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SUCCESSFUL URBANISATION: THE KEY TO CHINA'S FURTHER ECONOMIC DEVELOPMENT AND A CORNERSTONE FOR EU-CHINA COOPERATION

Gerhard Stahl[*]

China is set to embark on an intensive phase of urbanisation which will be an important contributor to its economic modernisation and to the improvement of its citizens' standard of living. The massive scale of the urbanisation that is envisaged in China makes it imperative that it be planned and implemented in accordance with sustainable development principles as otherwise there is a very serious risk that human welfare will be compromised, and not just in China.

Europe can rightly claim global leadership when it comes to creating sustainable, attractive and liveable cities, not least because of the positive effects of EU policies, especially in the field of the environment. Both China and Europe have much to gain from cooperating closely on urbanisation issues. With backing at the highest political levels on both sides, an important framework has now been put in place in order to support bilateral collaboration. The realisation of the potential of the EU-China Urbanisation Partnership to contribute to a more environmentally-sustainable society and a more economically-balanced world will require the fullest engagement of stakeholders at all necessary levels.

China's economic renaissance

China has achieved an extraordinary economic transformation over the past two decades, a period during which its economic growth has averaged over 9 percent per annum. Rapid economic development has been accompanied by remarkable progress across a range of social indicators – health, education, and housing, to name a few. For example, during the period 1997 to 2011, infant mortality declined from 34 to 13 per thousand live births, the enrolment rate in tertiary education increased from 6 percent to 26 percent and the share of the population living in urban areas went up from 33 percent to 51 percent. Nevertheless, GDP per capita in China is still behind the levels of more-developed Western societies towards which China aspires.[1]

China's renaissance and Asia's economic growth is a blessing because it improves the living conditions and the wealth of millions of people and contributes to human progress. At the same time, China's economic miracle has an impact on the prices of key natural resources, contributes to global warming and modifies the economic balance between countries inside and outside Asia. We live on one common planet and we must share air, water and other limited resources in a world which is becoming increasingly interdependent economically and financially.

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[1] The World Bank Group, *World Bank Indicators 2013*, retrieved January 16, 2013: http://data.worldbank.org/indicator.

'Business as usual' scenario

The challenge for the next phase of economic modernisation in China is to ensure the changes necessary in order to allow for a more sustainable pattern of development which better balances economic, social and environmental considerations. It is clear that a 'business as usual' scenario, based on the high consumption of resources, is neither sustainable for China, which will continue its rapid economic development but at a slower rate than in the past, nor for already developed countries in Europe and America. The prevailing model of economic development is not one that will allow for all of the nearly seven billion citizens of planet Earth to have the conditions for a decent life.

According to environmental outlook of the Organisation for Economic Cooperation and Development (OECD), without new policies world energy demand in 2050 would be 80 percent higher than today – with most of the growth coming from emerging economies – and still 85 percent reliant on fossil fuels. This could lead to a 50 percent increase in GHG emissions globally.[2] By 2050, urban air pollution would become the top environmental cause of mortality worldwide. The number of premature deaths could double from current levels to 3.6 million per year globally, with most occurring in China and India. Global water demand would increase by some 55 percent, with competing demands putting water use by farmers at risk. The number of people living in river basins under severe water stress would increase by 2.3 billion. Terrestrial biodiversity would decline by a further 10 percent, with significant losses in Asia, Europe and Southern Africa. Mature forests would shrink by 13 percent in area.

China's way to a sustainable future

China's urbanisation, if planned and implemented in line with sustainable development objectives, can make a huge contribution to achieving a more stabilised planet, particularly if this commitment to sustainable urbanisation in China is part of a global effort to tackle pressing environmental challenges. Moreover, urbanisation in China can be a major tool for economic modernisation, a means to provide jobs and socio-economic opportunities for hundreds of millions of rural dwellers and integrate them in the modern world. LI Keqiang, China's vice premier, has said that the process of urbanisation represents China's biggest potential for development in the coming decades and that it should aim in particular at expanding domestic demand.[3] Each percentage point increase in China's urbanisation rate represents more than 13 million people moving from rural areas to cities, creating huge requirements for investment in housing, urban services and infrastructure as well as increasing consumer demand. This is consistent with the school of thought which says that China must, in any event, increase internal demand in order to help reduce unsustainable global imbalances that have been

[2] OECD, *Organisation for Economic Co-operation and Development (OECD) Environmental Outlook to 2050*, OECD Publishing, 2012, retrieved 16 January 2013, http://dx.doi.org/10.1787/9789264122246-en.

[3] LI Keqiang, Vice Premier of the People's Republic of China, "Speech on the EU-China Urbanisation Partnership", Conference at Concert Noble, 3 May 2012, Brussels.

created by its export-oriented growth model. Both the IMF and the OECD advocate that China rebalance its economy toward private consumption with more 'people-centred' development.[4] More balanced socio-economic development in China will improve the wealth of ordinary Chinese citizens and will, in turn, have positive effects on Europe and America. In particular, it might help the United States to correct its imbalanced economic model which is too dependent on foreign capital investment.

While today more than half the Chinese population – 691 million people – lives in cities, its urbanisation rate is nevertheless still lower than that of more advanced countries and China expects to pursue a new round of its urbanisation process during the next decades. An increase in China's urbanisation rate to the level of that of Europe, i.e. 70 percent, would mean at least 250 million more rural dwellers moving to its cities. Urbanisation on such a massive scale will represent a huge challenge for China and also for the rest of the world because of the potential impact on resources, the environment and international economic relations.[5] For China to manage this transition successfully, that is in a harmonious and sustainable way, will demand a holistic approach that takes into consideration the different economic, social and environmental interests, balances competing priorities in areas such as food security, environmental protection and resource supply and mobilises all of the important actors in a multi-level governance framework.

Europe's path towards sustainable urban development

Günther Oettinger, European Commissioner for Energy, was right when he said that it is beneficial for the European Union to support its Chinese partners in their process of building cleaner and more liveable cities.[6] Europe has much to offer in this regard as it is arguably the global leader in creating sustainable cities that offer the quality of life and sources of opportunity that make them attractive to people as places to live and to businesses as places to invest. EU policy across a range of areas works to create European cities that are:[7]

- Clean and healthy (with safe drinking water, effective wastewater treatment, clean air and proper waste disposal);
- Green and pleasant (with ample green spaces, quiet streets, recreational parks for relaxation, sport, nature watching and social activities, and a built environment that conserves archaeological, architectural and historical heritage); and

[4] International Monetary Fund (IMF), *World Economic Outlook Update 2013*, retrieved 23 January, 2013: http://www.imf.org/external/pubs/ft/weo/2013/update/01/index.htm; OECD, *China in Focus: Lessons and Challenges*, 2012, retrieved 29 January, 2013, http://www.oecd.org/china, htttp://www.oecdchina.org; National People's Congress (NPC), *China's 12th Five-Year Plan for National Economic and Social Development*, 2011.

[5] OECD, Economic, Environmental and Social Sciences, *OECD Factbook 2011-2012*, OECD Publishing, 2012.

[6] G. Oettinger, EU Commissioner for Energy, Speech at EU-China Urbanisation Partnership, Conference at Concert Noble, Brussels, 3 May 2012.

[7] European Union, *Making our cities attractive and sustainable*, Luxembourg: Publications Office of the European Union, 2010.

- Efficient and sustainable (with energy supplied from renewable sources, green buildings that consume less energy and efficient public transport that ensures green mobility).

EU policy in these areas specifies common rules as regards objectives and outcomes to be achieved but leaves member states and regions considerable latitude in choosing the specific means for implementing the policy so that the wide diversity of situations across the European continent can be taken into account.[8] EU funding instruments are also available to support policy implementation.[9] What Europe has achieved based on common rules is impressive but ensuring consistent implementation in a multi-level system that must respect different competences is an on-going challenge. European policy has also focussed heavily on supporting agricultural production and developing rural areas and on strengthening the regulatory system in order to guarantee food quality for citizens.

Much of the functional and aesthetic attractiveness of European cities derives from features and traditions that are independent of EU policy. In this regard democratic and accountable urban governance, underpinned by a deeply-rooted sense of civic pride, local autonomy and self-government, and urban planning systems that try to engage citizens and other stakeholders in a meaningful way are important strengths. Involving citizens in urban planning helps to ensure sustainable development and is vital for creating well-planned cities. The Aarhus Convention on access to information and public participation in environmental decision-making guarantees the right of citizens in the EU to participate in urban planning processes.[10]

EU initiatives for eco-friendly cities

The European Green Capital Award promotes and rewards local efforts to improve the environment, economy and quality of life in Europe's cities. Established by the European Commission in 2010, it recognises cities that have found excellent ways of coping with environmental challenges and which show a high level of commitment to making progress. To receive the award a city must have a consistent record of high environmental standards; express a commitment to ongoing plans and demonstrate ambitious goals for further environmental improvement; and be an inspiring role model for other European cities as regards best practices in sustainable urban development and methods of combining economic development with environmental and quality of life improvement. To date five cities have won the European Green Capital Award – Stockholm (SE), Hamburg (DE), Vitoria-Gasteiz (ES), Nantes (FR) and Copenhagen (DK) (European Commission, 2013).

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[8] European Commission, *Communication on Implementing European Community Environmental Law*, COM(2008) 773 final, 2008.

[9] European Commission, *Practical Guide to EU funding opportunities for Research and Innovation*, 2012, retrieved 16 January 2013, http://cordis.europa.eu/eu-funding-guide/supporting-id_en.html.

[10] United Nations Economic Commission for Europe (UNECE), *Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters*, 1998, retrieved 16 January, 2013, http://www.unece.org/env/pp/treatytext.html.

The European Union is also very active in supporting local actions on climate change both to reduce carbon emissions and help prepare for climate change impacts. An example is the Covenant of Mayors which has been signed by more than 4,350 European regions, cities and local authorities.[11] In doing so, they commit to the development and implementation of Sustainable Energy Action Plans to ensure that they go beyond the EU's emission reduction target of a 20 percent cut in CO_2 emissions by 2020 through increased energy efficiency and the development of renewable energy sources.

Some challenges for Europe's cities

Europe's cities are not without problems and they do face important challenges. While they are prosperous, they contain significant pockets of deprivation, particularly in run-down inner city zones. In some cases poorly controlled urban development risks creating urban sprawl, which undermines the compact character that is an important asset of European cities. A particular challenge relates to adopting a more holistic approach to spatial planning, which would better address increasing land-use conflicts, integrate cities more closely with their surrounding regions and promote a more harmonious development of urban and rural areas. Above all, European cities need to find a more resource-efficient and low-carbon development path and mainstream climate change policies both as regards mitigation and adaptation. [12]

EU-China Urbanisation Partnership

Both the EU and China have much to gain from closer cooperation regarding urbanisation issues. At the EU-China Summit in Beijing in February 2012, leaders of the EU and China endorsed the EU-China Urbanisation Partnership, which aims to support China and the EU in achieving a number of common goals related to the functionality and attractiveness of Chinese cities and a more efficient use of energy in urban settings. Moreover, the volume and innovative nature of the investments that will be necessary to achieve China's urbanisation objectives – investment in areas such as energy, transportation, communications, waste and sanitation, building design, and green technology – make this a very interesting emerging market and create a basis for commercial cooperation to the great benefit of both parties.

The partnership has a five-pillar structure – Government-to-Government, City Networking, Science and Technology, Business and Finance and Public Participation in Urban Social Management. In operational terms, projects are pooled together according to priorities set by both sides. Furthermore, an annual EU-China Urbanisation Forum, an event for stakeholders and mayors from the EU and China, is held back-to-back with one of the two EU-China Summits organised each year at the highest political level. The first Forum was held on 19 and 20 September 2012 in the EU

[11] *Covenant of Mayors*, 2008, retrieved 16 January 2013, Http://www.covenantofmayors.eu/index_en.html.
[12] European Union, Directorate General for Regional Policy, *Cities of tomorrow*, Brussels, 2011.

Committee of the Regions and attracted 500 participants.[13] Among the partnership's main priorities for 2013 is the "Green, Smart and Civic" city vision, including renewable energies, energy efficiency in buildings, city renovation, wastewater treatment, new construction materials, resource efficiency in buildings; intelligent traffic management, intelligent public transport planning; and protection of historical sites. The EU-China Urbanisation Forum 2013 will take place in Beijing in the autumn and its theme will be 'Sustainable Urbanisation'.

Cooperation between China (as the world's most populated country with an impressive track record of economic growth) and the European Union (which constitutes the biggest internal market in the world) is essential for future economic development and for successful global governance. It is also needed if we are to succeed in the common challenge of achieving a sustainable pattern of development. As it addresses a process that is at the very core of China's modernisation and one that will inevitably have global impacts, the EU-China Urbanisation Partnership can be a model for wider cooperation.

Conclusion

The world and its environment can no longer sustain an international economic development model characterised by intensive resource consumption. Advanced Western countries must adjust their lifestyles whilst emerging countries must avoid an unsustainable development model. The scientific facts are clear: climate change is taking place and it is mainly caused by human activities. It is a global problem, even if the exposure to risks is different from one part of the world to the other, and it can only be solved globally. It is not just an ecological problem, but also an economic one. The Stern Review (Stern, 2006) predicts that climate change could cost 5 to 20 per cent of worldwide GDP annually until 2050. That alone would have huge negative impacts on human welfare. [14]

Therefore, successful cooperation between China and the EU to promote sustainable urban development is essential, not only for both partners and their economic development, but also for global progress.

