “China: Is Economic Growth Out of Control? Real Instituto Elcano. <http://www.realinstitutoelcano.org/analisis/imprimir/1053imp.asp>

<sup>9</sup> China Through a lens. “World Bank Says China Is Poverty Reduction Model <http://www.china.org.cn/english/2003/Feb/56694.htm>

<sup>10</sup> Yeh, Andrew. “Woman tops list of China's richest people”. October 11, 2006. <http://www.ft.com/cms/s/4e44f4ba-58c4-11db-b70f-0000779e2340.html>

<sup>11</sup> Oppenheimer, Andres. “Cuentos Chinos.” Andres Oppenheimer, 2005. Page 53.

<sup>12</sup> Bijian, Zheng. <http://chinavitae.com/biography/647>

<sup>13</sup> Bijian, Zheng. “Ten views on China's Development Road of Peaceful Rise and Sino European Relations” Real Instituto Elcano. <http://www.realinstitutoelcano.org/analisis/imprimir/863imp.asp>

reach US\$200billion<sup>14</sup>), a strong currency for trade, and stable economy. By the same token, the communication reports that China's increasing middle class represents a growing market for EU exports. In fact EU exports to China increased by over 100 per cent between 2000 and 2005, much faster than EU's exports to the rest of the world. Furthermore, EU exports of service to China expanded six-fold in the ten years to 2004. Hence all these economic figures demonstrate that not only is trade booming between the EU and China as a result of globalization, but also that both the EU and China can gain from trade and economic partnership. But only if both partners open their market and ensure fair market competition. Therefore, since Deng Xiaoping started opening up the country in 1978, EU-China trade has increased<sup>15</sup>. However, imports from China are adding pressures to the EU markets that must adjust to globalization, irritating, as put by Peter Mandelson<sup>16</sup> "those who see globalization, and the rise of China and India in particular, as the swamping of European markets by low cost producers<sup>17</sup>." In fact, Mandelson defends that the EU should continue to offer free and fair access to China's exports and to adjust to the competitive challenge. Nevertheless, the Commissioner stated that

"where trading practices contravene WTO rules we will robustly defend our interests. But I am not, as a matter of basic conviction, in favor of intervention in markets or managing trade. In the long run this is a cul-de-sac. It inhibits innovation and adjustment. It entrenches uncompetitiveness. In the short-term, it can bring desirable relief; but as we have seen, it can also have unforeseen and damaging consequences in a world where trade is flowing as fast and furious as today."<sup>18</sup>

Hence, the EU should develop and consolidate areas of comparative advantages.

According to David Ricardo<sup>19</sup> (1772-1823) if each nation specializes in the production of goods in which it has a comparative cost advantage and then trades with other nations for the goods in which they specialize, there will be an overall gain in trade, and overall income levels should rise in each trading country. The problem is to reach the comparative cost advantage which in the EU should be attained via proper investment of funds in research and development to maintain a high level of innovation. This innovation will press for upgraded knowledge skills and education to occupy one of the new jobs that innovation has created. As long as the EU maintains a level of innovation it should not fear China because as Tomas Friedman quotes in his book<sup>20</sup> "If you believe human wants and needs are infinite," said Andreessen, "then there are infinite industries to be created, infinite business to be started, and infinite jobs to be done, and the only limiting factor is human imagination" (267). On September 22, 2005, J.M. Durao Barroso gave a speech in Lisbon right after a recent visit to China and he emphasized that there was an urgent need to renew Europe's different and social structures while respecting values and principles intrinsic in the European way of pursuing competitiveness and social justice because

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<sup>14</sup> Comisión of the European Communities. Communication from the Commission to the Council and the European Parliament. Page 6

<sup>15</sup> Partor, Alfredo and David Gosset. "The EU-China Relationship: A Key to the 21<sup>st</sup> Century order" Real Instituto Elcano.

<http://www.realinstitutoelcano.org/analisis/imprimir/848imp.asp>

<sup>16</sup> European Union Commissioner for Trade

<sup>17</sup> Mandelson, Peter. "Challenges and Opportunities for EU and China in the age of Globalisation," Central Party School, Beijing, 6 September 2005.

<sup>18</sup> Mandelson, Peter. "Challenges and Opportunities for EU and China in the age of Globalisation," Central Party School, Beijing, 6 September 2005.

<sup>19</sup> He is an English economist who developed the first theory of free-trade comparative advantage.

<sup>20</sup> Friedman, T. "The world is Flat." Penguin Books 2006

he has just come back “from China and India and what I saw was a vivid demonstration of the sheer speed and scale of the changes going on in the world<sup>21</sup>.”

## **Conclusion**

The relationship between Europe and China has gained economic momentum. China causes fear in the EU, but this feeling should be used to stimulate the willingness to change and explore new ways to innovate in the EU. In *“The World is Flat”*, the author states that “(t)he Indians and Chinese are not racing us to the bottom. They are racing us to the top” (271). Therefore, the EU should prioritize investments in the binomial formula “innovation-productivity” as fundamental in order to find the comparative advantage necessary to avoid economic-trading relations based on a zero-sum game especially in a globalized country that makes the pie even bigger. The challenge for Europe is to be able to make all the necessary structural changes based on a consensus between the social-political institutions and the citizens in order to achieve those changes to get as much as possible of the bigger pie.

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<sup>21</sup> Duraó Barroso, J.M. “Building an open Europe in times of change European Ideas Network” Lisbon, 22 September 2005  
<http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/546&format=HTML&aged=1&language=EN&guiLanguage=en>