CHINA – PARTNER, COMPETITOR, OR FOE?

ECONOMIC AND POLITICAL OPPORTUNITIES, CHALLENGES AND RISKS

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1. INTRODUCTION

> **"**China can take pride in its successes, in reducing poverty and opening up new opportunities for its people. Of course, you [China] still face many challenges. But if you keep moving on the path of reform, development, democratization and human rights, I am sure you will meet them", UN Secretary-General Kofi Annan congratulating China to its reform process in January 2004.[1]

China has been at the center of both political and public debates over the past years, views ranging from very optimistic about its new role in the world (such as Kofi Annan's statement above) to outright pessimistic or even fearful. Since China's rise to political power cannot be separated from its rise to economic might, the following paper will focus mainly on economic issues such as growth rates, domestic reforms, China's position in the world economy, bilateral trade and investment relations. We should take a closer look at economic developments because they largely determine China's future political prospects as well as its role in the international community. Furthermore, they fundamentally shape our perception of and interest in China. The first part of this paper will therefore highlight the opportunities as well as challenges and risks which go hand in hand with China's recent ascendance to power. The second part will describe Germany's relationship with China in the wider context of the EU strategy, contrasting this to the approaches of the US and Japan.

2. CHINA'S NEW ROLE IN THE WORLD ECONOMY

A Goldman and Sachs study (Dreaming with BRICS: The Path to 2050) predicts that at present growth rates, certain big developing countries such as China, India, Brazil and Russia will overtake industrialized countries in the next forty years. These BRICS, whose combined production today still falls under 15 percent of the G-6 economies (US, Japan, Germany, Britain and France), would account for over half the size of these countries by 2025. Of the current G-6, only the US and Japan would remain among the globe's six biggest economies in 2050. If China keeps up its growth path, the Goldman and Sachs report expects it to pass stagnating Germany in the next four years, Japan by 2015 and the US in 2039. Despite the fact that China's growth rate is expected to fall to 5 percent in 2020 and to slow down to 3.5 percent in the mid 2040s, high investment rates, a large labor force and steady convergence would make China the world's largest economy by 2041.[2]

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[1] See Secretary-General Kofi Annan in New Year's Greeting to Chinese People, < http://www.un.org/News /Press/docs /2003/sgsm9101.doc.htm>, Jan. 2004.

[2] See Dominic Wilson/Roopa Purushothaman, „Dreaming with BRICs: The Path to 2050", Goldman Sachs, Global Economics Paper No. 99, October 2003.

2.1 Opportunities and Growth Potentials

Over the past years, China has clearly risen to considerable economic and political might. Indices for economic power are: 1. the absolute size of an economy as well as 2. its relative size in comparison to other countries, 3. its integration into the international division of labor (trade and financial flows), 4. its membership in international organizations, 5. the role of its currency and 6. the competitiveness of its companies on world markets. In all of these areas, China has improved its position (performed) strongly. Over the past quarter century, China has grown by a striking 9 percent per annum. Growth rates increased considerably after Deng Xiaoping's market-opening reforms in the late 1970s, accelerated in the early 1990s under the reform concept of "social market economy with Chinese characteristics" and got another boost in recent years after China's WTO-accession. Today, China is the world's sixth-largest economy with a GDP of$1.4 trillion (2003). If measured by purchasing power, Chinas economy would even rank second in the world. With a market of 1.3 billion consumers and an enormous pool of inexpensive labor, China has already changed today's global trading patterns and investment flows.

About 15 percent of its total GDP results from agricultural production, 51 percent from industrial production, and 33 percent from services.[3]

China's GDP and Employment per Sector

	Origins from GDP in %	Employment in %
Agriculture	15,4	50
Industrial Production	51,1	23
Services	33,5	27

Source: The Economist, World in Figures, London 2004.

Thus, China is an important producer of agricultural products: It is the world's largest producer of cereal, meat, fruit and vegetables. It is also an important producer of commodities such as lead (rank 2), zinc (rank 1), tin (rank 2), aluminum (rank 1), coal (rank 1), cotton (rank 1), and raw wool (rank 2), to name just a few. But China is also an important user of these commodities, especially when it comes to energy: China – being the world's second largest consumer of energy, only surpassed by the US – is the largest consumer of coal and second largest consumer of oil worldwide.[4]

China's growth is generated primarily by its explosive trade. From 2000 to 2002 trade accounted for more that 50 percent of its GDP; in 2003 alone, total exports grew by 23 percent, imports by 31 percent. In 2003, China was the fourth largest global goods exporter ($437.9 billion) and third largest importer ($413.1 billion). China generated a considerable current account surplus of 3.2 percent of its GDP, which was the fourth largest surplus in the world in 2003(in 2004 it increased to 4.2%).

