Europe and China should choose to cooperate with each other and China needs to adjust its policies towards multilateral economic mechanisms. A more important responsibility for China is to protect the international business policies and rules from erosion.

The Balance of Sino-European Economic Power: Managing Decline, Incline and Big-power Misconceptions

By **Fredrik Erixon**


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The human mind seems wired to gauge prosperity in terms of economic power – or the size of an economy vis-à-vis other economies. It is right at the heart of mercantilism – the system of power, still influential, that espouses the doctrine of accumulating wealth through ever-bigger trade surpluses. Power, for its disciples, is as important as plenty, if not more.

By historical standards, China's rise to the premier league of modern world economies has been smooth – surprisingly so, if one considers the scale and speed of its development, and the unsubtle mercantilist leanings in its economic policy. Yet China's trade and economic relations to other big economies are increasingly charged, and in the next decade there will arguably be much greater controversy around China's aspiration to become a leading world economy, perhaps the leading one. Mercantilist misapprehensions about "power and plenty" are again the source of friction – this time reinforced by the weak economic performance of the West.

Multilateralism as strategy for influence

Economists have for centuries been chronically vexed with people – surprisingly many, including famous scholars of geopolitics – that confuses the size of an economy with wealth. According to statistics from the International Monetary Fund, the country with the highest Gross Domestic Product (GDP) per capita is Qatar, a small Arab emirate with just a little more than 1.5 million citizens. All the other top five nations in this league are small economies without systemic importance for the world economy. Of the three biggest economies in the world, only one (the United States) qualifies to the list of the top 20 countries with the highest per capita GDP.

My simple point is this: people do not go to work every morning to expand the size of a country's GDP, but to improve their own welfare. They neither ask what they can do for the nation's economy nor what the nation's economy can do for them. They are active economic subjects because they want to improve their standard of living. None of this is to deny the importance of economic power for other societal ambitions such as peace and war. But many political leaders through history have made the error of judging their prowess in terms of relative economic size rather than prosperity.

Edward Gibbons noted in his magisterial study from 1776, The History of the Decline and Fall of the Roman Empire, that "the decline of Rome was the natural and inevitable result of immoderate greatness". In another great intellectual achievement of the same year – The Wealth of Nations – Adam Smith commented sardonically: "The rules of Great Britain have, for more than a century past, amused the people with the imagination that they possessed a great empire on the west side of the Atlantic. This empire, however, has hitherto existed in imagination only. It has hitherto been, not an empire, but the project of an empire; not a gold mine, but the project of a gold mine; a project which has a cost, which continues to cost, and which, if pursued in the same way as it has been hitherto, is likely to cost, immense expense, without being likely to bring any profit."

Adam Smith was proven right. But it took another 150 years or so before Great Britain had dismantled its empire (even longer if the exit from Hong Kong is included). From the end of the Second World War onwards, the guiding principle of its foreign policy was rather "managing decline", a derogative term for the adjustment to a new world order with less (and eventually no) emphasis on the imperial system. This was also true for other European countries such as France, whose imperial decline shrunk the size of the economy that it controlled.

Yet the post-imperial divestment evolved alongside the formation of new organizations and rules for global commerce and trade. These policy innovations helped to free up global commerce – also outside the imperial systems – and establish rules and norms to govern the international economy and international economic policy. They also spearheaded the economic globalisation of the past 50 years – the gradual geographic, functional and sectoral expansion of cross-border trade and investment. Many countries on the European continent went faster and farther. Starting with a Customs Union in 1957, an increasing number of European countries have jointly reduced, if not eliminated, barriers to cross border trade in the region.

Multilateralism and regionalism helped to maintain the clout that past European powers could draw from their relative economic size. New post-war international economic institutions were underwritten by the United States, but European countries conformed to American leadership, sometimes reluctantly, because at the end many believed they were the main beneficiaries of the new system. Equally important, these countries have increasingly accepted regional integration in Europe as a way to remain influential beyond their own borders. To maintain, let alone increase, Europe's influence in the world has been a leitmotif in many efforts to expand and deepen the European Union.

