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**The EU, China & the Financial Crisis:**  
How a Shift in Economic Power has affected the EU-China  
Human Rights Dialogues, the EU's arms embargo on China, and  
China's Quest for a Market Economy Status

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# Abstract

China's strong economic prosperity and the EU's economic hardship due to the financial crisis have generated tensions and uncertainty within the EU-China bilateral relationship. China's view of the EU as a strong economic superpower has begun to crumble, while it has become more assertive in international affairs. The effects of the financial crisis have made the EU realise that it might need China more than China needs the EU. A shift in economic power to China's favour within the EU-China interdependent economic relationship could result in the EU having less power and influence in its bilateral dealings with China, while China would be able to exert pressure on the EU for obtaining what it wants.

The aim of this paper is to analyse what implications the financial crisis has posed on the EU-China interdependent economic relationship and what consequences this, in turn, has had on the following bilateral issues: the EU-China Human Rights Dialogues, the EU arms embargo on China, and China's strive for Market Economy Status recognition by the EU. By applying theoretical instruments derived from interdependency theory, the overarching results show that the financial crisis has further exacerbated the economic power asymmetry between the EU and China to China's favour. However, the effects of the financial crisis on the cases are contrasting. The HR Dialogues has experienced the most drastic changes, where China no longer has an incentive in upholding the talks with the EU. The financial crisis has made it expensive for the EU to uphold the arms embargo and keeps the EU indecisive. However, the financial crisis and the economic power asymmetry have, surprisingly enough, not generated any significant effects on the MES case.

*Key words:* Interdependency, financial crisis, EU, China, asymmetry, power, Human Rights Dialogues, arms embargo, Market Economy Status  
Words: 19.452

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# Abbreviations

CFSP	Common Foreign and Security Policy
DG	Directorate General
EC	European Community
ECSC	European Coal and Steel Community
EEAS	European External Action Service
EU	European Union
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
HR	Human rights
HR <sup>1</sup>	High Representative
HRW	Human Rights Watch
IMF	International Monetary Fund
MES	Market Economy Status
MNC	Multinational Corporation
NGO	Non-Governmental Organisation
PRC	People's Republic of China
UN	United Nations
UNSC	United Nations Security Council
US	The United States (of America)
WTO	World Trade Organisation

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<sup>1</sup> The abbreviation HR that refers to the High Representative is throughout this paper followed by the surname "Ashton" to clarify its referral to the High Representative and not to human rights.

# 1. Introduction

Economic globalisation advanced as a phenomenon during the 1980's, more specifically, with the end of the Cold War. This was when the political condition in the world forum was strong and stable enough to form the true nature of global economy together with the driving forces of economic and technological developments. A synergy of these forces opened the door to a new level of a global trading system. Technological progress resulted in advancement in computer and telecommunication systems, which in turn facilitated and increased global financial flows and became the starting point for MNC's pursuance of global economic operations and strategies. This became the milestone for what we today call the global economic order (Gilpin 2001:8).

One of the most important consequences of the global economic advancement is the increased level of interdependency and cross-boarder engagement among states and actors. As a result bilateral relationships, trade and economic cooperation, and target strategies boosted, which in turn opened new doors for actors to collaborate and induce others to take certain measurements. An actors' continuous prosperity began to rely much on cross-border activities and the level of dependency between actors became an important source of power.

The European Union established diplomatic relations with China in 1975. Agreements on trade and economic cooperation followed shortly after and in 1988 the European Commission opened its delegation office in Beijing. The development of the EU-China bilateral relations has resulted in a relationship that is more interdependent than ever before, especially from an economic point of view. Considering the staggering increase of their economic interdependence, one might mainly think of it in a quantitative manner. Indeed, their trade levels have quadrupled within a decade (2000-2010), the EU has become China's most important export market, and numerous bilateral governmental contacts have been established. The high level of interdependence has

led to closer cooperation and more interaction; however, it has also had qualitative implications on their relationship (Vogt 2012: 219). Today, there are more students that study in each other's countries, more researchers that collaborate on different projects, more tourism exchanges, and more businesses that expand in each other's markets. A combination of these quantitative and qualitative terms have tied the EU and China much closer to each other and transformed their relationship into one characterised by complex interdependence. Their engagement in a wide range of issues has enabled both actors not only to mutually benefit from their relationship, but also negotiate and push for the issues that they consider important. Their individual levels of power thus become an important aspect for achieving and satisfying their own goals and needs within their bilateral relations. Traditionally, both actors have had the perception of each other as powerful and influential actors on the international arena; however, recent economic developments and impacts on the EU and China individually have caused power changes within their bilateral relationship.

While China has experienced a strong economic growth and has become the second largest national economy in the world after the United States, the EU has experienced severe economic setbacks caused by the financial crisis. Even though the tone between the two actors remains cooperative and cordial, these dramatic economic changes have generated tensions and uncertainty within the EU-China relationship. China's view of the EU as a strong economic superpower has begun to crumble, while its own economic prosperity has made China more assertive in international affairs. The effects of the financial crisis have made the European leaders realise that the EU might need China more than China needs the EU. If it is indeed so that the economic changes have made the EU more dependent on China than vice versa, then there has been a clear displacement of power to China's favour. The consequences of this on the complex interdependence relationship between the EU and China would be that the EU would have less power, influence and room for manoeuvre in its dealings with China, while China would be able to exert pressure on the EU for obtaining what it wants.

The EU-China bilateral economic relations can be seen as an important cornerstone in their relationship. In the broader picture, these relations integrate other policies such as

security, political strategy and cultural aspects. The obstacles that occur within their deep economic and trade relations have thus also led to political and commercial tensions between the two actors (Vogt 2012: 5). This paper will, on the basis of this scenario, examine and analyse how the EU-China interdependent economic relationship has been affected by the financial crisis and what implications this has had on the following three bilateral areas: the EU and China's HR Dialogues, the EU's arms embargo on China, and China's strive for Market Economy Status (MES) recognition by the EU.

## 1.1 Research problem and aim

The intertwined and extensive economic relationship between the EU and China has given rise to a series of theoretical debates and analyses. Within, for example, international political economy, there are mainly two theoretical dimensions to emanate from. Some analysts focus on the EU's or China's domestic forces and their impact on the relationship, while others emphasise on a more international perspective. Another theoretical dimension is the significance of institutional and societal factors (Frieden et al., 2000:17). This has resulted in a large number of recently published literatures that intend to conceptualise the situation from all possible angles. To immerse into this specific issue and to problematize something that has not yet been treated in this area has thus been a rather complex task to overcome.

However, despite the high level of interest in the EU-China relationship, I have not yet encountered a study that investigates the possible effects of the financial crisis on the EU-China interdependent economic relationship in general and three specific bilateral issues. My research questions can therefore be formulated as follows:

*What implications has the financial crisis posed on the EU-China interdependent economic relationship and what consequences has this, in turn, had on the bilateral issues that are the HR Dialogues, the EU arms embargo on China, and China's strive for MES recognition by the EU? Has there been an economic power shift between the two actors due to the crisis? Has the financial crisis made their bilateral relationship*

*more asymmetrical in terms of power within these three areas? Can we perhaps assume that these three areas have not been affected by the crisis?*

The research questions shall be divided into two analytical parts. The first part will deal with the implications of the financial crisis on the EU-China interdependent economic relationship to see if there has been an economic power shift between the actors due to the crisis. The aim is to identify the main pattern and characteristics of the financial crisis' effects on the EU-China interdependent economic relationship. The second, and more important, section shall elaborate on the three cases to see if the crisis has made the EU-China bilateral relationship more asymmetrical within these cases or not. Naturally, one might expect that a shift in power between two actors should have some effects on the outcome of important bilateral issues. This is one aspect that will be further examined in the analysis.

The three areas in the EU-China bilateral relationship that constitute the main areas of investigation in this paper are the EU-China HR Dialogues, the EU's arms embargo on China, and China's strive for MES recognition by the EU. I am well aware that there are other important areas and aspects of the EU-China relationship that could be included and analysed in this paper, however I have decided to solely focus on and conclude upon these specific areas for practical reasons<sup>2</sup>.

The aim of this paper is thus to analyse if there has been a power shift in economic terms between the two actors due to the financial crisis, and if so, how has this been reflected within the three specific cases? The aim is *not* to make future predictions about their interdependent relationship. I intend to primarily illustrate how the EU and China's interdependent economic relationship has developed prior to and after the financial crisis to target any possible power shifts and changes. My aim is to examine what implications these possible shifts have had on the three specific bilateral cases. Any change from the status quo, which in this case is the EU-China interdependent economic relationship prior to the crisis, is interesting to analyse. By taking a closer look at the development of the EU's and China's interdependent economic

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<sup>2</sup> See section 2.3.1 Material and Practical Delimitation

relationship before and during the crisis, and by analysing these changes, could yield answers to my above-mentioned research questions.

My ambition with this paper is to add new substance to the wide literature on the EU and China interdependent relationship. This thesis can therefore be perceived as a case study of three specific areas of interest that portray certain actions and reactions in the EU-China's interdependent relationship relative to the ongoing financial crisis.

## 2. Methodology

### 2.1 Methodological ambition

This paper is framed as a case study of three cases and applies the method of structured, focused comparison. Case studies can be seen as “analysis of persons, events, decisions, periods, projects, policies, institutions, or other systems that are studied holistically by one or more method. The case that is the subject of the inquiry will be an instance of a class of phenomena that provides an analytical frame- an object- within which the study is conducted and which the case illuminates and explicates” (Thomas 2011: 513). Thus, as quoted above, I must define the class of phenomenon, or “universe” that is the analytical frame of the study, which in this paper is the EU-China interdependent economic relationship. Secondly, the cases, or instances, that are the subjects for investigation within the class of phenomenon are the EU-China human rights dialogues, the EU’s arms embargo on China, and China’s strive for MES recognition by the EU (George, Bennett, 2005: 69).

The method of structured, focused comparison is characterised by a “structured” part that uses a number of questions that reflect the research objective. These questions are thus applied on each investigated case, which enables a comparison and cumulation of the findings of the cases and makes the method more “focused” (Ibid. 2005: 67). In line with this, I intend to apply the previously mentioned research questions (see section 1.1) on each of the three cases in order to facilitate the differences and similarities and cumulate the findings in the conclusion.

Moreover, for generating greater precision in the results, I shall move down the “ladder of generality” as explained by George and Bennett by looking at sub-classes within the general phenomenon (Ibid. 2005: 77). This research paper will therefore focus on how the financial crisis has affected the EU-China interdependent economic relationship, to

see how this in turn has affected their power relations within the three specific cases. Furthermore, in order to make the study more defined, I shall apply the “ladder of generality” on the theoretical framework as well by identifying the scope conditions of interdependency theory. I have identified interdependency theory by three main conditions: costly effects, power and vulnerability. Since the aim of this paper is to see if there has been a shift in power symmetry between the EU and China within the three cases due to the financial crisis, I will apply these three main scope conditions of interdependency theory as analytical instruments for investigating the three cases. I therefore intend to apply the scope conditions of interdependency theory on the development of these three empirical cases to identify what changes that have taken place during the financial crisis.

Interdependency theory states that an interdependent relationship seldom is perfectly symmetric, and that this creates sources of power and advantages for actors. My ambition is thus to apply this on the EU-China interdependent economic relationship to see if the effects of the financial crisis has shifted the economic power balance between the interdependent actors and if this in turn has created advantages and enabled new sources of influence for any actor within the three cases. Interdependency theory has the ability to grasp a wide scope of issues in a complex interdependency relationship, such as the one between the EU and China. It is a multifaceted theory that takes the multiple channels of contact between states and actors into account (Keohane, Nye 2012:21). The use of the theory is not restricted in the way that it can only be applied to governmental, domestic, or international relations, but it is applicable on all levels as it webs them together. This is an important attribute for my paper since I will need to include both national and transnational interests in order to conduct a viable analysis.

Finally, it is good to note that interdependency theory is, alike other theoretical frameworks, an ideal type, where its limitations and possibilities allow scholars to further elaborate on or complement the theory. To test interdependency theory seems more interesting compared with the more traditional theoretical approaches since it provides a well-founded and more complex portrayal of reality due to its diversified characteristics. It is therefore a more tempting and interesting theory to use compared

to the more traditional theoretical approaches. These are all reasons to why I have decided to use and test this theory.

