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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

EU – China: Closer partners, growing responsibilities

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1. What is at stake?

China has re-emerged as a major power in the last decade. It has become the world's fourth economy and third exporter, but also an increasingly important political power. China's economic growth has thrown weight behind a significantly more active and sophisticated Chinese foreign policy. China's desire to grow and seek a place in the world commensurate with its political and economic power is a central tenet of its policy. Given China's size and phenomenal growth, these changes have a profound impact on global politics and trade.

The EU offers the largest market in the world. It is home to a global reserve currency. It enjoys world leadership in key technologies and skills. The EU plays a central role in finding sustainable solutions to today's challenges, on the environment, on energy, on globalisation. It has proved capable of exerting a progressive influence well beyond its borders and is the world's largest provider of development aid.

Europe needs to respond effectively to China's renewed strength. To tackle the key challenges facing Europe today – including climate change, employment, migration, security – we need to leverage the potential of a dynamic relationship with China based on our values. We also have an interest in supporting China's reform process. This means factoring the China dimension into the full range of EU policies, external and internal. It also means close co-ordination inside the EU to ensure an overall and coherent approach.

To better reflect the importance of their relations, the EU and China agreed a strategic partnership in 2003. Some differences remain, but are being managed effectively, and relations are increasingly mature and realistic. At the same time China is, with the EU, closely bound to the globalisation process and becoming more integrated into the international system.

The EU's fundamental approach to China must remain one of engagement and partnership. But with a closer strategic partnership, mutual responsibilities increase. The partnership should meet both sides' interests and the EU and China need to work together as they assume more active and responsible international roles, supporting and contributing to a strong and effective multilateral system. The goal should be a situation where China and the EU can bring their respective strengths to bear to offer joint solutions to global problems.

Both the EU and China stand to gain from our trade and economic partnership. If we are to recognise its full potential, closing Europe's doors to Chinese competition is not the answer. But to build and maintain political support for openness towards China, the benefits of engagement must be fully realised in Europe. China should open its own markets and ensure conditions of fair market competition. Adjusting to the competitive challenge and driving a fair bargain with China will be the central challenge of EU trade policy in the decade to come. This key bilateral challenge provides a litmus test for our partnership, and is set out in more detail in a trade policy paper entitled "Competition and Partnership" which accompanies the present Communication.

Europe and China can do more to promote their own interests together than they will ever achieve apart.

2. Context: China's revival

Internal stability remains the key driver for Chinese policy. Over recent decades, stability has been underpinned by delivery of strong economic growth. Since 1980 China has enjoyed 9% annual average growth and has seen its share of world GDP expand tenfold to reach 5% of global GDP. China's growth has resulted in the steepest recorded drop in poverty in world history, and the emergence of a large middle class, better educated and with rising purchasing power and choices.

But the story of this phenomenal growth masks uncertainties and fragility. The Chinese leadership treads a complex daily path, facing a range of important challenges, primarily domestic, but which increasingly resonate beyond national boundaries:

- Disparities continue to grow. The wealth gap is significant and growing, as are social, regional and gender imbalances; there is huge stress on healthcare and education systems; and China is already facing significant demographic shifts and the challenges of a rapidly ageing population;
- China's demand for energy and raw materials – China is already the world's second largest energy consumer – is already significant and will continue to grow; and the environmental cost of untrammelled economic and industrial growth is becoming more and more apparent. At the same time growth patterns have not been balanced, with a focus on exports to the detriment of domestic demand.

Growth remains central to China's reform agenda, but increasingly is tempered with measures to address social inequality and ensure more sustainable economic and political development. Paradoxically, in a number of areas, the conditions for stability improve as the Party and State relax control. A more independent judiciary, a stronger civil society, a freer press will ultimately encourage stability, providing necessary checks and balances. Recognition of the need for more balanced development, building a "harmonious society", is encouraging. But further reform will be necessary.

China's regional and international policy also supports domestic imperatives: a secure and peaceful neighbourhood is one conducive to economic growth; and China's wider international engagement remains characterised by pursuit of very specific objectives, including securing the natural resources needed to power growth. At the same time we have seen China's desire to build international respect and recognition. The 2008 Olympic Games in Beijing and the 2010 World Expo in Shanghai will focus the world's attention on China's progress.

China has traditionally described its foreign policy as one of strict non-interference, but as it takes on a more active and assertive international role, this becomes increasingly untenable. The Chinese government is beginning to recognise this, and the international responsibilities commensurate to its economic importance and role as a permanent member of the UN Security Council as illustrated by its increasingly active diplomatic commitments.

The EU and China benefit from globalisation and share common interests in its success. It presents challenges to both and brings further responsibilities. We also share a desire to see an

effective multilateral system. But there remain divergences in values, on which dialogue must continue.

