China and the EU: The contradictions of exercising joint trade leadership

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China and the EU seem condemned to each other in matters of global trade and investment. In world trade, there are only three potential ‘leaders’ – China, the EU and the US – with ‘critical mass’ in trade and, in varying degrees, foreign direct investment. One of them has shaken off responsibility and ownership.

All other trading partners are relatively small. Japanese goods trade is only a third of the EU’s and in services, a fifth. Other countries, including India, have smaller shares still. The second layer of trading economies (from Japan and Korea to Canada, Mexico, Brazil or Australia and Singapore or other ASEAN countries) understandably looks to the EU and China for leadership and the forging of alliances to maintain an open world economy. A major segment of this second layer has concluded TPP-11, a credible signal that these countries would be ready to join an alliance to uphold an open global economy.

The EU and China recently provided verbal pro-trade leadership in similar speeches by Chinese and European leaders. Both have a strong interest in the stability of the international trade system and – with all its shortcomings – in the worldwide cobweb of bilateral foreign direct investment relations, given the global and regional value chains and the forceful pro-development and efficiency effects they have yielded. Millions of EU jobs depend on the bloc’s external trade and FDI – three million or more on European goods exports to China alone.

Awareness vs action

However, recognising that the two economies should work together to exercise this leadership beyond ‘management by speech’ is one thing. Realising effective cooperation with trade partners to render the World Trade Organization system more robust and to withstand the disruptive bilateralism originating from Washington is quite another.
The cardinal difference between the current US tactics of impatient confrontation and reckless bilateral punitive approaches – blended with a dose of unpredictability – and the strategies of the EU and China is that the latter are cooperative and diplomatic. They have annual summits and a huge multi-tier and dialogue-based machinery that generates a fair amount of useful low-key cooperation.

**Can the EU and China jointly exercise effective global trade leadership?**

Beijing has shown little leadership in the lengthy Doha Round. The same goes for the recent WTO ministerial in Buenos Aires. China will have to get used to not following its mercantilistic instincts first when trying to sway trade partners into accepting a reform of the WTO. If China wants trade partners to follow its leadership, it will need to bind itself much more convincingly and promote the market-oriented spirit of the WTO where the literal texts are somewhat vague or incomplete.

Unlike the Belt-and-Road project, this is not a question of money. The EU favours WTO reform but, so far, has worked somewhat informally with the US and Japan about it. This trilateral approach results mainly from longstanding frustration over China as a WTO partner.

**Chinese system is in the crosshairs**

One expression of this is the substantive support by the EU and Japan of the March 301 case by Washington on involuntary technology transfers imposed by China on US and other trilateral companies and related issues. Rather than bickering endlessly with China about many aspects of market access and specific elements of the country’s unusually tight FDI regime, the recent U-turn consists of regarding China as a ‘systemic’ trade and investment issue.

The question is whether China’s “socialist market economy with Chinese characteristics” is compatible with the letter and spirit of the WTO. Both the fundamentals of the ‘socialist market economy’ – with state ownership as ‘the leading force’, extensive and pervasive control by one party over the boards of state-owned and 150,000 private companies, planning at all government levels and in most sectors, with binding controls – and its ‘inner dynamics’ of the last (say) 15 years culminating in highly interventionist industrial policy, trade policy and inward as well as outbound FDI are seen as deeply worrying and indeed damaging for developed and emerging economies.

Joint trade leadership by Brussels and Beijing cannot possibly avoid combining the EU-China trade and investment agenda, the forging by China and the EU of alliances actively supporting stabilisation (rather than disruption) of an open world economy, and the WTO reform agenda. Effectively managing this combination, full of contradictions, is an extremely tall order.
How far will China go?

The EU and China formed a working group on WTO reform following their summit in July, an expression of the cooperative approach. To what extent can one expect Beijing to agree on new and revised WTO rules that would discipline a number of fundamental features in its economy?

If the first soundings of the reform debate are anything to go by, China is likely to be cooperative when resolving the problem of e.g. the Appellate Body. But it seems more than reticent to begin to address the fundamentals. For the EU and other partners, however, if China would play the reform game as they have too often done it at home, partners will begin to fall back on policy actions that mitigate or pre-empt damages. The upshot would be a new salvo of restrictions in the world economy. That, in turn, might also undermine joint leadership. A devilish dilemma.

Still, China has benefitted enormously from the WTO, and this enlightened self-interest might ultimately prevail for an overhaul of the global trade body.