## 2.2 Case selection

The three selected cases that will be analysed in this paper are the EU-China human rights dialogues, the EU's arms embargo on China, and China's strive for MES status by the EU. The cases are all important, highly relevant and currently ongoing in the EU-China relations, and they project implications for both actors in different ways, which makes an analysis of the three cases interesting from an economic interdependence and financial crisis point of view.

There are different important aspects to why I have chosen these three cases. One reason is because they are important issues for the EU and China respectively since there is a lot to win/lose for each actor depending on how the cases develop. The EU pushes to uphold the human rights dialogues with China while China wants the EU to lift the arms embargo and recognise China as a market economy. There is therefore a constant tug of war between the EU and China within each of these cases. This tug of war makes the cases extra sensitive to external events. It could naturally be assumed that if an external event, such as a financial crisis, affects the balance of power in the EU-China interdependent economic relationship, it could further affect the development and orientation of each case. The cases can therefore be seen as sensitive since they are fluctuating depending on how external events affects the EU-China interdependent relationship and thus the balance of the tug of war between them.

Moreover, it is also important to clarify that these three particular cases capture something interesting about one part of the EU-China interdependent economic relationship. However, there are other cases and other parts of the relationship that can complement this project and constitute a more complete and thorough picture of the actors' relationship.

### 2.2.1 The EU-China Human Rights Dialogue

Human rights have been a central issue in the EU-China relations and discussions are held both within their political dialogue pillar and through a specific Human Rights Dialogue that was established in 1995 on the EU's initiative. There were initially two annual rounds of the HR Dialogue taking place during each EU Presidency that aimed to achieve concrete human rights improvements in China (EU-China HR Dialogue). However, China has during recent years expressed resentment about conducting the two talks and declined to take part in the second HR Dialogue meeting during 2010 and 2011. Questions regarding Tibet and the condition of specific prisoners are from a Chinese perspective seen as a national sovereignty concern and not a concern for the EU or international community. The EU's constant pressure on human rights issues is seen as a way to force China to implement Western values, something that China has historically bad experience from. However, leading human rights NGO's believe that the EU is pursuing a weak human rights approach for fears of jeopardising its economic relations with China. These are said to be the underlying reasons to why the EU has failed to convince the Chinese government to uphold the two annual HR Dialogue talks (HRW.org).

### 2.2.2 The EU's arms embargo on China

The EU has through its external relations policy urged the Chinese authorities to implement freedom, human rights and democratic measures for pursuing the level of openness that the EU requires from its partners (eeas.europa.eu/sanctions). From a Chinese perspective, the embargo has strategic implications on arms technology transfer and inhibits China from developing its military industry (euobserver.com/defence). It is important to note however, that the EU did not exactly define the scope of the embargo, leaving each member state to individually interpret it (consilium.europa.eu). Member states such as Britain and France have exported certain equipments and technologies with potential military usage to China, while other states have expressed a need to reconsider, or even remove, the ban (sipri.org). Several EU member states have begun to question the purpose and effect of an arms ban. Some proclaim that it is a

lose-lose concept; Despite China's thirst for advanced European military material, the embargo is throwing spanners in the works for the European companies that produce these products in a time already characterised by economic hardship. Others argue that it is time to be more pragmatic about China's human rights ambitions and stop expecting that China will meet the EU's human rights aspirations any time soon.

### 2.2.3 China's strive for Market Economy Status

One of China's main objectives is to obtain MES. The first step towards this status was taken in 2001 with the WTO accession. A MES would both prevent Western markets to accuse Chinese firms for dumping goods and make China less vulnerable to Western protectionism (Chatham House).

China's economic transformation and growth gaining momentum in the beginning of the 21<sup>st</sup> century has given the EU an unparalleled trade partner with high dividends. On the one hand, China became the EU's cornerstone for goods and service exports and is a supplier of cheap goods. The EU, on the other hand, became a vital high value export market and an advanced technology and investment provider (Vogt 2012:6-7). The mutual trade benefit for both parts has therefore given China an incentive to push the EU to recognise China as a market economy before 2016, which is when China officially receives MES by the WTO (Chatham House, DG Trade). Discussions between China and the EU have resulted in China's former premier Wen Jiabao openly urging the EU to drop the arms embargo and offering to support the euro in exchange for MES (see [bbc.co.uk/news](http://bbc.co.uk/news), [euobserver.com/economic](http://euobserver.com/economic)).

## 2.3 Data collection

### 2.3.1 Material and practical delimitation

The material used for this thesis is taken from published books, scholarly publications and media reports from the Internet. Official documents, statements and press releases also constitute a substantial part of the material used. The reason for using various sources is to reflect different interpretations of the EU-China relationship. It lies in my interest as an author to provide a trustworthy and reliant paper for the reader, and I have therefore been obliged to carefully select and analyse the material before deciding to use it. My aim has throughout this thesis been to create a stable and credible fundament of information in order to deduct any possibility of using biased views and opinions.

Furthermore, this paper will not rely on the comprehension of interviews. This decision has both positive and negative effects on this paper. One positive aspect of conducting interviews in relation to such an international topic as the EU-China interdependent relationship is that they can amplify the paper by adding important inputs that books and official documents might not be able to add. An important negative aspect of including interviews in such a paper is that there is a risk of biased views and inputs, especially when discussing sensitive matters. Thus, it is due to these risks and the scarcity of time that I have decided to exclude interviews from this paper.

There are naturally some limitations that must be made within this topic and paper. The choice of only using one theoretical framework is one of these limitations, while another is the choice of analysing the three specific areas of interest. The negative aspect of the latter limitation is that the results derived from this investigation will not be applicable on other areas of the EU-China relationship even though one might be able to make certain assumptions based on the results of the analysis. However, I encourage further investigation on other areas within this topic. The positive aspect of the limitation is that it allows me to elaborate and provide an in-dept study of each of the

three areas rather than solely touching upon several areas in the EU-China bilateral relationship. The possibilities of extending this thesis are endless, both from a theoretical and empirical context. One could include other theoretical frameworks and/or analyse other aspects of the EU-China relationship. However, I have based on the above-mentioned reasons decided to limit this paper to include one specific theoretical framework and three cases within the EU-China relationship.

## 2.4 Disposition

The disposition of this paper is as follows. The following chapter outlines the theoretical framework and highlights the theoretical instruments used in this paper, namely costly effects, power and vulnerability. There is a need to outlay a relevant and extensive theoretical background in order to make it as comprehensive as possible for the reader.

The empirical section will firstly provide relevant background information about the EU and China in order to understand how their relations have developed and how their dialogue is constructed. Secondly, it will discuss how the EU-China trade relations have developed and what threats both actors faced from a trade perspective prior to the financial crisis. The third part of the empirical section will describe the impact that the financial crisis has had on the EU and China respectively, the EU-China trade relations, and how it has affected the way that the EU and China view each other. The final part will explain how each case has developed through time and what impacts the financial crisis has had on them.

The analysis will be divided into two parts where the first part analyses the general development of the EU-China interdependent economic relationship to see what changes that have taken place until the financial crisis in order to identify if the relationship has become more asymmetrical or not. The second part of the analysis is focused on the cases with the purpose to analyse what effects the financial crisis has imposed on each case.

The final section of the paper will entail a conclusion where the posed research questions are answered with the help of the analytical findings. The paper will end with an executive summary.

### 3. Theoretical Framework

*“Now we are entering a new era. Old international patterns are crumbling; old slogans are uninformative; old solutions are unavailing. The world has become interdependent in economics, in communications, in human aspirations.” - Henry Kissinger*

In today’s globalised world, few scholars would disagree that we are living in an interdependent era. Economical, military, social, and ecological interdependence among states is a recurrent reality in our contemporary world politics (Keohane and Nye 2001:4). As globalisation progresses, states become more intertwined and dependent on their surroundings, which can be well illustrated by, for example, the fluctuations in the world’s stock exchange markets. A state’s economy has become highly dependent on its international trade and external firms’ FDI. Corporations have become transnational by launching production industries in other countries where production is more profitable and costs are low. Not only is self-sufficiency no longer beneficial for an actor; some claim that it has become impossible (Nowotny 2011: 101). By going beyond the surface appearance of interdependency and studying the reasons behind interdependent behaviour within the multifaceted webs of dependency between states and actors, one could reveal the underlying features of these ties that shape the relationship between two actors. Interdependency theory could therefore uncover interesting facts regarding two actors’ interdependent and bilateral relationships. One actor might be more dependent on the other, or perhaps has an external event affected the interdependent relationship to an actor’s favour/disfavour. Interdependence theory could be a useful theoretical tool for answering these types of questions.

According to Robert O. Keohane and Joseph S. Nye, interdependency theory aims to provide a coherent theoretical framework through complementary models for the political analysis of interdependence (2001:4). They mean that interdependence can be defined simply as mutual dependence, which in the international political arena is

characterised by reciprocal events among actors and/or states. Interdependent policy affects governmental, domestic and transnational interests and ties foreign and national policy together (2001:7).

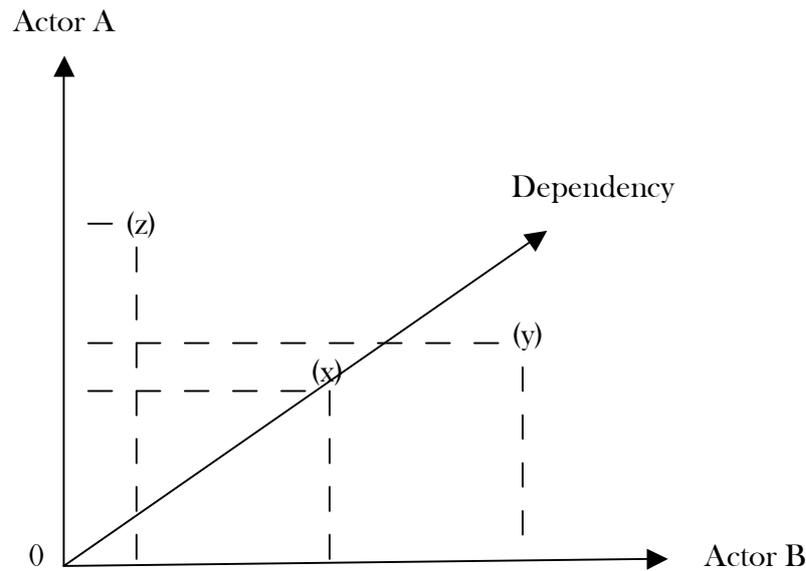
### 3.1 Costly effects

Interdependency includes costly effects, where the effects of transactions on interdependence are linked to the costs of the effects. To illustrate this one could compare a state that has no gas or oil reserves with a state that has no luxury items such as exclusive cars or gold. The state without oil and gas reserves is more dependent on a constant import flow of these products than the state with no luxury goods, even if the monetary value is equivalent. Hence, interdependency includes reciprocal costly effects, even if the relationship is not symmetrical (2001:8).

In order to use interdependency theory as a theoretical framework for analysing a given relationship, certain features of the theory must be clarified. According to Keohane and Nye, one particular criterion that will always be present in the concept of interdependency is cost, as explained above. Interdependence limits autonomy and it is not assured that the benefits of a relationship always exceeds the costs. Mutual benefit can therefore not be presumed when studying an interdependent relationship since it depends on the actors' values and the individual nature of the relationship (Ibid.).

Interdependence between actors is seldom perfectly balanced. Pure symmetry and pure dependence are two extreme points in which an interdependent relationship lies between. It is highly uncommon that an interdependent relationship is completely symmetrical or equally dependent. It is therefore the asymmetries that create space for advantages and sources of influence for actors. Actors that are in a less dependent position can often use the interdependent relationship as a means of power for bargaining on other issues. It is therefore necessary to include the asymmetries in the evaluation of an interdependent relationship (2001:9). This relationship can be illustrated by below figure.

