

N O V E

EU-CHINA RELATIONS

Landscape ahead of the 2019 EU-China Summit

APRIL 2019

CONTEXT

In recent years, the EU approach—at least in the Commission—has pivoted away from discussing China as an opportunity, instead reframing it as a challenge. This note outlines the most important initiatives being taken by the EU to ensure that China remains a complicated friend¹ rather than a dangerous enemy in the lead up to the **21st EU-China summit on 9 April 2019**, the most important date on the annual calendar between the two partners.

The Summit [agenda](#) is packed, covering a broad range of issues from global governance at the UN and G20, to human rights and foreign security concerns. While some reports predict that little of substance is likely to emerge, **the EU enters this year's summit with two strategic priorities:**

- (1) Maintain **EU competitiveness vis-à-vis China** (particularly in light of European [dependence](#) on Chinese ICT products); and
- (2) Ensuring **security** in its telecommunications infrastructure.

The **EU institutions have turned away from trying to change Chinese behaviours** (for example in trade, industrial policy, or data privacy) and have demonstrated a will to be more aggressive and defensive going forward. This is because while China ten years ago sought acceptance into the multilateral system as a “normal” state, it now seems fully committed to its role of the rebel as a stance that better serves its strategic interests. Beijing is buoyed by continuing growth and trade dominance which it attributes to its own unique economic approach, reliant on a strong role for (often unofficially) state-owned enterprises. Its recent show of resilience in the face of tariffs from the US has added to this confidence

Unable to depend on China to make the necessary reforms, **the EU has turned to unilateral actions**, adopting [reformed trade defence instruments](#) and a framework agreement for the screening of foreign direct investment², aimed squarely (albeit officially “country-neutral”) at a perceived threat of Chinese ownership of some of Europe's most important strategic infrastructure and technology sectors. 2019 promises to be a banner year for such moves, even if actions aimed at addressing the specific threat of foreign ownership of telecoms infrastructure and the cybersecurity of 5G—both at the top of the agenda—have been less coherent.

Critics [argue](#) about where legitimate security concerns end and protectionism begins. Others [downplay](#) the security threat China poses, preferring to accept desperately needed investments, come what may.

JOINT COMMUNICATION ON EU-CHINA RELATIONS

On 12 March 2019, the Commission presented “EU-China – A Strategic Outlook”, a joint [communication](#) prepared by the Commission and High Representative of the Union for Foreign Affairs and Security Policy,

¹China is the EU's largest trading partner and bilateral investment flows are strong. China recently announced it will establish a China Chamber of Commerce to the EU.

² The EU Framework Regulation for the Screening of FDI [became law](#) in April 2019, with its provisions entering into force in October 2020. The idea is to provide Member States with guidance on how to screen investments from third countries in strategic sectors, where such investments could cause a threat to public order and security. The Regulation incentivizes Member States to set up screening mechanisms (so far, only 14 have them in place) and enforces information-sharing obligations on EU Member States. It does not create any new screening mechanism, either at national or EU level. As part of this process of making the EU more aware of FDI flows, the Commission also published the first [annual report](#) on inward FDI flows in the EU, showing the overall increase over the past years in Chinese investment. However, a separate independent [study](#) showed that Chinese FDI in the EU has actually fallen in the past year.

Federica Mogherini. The document was meant to form a **basis for discussion among EU Member States in view of the EU-China Summit**.

It presents China as four things, namely:

- (1) A **“cooperation partner”** with closely aligned objectives;
- (2) A **“negotiating partner”**, with whom finding a balance is key;
- (3) An **“economic competitor”** pursuing technological leadership;
- (4) A **“systemic rival”** trying to alter global models of governance.

With whom the following overarching objectives will be pursued:

- Deepened engagement to promote common interests;
- More balance and reciprocity in the economic relationship;
- Action by the EU “to adapt to changing economic realities and strengthen its own domestic policies and industrial base”.

The communication goes on to list **10 “action points”** to fulfil those objectives. Of them, the first three³ fit more into the older “China as an opportunity” narrative, calling for cooperation on international security and climate change. As of Action 4, however, EU scepticism about China’s international industrial plans (particularly through the Belt and Road Initiative⁴) is apparent:

“Action 4: To preserve its interest in stability, sustainable economic development and good governance in partner countries, the EU will apply more robustly the existing bilateral agreements and financial instruments, and work with China to follow the same principles through the implementation of the [EU Strategy on Connecting Europe and Asia](#).”

