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# EU-China Relations: The Dawn of Great Change

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Since a few years, the European Union is no longer hesitant to be critical of its Chinese partner, assuming a strategic rivalry coupled with a quest for greater economic reciprocity and respect of its fundamental values. The Centres for European Policy Network wants to describe the current state of play between the two powers and draw some conclusions for the future.

- **Chinese imports in the EU reached €471bn in 2021, while exports to China reached €223bn, i.e. 47% of Chinese imports**. Chinese stocks in the EU reached €209bn in 2018, while EU capital stocks in China reached €372bn, i.e., 178% of the China capital stocks in the EU in value. **The level of trade integration between the EU and China is above the world's average but declines over time, illustrating the progressive shift towards domestic market growth at the expense of trade growth for China.** It also signals the potential for further integration with the EU.
- Nevertheless, EU-China relations take another direction: **beside freezing the Comprehensive Agreement on Investments and suing China at the WTO, the European Union has developed five defensive legal instruments to protect its values and commercial interests, all targeting among others China**:

  (1) An anti-coercion instrument to counter-sanction aggressive commercial policies,

  (2) An anti-foreign-subsidy instrument,

  (3) The Due Diligence Act, to impose environmental and social criteria to extra-EU suppliers of EU firms,

  (4) An instrument implementing reciprocity in terms of public market openness to foreign firms,

  (5) The Carbon Border Adjustment Mechanism (CBAM) affecting imports with a high carbon value.
- Hence if potential is there, relations have tensed over the last years and **the support of China to Russia despite the war in Ukraine is likely to deal them one more heavy blow.** However, there is room for cooperation between the two powers at least in the coordinated fight against climate change.

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# 1 Introduction

While trade between the European Union and China has never been as intense as in 2021,[1] t**he European Union is no longer hesitant to be critical of its Chinese partner**, assuming a strategic rivalry coupled with a quest for greater economic reciprocity and respect for its fundamental values. **This reversal, which has been taking place since the publication of the "Strategic Outlook" by the Commission on 12 March 2019,[2] is becoming increasingly concrete.**

**Hence, the European Union did not hesitate to announce on 18 March that it would impose trade sanctions on China** if the latter sent military equipment to Russia to support its war effort in Ukraine, after it had received confirmation of China's intention to do so.[3] **On 18 February, it lodged a complaint at the WTO against China because of the 150,000 euro daily fine** - deemed illegal by the EU - imposed on European companies wishing to file a complaint outside China for technology theft.[4]

In this context, the Centres for European Policy Network would like to review the current state of play of EU-China relations (Section 3), before detailing the range of defensive and even offensive European instruments developed in recent years, with the power to affect EU-China relationships (Section 4). Moreover, the still ambiguous Chinese position in the Russian-Ukrainian conflict suggests an intensification of tensions between the two powers, further restricting the scope for new cooperation (Section 5). Nevertheless, certain areas could continue to be the subject of joint work, to the benefit of all (Section 6).

# 2 State of Play of EU-China Trade and Financial Relations

## 2.1 Merchandise Trade

Since 2002, one year after the opening of the Chinese market following China's entry into the WTO, the EU has been Beijing's largest trading partner, and China the largest supplier of the EU[5]. **In 2021, imports and exports between China and the EU reached 696 billion euros, high as never before.[6]** This situation masks a large unbalance between the EU and China, as Chinese imports largely exceed exports to China in the EU: the value of exports amounted to less than 50% of the value of imports in 2021 (472bn euros vs. 223bn euros). **This discrepancy is usual when trading with China as it still broadly founds its economic growth model on trade surpluses accumulation.**

[1] This is the Chinese figure. The Commission's figure reaches €696bn. Financial Times, The rising costs of China's friendship with Russia, 10.03.2022.

[2] European Commission, EU-China – A Strategic Outlook, 12.03.2019, p. 1.

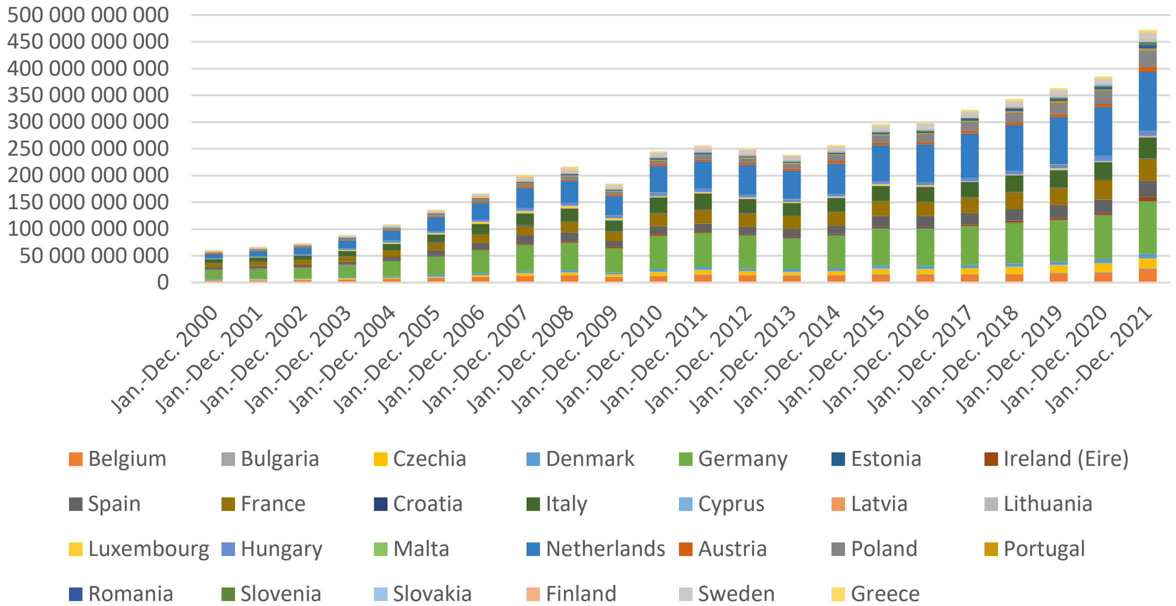
[3] Politico, EU has "very reliable evidence" China is considering military support for Russia, 18.03.2022.