[13] For further information, please see http://cor.europa.eu/en/news/highlights/Pages/Committee-of-the-Regions-to-host-EU-China-Mayors-Forum.aspx.

[14] N. Stern, *Stern Review on the Economics of Climate Change*, Cambridge: Cambridge University Press, 2006.

US, EU AND CHINA CONVERGING TOWARDS SOCIAL AND ENVIRONMENTAL SUSTAINABILITY

Pierre Defraigne[*]

Rising priorities: justice and the environment

With the emergence of the BRIICS[1] and the crisis in Western advanced economies, environmental sustainability and social cohesion are making their way to the top of national governments' political agendas. In order to meet the growing concerns from their respective populations, the leading countries, in particular the US, the EU and China, will have to engage in radical reforms of their respective development models, paving the way for a more effective and more balanced multilateral governance system which is currently in the midst of muddling through an inconclusive transition.

With regard to the environment, the world is currently experiencing two major trends which are shaping the global economy and modifying the geopolitical balance. On the one hand, the global population has reached 7 billion and will grow to 9-10 billion by the middle of this century. In parallel, real convergence between North and South is finally taking place with globalisation, best epitomised by the rise of China and its impact on other emerging economies. This concurrence of demographic growth and of the industrialisation of the BRIICS exerts an unprecedented pressure on the planet's resources. Will technology, policies and markets progress quickly enough to prevent irreversible damage to the environment and a clash between nations over the competition for resources? This question remains an open one. For example, climate change remains a key issue because our efforts are insufficient. The world will therefore have to absorb the damages caused by the changes in sea levels and the resulting consequences for rainfall regimes. The burden-sharing of climate change across nations is becoming a serious problem for global stability. Sustainability as a political priority will get increasingly in the way of advanced countries' growth, whilst it is already an increasing constraint for developing countries.

But in the short term, with global growth slowing, especially among advanced economies, the policy focus is shifting towards the distributional issue within countries. The existence of a problem with the distribution of globalisation benefits was denied during the previous phase of growth. Thanks to the 'trickle-down effect', growth brought by trade liberalisation was meant to forever remain a win-win game. Today with rising unemployment and lower wages as well as increasing inequalities in the West, it is all too obvious that the handling of the distributional effects of technological innovation and globalisation should rank first among policy priorities in all countries. This is even more the case if growth does not rise back to 2 percent, the threshold

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[1] Increasingly used term to refer to the group of emerging countries which includes Brazil, Russia, India, Indonesia, China and South Africa.

of job creation in mature economies. Countries must change their development and regulation models so as to factor in social justice and environmental protection as key priorities at global and national levels.

Re-embedding market capitalism

The functioning of modern economies rests upon three different, but closely intertwined, production and distribution subsystems: market capitalism, market economy and non-merchant and state sectors.

Market capitalism is the world of economies of scale and imperfect competition: large transnational firms and global finance compete globally for the concentration of market power and wealth. They have a real capacity to influence their business environment and they act as price-makers in markets. Market capitalism is the main driver behind innovation and growth. At the opposite end, the market economy is the universe of small- and medium-sized businesses (SMBs), professional and independent work, characterised by effective competition among peers, where firms are both environment- and price-takers. Eventually the state and non-merchant sectors fulfil the needs which do not respond to market rationale, either because they supply public goods or because prices are set up independently of cost for reasons of general interest.

Whilst the wave of neoliberalism exalted the efficiency of markets, the prevailing view today is that market efficiency depends heavily on their institutional framework. Markets do not work in a vacuum. They are embedded in institutions and are subject to social norms: such institutions and norms form the regulatory regime whose function is to warrant a socially acceptable balance between growth and distribution of wealth, between efficiency and equity, the latter encompassing inter-generational justice through environmental sustainability.

Any economic system has its own development model and regulation regime to organise the production and distribution of wealth. But global market capitalism enjoys, through the global output chain, a high degree of geographical mobility and therefore can pick and choose between political territories. Arbitrage by global firms between national competition regimes and social, environmental and tax regulation systems has significantly increased via globalisation over the last three decades, as production has shifted from the West mainly towards Asia, i.e. China. The balance between market forces and national polity has tilted towards global business and finance at the expense of nation states, whose sheer size has become a key factor in their capacity for regulation. Large continental states retain an effective bargaining power with regard to the markets. However, for most countries, only tight regional integration or multilateral governance can offset the size handicap.

Development models and regulatory regimes differ. Therefore interdependence between countries through trade, investment and capital flows, calls for a multilateral regulatory regime ensuring the compatibility of national models. Until the late 1970s, the West relied on the Bretton Woods system, based on the New Deal. Roosevelt's New Deal (1934) aimed at full employment and social protection. Europe followed with various versions of

the US benchmark, with the Anglo-Saxon liberal, Nordic social-democrat, and European continental (with singular and different features for Germany and France) making up a patchwork of closely related systems.

The Bretton Woods multilateral regime intended to reconcile free trade, monetary stability and the diversity of Western models. But market-driven globalisation has shaken up the overall balance between national and multilateral regulation regimes. Globalisation has signalled a turn in global economic history. Born out of the ICT revolution and trade and foreign direct investment (FDI) liberalisation, the global company has carried out globalisation through the global output chain. The latter has proved a powerful instrument of FDI dissemination and a stimulation of intra-firm trade. As a result, globalisation was successful in bringing about real convergence between East and West, between advanced and emerging economies. Convergence is a promising and equitable development, but also proves a formidable challenge for the harmonious integration of newcomers, especially the largest ones such as China and India. There are downsides to globalisation: first, unregulated finance provoked a major crisis that hit both Western and emerging economies; second, the multilateral governance has been deteriorating because of the change of relative weight within the membership and due to the variety and rivalry between development models; and last but not least, the effectiveness of social development models in Europe is waning, which poses a serious test for democracy. In particular, unemployment is reaching unprecedented levels since World War II while inequalities within countries are on the rise. Social cohesion is deteriorating and, as a result, democracy – which, in Europe, is firmly rooted in the social contract between business and labour – is passing through dangerous straits.

The transformation of the US market capitalism regulation regime has had a strong impact on Europe – despite its obvious shortcomings (twin deficit, high energy consumption and huge inequalities) – in quest of a more innovation-based growth model. On the one hand, from the early 1980s technology and globalisation have seriously aggravated primary income distribution in America. On the other hand, privatisation, deregulation and tax cuts have shrunk the government's ability to correct primary inequalities; in fact, tax cuts have made them drastically worse. As a result of stagnant wages and wealth concentration, global demand has started to level out. Financial innovation, deregulation and easy monetary policies facilitated the propensity of households to maintain their consumption level through overindebtedness, and the leveraging of financial institutions scrambling for still higher profits. This has sown the seeds of the 2008 financial crisis.

The systemic crisis of market capitalism

The systemic crisis of market capitalism in America is the product of two factors. One is simply the rationale of the market system, which is geared towards profit maximisation and capital accumulation leading to the concentration of wealth and thereby towards a fall in consumption; the other is the result of the deliberate relaxation of controls over market capitalism. Major deregulation, privatisation and tax policy encouraged by neoliberal

conservatives were pushed through the Congress and the White House by a formidable network of lobbies through the financing of political campaigns, which is the scourge of American democracy. The US crisis is the outcome of market excesses allowed by policy failures. Its result is a severe degradation of democracy.

Europe followed at a distance because of the resistance of trade unions and centre-left parties. Yet inequalities had been on the rise even before the 2008 crisis, which revealed the exposure and vulnerability of the European financial and banking sectors. They were aggravated by the severe deterioration of public finance caused by the rescue of the banking sector, by the post-2008 macroeconomic stimulus package implemented in most countries, but also by structural fiscal mismanagement seen in others.

It is not unsuitable to talk of self-inflicted wounds by the American and European democracies as these allowed, by unharnessing globalisation, a drastic shift of the bargaining power from labour and the government to business and finance.

Globalisation has indeed tilted the value-added distribution towards capital and highly-skilled professionals made more mobile by suppressing exchange controls and by the expansion of the global output chain. The impact on global labour has been conspicuous: in the West unskilled labour has lost in terms of jobs and wages, while it has gained in emerging economies since the labour market has gone global through trade liberalisation and offshoring of production by Western global firms.

Such change in the wealth production and distribution paradigm in most OECD countries has deeply altered the national development models and the regulatory regimes' effectiveness and fairness. Persistently high unemployment rates, growing inequalities and rising poverty are damaging social cohesion, which is undermining the very basis of democracy in Western countries. In the US and the UK low voter turnout is an issue, and eurozone periphery countries, now including Italy, are confronted with political instability. Even in France, populism and *'souverainisme'* are biting into traditionally centre-right and centre-left voters. Some countries in Central and Eastern Europe are also displaying disquieting signals. This weakening of the democratic sentiment is the direct consequence of the deterioration of regulatory regimes and the correlative loss of social cohesion.

With regard to emerging economies, they first are affected by the slowdown of growth in advanced economies which has a dampening effect on their own performance. But they are also confronted with the twin challenge of reconciling higher growth rates than in the West with fairer social models and a more sustainable performance environmentally. China is faced with growing and diverse expectations from its rising middle class and its poor working class. It needs to build up a more comprehensive and effective domestic regulatory regime.

Ideally, these challenges would be addressed through a reshuffled and rebalanced multilateral system which would re-establish a fair and effective balance between global market forces and polity. These days, however, multilateralism is half-asleep: the Doha Round is in a stalemate and is by-passed by 400 bilateral trade deals; the Bretton Woods monetary system

has given way to a polycentric monetary system which is proving potentially unstable; the norms-setting pillar is rather effective in some areas (health, environment, finance) but less so with regard to labour standards.

Therefore, it is important to focus on the domestic agendas of the main players since they will determine, by osmosis, the course of reforms in most countries in preparation for the transition towards a new Bretton Woods in order to make national systems converge. By putting social justice and environmental protection at the top of their respective agendas, leading countries' agendas will pave the way for restoring the supremacy of the multilateral rule of law over markets and countries.

The US: confronting the 'guns or butter' dilemma

America has always projected itself as a land of opportunity for ordinary people who are determined to improve their condition. An 'emptied' continent with vast amounts of land and resources was filled up through massive immigration accompanied by capital inflows, first from Europe, and since World War II from all over the world. This, along with a formidable sense of business-led innovation, turned America into the world's first economy in less than a century after independence. The large and growing domestic market allowed for development to take place despite high tariffs. Three heroic tales have forged the American imagination: the Odyssey of the Mayflower, giving the country its religious aura; the Tea Party, fighting autocracy and the 'Big Government'; and the Civil War legacy, making the quest for unity about freedom and through patriotism, central beliefs in the US.

For one century, the US' exclusive reliance on market and individual responsibility constituted the essence of the American production and distribution paradigm. The Great Depression of the 1930s changed this. The New Deal, however, was more the product of the American can-do practical ethics than an ideological turn. Post-World War II, the New Deal provided the global mould for 'embedded liberalism' through the Bretton Woods system with its unique combination of free trade and exchange controls.

But from Roosevelt's inauguration in 1933, conservative circles opposed high taxes and 'Big government', in a very dogmatic way. They led a four-decade fight against 'Big Government' and eventually succeeded under the label of neo-liberalism during the Reagan-Thatcher counter-revolution years. In 2007, the Gini coefficient was back to 1928 levels. Neo-liberalism is more of an ideology than a robust doctrine with a strong analytical basis. It served mainly as a political discourse for easing and socially legitimising the radical turn towards the technology- and market-driven globalisation which coincided with the collapse of communism. 'Market democracy', designed by lobbies eventually gave more leeway to market forces but less effective citizen involvement in policies. As such, it became the rallying slogan during the brief episode of 'Pax Americana' of the Bush Sr., Clinton and W. Bush presidencies. Neoliberalism proved more effective in delivering inequalities than stable growth.

The seeds of the systemic crisis of US market capitalism were sown during these Reagan years. From a land of strong inequalities but high social

mobility, from a melting pot nurtured by the American dream, the US turned into a class-society where ethnic and cultural divisions spread surreptitiously in a multi-ethnic and multi-cultural Nation. The concentration of wealth – the top 1 percent syndrome – dried up aggregate demand while overindebtedness severely undermined the stability of the US economy. The fiscal cliff and the fiscal sequestration are the symptoms of America's deep political divide between a Republican House and a Democratic President. During the standoff, in order to offset the fiscal policy paralysis, the Federal Reserve (FED) took on the job of rekindling growth by all means necessary, and this has taken the form of massive quantitative easing – a potential source of domestic inflation and financial bubbles in the US and in the emerging economies.

Today the US is confronted with a gradual relative economic decline despite its unique and strong capacity for innovation. As a result, their strategic hegemony is receding and the rise of China as a global hard and soft power is challenging America's role in the world. But above all, the US is confronted with a severe political split which will eventually force America to confront the 'guns or butter' dilemma, common to all nations, but from which the 'exorbitant' privilege of the dollar had insulated the US economy for several decades. This period is over due to the piling up of an external debt whose denomination in dollars proves a factor of vulnerability, as any serious fiscal crisis would expose America to a run on the dollar with severe consequences for domestic and international stability.

