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What's Next for EU-China Relations?

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President Xi's visit to Brussels prompts the question: are China and the EU willing to rekindle their relationship, to fuse it with other energy than buoyant mercantilism and tangential political squabbles, the two defining characters of Sino-European relations in the past twenty years? The answer is not obvious. While diplomats on both sides miss no opportunity to talk up the importance of Sino-European relations and President Xi's visit, neither side has a clear idea what they actually want to do with each other.

Europe, weakened by the crisis and its long-term relative decline, is struggling to find its role in the new Asian century. It mixes free-trade optimism and grand aspirations with introvert protectionism and political grandstanding. The mercantilists are increasingly geared towards clinching deals with big economies and growth markets like China. Yet Europe's Dr Jekyll – worldly, cooperative, and problem solving – is all too often undermined by its Mr Hyde, a bureaucrat of primitive regulatory convictions whose mission is to expand Europe's regulatory dominion.

China, on the other hand, has not made up its mind if Europe fits into its map of global strategy, other than as destination for Chinese goods. Europe has no real influence on China's regional strategy – and it offers little attraction for Beijing's grand ideas about new big-power relations in the world.

Yet Europe represents a philosophy of international law and cooperation that is both enticing and challenging for China. Even if the post-1945 institutions for global cooperation have a European colour, it is dawning on China's strategists that such institutions and international law are expedient, if not indispensible, tools for rising powers. Europe remains far too over-represented in bodies like the International Monetary Fund or the United Nation's Security Council, but Beijing is not very active to canvass a new leadership role for China in global institutions because it does not yet have an idea what it wants to use its leadership for.

So the trajectories of China and Europe are not matching: China is on its way up while Europe's stocks in global power politics are falling. Inevitably, such diverging trends entail frictions. In the past decade China and Europe have soured on each other in areas like trade policy, climate change, and the ousting of regimes in Northern Africa and the Middle East. And as the their differences err on the fundamental rather than the marginal side, it is not obvious that there are gains to both sides from an attempt to charge the relation with new cooperative ambitions, going beyond the current arrangement.

Yet status quo is not an option either. Mercantilism – the desire to export more goods and services – is no longer the glue that can keep the relation together. Trade between China and Europe is no longer growing at the high levels witnessed in the past decades. While China's annual growth in export to Europe used to be in the region of 20 percent, it last year grew by 2 percent, according to preliminary statistics, and did not grow at all in the previous year. Weak economic growth in Europe is of course a key factor behind the slow growth of trade in the past years. But even if Europe's ailing economy is recovering, no one expects medium-term growth levels to be much higher because the continent is weighed down by high debts that will continue to mute demand and consumption for several years. And there is a structural dimension to the trade slowdown, too, that should worry leaders in Beijing and Brussels. Both Europe and China have problems of substantial overcapacity in several industrial sectors and both countries are in the process of adjusting to a world that is not going to grow as fast in the next 15 years as it did in the past 15 years. That adjustment will eat itself into the trade relation.

Moreover, there are visible signs that a good part of the structural potential for trade growth between China and Europe has been exhausted. Trade will continue to follow cyclical trends, but the fast growth of bilateral trade in the past twenty years had less to do with cyclical trends and more to do with the fact that China had opened up and that Europe stood to benefit quite substantially from the new competition coming from China. But the windfall of China's entry to the world economy can no longer carry trade growth alone. And absent new reforms that open up for trade and investment, it is difficult to see how trade between China and Europe can climb much higher.

Stalling trade growth is a problem for both sides. In contrast to the United States, general economic growth in China and Europe are more dependent on trade than on innovation. While U.S. growth is historically a factor of the "perennial gale of creative destruction" described by economist Joseph Schumpeter, growth in Europe and China has to a larger extent followed the model of Adam Smith: economic growth through specialisation and the exploitation of comparative advantages.

A "Smithian" model of economic growth depends on a continuing process of trade liberalisation and structural economic change. Neither China nor Europe has excelled in such reforms in recent years. China's economic attention has been focused on keeping up investments and monetary liquidity. In Europe, harsh fiscal realities has pushed it to deal with apparent problems in taxes and expenditures, but little has actually happened in terms of general economic reforms to boost productivity and competition.

So in an odd sort of way, the paths of China and Europe are crossing each other, even if the two are moving in different directions. This also presents opportunities for rejuvenating their bilateral relation. Even if it is desirable that the Sino-European relation deepens in several areas, the only force that in reality can drive better cooperation is economic integration. There is an obvious reform agenda knocking at the doors of China and Europe. And they can both empower that reform agenda with bilateral initiatives in the fields of trade and investment. Europe, like China, has a political structure that does not easily connect with economic reforms. With political tailwinds from international negotiations it can push countries to actually pursue reforms more forcefully.

President Xi's visit is a good time to begin a conversation between leaders about a new economic compact. The new leadership in China has the authority and inclination for it. And political leaders in Europe have begun to realise that the confrontational approach to China in recent years in trade and investment has delivered losses rather than gains.