[4] European Commission, EU challenges China at the WTO to defend its high-tech sector, 18.02.2022.

[5] Toute l'Europe, Commerce: qui échange avec l'Europe ?, 13.04.2018.

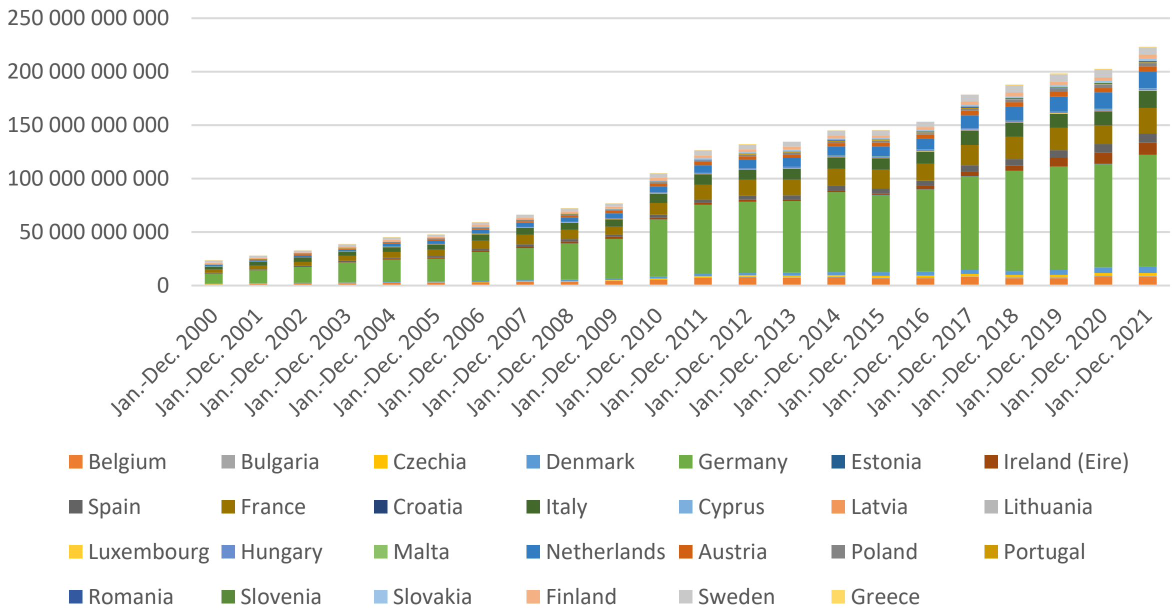
[6] European Commission, Europea Union, Trade in goods with China, p. 2.

**Figure 1: Chinese Imports in Europe by EU-Country (in million €)**




*Source: Eurostat. The value of Chinese imports is distorted by the "Rotterdam effect", according to which the Netherlands account for far more Chinese imports than it really receives for its own use, because of the Rotterdam port, which is the largest port in the EU. Nevertheless, these numbers remain a valuable source of information to understand the repartition of Chinese imports in the EU.*

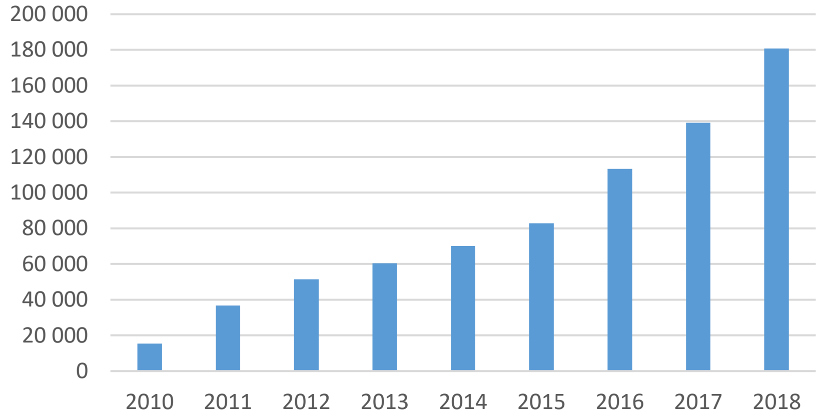
**Figure 2: European Exports to China by EU-Country (in million €)**




*Source: Eurostat.*

**Regarding European subsidiaries in China, there were more than 4,000 of them in 2018, generating almost twenty-three billion euros in value added, and employing more than 250,000 people. They are also concentrated in the manufacturing sector**, which is the sector that generates the most revenue for European companies (more than 13bn euros of value added at factor cost in 2018) and has the most employees (around 180,000 in 2018, see Figure 3)[7]. **The growth of European subsidiaries in this sector has been very steep since 2015**, and the best-represented European countries in descending order in 2018 are Germany, Sweden, France, Italy, and Hungary.

**Figure 3: Number of Employees of European Subsidiaries in the Chinese Manufacturing Sector**




*Source: Eurostat.*

**The second sector with many European subsidiaries is the wholesale and retail sector,** with an added value of almost 3 billion euros in 2018, and over 30,000 employees[8]. Another sector with significant European revenues is information and communication.