American boys are back at home after the Iraq and Afghanistan wars. The country in quest for peace dividends has given up its ambition of playing the role of the 'indispensable nation', and is now primarily concentrating on the domestic agenda. Yet serious external challenges loom ahead: the growing economic interdependence inextricably coupled with political rivalry as regards China, nuclear proliferation, the problematic course of Islamist fundamentalism and the current crisis of economic multilateralism.

But America must first concentrate on its domestic challenges since its political cohesion is at stake. First, it needs to restore public finance sustainability in view of the rising cost of health and pensions. Second, it needs to tackle the social divide by seriously addressing the problems of effective access to education, health and housing for the poor, a fairer tax system and a more even-handed wage ratio between the top and the bottom. Third, it needs to embark upon a 'de-carbonisation' strategy for the sake of limiting CO_2 emissions for the benefit of the planet instead of relying on shale gas, the daring exploitation of which relieves America from the price constraints of imported oil and energy, but which is not satisfactory from a long-term and global perspective.

The EU: behind the euro governance, a common social model

Europe's growth performance has been modest over the last two decades, and came almost to a halt with 2008 financial crisis. Growth before the crisis was slower than in the US – 2 percent against 3 percent – because the EU is a mature economy with an ageing population, which suffers from an

innovation deficit – R&D is stuck at 2 percent of the EU's GDP against 3 percent in America.

Yet the EU's economic situation has some strong points: a fair trade balance, a public debt and public deficit lower than those in the US and Japan, a more cohesive society despite some threatening trends, and lower average CO_2 emissions than in America.

Since September 2008, however, growth is nearing zero while unemployment and inequalities are on the rise. The public debt has reached unstable levels and the banking sector remains very vulnerable to overleveraging and to the risk of sovereign debt default.

But Europe's main problem is the institutional inconsistency of both the EU-27 and the eurozone which prevents them from effectively tackling the crisis. In fact, Europe's social model had already been hit by the loss of Western rent over developing countries, during the 1990s and the 2000s, which passed relatively unnoticed despite its critical impact on jobs, wages and purchasing power. For two centuries Europe enjoyed a rent which gave the European and American working class the global monopoly on well-paid jobs in the manufacturing sector and the privilege of low import prices on energy, minerals and food. This Western privilege, of which Europe was the main beneficiary because of its colonial past, was washed away by the offshoring and outsourcing of jobs to Asia brought about by globalisation and the change in the terms of trade with commodity producers.

Today Europe is confronted with three crises: a systemic crisis of market capitalism, an identity crisis of the EU-27 and the governance crisis of the eurozone.

The systemic character of the crisis of market capitalism stems from its symptoms and its origins. There are three symptoms. The first is the lack of sufficient growth to bring down structural unemployment, despite growth providing the social legitimacy of market capitalism. The second is the failure of orthodox policies to rekindle growth: the monetary policies from the European Central Bank (ECB) and the Bank of England (BOE) are caught in a 'liquidity trap' since the massive liquidity issued by Central Banks and the resulting low interest rates no longer stimulate investment and consumption; fiscal policies are constrained by excessive public debt and therefore exert a deflationary impact on global demand; a nominal exchange rate policy is neutralised by the risk of competitive devaluations from partners and competitors. And the third is the testing of heterodox policies by panicking governments: some measures, like the rescue of banks deemed 'too big to fail' using taxpayers' money, go against the very principles of market capitalism, namely the pecuniary liability of shareholders and creditors; others, like direct public support to industrial sectors or large individual firms, distort competition and raise the prospect of trade protectionism and retaliations.

A systemic crisis such as this will persist as long as excessive private and public indebtedness hangs over the European economies like an emblematic Damocles sword, inhibiting consumption and investment. But what are the origins of this systemic crisis? Its immediate cause lies in the massive purchases of toxic assets from the US – in particular the subprime loans – acquired

through massive debt by European banks in order to improve their profitability. But the deeper roots originate in the way that global firms, in their race for profit and the concentration of wealth, have exploited the IT revolution, globalisation, financial deregulation and tax evasion through offshore financial centres to free themselves from the regulatory framework imposed by national governments. This drive has nurtured a kind of 'inegalitarian growth' in Europe, albeit to a lower extent than in the US. This sufficed nevertheless to gradually choke off aggregate demand since unemployment and declining wages diminish the average household's consumption. Societal cohesion is threatened by the hollowing out of middle class and by the fear of falling into a situation of precarity. Like in America, the tradable sector is exposed to outsourcing and offshoring of output by global companies through the global output chain, losing jobs at the lower end while wage differentiation continues to rise; the non-tradable sector does not create jobs at a sufficient pace, partly because of the public finance crisis, while wages are lower than in the tradable sector because productivity is lower.

This huge transformation of the production and distribution patterns drastically affects social cohesion in Europe. But the EU is reluctant and not well-equipped for tackling these unprecedented challenges: its institutions are weak with regard to its rising heterogeneity, since there still lacks a deep unifying political principle.

The EU-27 is once again engaging in further enlargement, this time to Croatia (2013) and other Balkan countries, fuelling an identity crisis. With the growing membership comes higher heterogeneity in terms of levels of development and cultural features, including linguistic, religious and ethnic aspects. Also, the lack of a common purpose is becoming increasingly worrying for the public opinion. For instance, the EU has never clarified where its Eastern borders stop, what is its ultimate goal – economic or political union –, what is the common social development model, what is the degree of strategic autonomy its member states want to achieve, in particular in the field of defence vis-à-vis the US.

In such a loose context of political unity, rivalry between EU-27 member states increasingly prevails over cooperation. The Lisbon Treaty and the 2020 Strategy de facto encourage such rivalry while in February 2013 the European Council reduced the Pluriannual Financial Forecasts 2014-2020 compared to the previous period. The Single Market, the purpose of which is to facilitate free movement of goods, services, capital and labour, now features a race for jobs through internal devaluations, namely wage cuts, and tax and social competition. A race to the bottom has replaced convergence upwards.

Yet the third crisis, the eurozone governance crisis, is the most severe and the most urgent in need of being dealt with. As the very core of the EU-27, the 17 countries of the eurozone are themselves confronted with the challenge of near-zero growth and most of them with high structural unemployment. If the eurozone fails, the unity of the EU-27 will be severely jeopardised with the possibility of the EU sliding backwards towards a looser form of regional cooperation. The eurozone is not an optimum currency area: countries are heterogeneous and therefore subject to asymmetric

technological, energy, and financial shocks. Geographical and sectoral mobility of labour is weak while labour and nominal wages flexibility is low. The heterogeneity of membership is enormous since the criteria for joining the eurozone were exclusively related to nominal convergence, i.e. towards low inflation. But the level of development of a candidate country and its structural fault-lines are not taken into account. The eurozone was put into place in 1999 with a federal monetary policy, but, awkwardly enough, without fiscal policy. Loose fiscal coordination was preferred to a genuine federal budget with anti-cyclical and transnational built-in stabilisers. The eurozone banking sector was fragmented on a national basis. No tax harmonisation on mobile factors – corporate profits and financial savings –, nor harmonisation of social protection, nor integration of national labour markets despite free movement of labour was envisaged.

Under these conditions, the risk that a one-size-fits-all monetary policy – with a single interest rate and a single exchange rate – would, in the absence of strong fiscal and macroeconomic discipline, create severe trade and fiscal imbalances between the industrial centre and the weaker periphery, was very high. It should have been anticipated by economists, academics and officials. The unexpected occurrence of sovereign default risk revealed these institutional and structural fault-lines which ultimately aggravated the heterogeneity of the eurozone. Since the Greek crisis broke out mid-2010, the European Council has strengthened the governance architecture of the eurozone in three directions: by setting up a Banking Union, by establishing a stricter fiscal and macroeconomic coordination, and by creating a financial insurance mechanism – the European Stability Mechanism – flanked by strong conditionality for countries exposed to sovereign default risk and obliged to pay penalty interests to lenders on global markets.

Will this minimum eurozone governance suffice? In order to avoid a crisis, perhaps. Although, what matters in the end is not just the pressure from the financial markets, but the resilience of local populations burdened by austerity. Resuming growth, however, is yet another issue.

The eurozone's key problem is the inconsistency in its new governance model. There is an imbalance between the weighty fiscal and macroeconomic constraints imposed on member states and the light financial solidarity displayed in case of need. This inconsistency will maintain the future eurozone in a suboptimal economic policy regime.

The progress the European Council made under the pressure exerted by financial markets on Greece, Portugal, Ireland and Spain, hit by sovereign default crises, is indeed effective but will not suffice in order for the eurozone to tackle the main obstacle to growth in Europe – i.e. the huge public and private indebtedness which is hanging over the eurozone's economy. Without public debt mutualisation and restructuring, growth will probably not resume in Europe.

In order to be effective with a growth and jobs strategy, the eurozone must first accept a higher degree of solidarity in order to correct heterogeneity through real convergence of policies and to organise, through a sizeable federal budget, automatic transfers between countries who share the same currency and who are therefore subject to a one-size-fits-all interest

and exchange rate policy; second, it should agree on a path towards an integrated labour market and a common social model, balancing efficiency and solidarity, which calls for fair taxation and for the *aggiornamento* of the Welfare State; thirdly, it should develop a common strategy to re-industrialise Europe; and finally, it should harmonise or even centralise taxation of factor incomes, which move freely across countries thanks to the Single Market and the single currency and actually arbitrate between national tax regimes.

All these changes call for monetary and fiscal federalism, but federalism will not remain confined to the economic sphere. Someday, as a sense of commonality of destiny reveals itself to the Europeans of the eurozone, federalism will have to be extended to the sphere of security and defence, turning Europe into an effective and reliable global player.

China: wealth distribution and the environment matter too

China has provided an unexpected turn to the course of globalisation. Long-term strategy and experimental implementation, the distinctive marks of the Chinese Communist Party since the Deng Xiaoping reforms, have triggered a massive and fast renaissance of the world's most populous country. As a result of its response to globalisation, China is becoming the world's second largest economy.

Modern China's rapid rise over the last three decades will be remembered in the future as the start of a new era. In less than ten years China doubled the GDP per capita, winning the World Bank blue ribbon of growth performance in the 1980s and pulling hundreds of millions out of poverty. China's rise also brought the BRIICS along in its wake, shifting the global centre of gravity eastwards and thereby marking the end of two centuries of Western hegemony over the world. Yet as China builds on its 34 uninterrupted years of high growth, severe difficulties lie ahead which could put the formidable endeavour at risk.

The first challenge is to maintain the dynamics of high growth which, like with any human trend, tends to level out after a while and take an asymptotical shape. Making China's growth more endogenous calls for a shift to an innovation-driven economy. Such a move is about the right incentives, the allocation of finance, and striking a balance between fundamental research ensured by the state and market innovation at company level. This ambition can trigger a high-powered political evolution since innovation is not just technological progress. Institutional and cultural change is needed for an innovative society to be born. This has an impact at the political level.

The second challenge is to regain control of the environment. Air, water and earth pollution hampers development and health in China and destroys the growth potential of the country. Taking green collateral damage into account when it comes to measuring GDP would significantly correct China's growth indicators. Moreover, despite still being in the industrialisation phase, but because of its size and fast development China must make a substantial and fair contribution to the relative decarbonisation of the planet in order to cope with climate change.

Third, China has opted for an accelerated phase of capital accumulation which always implies huge consumption efforts from the

population. The outcome is impressive in terms of advanced public infrastructures, productive equipment and housing. Yet this fast process has also led both to capital waste and excessive concentration of wealth. Profit-driven wealth originating in innovation and entrepreneurship within a competitive environment, nurtures positive externalities in terms of productivity and jobs and therefore carries a strong economic rationale. The same does not hold true, though, when wealth is obtained through cronyism and collusion. China's Gini coefficient is not abnormal in this phase of development, but is more reminiscent of Victorian England than indicative of a socialist collective ambition. As growth rates begin to diminish, the Chinese caught in the slow lane will prove more and more sensitive to the equality issue.

Fourth, China will soon have an ageing population and the one-child policy which contributed to the growth of GDP per capita will prove a severe handicap. This should be offset by a huge effort in productivity, hence the emphasis on innovation.

Fifth, as China grows, so goes its hunger for energy, minerals and food. In this respect the rise of China proves a blessing for Africa, Latin America and the rest of the commodity-exporting countries. Yet as prices go up, imported inflation becomes a problem. Change in the terms of trade means lower real wages, and combating imported inflation will require an appreciation of the Renminbi (RMB) with an impact on jobs. But the main issue raised by the growing scarcity of natural resources lies elsewhere. China is by no means the only emerging country. It is the locomotive of the BRIICS train. Therefore the race for natural resources will be of real concern to China and the rest of the world whilst the security of maritime routes and commodity sources is already a strategic issue.

There are three ways to cope with the global challenge of resources sharing: markets, political deals or strategic rivalry and confrontation. China's option will be decisive for prosperity and peace in the world. China is the newcomer in the race, but America and Europe who have enjoyed the prime movers' privilege, are still taking the lion's share of the world's resources. It is here that the choice of organising multipolarity on a multilateral rules-based system or through an intergovernmental power play regime will prove decisive for the world's stability.