Graph 3.1.1: The dependency relationship between two actors



Source: Author's own compilation

The figure portrays the dependency relationship between Actor A and Actor B. Point (x) shows the dependency relationship as perfectly symmetrical, where Actor A and Actor B are mutually dependent. As previously mentioned, this situation rarely ever occurs. A more probable situation is point (z) or point (y). Point (z) shows a very uneven dependency relationship, where Actor A is much more dependent on Actor B than vice versa. Actor B would, in this case, have a power advantage towards Actor A since the dependency differences are rather extreme. This situation could arise between a state that has rich oil reserves and a state that has very limited, or no, reserves and relies on oil imports. Point (y), on the other hand, illustrates a more balanced dependency relationship, yet still asymmetric. In this case, Actor B is more dependent on Actor A, but Actor A also has a personal interest in upholding an interdependent relationship with Actor B. The space for Actor A's negotiation power towards Actor B is therefore much more limited compared to the situation outlined for point (z).

## 3.2 Power

Interdependency and power are two concepts that go hand-in-hand and excluding one from the other is difficult, as seen above. Both Nowotny, and Keohane and Nye state that power in relation to interdependency can be thought of as an actors' capability to influence another actor to do something that is against its will for a reasonable cost (Nowotny 2011:102, Keohane and Nye 2001:10). However, Nowotny argues that this is a more traditional view of power, when the use of force and threat on the non-compliant actor was more common. The contemporary version of power is not as hostile as the traditional view, but rather based on the actor's capacity to retrieve what it wants by offering options that others may gain from as well. Nowadays, power depends on a state or an actor's position and superiority in the web of global economic interdependence and exchange. State/actor's lay on different levels in the world-economy depending on their independent abilities and resources (Nowotny 2011:103,113). By taking this a step further, one could assume that the complex web of global interdependence could make the state/actor more vulnerable to external events that, in turn, could impact their level of power.

According to Keohane and Nye there are different ways of measuring power. One focus could be on the actor's actual power resources that give it a certain capability, while another focus could be on the patterns of outcome and the actor's influence on these. This paper follows Keohane and Nye's idea where asymmetrical interdependence is perceived as a source of power for one actor when considering power as control over resources, or the possibility to impact outcomes (Keohane and Nye 2001:10).

## 3.3 Sensitivity and Vulnerability

Sensitivity and vulnerability can be perceived as two important factors when studying the political structure of interdependence relationships. The dimensions of sensitivity and vulnerability interdependence can be explained by the level of responsiveness in a

policy framework. Sensitivity interdependence measures costly effects of transaction changes on governments and societies. It is created by interactions within a policy framework that is assumed to be unchanged. Vulnerability, on the other hand, assumes that the policy framework could be changed and is therefore a more important measurement when studying the power resources of actors. By assuming a change in one state and analysing the costs that these changes infer on another state one can measure the costly effects and the cost of adjusting to external change through new policies (Keohane and Nye 2001:10-11). Two states, x and y, that import 45 per cent of their oil needs can be assumed equally sensitive to a rise in oil prices. However, if state x discovers a domestic energy substitute to oil at a reasonable cost, while state y does not have such an alternative, state y would be more vulnerable than state x. Hence, related to interdependence, vulnerability can be measured based on the costliness and availability of substitute alternatives for states (Ibid.).

Based on what has been explained above, we can derive the conclusion that measurements of asymmetrical interdependencies are useful tools when analysing international interdependence between states, actors, governments or MNCs. The levels of interdependency relationships depend on what type of interdependence measurement one takes. Sensitivity interdependence can be used for explaining the basis for political influence on changes in norms and rules within a fixed policy framework. However, if changed norms and rules leave an actor in a disadvantageous situation, that actor would most probably intend to change the rules at an acceptable cost. The variability interdependence is therefore a more profound measurement when explaining interdependent asymmetries. Disadvantageous situations can also lead to desperation and make the actor use military force as an attempt to amend the situation. However, although the use of military force dominates non-military vulnerability costs of pursuing alternative policies, it is much more costly to implement and thus not considered a usual or profitable approach (Keohane and Nye 2012:15).

### 3.4 Complex interdependence

What we have seen thus far are interdependent asymmetrical relationships between actors and ways to measure these norms and rule asymmetries through vulnerability and sensitivity interdependence. However, to theoretically explain events in contemporary world politics, we would need to follow and apply ideal types of theories. These ideal types present certain conditions in order to explain events and happenings within, in this case, the EU and China relationship. The fundamental conditions of, for example, the political realist ideal type is that states are predominant and act as coherent units, the use of force is the most effective way of exercising power, and that world politics is characterised by a hierarchy of issues that is dominated by military security before economic and social affairs. These assumptions give an idea about how the ideal type of realism interprets world politics. However, the opposite of political realism is the ideal type of complex interdependence. It is this explanatory model of complex interdependence that will be followed and applied in this paper. The reason for using complex interdependence is because its conditions give a more accurate reflection on global issues such as the EU-China economic interdependence relationship than the more traditional explanatory models such as realism.

There are three main characteristics of complex interdependence: *multiple channels*, *absence of hierarchy among issues*, and *minor role of military force*. Multiple channels can most simply be understood as interstate, transgovernmental, and transnational relations. By looking at the EU-China relationship today, we can note that the decisions taken by multinational actors such as banks, firms, corporations and organisations affect the EU and China's domestic relations, as well as their bilateral relations. These actors not only channel activities that are important for governments since their decisions transcend national boundaries, but they also makes different countries' government policies more sensitive to one another. This means that foreign economic policies impose much greater influence and consequences for domestic economic activity than ever before, leaving the lines between domestic and foreign economic policies indistinct. The interdependent relationship between the EU and China is defined by company expansions from the EU to China and vice versa, FDI investments, imports and exports of goods and services, banking interactions, weekly high-level governmental

meetings and other types of multiple channels. These channels constitute the fundamentals that further develop and strengthen the EU and China bilateral relationship.

By absence of hierarchy among issues is meant that the number of relevant issues for foreign policy have increased and become more diverse. Military security is no longer the superior issue on the agenda. It is instead accompanied by multiple and overlapping issues, where domestic and foreign policies impinge on one another. The IMF, the EC and the GATT are examples of consultative arrangements where foreign and domestic policies overlap and where multiple issues are discussed. The EU and China coincide in these arrangements and also conduct a series of bilateral consultations within a wide range of issues. The backside of an absence of issue hierarchy is that it complicates the formulation of a clear and comprehensible foreign policy and often imposes delays on the decision-making process, something that is true for the EU in its dealings with China (Keohane, Nye 2012:19, 21-22). China is increasingly puzzled by the EU's lack of cohesion in its policies and its disability to reach an internal consensus on issues such as the lifting of the arms embargo (Zhimin 2012: 12).

Furthermore, it is widely accepted that military force is the dominant source of power when an actor or state needs to fight for survival. Force is an essential part of national power, but its practice has changed since the level of safety and interdependence among states has increased. This is particularly true for industrialised and pluralist countries that perceive force as an unimportant and dysfunctional instrument of policy for achieving goals. Traditionally, the fears of military attacks and threats forced states to develop a steady defence and military foundation. However today, the level of mutual influence between states and actors has diminished the fears of attacks (Keohane, Nye 2012:23). As within the EU-China relationship, not much emphasis is placed on military rearmament, but rather on trading military technology and material. The EU-China interdependent relationship is mainly characterised by bilateral trade relations, an arrangement that is mutually beneficial for both actors. There is thus no reason to include military force as a source of power when evaluating the EU-China interdependent relationship even if it is the dominant source of power.

## 4. Historical Contributions to China and Europe's Contemporary Values

China and the European states have both inherited strong cultural, traditional and religious legacies from their far-reaching historical background. At points their paths have crossed and left imprints on each other's values and societies, which has to a large extent influenced their contemporary behaviour, mindset and relations with foreign actors. This section intends to illustrate how some of the most important historical events have shaped and characterised China and the EU's current values to facilitate the understanding of their actions today.

### 4.1 China: National sovereignty and security above all

The legacy of China's cultural traditions and values originate from the development of ancient Chinese dynasties and can be traced thousands of years back in history. Foreign imprints on these traditions and values have been few, which allowed them to grow stronger and become a foundation of the Chinese national identity. However, China experienced greater foreign impacts during its modern history and one of the most profound and long-lasting imprints were made by the Europeans during the "century of shame and humiliation" that took place from the 1800's until 1949. This epoch brought a significant psychological and intellectual impact on China by imposing modernity and threatening not only Chinese territorial integrity and sovereignty, but also more importantly, Chinese values and traditions (Yahuda 2008: 13, 17-18).

The effects of the exploitation on China by colonial powers and the loss of Chinese sovereignty during the shame and humiliation period have had far-reaching impacts on Chinese politics and nation building. National security and state sovereignty have since

this historical experience being listed as China's top national interest. The founder of PRC, Mao Zedong, and his country leading successors Deng Xiaoping, Jiang Zemin, and Hu Jintao have all stressed and conveyed the priority of national sovereignty and security above all. All other concepts, be they human rights, democracy, or economical and social development, obtain a lower priority (Men 2011: 541-542).

## 4.2 The EU: Counter war, peace and cooperation

In contrast to China's "shame and humiliation" period, where the Chinese had to fight to keep their traditional values away from external influence, the EU was enacted for avoiding internal wars. With the end of the Second World War, the fundamental idea of a European community was to build a peaceful and united Europe. By primarily unifying the French and British coal and steel industries that were essential for making war under a single authority, the ambition was to create what Robert Schuman called a "de facto solidarity", which thus would make wars between the two former enemies "materially impossible" (Nelsen, Stubb 2003: 13).

The emergence of the EU has since the signing of the ECSC treaty in 1951<sup>3</sup> been staggering. As a complex and interwoven sui generis actor that has a policy-making process that extends across the subnational, national and supranational level, it obtains competencies where common interests and resources are gathered to meet regional, national and international challenges (Algieri 2008: 65-66). The latter came with the implementation of the Maastricht Treaty in 1993 and the establishment of the CFSP as the EU's second pillar. The main purpose of the CFSP is to strengthen the EU's role in international politics and it is viewed as a vital framework through which the EU conducts its external relations (europa.eu/legislation).

Since the underlying reason for establishing the EU is to hinder the outbreak of war within the European boundaries, its core values are often stated to be human dignity, freedom, democracy, equality, the rule of law and the respect for human rights

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<sup>3</sup> The ESCS treaty was signed on 18<sup>th</sup> April 1951 and entered into force on 25<sup>th</sup> July 1952.

(europa.eu/Lisbon). These values are projected through the EU's CFSP framework, where especially human rights and support for democracy constitute central aspects of the EU's external relations policy. These aspects pervade all external policy-making processes and policy implementations, and all cooperation agreements being trade, energy, climate, or others, contain clauses that stipulate human rights as a fundamental factor in relations between the EU and its partners (EEAS human rights). A breach of the objectives set out in the CFSP can result in the EU imposing sanctions or restrictive measures through trade restrictions, arms embargoes, or through other diplomatic or economic consequences. The purpose of these punitive instruments is to bring forth a change in governments' or non-state entities' policies or activities that violate human rights, international law, rule of law, or democratic principles (eeas.europa.eu/cfsp/sactions).

## 5. Crossing Paths and Enhanced Cooperation

Since the establishment of diplomatic relations between the EU and China in 1975, their relationship has undergone major transformations. While the EU has strengthened itself as a major actor in global affairs, China has experienced a massive growth in terms of economic development and international influence (Zhimin 2012: 7). The EU has become China's biggest trading partner, and China is by far the EU's largest import source and second largest partner in two-way trading after the United States ([ec.europa.eu/trade](http://ec.europa.eu/trade)). Their extensive development in terms of trade indicates that they share common interests and enjoy mutual benefits by further fostering and deepening their bilateral economic cooperation (Men 2012: 333).

The completion of the EU's single market in 1992 led the EU to focus on stimulating the European economy by engaging in international trade relations. The dynamic economic transformation in China was given substantial attention, resulting in the first China policy paper, *A Long-term Policy for China-Europe Relations*, to be issued in 1995. In this paper, the European Commission acknowledged China as "increasingly strong in both the military-political and the economic spheres" and "becoming part of the world security and economic system at a time of greater economic interdependence" (Men 2012: 334, Commission of the European Communities). For the EU, close engagement and development of a long-term relationship with China have since then been a prioritised EU policy and led to enhanced cooperation in economic and political areas, among others. Consequently, this resulted in a major increase in the number of high-level visits between China and the EU, which in turn made their bilateral relations more complex and profound. The advancement of their bilateral cooperation and relationship marked the beginning of what would be called a "honeymoon" period (Men 2012: 334-335).