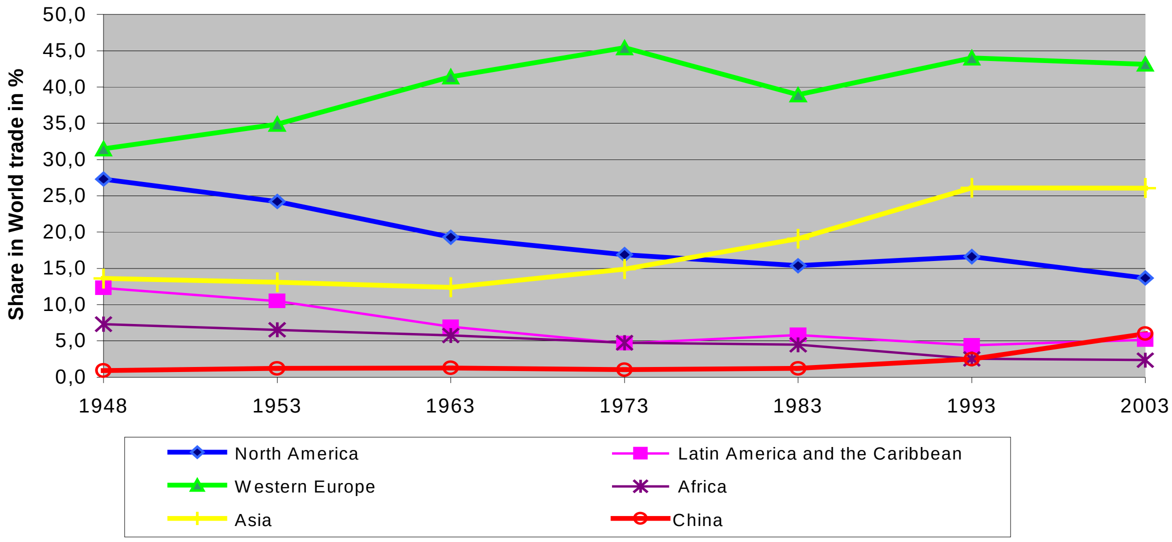
[3] See WTO, Statistical Database, <http://www.wto.org/english/res_e/statis_e/statis_e.htm>.
[4] See The Economist, World in Figures, London 2004.

The World's Largest Goods Exporters and Importers, 2003

Rank-ing	Exporter	Value in Billion $	Share in %	Annual Growth Rate in %	Ranking	Importer	Value in Billion $	Share in %	Annual Growth Rate in %
1	Germany	748.3	10.0	22	1	USA	1303.1	16.8	9
2	USA	723.8	9.6	4	2	Germany	601.7	7.7	23
3	Japan	471.8	6.3	13	**3**	**China**	**413.1**	**5.3**	**40**
4	**China**	**437.9**	**5.8**	**34**	4	GB	390.8	5.0	13

Source: WTO, Statistical Database, <http://www.wto.org>.

Furthermore, China's percentage of world trade has grown steadily. While it accounted for only 2.5 percent of global goods exports in 1993, its share in world exports has risen to almost 6 percent in 2003. Its share in world total imports amounted to 5.3 percent in the same year.



Share in Global Goods Exports of Selected Regions 1948-2004
Source: WTO, International Trade Statistics,<http://www.wto.org>.

China exports its products mainly to the US, Hong Kong, Japan and the EU, while it imports primarily from Japan, the EU, South Korea and the US.

China's Main Export and Import Destinations, 2003

Main Export Destinations	Share in %	Main Import Destinations	Share in %
United States	21.5	Japan	18
Hong Kong	17.4	EU	12.8
EU	16.5	Taipei, Chinese	12
Japan	13.6	Korea	10.4
Korea	4.6	United States	8.2

Source: WTO, Country Profiles, <http://www.wto.org>.

Manufactured goods make up around 90 percent of China's exports. Agricultural and mining products account for about 5 percent and 4 percent respectively. China's principle manufactured exports are apparel and clothing, office equipment, telecommunications equipment, electronic machinery, and footwear. Main imports are electric machinery, petroleum products, office equipment, other machinery, and telecommunications equipment.

China’s Main Exports and Imports in Billion US Dollar

Principle Exports	Exports in billion Dollar	Principle Imports	Imports in billion Dollar
Apparel and clothing	41.3	Electric machinery	55.4
Office equipment	36.2	Petroleum products	17.2
Telecom equipment	32.0	Office equipment	17.1
Electronic machinery	31.9	Other machinery	15.6
Footwear	11.1	Telecom equipment	14.2

Source: The Economist, World in Figures, London 2004.

However, China is not only a profitable trading partner. It is also an attractive market for investment. In 2003 alone, $54 billion in FDI flowed into China, accounting for about 9.5 percent of worldwide inward FDI flows (foreign direct investment) and 31 percent of inward FDI flows to developing countries. In 2004, China maintained its position as the number one most attractive FDI destination in the world, with investors showing high confidence in its economic and political developments.[5] Additionally, China now owns the second largest currency reserves worldwide ($600 billion).

Foreign Direct Investment Overview in Billion US Dollar

	1985-1995	1999	2000	2001	2002	2003
China						
Inward	11.887	40.319	40.715	46.878	52.743	53.505
Outward	1.591	1.775	916	6.884	2.518	1.800
Developing Economies						
Inward	50.773	231.880	252.459	219.721	157.612	172.033
Outward	21.520	21.620	75.488	98.929	59.861	44.009
World						
Inward	181.704	1.086.750	1.387.953	817.574	678.751	559.576
Outward	203.620	1.092.279	1.186.838	721.501	596.487	612.201

Source: Unctad, Country Fact Sheet China, <http://www.unctad.org/Templates/Page.asp?intItemID=2441 &lang=1>.

Due to the sheer size of its economy as well as its population, China will give a huge boost to both global demand and supply. As income increases in China, so will demand for imports. “The Economist” predicts that by 2020, the top 100 million households in China will have an average income equivalent to the current average in Western Europe if China’s economy grows by 8 percent a year and income distribution remains unchanged. This would create a vast market for consumer goods.[6] China’s economic growth will expand the size of global markets, create a greater scope for the division of labor, allow for greater specialization and lead to higher productivity worldwide.

