THE STATE OF EU-CHINA RELATIONS

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CHINA-CEE: A CELEBRATION SPOILED

The Cooperation between China and Central and Eastern European Countries was established in 2012. This year, according to diplomatic practice, should have brought about a series of celebrations for its tenth anniversary – in reality, however, nothing festive has happened except for the issuing of a commemorative envelope by the China Post. On the contrary, two more CEE countries, Latvia and Estonia have left the Cooperation, following in the footsteps of Lithuania, which had left in 2021. The Czech Republic was also reported to be considering abandoning the framework. This is an obvious setback and a loss of face for China, and it is no wonder no China-CEE summit, supposed to be held annually, is on the calendar for 2022.

The crumbling of the Cooperation can be explained by many factors. The first one is disillusionment. CEE leaders, completely ignorant of Chinese communication habits, took vague Chinese statements about cooperation opportunities as specific promises and are now complaining that these promises have not been kept. Second, American and Western European diplomacy and the press have done everything possible to undermine the Chinese-CEEC Cooperation, picturing it as a Trojan horse for Chinese influence. One example of these efforts is the series of well-publicized reports issued by the Washington-based Center for European Policy Analysis in August-September, which pictured Chinese presence as invariably malign, evil, and harmful. Third, Chinese decision-makers have not made much effort to understand the region and offer customized investment and financing packages instead of applying their one-size-fits-all approach. Fourth, China has failed to understand the Russia factor. Many CEE countries, quite understandably, look at Russia as an existential threat, and China's commitment to its "limitless friendship" with Russia makes trusting China impossible. Fifth, the Chinese reactions to anything uncomfortable for them, like last year's negative Lithuanian gestures toward Beijing, are quite irritating to CEE countries. Chinese politicians and the media were quick to learn the same condescending, patronizing, and at the same time threatening tone that they used to refute so fiercely when they were targeted by it by the West. This makes China's previous promises of win-win cooperation, respect of sovereignty, and equal partnership look like empty rhetoric.

As these factors are not likely to change, the prospects of China-CEEC Cooperation in the near future are not very bright. Some CEE countries will cut back their ties further with China, some will maintain the present level of cooperation in order to keep the communication channels to Beijing open, and only a few (most probably Serbia and Hungary) will work on further developing their China relations. China's focus will also be elsewhere.

EU-CHINA RELATIONS AT A CROSSROADS

The European Parliament has maintained its highly critical stance vis-á-vis China, while the European Commission has accepted the overtures of the Chinese side over the past few months. This indicates that the various EU institutions do not speak with one voice with respect to how relations with Beijing should be managed. The European Parliament adopted a resolution in September that denounced China's live-fire military exercises in the Taiwan Strait in connection with Nancy Pelosi's visit to Taiwan. Moreover, the resolution urged the European Union to bolster its relations with Taiwan, and it specifically repeated its request that the Commission launch an impact assessment, public consultation, and a scoping exercise on a Bilateral Investment Agreement with Taiwan without delay.

On 21 September, a few days after the adoption of the EP resolution, High Representative for Foreign Affairs and Security Policy Josep Borrell met with his Chinese counterpart, Foreign Minister Wang Yi in New York, in the margins of the UN General Assembly. While the EU's expectations that China use its influence on Russia to end its aggression against Ukraine were raised at the meeting, the Chinese read-out merely stated that the negative spillover effects of the war are becoming more severe, which "China does not want to see."

The European Parliament advocates a critical approach in dealing with Beijing, while the European Commission wants to maintain the channels of engagement and hopes for better times to come. The 9th EU-China High-Level Economic and Trade Dialogue (HED), held in July, can be viewed in this cautiously optimistic manner. The meeting was a sign of continuing business as usual, although it did not bring any major progress regarding the thornier issues.

The developments over the past months seem to confirm that two security and political issues will impact the future of economic cooperation between the EU and China in a significant way, namely China's attitude to the Russian aggression in Ukraine and the European approach regarding cooperation with Taiwan. Both are likely to play a major role in how bilateral relations will be evolving in the coming months.