## 5.1 The present construction of the EU-China dialogue model

The present model for dialogue interactions between the EU and China can be seen as divided into three pillars where each pillar engages in political dialogue, economic and sectoral dialogue, and people-to-people dialogue. The EU conducts the dialogues through the presidents of the European Council and the Commission (EU-China dialogues). The high level of dialogue exchange between the EU and China also includes a human rights dialogue. Since democracy and human rights are viewed as central aspects of the EU's external relations policy, the EU has undertaken several projects and programmes with the aim to strengthen these values in China's rule of law and civil society.

## 5.2 Is the honeymoon over?

However, history can transmit old values to impact the contemporary mindset of states and actors. Based on what we have seen thus far, the EU's and China's separate history has created events that have left distinct marks on their mindsets and how they view issues. Both have a different hierarchical structure of values, which has led to difficulties in understanding each other's opinions and given rise to deadlocks in some issues within the EU-China bilateral relations.

## 6. EU-China trade: a Success and Setback Story

### 6.1 From the Tiananmen incident to flourishing trade

The Tiananmen Square killings in Beijing in 1989 devastated much of the bilateral relations between the EU and China, including their initiated trade relations. It was not until 1995 when the EU decided to remove many of its sanctions on China that their trade relations began to blossom and their political and economic relations were intensified and deepened. Their bilateral trade developed into a relationship characterised by a high level of complementarity and mutual benefits and experienced a rapid increase from 2002-2003 and on. The EU-China trade in goods has increased by 400% between years 2000-2010, from €101 billion (bn) to €395 bn. In the year 2000, the EU exported goods to China for a value of €26 bn and imported goods for €75 bn. In 2010, the same export and import levels of goods reached €113 bn and €282 bn respectively (EU-China Trade Relations 2011: 6-7).

### 6.2 From mutual trade benefits to mutual trade concerns

China's large population is offering a broad market and cheap workforce, and its competitive advantage is primarily resting on labour-intensive products. Its speciality has mainly been exports of light industry goods with simple technological content to the EU. The EU, on the other hand, has developed a competitive advantage on capital-intensive and technology-intensive products, and is mainly exporting machines, equipment and other high-technology products to China. This division of production capabilities is perceived as being the essential driving force behind the EU-China trade symbiosis. However, these positive views and trade progressions of the bilateral relationship come with a downside of concerns for both actors. The effects of China's continuous rise and its internal political views on the economic relations threaten to

impose serious consequences on the EU in terms of trade, investments and on the EU-China political relations (EU-China Trade Relations 2011: 6-7, Qingjiang 2012: 4-5).

One of the obvious consequences of China's economic prosperity is its production expansion to high-end and high value-added products. China's production of both low and high value-added goods threatens to displace the mutual competitive advantage between the two actors and diminish the EU's own production and exports of high value-added goods to China due to the formers inability to compete with China's low production costs. These types of shifts have led to increased protectionism in certain production fields. The Chinese complain that the EU poses restrictive measures on exports of competitive products from developing countries to the EU, while allowing exports of other products that are unable to compete with their European counterparts (Wai 2011: 189, 193).

However, it is not only China that complains on the barriers to market access and unfair competition. One of the prerequisites for China's accession to the WTO in 2001 was that it had to undertake certain WTO obligations on market rules and access. China has implemented many of the measures outlaid by the WTO, but according to the EU, it has still not opened its markets to the extent that the EU had expected (EC EU-China 2006: 7). The EU was hoping that the WTO accession would liberalise Chinese restrictions on imports and investments and thus result in removing tariffs and opening the Chinese market for foreign companies. However, despite China's tariff reduction on certain products, barriers of trade still remain on industries that are particularly important for the EU (Glen, Murgu 2007: 342). These barriers cost the EU businesses approximately €20 bn in lost trade opportunities annually, equivalent to one-third of the current EU exports to China. This is seen as a vital reason behind the growing trade deficit that the EU has vis-à-vis China (Qingjiang 2012: 16-17).

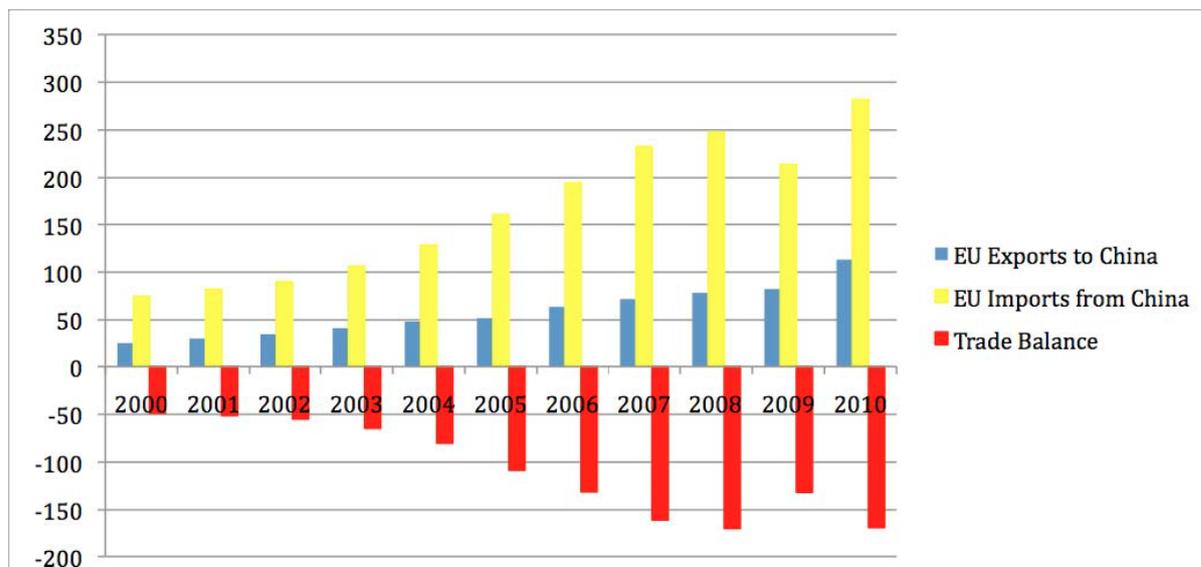
### 6.3 The threats of a growing trade deficit

The EU has faced a growing trade deficit in manufactured goods with China since 1997, and the trade imbalance has more than tripled between 2000-2010. Despite an

increasing consumer market and middle-class population in China, the EU is still exporting more to the 7.5 million inhabitants in Switzerland than to the 1.3 billion people in China (Ibid. 2012: 18).

Table and Graph 6.3.1: Evolution of EU – China Trade in goods (billions of Euros)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
EU Exports to China	25,8	30,6	35	41,4	48,3	51,8	63,7	71,9	78,4	82,4	113,1
EU Imports from China	74,6	82	90,1	106,2	128,5	160,3	194,9	232,6	247,9	214,1	281,9
<b>Trade Balance</b>	<b>-48,7</b>	<b>-51,3</b>	<b>-55</b>	<b>-64,7</b>	<b>-80,2</b>	<b>-108,5</b>	<b>-131,1</b>	<b>-160,7</b>	<b>-169,5</b>	<b>-131,7</b>	<b>-168,6</b>



Source: EU-China Trade Relations

The EU's concern with the trade imbalance is not the mere fact that it exists, but rather its size and continuing increase. According to a study from 2011 requested by the European Parliament's Committee on International Trade on EU-China trade relations, a trade imbalance gives rise to an increasingly unfair level playing field for the EU companies in particular. While Chinese exporters increase their competitiveness along with China's economic prosperity, the EU companies face market access difficulties, which cause an overall imbalance in the EU-China trade and economic interdependent relations (EU-China Trade Relations 2011: 11-12). For the EU there are mainly two ways of handling the trade imbalance; either by reducing Chinese

imports to the EU or by increasing European exports to China. While the former would result in protectionist reactions and culminate in Chinese irritation, the latter would require China to make a stronger effort to enable access to its markets. However, since the Chinese government asserts that market access exists, while the European companies argue the opposite, the conflict regarding market barriers remains unresolved (Qingjiang 2012: 18).

The European Commissioner for Trade, Karel De Gucht, mentioned some of the trade challenges between the EU and China during the EU-China High Level Political Forum in Brussels in November 2011. He stated that China's economic rise could not have happened without an open global trading system. Open markets are a prerequisite for China's own continuous development, and "are essentially a two-way street". He said that problems concerning market access and non-discriminatory treatment of companies could lead to "people questioning the legitimacy and rationale of keeping the European market open". Reciprocal market access is necessary in order to overcome the short-term trade irritants before they amount and jeopardise the long-term economic relationship between the EU and China, according to De Gucht (EU-China High Level Political Forum).

#### 6.4 The EU's coordination weakness: A trade hindrance

Another issue that is said to hamper the EU's position and acting power towards China is the EU's own lack of coordination and strong consensus in its policies. There is a need to refine the EU's strategy towards China and make it more united and target-oriented in order to face the economic opportunities and challenges that are generated by China's increase in economic power and growth. The Chinese government is aware that the EU member states have different positions regarding market access. While some member states advocate greater protectionism, others push for free trade or have no clear position. A lack of internal consensus does not only complicate the EU's efforts to achieve reciprocal market access with China. It further allows China to take advantage of these internal disagreements by offering individual member states bilateral trade opportunities in exchange for support in other economic or political issues, such

as granting China MES or lifting the EU's arms embargo. The EU's inability to create an internally firm position among its member states on reciprocal market access offers China opportunities to gain leverage against the EU by bonding with individual member states, which in turn dilutes the EU's decisiveness and results in an uneven balance of power to China's favour (EU-China Trade Relations 2011:11, 21-22, Glen, Murgu 2007: 343-344).

In sum, it is clear that the EU and China enjoy high levels of bilateral trading and view each other as important economic and trade partners. Both actors' economic and trade development has undergone remarkable progress since their real initiation of bilateral trade relations in 1995. China's accession to the WTO in 2001 further boosted China's international trade levels and created a tighter trade link between the two actors. However, closer economic ties has led to higher expectations on each other regarding the opening of markets and non-discrimination of foreign companies. They have also revealed the EU's weakness in coordinating and creating a strong internal consensus for establishing reciprocal market access with China. The EU's internal issues have enabled China to offer lucrative trade opportunities to individual member states in exchange for supporting China's strive for MES or the lifting of the EU's arms embargo. Thus the backsides of increasing bilateral trade relations are these types of trade obstacles and conflicts that remain topical and unresolved and could impose serious implications on the EU-China long-term bilateral trade relationship.

## 7. The Financial Crisis: A Game Changer in Economic Power

The impact of the 2008-2009 global financial crisis has brought serious repercussions for the EU and its member states. A conjunction of the construction collapse, housing and real estate booms in Ireland and Spain in the end of 2007 was further amplified by the global economic and financial collapse and led to the most severe economic contraction that Europe has experienced since the 1930's. In the end of 2008, 25 out of the 27 EU member states, all except Poland and Slovenia, found themselves either in a recession or a depression (the Baltic States). The EU's weak reaction and resistance to inject an immediate and strong fiscal stimulus into the economy further exacerbated the situation. The EU's inability to take drastic measures, together with the high levels of trade and financial interdependence among the EU states, generated a chain of negative effects that resulted in a sovereign debt crisis that paralysed the economy of the European states in early 2010 (Cameron 2012: 3-4, 91-92, 163).

The effects of the global financial crisis have caused a major power-shift in the world economy in favour of emerging powers. While leading western powers such as the EU are economically weakened and suffering from economic losses and heavy debt, China has managed to avoid the economic crisis, pursue its rapid economic growth and overtake Japan position as the second largest national economy in the world during 2010 (Zhimin 2012: 8). While the EU is focusing more on internal austerity measures and bailouts of its own member states, China is becoming increasingly assertive and establishing itself as a pivotal player in international affairs. The EU's relative loss of competitiveness, weak domestic demand, increasing unemployment rates, costly public sector and expensive welfare systems are some of the crisis consequences that forecast a gloomy long-term economic performance. Chinese firms, on the other hand, are taking advantage of their low production prices and rapidly expanding and taking over markets

in Asia, the Middle East, Africa, and Latin America that used to have strong European economic presence (Vogt 2012: 222-223).

