

## **Policy Evolution of the China-EU Trade and Economic Relationship**

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**Abstract:** The core of China-EU relations exists in trade and investment. The bilateral trade and investment started from a low level, yet has mounted to a brand-new height with more than 30 years' development, esp. after the 21<sup>st</sup> century. Starting from a secondary and subordinate status, China-EU economic and trade relationship has reached an ever-high climax with the strategic partnership. Building up China-EU economic and trade relationship turns out to be a big success, although how to maintain the expanding relationship would test the wisdom of the leaders from both sides. Trade growth has not merely laid a solid ground for bilateral relationship, but also enhanced the cooperation in the economic field which now has extended to a broad spectrum. Both China and EU have benefited from the rapid growth of trade, although they need to face the brewing difficulties, namely, trade unbalance, trade conflicts and etc. The trade balance does not necessarily reflect the real benefits of the two sides. A set of dialogue mechanism has been established in order to provide the channels for solving the trade conflicts. The future of China-EU economic and trade relationship will depend on a partnership of cooperation or a partnership of competition.

**Key words:** China-EU economic and trade relationship trade conflict trade unbalance policy dialogue

The core China-EU relationship today remains trade and investment. The bilateral trade and investment started from a very low level, and through more than 30 years development, have reached an ever high peak, especially after entering into the 21<sup>st</sup> century. The rapid growth in trade has been provided solid ground for the development of bilateral relationship, but also enhanced

the cooperation not only in the economic field but also extended to a broad spectrum. Both China and EU have been benefited in the rapid growth of trade, although they need to face the brewing difficulties, such as trade unbalance, trade conflicts. Even some Europeans treat China's dynamic economic development as a threat. In order to have a better understanding of China-EU trade and economic relationship, it would be useful to make a short review on where it started and how developed, after then we may find a track for the future sustainability.

### ***I. From Secondary Relationship To Strategic Partnership***

If we take a longer timing axle to observe the China-EU trade development, we can find that an earthshaking change had been happened. At the time when China and EEC had established their diplomatic relations in 1975, the trade volume between the two sides was only 2.4 billion USD in 1975<sup>①</sup>. At the end of 2008, the annual trade volume reached to 425.6 billion USD, 177 times increased since then! Graphic 1 describes the amazing development of the China-EU trade in 30 years.

Also if we try to understand the policy evolution of the China-EU trade and economic relationship, we cannot neglect a very important background — the path of the China's economic reform, especially the openness in the field of foreign trade, which has provided the essential prerequisites for the rapid development of the China-EU trade. If we compare with the Graphic 1 and 2, we can find the synchronous tracks between the China-EU trade and China's foreign trade.

Here we'd like to follow the short briefings on the important steps along the development of China-EU trade and economic relations.

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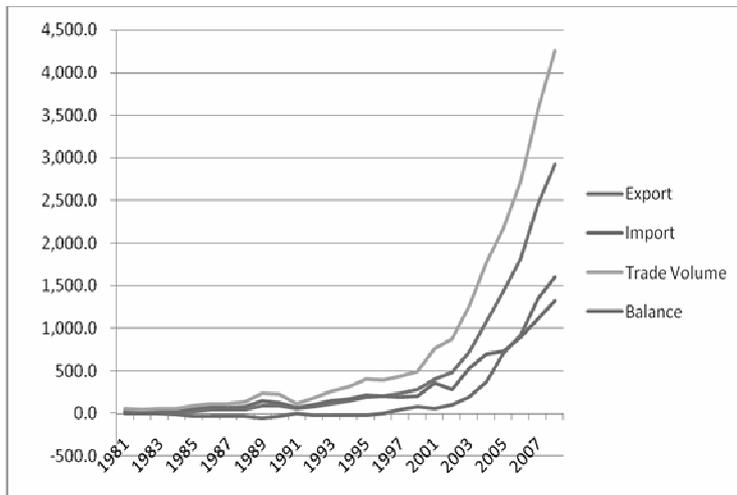
<sup>①</sup> Pei Changhong et al, "Ou Meng Yu Zhong Guo: Jing Mao Qian Jing de Gu Liang" (EU and China: Estimates on the Trade and Economic Prospects), She Hui Ke Xue Wen Xian Chu Ban She, 2000, p.30.

### 1.1 Waking-up and Warming in 1970s and 1980s

China and EEC had established their diplomatic relations in 1975. Due to context of Cold War, China and EEC were unlikely to prioritize economic interests on their agendas to develop bilateral links.<sup>①</sup> The bilateral relationship had a secondary and subordinate nature.<sup>②</sup> The trade volume was only 2.4 billion USD in 1975.

**Graphic 1 China-EU/EC Trade in 1981-2008**

(100 Million USD)

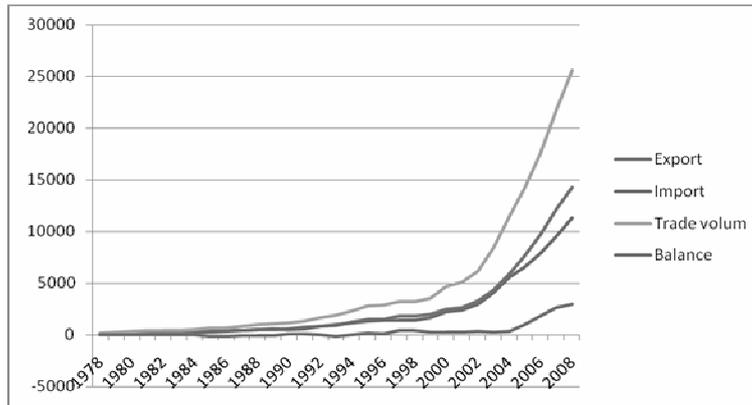


Resources: Data from the websites of China Customs and MOFCOM.