Along with its rising economic power, China has become more assertive on the world stage, clearly demanding to have a voice in all important global issues. Moreover, many of these issues cannot be tackled without China such as the preservation of the environment, global

[5] See Unctad, Country Fact Sheet China, <http://www.unctad.org/Templates/Page.asp?intItemID=2441 &lang=1>.

[6] See „The Halo Effect“, in: The Economist, Sep. 30th 2004.

financial stability and poverty alleviation. Early this year, China sent one of the biggest delegations to the Davos World Economic Forum, and it will attend the up-coming G-8 meeting in July. Recently, China resisted US demands to give up its currency peg to the US-Dollar and revalue the yuan. It also stood firm in international negotiations on textiles, not quickly bowing to the demands of the EU and the US to restrict textile exports. After the US introduced safeguard quotas on seven categories of Chinese textiles, China announced on May 30 that it would scrap export tariffs it had introduced earlier this year on 81 textile products to slow down the surge in exports. Furthermore, China retracted its announcement to increase these taxes in 74 products up to 400% which it had made ten days earlier. China has also played a more assertive role in the WTO, which it joined in 2001. While China had been largely satisfied with observing and trying to better understand the WTO process rather than actively promoting new initiatives or filing complaints during the first few years after its accession, this has begun to change. China has been actively pressuring foreign governments on various trade measures such as US special safeguards in textile and apparel, Japanese farm measures or EU environmental barriers. It has also started to actively shape the negotiation agenda, being a member of the G-20, a group of influential developing countries, including Brazil and India. As China will gain negotiation power, it is further likely to file complaints with the WTO dispute settlement body.

China is also gaining political and economic influence in Asia. Thus, Southeast Asian countries have begun reorienting themselves towards China as their discontent with unilateral US policies has grown. Last November, China signed a trade agreement with ASEAN (Association of Southeast Asian Nations), which aims at implementing a free trade area by the year 2010. With a population of 2 billion people, this would be the world's biggest trading bloc. Even today, China and ASEAN have strong economic ties; during the first nine month of 2004, China-ASEAN trade increased by 35 percent. If this growth continues, China will soon replace the US as ASEAN's most important trading partner.[7]

2.2 Challenges and Risks

China's domestic development is characterized by six main features: 1. rapid social change (urbanization, modernization of institutions etc.), 2. economic bottom-up privatization, 3. economizing of the bureaucracy and of politics, 4. transformation of attitudes towards the state, 5. alteration of ideologies, and 6. change of political and administrative structures. This confirms that China is a market with great potential – including, however, risk potential, such as increasing social insecurity, rising unemployment, as well as growing regional and income disparities.[8] In spite of swift economic growth, China is still a developing country with an average per capita income of no more than 1000 dollars. In the UNDP human development index, China ranked only on place 104 in 2003. About 50 million people live below the pov-

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[7] See Claudia Decker/Stormy Mildner, „A New Geography in International Trade", in: Internationale Politik, Transatlantic Edition, Spring 2005.

erty line, many of them in the western provinces.

China's transition to a free market economy is still far from complete. While China has shown commitment to free market principles by joining the WTO and keeping its obligations thereunder, for instance removing import restrictions on steel, natural rubber, wool, acrylic fibers, and plywood by December 2004, the way from a closed to an open market economy and the transition from a rural society to an industrial or service society remains long and arduous. China is still a relatively closed economy: its average tariff on agricultural products lies at almost 20 percent, its average tariff for non-agricultural goods at about 11 percent. Concerning economic freedom (including non-tariff barriers to trade, corruption, rule of law, restrictions on banks etc.), China ranks only on position 129 of 161 evaluated countries worldwide.[9] China is also burdened with the world's second highest foreign debt ($247 billion in 2004), and is still the fifth largest recipient of bilateral and multilateral aid.

Needed reforms include a further restructuring of the 170.000 state-owned enterprises, which still accounted for half of the country's industrial output in 2002. Many of these companies make continuous losses due to redundant investment, overproduction, corruption and rising competition from private companies, which produce better products more efficiently. Although the economic standing of state-owned companies is decreasing steadily, they provide about two thirds of the jobs in urban areas. It is estimated that about 15 percent of their workforce is dispensable. Therefore, reforms will be both politically and socially challenging, increasing unemployment and widening disparity of income and wealth in the short-run. Equally difficult will be reforming the agricultural sector. Although this sector contributes only 15 percent to the GDP, it still employs 50 percent of China's workers. Here, the dispensable work force is estimated at 120 to 140 million people. Nevertheless, a restructuring of both sectors is desperately needed for healthy and sustainable long-term growth in China.

Further on the agenda is a restructuring of the banking sector; today bad loans and non-performing assets constitute more than 25 percent of the whole asset portfolio. Additionally, China's exchange rate policy must be revised. By pegging the yuan to the dollar at 8.28 since 1995, the Chinese government deliberately stimulated domestic growth as well as stabilized the economy, keeping inflation rates low and investor confidence high. While the currency peg underpinned the country's rapid economic growth and helped to stabilize financial markets during the Asian crisis in 1997/98, the situation has changed considerably today. Currently, the peg is creating more and more distortions in the economy: First, it prevents China from running an appropriate monetary policy, forcing it to import the lose monetary policy of the US, whereas its fast growing economy needs a tighter policy. Second, it sows the seeds for excess liquidity creation, asset price inflation, large speculative capital inflows, and over-investment. Third, too many resources are allocated to exports and too few to domestic demand. Fourth, the peg limits the ability of China's neighbors to follow independent, anti-

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[8] See Thomas Heberer, China's Domestic Development, China-EU Relationship, and EU-China Policies, <http://www.dgap.org/>, May 13th 2002.