## 7.1 Increased tensions and loss of trust

The challenges that the financial crisis has imposed on the EU's economy have also created a number of tensions between the EU and China. China's growing assertiveness in international forums has made it less eager to compromise on issues such as trade negotiations (EU-China Trade Relations 2011: 23). The EU must therefore devise a new strategy on how to come to terms with China from a weaker negotiating position (Vogt 2012: 221). However, maintaining good relations with the EU is a top priority for China. Taking into account that China's growth heavily depends on its exports, and that the EU is China's largest export market, makes it important for China to maintain and help to improve the EU's financial situation. Thus the role that China has taken in the European sovereign debt crisis has been to invest millions of euros in infrastructure programmes, offering to buy European bonds and to give financial support to the financially vulnerable European member states (EU-China Trade Relations 2011: 23). However, the EU has been reluctant to accept China's helping hand for certain reasons. Even if the EU and China have maintained cordial political relations and expressed firm commitments for strengthening their bilateral ties, the EU remains persistent on democracy and human rights issues in China. There is a European fear in losing political power in promoting these core issues if the EU would allow China to provide support in its internal affairs (Zhimin 2012: 14).

## 7.2 In the eyes of China: Is the EU an overrated partner?

There are further arguments that the European debt crisis has changed the Chinese perception of the EU as a global economic power. There are views that China sees the EU as a success story of how Europe has managed to establish itself as an economic superpower on equal level with the United States. Maintaining close economic

cooperation with the EU and its member states is therefore of vital importance for China's economic growth and modernisation. However, the impacts of the financial crisis have resulted in Chinese observers questioning the EU's status in the international economic arena. The Chinese are surprised of how the EU is transforming, from a role model on many fronts to a union of many problems. The Chinese elites and the general public have become more pessimistic about the EU as a rising power and pay less importance to the China-EU bilateral relationship after the EU sovereign debt crisis compared to before the crisis (Ibid. 2012: 12-13).

Table 7.2.1: The most influential bilateral relationships as viewed by the Chinese: 2006-2011

	2006	2007	2008	2009	2010	2011
China- US	78.0	85.2	75.6	81.3	76.8	76.6
China-Japan	48.7	48.2	35.0	21.4	29.2	21.5
China- Russia	19.8	22.0	23.4	21.3	20.5	20.6
China- Europe	13.2	13.6	13.6	19.9	7.3	8.0
China- Africa	6.2	3.3	7.3	6.4	1.7	1.8

Source: Zhimin 2012: 20

Note: The survey respondents were allowed to select the two bilateral relationships that they perceived as the most important. The surveys were conducted on an annual basis, i.e. during four consecutive years (2006-2010). The figures for 2011 are provided by the source.

The above table illustrates how the Chinese perceptions regarding China's most influential bilateral relationships have changed between 2006-2011. The information is taken from an annual survey conducted by China's newspaper *Global Times*, affiliated with the official newspaper *People's Daily*. The table shows that the China-US bilateral relationship was seen as the most important relationship during the five consecutive years. Compared to the China-Europe bilateral relationship, it is evident that China-Europe was perceived as much less influential. However, what is interesting about the China-Europe figures is the dramatic drop that the bilateral relationship had in the eyes of the Chinese between 2009-2010, from 19.9% down to 7.3%. Based on this

information, one could assume that the Chinese perception of the China-EU bilateral relationship as less important after 2009 could be chained to the EU's sovereign debt crisis that occurred during the same period of time. Hence, the EU member states' internal economic problems might have caused the Chinese to lose faith in the EU both as an economic superpower and as an important bilateral partner.

## 8. Cases

### 8.1 The EU-China HR Dialogues

#### 8.1.1 How it all began

The EU has since its founding Treaty of the European Union from 1993 stated that “democracy and the rule of law, and respect for human rights and fundamental freedoms” are viewed as an essential objective within the EU’s CFSP (Glen, Murgu 2007: 334). As a steadfast advocate for human rights, the EU has stipulated that all cooperation agreements between the EU and third parties must contain a human rights clause where the EU reserves the right to implement punitive approaches against HR violations in these countries (Men 2011: 539-540). However, from Chinese perspective due to its historical experience, state sovereignty and national security are prioritised higher than human rights (Men 2011: 541).

#### 8.1.2 A bilateral deal becomes another actor’s frustration

In line with the EU’s HR ambition, the EU-China annual HR Dialogues were established in 1995 on EU’s initiative for supporting China’s transition to an open society that respects human rights and implements the rule of law (EU-China HR Dialogue). For China, the EU was seen as an important and powerful trade partner that held many keys for China’s continuous economic growth. Thus for establishing stronger and closer bilateral ties with the EU, China agreed to meet some of the EU’s requests such as the annual HR Dialogues as a way to show the West that it is a responsible and serious actor on the world stage. The EU’s aim of the dialogues was to

influence HR developments in China through softer and more low profile means that respected China's national values and dignity (Wai 2011: 206).

However, despite conducting the annual bilateral HR Dialogues twice a year since 1995, little progress has been made within the HR area. In 2006 the EU expressed its frustration over the results of the dialogues in the communication "EU-China: Closer partners, growing responsibilities". The paper stated, "The EU's expectations- which have increased in line with the quality of our partnership- are increasingly not being met." (EU Communication 2006).

One explanation to the HR Dialogue failure could be the EU and China's differences in prioritising when it comes to human rights. The EU's high profile commitment to human rights and democracy in contrast to China's focus on economic development and state sovereignty has undoubtedly created cooperation difficulties within the human rights area and resulted in irritation on both sides. Furthermore, issues like Tibet and European leaders' meetings with the Dalai Lama has generated even greater nuisances for China and further infected the EU-China relations. China's irritation stems from the fact that it considers these issues to be a part of its national interest and that Europe thus interferes in China's domestic affairs (Men 2012: 347).

### 8.1.3 HR Dialogues- litmus test for the EU-China relations

In 2008 the Dalai Lama quarrel would mark the beginning of a new stage in the EU-China relationships. When the former French president Sarkozy scheduled a meeting with the Dalai Lama, China showed its disagreement by cancelling the 2008 summit meeting with the EU that had run for 11 consecutive years. This was an unprecedented step by China to penalise the EU for its human rights endeavours. President Sarkozy, who had already sidestepped an earlier meeting with the Dalai Lama the same year to avoid displeasing China, criticised China for intervening with his decision-making power as the French president and as the EU president at the time (nytimes.com, Men 2012: 347).

The cancellation of the summit meeting became the starting point for China's more aggressive tone towards the EU regarding issues that China perceives as strictly national matters. The summit was supposed to discuss the increasing Chinese trade surplus with the EU and issues related to the financial crisis ([guardian.co.uk/dalailama](http://guardian.co.uk/dalailama)). Due to the EU's crisis situation and its wish to solve the trade imbalance issue, the upholding of the summit meeting could be seen as more beneficial for the EU than for China. The cancellation thus imposed consequences for the EU in a double sense; from one perspective China showed that it was not hesitant to implement penalising measures on the EU if the EU acts in a way that China perceives as "crossing the line", and from another perspective China showed that it could be disobliging in discussing issues that are of great importance for the EU.

The above mentioned is an early indication of an influential and more assertive China in international affairs. It became a litmus test for the EU-China relations to see how far China could direct the EU to follow its requests. From an EU perspective, the disappointment on the results of the HR Dialogues was a first realisation that things are not progressing in the way that the EU had wished for in the human rights area. Another setback was when China began to issue consequences for the entire EU due to actions taken by single member states. This can be regarded as a great shift in the EU-China relationship towards a more demanding China.

However, the most significant adversity in the EU-China HR Dialogues occurred in 2010 and 2011 when China declined to take part in both years' second sessions of the dialogues as a strategy to reduce the number of dialogues to once a year. This was a major setback for the EU member states, which despite the acknowledged HR Dialogue fatigue do not have any other policy towards China directed solely on human rights issues (Men 2012: 348). However, the biggest setback clearly struck the EU, who as a union has made a clear and firm commitment to promote human rights and democracy internationally. During the first HR Dialogue session in 2012, the EU expressed its disappointment to the Chinese delegation and reiterated its wish to uphold the dialogue twice a year ([consilium.europa.eu/hrdialogues](http://consilium.europa.eu/hrdialogues)).

Yet, international human rights NGO's have voiced concerns regarding the EU's diminishing engagement in human rights issues in China in exchange for China's involvement in an economic bailout of European member states. According to Human Rights Watch, the EU's and the member states' approach to human rights issues in China is weak for fear of jeopardising economic relations ([hrw.org/hrec](http://hrw.org/hrec)). In another report HRW observes that the EU only made general references to China's human rights situation in its joint press communiqué of the 14<sup>th</sup> EU-China summit in 2012. However, the general points made by the EU were an improvement compared to the previous communiqué released a year before, which according to HRW did not even mention human rights ([hrw.org/news](http://hrw.org/news)). Amnesty International is another NGO that has raised concerns that "human rights might be traded away in return for Chinese assistance in the euro crisis" ([dailymail.co.uk/amnesty](http://dailymail.co.uk/amnesty)). Amnesty also noted a trend in silencing criticism when economic relations grow, and stated that the EU's economic situation will probably have an impact on how the EU handles its human rights discussions with China ([guardian.co.uk/bailout](http://guardian.co.uk/bailout)).

There is thus a common understanding among human rights organisations that economic deals such as bailouts will give China greater influence and leverage on the EU. For further enhancing this statement, there are recent reports that alert a worsening of the human rights situation in China. Upon HR Ashton's first visit with the new Chinese leaders in Beijing in April 2013, HRW reported that the human rights environment is deteriorating in China and that "human rights and the rule of law have become mainstream topics in today's China (...)" ([hrw.org/china](http://hrw.org/china)).

The initial purpose of the Human Rights Dialogues was to promote human right values in China through a soft and sustainable approach. Despite the dialogue's inability to reach tangible results, the real human rights' setbacks took place with the beginning of the financial crisis. China went from being accommodating in its efforts to reach some of the human rights goals set out by the EU, to imposing consequences on the EU and its member states for conducting meetings with the Dalai Lama. This enormous contrast in behaviour has obviously strained the EU-China relationship and raised concerns regarding the EU's weakening position in human rights discussions contra China in line with China's bailout contribution to financially sinking EU member states.

China has managed to disintegrate the EU's firm standpoint on human rights issues *pari passu* with providing financial support to its member states. However, despite this change in direction, the Human Rights Dialogue is still ongoing, even though question marks regarding its relevance persist.

## 8.2 The EU's arms embargo on China

### 8.2.1 How it all began

The EU's arms embargo was introduced in 1989 after the Tiananmen incident and the military crackdown on Chinese students that occurred the same year. The EU's main reason for implementing and maintaining the embargo has been to send China a strong signal of disapproval against the repressive actions and executions and of support for the improvement of human rights, democratic values and freedom in China (EC sanctions). In order to lift the arms embargo, the EU demands significant human rights progress in China and has previously stated that "nobody has said we [the EU] are going to lift our embargo for free" (Men 2011: 547). However, the imposition of the EU embargo has never had codification for being legally binding for member states, neither has a duration or verification of the embargo been specified. This general political declaration has allowed member states to make individual interpretations of the ban and the EU has permitted selected sales and transfers of military material. This has in turn legitimised the distribution of non-lethal military products from the member states to China (nti.org).

### 8.2.2 Financial gains: Europe's temptation to lift the embargo

Along with China's economic boost and transformation into a leading economic superpower during the beginning of the 21<sup>st</sup> century, and the EU member state's stagnant growth rate since the end of 1990s, the temptation for lifting the EU arms

embargo in order to obtain lucrative military orders became somewhat irresistible for certain EU member states. The main advocates for lifting the arms embargo were France and Germany during the EU-China “honeymoon period” in 2003-2004. Germany and China’s relationship is mainly characterised by strong economic ties in terms of trade, inward investment and technological cooperation, which in turn means that both actors are eager to maintain good political relations with each other. France, on the other hand, has sought to strengthen its relationship with China for realising economic gains as their German counterparts (Glen, Murgu 2007: 337). In 2003, President Jacques Chirac welcomed President Hu Jintao to Paris with one of the most extravagant receptions ever given a foreign leader by lighting up the Eiffel Tower in red and designating the following year 2004 as the “Year of China” (Heritage.org).