## 2.2 Bilateral Financial Positions

As regards financial relations between China and the EU, there has been a clear acceleration in the financial interpenetration of the two powers since the mid-2010s, in both directions. **In 2018, the European capital stock in China exceeds 350bn euros, while it exceeds 200bn euros for China in the EU[9].**

**The acceleration is even more marked for China than for the EU from 2014 onwards, partly due to the implementation of the Belt and Road Initiative (BRI)**, which has seen the Chinese government commit between 500bn dollars and 1000bn dollars of investment between 2014 and 2020[10]. The investments are focused on infrastructure facilitating connectivity with China. In Europe, the countries of the former Soviet bloc, the Balkans and Greece benefit from these investments in the framework of the "17+1" partnership[11]. However, China is also investing more in Western European countries as of 2014.

[7] Data from Eurostat.

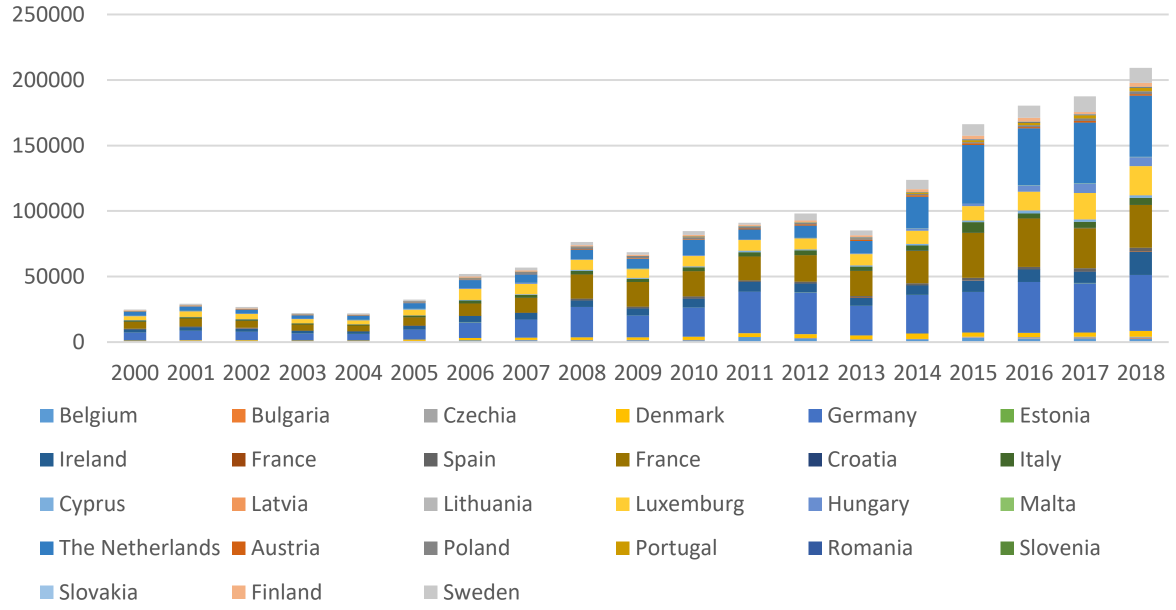
[8] Data from Eurostat.

[9] Data from Eurostat.

[10] The exact numbers are unknown. See Section 3.2.1 for more details.

[11] Cooperation between China and Central and Eastern European Countries, website.

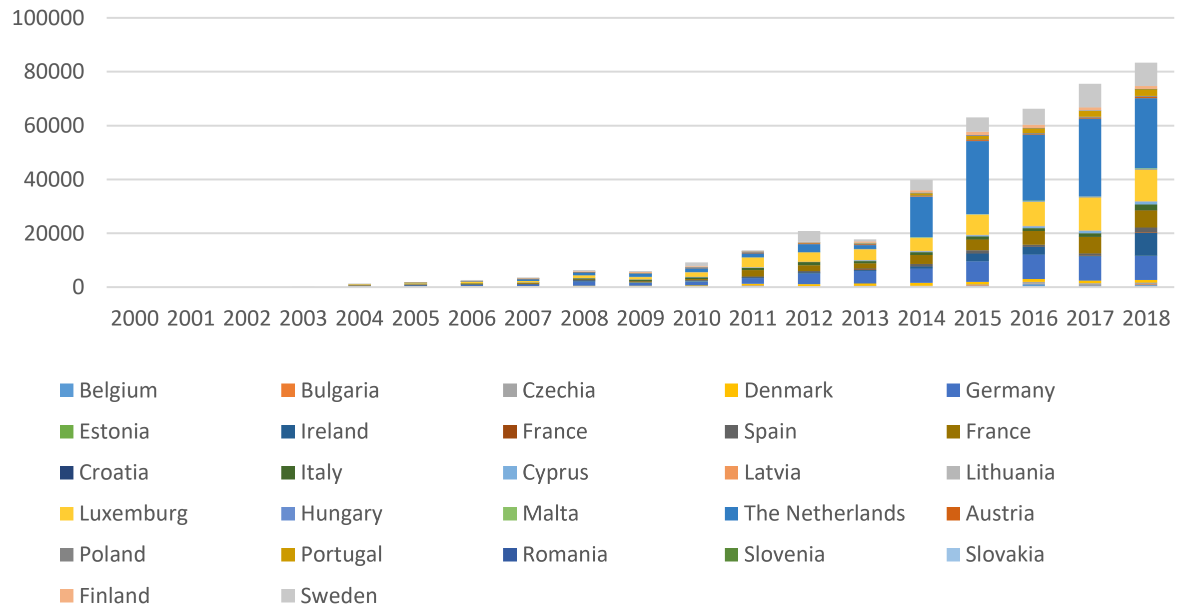
**Figure 4: Chinese Capital Stock in the EU, by EU-Country (in million €)**




*Source: Eurostat.*

**In terms of the composition of the Chinese capital stock in the EU, portfolio investments are unsurprisingly going to the European financial centres (Ireland, the Netherlands, Luxemburg, Cyprus) but also to France and Germany[12].** Chinese direct investment took off from 2014 onwards, with the Netherlands benefiting the most by far (see Figure 5), although a significant increase in stock can also be observed in Luxembourg and Ireland. Finally, as regards official investments (purchase of public debt to build up central bank reserves, public investments), the Netherlands also benefits the most from 2014.