The rest of the actions read like a shopping list of how the EU will counter Chinese economic influence:

- 5 In order to achieve a more balanced and reciprocal economic relationship, the EU calls on China to deliver on existing joint EU-China commitments. This **includes reforming the World Trade Organisation⁵, in particular on subsidies and forced technology transfers, and concluding bilateral agreements on investment by 2020**, on geographical indications swiftly, and on aviation safety in the coming weeks.
- 6 To promote reciprocity and open up procurement opportunities in China, the European Parliament and the Council should **adopt the International Procurement Instrument** before the end of 2019.
- 7 To ensure that not only price but also high levels of labour and environmental standards are taken into account, the Commission will publish **guidance by mid-2019 on the participation of foreign bidders and goods in the EU procurement market**. The Commission, together with Member States, will conduct an overview of the implementation of the current framework to identify gaps before the end of 2019
- 8 To fully **address the distortive effects of foreign state ownership and state financing in the internal market**, the Commission will identify before the end of 2019 how to fill existing gaps in EU law.
- 9 To safeguard against potential serious security implications for critical digital infrastructure, a **common EU approach to the security of 5G networks is needed**. To kickstart this, the European Commission will issue a Recommendation following the European Council.
- 10 To detect and raise awareness of security risks posed by foreign investment in critical assets, technologies and infrastructure, Member States should ensure the **swift, full and effective implementation of the Regulation on screening of foreign direct investment**.

³ Action 1: The EU will strengthen cooperation with China to meet common responsibilities across all three pillars of the United Nations - Human Rights, Peace and Security, and Development.

Action 2: In order to fight climate change more effectively, the EU calls on China to peak its emissions before 2030, in line with the goals of the Paris Agreement.

Action 3: The EU will deepen engagement with China on peace and security, building on the positive cooperation on the Joint Comprehensive Plan of Action for Iran

⁴ The Belt and Road Initiative (BRI) aims at improved infrastructure, trade, and investment links between China and some 65 other countries (together over 30% of global GDP, 62% of population, and 75% of known energy reserves). The BRI is still evolving and is open to all countries and international and regional organisations.

⁵ Brussels considers a reform of the WTO crucial to keep China in check. Following the Summit, European Council President Donald Tusk shared that EU leaders hoped to persuade China to include industrial subsidies as part of WTO reform. It is this aspect of WTO trade rules—the “special and differential treatment clause” under which China justifies its overcapacity production and domestic subsidies—that China, according to the EU and other allies such as Japan, exploits for unfair trade gains. The China-EU WTO Reform working group can be a vehicle for this. Brussels may also be able to advance reform by persuading the US to join its cause and as a consequence, China to compromise – the EU-US-Japan “trilateral” is particularly important in this regard. The trick will be to convince Washington that it cannot address Chinese dominance alone.

The swift steps taken by the European Commission and Member States show that the Joint Communication was more than rhetoric. Rather than look at all action points mentioned in the document – many of which refer to ongoing or even complete legislative/political processes e.g. on WTO reform (Cf footnote 4) and FDI screening (Cf footnote 2) – we will focus on two initiatives which clearly derive from the recommendations within the joint communication.

PROCUREMENT

Most notable, perhaps, is the [call](#) by EU leaders at the 21-22 March 2019 European Council (where the Communication was discussed) to **relaunch the [International Procurement Instrument \(IPI\)](#)** (see action 6), a piece of legislation that Member States have essentially been sitting on since 2012.⁶ The IPI proposes a mechanism whereby the EU could exclude companies from its procurement market (the world's largest, worth €2 trillion per year) on the basis of reciprocity. The IPI proposal foresees three steps:

1. In cases of alleged discrimination by a third country of EU companies in foreign procurement markets, the Commission initiates a public investigation.
2. Should this investigation find discriminatory restrictions vis-à-vis EU goods, services and/or suppliers, the Commission will “invite the country concerned to consult” on the opening of its procurement market – forcing countries to open procurement being the main focus of the law. This “consultation” can also happen in the context of an international trade negotiation, should one be ongoing.
3. As a last resort, the Commission can, after consultation with Member States, apply a price penalty to bids from the targeted country with a total value of at least €5m, provided that at least half of its goods and services originate from the third country in question. The proposal suggests inflating the given price for the tender in question by 20%, giving a competitive edge to EU and non-targeted countries' companies.

5G

No comment on EU-China relations would be complete without a discussion of the situation surrounding Huawei, and in particular, its perceived threat to European telecoms infrastructure and therefore data privacy standards. Already, the EU has forged a somewhat independent path with Huawei, [refusing](#) to bow to US pressure to ban the company from participation in construction of EU 5G infrastructure. Thus, including the protection of 5G networks (through some kind of “European model”) in the joint communication is hardly surprising (see action 9). The Commission followed through with the issue of a [Recommendation on the cybersecurity of 5G networks](#) on 26 March.

The Recommendation calls upon Member States to conduct cybersecurity risk assessments by 30 June 2019 which “should consider various risk factors, such as technical risks and risks linked to the behaviour of suppliers or operators, including those from third countries”, which it states will be “a central element towards building a coordinated EU risk assessment.” Furthermore, it lays out a plan for Member States, the Commission and the European Agency for Cybersecurity (ENISA) to complete a coordinated risk assessment by 1 October 2019. On that basis, Member States are to agree on a set of mitigating measures that can be used at national level.