<sup>①</sup> Wu, Xian, 2004, "The Economic Incentives in the China-EU Partnership", in Zhou, Hong and Wu, Baiyi eds., "China-EU Partnership: Possibilities and Limits", Beijing: China Social Sciences Press, p.294.

<sup>②</sup> Shambaugh, David, 1997, "China and Europe: the Development from Secondary to an Independent Relationship", in Song, Xinning and Zhang, Xiaojing et.al., "China and Europe

**Graphic 2 China's Foreign Trade in 30 Years (1978-2008)**  
(100 Million USD)



- Resources:1. China Foreign Trade and Economic Yearbook 2007, China Statistic Publisher 2007;
2. Data of 2007 are from Statistic Communiqué on National Economy and Social Development 2007, National Bureau of Statistics of China, Feb 28, 2008;
3. Data of 2008 are from China Customs.

China started reform and opening process in 1978. And at the same year, China and EEC had signed the first trade agreement, which is the first EEC agreement with “state trading countries”.<sup>①</sup> Later it was replaced by a trade and cooperation agreement in 1985<sup>②</sup>, extended to the field of investment and development aid. In 1979, China and EEC had reached an agreement on textile products trade, and China entered into the GPS.

In the 1970s and 1980s, the aim of China’s foreign trade was to serve the national economic development. The purpose of export was to gain foreign currency in order to buy equipments and technologies for the national

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*towards the Twenty-first Century*”. Hong Kong: The Social Sciences Press, 1997, pp.33-34.

<sup>①</sup> Shan Wen Hua, “Ou Meng Dui Hua Tou Zi de Fa Lv Kuang Jia: Jie Gou Yu Jian Gou” (The Law Framework of EU Investment in China), Bei Jing Da Xue Chu Ban She, 2007, p.11.

<sup>②</sup> Which is also the first EEC trade and cooperation agreement with State Trading Countries. See *Ibid.*, p.11.

economic development. The state-owned foreign trade companies were in the dominant position in all export and import transactions. Shown by Graphic 1 and 2, the China's trade volume (including China-EC trade volume) was in a modest manner.

In 1978, China and EEC bilateral trade had reached 3.3 billion USD<sup>①</sup>, and in 1981 it had reached 5.3 billion USD, more than double to the year of 1975. In 1986, the trade volume had increased to 11.65 billion USD, more than twice as in 1981. A further jump happened in 1989, which reached 23.51 billion USD, and took 21.1% of the China's foreign trade volume.

### ***1.2 Downs and Ups in 1990s***

The increasing tendency had been stopped in 1990 and the even crashed down in 1991 to the half of the volume in 1989, because of the "Economic Sanction" made by EEC toward China due do the well known reason. Different member states had different opinion on how to develop relationship with China, but the interest in the Chinese market and the potential huge benefit on economic cooperation brought the EEC to reach a conclusion on the importance to develop relationship with China.<sup>②</sup> In 1992, EEC and China normalized the trade relationship (except arms trade).

The real increase of bilateral trade volume started from mid 1990s. After the decision of the CCP in 1993 on establishing the Socialist Market Economic System, Chinese economy started a dynamic growth. Since then reform measures had been implemented in China's foreign trade field. A milestone is that the Foreign Trade Law had been adopted by the China's National People's Congress in 1994, which provided an important impetus to liberalize the China's international trade, and broke the monopoly dominated by the state-owned trading companies. Private companies and JVs started to play more and more important role and to hold the growing proportion in China's external trade. Along with the increase of the China's foreign trade, China-EU

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<sup>①</sup> Wu, Xian, 2004, "The Economic Incentives in the China-EU Partnership", in Zhou, Hong and Wu, Baiyi eds., "*China-EU Partnership: Possibilities and Limits*", Beijing: China Social Sciences Press, p.302.

<sup>②</sup> Devuyt, Youri and Men, Jing, 2007, "*The European Union Transformed: Community Method and Institutional Evolution from the Schuman Plan to the Constitution for Europe*", Chinese Edition, Beijing: China Remin University Press, p.131.

trade was back to the growth track, both in terms of export and import (see graphic 1 and 2).

In order to provide fresh energy for the European economic growth, EEC expressed its wishes to enhance the cooperation with other parts of countries in the World. EC Commission's report "Towards a New Asia Strategy" in 1994 enhanced the position of East Asian countries in the EU diplomacy. China was highlighted as the focus of the New Asian Strategy. A year later, "A Long Term Policy Paper for European-China Relations" was launched by the EU, which opened a new chapter in the history of China-EU relationship.

In 1998, China-EU relationship entered into a new period. EU announced with its policy paper to building a Comprehensive Partnership with China, and also held the first EU-China summit in London (during the UK EU Presidency). Ever since, summits have been held on an annual basis, alternating between Beijing and the country hosting six-month rotating EU presidency at the time. They are attended by the Chinese prime minister and other relevant ministers and, on the EU's behalf, by the president of the Council of Ministers, the president of the European Commission and the High Representative for Common Foreign and Security Policy, as well as other relevant ministers and European commissioners. The last summit was held in Beijing in November 2007.

### ***1.3 Rapid Growth towards the "Honey Moon"***

Since 1998, the Community strategy has been regularly updated and re-evaluated in 2000, 2001 and 2003, leading to an evolution of the semantic terms used by the Community: from a 'global partnership' in 1998 to a 'mature partnership' in 2003, the characterization of this partnership has been endowed with a strategic dimension<sup>①</sup>.

