
The Trump effect on EU-China relations

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Theme

What are the implications of the Trump Administration's security and trade policies on relations between China and Europe?

Summary

For the time being, Donald Trump's decisions on defence and trade have not been so significant as to trigger a realignment of relations between the US, China and the EU. However, his term in office throws up opportunities for the strengthening of relations between the EU and China, especially if Europe decides to intensify its Common Security and Defence Policy and Beijing decides to take its process of economic reforms further and attain a greater level of reciprocity with Europe in terms of its trade and financial regulations.

Analysis

It is not yet clear what line the Trump Administration will take in two key areas –security and trade– although we are starting to get certain indications on the former. The way both issues unfold will leave a mark on future relations between Washington, Beijing and the countries of Europe. It makes sense, therefore, to focus on setting out possible lines of approach for the Trump Administration in these areas and their most likely effect on relations between the EU and China. These are still early days for the Administration of Donald Trump, who has not even finished assembling his governing team, something that behoves caution in drawing conclusions. In identifying the possible reactions of China and the European countries to this new political scenario, it will also be necessary to bear in mind the evolution of the European integration process, which will be marked by Brexit and this year's European electoral calendar.

European security: more or less dependent on the US?

In November 2016 the official Chinese media exhibited a very positive attitude towards the election of Donald Trump, as opposed to the continuity with Obama's pivot to Asia embodied by Hillary Clinton. In the eyes of Beijing, Trump's isolationist slant, representing the fatigue felt by a section of the US populace that regards the effort their country expends on maintaining the world order as excessive, would yield a significant reduction in US military presence in East Asia, creating the opportunity for China to fill the strategic vacuum.

Over the last month, however, there have been various developments suggesting considerable continuity between Trump's security policy towards East Asia and

Obama's. Both Administrations would concur in seeing an eventual Chinese leadership of East Asia as the greatest threat to maintaining US pre-eminence in the international community. During his visit last February to South Korea and Japan, where 24,000 and 39,000 US soldiers are stationed respectively, the Secretary of Defence, James Mattis, underlined the US commitment to maintaining the security of East Asia, and heaped praise on the roles of Seoul and Tokyo in their alliances with America. At no time did he ask these countries to increase their defence efforts, which represented a shift compared with Trump's rhetoric prior to his installation in the White House. Moreover, during the subsequent visit to the US of the Japanese Prime Minister, Shinzo Abe, Trump himself reiterated the same message on various occasions, praising Japan for the work it was doing alongside the US in maintaining peace in Asia, without any mention of a possible renegotiation of the terms that govern the US military presence in Japan. In addition, Trump emphasised the importance of maintaining the freedom-of-navigation principle in Asia and thwarting North Korea's nuclear and missiles programmes, an issue on which he made a joint declaration with Prime Minister Abe.

Once Trump publicly proclaimed his commitment to the 'One China' principle, the South China Sea probably became the main scenario for assessing the point at which the new government is going to pursue a more assertive security strategy towards China compared with Obama's. During Obama's second term of office, the US Navy carried out four operations in the South China Sea aimed at preserving freedom of navigation in the region. It was thus a matter of isolated operations, and in none of them did the US vessels drop anchor less than 12 nautical miles from the geographical features occupied by Beijing, thereby avoiding any direct challenge to Chinese sovereignty. Various private comments made during these diplomatic visits, as well as an article published on 12 February in the *Navy Times*, suggest that the US Commander of the Pacific Fleet hopes to increase the presence of the US Navy in the South China Sea to a level not entertained by Obama, who feared that this would involve a substantial deterioration of relations with Beijing that would stymie cooperation between the two countries on other issues. If Trump were to accept the suggestion of the Commander of the Pacific Fleet, it would increase the number of freedom-of-navigation operations (FONOPs), and they might even be carried out on a periodic basis and include the anchoring of US vessels less than 12 miles from positions controlled by Beijing. The deployment of the combat group led by the supercarrier Carl Vinson to the South China Sea in the middle of February also points in this direction.

Parallel to this, Trump has also talked to his NATO partners, including the leading member states of the EU, and his message was rather different from the one aimed at his Asian allies. In addition to restating the US commitment to NATO, President Trump stressed to his European allies that he expected them to make, unlike South Korea and Japan, a greater effort in the defence arena, manifested by increases in their military budgets. Regardless of the size of the increase in European military spending, NATO is not going to deploy troops in Asia, which reduces the chances of friction between Europe and China.

By contrast to the situation that prevailed in Obama's second term, when he floated the possibility at the NATO Cardiff summit of the Alliance deploying in East Asia to accompany the US pivot towards the region, now we are in a context of greater European

concentration of defence in its own vicinity, in part due to the perception of a loss of interest in the White House for the area around Europe. This could at least serve as a spur to making headway on the Common Security and Defence Policy, as proposed on 6 March in Versailles by the heads of the four largest Eurozone countries, among those countries with an appetite for it, which would include Germany, France, Italy and Spain.