During the former German Chancellor Gerhard Schroeder’s visit to Beijing in December 2003, he told his Chinese host, Premier Wen Jiabao, that Germany was amenable to end the arms embargo (heritage.org). Premier Jiabao, who referred to Schroeder’s visit as “another family meeting” expressed wishes for a removal of the arms embargo and called it a product of Cold War times and not in line with the established partnership<sup>4</sup> between China and the EU (china.org.cn). The former French President Jacques Chirac followed the same line of thought as his German colleague and stated during his visit to Beijing in 2004 that arms embargo is “groundless and illogical” and “no longer justified” (chinadaily.com, news.bbc.co.uk Chirac). His at the time foreign minister Dominique de Villepin stated in 2004 that the embargo “is outdated” and referred to Beijing as “a privileged partner of the EU and has a major and responsible position in the international system” (bbc.co.uk Villepin).

The eagerness by the Franco-German axis to lift the arms embargo has strong reciprocal advantages. A lift would quench the Chinese thirst for modernising its military material and provide a money haven for states such as Germany and France that are leading in high-technological military products. It would also give China an ability to diversify suppliers, something that is not possible at the moment. China’s current suppliers of military technology, mainly Russia and the Middle East, cannot provide as advanced material as the European countries, but they still place China in a

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<sup>4</sup> A Strategic partnership was established between the EU and China in 2003

weak bargaining position due to China's limitation in suppliers. An EU ban removal would thus give China more bargaining leverage vis-à-vis its current suppliers and generate lower profit for Russia and the Middle Eastern countries (nti.org).

However, despite the win-win situations that an arms ban removal would allegedly invoke on both the EU member states and China, there are different reasons to why the ban has still not been lifted since its implementation 24 years ago.

Firstly, not all EU member states support a lifting of the ban. The Scandinavian member states, the Netherlands, and to some extent Portugal and Belgium have earlier opposed to lift the embargo without demanding significant human rights progress in exchange from China (nti.org, Glen, Murgu 2007: 338) During 2004 there were several attempts to remove the arms embargo through voting. The French foreign minister de Villepin's suggestion to lift the ban at the EU foreign ministers conference in January 2004 was voted down by 14 to 1 (Heritage.org). The European Parliament passed four resolutions where all supported the continuous upholding of the embargo in 2004. In another attempt in April 2005, the European Parliament voted 431 to 85 (31 abstentions) in favour of a resolution that proclaimed that the EU should not remove the arms embargo (Men 2011: 547). This was repeated in 2008 where the European Parliament stressed that the EU must maintain its arms embargo on China (EP 2007/2255).

Secondly, the lifting of the embargo is not only an EU member state concern, but also a concern for the US. The US has been a strong opponent to lifting the EU embargo and considers it as complementary to its own arms ban on China (Glen, Murgu 2007: 338). In contrast to the European correlation between the lifting of the arms ban and economic gains, the US is more concerned about the strategic implications that a removal would signify (nti.org). The case of Taiwan is the most important problem in Sino-American relations. If the EU would lift the arms embargo and China, in turn, would make reality of its threats to declare war across the Taiwan Straits, the US would find itself in an open and armed conflict with a military strong China equipped with advanced European weapons. A scenario where US soldiers are killed by European weaponry purchased by China is unacceptable for Washington and it is mainly for

these potential consequences that the US strongly opposes the EU's arms embargo removal (Wai 2011: 200, 202).

### 8.2.3 The embargo today- an outdated impediment at the EU's expense?

The EU member states' inability to reach consensus on the Chinese arms embargo issue has left the question untouched until this day. However, continuous discussions regarding a lift are conducted raising new voices and opinions. In December 2010, Catherine Ashton, the High Representative of the Union for Foreign Affairs and Security Policy, and the Vice President of the European Commission, released an EU strategy paper where she recommends the EU leaders to drop the arms embargo on China as a way to improve relations with Beijing and remain on the world stage. She referred to the embargo as "a major impediment for developing stronger EU-China cooperation on foreign policy and security matters" and further admitted "China will not match EU standards of human rights and rule of law for some time to come. Future convergence is best sought by concentrating on common ground" (euobserver.com/ashton, eubusiness.com). This pragmatic statement by HR Ashton can easily be interpreted as a change in the EU's approach to promote human rights in China. Even though the paper stresses the importance of working for the release of political prisoners in China through diplomatic measures, it also gives impetus to the member states that advocate for a lift and creates headwind for the opponents.

Another fine detail in HR Ashton's strategy paper is the bold description of China as a "major world power". In contrast, Russia is termed a "key player", which is a significantly lower diplomatic designation. Russia is also depicted as dependent on EU technology for petrol industrial modernisation purposes, which the EU can use as "issue-based leverage" for pushing for democratic and human rights improvements. Interestingly enough, the paper makes no such referrals to China (euobserver.com/ashton).

China has persistently urged the EU to remove the arms embargo, but has recently taken a new strategic approach on the issue. In 2010, China's ambassador to the EU

stated that the arms embargo only triggers China to develop its own arms faster, and “at the end of the day, it is the [arms] companies in Europe that are losing out” (Ibid.). This statement not only dilutes the purpose of the EU arms embargo, but also pressures the EU to revalue the purpose and effect of the embargo and the costs that an upholding of the ban could inflict on the European economy and companies in a time characterised by crisis. HR Ashton’s strategy paper thus becomes less startling from this point of view.

Despite HR Ashton’s alignment with the anti-embargo member states, a lift of the ban was yet again down-voted. The Nobel Committee’s recognition of the Chinese dissident Liu Xiaobo and China’s aggressive response to this reminded many EU member states why the arms embargo was once enacted. However, China’s reaction against the Peace Prize was not only directed towards the Nobel Committee but mainly towards the EU member states’ embassies in Oslo that were urged to boycott the gala or face “consequences”. These alleged consequences could very probably be economic as China, during the same period as the announcement of the Peace Prize, promised to support Spain, Greece and Portugal’s ailing economies by buying large amounts of their government bonds ([euobserver.com/bonds](http://euobserver.com/bonds)).

The EU’s historical and present internal commotion regarding the embargo lift demonstrates how fragile and sensitive the question really is and how the situation has changed through time. China’s rapid economic growth and the EU’s critical economic situation have further bolstered parts of the EU’s conviction in removing the ban and given China more leeway in its negotiations with the EU. However, despite how this situation has transformed during the past decade, and despite China’s continuous plea to lift the arms embargo, it is yet formally in effect, even if single EU member states informally continue to provide non-lethal military material to China.

## 8.3 China's strive for a Market Economy Status

### 8.3.1 How it all began

China has during the past two decades transformed into a global economic power and is today recognised as the second largest economy in the world after the US. However, China's road to economic prosperity has been rather long and at times thorny. The Tiananmen incident led to both economic and military sanctions, among others, on China and interrupted the steady bilateral developments between the EU and China. Their bilateral economic relationship began to recover during 1995 based on the EU's release of a new concrete policy toward China. China's economic transition and trade liberalisation created vast economic opportunities for the EU and closer economic relationship thus became a European priority (Qingjiang 2012: 3-4). For China, closer economic ties with the West signalled increased economic growth and a step closer to a WTO accession, which would place China on an equal playing level as other actors and thus eliminate international trade discrimination measures contra China (economist.com/mes).

### 8.3.2 Granting China MES- the EU's disservice to self

A WTO accession would allow China to experience greater market access and ability to enjoy the same trade related rights as the other WTO member states. China would also be much closer in its quest towards a market economy status, which would enable a more open and competitive based trade in foreign markets, such as the EU market. A Chinese WTO membership also obliged China to reduce its import tax and remove trade barriers, for stimulating the opening of the Chinese markets for other actors. This was one of the reasons why the EU decided to support China's WTO accession. It was a beneficial opportunity for the EU to gain greater access to Chinese markets and thus reduce its growing trade deficit with China. However, when China finally was granted a WTO accession in 2001, some of the non-trade barriers remained and are still today

preventing EU companies from entering the Chinese market (Men 2012: 342). As a result, the EU's trade deficit vis-à-vis China is increasing instead of decreasing as the EU was initially expecting. The EU's eagerness in reducing the trade deficit with China is based on the consequences that a long-term trade deficit inflicts, such as reduced GDP, and increased debts and unemployment rates. It also leads to an unstable economy and triggers repercussions during a recession ([economywatch.com/tradedeficit](http://economywatch.com/tradedeficit)). For the EU, these are serious concerns that threaten the European economy and could be avoided if China would allow greater access to its markets. These are some of the issues that the EU wants to resolve before granting China MES at an earlier stage than what the WTO has decided upon.

The EU would face several implications if it would acknowledge China as a market economy. First, the price benchmark to which the Chinese exports are compared to would shift. Currently, Chinese export prices are compared to other low-cost exporters to detect if China is excessively dumping cheap goods. By becoming a market economy, the price comparison would change to China's domestic prices, which would mean that fewer products would pass the dumping grade since Chinese domestic prices initially are very low. Hence, the EU would not be able to take anti-dumping measures against China to the extent that it does today ([euobserver.com/dumping](http://euobserver.com/dumping)). Since Chinese production prices are low and the price of trade goods are among the cheapest in the world, a free trade regime would ease the massive inflow of cheap Chinese products to compete with more expensive European manufacturers. This in turn would devastate the affected European industries and replace them with Chinese imports (Wai 2011: 194). If China receives MES it would generate great disadvantage for European companies and yield tremendous trade possibilities for Chinese manufacturers and products.

It is thus the EU's and China's different levels of development and competitive advantage in trade that creates trade conflicts and insecurity and results in protectionist measures. The expectations that both parties had on each other prior to China's WTO accession, China in terms of MES recognition and the EU in terms of easier access to the Chinese market and reduction of trade imbalances, have hampered their bilateral trade relations and given rise to a need to "retain" trade in sectors that are vulnerable

for foreign competition (Wai 2011: 195). These issues are the main problem areas in the EU's and China's bilateral trade relationship.

### 8.3.3 China's MES- Europe's cul-de-sac?

Despite years of consultations and negotiations for solving the trade disputes between the EU and China, the situation remains unaltered. The EU is resisting giving China MES recognition and is continuously complaining over the trade barriers and its increasing trade deficit with China. China's counter argument is that the EU will decrease its trade deficit once it relaxes its import restrictions on high-tech products to China and acknowledges China as a market economy (Men 2012: 342).

With the culmination of the financial crisis in 2008-2009, the tension between the EU and China regarding the trade disputes has increased. However, despite of the continuous "deadlock" in solving the disputes, the EU's sovereign debt crisis has enabled China to use the EU member states' substandard economic situation as leverage for pushing the EU for MES recognition. EU member states such as Spain, Greece, Portugal and Italy have reached out to China as a potential buyer of their debt, which in turn has enabled China to demand favours in exchange, such as MES ([telegraph.co.uk/finance](http://telegraph.co.uk/finance)). Indeed, China has openly offered to help the euro by expanding their European investments, bailing out collapsing member states, and buying European bonds and member states' debts. However, the price that the EU would have to pay for a Chinese helping hand could indeed be higher than not accepting any help from China at all. If the EU takes China's offer and allows larger inflows of cheap Chinese goods to Europe, the price competitiveness of European manufacturers would be undermined, which in turn would lead to more European companies going bankrupt for the cost of increased Chinese sales to Europe. This can most probably explain why the EU has yet today persevered in granting China a market economy status.

China has expressed its willingness to help the EU with its sovereign debt problems and has also openly signalled that it wants EU's MES recognition in return. In September

2011, China's former Premier Wen Jiabao offered a helping hand to troubled European member states but added "If EU nations can demonstrate their sincerity several years earlier [than WTO's recognition of China as a market economy in 2016], it would be the way a friend treats a friend" (euobserver.com/MES). This implies that China is expecting the EU to acknowledge China as a market economy prior to 2016 as a friendly gesture for receiving financial help from China.