[9] See Heritage Foundation, Index of Economic Freedom, <http://www.heritage.org/research/features/index/ChapterPDFs/chapter5.HTML>.

inflationary monetary policies because of competitiveness considerations relative to China. Poor countries which export and import similar products as China (such as Bangladesh or Cambodia) already suffer in their terms of trade, experiencing a steady rise of import prices and loss of export earnings. A revalued yuan could therefore temporarily lessen their adjustment pain. Keeping the currency undervalued and thereby accelerating global competition, on the other hand, increases resentment of Chinese imports – particularly in the US – and invites international irritation.

Clearly, the currency regime needs to change in order to ease current distortions as well as to allow China to cope with financial turbulences in coming years. Thus, China could either let its currency float or peg it to a basket of currencies with a wider band for fluctuations. In both cases, however, the Chinese government has to allow the yuan to appreciate in order to reduce domestic and international distortions. While an appreciation of the yuan will most likely slow down economic growth temporarily, China's exports have a high content of imported goods. Thus, its producers will clearly benefit from a lower yuan. Despite these domestic economic considerations, Wen Jiabao, China's prime minister, so far resisted foreign demands to revalue the yuan, stating that China's currency was an issue of "China's own sovereignty" and "any pressure or effort to politicize an economic matter will not help solve problems."

3. GERMANY AND CHINA

Given China's new role in the global economy, many countries – including Germany – see China as prospective economic partner. Chancellor Schröder recently emphasized about relations with China:

> "The China of today is not yesterday's China anymore. This is why the EU has implemented a new China strategy in fall 2003, and this is why the EU has decided to work towards lifting the weapons embargo. [...] During prime minister Wen Jiabao's visit to Berlin last year, we have agreed on a strategic partnership which means building up ties in all fields: politics, the economy, science and culture. [...] China has gained enormous political and economic clout in recent years. It is therefore also my duty to bring a country as dependent on foreign trade and payments as Germany into a close partnership with China. [...]."[10]

Germany is a country, which is highly dependent on international trade. Exports of goods and services account for about 35% of Germany's GDP. Export growth is particularly important in times of sluggish domestic consume and economic growth as Germany has experienced in the last years. Therefore, Schröder placed a great emphasis on opening up new markets – including China – for German goods and services as well as for investment, this being reflected in his many visits to China, which were accompanied by a multitude of business representatives. China is an important trading partner of Germany: Germany's exports to China amounted to almost $21 billion in 2004; imports from China added up to $32 billion. This makes China the 10th most important export market of Germany. With regard to imports,

[10] See „Rede von Bundeskanzler Schröder vor dem Deutschen Bundestag zum Waffenembargo gegen China", <http://www.bundeskanzleramt.de>, April 14th 2005.

China is Germany's 6th most important supplier. Outside the EU, China is Germany's second largest trading partner closely trailing the US and ahead of Japan.

Main Trading Partners of Germany in Million US Dollar

Trading partner	Imports	Trading Partner	Exports
	2004		2004
France	52,203	France	75,300
Netherlands	47,864	USA	64,802
USA	40,264	UK	61,057
Italy	34,963	Italy	52,441
UK	43,313	Netherlands	45,491
China	**32,455**	Belgium	41,164
Belgium	28,499	Austria	39,434
Austria	24,236	Spain	36,809
Switzerland	21,416	Switzerland	27,952
Japan	17,312	**China**	20,995

Source: Statistische Bundesamt, Rangfolge der dt. Handelspartner im Außenhandel, <http://www.destatis.de/download/d/aussh/rangfolge04.pdf>.

Since 1999, Germany has been China's largest European investor. By the end of 2003, Germany had invested about $9.3 billion in China, mainly in the chemical and automobile sector. Germany and China cooperate closely in the field of scientific research and technological development. Measured by the number of joint projects and financial volume, China is Germany's most important cooperation partner in this area.

The following economic interests can be identified: First, Germany aims at increased market access for its main export goods, including automobiles and machinery, as well as its services exports. Closely connected to this is a further liberalization of investment flows, allowing German companies to set up subsidiaries in China more easily. This goes hand in hand with investment protection as well as the protection of intellectual property. Therefore, Germany wants a more efficient implementation of the rule of law in China, particularly in the area of intellectual property rights. However, in order to ensure a long-term stable investment climate in China, Germany does not only advocate further market opening. Moreover, it has a great interest in economic stability in China, including macroeconomic stability and good governance. It therefore strongly supports economic reforms in China, including a reform of the banking sector. Lastly, Germany advocates environmental reform, not only with regard to international concerns such as global warming, but particularly with regard to domestic growth. Thus, environmental degradation, such as air pollution, can seriously hinder production and reduce productivity.

Accordingly, Germany aims at a strategic partnership with China not only in the economic, but also the political, cultural and technological sphere. Its overall China policy rests on three main pillars: 1. maintaining frequent high-level visits and exchanges as well as strengthening bilateral political co-ordination and co-operation; 2. expanding exchanges and co-operation in various fields and enhancing people-to-people communication; and 3. seeking common grounds, solving differences, and properly handling issues of common concern to maintain a healthy bilateral relationship. An important component of Germany's bilateral dialogue with China is the Rule of Law Dialogue (including the bilateral human rights dialogue). Under this dialogue, Germany provides assistance for reforms in the legal sector. Closely connected with this is the development cooperation between the two countries: Germany is the largest bilateral donor to China after Japan. Its development strategy focuses on the following issues: 1. environmental policy and conservation of natural resources, 2. economic reform and transition to a market economy, 3. water and waste management, and 4. rail transport and urban planning.