Any increase in Europe's strategic independence from the US would facilitate the strengthening of cooperation in defence between China and Europe, which at the moment is essentially limited to coordination on naval missions owing to a lack of interoperability between the equipment and doctrines of the European armies and the People's Liberation Army. Although the reactivation of European security is essentially a response to Brexit and the wave of attacks in Europe, it should not be forgotten that its main objective at an operational level would be to intervene in the vicinity of Europe in the event of not being able to rely on the US, and this includes areas such as the Middle East and Central Asia where stabilisation is a shared interest of Europe and China. Beijing is an increasingly influential player on the global stage and consequently a potentially valuable ally in resolving crises in this region, as has already been made evident in the agreement to curtail the Iranian nuclear programme. A case in point is Afghanistan: its destabilisation contributed to heighten the terrorist threat in both the EU and in Beijing, and both have been actively pursuing a peace process in recent years aimed at helping to consolidate the government in Kabul.

If Washington were to rein back on its commitment to providing globally-shared assets, whether in terms of a significant cut in its contribution to the United Nations or breaking its acquired commitments in the fight against climate change, this too would favour a strengthening of cooperation between Europe and China. It is not insignificant that China is the second-largest funder of UN peacekeeping missions, the permanent member of the Security Council that supplies the greatest number of peacekeeping troops and one of the main brokers of the agreement reached at the Paris Climate Summit.

Another factor that could intensify relations between the EU and China in the realm of defence would emerge if Trump plays the Russian card, in an inverse ploy to that of Nixon in 1972. This would be a case of moving closer to Moscow in order to offset Beijing. Michael Flynn's resignation as National Security Advisor and his replacement by General McMaster seems to point in the other direction, however, since McMaster has systematically identified Russia as an opponent rather than a potential partner of the US.

In any event, the lifting of the EU arms embargo on China remains highly unlikely so long as the US remains committed to the collective defence of Europe, something that was underlined by Vice President Pence and by James Mattis in February at the Munich Security Conference.

Are we heading towards a trade war with China?

The Chinese authorities are on high alert on this issue, because the Trump Administration has still not announced any concrete measures on trade relations with China. Note that this is an issue on which Donald Trump made pronouncements on various occasions after being nominated as the Republican Party candidate to the US

presidency and is included in the action plan for the first 100 days of his government, which he disclosed at the end of October 2016 in Gettysburg. On all these occasions, Trump threatened to impose severe sanctions on China, including a tariff of up to 45% on all Chinese imports. In a much more measured way, the new US Treasury Secretary, Steven Mnuchin, has already warned his Chinese counterparts (in a round of telephone calls he held with various Chinese officials at the end of February) that they hope to obtain a bilateral economic relationship that is considerably more balanced.

As a consequence of all this, Beijing takes it as read that there will be some shift in this area on the part of the new government. Despite Trump's intemperate denunciations of the Chinese government's economic policy and the fact that his cabinet includes figures with a long record of anti-China declarations such as Peter Navarro, Director of the National Trade Council, and Robert Lighthizer, US Trade Representative, the consensus in Beijing is that the two governments will be able to negotiate and find a mutually acceptable agreement. This is due, among other reasons, to the fact that the more protectionist wing of the Trump cabinet seems to be losing ground to another group advocating more continuity with Obama's trade policy, which is closely linked to Wall Street and led by the Director of the National Economic Council, Gary Cohn. In this context, Beijing sees it as highly unlikely that Washington is about to erect 45% tariffs on Chinese exports to the US, when currently the average tariff on Chinese agricultural produce in the US is 2.5% and 2.9% for other products, whereas the average tariff on US exports to China is 9.7% for agricultural produce and 5% for other products. Beijing does not therefore perceive an imminent risk of a trade war with the US. This would be no impediment to China deciding to react if a tariff hike on all its imports into America is ultimately introduced. Significantly, China is the largest supplier to the US, being the source of 21.5% of all its imports.

Meanwhile, the conclusion reached by such Chinese think tanks as CIIS, CICIR and CASS is that, for the time being, Trump's protectionist slant is essentially benefiting China in two areas of a geopolitical nature. First, the US withdrawal from the Trans-Pacific Partnership reduces its influence in East Asia, which benefits China from a geostrategic standpoint. Secondly, it represents an opportunity in terms of public diplomacy for China, which seeks to present itself as the new underwriter of the international liberal order. Xi Jinping's speech in Davos was a clear example of this. But one thing is the rhetoric emanating from Beijing and another is whether the Chinese authorities are capable of implementing the internal reforms needed to sustain it, something that remains to be seen.