**Figure 5: Chinese Direct Investments in the EU, by EU-Country (in million €)**

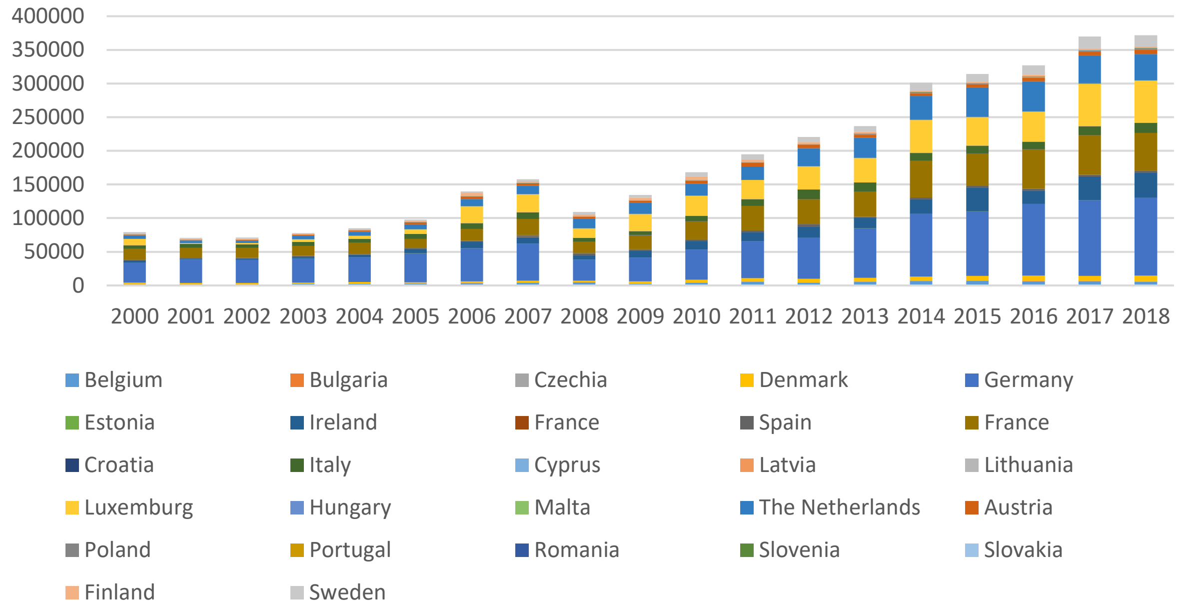



[12] Data from Eurostat.

*Source: Eurostat.*

**In terms of EU capital stock in China, Germany is the best-represented country, with over 100bn euros of stock in 2018, compared to around 50bn euros for France.** Germany's stock is mainly made up of direct investments from the private sector, while the French stock is dominated by official investments (central bank reserves, public investments). The financial centres are also doing well, with substantial stocks in Luxembourg, the Netherlands and Ireland (between 30bn and 50bn euros).[13]

**Figure 6: EU Capital Stock in China, by EU-Country (in million €)**




*Source: Eurostat.*

## 2.3 The Evolution of EU-China Integration: What Does the Data Say?

The previous figures should be put into perspective with the tremendous overall economic and trade growth that China has experienced in this stage. **China's Gross Domestic Product (GDP) has increased more than sevenfold since 2000.**[14] Thus, to some extent, **the increases in bilateral trade and investment are attributable to China's increased market size**, which is also reflected in enhanced trade with third countries. Thus, the question of the true extent of interconnectedness between the EU and China arises. One approach to develop such a measure is to ask what level of trade and investment activity would be expected given the size of the economies involved. In trade economics, three basic variables are considered for this purpose: the GDP of sending country, the GDP of recipient country and the spatial distance between the economies. If the level of trade and investment estimated on this basis deviates from the observed state, the reason must lie in other factors that do not result directly from the economic size and geography of the economies.

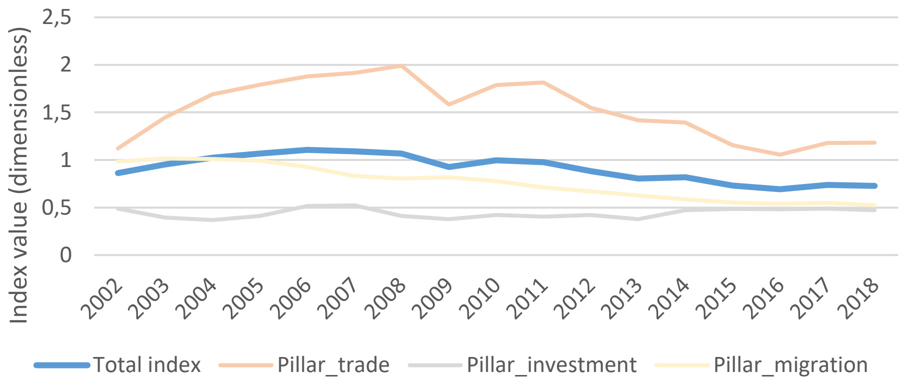
We apply such an approach below to compare the true state of interconnectedness between the EU and China, both over time and vis-à-vis the EU's relations with other countries. Specifically, we con-

[13] Data from Eurostat.