Along with the Policy Papers and Communications published by EC/EU, China government published his first strategic paper on EU in 2003, "China's Policy Paper towards EU". Although it was 8 years later then the first EC policy paper toward China, it was the first Policy Paper for China's

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<sup>①</sup> Sautenet, Antoine, 2007, "The Current Status and Prospects of the 'Strategic Partnership' between the EU and China: Towards the Conclusion of a Partnership and Cooperation Agreement", *European Law Journal*, Vol. 13, No. 6, p.704-705.

government on specific region and countries. The importance is obvious.

The interactions between two sides brought the bilateral relations into a stable and rapid track. As Romano Prodi, the former president of European Commission said, EU-China relationship if it is not a marriage, at least it is a serious engagement.<sup>①</sup>

The development of China-EU economic relations is not only based on the rhetoric from both sides, but also relied on the real practices. From Graphic 1 we can see that, the real jump had been started from 2001, after China accessing into the WTO. EU became China's first trade partner in 2004.

In the field of investment, after China implemented Joint Venture Law in 1979, first European investor came back to China in 1980.<sup>②</sup> Following with hesitations and stagnations in 1980s, EEC's investment in China started a jump in 1992, and achieved the first peak in 1995, with contractual value 8 billion USD. Till the end of 1992, China has signed the agreement on protection and promotion of bilateral investment with 14 of 15 member states of EEC (except Ireland). In 2000, EU became the biggest foreign investor in China. EU's investment in China reached 5.15 billion USD in 2005, and accumulated 35 billion Euro till 2006.

The bilateral trade and economic relations had reached an ever high peak.

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<sup>①</sup> Romano Prodi, "Relations between the EU and China: More than Just Business", speech at the EU-China Business Forum, May 6<sup>th</sup>, 2005.

<sup>②</sup> Ibid., p.10.

**Table 1 EU investment in China 1986-2005**

**10,000 USD**

Year	Number of Projects			Contracted value			Actual investment		
	EU invest st (1)	All in in China a (2)	1/2	EU invest (3)	All in China (4)	3/4	EU invest (5)	All in China (6)	5/6
年度	项目个数			合同外资金额			实际使用外资金额		
	欧洲联盟	全国	比重%	欧洲联盟	全国	比重%	欧洲联盟	全国	比重%
1986	32	1498	2.14	35194	333037	10.57	17853	224373	7.96
1987	40	2233	1.79	42293	370884	11.4	5271	231353	2.28
1988	87	5945	1.46	28531	529706	5.39	15727	319368	4.92
1989	78	5779	1.35	33289	559976	5.94	18761	339257	5.53
1990	82	7273	1.13	22422	859611	3.4	14735	348711	4.23
1991	163	12978	1.26	75939	1197682	6.34	24562	436634	5.63
1992	763	48764	1.56	96360	5812351	1.66	24297	1100751	2.21
1993	1726	83437	2.07	318176	11143566	2.86	67124	2751495	2.44
1994	1464	47549	3.08	562958	8267977	6.81	153769	3376650	4.55
1995	1582	37011	4.27	741977	9128153	8.13	213131	3752053	5.68
1996	1167	24556	4.75	675922	7327642	9.22	273706	4172552	6.56
1997	1040	21001	4.95	422882	5100353	8.29	417115	4525704	9.22
1998	1002	19799	5.06	593938	5210205	11.4	397869	4546275	8.75
1999	894	16918	5.28	409566	4122302	9.94	447906	4031871	11.11
2000	1130	22347	5.06	885516	6237952	14.2	447946	4071481	11
2001	1214	26140	4.64	515284	6319455	7.45	418270	4687759	8.92
2002	1486	34171	4.35	450693	8276833	5.45	370982	5274286	7.03
2003	2074	41081	5.05	585432	11506969	5.09	393031	5350467	7.35
2004	2423	43664	5.55	836189	15347895	5.45	423904	6062998	6.99
2005	2846	44019	6.47	1E+06	18906398	6.10	519378	7240569	7.17

Resource: [http://www.fdi.gov.cn/pub/FDI/wztj/Intjsj/wstzsj/2005nzwgwtj/t20060906\\_61354.htm](http://www.fdi.gov.cn/pub/FDI/wztj/Intjsj/wstzsj/2005nzwgwtj/t20060906_61354.htm).

**1.4 Post “Honey Moon”: Certainty and Uncertainty**

In 2006, EU launched its new policy paper “EU-China: Closer Partners, Growing Responsibilities”, which requires to increase growing responsibilities when establishing closer partnerships. Together with the policy paper, EU published its first policy paper on EU-China trade and investment (“EU-China Trade and Investment: Competition and Partnership”), which emphasizes the competition factor in the China-EU trade and economic relations and raises tougher requirements against China. These documents had

been treated as turning point in the China-EU relationship.

Some scholars even consider that if the China-EU relationship could be taken as a marriage for metaphor, then the “Honey Moon” period was over. And only after the “blind honey moon” finished, the normal partnership can really start<sup>①</sup>. China-EU relationship enters into a period for adjustment.

Although the uncertainty emerges in the China-EU relationship, the bilateral trade volume still keeps its rapid growth tendency in the post “honey moon” period, as shown in Graphic 1. The trade relationship acted as the stabilizer for the China-EU relationship. Trade and investment is still the core of the EU-China relations<sup>②</sup>. In 2006 China became EU’s second trade partner after US. EU became the China’s first trade partner since 2004 and first export market and second import resource since 2007. China is the biggest manufactured products import resource of EU, and also the fastest growing market for EU export. On the comparison, two decades ago China and Europe traded almost nothing<sup>③</sup>.