Relations with China are clearly dominated by economic aims and less – as in the case of the US – by security concerns such as the Taiwan question. Accordingly, Germany is a strong advocate of lifting the arms embargo, which Europe had implemented in 1989 in reaction to the Chinese military's killing of civilians in Tiananmen Square. Germany doesn't stand alone on this issue in the EU; altogether 16 states, including France, Italy and Spain, favor lifting the embargo. The German government argues that China has undergone considerable reforms, pursuing the right direction on human rights. It also points out that lifting the embargo – being more of a symbolic act than anything else – does not mean an actual increase of weapon sales to China. Moreover, the EU Code of Conduct would still prohibit sales of arms to countries that use it for internal repression or external aggression. Accordingly, China's human rights record as well as its willingness to use force against Taiwan would remain an important constraint for exports of strategic goods to China. Although Germany follows a One-China policy, it does not want to contribute to China's power capabilities and military intimidation of Taiwan. Lastly, the government highlights the many shortcomings and loopholes of the embargo, which already inhibit it considerably from effectively preventing weapon sales to China. Germany's support to end the weapons embargo has invited intense criticism from the US, further straining the already tense US-German relationship. The US criticized that increasing weapon sales to China would seriously endanger the balance of power in the region, regardless of whether or not China would actually make use of its military capacities.

Overall, Germany's perception of China is clearly positive, considering it as a long-term strategic economic partner. At the same time, Germany acknowledges the international economic risks an unstable China could pose to the world economy as well as the systemic international political and military risks. To confine these risks, Germany sees the best strategy in integrating China into the international community through multilateral and bilateral initiatives, financial and technical help, dialogues and cooperation. Thus, Germany follows a very institutionalist and diplomatic approach towards China.

4. THE EUROPEAN UNION AND CHINA

Concerning the EU-China relationship, the new EU Commissioner for Trade, Peter Mandelson, stated in February 2005:

> „To Europeans, more accustomed to seeing the world through the prism of the Atlantic than the South China Sea, [China's emergence] is arresting. Along with the rest of the world we are

reeling, trying to work out how to react. China's new strength has the potential to test the credibility of the multilateral trading and security system to the breaking point. [...] In the flush of its new power, Beijing could easily resent attempts to bring it properly into the system of international trading rules, or to pressure it on its global responsibilities. Those who see the nation's rise mainly as a threat will look closely for signs of that resentment. [However] they ignore the fact that China shows every sign of wishing to play by the rules."[11]

Political and economic ties between the EU and China have grown rapidly over the past years. On one hand, EU members are deepening their ties with China individually through bilateral dialogues and cooperation. On the other hand, they are intensifying their relationship with China collectively through the EU's institutionalized China policy. The EU has implemented a broad based, comprehensive strategy, aiming at a multidimensional and in some areas even strategic partnership. This partnership rests mainly on economic grounds. The EU is one of the top foreign investors in China. Investment by EU companies grew considerably: in the last five years they invested an average of $4.2 billion in China, bringing stocks of EU FDI to over $35 billion. Furthermore, with a share of about 12 percent, China is the second biggest supplier of EU imports worldwide, closely trailing the US. With regard to EU exports, China is the EU's third largest trading partner.

Main Trading Partners of the EU

Country	Share of all EU Imports in %	Country	Share of all EU Exports in %	Country	Share of all EU Trade (Exports+Imports) in %
USA	15.3	USA	24.3	USA	19.7
China	**12.3**	Switzerland	7.8	**China**	**8.8**
Russia	7.8	China	5.0	Switzerland	6.9
Japan	7.2	Russia	4.7	Russia	6.3
Switzerland	6.0	Japan	4.5	Japan	5.9

Source: European Commission, European Union and its Main Trading Partners, < http://europa.eu.int/comm/ trade /issues/bilateral/data.htm>.

While the EU enjoyed a trade surplus with China at the beginning of the 1980s, the EU-China trade relations are now marked by a sizeable and widening EU deficit. In 2004, the EU imported goods amounting to $157 billion from China, while it exported goods being worth almost $60 billion to China, leaving the EU with a deficit of about $97 billion. This deficit, which is the largest bilateral deficit of the EU, is particularly high in trade in machinery as well as textiles and clothing.[12]

[11] See Peter Mandelson, „China: Global Trade's Make-or-Break Player", in: South China Morning Post, Feb. 26th 2005.

EU Trade with China

Year	Imports of Chinese Goods as Share of Total EU Imports in %	Annual Change in %	Exports to China as Share of Total EU Exports in %	Annual Change in %
2000	7.47		3.01	
2001	8.30	9.7	3.42	18.6
2002	9.51	9.8	3.87	14.1
2003	11.24	17.6	4.69	18.1
2004	12.33	20.2	4.99	16.7

Source: European Commission, Bilateral Trade Relations, China, <http://europa.eu.int/comm/trade/issues/ bilateral/countries/china/index_en.htm>.

The EU-Chinese trade relationship rests on two pillars, the „EU-China Cooperation Program“ and the „Trade Policy Dialogue”. The cooperation program focuses on integrating China more closely into the world trading system. Thus, the EU firstly supports the Chinese government in carrying out its obligations and commitments under the WTO. Secondly, it assists China in implementing economic and trade policy reforms through technical assistance, particularly for training and institutional capacity-building. Main goals of the EU are: 1. further liberalizing trade in goods and services, 2. reducing barriers to investment flows (for example discriminatory registration requirements or arbitrary sanitary standards), and 3. enforcing intellectual property laws. While the EU has praised China for following its WTO commitments, it expressed doubt that China was upholding all of its commitments on services and automobile tariffs. The „Trade Policy Dialogue”, on the other hand, addresses various – often conflictual – issues in the rapidly-growing bilateral trade relationship such as trade in textiles and clothing. This dialogue aims at facilitating the exchange of views between China and the EU to create a better understanding about each other‘s positions on multilateral, regional and bilateral economic and trade issues.