[14] expressed in Purchasing Power Parity.

struct **an index measure that incorporates data on bilateral trade** (export and import volumes of merchandise goods), **bilateral investments** (stocks of direct investment, portfolio investment, other investment) **and exchange in the form of migration** (number of migrants with corresponding nationality). For each indicator, actual and expected levels[15] are set in relation to each other. **The index value is then calculated as the simple mean of these ratios.** In this way, we can interpret an increase in the value of this index as a gain in integration: the observed growth of bilateral exchange goes beyond what would be expected based on pure income growth.

**Figure 7: Evolution of Index Values of Each Pillar of the Integration Index in the Case of EU-China**




*Source: Eurostat, Comtrade, FINFLOWS.*

Figure 7 plots the results for EU-China over time, both as an overall index and for the three pillars trade, investment, and migration. The results do not confirm the common notion of a steadily increasing connectivity. An increase in the overall level of integration can only be observed up to 2006. Since then, the trend has been slightly downward. **In recent years, the value is well below one, i.e., the strength of economic ties is weaker than expected from distance and size of the partners involved.** This reduction of integration is mostly driven by a slowdown of trade growth since the Great Financial Crisis, which is global.[16] **This slowdown driven by weak demand for usual high-traded products, deceleration of the pace of trade liberalisation, slowing down of cross-border supply chain formations and before anything else the inward shift of the Chinese GDP growth.**

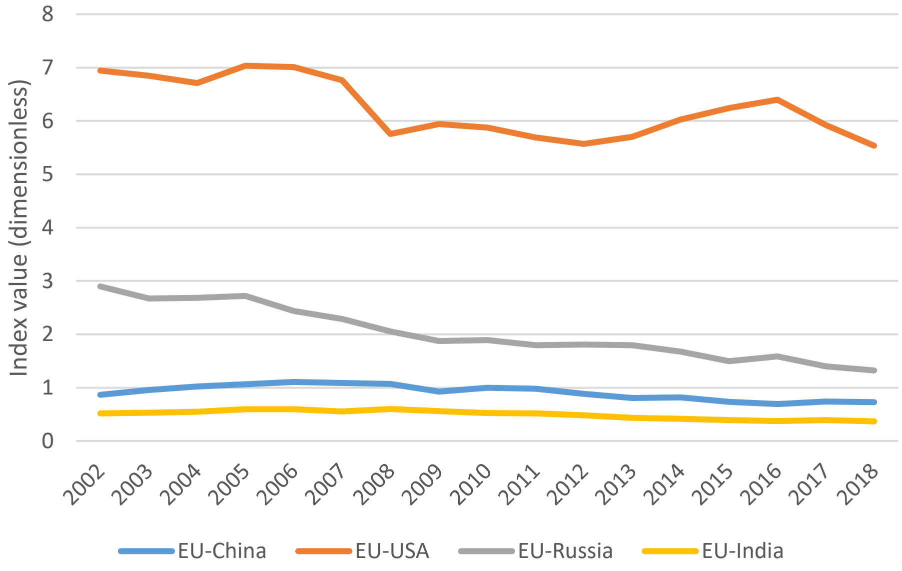
A comparative view of the EU's economic relations with other large countries is also insightful (see Figure 8). According to our measure, **the level of integration with China is still far from comparable with the strength of ties between the EU and the USA**. Even for EU-Russia relations, constantly higher levels of integration are measured, including the period after 2015 (beginning of EU sanctions policies). **Transatlantic finance explains a great deal of the high value of the index for the EU-USA bilateral relationships.** On that aspect, China is way below 1, suggesting that bilateral investment levels are

[15] In each case, expected values were calculated as estimates from a Gravity regression model including the following variables: GDP of sending country, GDP of recipient countries, spatial distance (population-weighted distance between the most populated cities). Estimations were conducted based on a global Panel-Dataset spanning the period 2002-2018, with data stemming from the following sources: UN Comtrade (trade data), FinFlows (Investment data), UN Global Migration Database (migration data).

[16] Fed, Causes of the Global Trade Slowdown, 10.11.2016.

smaller than respective GDP sizes and distance would predict. Hence, despite the various existing interdependencies through global value chains, **there is still a great deal of untapped potential in the economic exchange between the EU and China.**

**Figure 8: Evolution of Integration Index Values for the EU with China and Other Large Economies**




*Source: Eurostat, Comtrade, FINFLOWS.*

# 3 Latest Legal Developments Related to Commercial and Financial Relations

## 3.1 Developments Related to Trade Relations

While bilateral relationships between China and the EU could further develop, they started to experienced turbulences since 2019, besides the covid-19 pandemic which was a shock especially for both partners, due to pervasive supply chain disruptions.[17] Hence, **the EU developed five legislative instruments to protect its values and commercial interests, besides freezing an agreement on investments and suing China at the WTO.**

### 3.1.1 Freeze of the Comprehensive Agreement on Investments

**The Comprehensive Agreement on Investments[18], under negotiation since 2013 and signed on December 30th, 2020, was frozen by the Commission on May 4th, 2021, because of the Chinese repression of Uighurs and Hong-Kong[19].** This agreement was among others intended to open Chinese markets for European companies by intensifying partnerships between the EU and China on respect for human rights and the environment, and by opening key markets for European companies, which are limited for the latter despite China's entry into the WTO. This agreement was emblematic of this desire

[17] Exports of goods to China increased by 2.2% in 2020, vs. 5.6% in 2019 and 10.1% in 2021. European Commission, European Union, Trade in goods with China, 2021.

[18] European Commission, press release, Key elements of the EU-China Comprehensive Agreement on Investment, 30.12.2020.