After 30 years economic reform, the foreign trade had become an important driven role for the China’s economic growth. In the global trade in goods in 2008, China listed in the 3<sup>rd</sup> place, comparing to the 22<sup>nd</sup> in 1978<sup>④</sup>. Also in 2008, China had passed the US and became the global second largest exporter after Germany<sup>⑤</sup>. Following the scale of the expansion of China’s external trade, China-EU trade had reached considerable progress. As shown in

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<sup>①</sup> Dai Binran, “Shi Shi Geng Wei You Xiao de Dui Ou Zheng Ce” (Implementing more effective policy toward EU), in “Ou Zhou Yi Ti Hua de Zou Xiang He Zhong Ou Guan Xi” (The Trend of European Integration and Chia-EU relationship), Wu Yikang et al eds, Shi Shi Chu Ban She, 2008, p.286.

<sup>②</sup> Charles Grant, Katinka Barysch, “Can Europe and China shape a new world order?”, Center For European Reform (CER), London, May 2008, p.31.

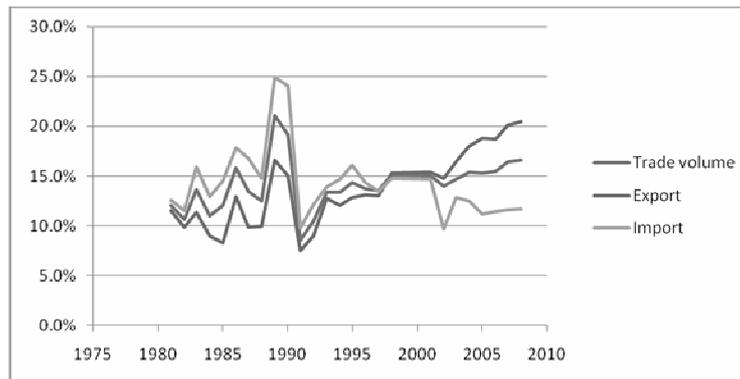
<sup>③</sup> European Commission, “EU-China trade in facts and figures”, MEMO/09/40, Brussels, 30 January 2009.

<sup>④</sup> Zhang Ning, Song Xianliang, “Zhong Guo Wai Jing Mao Fa Zhan: Gei Ge Kai Fang 30 Nian de You Shi Bian Qian”(The Development of China’s Foreign Economy and Trade: the evolution of the advantages in 30 years Reform and Openness), Guo Ji Mao Yi, issue 5, 2008, p.4.

<sup>⑤</sup> European Commission, “EU-China trade in facts and figures”, MEMO/09/40, Brussels, 30 January 2009.

Graphic 3, China-EU trade has experienced 3 times upside downs in the 1980s. Since 1991 the proportion of China's export to EU shows the climbing tendency, from the historic bottom in 1991 with 7.5% continuously climbing to peak with 20.5% in 2008. The proportion of China-EU's trade volume also climbed gradually to 16.6% in 2008 from 8.9% in 1991. The proportion of the import was maintained around 15% in the 1990s, and dropped back to 11-12% after China's entry into the WTO, and the scissors between the proportion of export and import is growing.

**Graphic 3 The Proportion of China-EU Trade in China's External Trade (%)**



Resources: Calculated by the author based on the data from the website of China's MOFCOM, <http://www.mofcom.gov.cn>.

## ***II. China-EU Trade and Investment in 2008***

After entering into 2008, China-EU trade and investment keeps the tendency of growth, but some adjustments can still be observed.

### ***2.1 China-EU Trade Volume Reaches the Historical Peak, both in terms of Export and Import.***

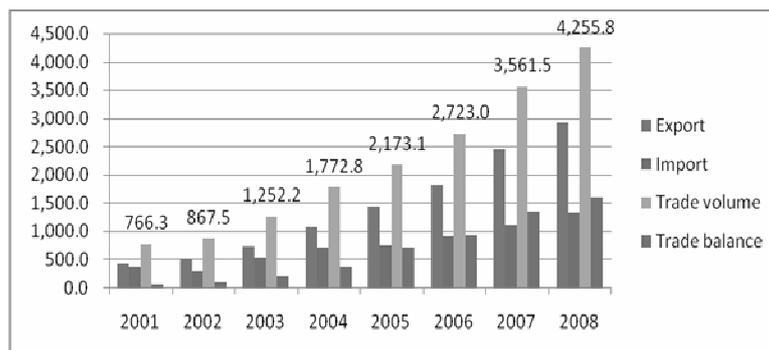
China's trade volume with EU27 was 356.15 billion USD in 2007, in which export was 245.19 billion USD and import was 110.96 billion USD. Till the end of October 2008, China's trade volume with EU27 in the year reached 359.37 billion USD, surpassing the level of 2007 both in terms of export and

import. By the end of 2008, China-EU trade reached 425.58 billion USD. EU27 is China's biggest export market with 292.88 billion USD, and second largest import resource with 132.70 billion USD (see graphic 4). The proportion of China-EU trade in China's whole trade volume is 16.6%. EU keeps the China's first trading partner since 2004, and widens the gap with China's second largest partner the US (13.0%) and the third one Japan (10.4%).

Although the trade volume is increasing, the annual growth rate drops to the lowest level since 2003 (Graphic 5). The average growth rate of China's export to EU between 2003 and 2007 was 38.7%, and the growth in 2008 was only 19.5%. The average growth rate of the import from EU in the last 5 years was 33.7%, and for 2008 it is 19.6%.