Over the last three decades China's leadership has demonstrated an exceptional capacity to cope with daunting challenges by combining long-term vision and pragmatism. China has exploited its unique balance of centralisation and decentralisation to mix strategy and field experimentation. However, more will have to be done with the additional complication that as China's economy and society are entering into qualitative transformations, demands on the political system will increase. More responsiveness from the leadership and stricter accountability from the lower-ranking officials will be needed to ensure political stability, a key condition of success. Political stability calls therefore for movement and continuation of reform.

The 12th Five-Year Plan (FYP) provides a robust framework for adjusting China's export-driven and FDI-pushed development model towards stable growth, domestic consumption, and environmental protection. China will

need a more comprehensive social safety net so as to allow people to switch from excessive savings towards higher household consumption. This implies effective trade unions to ensure a fair share of productivity gains and financial reform so as to guarantee a higher return on savings. Financial reform should improve the allocation of savings towards more efficient investment. It would also pave the way for an unavoidable full convertibility of the RMB, called to play a bigger role as a transaction and even global reserve currency in the future. China will gradually have to replace direct or indirect state intervention with rules-based incentives in order to influence investors' behaviour in the private sector, the SOEs and even the regional and local authorities. The vast effort envisaged in the field of research and education must encompass fair access to the best schools and universities, specifically access based on merit so as to ensure that the best reach the top, in the very Confucian tradition, regardless of their geographical and social origins and their social connections. China must also devote the necessary resources in order to bring its defence capacities in line with its growing economic interests and its new international responsibilities. In doing so, China must ensure that the CPC keeps full control of the People's Army and that a problematic 'military-industrial complex' does not interfere with the country's strategic choices.

There are serious reasons based on past experience to entrust China with the capacity to deliver on a broad and deep reform agenda which will reconcile job creation and a fair and sustainable development at home, with the rising international responsibilities attached to its new status as the future first economy of the world.

There might be temptations in the West to develop a 'rising China syndrome'. Some will raise the fear of a strategic dilemma of the type 'either them or us'. Three tactics might be used as a way of preventing China from reaching strategic supremacy. One is to highlight the link between the one-party system and the mounting strategic capacity so as to question the very legitimacy of China's strategic efforts. Another tactic would be to undermine China's ability to pursue its economic performance, which provides the key to China's rising strategic power, by branding China as an unfair competitor on the commercial scene. A third tactic is to replicate the 'containment policy', led successfully by the West against the former communist camp, vis-à-vis China. Some observers consider the US-led Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP) as two economic claws which could eventually encircle China and hamper its growth.

But at the end of the day, what will matter most is China's ability to deliver development at home and peace abroad. Among the realist school in international affairs there is an implicit consensus that China should not be assessed on the basis of process legitimacy, like in Western democracies, but through output legitimacy. Three aspects will be carefully considered in the future and will weigh heavily on the judgement passed by foreign countries. The first is China's ability to regain control of income and wealth distribution, the second is its actions at home regarding the environment and therefore its willingness to take on climate change commitments, and last but not least, its capacity to nip corruption in the bud – starting by cutting out the

intermediate bureaucratic levels and red tape – and to enhance the profile of the CPC as a true People's party whose behaviour is consistent with its proclaimed communist ethics.

Forging new foundations for global market capitalism

Lessons are being drawn in the US, the EU and China, from the policy and market failures that caused the most severe crisis endured by the global economy since World War II. These are usually related to the banking and financial industry on the one hand, and public finance and fiscal policy on the other. But deeper reforms should be envisaged in order to prevent the repetition of such dangerous and harmful crises.

Three areas should be covered by reformers, ideally together, but probably separately since consensus would be difficult to reach and time should not be wasted; the pioneering countries should not be held back by the reluctance or the passivity of others.

Three areas should be addressed in order to bring about the re-foundation of market capitalism. The corporate governance pillar should deal with bigness (dismantling companies deemed 'too big to fail'), 'hit and run' shareholders' practices, excessive wage gaps and the criminal responsibility of business leaders in case of fraudulent or excessively risky behaviour with a severe impact on the economy. The financial pillar should aim at keeping finance at the service of the real economy, downsizing it, recapitalising it and focusing it on financial transformation, limiting innovations to reliable and transparent vehicles. The tax pillar should focus on the monitoring and surveillance of capital flows coming in and out of under-taxed and under-regulated offshore financial places, while unitary taxation at the multilateral level would both ensure effective taxation of global companies and the fair sharing of tax revenues between host countries.

Europe would find in the re-foundation of market capitalism both a sense of purpose for its citizens in search of a common identity, and a role as pioneer for future multilateral governance.

CHINA'S LEADERSHIP CHANGE AND ITS IMPLICATION FOR CHINA-EU RELATIONS

Jiang Shixue[*]

At the 18th party congress in November 2012, XI Jinping was elected as the General-Secretary of the Central Committee of the Communist Party of China (CPC). At the 12th National People's Congress (NPC) in March 2013, XI Jinping and LI Keqiang became China's President and Premier, respectively.

The new Chinese leaders are by no means strangers to the Europeans. Both XI and LI were made known to the public over five years ago. They have been to Europe several times and have met with European leaders, members of the business community and the media. What is more, the new Chinese leaders possess substantial knowledge of Europe, an aspect that has positive implications for the future development of Sino-EU relations.

China's foreign policy

From a Chinese perspective, the leadership change will not greatly impact the country's current foreign policy. This has already been promulgated in the report of the 18th Party Congress.

In his report at the Congress, HU Jintao, then General-Secretary of the CPC, outlined China's new foreign policy framework, expressed China's desire to commit to growing friendship and cooperation with other countries in all fields, on the basis of the Five Principles of Peaceful Coexistence[1], highlighted China's desire to improve its relations with developed countries more specifically by expanding areas of cooperation, and affirmed China's wish to establish better relations with other major countries. Furthermore he stated that China would actively participate in multilateral affairs and will support the United Nations, the G20, the Shanghai Cooperation Organisation, and BRICS (among other multilateral organisations).[2] China through such action seeks to forge the international order and system more just and equitable.[3] The country would also take steps to promote public diplomacy and encourage people-to-people as well as cultural exchanges.[4] In the meantime, China looks to protect its legitimate rights and interests overseas.

Alterations to a country's foreign policy however are not uncommon given that we live in an uncertain world where the environment is forever changing. For instance, as Japan continues to make trouble over the Diaoyu

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[1] The Five Principles of Peaceful Coexistence are: mutual respect for sovereignty and territorial integrity, mutual non-aggression, non- interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence.

[2] HU Jintao's Report at the 18th Party Congress, XI. Continuing to Promote the Noble Cause of Peace and Development of Mankind, *Xinhua net,* 17 November 2012, retrieved 13 April 2013, http://news.xinhuanet.com/english/special/18cpcnc/2012-11/17/c_131981259_12.htm.

[3] *Ibid.*

[4] *Ibid.*

Islands dispute, China might adjust its policy towards this neighbour,[5] which has yet to acknowledge its war crimes in the past. The purpose of the adjustment would be to safeguard China's territorial integrity, preserve peace and tackle complex regional and international issues through dialogues, consultation and negotiation. It is China's hope that Japan agrees to make concrete efforts to improve its relations with China, and play a positive and responsible role so as to limit conflict and maintain stability and development in the region.

China-EU relations towards the future

The EU is one of China's most important trade partners as well as a major source of high-tech and capital. At the same time, the EU is an important receiver of China's outward direct investment. In regards to world politics, the EU is a vital force in establishing the 'harmonious world' proposed by China.[6] Therefore, the EU will continue to occupy an important position in China's foreign policy agenda, and it is unlikely that China's policy towards the EU will be greatly changed in the future.

The China-EU relationship has reached a mature and fruitful stage. During the news conference on the side lines of the first session of the 12th NPC on March 9, 2013, Chinese Foreign Minister YANG Jiechi said that China hopes to strengthen collaboration with the EU in areas such as urbanisation, new energy sources, scientific and technological innovation and green development.[7] In order to realise this objective, both China and the EU need to pay attention to the following issues.

How to make the Comprehensive Strategic Partnership more meaningful?

In 2003 China and the EU established a comprehensive strategic partnership, which has important implications for bilateral relations. It has since become clear however, that China and the EU have a different understanding of the term 'comprehensive strategic partnership'.

The EU officially introduced the expression 'strategic partnership' in December 1998 by identifying Russia as a strategic partner.[8] Apart from Russia and China, the EU has built strategic partnerships with the countries including the US, Japan, Brazil, India, Canada, Mexico, South Korea and South Africa.

Herman Van Rompuy, President of the European Council, was reported to have stated on 14 September 2010, that "Until now, we have

[5] For instance, Chinese surveillance ship fleets will patrol at waters around Diaoyu islands more regularly.

[6] The notion of 'harmonious world' can be understood as promoting peace, strengthening cooperation among countries on a win-win base, encouraging diversities in choosing nation development paths, resolving disputes based on the Five Principles of Peaceful Coexistence, etc.

[7] "FM opposes EU moves against China's PV products", Xinhua News, 9 March 2013, retrieved 19 March 2013, http://news.xinhuanet.com/english/china/2013-03/09/c_132220663.htm.

[8] "EU Strategic Partnerships with Third Countries", Library Briefing, Library of the European Parliament, 26 October 2012, p.1, retrieved 22 April 2013, http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2012/120354/LDM_BRI(2012)120354_REV1_EN.pdf.

strategic partners; now we also need a strategy".[9] If this is indeed the case, what then can be considered as the EU's strategy towards its strategic partners?

It seems that the EU has different strategies towards its various partners, and the baseline for designing the different strategies is the so-called 'normative convergence'. Therefore, the US, Canada and Japan are seen by the EU as 'established partners' that share the same or very similar goals and values. Russia enjoys the status of strategic partnership because the EU believes they have 'common interests'. Mexico is considered a strategic partner as it has regional influence. China is regarded by the EU as capable of building an "enduring and mutually beneficial relationship of equals".[10]

China has more strategic partners than the EU. Furthermore, in China's diplomatic vocabulary, there are more types of partnership such as 'strategic and cooperative partnership for peace and prosperity', 'strategic cooperative partnership', 'mutually beneficial strategic partnership', 'constructive strategic partnership', among others, of which the comprehensive strategic partnership certainly represents the highest level.

Apart from the EU, China has also set up strategic partnerships with some EU member states. China maintains partnerships not only with the large member states such as Germany, France, the UK and Italy, but also with small member states such as Ireland.[11]

Regrettably, after ten years of comprehensive strategic partnership with China, the EU still fails to grant the country market economy status (MES) and continues to maintain the arms embargo against China. At the 15th China-EU summit in September 2012 that took place in Brussels, Chinese Premier WEN Jiabao said that he felt disappointed that he had been trying for the past decade to ask the EU to recognise China's MES and to lift the arms embargo.

Some European scholars have different points of view. A European professor said for example that "The EU and China have never created a strategic partnership, but it has been established as a goal, or even more, as a process, a long-term process".[12] Another European scholar noted that "perhaps there is more strategic thinking behind such initiatives [as the comprehensive strategic partnership] on the Chinese side".[13]

How to reduce trade frictions?

Trade between China and the EU has been growing rapidly. According to China's Ministry of Commerce, two-way trade increased from US$125 billion in

[9] European Parliament, "The EU Foreign Policy towards the BRICS and Other Emerging Powers: Objectives and Strategies", 2011, p. 28.
[10] "EU Strategic Partnerships with Third Countries", *op. cit*., p. 2.
[11] In March 2012, China and Ireland agreed to forge a mutually beneficial strategic partnership.
[12] *China Daily,* 12 October, 2012, p. 32.
[13] Institute of European Studies of China Academy of Social Sciences, "Prof. Thomas Christiansen on China-EU Relations", 25 February 2013, retrieved 19 March 2013, http://ies.cass.cn/en/Interview/201302/5994.asp.

2003 to US$546 billion in 2012, more than four times bigger in just ten years.[14] That is to say, at present, daily trade has reached US$1.5 billion.

It is natural that such a huge amount of trade can create frictions between the two sides. As a matter of fact, the EU is a partner that has frequently utilised the anti-dumping practice against Chinese products.

The EU Commission believes that its trade and defence instruments such as anti-dumping cover only around 1 percent of its total imports from China,[15] implying that its protection is not a big issue. In 2012, China exported US$334 billion to the EU. Therefore, 1 percent was equal to US$3.3 billion. However, if this amount of exports was generated by one or more sectors in several areas, its negative impact would be enormous.

China needs to strengthen its competitiveness but *not through cutting prices*. The EU, on the other hand, needs to follow the WTO rules more strictly. It is encouraging to see that, in November 2012, in its final ruling the European Court of Justice states that: "The EU needs to pay all of China's shoemaking giant Aokang's litigation expenses and refund the paid anti-dumping duties to its trading importers, which are estimated to total around 5 million Renminbi (RMB) or US$802,000".[16]

China has been enjoying a trade surplus with the EU of US$122 billion in 2012.[17] As a result, the EU has been complaining about it over the years. There are two ways of correcting the trade imbalance. China is expected to either export less to the EU and/or import more from it. A large part of China's exports are labour-intensive, which is beneficial to the EU consumers, particularly at a time when austerity measures have been taken in many parts of the EU. China has been trying to import more from the EU. However, it is not realistic to ask China to purchase more consumer goods from the EU as China itself has a comparative advantage to produce them. There is increasing demand for European technology in China. In other words, if the EU can reduce its restrictions on technology transfer to China, it would be much easier to correct the trade imbalance.