Despite China's many efforts to exert pressure on the EU for recognising China as a market economy, the EU has not yet yielded to its demands and offers and is continuously insisting on China's compliance on removing trade barriers and opening up its markets. However, as time passes, the leverage that the EU is exercising on China for opening up its markets for foreign companies in exchange for MES is shrinking. China has been urging the EU to grant it a market economy status since 2001 without success, and China now only has to wait for another three years in order to receive it by the WTO. This implies that if the trade "deadlock" between the EU and China persists until 2016, China will receive its anticipated market economy status regardless of the EU's demands on China to further open its markets. This would exacerbate the EU's trade situation with China since the EU would remain on status quo, meaning that the European companies would not enjoy greater access to Chinese markets, while Chinese products would have free inflow to the European market.

## 9. Analysis of the EU-China Interdependent Economic Relationship and Cases

This chapter has been divided into two parts in order to make it as structured as possible for the reader. The first part intends to analyse the general development of the EU-China interdependent economic relationship to see what changes that have taken place until the financial crisis in order to identify if the relationship has become more asymmetrical or not. The second part of this chapter will further elaborate on the analytical findings from the case perspectives. This means that the findings from the first part will constitute the basis for the analysis on each of the cases. My aim with this section is to examine how the financial crisis has affected the EU-China interdependent economic relationship and thus the three bilateral cases by applying the theoretical instruments of power, vulnerability and cost perspective.

### 9.1 Part I: General analysis of the EU-China interdependent economic relationship

What we have seen thus far is that the EU and China have come a long way in the development of their interdependent economic relationship. Both have acknowledged the benefits in strengthening their bilateral ties and are actively pursuing and adhering to common strategies and goals for achieving a fruitful and more advantageous relationship. However, despite their mutually beneficial intentions, economic factors have led to disruptions and tensions between the EU and China on several issues, which in turn have affected the level of symmetry of their interdependent economic relationship.

### 9.1.1 Status quo: asymmetrical interdependence favouring the EU

When the EU-China bilateral trade relationship really began to soar during the second part of the 1990s, their relationship benefits outshined both actors' differences. China's economy was on the upswing, but it needed the EU's markets and expertise in capital-intensive and technology-intensive products to further bolster the Chinese economy. The EU, on the other hand, saw immense trade opportunities in China that could yield much needed investments and revive the stagnant growth rate that Europe was facing during the 1990s. However, from an economic interdependence point of view, one can correctly assume that China was more dependent on the EU during that time since it was not yet a WTO-member and also in need of the European market and knowledge for expanding further. For these reasons, China needed to show the international community that it was a compliant and mature actor that needed to be taken seriously. This could explain why China agreed to engage in bilateral HR Dialogues with the EU, even though it views these issues as strictly national concerns. In accordance with the concept of power, the EU used the sources of power that China's more economically dependent situation gave rise to and managed to enact the HR Dialogues. This was the price that China had to pay, i.e. the cost, for establishing closer ties with the EU that would eventually yield further economic prosperity for China. Nevertheless, this does not mean that the EU was not dependent on China for economic reasons. Both actors had much to win from enhanced cooperation, but at the initial stage, China had more at stake by not complying with the EU's requests. Thus from this perspective, we can conclude that the interdependent relationship between the actors was initially asymmetrical to the EU's favour.

### 9.1.2 Shift in trade dependency and power asymmetry to China's favour

With China's WTO accession and strong economic advancement in the beginning of the 21<sup>st</sup> century, the asymmetrical interdependent economic relationship between the EU and China began to shift. The EU's expectations in gaining greater access to China's markets were not entirely fulfilled by China's WTO accession. The accession opened up the Chinese market, but not to the extent that the EU had expected.

Instead, China's competitive advantage began to expand to high-end and value added products, which are the EU's main export competences. This did not only lead to increased protectionism, but also to a shift in trade dependency between the EU and China. European companies were not given full access to Chinese markets, which led to great economic losses for the EU; the production capabilities shifted which limited the EU's competitive advantage in high-technological products; and the EU's trade deficit with China continued to grow. These issues strongly influenced the division of power and symmetry in the EU-China interdependent economic relationship to shift to China's favour. The EU became more vulnerable since the changes that took place in the EU-China economic policy framework inferred greater costly effects on the EU than on China, even if China is affected by the EU's increased protectionism. Furthermore, China's economic advantage and the European member's economic hardship enabled China to apply the carrot and stick measure against individual member states. China uses its ability to reward or withdraw profitable orders to European states depending on their actions. At this stage, the situation became reverse since it now was the EU member states that had more at stake economically by not complying with China's requests.

From a trade point of view, China is dependent on the EU since it is China's greatest export market. However, the power that the EU has in this respect is hard to use as leverage on China. If the EU would take drastic protectionist measures and close the European market for Chinese products to force China to open its markets for European companies, it would invoke devastating consequences not only for China, but also for the EU. The costliness for the EU would be much higher import prices since the substitute alternatives for Chinese products are few, both from a quantity and price perspective. Options such as India, Bangladesh, and Indonesia could be matching substitutes in terms of price, but it would take time for these states to produce the same quantities as China. For China, there would be short-term consequences. China would lose its most important export market, but would be able to maintain, or maybe even increase its exports to other parts of the world. China's low production prices, broad market, and cheap workforce give it a competitive advantage in practically all markets. This illustrates that the EU is much more vulnerable to any changes in its trade policy with China, since it would infer much higher costs for the EU than for China.

### 9.1.3 Financial crisis: A stronger China versus an even weaker EU

The effects of the financial crisis have further exacerbated the economic power asymmetry in the EU-China interdependent economic relationship. The economic advantage that China enjoys vis-à-vis the EU has increased in line with the EU's sovereign debt crisis, which has created opportunities for China to exercise a tougher bargaining line against a more economically desperate Union. From a power perspective, China has become more assertive and less willing to compromise on trade issues. China's willingness to help the EU financially comes with official requests for MES and a removal of the arms embargo, among other things. If the EU would decide to meet China's requests, it would not only make the EU more dependent on China, but it would also leave the EU without any political leverage against China. Thus, the costliness of accepting financial help from China is very high and could have severe long-term implications on the EU-China bilateral relationship if the EU would decide to remove the arms embargo and grant MES to China. The EU has thus far been cautious in accepting China's help. However, the help that the EU member states have received in terms of investments and purchasing of government bonds has created internal discussions within the EU, where the member states that are receiving Chinese financial help are proclaiming to remove the arms embargo. This has contributed to increased asymmetry in the EU-China bilateral relationship to China's favour. China now pays less attention to the EU's demands and has begun to make demands on its own by, for example, taking the sudden decision not to participate in the second round of the HR Dialogues.

Due to the EU-China interdependent economic relationship, the EU's sovereign debt crisis can impose negative reciprocal effects on China as well. If the EU member states' purchasing power drops, the EU will not be able to maintain its import levels, which would primarily affect China as the EU's largest exporter. It is therefore in China's interest to keep the EU from collapsing, since China's profits depend on their interdependent economic relationship. From this point of view, the EU can manage to accept some economic help from China without having to promise favours in return. However, if the EU would become much more economically dependent on Chinese help, then China would have a higher demand on the EU to meet China's requests.

## 9.2 Part II: Analysis of the cases

### 9.2.1 HR Dialogues- A losing game for the EU

Compared to the other two cases, the HR Dialogues is the case that has experienced the most radical changes in the EU-China interdependent relationship with the financial crisis. Being initially an initiative by the EU to promote the importance of human rights in China during China's transition into an economic power, it has become a secondary issue with little effect on China.

The only incentive for China to engage in HR Dialogues with the EU was to improve its image as a responsible and reasonable actor during a time when China was more dependent on the EU than vice versa. The costliness for China to engage in the dialogues was low for what it was worth; establishing closer relations with the EU, which in turn would contribute to further economic prosperity for China. The reciprocal costly effects of the dialogues were thus beneficial for both actors; the EU was satisfied that China decided to meet the EU's human rights demands, and China was satisfied with establishing closer bilateral relations.

However, in line with China's economic prosperity and the EU's economic crisis, China's incentive for upholding the dialogues with the EU disappeared. China became less dependent on meeting the EU's requests, while the EU's economic dependency on China increased. This allowed China to decide that it no longer wanted to participate in one of the two annual human rights meetings. This is a clear indication of a shift in power asymmetry between the EU and China. Furthermore, it illustrates that there are no extreme costly effects for China when it refuses to attend one of the annual meetings. One consequence of China's actions in this case is that it can create fractures in China's political relations with the EU. It can also complicate the removal of the arms embargo, which is maybe the most important cost that China's action imposes. However, if China manages to produce own high-technological military material, it

would demote the importance of the embargo for China and thus also reduce the cost of refusing to take part of the HR Dialogues.

The main difference between the HR Dialogues and the arms embargo is that the EU cannot use the dialogues as leverage on China for requesting human rights improvements in return. The reason why the EU argues that the dialogues have generated poor results can to a large extent depend on the fact that China no longer has an incentive in upholding the dialogues.

Furthermore, the economic power asymmetry has allowed China to issue economic consequences on the EU and its member states for arranging meetings with the Dalai Lama. Since issues such as Tibet and the Dalai Lama are considered strictly national interests, China has begun to penalise the EU by cancelling bilateral summits about the trade imbalance and other crisis related issues. This is a clear example of China taking advantage of the economic asymmetries as means of power for preventing meetings between the EU and the Dalai Lama. In this respect, the costs of conducting meetings with the Dalai Lama become very high for the EU, since the EU is in need of China to open its markets in order to solve the trade imbalance issue.

### 9.2.2 Arms embargo- From HR commitment to a stone in the shoe

By analysing the arms embargo from a cost perspective we can identify a clear shift in costly effects of the EU's arms embargo lift prior compared to after the financial crisis. Prior to the crisis, the EU believed that the arms embargo was needed as an incentive for demanding improved human rights in China and an upholding of the embargo was therefore prioritised before the economic gains that a lift would have generated. A removal without any signs of human rights improvement in China could have been interpreted as a failure of the EU's human rights commitment and an easy recognition of China's demanding power. The voting polls by the European Parliament and the member states against a lift confirmed the importance of keeping the embargo in place even if internal disagreements remained.

However, with the outbreak of the financial crisis and the EU's disappointment on China's human rights improvements, the costly effects in upholding the embargo have increased. Not only have the discussions regarding a lift continued, but they have also begun to involve higher instances within the EU, which has added further pressure on the issue. The recommendation of HR Ashton's strategy paper to drop the embargo has shed new light on the EU's changing opinion. On the one hand the strategy paper signals that the embargo is no longer serving its purpose as an incentive for China to improve its human rights situation and should therefore be lifted. On the other hand, the embargo has become a stone in the shoe for the EU-China relations. The embargo has not only undermined its purpose, but it is also hampering the EU's development of stronger bilateral ties with China. The strategy paper realises that the maintenance of a no longer efficient statement such as the arms embargo has both political and economic implications for the EU in its relations with China, and since it is no longer serving its purpose, the costs of keeping the embargo are higher than lifting it.

Yet, HR Ashton's paper has not yielded any significant changes on the issue since the embargo still remains today. According to the concept of power in interdependency theory, a powerful actor could influence another actor to do something against its will for a reasonable cost or by offering options. In the arms embargo case, China has indeed intended to persuade individual member states to push for a lift in exchange for financial help and lucrative contracts. Even if certain member states have captured the bait, others have declined, which implies that these options are not convincing enough for all. Some member states' conviction of retaining the embargo has rather been strengthened due to China's recent reactions on human rights issues, such as its condemnation of Liu Xiaobo's Nobel Peace Prize nomination.

When related to vulnerability in interdependency theory, the implementation of EU's arms embargo forced China to purchase military material and technology from other suppliers. The inferred cost that the embargo placed on China was that China had to adjust to arms policies of other states that are not as advanced as the European material, but yet substitute alternatives. The changing of the arms policy framework thus showed that China is not extremely vulnerable to the EU's embargo even if it infers costs on China in terms of modern and high-technological material that China cannot attain

from its current suppliers. Furthermore, in line with its economic prosperity, China has the means to invest in and develop its own high-technological material, which would make China even less vulnerable to the EU arms embargo. However, the restrictions of the embargo has placed China in a disadvantageous and more vulnerable position since it imposes extra costs on China for acquiring less advanced material from fewer suppliers.