Both initiatives largely reflect the EU’s general China policy, which is based on the European Commission’s policy paper “A maturing partnership: shared interests and challenges in EU-China relations”. This paper updated the EU’s “Strategy towards China: Implementation of the 1998 Communication and Future Steps for a more effective EU Policy” (2001) and the 1998 Communication “Building a Comprehensive Partnership with China”. The main goals of the EU’s China policy are: 1. to engage China further, both bilaterally and multilaterally, through an upgraded political dialogue, 2. to support China’s transition towards an open society based upon the rule of law and respect for human rights, 3. to encourage the integration of China into the world economy through bringing it fully into the world trading system, and 4. to raise the EU’s profile in China.

EU-China relations have been pursued under three main headings: 1. political dialogue (including human rights, global and regional governance, security issues etc.), 2. economic and trade relations, and 3. the EU-China Cooperation Program. Within the political dialogue, meetings take place regularly on all levels – from heads of governments to technical meet-

[12] See European Commission, Bilateral Trade Relations: China, <http://europa.eu.int/comm/trade/issues/ bilateral/countries/china/index_en.htm>.

ings of high officials. The annual EU-China summits aim at developing a strategic vision for the relationship, for instance by establishing a new dialogue on industrial policy or cementing China's participation in the EU's new satellite navigation system (Galileo). At the last summit in late 2004, a 'Joint Declaration on Non-Proliferation', as well as agreements on peaceful nuclear research, customs operation and the prolonging of the 'Science & Technology Agreement' were signed. The EU-China Cooperation Program, on the other hand, aims at underpinning the broader EU-China dialogue by assisting China with its political and economic reforms. The "Country Strategy Paper 2002-2006" sets forth three areas of activities: 1. supporting the social and economic reform process to ensure sustainable development and poverty reduction, 2. preventing environmental degradation, and 3. aiding the transition to an open society.[13]

Overall, the EU recognizes China as an emerging political and economic power on the international scene. It sees in China less a threat or risk than an opportunity and chance. Acknowledging the challenges rising by China's new international role, it believes to tackle these best by bringing China more closely into the international economic and political architecture through institutionalized bilateral and multilateral dialogues. Thus, the EU – like Germany – pursues a diplomatic as well as institutionalist approach, using the instruments of technical and financial assistance, dialogues and cooperation more than open confrontation or threat.

5. THE UNITED STATES AND CHINA

Contrary to the China policies of the EU or Germany, the US-China relationship is considerably more conflictual and confrontational. President Bush stated:

> "[The US-China] relationship is complex. On trade, we're pressing China, for example, for floating her currency, so we can have free and fair trade with China. With human rights, we expect China to be a society that welcomes all religions. When it comes to foreign policy, we expect China to cooperate in the war on terror, and we expect there to be peace with Taiwan."[14]

Robert Portman, the new United States Trade Representative (USTR) emphasized:

> „Part of [the US] deficit is because the Chinese do not always play by the rules. I think we need a tougher approach. I think we need to hold China to its commitments. [...] I will focus on stopping Chinese pirating of U.S. intellectual property, rolling back China's industrial policies that exclude our products, expanding market access for our goods and services and realizing China's full implementation of its commitments on transparency and distribution rights for American products."[15]

The US sees in China mainly an economic competitor and rival. China's economic ascendance is perceived as a challenge to the US position in the world economy, US production and

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[13] See European Commission, The EU's Relations with China, <http://europa.eu.int/comm/external_relations/china/intro/index.htm>.

[14] See „President Bush Addresses American Society of Newspaper Editors Convention", <http://www.usembassy.org.uk/bush346.html>, April 14th 2005.

[15] See Robert Portman in: Bruce Odessey, Bush Trade Nominee Vows Tougher Action on Chinese Compliance, <http://tokyo.usembassy.gov/e/p/tp-20050422-02.html>, April 2005.

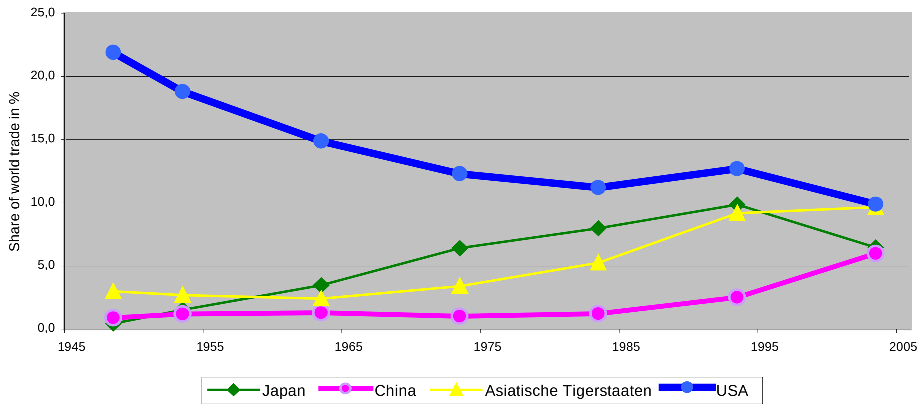
employment as well as US wages, labor and environmental standards. Judging US-China trade as being important to the US economy, most Americans believe, however, that China benefits more from bilateral trade than the US. In 2004, China was the second largest supplier of US imports and fifth largest buyer of US goods.