[19] Toute l'Europe, Commerce international: la Commission européenne freine sur l'accord d'investissement entre la Chine et l'UE, 05.05.2021.

to go further with Beijing, allowing the Union to establish a more respectful and intense partnership with China, freeing it from its dependence on the United States and thus placing itself as a key player on the international scene.

### 3.1.2 Foreign Country Subsidy Regulation

Following the freezing of the agreement by the Commission, **the latter proposed a regulation the next day, on May 5th, 2021,** to allow the EU to adapt to the difficulty of entering Chinese markets. **It allows the Commission to have a right of scrutiny and control over foreign subsidies[20].** It could give the Commission a right of investigation in the event of presumed aid from third countries, and an obligation to notify companies when the latter have an action on the EU's internal market. **A disruption of competition will be found if the sum of the subsidies granted is equal to or exceeds 5 million euros over a period of three years (compared to 200,000 euros under European competition law).** This sum seems large because the Union wishes, through this regulation, to protect projects of general interest or affecting public order, thus blocking companies publicly financed by States, as in the case of China. This will restore a healthy environment for European companies that were not competitive enough, as they did not have such support[21].

### 3.1.3 Anti-Commercial-Coercion Regulation

**At the same time, tensions have been building between China and one EU State: Lithuania.** By leaving the "17+1" group, the latter clearly showed its disagreement with China's practices[22], seeking to divide the Union into two groups. Secondly, in August 2021, Vilnius let Taiwan open a representative office “of Taiwan”, not “of Taipei”, an affront to Beijing. Lithuania thought estimated its losses in the event of anti-competitive practices at 357 million US dollars (amount of exports to China), but the damage is more consequential because China is also blocking its own exports to Lithuania. **Lithuania imports 1.3 billion US dollars’ worth of Chinese goods (mainly electronic products), which represents a huge loss for the Baltic country.** Lithuania thus serves as a guinea pig for China for the launch of its coercive practices[23]. Furthermore, if a product shows a link to Lithuania in its supply chain, or in transit, the good is blocked at Chinese borders, also increasing the amount of EU exports blocked at Chinese borders.

In response to this unacceptable situation, justified according to Beijing by individual product controls, **the Commission proposed, in December 2021, a regulation allowing the establishment of an anti-coercive tool, enabling the Union to sanction Chinese imports with quantitative restrictions in case of trade aggression[24].** While Beijing accuses the EU of going against international law by establishing quantitative restrictions, through its practices and through this regulation[25], the Commission fully justifies the mechanism of the proposed regulation. International law and the WTO prohibit the introduction of quantitative restrictions or any other anti-competitive measures that would impede world

[20] European Commission, press release, Commission proposes new Regulation to address distortions caused by foreign subsidies in the Single Market, 05.05.2021.

[21] European Commission, press release, Questions and Answers: Proposal for new Regulation to address distortions caused by foreign subsidies in the Single Market, 05.05.2021.

[22] Le Monde, La Lituanie tient tête à la Chine et s’écarte des « routes de la soie », 21.10.2021.

[23] Le Monde, La Lituanie, pays test pour la stratégie de coercition économique de la Chine en Europe, 06.01.2022.

[24] European Commission, press release, EU strengthens protection against economic coercion, 08.12.2021.

[25] Financial Times, China accuses EU of threatening global trade, 15.11.2021.

trade. However, if these impediments are taken to dissuade a third country from continuing or terminating such practices, then, acting as a backlash, these measures are not contrary to international law. Measures restricting Chinese imports may then be put in place, or advantageous access to certain markets for EU firms, etc.

### 3.1.4 WTO Complaint Against China

Tensions escalated further in February. **The Commission filed a WTO complaint against China[26].** To set up in China, companies usually must transfer technology to take advantage of the attractiveness of Chinese markets. However, there has been one case of patent theft, but when European companies took the case to the Chinese courts, the courts set the price of the intellectual property so low that Chinese companies took the case back[27]. **Since recourse to a jurisdiction other than China was punishable by a fine of 150,000 dollars/day, no other option was open to companies from the old continent.**

### 3.1.5 Due Diligence Act

On the other hand, **the Commission made a new proposal for a directive: the Due Diligence Act, on February 23rd 2022[28]. The aim of this directive is to promote sustainable and responsible business behaviour and to embed human rights and environmental considerations in the activities and governance of companies.** The new rules will ensure that companies take into account the negative effects of their actions, including in their value chains inside and outside Europe. The draft directive[29] is therefore part of the Commission's desire for companies to move towards environmental sustainability, even in their procurement. **If this is part of the European desire to act in a more eco-responsible way, it is clearly a message to third countries that do not have the same considerations as the Union, starting with China.**

### 3.1.6 Regulation Introducing a Reciprocity Mechanism in International Public Procurement

**Furthermore, on Monday March 14th, 2022, after ten years of negotiations, a meeting between the European Parliament, the Commission and the Council of Trade Ministers finally defined their reciprocity mechanism in international public procurement[30].** The goal of this new regulation is to create a climate of reciprocity between the EU and third countries in the international public procurement sphere. With the WTO, multilateralism and the opening of public procurement are the default choices and so, the EU does open its market up to 90%. However, its partner, like China, the United States, but also Brazil or India do not walk on the same line as the EU: Some of them open their public procurement only up to 30%, or even less, displaying national preferences against the European companies,

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[26] European Commission, press release, EU challenges China at the WTO to defend its high-tech sector, 18.02.2022.

[27] Financial Times, EU accuses China of 'power grab' over smartphone technology licensing, 18.02.2022.

[28] European Commission, COM(2022) 71 final 2022/0051 (COD), 23.02.2022.

[29] European Commission, Corporate sustainability due diligence, Fostering sustainability in corporate governance and management systems, 23.02.2022.

