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The China-EU Trade Spat

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At a time when neither side can afford it, this year is likely to be a turbulent one for China-EU trade.

Both Chinese Premier Li Keqiang and German Chancellor Angela Merkel have made statements over the last two days relating to the brewing EU-China trade disputes. Although apparently unrelated, another EU trade probe – this one into controversial (in some economies) telecommunications network equipment makers Huawei and ZTE – is actually addressing very similar underlying issues (implicit Chinese subsidies to its manufacturing sector). In both cases, the role of Germany, the EU's largest economy, is set to be an important factor in how things proceed.

Merkel promised during statements to the press in Berlin after meeting with Li that Germany would work hard to make sure that “no permanent import duties” would be placed on Chinese solar panels, and that the issue would be cleared up “as quickly as possible.” Premier Li had already voiced his country's unsurprising “firm opposition” to the two cases whilst on his way to Germany.

Li Keqiang is facing a very trying economic situation back home that would be made all the more difficult if trade hostilities were to break out with the recently enlarged EU, China's largest trading partner (if all EU member states are counted as one economy). Wu Hailong, China's ambassador to the EU, wrote a sharp critique of EU trade policy towards China in the *Financial Times*.

It is easy to understand China's discomfort with the EU commission's new focus on its trade practices; China runs a significant bilateral trade surplus with the EU bloc, \$121 billion in 2012, and the trend is already moving towards decline. China's internal model involves many implicit subsidies to manufacturers, including de facto subsidies in financing as well as cheap land and other benefits. These subsidies have recently been the focus of a new book by Usha and Geroge Haley and form the core of the EU Commission's argument.

Whilst China is embarking on a tough internal economic shift, the Eurozone (EZ), along with other non-EZ EU states, is already years into its own crisis. Eurozone trade used to be roughly balanced externally, despite severe internal imbalances (with Germany running current account surpluses), but now, as internal demand has collapsed within the periphery EZ states, the currency bloc is moving towards an external surplus with the rest of the world.

Whilst Merkel's “permanent” qualifier suggests some doubts about the short-term actions of European Trade Commissioner Karel De Gucht, the apparent lack of consensus between the EU Commission and a significant (if unknown) number of its member states' national governments on the solar dispute with China is yet another example of the EU's fundamental contradiction between its member governments' national sovereignty (and interests) and the power of its supranational institutions. Germany is not alone in its opposition to the imminent tariffs on Chinese solar products, even if so far Merkel has done the most to undermine the Commission in her public statements.

On the solar issue, China's threats of retaliatory tariffs on products needed for PV manufacturing along, more general rumblings about trade, negotiations as well as charm (investment) offensives against key national governments looks set to undermine the commission and perhaps limit the time that tariffs will be imposed if come June, De Gucht sticks to his guns despite the mounting pressure. On the telecommunications case however, China will probably have a much tougher time. Germany, Finland and other key EU states have a significant interest in the

telecommunications equipment sector, and this is before security concerns (such as those voiced in the US and elsewhere) against Huawei and ZTE are taken into consideration.

It is set to continue being an interesting year for China-EU trade.

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