Main Trading Partners of the US in Billion US Dollar

Trading partner	US Imports		Trading Partner	US Exports	
	2000	2004		2000	2004
Canada	230.838	255.928	Canada	178.941	190.163
China	100.018	196.699	Mexico	111.34	110.775
Mexico	135.926	155.843	Japan	64.924	54.400
Japan	146.479	129.595	UK	41.570	35.960
Germany	58.513	77.236	China	16.185	34.721
UK	43.345	46.402	Germany	29.448	31.381

Source: Exportgov: US Aggregate Foreign Trade Data, <http://www.ita.doc.gov/td/industry/otea/usfth/ tab-con.html>.

While the US share in world exports has decreases from 12 percent in the early 1990s to about 10 percent in 2003, China's share has risen steadily from about 2 percent to 6 percent in the same period.



Share in World Goods Exports of Selected Countries 1948-2004
Source: WTO, International Trade Statistics, <http://www.wto.org>.

The highest bilateral trade deficit of the US arose from trade with China: $124.07 billion of its cumulative deficit ($547.5 billion) resulted from trade with China in 2003.

Highest Bilateral Trade Deficits of the US in Billion US Dollar in 2003

China	Japan	Canada	Mexico	Germany	Ireland	Italy	Malaysia	Taiwan	Venezuela
-124.07	-66.034	-51.671	-40.648	-39.280	-18.059	-14.853	-14.526	-14.151	-14.305

Source: US Census, US Trade by Country, <http://www.census.gov/foreign trade/ balance/index.html>.

Consequently, the US often accuses China of unfair trade practices such as dumping its products on world markets (particularly on the US market) and creating an unfair competition by producing its goods with cheap labor (partially even with prison labor) under low social and environmental standards. Since the recent decline of jobs in the US manufacturing has coincided with an ever increasing US trade deficit with China, China is blamed for snatching away US jobs, pushing US suppliers out of the market and leading to lower standards worldwide. Fear of foreign competition is not new in the US. In the 1980s, the US particularly feared competition from Japan, mainly in the areas of steel and automotive production. Today, however, the economic and political stakes are even higher than in the 1980s: the US is the world's largest debtor, with China being an important creditor. A sharp reversal in China's demand for US treasury bonds could send interest rates sky rocketing.

While the US underlined that China is largely following its WTO commitments, it points out that doing business in China is still unpredictable due to the "systematic opacity" of its regulatory regimes. Furthermore, the US complains that China does not sufficiently enforce intellectual property rights protections (IPR). The 2004 USTR Foreign Trade Barriers Report to the US Congress also found China's efforts to comply with its WTO obligations "impressive" but "far from complete", particularly with regard to IPR protections and services.[16] The report lists several areas in which it sees potential disputes with China, including 1. Chinese import substitution policies in areas such as fertilizer, 2. automobile investment guidelines, 3. tariffs on products that compete with sensitive domestic goods such as motorcycles and electronic equipment, 4. tariff classification and customs valuation procedures, 5. Chinese boarder policies, 6. non-tariff barriers to trade in services such as banking and insurance, 7. unwarranted inspection of agricultural products, 8. rules on biotechnology, 9. sanitary and phytosanitary measures, and 10. export subsidies on corn.[17] The US also filed the first ever WTO dispute against China, regarding China's tax refund policy for semiconductors. In the other areas named above, the US has not filed a WTO complaint so far, relying on negotiations within the US-China Joint Commission on Commerce and Trade (JCCT).

Currently, the US-China economic relationship is particularly strained by two issues: 1. Chinese textile exports and 2. the undervalued yuan. On April 6th 2005, 67 senators voted against dumping a bill proposed by Charles Schumer, a Democrat from New York, that plans to impose a 27.5 percent tariff on all goods from China unless Beijing adjusted its currency within the next six months. Another bill, which underlines the anti-Chinese sentiment, is the "Stopping Overseas Subsidies Act", advocated strongly by the Senators Susan Collins and Even Bayh. This legislation would allow US firms to get countervailing duties to level out Chinese subsidies, including a subsidized exchange rate. Currently, China is not subject to US anti-subsidy law as it is still declared a non-market economy. The new bill would amend title VII of the Tariff Act of 1930 to provide that the provisions relating to countervailing duties also apply to non-market economy countries. Additionally, Duncan Hunter and Tim Ryan have

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[16] See Bridges, China Marks Three Year Entry into the WTO, < http://www.ictsd.org/weekly/04-12-15/story4.htm> Dec. 15 2004; USTR, 2004 Report to Congress on China's WTO Compliance, <http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/asset_upload_file281_6986.pdf>, 2004

[17] See Glenda Mallon/John Walley, China's Post Accession WTO Stance, NBER Working Paper 10649, < http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN020108.pdf>, August 2004.

proposed a legislation in the House of Representatives that would allow American companies to use "exchange-rate manipulations" as a reason for demanding protection under US trade laws. Furthermore, the "Congressional China Currency Action" has filed a Section 301 petition, asking the Bush administration to file a formal case to the WTO about the undervalued yuan. The administration recently came close to accusing China of currency manipulation, declaring China's currency policies as highly distortionary, making clear that it wanted to see a substantial alteration in the next months. Furthermore, the administration imposed safeguard quotas in seven categories of Chinese textiles, including cotton underwear, shirts and trousers. In mid May 2005, John Snow, the US treasurer, appointed Olin L. Wethington as his Special Envoy on China, who will be responsible for China on issues related to exchange rates and financial market reforms.[18] Main goals of the US economic policy towards China are therefore: 1. restricting China's unfair trade practices (dumping, subsidization, currency manipulation etc.), 2. increasing access to the Chinese market for US goods and services, 3. increasing market access for US FDI, particularly in the area of banking and insurance, 4. improving the protection of intellectual property in China, 5. creating a stable investment climate in China, and 5. fostering economic reforms and stable macroeconomic policies.