Apart from trade imbalance, China and the EU are faced with another problem, that of market economy status. According to the EU, there are five criteria to determine whether a country can be considered a full market economy for the purpose of anti-dumping investigations.[18] Judgment of these

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[14] Ministry of Commerce of the PRC, "Trade Volume Statistics between China and European Countries between January and December 2012", retrieved 28 March 2013, http://ozs.mofcom.gov.cn/article/date/201302/20130200025487.shtml.

[15] The EU Commission, *Facts and figures on EU-China trade*, September 2012, retrieved 20 March 2013, http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc_144591.pdf.

[16] R. Yu, "Aokang anti-dumping win 'positive precedent'", China Daily, 19 November 2012, retrieved 26 March 2013, http://www.chinadaily.com.cn/china/2012-11/19/content_15942778.htm.

[17] Ministry of Commerce of the PRC, *op. cit.*

[18] The five criteria include: 1) A low degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly (e.g. public bodies), for example through the use of state-fixed prices, or discrimination in the tax, trade or currency regimes; 2) An absence of state-induced distortions in the operation of enterprises linked to privatisation and the use of non-market trading or compensation system; 3) The existence and implementation of a transparent and non-discriminatory company law which ensures

criteria is often considered subjective. The EU granted the MES to Russia as early as before it entered the WTO, simply because the EU needed and continues to depend on Russia's energy. Regrettably, years of discussions, complaining and lobbying by the Chinese government has failed to convince the EU to recognise China as a market economy. But this status will be automatically granted to China in 2016 on the basis of the protocol it signed to become a member of the WTO in 2001.

It is interesting to note that a European scholar believes the granting of MES to China is not automatic in the year 2016 or afterwards. "There is nothing in the WTO rules, or elsewhere, to provide that China automatically gets market-economy status in 2016. The idea that it will is a misunderstanding shared by many in China, the EU and the US," the scholar writes.[19] Some EU officials also believe that China's right to be granted MES in 2016 should be determined by all the EU member states as well as the European Parliament. In that case, China will have to wait many more years before the EU will be prepared to grant China MES.

How to deepen mutual understanding?

In order to ensure that bilateral relations prosper, there is an inherent need for mutual understanding between parties. Over the years both China and the EU have undertaken some measures to improve mutual understanding of one another.

The Chinese have gone to great lengths to enable Europeans to gain insight into China. *China Daily,* China's flagship English newspaper, is available in many European hotels and universities; China's TV programs are accessible in many parts of Europe; by October of 2010 more than one hundred Confucius Institutes had been built in 31 European countries;[20] and terracotta army exhibitions among others are held in Europe several times a year.

China has made great efforts to inform Europeans about its politics, economy, foreign policy, society, etc. But China is told by the European Union that "to inform is not to communicate". Instead of learning real facts about China offered by the Chinese media, some Europeans tend to believe an inaccurate account published in the Western media.

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adequate corporate governance (application of international accounting standards, protection of shareholders, public availability of accurate company information); 4) The existence and implementation of a coherent, effective and transparent set of laws which ensure the respect of property rights and the operation of a functioning bankruptcy regime; 5) The existence of a genuine financial sector which operates independently from the state and which in law and practice is subject to sufficient guarantee provisions and adequate supervision, information found in European Commission, *Commission Staff Working Document, Report from the Commission to the European Parliament - 29th Annual Report from the Commission to the European Parliament on the EU's Anti-dumping, Anti-subsidy and Safeguard activities (2010)*, COM(2012) 59 final, 16 February 2012, Brussels, retrieved 26 March 2012, http://trade.ec.europa.eu/doclib/docs/2012/may/tradoc_149395.pdf.

[19] B. O'Connor, "Market-economy status for China is not automatic", Vox, 27 November 2011, retrieved 26 March 2013, http://www.voxeu.org/article/china-market-economy.

[20] Confucius Institute Headquarters, "About Confucius Institute", retrieved 26 March 2013, http://www.hanban.edu.cn/confuciousinstitutes/node_10961.htm.

With the rapid rise of China on the world stage, more and more European think-tanks and scholars have conducted meaningful academic research on China. It seems that, however, mutual understanding between China and the EU will never be more than enough. Yet, often many Europeans are surprised to learn that, in China, there are eight non-communist parties.[21] They are equally surprised to learn that the multi-party cooperation and political consultation under the leadership of the Communist Party of China constitutes a political system in China.[22]

The key issue is to learn how to agree to disagree on certain issues. The EU emphasises the importance of human rights, democracy, politics and universal values among other things. Conversely China insists that sovereignty and non-interference are important.

As a populous nation with 1.3 billion people, China would like to choose a different path with regards to political and economic development. As WAN Exiang, Chairman of the Central Committee of Revolutionary Committee of the Chinese Kuomintang, said, "Only the feet know whether the pair of shoes is comfortable or not".[23]

In China there are 58 large cities with a population of more than 6 million whereas in Europe there are only two (London and Paris). Within the EU there are 11 member states (Cyprus, Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, Luxemburg, Malta, Slovakia, and Slovenia) whose national population is less than 6 million. The Chinese Vice Foreign Minister FU Ying's words are very enlightening: "Europeans need to look at China with a historic view, respect its development path, and acknowledge its efforts. Chinese need to look at the criticism of the Europeans in an objective way by accepting the correct opinions and doing more explanations in order to address misunderstanding and prejudice. China needs to embrace the world with a more open mind".[24] Minister FU expressed her wishes at the fifth Lanting Forum held by the Chinese Foreign Ministry on December 2, 2011.

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[21] The eight non-communist parties are: the Revolutionary Committee of the Chinese Kuomintang, the China Democratic League, the China National Democratic Construction Association, the China Association for Promoting Democracy, the Chinese Peasants and Workers Democratic Party, China Zhi Gong Dang, the Jiu San Society and the Taiwan Democratic Self-Government League.

[22] The system means that the CPC is the only party in power in the People's Republic of China while under the precondition of accepting the leadership of the CPC, the eight other political parties participate in the discussion and management of state affairs, in cooperation with the CPC. Political consultation means that under the leadership of the CPC, all parties, mass organisations and representatives from all walks of life take part in consultations of the country's basic policies and important issues in political, economic, cultural and social affairs before a decision is adopted and in the discussion of major issues in the implementation of the decisions. Political consultation takes the organisational form of the Chinese People's Political Consultative Conference.

[23] "Wan Exiang, Chen Changzhi: multiparty cooperation and political deliberative system is appropriate to Chinese National Conditions", *Xinhua net*, 6 March 2013, retrieved 26 March 2013, http://news.xinhuanet.com/2013lh/2013-03/06/c_114914855.htm.

[24] Fu Ying, "Sino-EU relations make progress despite of difficulties", speech given at the Lanting Forum of the Ministry of Foreign Affairs of the PRC, 2 December 2012, retrieved 28 March 2013, http://news.xinhuanet.com/world/2011-12/02/c_111212659.htm

Conclusion

Leadership change in China will not result in significant changes to Chinese foreign policy. The Sino-EU relationship has reached a mature stage. In order to promote the bilateral ties further, both sides need to pay attention to the following issues: how to make the 'comprehensive strategic partnership' more meaningful; how to reduce trade frictions; and how to deepen mutual understanding.

GLOBAL VALUE CHAINS AND THEIR IMPACT ON EU-CHINA RELATIONS

*Dinos Stasinopoulos**

Until late 1980's international trade was mainly restricted by transport costs which resulted in trading on the basis of proximity. The focus was on the expansion of trade through the reduction of border barriers. Trade policy dealt primarily with border issues although the General Agreement of Trade and Tariffs (GATT) Tokyo Round in 1984 tackled non-tariff and regulatory measures such as government procurement, subsidies and technical barriers to trade. The global trade GATT system was at the core of multilateral efforts to create a more open and competitive trade regime.

The scope for further rule making along these lines has receded and the regime has become less relevant for the trade practices of today. A major transformation in the global economic environment coincided with the creation of the World Trade Organisation (WTO) in 1995 and has had profound implications for the international and national governance of trade. An expansion of the trading system (characterised by deepening and widening of commercial transactions) has brought about a new paradigm in trade policy and the need to deal with additional issues of domestic policy barriers to trade. The new paradigm of trade policy is no longer confined to tariffs and quotas and is often linked to a country's social and environmental policies and its overall economic and development strategy. Technology changes in transport, in particular with regards to containers have reduced the problems of distance. The cost of transporting goods by sea has been reduced by 50 percent in the space of a few years and the internet has had a similar effect on communications resulting in fragmentation of the logistics chain and the development of global value chains (GVCs).[1]

This paper reviews these changes in trade practices, notes the development of global value chains in relation to trade policy, studies their impact on EU-China relations and examines whether they require a fundamental rethinking of EU-China trade relations.

EU relations with China were established in 1975 and are governed by the 1985 EU-China Trade and Cooperation Agreement and several other legally binding agreements. Trade and economic cooperation now serve as the basis for the EU-China partnership.

EU-China trade has increased dramatically in recent years. The EU is China's biggest trading partner while China is the EU's second largest two-way trading partner, behind the United States, and by far the EU's biggest source of imports. For the year 2010 EU goods exports to China were €113 billion (38 percent more on 2009) and imports from China were €281 billion (31 percent

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[1] Global value chains are often referred to as fragmentation of production, trade in tasks or trade in intermediate products.

more on 2009). For the year 2010 EU services exports to China amounted to €20 billion and EU services imports from China were €16 billion. For the year 2010 EU's foreign direct investment to China totalled €4.9 billion and China's direct investment to EU was €0.9 billion .[2]

The EU's open economy has been an important contributor to China's growth and the EU has benefited from the growth of the Chinese economy. Over the last decade, China's economic growth outpaced consumption, with household consumption reaching 35 percent of GDP. Such a low share left rising investment and trade surpluses as the main engines of Chinese growth. China's rapid growth has caused some anxieties in terms of competition for trade and investment opportunities.

Despite the over 30 percent growth in bilateral trade over the last year, trade relations have been bedevilled by concerns over China's excessive trade imbalances with the EU, since some European countries tend to see trade imbalances through commercial and mercantile lenses. These concerns have created tension between the EU and China and led to trade disputes and protectionist measures.

The effective practice and implementation of a new paradigm of trade policy has led to the efforts of the EU and organisations such as the WTO and the Organisation for Economic Cooperation and Development (OECD) to carry out research on trade flows in order to understand better the impact of logistics' changes brought about by globalisation.[3]

New trade reality - from trade in goods and services to trade in tasks

Globalisation is the main force defining the new global trade and economic environment. Forces driving the process of globalisation are rapid advances in communication and transportation technologies which have reduced the costs of moving goods and people. These forces are in turn, important factors that have shaped the current economic environment and required a shift in policy orientation from border barriers to domestic regulatory policies.

The global economy has undergone major changes in the past 20-30 years. The first change involves a radical shift in economic activities from Western Europe towards Asia and in particular China - a rising economic and commercial power. China's output today accounts for over 8 percent of the global economy and in twenty years it is expected to account for 20 percent. China already accounts for 9 percent of world trade and about 25 percent of global growth.[4] The increasing economic and commercial clout of emerging economies, especially China, offsets the relative decline of the United States and Europe.[5]

The second major change in the global economy is a profound transformation in the production and distribution of goods and services

[2] European Commission, "Global Europe, EU-China Trade and Investment, Competition and Partnership", 2006; and European Commission, "Global Europe, A Stronger Partnership to Deliver Market Access to European Exporters", 2007.
[3] M. Hart, "The WTO and the Political Economy of Globalisation", *Journal of World Trade*, 1997.
[4] See K. De Gucht, EC Trade Commissioner, Opinion piece on China's role in the World Economy, 11 July 2011.
[5] R. Sally, "Trade Policy in the BRICS: A Crisis Stocktake and Looking Ahead", EGIPE, 2009.

resulting in the slicing of the tasks of the logistics chain. This change is illustrated by the rising proportion of global trade represented by intra-firm, intra-industry transactions, increasing trade in intermediate inputs, and foreign direct investment.[6]

With fragmentation in production and distribution, the traditional measures of trade that record gross flows of goods and services when they cross borders may no longer provide an accurate picture of the importance of trade in economic growth, nor can they explain the true structural nature of bilateral trade balances.

A large proportion of international trade is conducted within production networks and chains that cross international borders. In addition, much of the manufactured goods consumed worldwide is produced within international networks and supply chains.

This situation has created the need for additional information on value-added chains in order to take into account double counting (implicit in current flows of trade) when measuring the value that is added by a country in the production of exported goods and services.[7]

What should be the impact of new commercial practices of value chains on the design of trade policy? How does this affect old-paradigm trade policy based on the old concept of zero-sum game between our producers and theirs? The next section attempts to provide some answers to these questions in the context of EU-China trade relations.

Implications and impact of global chains for EU-China trade relations

In this fast changing production and trade patterns, China's policies have been the target of criticisms. Given the current economic crisis and trade imbalances, many Europeans see China's trade surplus with the EU as a problem. Some even argue that China's overvalued currency, the Renminbi (RMB), boosts Chinese exports and contributes to the surplus.

Contrary to the popular argument, economic data indicate that, the strength of the RMB does not have a strong correlation to EU's trade deficit with China.[8] This is partly because EU's imports of Chinese goods are located in different market segments and when the Chinese currency rises, the EU simply imports less from China and increases its imports from other Asian countries. The trade deficit with China seems to be a problem, but perhaps quite misleading because global value chains are not taken into account.