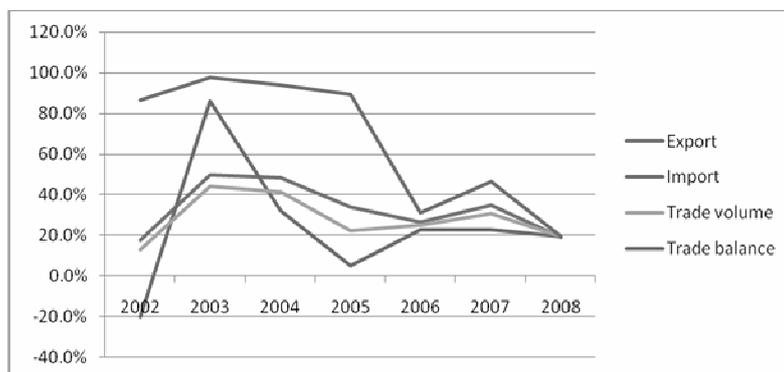
From the point of monthly growth rate, as shown in Graphic 6, the growth has been shown weakened in May of 2008, and since July the slip-down of the growth rate can be obviously observed. In October, the growth rate was 25%, lower than 27% in 2007 at the same period. After November, the decline of the growth rate is seen. This tendency will be kept in 2009, because of the lack of demand in European market due to the financial crisis.

**Graphic 4 China-EU Trade after China's Entry into WTO**  
(100 Million USD)



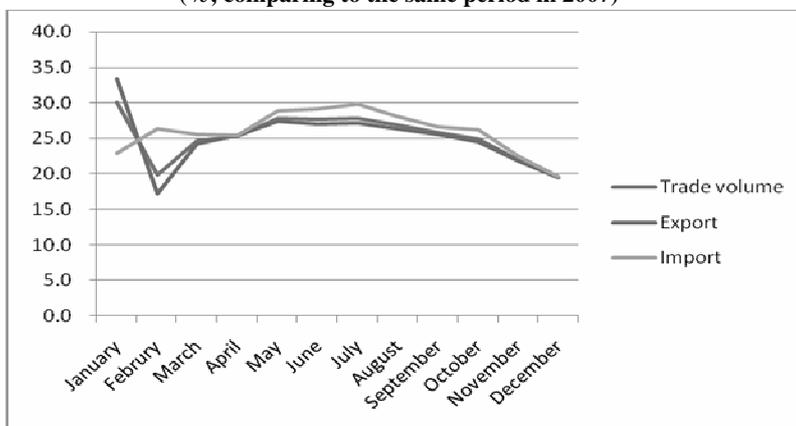
Resources: Calculated by the author based on the data from the websites of China Customs and MOFCOM.

**Graphic 5 Annual Growth Rate of China-EU Trade  
2002-2008 (%)**



Resources: Calculated by the author based on the data from the websites of China Customs and MOFCOM.

**Graphic 6 Monthly Growth Rate of China-EU Trade in 2008  
(%, comparing to the same period in 2007)**



Resources: Calculated by the author based on the data from the websites of China Customs and MOFCOM.

**2.2 EU Keeps as the Second Biggest Partner in China's Processing trade. The surplus in the processing trade continues increasing, but the growth slows down.**

The total volume of China-EU processing trade in 2007 was 146.78 billion

USD with a growth rate of 26.9%. It is increased to 166.47 billion USD in 2008, but the growth rate was dropped to 13.4%. The processing trade took 41.2% of the China-EU bilateral trade in 2007, 52.0% of the China's export to EU. In 2008 they are declined to 39.1% and 49.1% accordingly. The China's surplus in the processing trade with EU was 108.11 billion USD in 2007 with a growth rate of 32.1%, and took the share of 80.5% of China's trade surplus to EU in the year. In 2008, the surplus of processing trade increases to 121.23 billion USD, with a growth rate of 12.1% only, and the share of the China's surplus to EU decline to 75.7%<sup>①</sup>.

### ***2.3 On the Structure of the Trading Products, the Growth of the High Tech Products Declines, Textile Products Trade Increases, and the Export of High energy Consuming Products Decreases***

Although the European market is affected by the financial crisis, it is still the China's biggest export market of High Tech products, with a volume of 97.95 billion USD, and the growth rate is 15.2%, declined with 20.7%. High Tech products take 33.4% of China's export to EU in 2008.

On the textile products trade, as EU removed the textile products import quota in 2008, and China's government raised the rate of tax-refund of the textile product to 14%, the decline of the textile products growth had been stopped. In 2008, China's textile products export to EU reaches 38.84 billion USD, comparing to the 28.2 billion USD in 2007, with a growth of 37.7%. The proportion of textile products in China's export to EU rises from 11.5% in 2007 to 13.3%.

The China's export to EU of high energy consuming products such like steel, ferroalloy, steel billet, iron, alumni, bronze, cement, fertilizer etc, is 12,390 thousand Tones in 2008, with a decline of 43.2%. Among which the steel export was 7,689 thousand Tones, decline with 31.4%. This is because that on the one hand, China's macro-control takes the effect on the export of high energy consuming products, and on the other hand, starting from the second half of 2008, the prices of China's steel products export are higher than the similar products of Russia, which affected the China's export<sup>②</sup>.

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<sup>①</sup> Calculated by the author based on the analytic reports published on the website of China Customs. <http://www.customs.gov.cn>.

<sup>②</sup> Ibid..

**2.4 On the Member States Level, Germany, Netherland, UK, France and Italy Lead the China-EU Trade, and the Top Five's Volume altogether Reach 67.9% of the Whole China-EU Trade, a Slice Decrease from 68.8% in 2007.**

According to table 1, China-German trade is far beyond the other fours, reaches more than one quarter of China-EU trade. Among which, the China's export to Germany is around 1/5 of China's export to EU, and the proportion of import from Germany takes more than 40% of the total import from EU, and also more the sum of the other four member states! The surplus of China trade toward Germany takes the least proportion among the top fives.