Yet China's rapid economic rise, and its aspiration of having a prominent seat at the table of multilateral economic institutions, has subtly introduced doubt in the U.S. and European outlook on the usefulness of multilateralism. Their tacit, unspoken quandary is about whom these organizations really should work for. While their readiness to lend high-minded support to the idea of multilateralism is yet uncontested, they increasingly cogitate its post-war history: the U.S. and Europe created multilateral economic institutions with the purpose of championing their view of the world economy and economic policy. Their hesitancy is amplified by China's ambiguous view of what it wants to use these institutions for – or, more generally, how it should deploy its newly acquired economic power. And European doubts are bigger than on the other side of the Atlantic. While multilateralism was an expedient strategy for influence in the post-war era, Europe is now rather meditating how its own relative decline, accelerated by the Eurozone crisis, now will diminish its multilateral influence. Multilateralism is no longer a counter-force to dwindling power by relative economic decline.

EU-China relations: economic convergence, political divergence

China has an irresolute approach to managing its incline. And Europe is erratically managing its decline. The distance between them is causing friction in trade and economic policy. How will this relation evolve in the future?

The good news is that the China-Europe relationship is too big, and too well developed, to fail. Bilateral economic exchange recovered quickly from the sharp drop in 2008-9, and bilateral trade, despite the overall contraction in the Eurozone, increased considerably in 2011. Even in the instance that the growth in trade and investment slows down in 2012, which is likely, the European Union and China will post a record high for bilateral exchange, provided the Eurozone does not blow up. The EU is China's biggest trading partner, and China is the second biggest trading partner for the EU. These basic observations have become increasingly important for economic and commercial policy relations between the European Union and China in the past year. Neither party will allow it to be fractured by serious economic and commercial policy conflicts. It is a sign of the maturity of the bilateral exchange that current volumes of trade and investment glue the relation together.

The bad news is that this defensive interest to protect past achievements is currently one of few things keeping EU-China relations in balance. The climate of EU-China policy cooperation has soured considerably in the past two years. Cooperation on trade and investment policy is fraught by misunderstandings, offended egos, discontent, and anger. In some quarters, and especially in Europe, frustration is reaching a boiling point. The EU-China High Level Trade and Economic Dialogue, which followed hard on the heels of the U.S.-China Strategic and Economic Dialogue (S&ED), has largely become dysfunctional, both as a forum for efficient, business-like negotiations on selective market-access issues and as a venue for forming joint strategic visions for future bilateral economic relations. In some policy areas, relations are not far away from a complete breakdown. Key officials do not speak to each other. E-mails and phone calls go unanswered.

Moreover, despite Wen Jiabao's recent defense of a Chinese role in the European Financial Stability Facility (EFSF) and >>

the smaller sums that have been contributed quietly, Europe's previous hopes of China accepting a greater paymaster role to Eurozone countries with wrecked public finances have withered away. The fact that China has rejected EU calls on investing more in the EFSF, disavowed past promises of considerable bilateral loans to individual crisis countries in Europe, and instead committed itself to increasing its financial support to the International Monetary Fund, is a sign of the frustrated bilateral policy relation between the EU and China. In effect, China has been disloyal to its own core strategy of dealing directly with Europe, preferably through national capitals in a way that allows Beijing to sweeten policy agreements with financial assistance or trade-promotion deals – or, if necessary, through dialogues with the institutions in Brussels. That China prefers to route new money to the Eurozone's crisis arsenal through a multilateral organization, and one it is suspicious about, is a measure of Beijing's dissatisfaction with Europe.

Both Beijing and Brussels seem content to wait for the new leadership in China to take office before they attempt to deepen economic and commercial policy cooperation. However, the hope that the bilateral relationship will radically improve under a new leadership in Beijing is naive. Individuals matter, but the problems in China-EU relations are rooted in divergent views on state, government and international economic policy. The economic crises in the past years have weakened EU-China relations. Yet their main effect has not been to provoke new economic disputes but to accentuate instincts and characters that were on display already before the global financial crisis.