Actually, changes in Asia's supply chain are the main driver of our trade deficit with China. As the final leg of the supply chain shifted to China, EU imports from China rose as the EU imported less from the rest of Asia. The bilateral trade deficit with China is the by-product of a global value chain resulting from production and distribution fragmentation. Fragmented trade patterns mean a longer value chain and China is more likely to be the last step from which the assembled final product goes to Europe as a main

[6] See S. J. Palmisano, "The Globally Integrated Enterprise", *Foreign Affairs*, 85, N° 3, 2006.
[7] A. Maurer & C. Degain, "Globalisation and Trade Flows: What you see is not what you get", WTO, 2010.
[8] For more information, see Z. Zhang & K. Sato, "Should Chinese Renminbi be Blamed for its Trade Surplus? A Structural VAR Approach", *The World Economy*, Volume 35, Issue 5, May 2012.

market. Whatever is exported by China is an aggregation of inputs from many countries. As the last production link China's value-added share is much smaller.

Despite the important changes in commercial practices in production and distribution systems, the EU and its member states often maintain certain aspects of trade policies, for instance, rules of origin and anti-dumping measures, that are inconsistent with the new trade reality. There is a growing gap between trade policy and reality regarding preferential rules of origin that determine the nationality of goods that are imported in free trade areas. In the new trade environment market price is increasingly global which makes it difficult to determine the origin of a commodity. There is a need to reform rules of origin to better align them with trade practices.

The trend towards GVCs has made EU's enterprises increasingly dependent on inputs at competitive prices. But as the OECD and the WTO research indicates, trade in inputs is very sensitive to import barriers.[9] There is a need for cost/benefit studies to identify changes required and to determine policies consistent with the new trade reality.

These changes require a different approach in the exercise of EU trade policy and in the measuring of trade flows to take into account the transformation of the global trade environment.

In this new context of international trade, commercial issues transcend the mere issue of trade imbalances. Therefore measures of bilateral trade based on gross concepts of trade flows can present a misleading picture of who benefits from bilateral trade and exaggerate the importance of countries involved in the production at the end of the production chain. Bilateral trade imbalances become meaningless when China's export to the EU include approximately 35 percent of Chinese added value while EU exports to China contain much larger added value. It does not make sense to continue calculating bilateral trade balances the way we do today. To reflect this new reality, we need to supplement the collection of trade statistics, measure the effective value added and not the overall value of imported and exported goods and services.

The EU's trade policy which aims to reduce imports from China not only affects Chinese exporters, but also impacts on subsidiaries of EU companies and manufacturers that have their supply chain in China.

Policies based on conventional import-export flows have resulted in protectionist defence measures targeting countries at the end of the value chains, because of the wrong understanding of the origin of trade imbalances.[10] Similarly measures based on gross trade concepts can give a misleading assessment of who ultimately benefits from the trade as they attach undue importance to countries producing at the end of value chains.

The EU's trade policies predicated on the conflation of producer interests result in commercial tension between the EU and China. The fragmentation of production and slicing of global value-added chains has

[9] OECD, Joint OECD-WTO Note, "Trade in Value-Added: Concepts and Methodologies and Challenges", 15 March 2012.

[10] D. Ikenson, "Made on Earth: How Global Economic Integration Renders Trade Policy Obsolete", *Trade Policy Analysis*, N° 42, 2 December 2009.

contributed to the creation of trade imbalances.[11] Trade disputes and trade imbalance issues should therefore be considered in a different context when value-added data and measures of trade are utilised.

Analysis of trade issues based on current trade export-import flows data tend to overestimate trade imbalances. If these imbalances are interpreted on the basis of a single country of origin statistics in value-added terms, we obtain a more reliable way of dealing with conflict in trade issues. It has been argued that looking at trade in value chains as opposed to traditional statistics may result to reduction of trade deficits with China by as much as 30 percent.[12]

The cost of national borders has grown as a result of GVCs and this has undercut protectionist arguments and underlined the need for non-discriminatory trade policy regulations.

The EU/China textiles conflict in 2004-2005 is an example. During that period, large quantities of clothing from China were confined to EU ports for weeks, while EU's retailers and shippers were lined up against the EU's textile industry. The so-called 'bra wars' were the result of the EU restrictions on clothing imported from China, and left retail shelves empty for weeks resulting in losses for retailers and higher prices for consumers. If EU policy makers had considered the interests of all links and participants in the supply chain, this conflict could have been avoided.

The European Union's trade deficit with China is driven by a variety of factors. One of these is the macroeconomic imbalance between saving and investment. The EU consumes more and saves less, except for Germany, while China saves more than it invests.

Today the factory floor is spread across borders and travels from the design and marketing establishments in Europe to assembly operations to China and other Asian countries back to the European distribution centres.[13]

Exports to Europe generated mainly from foreign direct investment, joint ventures and affiliates of multinational and European enterprises have small value-added from China.

Conclusion

This paper stresses that understanding the new reality and business practices of GVCs is very important for EU's relations with China. The increasing importance of GVCs has been widely noted in economic and trade policy periodicals. GVCs are not new. What is new is the public debate on what this trade reality means for the global economy. The debate is on the growing gap between the reality of trade transactions and trade policy.

The rising influence of emerging economies and in particular China's fast developing supply chains are an important factor of the new trade reality. With globalisation and fragmentation of production and distribution,

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[11] P. Lamy, Director General WTO, "The Future of Europe in the New Global Economy", Speech, February 2012.
[12] K. De Gucht, *op. cit.*
[13] For more information, see Y. Xu, "Understanding International trade in an Era of globalisation, A value-added approach", *Policy Analysis*, Manufacturers Alliance for Productivity and Innovation (MAPI), 19 March 2012.

China has become the main assembly point for the manufacture of goods previously imported by Europe from other countries such as South Korea, Malaysia and Taiwan. As the final part of the supply chain has moved to China, EU's imports from China have increased but its imports from the rest of Asia have decreased. Chinese exports to Europe and the rest of the world contain increasing import content. These developments tend to inflate the export/import trade figures from China and make conditional rules of origin less relevant since commodities are imported/exported from everywhere because of global value chains.

Furthermore, anti-dumping investigations in the European Union should also be changed to take into account the competitive inputs for the European producers. These rules should be modified to reflect the new trade and production/technology reality. In addition to the above mentioned changes, there is a need to obtain more realistic data on EU-China trade flows.

Recent trade conflicts with China over trade imbalances should not be exaggerated, as they do not reflect the new commercial reality. In 2012, a joint WTO/OECD research report identified the importance and extent of trade in tasks in global commerce and called for the production of new statistics to complement existing trade data.[14]

It is of paramount importance that the EU abandons its bias towards domestic producers and engages in trade negotiations with China by considering the wider interests of consumers, importers and globally integrated producers who rely on imports. It should also be acknowledged that domestic producers' interests have never been an adequate representation of the broader economic interests and are even less representative today given the new transnational production and distribution patterns. Producers in China should be thought of as customers, suppliers and potential collaborators instead of competitive threats.

The adoption of new approaches of measuring trade flows may help to dispel the myths of large trade imbalances with China and reduce trade friction and disputes.[15] Studies carried out by the WTO and the OECD indicate that EU-China trade imbalances are exaggerated. Some preliminary results indicate that China's trade surplus with the EU will be reduced by one third if the trade flows are measured in value added terms. Several research initiatives are now under way: the WTO has joined efforts with the European Commission to develop a system of trade data based on the concept of value chains. The EU's 7th Framework programme for research and development has funded a World Input Output Data Base on the fragmentation of the supply chain. The results of these studies are expected to help us improve our understanding of the GVCs' impact and rethink our trade policy and trade imbalances with China.

[14] OECD, Joint OECD-WTO Note, *op. cit.*
[15] S. Plasschaert, "Is the Renminbi Undervalued? The Myths of China`s Trade Surplus and Global Imbalances", EGIPE, February 2011.

IS THE TTIP ANTI-CHINA, THE END OF THE ASIAN CENTURY, OR A MIRAGE?

*David Fouquet**

When the European Union and the US on 13 February 2013 announced their intention to begin negotiations on a new Free Trade Agreement what at first seemed strictly a Transatlantic matter, quickly caused repercussions that spread across China, Asia and the entire international trading community.

A Transatlantic economic community was an early Post-war ambition considered by numerous idealists. Such an ambition was both encouraged and undermined by the NATO alliance, the European Community and even by strenuous economic rivalry between the two shores of the Atlantic.
Despite decades of economic trade disputes over a range of issues, leaders from both nations have decided to begin talks with regards to eliminating tariffs and reducing other obstacles to trade.

The Economic Imperative

The bilateral announcements in Washington and Brussels focused largely on the potential economic benefits to both sides that anticipated trade volumes to stimulate their flagging economies and improve investment and job opportunities. They reasoned that the existing trade and economic relationship, already the most extensive in global terms, was mature enough (despite some persistent differences and problems) to consider a new more profound form of economic cooperation. They also expressed the desire to proceed beyond the mere elimination of low tariffs which are quantifiable and represent relatively minor obstacles to businesses wanting to develop new markets. The main objective was to reduce, eliminate and or harmonise non-tariff barriers as well as regulate any potential obstacles.

President Barack Obama and various EU leaders laid emphasis on trade and economic benefits that tend to accumulate from the establishment of free trade between the US and EU, a sector that currently makes approximately €0.5 trillion annually in trade in goods across the Atlantic and more than €250 billion in services trade.

The statement issued on 13 February 2013 noted that the US and the EU account for close to half the total world GDP and one-third of world trade, and have more than €2 trillion in accumulated direct investment on each side of the Atlantic.

While such an accord could be expected to generate an extra 0.05 percent GDP growth in the EU, the EU Trade Commissioner Karel De Gucht also pointed out that caution is needed:

> Transatlantic economic flows have also raced ahead: today, €2 billion a day in goods and services trade and over €2 trillion in mutual direct investment support 15 million jobs. However, these flows have not been

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> supported by similar legal structures to guarantee and further open our markets. We may have survived without these so far, but today's context is different. Both the U.S. and European economies need a boost following the longest and deepest economic crisis since the Great Depression.[1]

Although trade barriers are already low, the sheer size of the transatlantic economy (US$30 trillion) means that even small improvements can yield significant gains. With half of the world GDP, one-third of world trade flows and 15 million jobs linked to it, the transatlantic economy is still the driver of the world economy. A Transatlantic Trade and Investment Partnership would thus have global implications and could also deliver much needed progress for global trade. According to a new study, a comprehensive agreement could bring significant economic gains to the EU (€119 billion a year) and the U.S. (€95 billion a year) once it is fully implemented.[2]

Overcoming Differences

Such negotiations as well as a possible pact have been advocated for years by the German, British, and Irish governments, as well as some industrial and interest groups on both sides. The announcement was delayed partly due to the US Presidential election campaign, during which the Republican candidate Mitt Romney criticised Europe, China and other foreign relations

Although the Atlantic partners show unity and solidarity in certain areas, distinct economic and social cultures continue to exist in particular sectors (such as in competition policy, in the business regulation sector and in the consumer and environmental protection sector). Differences are predominantly discernible in the South of Europe where agricultural interests for example, have been considered threatened by the accessibility that has ensued from globalised trade and competition.

Europeans have long resisted American practices regarding genetically modified crops, antibiotic treatment in animals and fisheries, and the imports of certain American agricultural products. Although at first glance the ambitious and long-discussed project representing trillions of dollars in trade and investment, directly concerns the European Union and United States, its impact, and even motivation, is clearly directed at China and other rising Asian partners. Not only was the economic rise and influence of China cited by officials and covered in the media as a primary stimulus for the proposed trade zone on both sides of the Atlantic, it was also quickly characterised as an 'Economic NATO'. Some have equally considered it an effective mechanism capable of facilitating a 'rebalancing' toward Europe.

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[1] K. De Gucht, "Trade & Investment: The Time Is Ripe for a New Transatlantic Economic Agreement", Brussels Forum Views, 15-17 March 2013, Brussels, retrieved 19 March 2013, http://brussels.gmfus.org/files/2013/03/BF2013Papers_web.pdf.

[2] Center for Economic Policy Research, *Reducing Transatlantic Barriers to Trade and Investment, An Economic Assessment*, Final Project Report, March 2013, p. v ii, retrieved 19 March 2013, http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150737.pdf.

One Australian editorialist was reported to have referred to the prospective transatlantic agreement as signalling "the end of the Asian century".[3]

The China Factor

Officials in both Washington and Brussels were reported to have said that the trade agreement would provide a more united front against Chinese standards and norms on areas such as product safety and intellectual property.[4] EU Trade Commissioner Karel De Gucht stated that without such an agreement, "we would be forced to accept Chinese standards […] that's what it's all about". He equally professed that "a deal will have worldwide importance […] the talks are about our place – and by our place I mean the United States and Europe – within a decade on the world economic scene".[5] On 15 February 2013 London *Financial Times* commentator Philip Stevens stated the fact that:

> The advanced nations are losing ground to the rising states. The flow of power to the east and south puts a question mark on the relevance of 'the west'. […] [T]he paramount case for a transatlantic trade deal is geopolitical. The economics are a means to an end. The reward is the advance of the liberal political order that has lately seemed in retreat. […] If the bilateral numbers matter so, just as much, does the shared interest in preserving an open, rules-based international order as the best guarantor of the west's security.[6]

The German media also underlined the global political importance of the proposed arrangement in potentially strengthening the West. However Germany, the EU's most important international economic and trade power, has openly supported the notion of a free trade agreement between the EU and China. Remarkable encouragement has ensued from the business community predominantly.