China's export to Netherland reaches more than 15% of the its total export to EU on the one hand, and at the other hand, the import only takes 4% of the total import from EU, the China's trade surplus to Netherlands is the biggest among the EU member states, takes one quarter of China-EU trade surplus.

China's trade with UK is similar with Netherland, holds the second biggest trade surplus.

China's export to France is listed at the end among the top fives, but the import from France reaches number second. That's the reason why the China's trade surplus with France is less than 5% of the China-EU trade surplus.

China's trade with Italy is listed in the fifth, either in terms of trade volume, or export and import. They all take around 9%.

**Table 2 Top Five of the China-EU Trade in 2008 (%)**

	<b>Trade volume</b>	<b>Export</b>	<b>Import</b>	<b>Trade Balance</b>
Germany	27.0%	20.2%	42.1%	2.1%
Netherland	12.0%	15.7%	4.0%	25.4%
UK	10.7%	12.3%	7.2%	16.6%
France	9.2%	8.0%	11.8%	4.8%
Italy	9.0%	9.1%	8.8%	9.3%
5 in total	67.9%	65.2%	73.8%	58.1%

Resources: Calculated by the author based on the data from the websites of China Customs and MOFCOM.

***2.5 On the Investment, From the Number of the Newly Approved Investments from Main EU Countries to China, it is less than in 2007, but the Actual Volume of the Investment are much Higher than in 2007.***

The number of accumulated investments is 1844 projects from January to December in 2008, less 22.65% in 2007. The proportion of the total newly approved projects remains unchanged at 6%. The top 5 investors are Germany, UK, Italy, France and Netherland, the same as in 2007.

The actual arriving investments reach 4.99 billion USD, 30.12% higher than in 2007. The proportion remains the same as 5%, and the top five are then same as in 2007, namely UK, Germany, Netherland, France and Italy<sup>①</sup>.

***III China-EU Trade and Economic Relations at a Crossroad***

Although building up the China-EU bilateral trade and economic relationship was a success story, how to maintain this tendency and keep it in a right track is a big challenge for both sides. When the bilateral trade at a low level, the focus from both sides was on how to increase the trade volume and benefit from the development of the bilateral trade. But at the time when the bilateral trade has a dramatic growth rate and challenges ever high peak year by year, trade conflicts are inevitable if the trade is unbalanced.

From Graphic 1 we can find that in the 1980s and till mid 1990s, China had a trade deficit with EEC. Only since 1997, China became a trade partner with a surplus to EU, and the surplus was in a modest way till early this decade. China's entry into WTO in 2001 became a catalyst for China's foreign trade development, especially for China-EU trade. The bilateral trade started a dynamic development, and the China's surplus is growing due to the fact that the import growth rates are lower than the export growth rates, except in 2003 (Graphic 5). After annual 40% rapid increase in 2007, the trade surplus growth rate dropped down to 19.3% in 2008 with 160.18 billion USD. EU is the third resource for China trade surplus after Hong Kong and US.

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<sup>①</sup> Investment Promotion Agency of MOFCOM, <http://tzswj.mofcom.gov.cn/aarticle/g/200902/20090206021117.html>

On the other hand, China is the EU's fastest growing export market. According to EU statistics, EU exported 72 billion Euro worth of goods to China in 2007. Exports from EU to China grew by 75% between 2003 and 2007<sup>①</sup>. EU's export to China still cannot reach the speed of China's export to EU. The main surplus is focused in office and telecom equipment, textiles, light manufacturing, iron and steel.

International trade used to be treated as a "Zero Sum" game, one side wins in the trade and the other loses. Many people still believe that only the trade surplus is only good if their country runs a surplus and they fear that rising imports could cost them their job. Therefore, trade balances easily become a focal point of political attention<sup>②</sup>, and rather as the result of "unfair competition"<sup>③</sup>. However, focus on a single bilateral trade statistic fails to capture the complex trading relationships which exist in a world of globalization<sup>④</sup>.

China actively integrated itself into the international market and world economy with the entry into WTO, and at the same time promoted the arrangement of the labor division and capital flows in East Asia. Because China's has incomparable advantage of labor cost and favorable conditions for absorbing foreign investment, huge processing trade flows had arrived in China accompany with the capital flows from the countries and regions in East Asian economies like Japan, South Korea, Taiwan etc. China's export started an explosive expansion to the world markets. The trade surplus with EU is growing, and the trade deficit with East Asian economies is also increasing at the same time. On the other hand, because the mass production had been moved to China, these East Asian economies' trade surplus with EU is dramatically declined. In other words, these trading partners exported directly to EU with huge surplus before China's entry into WTO. Now they export semi products and parts to China, assembled and manufactured, then

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<sup>①</sup> European Commission, "EU-China trade in facts and figures", MEMO/09/40, Brussels, 30 January 2009.

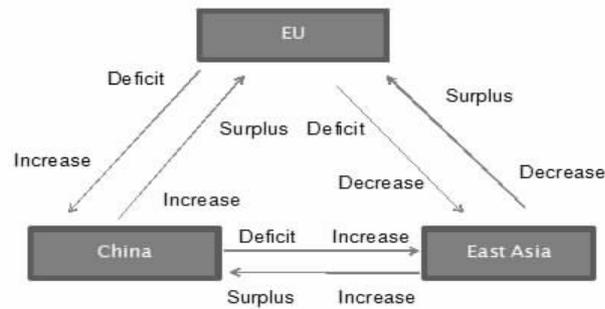
<sup>②</sup> Charles Grant, Katinka Barysch, Can Europe and China shape a new world order?, Center for European Reform (CER), London, May 2008, p.34.