However, economic interest is only one facet of the US-China economic relationship. The US administration sees its relationship with China much more in a wider security context, being strongly influenced by human rights issues, the persecution of Christians, dissidents and free thinkers, the Taiwan question, missile defense and the stealing of nuclear secrets. Particularly the Taiwan question has strained US-China relations, reaching back to the 1979 Taiwan Relations Act, which explicitly supported the sales of arms of a defensive character to Taiwan in order to create a balance of power in the region. Ever since, arms sales to Taiwan have been a sore spot in the US-China relationship. Accordingly, the majority of Americans, while not seeing in China an immediate military threat, view the US-China relationship as unfriendly rather than friendly. While the EU has moved towards closer economic and possible strategic ties with China, the Bush administration perceives China primarily as a challenge (both with regard to Taiwan as well as strategic and economic competition), pursuing a more aggressive approach in its China policy, often resorting to threats.

6. JAPAN AND CHINA

Less clear cut is China's relationship with Japan, ranging from cooperation to competition and even confrontation. Like the US, Japan views Taiwan as an issue of great concern, clearly influencing its general relationship with China. Japan has been on edgy terms with China in the past years, conflicts including Chinese posturing in the South China sea, an unresolved dispute over the Senkaku islands, and Chinese incursions into Japan's waters. Japan is also worried about China's appetite for natural resources, including its territorial claims in the seas surrounding it, as well as China's ability to modernize its armed forces and thereby changing

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[18] See „Chinas Currency. Time to Let Go", in: The Econmist, May 21st 2005; „China Bashing and trade. Putting up the Barricades, in: The Economist, April 23rd 2005.

the strategic balance in the region. An issue of long-lasting conflict is how Japan deals with its history, in particular its softening accounts of World War II atrocities and the refusal to compensate war victims. Protests in China also occur whenever Japan's prime minister, Junichiro Koizumi, pays his annual visits to the Yasukuni Shrine, which commemorates Japan's war dead, including 14 class-A war criminals executed in 1948 after the Tokyo war-crimes trial.
Being alarmed by a rising China and an increasingly hostile North Korea, Japan has been upgrading its security alliance with the US. Early this year, Japan announced in a joint statement with the US that it wanted to encourage a "peaceful resolution of issues concerning the Taiwan Strait through dialogue", which considerably increased tensions with China. Since Japan and China are natural rivals for regional leadership, China believes that Japan and the US are trying to constrain its growing influence in Asia and beyond. Japan has also lobbied for the EU not to lift its arms embargo on China.[19]
Political tensions between the two countries are increasing at the same time as economic ties are growing and deepening. In 2003, about 12 percent of Japan's exports went to China (rank 3), while about 20 percent of its imports originated in China (rank 1). In 2004, Japan's exports to China amounted to $93 billion and imports from China to about $72 billion, leaving Japan with a trade deficit of over $20 billion. Japanese direct investment in China has significantly increased since 1984; China is now the largest destination for Japanese direct investment in Asia.

Main Trading Partners of Japan in Billion US Dollars, 2003

Trading Partner	Exports	Trading Partner	Imports
United States	24.9	China	19.7
EU	15.3	United States	15.6
China	12.2	EU	12.8
Korea	7.4	Korea	4.7
Taipei, Chinese	6.6	Indonesia	4.3

Source: WTO, Trade Profiles China, >http://www.wto.org>.

Despite increasing bilateral integration, economic relations are not always running smoothly. Currently, the relationship is strained by Japan's steadily increasing current account deficit in its China trade as well as the undervalued. As both countries have become richer, more powerful and important as trading partners, they also have become rivals not only for political but also economic dominance in their region, which is creating additional tensions.[20]

7. CONCLUSION

The key precondition for China's ascendance to economic and political power is that it will maintain policies and develop institutions that are supportive of growth, including macroeconomic stability (low inflation, sound public finances, well managed exchange rate etc.), good governance, an end to corruption as well as openness of the economy. China thus faces a sig-

[19] See „So Hard to Be Friends", in: The Economist, March 23rd 2005.

nificant challenge of keeping its growth on track. Despite their differing perceptions of China and varying strategies, Germany, the EU, US and Japan have a common interest in a politically and economically stable China: Thus, an unstable China, which could drag down the whole region in an economic recession, is more threatening than a growing and prospering China, which is creating more international competition. Moreover, a stable China could not only foster development in the region, it could also become a political anchor-state, taking responsibility for poorer neighbors.

Demonizing China, as often done in the US Congress, using threats or sanctions will most likely result in similar responses by China, hindering reforms rather than enhancing them. Treating China with respect, however, may lead it to repay the compliment. The way ahead is therefore to strengthen the multilateral and bilateral institutionalized as well as informal dialogues with China in all areas of cooperation – including strengthening the cultural dialogue to reduce misunderstandings and misinterpretations. Furthermore, China still has to be assisted in transforming its economy to a real market economy through technical and financial assistance. Threats or aggressive demands, on the other hand, are likely to fail.

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[20] See „The Uneasy Triangle“ in: The Economist, March 15th 2001; „Keeping their Balance“, in: The Economist, Feb. 24th 2005.