Both the efforts of the US government to balance its economic relations with China and Beijing's attempts to present itself as the defender of free trade could be used by Brussels to promote its bilateral economic interests with China, which boil down to the idea of attaining the highest level of reciprocity in the rules of the game observed by European and Chinese businesses. In this respect, the Chinese economic system exhibits three features that conflict with a liberal economic order and that benefit Chinese companies to the detriment of their foreign counterparts: (1) a financial system geared towards supporting companies under public ownership; (2) feeble and arbitrary protection of intellectual property rights; and (3) widespread restrictions on foreign investment. By way of illustration, according to the index drawn up by the OECD to

measure the restrictiveness of the regulatory frameworks governing investment in 58 countries, China is the second most restrictive, with a score of 0.386 in 2015, whereas the EU member states range from 0.004 for Luxembourg to 0.106 for Austria.

This problem is becoming more and more pressing as Chinese enterprises go further in their process of internationalisation, investing also in strategic sectors in Europe and reducing European companies' market share both within and beyond the EU, and is now having repercussions in the political sphere. The undeniable imbalance in China's economic relations with the US and the EU is contributing to a growing questioning of free trade in the most open societies. Electorally this is reflected in the election of political leaders of a more protectionist bent, as in the case of Trump, and in the rise of various populist parties in Europe. In this context China needs to ask itself how it wishes to make such relations more balanced.

Is China really committed to its process of economic reforms and does it wish to join Europe and the US in a more liberal regulatory framework? Or is Beijing trying to influence international economic governance to normalise the practices referred to above? In the former case, despite facing major social and political difficulties associated with the implementation of the reforms, the Chinese authorities will be disposed to meeting their Western partners in a more liberal legal framework ensuring more plentiful absolute dividends for all parties. This is the position that is currently favoured in Europe and that would be imperilled if leaders with a protectionist agenda such as Marine Le Pen came to power. The longer such reforms are delayed in China the more likely it is that the US and Europe come to adopt protectionist positions, which would also lead to more balanced economic relations with China, but within a much more restrictive regulatory framework, in which the absolute dividends would be diminished for all sides.

China thus faces a dilemma. On the one hand, it could choose to extend its reforms towards greater openness and liberalisation of its economy, which the Chinese authorities themselves consider essential over the medium to long term to break out of the middle-income trap, but whose implementation would generate tensions linked to greater levels of unemployment and push-back from interests groups within the regime (such as large state enterprises and local governments). On the other hand, it could take refuge in a system that fosters the growth and internationalisation of its companies, thanks to the existence of a captive market at home and preferential financing conditions, even though this comes at the expense of Chinese consumers' and savers' interests, an increasing public debt and growing criticism from abroad. China may try to maintain the latter position for as long as possible, and hence the message that needs to be broadcast from Europe, in concordance with the US, is that it is not feasible to maintain rules of the game for Chinese companies that differ so markedly for the rest (the growing disillusion with globalisation in the West shows this) and that we risk entering a protectionist spiral if Beijing drags its feet on such reforms as doing away with financing breaks for state enterprises, respecting intellectual property rights and reducing restrictions on the entry of foreign companies.

Thus it is that since the publication in October 2015 of the most recent European trade strategy, both the Commission and the leading member states have been repeating with growing insistence that reciprocity should be the main premise governing economic

relations between the EU and China. Hence the Commission does not propose embarking upon negotiations for a free trade agreement with China until Beijing takes tangible steps towards reforming the points referred to above, which should pave the way to signing the bilateral investment agreement that is currently being negotiated.

Moreover, there have been two recent developments that point to growing European pressure to make China give a greater role to the market in its economic governance and guarantee European companies a regulatory environment that is not loaded against them in favour of local enterprises. Germany, France and Italy have requested the European Trade Commissioner to set up a specific mechanism to block Chinese investments in Europe, especially in strategic sectors, when the Chinese purchaser has preferential access to state financing. In addition, the Commission is investigating the financing deal for the high-speed railway line between Belgrade and Budapest, underwritten by the Hungarian government and the Export-Import Bank of China, construction of which was awarded to China Railway International Corporation without any type of public tendering process, in apparent violation of EU regulations requiring public bidding for large transport projects.

Conclusions

It is still too early to analyse in any detail what the trade and security strategy of the Trump Administration will be. For the time being it seems that the changes are not going to be so substantial in these areas compared with the Obama Administration as to trigger a realignment of relations between the US, China and the EU. There are no signs that Trump is going to reduce US military presence in East Asia, or play the Russian card, or slap an exorbitant tariff on Chinese products. Be that as it may, his term in office presents opportunities for the strengthening of relations between the EU and China, because it offers Europe incentives to underpin its Common Defence and Security Policy, which would reduce its strategic reliance on the US; and incentives to Beijing to make headway in its process of economic reforms, which would enable it to attain a higher level of reciprocity with Europe in terms of its trade and financial regulatory framework.