<sup>③</sup> Andreas Freytag, The Chinese "juggernaut" – should Europe really worry about its trade deficit with China?, Policy Briefs, No.2, European Centre for International Political Economy (ECIPE), Brussels, 2008, p.2.

<sup>④</sup> Marcin Zaborowski edit, Facing China's rise: Guidelines for an EU Strategy, Chaillot Paper No.94, EU Institute for Security Studies (EUISS), Paris, December 2006, p.17.

export to EU as China's export. The trading pattern dramatically changed and economic integration deepened in East Asia. A trade triangle has been emerged among China, EU and the other main economies in East Asia (Graphic 7<sup>①</sup>).

**Graphic7 China-EU-East Asia Trade Balance-A triangle**



The relevant statistics supported this triangle model. China's export to EU increased from 23.8 billion USD to 245.2 billion USD between 1997 and 2007, 10 times growth in 10 years, and Asia's share of total EU imports has increased only very moderately by 10% over the last decade<sup>②</sup>. China became the world factory and assembly line, and replaced the other East Asian main economies export to EU<sup>③</sup>.

With the bilateral trade figures, it is not observed that in what extent the cheap and competitive Chinese products had made savings for the European consumers. When the former trade commissioner Peter Mandelson delivered a speech at Tsinghua University, he referred to one study from the Netherlands

<sup>①</sup> The model is based on a China-US-East Asia triangle model, which is described by Yang Zhengwei in *China's Foreign Trade and Economic Growth*, China People's Publishing House, 2006, p.375. The author of present paper verified with EU trade data, and found that there is a similar trade triangle among China-EU-East Asia.

<sup>②</sup> European Commission, "EU-China trade in facts and figures", MEMO/09/40, Brussels, 30 January 2009.

<sup>③</sup> Andreas Freytag, *The Chinese "juggernaut" – should Europe really worry about its trade deficit with China?*, Policy Briefs, No.2, European Centre for International Political Economy (ECIPE), Brussels, 2008, p.4.

which suggested that cheaper Chinese goods have saved the average European household around 300 Euro a year<sup>①</sup>. Also according to the OECD statistics, China's export to Europe made the inflation rate 0.2% lower in the Eurozone, which led to 60 billion USD savings a year for the EU consumers<sup>②</sup>.

With the bilateral trade figures, it cannot be observed that what the value-added part is in the China's export to EU. As well known, China's processing trade mainly locates at the end of the production chain, and the Chinese enterprises gain the little processing fees. When the product is exported, they are calculated on the price of the whole product, not the price which the value-added work produced. Therefore, in the price of the product export to EU after the processing manufacturing and assembling in China with the parts and semi products imported from other economies including from EU, the price of the imported parts and semi products is also included. China has the name of the trade surplus, but bears all the imported prices from other economies during the processing trade. It is not hard to understand that why China has huge trade deficit with Japan, South Korea. Besides, the foreign enterprises take nearly 60% of the China export to EU, including the EU enterprises in China. In the biggest category of the China's export to EU, the machineries and electronics, the Chinese enterprises can only gain the 10% of the sales, the other 90% sales are realized by the foreign enterprises in China. In the textile category, the profit of the Chinese enterprises is less than 5%.

With the bilateral trade figures, it cannot be observed that in what extent the European enterprises enjoy the huge opportunities in the Chinese market through their investment in China. East Asian economies' investment in China is mainly vertical, and the investment transfers the trade. European investment in China is mainly horizontal, and the investment replaces the trade. On the one hand, the spill-over impact of the foreign enterprises in China improved the competitiveness of Chinese products, and promoted China's export to EU. On the other hand, As the EU investment in China is growing, their local products are sold in China, which replaced the EU export to China and sharpened the China-EU trade unbalance<sup>③</sup>. Some Chinese scholars used the panel data to

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<sup>①</sup> Charles Grant, Katinka Barysch, Can Europe and China shape a new world order?, Center for European Reform (CER), London, May 2008, p.32.

<sup>②</sup> Speech delivered by Li Ruiyu, the Director General of the European DG, China MFA at a China-EU roundtable. <http://www.chinamission.be/chn/sgxx/t520462.htm>.

<sup>③</sup> Feng Lei, Wang Yingxin, "Zhong Guo Dui Ou Meng Mao Yi Shun Cha Yan Jiu" ( A Study

make an empirical research on the relationship between China-EU trade and EU investment in China. The results showed that EU direct investment in China is one of the reasons of the growing China-EU trade surplus<sup>①</sup>.

In general, China-EU trade surplus in some extent goes beyond the bilateral scope. On the one hand, what the EU facing is not a simple challenge from China, but from the fact of Asia's increasing economic integration. China may be a central pillar of this integration, but it is one part of a much broader phenomenon<sup>②</sup>. EU always treats itself as the model of regional economic integration, it should be well aware of the challenge. On the other hand, "China does behave in the way economic theory as well as Western politicians always have recommended"<sup>③</sup>, and fast integrated into world economy. When the western countries suddenly find that they are facing the China's export with a explosive growth, and the wealth flow changes from the hundreds years sole direction in favor of the developed countries, to the two way directions, they (including EU) are realizing that they do not be well prepared indeed<sup>④</sup>.

#### ***IV. Challenges for Future Stable Development***

China-EU trade surplus is mainly determined by the different level of economic development, industrial structure, competitiveness, international labor division and trade pattern at both sides. It cannot be turned in a short time.

China and EU still have reciprocity natures in trade and economic

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on the China's Trade Surplus to EU), <http://ies.cass.cn/Article/xshd/xshdds/200710/539.asp>.