[30] European Commission, press release, Trade: provisional agreement to promote reciprocity in access to international public procurement markets, 14.03.2022.

or adding some administrative barriers in order to block the markets[31]. European companies have suffered this lack of opportunities for an exceptionally long time, knowing that the international public procurement accounts to 15%-20% of the global GDP. **This new regulation gives the Commission a right of investigation in other countries in order to know if a discrimination has been made against European companies[32]**. If such a disruption in competition is found, then the Commission will invite the third country to find an agreement in order to end this disruption of competition. If the European companies still face serious and recurring restrictions after those discussions, **the Commission will have the power to impose IPI (International Procurement Instrument) measures[33] in order to respond to those disruptions in competition** in one hand, and to respond to the inaction of the third country in the other hand. **Such limitations on access may be imposed either by applying a penalty to the scoring of tenders submitted by economic operators from that country (from 50% up to 100%), or by excluding such tenders entirely from award procedures.**

### 3.1.7 Carbon Border Adjustment Mechanism

**Finally, on Tuesday March 15th, 2022, the Ministers of Finance of the 27 EU Member States agreed on a Carbon Border Adjustment Mechanism[34] , after almost a year of negotiations following the Commission's proposal in July 2021[35].** While this agreement in principle is a huge step forward for the European normative spectrum, it is an economic-ecological weapon for the Union. It will simply allow a tax to be put in place on companies that are not paying attention to the climate issues that the entire world is facing. European companies have been adapting to this for several years now, but the production costs they must face have put them at a disadvantage, even within the European market. **Now, thanks to this agreement, foreign companies that do not respect the environment and therefore have an excessive carbon footprint will have to pay a tax.** The second objective is to limit "carbon leakage" (relocation to countries with a lower ecological impact) and thus boost the competitiveness of European companies[36]. This agreement seeks to raise awareness among the Union's trading partners so that they adopt more environmentally friendly practices in order to launch their energy transition. Some countries, such as China, view this negatively and argue that developing countries should be given time to develop their economies and that these European practices would therefore be counterproductive[37] .

## 3.2 Developments in Financial Relations

### 3.2.1 The Global Gateway

While China has led the Belt and Road Initiative (BRI) with 115 participating countries and colossal amounts of investment (probably between 500bn and 1000bn US dollars, with a project value likely to exceed 4000bn dollars),[38] **the European Union and its Member States (known as "Team Europe")**

[31] Le Monde, L'Union européenne veut s'ouvrir l'accès aux marchés publics étrangers, 15.03.2022.

[32] Ibid, op.cit.(30).

[33] European Parliament, press release, International public procurement: a new instrument to support EU firms, 30.11.2021.

[34] Toute l'Europe, Les Vingt-Sept s'accordent sur les grandes lignes de la taxe carbone aux frontières, 16.03.2022.

[35] Wealth Monaco, Accord Européen sur le Mécanisme d'Ajustement Carbone aux Frontières (MACF), 17.03.2022.

[36] Les Échos, Feu vert des Etats européens à la taxe carbone aux frontières, 15.03.2022.

[37] 20 minutes, Climat : Xi Jinping contre le projet de taxe carbone de l'Union européenne, 16.04.2021.

[38] The precise value of Chinese investments in the context of the BRI is not known. Conservative estimates place its value in the 500bn dollars-1000bn dollars range.

**have decided to commit 300bn euros to infrastructure, digital and green transition projects between 2022 and 2027, following a G7 decision last year.**[39] The EIB, IBRD, and the European Fund for Sustainable Development (EFSD+) will participate in this "Global Gateway" program, hoping that public investment will leverage private investment because of the guarantee - implicit or not - that is attached to it.[40]

**In addition, the EU is exploring the possibility of setting up a European export credit scheme to complement existing arrangements** at Member State level and to increase the EU's overall leverage in this area.[41] This would help to ensure a more level playing field for EU companies in third country markets, thus facilitating their participation in infrastructure projects. **The EU will not only offer its partners sound financial terms, but will also promote the highest standards** of social, environmental, and strategic management.[42] It will provide technical assistance to partners to strengthen their capacity to develop credible and cost-effective infrastructure projects. **In this way, the European Union hopes in part to counterbalance the economic influence acquired by China since the establishment of the BRI in 2013-2014.** This Chinese influence has sometimes backfired on the beneficiaries of Chinese BRI loans, particularly in the context of covid-19, which has made it difficult to repay these loans because of the stoppage of infrastructure construction.

### 3.2.2 Chinese Attempts to Dedollarise its Trade Relationships

In addition to financing infrastructure projects to increase its economic influence and connectivity, while at the same time evacuating the capital accumulated thanks to its trade surpluses, **China is increasingly trying to "de-dollarize" its international trade**. In other words:

- It seeks to buy its raw materials in yuan while the vast majority of its trade is in dollars.[43]
- It is also seeking to diversify its foreign exchange reserves, while dollar-denominated assets still constitute a large share of its portfolio.[44]
- It seeks to use payment systems that do not use the dollar as a unit of account. This is why it has created the CIPS system, [45] a competitor to SWIFT, in the same way that Russia created SFPS.
- It is also seeking to impose the yuan in its bilateral trade agreements. For example, it has obtained clauses imposing the yuan in agreements with Australia, Russia, Japan, Brazil and Iran. Thus, for the first time, in the first quarter of 2020, the share of China-Russia bilateral trade in dollars was below 50%.[46]

[39] Reuters, G7 rivals China with grand infrastructure plan, 13.06.2021.

[40] European Commission, Global Gateway: up to €300 billion for the European Union's strategy to boost sustainable links around the world, 01.12.2021.

[41] European Commission, Global Gateway: up to €300 billion for the European Union's strategy to boost sustainable links around the world, 01.12.2021.

[42] European Commission, Global Gateway: up to €300 billion for the European Union's strategy to boost sustainable links around the world, 01.12.2021.