The **European Parliament has also been active on this topic**, having voted through a [resolution](#) in early March 2019, specifically on the question of the threat of Chinese technological dominance and security concerns. The Parliament's asks are more or less in line with what the Commission has proposed, though they also call for extending the cautious, monitoring-based approach “to other critical sectors and services that are not covered by sector-specific legislation.”

⁶ Then, as now, some Member States (e.g. the UK and Sweden) blocked the progress of the legislation due to its perceived protectionism. In 2016, the Commission revised the proposal in an attempt to quell some specific concerns (e.g. by targeting large bids only) in the hope that the Member States could reach agreement. This did not transpire. Since then, the Commission has been heaping on the pressure, for example through the explicit mention of the file as a priority in both the 2018 State of the Union [letter of intent](#) and the 2019 Commission [Work Programme](#).

The EU's newly strengthened stance vis-à-vis China suffers somewhat from internal division.

On trade, it has already become clear that there is significant disagreement between the EU and certain Member States on how to manage the relationship with China. As was seen with the trade defence reform and FDI screening, **two groups of countries prove difficult to convince on taking a harder line**: liberally-minded northern Member States (e.g. Sweden, Netherlands) and southern/eastern countries (e.g. Italy, Hungary) dependent on Chinese investments. In the case of FDI Screening, Italy even attempted to block the measure. However, this bloc of countries has been weakened significantly with the (upcoming) departure of the UK, a liberal trade policy champion. Therefore, the passing of the IPI may now be more feasible than before, though in any case, it will have to wait: the European Parliament has already adopted a position on the file, but the Council has not, and there is no possibility to conclude trilogue negotiations before the end of this parliamentary term.

On industrial policy, the **tension** is between the (current) Commission's loyalty to market-driven competition policy as the best stimulant for industrial growth, versus the emerging Franco-German consensus on the need for the creation of European "champions". **Smaller Member States also tend to favour the Commission's approach**. This divergence was most obvious in the case of the Commission's decision to refuse the merger of Alstom and Siemens. With France, the loudest voice, calling for a more interventionist approach, this will be a key consideration for Paris when it comes to choosing a Competition Commissioner (as well as a Commission President). From the perspective of Berlin, Economy Minister Peter Altmaier has recently [spoken highly](#) of Competition Commissioner (and Commission President Candidate) Margrethe Vestager, indicating that Berlin may be more open to an EU-level approach, despite its moves towards a [domestic industrial policy](#) and its [joint initiative](#) with France. Of course, Berlin will also be hoping that the EU-level approach reflects the Franco-German position. [Draft conclusions](#) for a Competitiveness Council on 4 April 2019 see Member States again call upon the Commission to outline a 2030 vision for EU industry, but also ask for the EU competition law framework to be updated "to new technological and global market developments [and to] so as to provide the best possible conditions and enable it to compete globally on a level playing field." What this update will look like remains to be seen.

As for the question of **how much security concerns are misused as a thinly veiled protectionist measures** to stimulate European capabilities in sectors such as ICT, the shape of security measures (as above) on 5G by the end of the year will be telling. It is rumoured (and even [suggested](#) by current Commission VP Andrus Ansip) that the 5G rules are just the beginning of what will become a more wide-ranging project to develop **rules on "supply chain security"** that would [raise](#) more barriers to entry to European markets for foreign players. Member State activity in this direction is already happening, with Germany [publishing](#) stronger measures on cybersecurity in March 2019, while France is set to [discuss](#) the topic in a Ministerial meeting. A [position](#) from Germany, the Netherlands, the Czech Republic, Poland and Lithuania – published by Politico recently – also indicates that Member States are willing to coordinate with the Commission. Italy represents a bit of an enigma, recently becoming the first G7 country⁷ to sign up the BRI in March 2019, while simultaneously tightening FDI screening rules to defend against Huawei and 5G. It is reported that pro-China action is the work of the 5-Star Movement, while moves that tend to be cautious with China are at the behest of the Lega party.

As we move closer to the Summit, the real trick for EU leaders will be to emerge from these talks with at least the appearance of a unified stance on all things Beijing-related. Not only is this a matter of **internal coherence in the EU**, it is also key to ensuring that the **EU does not get left behind as the China-US relationship improves**. In an election year, and as trade, industrial, and investment policies face a serious reboot, many will look back to what emerged from this meeting as a pointer towards future policy priorities.

⁷ Note though that Italy is not the first EU Member State to sign a Memorandum of Understanding (MoU) under the BRI: Bulgaria, Greece, Hungary, Latvia, Poland, Croatia, the Czech Republic, Slovakia, Romania and Portugal have all done the same.