The EU increasingly embodies Sisyphean traits in its economic and commercial policy posture towards China. Like Sisyphus, condemned to repeatedly roll a huge boulder to the top of a steep hill, the EU has time and again put pressure on China to open up its markets for European exports. Its approach has often been confrontational, threatening China with assorted sticks unless it catered to EU demands. But this strategy has had little payoff. Every time the boulder has approached the top, it has rolled back again. Some member state governments have supported this approach, which has allowed them to play the role of the "good cop". But the EU does not work when it is tasked to drum up protectionist threats. It has neither the treaty support nor the necessary policy tools to carry them through. For instance, the Commission's recent attempts to introduce a European version of the U.S. Committee on Foreign Investment in the United States (CFIUS), which screens all incoming investments for national security threats, cannot be squared by the Lisbon treaty. Equally important, taking on the role of arch mercantilist/protectionist in Europe goes against the ethos of the Commission. The role of the Commission has always been to find the balance between opposing camps in the EU membership – in this case between free trade and protectionism leaning countries –

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that allows Europe to gradually liberalise its foreign economic and commercial policy. Beijing knows this and has safely ignored the EU's threats and demands.

Sisyphus' perpetual struggle, said French author Albert Camus in the Myth of Sisyphus, has no chance of ultimate success but gives meaning to his life. It is an absurd meaning, but as long as he accepts the repetitious struggle, it gives happiness "enough to fill a man's heart". It may be surprising to some, but many EU politicians and officials are satisfied with the current approach to China, despite the lack of progress. As Camus ended his essay: "One must imagine Sisyphus happy".

China, on the other hand, is more like an Icaros. Having acquired serious market power in the past ten years, China flaunts its new fortunes in its relations with the EU (and others). But China is profoundly uncertain about what it should use its newfound economic power for.

Beijing's ambivalence is symptomatic of what has been a more general strategy of keeping a low international profile, biding its time and avoiding relationships with other big economies that could force China to (prematurely) change this strategy. But this policy does not befit an economy of China's size. When its core foreign economic policy seems confined to securing access to raw materials and maintaining a largely mercantilist trade strategy, it encourages other economies to mistrust China. As the United States in the 19th century, China has grown to become one of the giants of the world economy, but has yet to accept that its newly acquired systemic importance requires a corresponding and attendant responsibility for the international system of exchange. China's foreign economic aspirations remain an enigma: does Beijing accept a gradual but constant move towards a globalization based on market-economy principles and shared responsibility for a multilateral system of rules? Or does it want to rewrite that principle?

Admittedly, the question is somewhat metaphysical and unfair. China has largely been a loyal rules-follower during its ten years as member of the World Trade Organisation. Its more limited role in the IMF and the World Bank has more to do with incumbent (European) powers ineptitude to accept that the world economy has changed. Where China has been involved in writing the rules – like formative phases of G20 responses to the crisis – it has behaved constructively.

Yet there are real concerns over China's direction in international economic policy. And for the EU, the crisis has been a litmus test of China's loyalty to the international economic system. The EU was created by the same post-war trends of economic cooperation that midwifed the multilateral economic institutions. But most EU countries, in contrast to the United States, were neither capable nor willing to economically underwrite multilateral institutions. Europe received the benefits from U.S. Cold War economic leadership, but it conditioned its support on Europe receiving at least a proportionate share of the gains. Often it was unwilling to accept new trade or monetary deals when gains were unevenly spread between countries, even if the net outcome was positive for Europe. Europe championed for several decades the idea that it was the main beneficiary of the post-war system of international economic exchange. And many parts of Europe have yet not disassociated itself with that notion. Consequently, they believe it is unfair that China has gained much more than it has contributed. For many officials in Europe, the EU-China High Level Trade and Economic Dialogue started from the premise that China now would return on some of the gains. When Beijing made it clear that it was not prepared to dance to that tune, irritations in Europe exacerbated.