Soon after that, the EU among other officials sought to reduce the importance of China and placed more importance to the possible stimulus the transatlantic deal could provide to resume the long-stalled Doha Round of multilateral trade negotiations under the auspices of the World Trade Organisation (WTO).

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[3] A. Sapir, "The Transatlantic Trade and Investment Initiative: Hope or Hype?", Bruegel, 5 March 2013, retrieved 19 March 2013, http://www.bruegel.org/nc/blog/detail/article/1034-the-transatlantic-trade-and-investment-initiative-hope-or-hype/#.UUiphBxLNe4.

[4] D. Fouquet & S. Jiang, "Transatlantic FTA's Strategic Re-pivoting and Balancing from Asia", EU-Asia at a Glance, European Institute for Asian Studies, February 2013, retrieved 19 March 2013, http://www.eias.org/sites/default/files/EU-Asia-at-a-glance-Fouquet-Shixue-Transatlantic-FTA_0.pdf.

[5] Quoted in J. Kanter and J. Ewing, "A Running Start for a U.S.-Europe Trade Pact", 13 February 2013, retrieved 19 March 2013, http://www.nytimes.com/2013/02/14/business/global/obama-pledges-trade-pact-talks-with-eu.html?pagewanted=all&_r=0.

[6] P. Stephens, "Transatlantic pact promises bigger prize. The real reward of a US-EU free trade area would be geopolitical", *Financial Times*, 14 February 2013, retrieved 19 Marc 2013, http://www.ft.com/cms/s/0/de81b668-753b-11e2-b8ad-00144feabdc0.html#axzz2O0zdvFVh.

Chinese Reactions

The reaction in China was mixed. Initially, Chinese scholars and media examined the possible repercussions regarding Chinese interests. Dr CHEN Xin of the Chinese Academy of Social Sciences Institute for European Studies, writing in the *People's Daily*, noted that the historic trade plan between the EU and US did not directly include China. This small detail coupled with the fact that the, Transpacific Partnership is openly being discussed by the US and a number of Asia-Pacific states, will certainly have indirect consequences for Chinese trade. He also remarked that "some negative effects also can become an external driving force for reforms; some contents of the EU-US negotiations can even become a lesson for us to develop hereafter a free trade area dialogue".[7] He concluded that: "A major challenge is how China can avoid being absent from the formulation of the new rules of the game. As long as China keeps up its strong economic development, as long as it further deepens reforms, and it continues economic growth, it should be able to face this challenge".[8]

HE Weiwen, co-director of the China-US-EU Study Centre under the China Association of International Trade, writing in the *Global Times*, remarked:

> The EU, for its part, has rich experience in regional market and economic integration. As a result, there is nothing strange in the two cooperating against external pressures. The FTA negotiations that are being ambitiously promoted by the US and EU will inevitably promote global trade liberalization. This will bring a new driving force for China to enter further into globalization as well as more challenges.[9]

He argued that since China has limited power in determining world trade rules, it should step up its negotiations and cooperation with its neighbours including Japan, Korea and the ASEAN, to increase its potential for influence. HE Weiwen also advised that China should increase the level of investment with regards to its transatlantic partners. This is particularly important as some Chinese firms such as Haier and Wanxiang need to overcome the threat of protectionism. He claimed that although China has in the past expressed anxiety over the effects of the North American Free Trade Area (NAFTA), the country has yet to show signs of causal vulnerability and weakness.

Yet another approach was articulated in a *People's Daily* editorial that remarked that the objective of the transatlantic exercise was to:

> try to retain and control dominance in regional economic and trade agreements, shape the WTO Doha Round and the following negotiations according to their own wills by outflanking. If the attempt

[7] X. Chen, "Changing the trade rules: strength is the most fundamental principle", trans. M. Chen, Chinese Social Sciences Network, 25 February 2013, retrieved 20 March 2013, http://www.cssn.cn/news/674943.htm.
[8] *Ibid.*
[9] W. He, "China must brace for impact of possible EU-US free trade agreement", *Global Times*, 26 February 2013, retrieved 19 March 2013, http://www.globaltimes.cn/content/764321.shtml.

succeeds, Asia, whose shares rise fastest in the global trading system, will be the most affected area. Certainly, if the United States and Europe demands in the Doha Round are completely fair and reasonable, and are consistent with the development guidelines of the Doha Round, the above US and EU strategy motives are not poisonous. The uneven distribution of benefits has represented the biggest issue affecting the trend of economic globalization since the 1990s. The burdens associated with heavy transformation are far greater than the benefits associated with globalisation. Rules of the two pillar organizations in the context of economic globalization, WTO and IMF, are faulty in this regard, and have more problems during implementation.[10]

An EU-China FTA?

Trade Minister CHEN Deming, during the mammoth twin governmental meetings in Beijing in mid-March appeared less conflicted when considering the matter. He responded positively by stating that China was prepared to engage in any resumption of WTO talks and negotiations with regards to a multilateral Doha Round of trade rules.[11]

The Chinese Ambassador to the EU, WU Hailong, was reported to have said that the EU and China could start talks on an investment treaty in the coming months. He was also reported to have said that China had already submitted a proposal on launching a feasibility study on a free trade agreement with the EU. It was noted that China did not want to be left behind while the EU-US trade negotiations were underway. He further assured that China "believes the time is ripe to discuss free trade with the EU". Ambassador WU said "China is ready" and added that the EU was seeking authority for a negotiating mandate to begin conceivably by the end of April.[12]

The EU and its industries and companies have been major investors in China for years and China has also become an increasingly important investor in the EU in recent years. SHI Mingde, the Chinese Ambassador to Germany, was quoted as saying that "there [was] huge potential for Chinese investments, especially in Germany".[13]

On 12 March, however, the EU Commission was reported to have approved a proposed TTIP mandate that has yet to be debated, amended and approved by the Council of Ministers. It also has to be considered by the European Parliament. It could therefore be awhile before the final mandates

[10] X. Mei, "The US-EU Free Trade Agreement faces an unpredictable future", *People's Daily Online*, 17 February 2013, retrieved 19 March 2013, http://english.people.com.cn/90883/8130774.html.
[11] "Doha trade talks should be pushed forward: commerce minister", *Xinhua*, 8 March 2013, retrieved 20 March 2013, http://english.people.com.cn/102775/206769/8159618.html.
[12] Q. Ding, "Nation plans study for free trade deal with Europe", *China Daily*, 8 March 2013, retrieved 20 March 2013, http://usa.chinadaily.com.cn/epaper/2013-03/08/content_16291668.htm.
[13] *Ibid.*

for the EU and the US are approved and negotiations actually begin.[14] At the same time, the EU and China will have to be prepared to organise and arrange negotiating positions and mandates before launching their own bilateral process.

Concluding Remarks

The Transatlantic trade project between the US and the EU may represent part of a greater concern and subsequent need for regional trade and economic cooperative initiatives. This does not necessarily mean the end of a global approach to trade issues. Indeed, the former Chinese Trade Minister CHEN Deming among others continues to show interest. There may however be a growing realisation and interest in closer economic and trade alignments on a regional basis with one's neighbours rather than the costlier or more unpredictable global trade links characteristic of past decades, especially in a global economic and financial crisis.

This may indeed be illustrated in the fact that China's new leader XI Jinping will travel to Russia for his first visit abroad, at a time when Russia is joining the WTO and may represent a newer and expanding trade partner for Beijing than Western economies in an economic slump.

The EU has also engaged or completed FTAs with a number of other Asian partners, ranging from the already completed FTA with South Korea that is currently being implemented, the completed but not yet ratified agreement with Singapore, the lengthy talks with India which optimists consider nearly completed, the negotiations launched with Malaysia and Thailand, and the preparations for other negotiations with Japan and Vietnam.

These discussions were being conducted at one level, while at another level discussions involving the Transpacific Partnership (TPP) between the US and a number of other partners in the region, but without China, were also taking place.

When all such agreements are concluded, ratified and implemented, other trade partners who judge that they have been adversely affected can, under WTO rules, begin a process to claim compensation for any prejudice or damage.

Another challenging question is whether bilateral agreements are positive for other multilateral accords and negotiations, whether they represent unique stand-alone achievements, or conversely whether they have a negative impact on the latter.

[14] European Commission, DG Trade Press release, "European Commission Fires Starting Gun for EU-US Trade Talks", 12 March 2013, Brussels, retrieved 20 March 2013, http://trade.ec.europa.eu/doclib/press/index.cfm?id=877.

A STABLE AND REGIONALLY INTEGRATED AFGHANISTAN? CHINA, THE SHANGHAI COOPERATION ORGANISATION AND THE EUROPEAN UNION IN AFGHANISTAN

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Even though since the fall of the Taliban in 2001 Afghanistan has engaged in a process of reforms and has made significant progress in areas such as education and healthcare,[1] the country is still situated in the lower human development category, ranked 172 out of 187 countries.[2] As opium production and drug trafficking activities continue to thrive, state institutions are vulnerable to corruption. This problem is deeply rooted and difficult to eradicate since a significant part of Afghanistan's formal GDP comes from these illicit activities.[3]

The stability of Afghanistan is crucial for the whole region of Central Asia and more specifically for the neighbours of Afghanistan, among which China. Extremist groups and terrorist movements threaten to cross the porous borderlines Afghanistan shares with some of its neighbours. Due to overall fragility, Afghanistan continues to be strongly reliant on international assistance. In the meantime, the troops of the International Security Assistance Forces (ISAF), present in Afghanistan since 2001(with a mandate from the Security Council of the United Nations and since 2003 under the command of the North Atlantic Treaty Organisation (NATO)) are expected to withdraw by the end of 2014.[4] Besides maintaining security, the ISAF forces helped train the Afghan National Security Forces (ANSF). The ANSF are expected to assume full responsibility in terms of security for the country as a whole by the end of 2014.[5] Important efforts both from the Afghan government and the international community (regional organisations playing a crucial role) are required to maintain peace and stability and guarantee a continued economic recovery of Afghanistan.

China and the European Union (EU) are two of the major international players while regional organisations such as the Shanghai Cooperation Organisation (SCO), of which China is an important member, are indispensable for the sustainable development and regional integration of Afghanistan. Through the prism of interactions between China, the SCO and the EU, this paper will investigate the roles of China, the SCO and the EU in Afghanistan and the possibilities of cooperation between the three in

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[1] See European Commission, *European Union-Afghanistan State of Play July 2012*, p. 2.

[2] United Nations Development Programme, *Human Development Report 2011, Explanatory note on 2011 HDR composite indices of Afghanistan*.

[3] European Commission, *EU's Country Strategy Paper to the Islamic Republic of Afghanistan (2007-2013)*.

[4] NATO, *NATO Chicago Summit Declaration on Afghanistan*, 21 May 2012.

[5] NATO, *NATO and Afghanistan, Questions and Answers*, 2012.

securing stability in Afghanistan against the backdrop of the gradual withdrawal of the ISAF forces.

SCO engagement in Afghanistan

In order to enhance regional security and economic cooperation in Central Asia, the Shanghai Five was founded in 1996, and subsequently transformed into the SCO in 2001. Starting from 2004, the SCO has been engaged in cooperation with Afghanistan: the Afghan President has been attending the SCO Summits since 2004, a SCO-Afghanistan Contact Group was created in November 2005 to propose cooperation on issues of common interest, a vice-ministerial consultation conference on Afghanistan was held in January 2009 and later in March a special conference on Afghanistan was convened in Moscow.[6] The declaration issued thereafter stated that the SCO was "one of the appropriate fora for a wide dialogue [...] and for practical interaction between Afghanistan and its neighbouring states in combating terrorism, drug trafficking and organized crime".[7] Furthermore, the newly launched Istanbul Process of Regional Cooperation or 'Heart of Asia Process'[8], gathering for the first time all regional countries to address the future of Afghanistan, underlines "the importance of a more structured approach to regional cooperation through various regional organisations" and recognises the crucial role of the SCO.[9]

Nevertheless, the interests of members states (and the observer states[10]) of SCO in Afghanistan are often dissimilar.[11] It seems that Central Asian states, in particular, Afghanistan's direct neighbours have exploited the situation in Afghanistan for their own economic and political interests.[12] This may even lead to further destabilisation of the region and in the worst case scenario[13] to "a proxy war [...] with regional powers backing different ethnic or sectarian factions in pursuit of their own interests".[14] The SCO deems it necessary to stress shared objectives, the most important being the emergence of a stable, secure and moderate Afghan state. In the Joint

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[6] H. Zhao, *China and Afghanistan, China's Interests, stances and perspectives,* Report of the CSIS Russia and Eurasia Program, March 2012, pp. 9-13.
[7] SCO, *Declaration of the special Conference on Afghanistan convened under the auspices of the Shanghai Cooperation Organisation,* 27 March 2009, Moscow.
[8] The Istanbul Process on Regional Security and Cooperation for a Secure and Stable Afghanistan was launched in November 2011, as a Turkish initiative, in order to promote regional political and economic cooperation between Afghanistan and its neighbours. It comes as a better tailored approach and an addition to the international conferences on Afghanistan. The first international conference on Afghanistan took place in Bonn in 2001 and since the establishment of the Afghan Compact in 2006 international conferences on Afghanistan have been organised on a yearly basis.
[9] 'Heart of Asia' Ministerial Conference Kabul, *Conference Declaration*, 14 June 2012, p. 10.
[10] Afghanistan, India, Iran, Mongolia and Pakistan hold an observer status in the SCO.
[11] C. Castillejo, "Regional implications of NATO withdrawal from Afghanistan: What role for the EU?", Agora Asia-Europe, No 4 February 2012, FRIDE, p.2.
[12] Reza Kazemi, *op. cit.*
[13] For the possible scenarios for Afghanistan post-2014, see: S.Hu, "Afghan Reconstruction vs. Regional Challenges and Responsibilities", China Institutes of Contemporary International Relations, 8 October 2012.
[14] Castillejo, *op. cit*., p. 4.