### 9.2.3 Market Economy Status- the EU's leverage until 2016

What we have seen thus far based on the other two cases is that China's economic prosperity has enabled it to put the EU in a more imbalanced bilateral position by exerting economic pressure on the EU. However, the interesting point of the MES case is that the financial crisis or China's economic power has not affected the EU's position in granting MES to China. Despite the asymmetrical trade and economic imbalance between China and the EU, the EU has not yielded to China's pressure for MES recognition. From a power perspective, this is an interesting aspect since China has expressively expected MES in return for helping EU member states economically. One explanation to the EU's steadfast position could be that the reciprocal costly effects are very uneven for the EU and China in this case. If China receives MES it would enable an easier inflow of cheap Chinese products to European markets. However, for the EU the costliness of granting China MES is very high since it would make it significantly harder for European companies to reach the same level of price competitiveness as the Chinese equivalent. Hence, Chinese products would take over a much larger part of the European market and leave the European companies worse-off.

Another important aspect is that the EU has urged China to open up its markets for foreign companies as a way to decrease its trade deficit with China. However, China is demanding MES before opening up its markets, which has given rise to a deadlock. This has enabled the EU to use China's strive for MES as leverage for demanding China to open markets and remove trade barriers. The costliness for China to open up its markets is not extremely high, but it is a cost that China would not have to pay in 2016 when it will be recognised as a market economy by the WTO.

Therefore, even if China is in a vulnerable position, its vulnerability is diminishing with time due to the WTO's decision to recognise China as a market economy by 2016. This means that as time elapses, China becomes less dependent on the EU in receiving MES. The EU's position against MES will continue to hamper China's economic progression until 2016, but from there and on, the EU will lose its MES leverage on China and China will not have had to meet the EU's demands for more open markets. If this situation occurs, the economic power asymmetry will become even greater between the EU and China, and it will have considerable impact on the EU's overall power capacity towards China.

## 10. Conclusion

For facilitating the conclusion of what has been stated hitherto, it could be convenient to primarily restate the initial research question of this paper before proceeding:

*What implications has the financial crisis posed on the EU-China interdependent economic relationship and what consequences has this, in turn, had on the bilateral issues that are the HR Dialogues, the EU arms embargo on China, and China's strive for MES recognition by the EU? Has there been an economic power shift between the two actors due to the crisis? Has the financial crisis made their bilateral relationship more asymmetrical in terms of power within these three areas? Can we perhaps assume that these three areas have not been affected by the crisis?*

From a general perspective, we can conclude that the interdependent economic power asymmetry between the EU and China shifted from being somewhat in the EU's favour before China's WTO accession to be more favourable for China after the WTO accession. This means that the initial shift in power asymmetry between the EU and China emanated already before the financial crisis. Hence, it is not the crisis that has given rise to this shift, but it has however further exacerbated the level of power asymmetry between the two actors. The financial crisis has not only made China more assertive on the international arena, but it is also showing a much tougher bargaining line towards the EU with higher demands and much less space for compromise than before the crisis. The EU's deteriorating economic situation due to the crisis has enabled China to use its economic strength by offering financial help to exposed member states in exchange for high demands such as MES and lifting the arms embargo.

This takes us to conclude upon the three cases by using the theoretical instruments, cost, power and vulnerability, derived from the interdependency theory. To conclude upon the HR Dialogues we can state that the financial crisis has made the EU-China

bilateral relationship extremely asymmetrical within this case. Out of the three examined cases, the HR Dialogues is the one that has experienced the most palpable and drastic changes. Initially, China had much to gain by accepting to take part of the HR Dialogues with the EU since the EU-China interdependent economic relationship was more asymmetric to the EU's favour. However, with China's economic prosperity and the EU's economic crisis situation, China no longer has an incentive in continuing with the dialogues and can afford to decline taking part in discussing issues that are considered as strictly national matters. The reason why China abruptly decided not to attend one of the two annual HR Dialogue meetings was because the cost of not participating was very low. The EU cannot use this issue as leverage on China and China does not have any incentive to uphold the dialogue. In sum, the only reason for China's participation in the dialogues in the first case was because the EU demanded it in order to strengthen their bilateral cooperation. However, with the financial crisis and the previous shift in economic power symmetry to China's favour, China has grown in economic power and can manage the cost of not having to adhere to the EU's demands anymore. This is a clear signal that the EU-China bilateral relationship has become extremely asymmetrical in this case due to China's economic prosperity and the EU's economic hardship as a result of the financial crisis.

In the arms embargo case, we can identify important changes prior and after the crisis. The financial crisis has made it more costly for the EU to uphold the arms embargo on China, not only from an economic and trade perspective, but also since it hampers the strengthening of bilateral ties between the EU and China. It has also made the EU realise that the embargo will not serve its initial purpose, which was to encourage China to improve its human rights situation. This can be seen in Catherine Ashton's pragmatic approach in her strategy paper. Instead, there are reports that the human rights situation has deteriorated in China, which furthermore questions the purpose of upholding the embargo.

From a vulnerability and power perspective, we can conclude that the financial crisis has empowered China to use the EU member states' debt crisis as leverage for lifting the embargo in exchange for financial support. However, even if China has managed to persuade individual member states to vote for a removal of the embargo, it has not yet

yielded any effect since the embargo is still in place. China used to be the vulnerable part in this case prior to the crisis since it was in need of advanced European military technology for enhancing its own military equipment. However, I argue that the financial crisis has shifted the vulnerability to affect the EU more than China. China's economic prosperity has enabled it to focus more on developing its own military technology, which in turn makes China less vulnerable to the EU's embargo. If China develops advanced military technology, it would mean that the necessity for European military products would decrease and the EU would lose a substantial amount of cash inflow in a time already characterised by crisis. The financial crisis has made the issue more urgent for the EU and has thus left the EU in a more vulnerable position than before the crisis. Based on the above, we can conclude that the financial crisis has made the arms embargo case more asymmetrical to China's favour.

The impact of the financial crisis and China's economic prosperity has, in contrast to the previously mentioned cases, not posed any great consequences upon the MES case. Even if the economic power asymmetries have changed between the EU and China in general, it has not generated any significant effects on the MES case. This is a rather remarkable discovery since it proves that the MES case is more resilient to asymmetrical power changes within the EU-China interdependent economic relationship.

From a cost perspective we can conclude that the financial crisis has made it more costly for the EU to recognise China as a market economy. A MES would impose additional economical challenges for the already struggling European companies and would very probably increase the EU's trade deficit with China. The EU has therefore no cost incentive in granting China MES before 2016. From an economic power perspective we can conclude that the financial crisis has empowered China to demand MES in exchange for providing economic support to individual member states. However, the costly effects for the EU are much higher in granting China MES than not receiving economic support from China, which is why China's demand has not yielded any results. From a vulnerability perspective we can conclude that China has become less vulnerable in the MES case, however, this is not due to the financial crisis, but rather due to the elapsing of time. The closer we get to 2016, the less vulnerable

China becomes to the EU's refusal to grant China as a market economy. Hence, based on the above mentioned, we can conclude that the financial crisis has *not* made the EU-China bilateral relationship more asymmetrical within the MES case.

# Executive Summary

## Research Problem and Aim

The bilateral relationship between the EU and China has during the last decades given rise to numerous debates and analyses from a domestic, institutional, societal, or international perspective. However, I have not yet encountered a study that analyses the effects of the financial crisis on the EU-China interdependent economic relationship. What implications has the financial crisis had on the EU-China interdependent relationship and how have these effects, in turn, affected the EU arms embargo on China, the Human Rights Dialogues, and China's strive for MES recognition by the EU? Has the financial crisis made their bilateral relationship more asymmetrical within these three cases? Is it possible to assume that the financial crisis has *not* affected these three areas of analysis?

My aim is thus to analyse if there has been a power shift in economic terms between the actors due to the financial crisis, and if so, to see how this has been reflected within the three specific cases.

## Methodology

The intention of this paper is to carry out a case study of three cases. The method that will be applied is the method of structured, focused comparison. The analytical frame of this study is the EU-China interdependent economic relationship and the cases that are subject for investigation are the EU-China Human Rights Dialogues, the EU's arms embargo on China, and China's strive for MES recognition by the EU.

The “structured” part of the method is characterised by the fact that it uses a number of questions that reflect the research objective. These consist of my previously presented research questions presented. These questions are thus applied on each investigated case, which enables a comparison and cumulation of the findings of the cases and makes the method more “focused”.

This paper will focus on how the financial crisis has affected the EU-China interdependent economic relationship, to see how this in turn has affected their power relations within the three specific bilateral cases. The scope conditions derived from interdependency theory are costly effects, power, and vulnerability. These conditions will be applied as instruments for investigating the cases to see how the effects of the financial crisis have changed these.

## Theoretical Framework

The basic idea of interdependency theory is that it can be used for making political analysis of the level of interdependence between states/actors. It is characterised by reciprocal events among states/actors and can be defined simply as mutual dependence. The scope conditions derived from interdependency theory are costly effects, power, and vulnerability. These conditions are applied as analytical tools for investigating the cases in the analysis of this paper.

Moreover, the concept of interdependent asymmetry is also deployed in this paper. Asymmetries create space for advantages and sources of influence for actors such as the EU or China that are engaged in a complex interdependent relationship.

## Empirical Material

The empirical material is divided into two parts. The first part outlines the development of the EU-China interdependent economic relationship and illustrates the

characteristics of the relationship. It further elaborates on the EU-China trade relations and highlights the benefits, setbacks, threats, and weaknesses of the trade relationship. This information further moves on to a section that employs the effects of the financial crisis on the EU-China trade relations. The second part outlines the information of the three main cases in this paper. It provides information about the background, historical development, and the development during the financial crisis of each case. This is done to facilitate the understanding of how the cases have evolved between the EU and China.

## Analysis

The analysis is, alike the empirical section, also divided into two parts. The first part analyses the general development of the EU-China interdependent relationship to identify how the symmetry within their interdependent relationship has developed and changed, and if there has been any shift in dependency between the two actors. This is performed by applying the scope conditions of costly effect, power, and vulnerability, derived from interdependency theory. The second part of the analysis undertakes each of the cases' developments during the financial crisis and applies the same theoretical scope conditions on each case to identify what shifts or changes that have taken place.

## Main Conclusion

The conclusion of the first part of the analysis indicates that the EU-China interdependent economic relationship was initially asymmetrical to the EU's favour. However, China's WTO accession shifted this asymmetry to China's favour. It was thus not the effects of the financial crisis that gave rise to this shift. However, the financial crisis has further exacerbated the power asymmetries within the EU-China interdependent economic relationship.

The conclusion based on the analysis of each case demonstrates different results. The main conclusion on the HR Dialogues is that the financial crisis has made the EU-China interdependent relationship extremely asymmetrical within this case. The HR Dialogues case is the one that has experienced the most dramatic change compared to the other two cases. China's economic prosperity and the EU's sovereign debt crisis has exacerbated the level of asymmetry within the EU-China bilateral relationship in this case since China no longer has any incentive in upholding the two annual dialogues and has openly demonstrated this by only attending one annual meeting.

The arms embargo has become more expensive to uphold for the EU due to the financial crisis. China is no longer as vulnerable as before against the arms embargo, instead it is the EU who has become vulnerable in this issue. The main conclusion is that the financial crisis has made the arms embargo case more asymmetrical, even though it is still in effect.

In contrast to the above-mentioned case findings, the main conclusion on the MES case is that the financial crisis has *not* made the case more asymmetrical. However, from the EU's perspective, the financial crisis has imposed a higher cost on recognising China as a market economy. From China's perspective, time is making China less vulnerable to the EU's refusal to grant it MES. Despite this, China's economic prosperity and the EU's economic hardship have, surprisingly enough, not generated any significant effects on this case. This illustrates that the MES case is the most resilient out of the three examined cases to economic power shifts between the EU and China.

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