[43] The dollar remains the first currency for foreign exchange reserves, international debt denomination, international loans denomination, foreign exchange turnover, and global payments via SWIFT. ECB, the international role of the euro, 06.2021.

[44] The exact composition of China's foreign exchange reserves is classified information. In July 2021, China held 1,068.3 billion dollars of US Treasury Bonds, i.e. about one third of its foreign exchange reserves. US Treasury, Major Foreign Holders of Treasury Securities (in billion of dollars).

[45] Cross-Border Interbank Payment System.

[46] Nikkei Asia, China and Russia ditch dollar in move toward "financial alliance", 06.08.2020.

- Finally, in the context of its portfolio investments, it is also seeking to impose the yuan as a denomination currency, notably in the context of its BRI-related lending.

**Despite this effort, the yuan only represents so far 2.5% of global foreign exchange reserves, mainly located in Russia (13% of the Russian central bank's foreign exchange reserves), and between 10 and 15% of the amounts traded by China since 2016.[47] In total, the yuan accounts for only 3% of total transactions on the foreign exchange market.** This is mainly due to the intense capital controls entering and leaving China and the immaturity of the Chinese yuan bond and money markets. The dollar's status is due in part to the depth of the US financial markets that make it the exclusive unit of account, and to the major importance of government deficits in meeting the "infinite" demand for the main currency of international trade.[48] **As long as the Chinese currency is strictly controlled by China, there is no hope for a real voluntary de-dollarization.** The coming weeks will show whether "forced" de-dollarization is possible: China could threaten break its trade links could get some countries to trade in yuan. Digital central bank currencies are not necessarily a game changer in this respect.

## 4 Potential Impact of the War in Ukraine on EU-China Relations: Risk of Sanctions

**Since the beginning of the war in Ukraine, China has held an ambiguous position that persists today.** In this case, the watchword today is not to criticize Ukraine or Russia, to speak out in favour of peace and "tranquillity" without disengaging, especially militarily, from Russia. If the situation persists, China, like Russia, could be sanctioned commercially (increased customs duties) and financially (sanctions on Chinese banks dealing with Russia). Will China persist in not denouncing Russia in this conflict? It may be the case. Nevertheless, China has much to lose.

**Indeed, China's economic relationship with the US and its allies in Asia is much larger and deeper than that with Russia.** By 2021, almost half of China's 3.3tn US dollars in exports were destined for the US, the EU, the UK and US allies in Asia; **only 2% went to Russia**.[49] China's technology industries still rely heavily on equipment and know-how supplied by the US and its friends.

**Moreover, China is far from self-sufficient in energy or food.[50] It is all too aware of the vulnerabilities inherent in its supply routes through the Asian seas dominated by the US Navy.** The possibility of a naval blockade, however remote, is accompanied by the ability of the US to freeze a substantial portion of China's foreign exchange reserves held in US Treasury bills. Nevertheless, China could benefit from Russia's deported energy and food exports. In exchange, Russia would accept more Chinese infrastructure (UnionPay instead of Visa and MasterCard, CHIPS payment system).

Besides, it seems that China is also massively arming itself and developing a substantial stockpile of nuclear warheads to strengthen its deterrence. Has it in fact already chosen sides, to the detriment of global prosperity? **If so, the EU should be expected to break away from China, both commercially and financially. This 'tear-off' will be accompanied by a major rapprochement with the rest of the 'free**

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[47] Financial Times, Digital renminbi will not help Russia evade sanctions, 16.03.2022.

[48] Financial Times, The US dollar's status is safe for now, 05.04.2022.

[49] Financial Times, Digital renminbi will not help Russia evade sanctions, 16.03.2022.

[50] The Diplomat, China's Evolving Food Security Strategy, 25.11.2021.

**world', namely the American continent and Great Britain, despite the Brexit. It goes without saying that both areas would still lose out overall.**

If China continues, even implicitly, to support the Russian war effort, whether militarily or commercially, the West risks welding itself together against a new Sino-Russian or even Sino-Indo-Russian bloc that the Russian government is clearly calling for.

This China-India-Eurasian-Union bloc now has an economic strike force almost equivalent to a European Union-United States-Japan bloc (42,000bn dollars versus 49,800bn dollars of GDP in purchasing power parity in 2021 according to the IMF),[51] even if its cultural and historical coherence is less obvious than for the latter.

## 5 Conclusion: Which Common Ground for the EU and China?

**What does the EU want from China? That it accepts more reciprocity in trade and returns to a more peaceful international posture.** While China does not seem to be moving in this direction, the EU is now determined to create more barriers to keep itself out, while implementing a policy of strategic rivalry. If China remains on Russia's side, the EU should continue to build these barriers, including the one implied by a new European military power allied to the US. Indeed, the 100bn dollars increase in the German defence budget for 2022, and its maintenance at 2% of GDP, seems to be aimed above all at reassuring the American ally in a context of increasingly obvious polarisation around the American and Chinese poles. The announcement of the purchase of many American F-35s to equip the German air force is a step in this direction.

**What does China want for the European Union? It hopes that the EU will develop into a "balancing power", capable of arbitrating the China-US confrontation.** For China, the European Union must remain its leading trading partner, with Germany at the forefront - 47% of EU exports to China in 2021. It rejects the idea of reciprocity, attached to a vision of international relations based on power relations, but remains a fervent supporter of "win-win", which it believes is always possible.

The strategic rivalry between the two powers is likely to persist, perhaps ultimately to the detriment of multilateral institutions such as the G20, which will then have to be reinvented. Nevertheless, facing common dramatic issues like climate change, they may find further ground for cooperation.

[51] IMF, World Economic Outlook, 04.2021.

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