Communique of 2011, member states of the SCO stated the negative spill-over effect a conflict in Afghanistan would have on their own security (by increasing ethnic and sectarian violence and giving free flow to terrorist organisations), economic development (by jeopardising important trade routes linking China, India and Pakistan to Central Asia and Iran and by threatening investments in Afghanistan) and society (by provoking mass flows of refugees in neighbouring countries and thus causing economic and social instability).[15]

Sino-Afghan relations and the role of the SCO

Adhering to the principle of non-interference in domestic affairs and cautious of not harming its image of a peacefully rising nation, China carefully calculates its moves in Central Asia and particularly in Afghanistan.

Since the establishment of diplomatic relations with Afghanistan in 1955, China has traditionally kept "relatively low-profile positions", supporting the efforts of the international community but at the same time not involving itself militarily and refusing participation in the ISAF forces.[16] Having significant interests in Afghanistan, China is now trying to "position itself as an active player".[17] Bilateral ties have witnessed a positive evolution with the signing of the Treaty for Good Neighbourly Policy Friendship and Cooperation in 2006 and the Joint Declaration on Establishing Strategic and Cooperative Partnership in 2012.

Although on paper the China-Afghanistan partnership is based on five pillars ("cooperation in the political, economic, cultural and security fields, as well as on regional and international affairs"),[18] in reality, in accordance with China's interests, the focus is laid on security and economy. Specific emphasis has been put on cooperation in the fight against terrorism, separatism and extremism,[19] illegal immigration, organised crimes, illegal trafficking of drugs and weapons.[20] China sees the spread and infiltration of Islamic militancy through the borders with Pakistan and Afghanistan in the already tumultuous Autonomous Region of Xinjiang, as a real threat to the stability and even the integrity of China while making it a target to Islamist terrorism. These security concerns have led to the landmark visit[21] of the then top Chinese security official and member of the Standing Committee of the Political Bureau of the Chinese Communist Party, Zhou Yongkang, in September 2012 when China

[15] See SCO, *Joint Communiqué of Meeting of the Council of the Heads of the Member States of the Shanghai Cooperation Organisation Commemorating the 10th Anniversary of the SCO*, 14-15 June 2011, Astana.
[16] Besides the 28 NATO countries, 14 non-NATO countries contribute to the ISAF forces, SCO countries are not among those.
[17] Zhao, op. cit., p. 1.
[18] *Joint Declaration between the People's Republic of China and the Islamic Republic of Afghanistan on Establishing Strategic and Cooperative Partnership*, 12 June 2012, Art. 2.
[19] Qualified as the 'Three Evils' by China.
[20] *Treaty of Good Neighbourly Friendship and Cooperation between the Islamic Republic of Afghanistan and the People's Republic of China*, 2006, Art. 5.
[21] Analysts say the last visit of high-level Chinese official was in 1966, when former President LIU Shaoqi went to Afghanistan.

and Afghanistan signed a number of security and economic agreements.[22] China is willing engage over the next four years in training 300 Afghan police officers.

As China is Afghanistan's biggest foreign investment partner, the bilateral relationship is, above all, economic.[23]Like many other global players, China is very much attracted by Afghanistan's mineral and other natural resources. The US$3.5 billion investment of the China Metallurgical Construction Company in the Aynak copper mine in Logar province is the largest foreign direct investment in Afghanistan.[24] China has also invested in the oil extraction business in the Amu Darya basin and in numerous infrastructure projects so as to improve transportation conditions and participate in the economic development of the country.

China's active engagement in Afghanistan is not only bilateral but also multilateral and regional through fora such as the SCO. A "mature organisation with global reach and influence" serves China's strategic interests and at the same time limits the influence of other players such as the USA.[25] To a certain degree, China's active stance through the SCO has become "a sign of China's ambition as a global and regional power".[26]

In the last few years, China has been willing to pioneer SCO engagement with Afghanistan. In May 2012, less than a month before Afghanistan was granted the observer status at the SCO Annual Summit in Beijing, the China Institute of Contemporary International Relations organised an international forum on "The Future of Afghanistan and Regional Cooperation". At the forum, the Director General of the Institute of Strategic Studies in Islamabad stressed the importance of the SCO in "help[ing] all the Afghan parties to succeed in their efforts at peace and reconciliation".[27] This new status creates more opportunities "to discuss the regional security framework that will emerge after the NATO forces stationed in Central Asia leave"[28], and to enhance ties between Afghanistan and its neighbours.

The EU in Afghanistan

As a close ally to the USA in the fight against terrorism, the EU is interested in establishing strong and accountable democratic institutions in Afghanistan dismantling the narcotics industry, and encouraging the development of sustainable industries.

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[22] "China and Afghanistan sign economic and security deals", BBC China, 23 September 2013, retrieved 24 March 2013, http://www.bbc.co.uk/news/world-asia-china-19693005.
[23] S. Reza Kazemi, "A Potential Afghan Spill-Over: How Real Are Central Asian Fears?", 12 December 2012, Afghanistan Analysts Network.
[24] J. Benitez, "Shanghai Cooperation Organisation seeks role in Afghanistan after NATO forces leave in 2014", NATO Source, Alliance News Blog, 6 June 2012.
[25] J. Panda, "China or the SCO: Who will supervise Afghanistan", *China Brief*, Volume 11, Issue 15, 12 August 2011, The Jamestown Foundation.
[26] O. Antonenko, "The EU should not ignore the Shanghai Cooperation Organisation", Policy Brief, Centre for European Reform, May 2007, p. 2.
[27] Interview with A.J. Qazi, Director General of the Institute of Strategic Studies, interviewed by Zhang Nini, Beijing, 30 May 2012, CCTV News, retrieved 26 March 2013, http://english.cntv.cn/program/asiatoday/20120530/122836.shtml.
[28] R. Weitz, "China-Russia's Anti-NATO", *The Diplomat*, 4 July 2012, p. 2.

After the fall of the Taliban regime the European Commission increased its contacts with Afghanistan to become one of its major donors.[29] The Joint Declaration signed by the EU and Afghanistan in November 2005 provided for the formal basis of bilateral cooperation, while the Afghanistan Country Strategy Paper for the period 2007-2013[30] came as a response to the changing political and economic situation in Afghanistan.

In addition to the 30,000 troops that 25 EU member states made to the NATO-led ISAF forces the EU (EU and member states) has made investments of over EUR 8 billion for the period 2002-2010 for the reconstruction and stabilisation of the country. Moreover further EUR 600 million was pledged for the period 2011-2013.[31] In accordance with the priorities set out in Afghanistan's National Development Strategy of 2008, EU's assistance to Afghanistan focuses on combating narcotics production, "strengthening the rule of law and structures of government at the provincial and district level" and contributing to reforms in the health sector.[32]

Probably one of the key EU contributions to the military security in Afghanistan is the European Police (EUPOL) mission, launched in June 2007 under the Common Security and Defence Policy in response to a request by NATO. EUPOL provides highly qualified civilian policing, operational security sector reform expertise, and focuses its activities on the institutional reform of the Ministry of Interior, the professionalisation of the Afghan National Police and the increase of "public trust in the Afghan justice system".[33]

Afghanistan and the EU-SCO relationship

The EU understands that Afghanistan cannot engage in a path of stability if it is not regionally integrated: in all of the recent documents concerning Afghanistan the EU reiterates the importance of regional cooperation on security and economic issues.[34] In its Country Strategy Paper on Afghanistan, the EU underlines the importance of enhanced trade relations between Afghanistan and its neighbouring countries.[35] This is acknowledged in the EU Strategy towards Central Asia as well, but little has been done in reality.[36] Until now the EU has allocated a very meagre part of its assistance package for regional cooperation. What is more, the EU seemingly "lacks a joined up and strategic response to Afghanistan's neighbourhood". If the EU is committed to

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[29] For a complete overview of EU aid to Afghanistan see: European Commission, *European Union-Afghanistan State of Play July 2012*, pp. 7-17.
[30] European Union, *EU's Country Strategy Paper to the Islamic Republic of Afghanistan (2007-2013)*.
[31] European External Action Service (EEAS), *EU Engagement in Afghanistan*, January 2011.
[32] *Ibid,* p. 3.
[33] EEAS, Common Security and Defence Policy (CSDP), *EU Police Mission in Afghanistan*, September 2012.
[34] European Union, *EU's Country Strategy Paper to the Islamic Republic of Afghanistan (2007-2013)*, p. 7.
[35] *Ibid*, p. 12.
[36] Council of the European Union, General Secretariat, *European Union and Central Asia: Strategy for a New Partnership*, October 2007, p.16 and p.30; Council of the European Union, Council conclusions on Central Asia, 3179th Foreign Affairs Council Meeting, Luxembourg, 25 June 2012.

engaging China as a responsible international actor in Afghanistan, it is important for the EU to re-evaluate its relationship with the SCO.

The success of the international strategy in stabilising Afghanistan strongly depends on "a political settlement between Afghanistan's main actors [the Taliban included] that is actively supported by regional powers".[37] The 'Heart of Asia' Process is maybe the only multilateral platform where the EU and the SCO can interact on the Afghan issue. Yet, it should be stressed that the SCO is in a better position than the EU because SCO countries are participants in the Istanbul Process, whereas the intentions of several EU member states to join the Process were not welcomed. In this sense, as the SCO has been pushing for further involvement in Afghanistan through regional cooperation, the EU should consider more carefully the possibility to develop ties with the SCO. What is encouraging is that the SCO has reiterated its commitment to enhance cooperation with the EU, among other organisations, on counter-terrorism, counter-narcotics and the fight against organised crime.[38]

Possible cooperation between the SCO and the EU in Afghanistan

Though EU's leverage in Afghanistan's neighbouring countries is not very significant, the EU can, nevertheless, effectively promote regional cooperation and in this way optimise the resources and maximise the results of the international assistance in Afghanistan. Of course, possible future cooperation between the SCO and the EU depends very much on the evolution on the SCO, but the current situation draws the attention to several fields of common interest.

The 'Heart of Asia' Ministerial Conference, held in Kabul in June 2012, emphasised the implementation of seven of the Confidence Building Measures (CBMs), identified in the Istanbul Process Document. Both the EU and all the SCO countries declared their intention to engage in the counter narcotics CBM.[39] Now, when the SCO's Regional Anti-terrorism Structure (RATS), created in 2004, is considering enlarging the scope of its mandate by engaging in counter-narcotics operations, EU's technical and logistic expertise in the fight against drug trafficking can be of particular relevance. Moreover, stronger ties between RATS and the EU-UNDP Border Management Programme in Central Asia (BOMCA), functioning since 2003, could contribute to a more effective management of the borders with Afghanistan and subsequently to the regional economic and trade development and the gradual regional integration of Afghanistan.

During the last few years the SCO countries have been trying to better economic cooperation. Indeed, the Interbank Consortium was created in 2005, and the Business Council of the SCO in 2006. Among the priority areas of the latter are: "energy, transportation, telecommunications, credit and banking, [...] education, science, new technology, healthcare and

[37] Castillejo, *op. cit.*, p. 4.
[38] Shanghai Cooperation Organisation, *Statement by the Shanghai Cooperation Organization Member States and the Islamic Republic of Afghanistan on combating terrorism, illicit drug trafficking and organized crime*,2009.
[39] *Conference Declaration*, 'Heart of Asia' Ministerial Conference, Kabul, 14 June 2012, pp. 6-8.

agriculture".[40] This is where EU's experience in terms of economic integration and infrastructure development could be useful. Moreover, the positive leverage of the already existing cooperation between SCO countries and the EU in the fields of urbanisation and environmental protection could be wisely used to contribute to the future sustainable development of Afghanistan.

Tentative conclusion

Since the launch of the global fight against terrorism, Afghanistan has been in the spotlight and even though regional and global players do have colliding economic and geopolitical interests, they share a common goal – securing a stable transition process in Afghanistan, guarantying stability and sustainable economic and social development through regional integration. In a post-2014 context cooperation and coordination between major international players in Afghanistan, such as the EU and the SCO, are crucial for the sustainable regional integration of Afghanistan which is the only way for the country to overcome poverty and create stable and trustworthy state institutions capable of fighting terrorism, extremism and drug trafficking, among other issues. Moreover, the EU can indirectly promote the international engagement of China in global issues, in general, and in Afghanistan, in particular, by further collaboration with the SCO.

[40] SCO, "The Business Council of the Shanghai Cooperation Organisation", 16 March 2009.

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