But China is not innocent in all of this. It has tried to bypass Brussels in its dealings with Europe. Beijing's officials often claim that they do not understand how EU politics work. This is partly understandable. Confusions about how the EU works have only increased as a consequence of the Eurozone crises. Its post-modern political personality has entrenched. While many other regions in the world still espouse a classic, Westphalian, modernist view on nation, state and government power, the EU has been in the rival business of substituting modernist government with post-modern governance. Governments in Europe have deliberately and willingly weakened their own autonomous authority and power, even when new pan-European structures of power have proven inadequate. National economic interests are now channeled through Brussels and arduous negotiations between EU member states. The EU is a political construct based on perpetual internal negotiations about what it can or cannot do. Chinese politicians, who are used to hard-power realities and schooled in a one-nation mentality, find working with a centralized Europe both difficult and threatening. In Beijing's view, the EU is unpredictable.

While the EU's complicated structures might be confusing, Beijing's bypassing of Brussels is at least partly deliberate. Beijing prefers to deal directly with big European capitals, even on those issues where policy has been clearly centralised to Brussels, because it has more leverage over individual governments than the Union as a whole. There are short-term gains for China from a divisional approach to Europe. A divided Europe will put less pressure on political change and economic reform in China. But a fractured Europe will have negative long-term consequences for China and its economic interests. Beijing has taken its big-power strategy too far for EU-China relations not to be weakened.

Icarus has a lesson for China. Daedaleus, according to the Roma poet Ovid, tells Icarus to keep to the middle range and don't fly too high. But Icarus, increasingly hubristic, wonders "what limits there are to his father's invention. He flaps his wings and rises higher – but nothing bad happens." Those watching Icarus from the earth assumes the winged creature is a god. What Icarus cannot see is that the wax melts. Soon he plunges into the sea.

Managing incline and decline

China has made a bad bet in assuming that its interests are better served by weak rather than effective centralized policies and institutions in Europe. The divisional strategy may work for yet another few years. But before long China will learn the same lesson as others in the past 60 years of global economic policy: a fractured Europe will be less reliable and predictable, and occupied by intra-continental squabbles rather than designing rules and policies for global commerce.

China's approach to multilateral economic institutions will have to change for its policy relations with Europe, and other parts of the world, not to be weakened. It will have to develop an authoritative idea of how China would like to see them evolve – and to a much greater extent accept that it also has to take a greater guardian role in protecting international commercial policy and rules from erosion. Only fools would argue that China already now possesses requisite economic, political and institutional capacities to compete with the U.S., and to a lesser extent Europe, to be a global economic leader. But for China to invite a greater degree of trust Beijing must rekindle its overall economic policy. The state mercantilist policies will have to be moderated – or preferably ditched. That is a big step – but managing a country's incline is often as demanding as managing a country's decline.

China's approach to multilateral economic institutions will have to change for its policy relations with Europe, and other parts of the world, not to be weakened. For China to invite a greater degree of trust Beijing must rekindle its overall economic policy. The state mercantilist policies will have to be moderated – or preferably ditched.

Europe, on the other hand, should accept that its influence in world-economy matters will be shrinking – even faster in the next ten years than in the past decade. But the loss of such power should not interfere with aspirations to expand welfare. The subtle turn to mercantilism in Europe will only serve to speed up its relative decline – and as soon it distances itself from such erroneous beliefs it will improve its capacity to grow its welfare. Its recent strategy of cajoling China to acquiesce to Europe's demands should be buried. It is leading nowhere and Europe's leverage over China has diminished fast. China's economy adds another Greece to world GDP every twelfth week. Many Eurozone countries will exit this decade in a poorer state than when the decade started. Such simple arithmetic suggests the EU choose a cooperative approach.

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