<sup>①</sup> Ye Wenjia, Yu Jinping, "Ou Meng Dui Zhong Guo FDI Yu Zhong Ou Mao Yi Guan Xi de Shi Zheng Fen Xi" (Empirical Study on the Relations between EU FDI to China and China-EU Trade), *Shi Jie Jing Ji Yu Zheng Zhi Lun Tan*, no.4, 2008, p.27.

<sup>②</sup> Marcin Zaborowski ed., *Facing China's rise: Guidelines for an EU Strategy*, Chaillot Paper No.94, EU Institute for Security Studies (EUISS), Paris, December 2006, p.18.

<sup>③</sup> Andreas Freytag, *The Chinese "juggernaut" – should Europe really worry about its trade deficit with China?*, Policy Briefs, No.2, European Centre for International Political Economy (ECIPE), Brussels, 2008, p.10.

<sup>④</sup> Inotai András, *Az Európai Union és Kina Kapcsolatai: Múlt, Jelen és Jövő*. In: Inotai András és Juhász Ottó eds., *Kína: Realitás és Esély – Tanulmányok Magyarország Kína stratégiájának megalapozásához*. Institute of World Economics, Hungarian Academy of Sciences together with Primer's Office of Hungary, Budapest, 2008, p.101.

development today. The way for the future stable development of the bilateral trade and economic relations is how to identify and utilize each side's comparative advantages.

EU is the largest source of China's imported technology. China had benefited a lot for its economic reform and development. Till September 2008, China has imported 28794 technologies from EU, and the accumulated contract values 116.72 billion USD<sup>①</sup>. Enhancing High Tech contented products export to China can exploit EU's advantages and promote further research and development of the products; at the same time it can make significant contribution to balance the China-EU trade. Unfortunately the EU's Arms Embargo on China has limited the scope and the extent of the High Tech contented products. Because of pressure from Washington, differences in the EU new and old member states, as well as the political leaders changes in France and Germany, the EU shelved the plan to lift the arms embargo. Till today, this binding has hindered possibility to increase the EU's export to China.

EU's Enlargement in 2004 and 2007 also mixed the picture on identifying the comparative advantages of EU. There is a big economic gap between the new and the old member states of EU. Most of the new member states are also relying on the processing trade and investment for their economic development. In some extent, they take the similar or little high position in the production chain than China. They are facing the challenges with the China's export, for example, in textile products and electronics, even in IT products.

The further challenge is that China is not willing to be always at the end of the production chain, not only because of the low added value, and also because of bearing the blame for others else. China had started adjusting the structure of the processing trade in 2007, switching from the labor intensive oriented production to capital intensive oriented production, and developing the High Tech and New Tech productions. Based on the guidance of the state industrial policy, the processing trade in the production chain started moving to an upper phase – the R&D development<sup>②</sup>. China begins changing the development

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<sup>①</sup> Ministry of Foreign Affairs, China, [http://www.mfa.gov.cn/chn/wjb/zzjg/xos/gjlb/European Union/default.htm](http://www.mfa.gov.cn/chn/wjb/zzjg/xos/gjlb/European%20Union/default.htm).

<sup>②</sup> Pei Changhong, "Zheng Que Ren Shi Wo Guo Jia Gong Mao Yi Zhuan Xing Sheng Ji" (Understanding the Upgrade of the China's Processing Trade), Guo Ji Mao Yi, no.4 2008, p4.

mode of the foreign trade, and preparing the shift from a big trading state to a big trading power.

Facing to the challenges, applying the anti-dumping and safe guard measures is not the way to solve the trade conflict. China now is the biggest target of trade defense investigations in the EU. The EU currently has 45 definitive and 3 provisional anti-dumping measures in force against Chinese import. These are over less than 2% of Chinese trade<sup>①</sup>. As the EU applies double standards in the issue of the Market Economy Status, and not provides MES to China, the unfair replacement mechanism used to be implemented when the anti-dumping case was initiated. As the result, the high anti-dumping tax could be manipulated. MES becomes an economic barrier for EU to protect self interests in the China-EU relations, losses its fairness, and the anti-dumping measure has more description feature. At the same time, some EU companies are aware that EU does not recognize China's MES, and plays the EU anti-dumping measure for its own business purpose.

During the rapid development of China-EU trade and economic relations, although the partial trade conflicts exist, both sides prefer to apply bilateral dialogues for solving the problems. Multi level trade and economic dialogue system has been established, including Economic and Trade Joint Committee (ministerial level), Trade Policy Dialogue (vice-ministerial level), Trade Balance Dialogue (vice-ministerial level), Competition Policy Dialogue (vice-ministerial level). Besides, China and EU started policy dialogues and workgroup discussions in more than 40 areas. The set of dialogues provide active contributions to the healthy and stable development of the China-EU trade and economic relations. The China-EU High Level Trade and Economic Dialogue lead the bilateral trade and economic relations to a more strategic level.

#### ***V. Concluding Comments***

The China-EU economic and trade relationship started from a secondary and subordinate status, had reached an ever high peak with the strategic partnership. Building up China-EU economic and trade relationship is a big

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<sup>①</sup> European Commission, "EU-China trade in facts and figures", MEMO/09/40, Brussels, 30 January 2009.

success. The trade balance does not necessarily reflect the real benefits of the two sides. A set of dialogue mechanism has been established in order to provide the channels for solving the trade conflicts. The future of the China-EU economic and trade relationship will depend on a partnership of cooperation or a partnership of competition.

From the second half of 2008, the financial crisis reached EU, and EU's economic growth declined, which affected China-EU trade. The tendency will go on in 2009. At the time of recession, how to overcome the difficulties, get rid of the crisis, recover the economic growth, these are the common concerns on both sides. Enhancing the dialogue mechanism, reducing the trade conflicts and regaining the market confidence should be the policy choice for China and EU.

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