DETERIORATING PROSPECTS FOR THE EUROPEAN ECONOMY IN CHINA

On 21 September, the European Union Chamber of Commerce in China released its annual "European Business in China" Position Paper for 2022/2023, raising a number of concerns about doing business in China. The most pressing of these is China's zero-Covid policy, which is having a negative impact on economic growth, consumption, and the functioning of European value chains, and it is also damaging for tourism and educational migration. A major criticism is that China's economic development policy (dual circulation) increasingly isolates it from the international environment and makes it less competitive by supporting national companies. The interference of the Chinese state in the functioning of the economy also damages Beijing's image in the eyes of European respondents. Finally, the growing geopolitical risks associated with China, particularly the Taiwan issue, are viewed negatively by European countries, and international criticism of human rights issues is putting pressure on European countries in international public opinion. Despite the growing difficulties, the analysis concludes that European companies continue to believe in the strength of the Chinese market and China's medium and long-term economic potential, as well as its manufacturing base and world-class industrial clusters, which are difficult, if not impossible, to replicate elsewhere. The China Position Paper reflects the strategic dilemma facing European companies. Their profit and development interests would be served by the further deepening of globalization and cooperation with China. The challenges posed by China's domestic political developments continue to be viewed by European companies as a temporary phenomenon, in contrast to the prevailing view in European politics that these developments point to a permanent transformation of the Chinese political system. The real challenge for companies, however, is that the political upheavals may be accompanied by a reversal of globalization, and their continued involvement in China will be identified as an exposure.

BUCKING THE TRENDS: SOARING AUTOMOTIVE FDI FLOWS BETWEEN THE EU AND CHINA

China-based CATL, a global leader in lithium-ion battery development and manufacturing, announced in mid-August that it had picked Hungary as the location of its second European plant to supply the Chinese company's OEM customers in Europe, including Mercedes, BMW, Stellantis, and Volkswagen. At the same time, FDI from the European Union to China exceeded pre-pandemic levels in the first half of 2022, as reported by research firm Rhodium Group. The automotive industry, particularly German carmakers, represented more than a third of all European FDI in China in the given period.

These dynamics and statistics may come as a surprise for several reasons. First, Chinese FDI into the EU has been weak for years compared to the peak period around 2016. Second, Chinese investment activity has come under increased scrutiny in the EU, and third, China's ongoing zero-COVID strategy is generating an uncertainty that scares several Western companies away from new FDI projects in the country. Moreover, the increasing tensions between Brussels and Beijing do not encourage FDI flow in either direction. Yet the automotive industry does not seem to take notice of Germany and other member states planning to reduce dependence on Chinese suppliers and the Chinese market.

What could be the reason for bucking the overall trend? On the one hand, in the industrial segments that drive the transformation of the global economy, there have been no signs of falling FDI levels despite the COVID-19 pandemic, the disruption of supply chains, and growing geopolitical tensions. Electromobility and the manufacturing of electric vehicles (EV) is one of these segments. The evolution of the supply chains of this relatively new sector is currently under way, which motivates Chinese battery manufacturers to go overseas. Moreover, Europe and China are leading the way on EV adoption, which sets the direction of future market expansion for both European and Chinese automotive companies. On the other hand, locating manufacturing close to key customers fits the concept of flexible and more resilient supply chains perfectly, which has been high on corporate agendas since the outbreak of the pandemic.

Is it a risk that the German EV industry will be dependent on Chinese batteries manufactured in European sites? Well, it is certainly less risky than if the same batteries were transported from production sites in China. It is true that the most valuable component of an EV is its battery, which represents about 40% of the total value. In other words, almost half of the added value of a German EV will come from Chinese technology, which may sound somewhat frightening at first. However, this ratio is expected to shrink with the evolution of batteries, and it is not necessarily Chinese companies that will pioneer the emerging new technologies. Besides, as the industry moves towards autonomous driving, IT components and software will represent an increasing share of the total product value, and considering the dynamics of West-China technology decoupling, Chinese tech suppliers will certainly not be the top choice of European OEMs in that field.