As the partnership strengthens, expectations and responsibilities on both sides increase. As China's biggest trading partner, EU trade policy has an important impact on China, as do China's policies on the EU. Increasingly, both sides expect that impact to be taken into account in their partner's policy formulation.

3. The way forward

The EU should continue support for China's internal political and economic reform process, for a strong and stable China which fully respects fundamental rights and freedoms, protects minorities and guarantees the rule of law. The EU will reinforce co-operation to ensure sustainable development, pursue a fair and robust trade policy and work to strengthen and add balance to bilateral relations. The EU and China should work together in support of peace and stability. The EU should increase co-ordination and joint action and improve co-operation with European industry and civil society.

Until now the legal basis for relations has been the 1985 Trade and Co-operation Agreement. This no longer reflects the breadth and scope of the relationship and at the 9th EU-China Summit leaders agreed to launch negotiations on a new, extended Partnership and Co-operation Agreement (PCA) to update the basis for our co-operation. This new agreement presents an important opportunity. It will provide a single framework covering the full range and complexity of our relationship, and at the same time should be forward-looking and reflect the priorities outlined in this Communication.

3.1. Supporting China's transition towards a more open and plural society

The Chinese leadership has repeatedly stated its support for reform, including on basic rights and freedoms. But in this area progress on the ground has been limited. The EU must consider how it can most effectively assist China's reform process, making the case that better protection of human rights, a more open society, and more accountable government would be beneficial to China, and essential for continued economic growth.

Democracy, human rights and the promotion of common values remain fundamental tenets of EU policy and of central importance to bilateral relations. The EU should support and encourage the development of a full, healthy and independent civil society in China. It should support efforts to strengthen the rule of law - an essential basis for all other reform.

At the same time, the EU will continue to encourage full respect of fundamental rights and freedoms in all regions of China; freedom of speech, religion and association, the right to a fair trial and the protection of minorities call for particular attention – in all regions of China. The EU will also encourage China to be an active and constructive partner in the Human Rights Council, holding China to the values which the UN embraces, including the International Covenant on Civil and Political Rights.

The twice-yearly human rights dialogue was conceived at an earlier stage in EU-China relations. It remains fit for purpose, but the EU's expectations – which have increased in line with the quality of our partnership – are increasingly not being met. The dialogue should be:

- more focussed and results-oriented, with higher quality exchanges and concrete results;

- more flexible, taking on input from separate seminars and sub-groups;
- better co-ordinated with Member State dialogues.

3.2. **Sustainable development**

One of today's key global challenges is to ensure our development is sustainable. China will be central to meeting this challenge. China's domestic reform policy is important and the Commission will continue to support this through its co-operation programme, including corporate social responsibility. On issues such as energy, the environment and climate change, respect for international social standards, development assistance, as well as wider macroeconomic issues, the EU and China should ensure close international co-operation. Both sides should:

Ensure secure and sustainable energy supplies. As important players in world energy markets, the EU and China share a common interest and responsibility in ensuring the security and sustainability of energy supplies, improving efficiency and mitigating the environmental impact of energy production and consumption. The EU's priority should be to ensure China's integration into world energy markets and multilateral governance mechanisms and institutions, and to encourage China to become an active and responsible energy partner. On that basis both sides should work together to:

- increase international co-operation, in particular efforts to improve transparency and reliability of energy data and the exchange of information aimed at improving energy security in developing countries, including Africa;
- strengthen China's technical and regulatory expertise, reducing growth in energy demand, increasing energy efficiency and use of clean renewable energy such as wind, biomass and bio fuels, promoting energy standards and savings through the development and deployment of near zero emission coal technology;
- commit to enhance stability through a market-based approach to investment and procurement; dialogue with other major consumers; encouragement of transparent and non-discriminatory regulatory frameworks, including open and effective energy market access; and by promoting the adoption of internationally recognised norms and standards.

Combat climate change and improve the environment. We already have a good basis for co-operation on environment issues and on climate change through the Partnership established at the 2005 EU-China Summit.

- The EU should share regulatory expertise, working with China to prevent pollution, safeguard biodiversity, make the use of energy, water and raw materials more efficient, and improve transparency and the enforcement of environmental legislation. Both sides should work together to tackle deforestation and illegal logging, sustainable management of fisheries resources and maritime governance;
- Both sides should build on the Climate Change Partnership, reinforcing bilateral co-operation, and strengthening international co-operation, meeting shared international responsibilities under the Climate Change Convention and Kyoto Protocol and engage actively in the dialogues on international climate change co-operation post-2012. We should strengthen the use of emissions trading and clean development mechanisms.

Improve exchanges on employment and social issues. China is committed to tackle social disparities and promote more balanced development. The EU and China should:

- intensify co-operation on employment and social issues reinforcing and expanding bilateral dialogue to include issues such as health and safety at work, decent work standards, and meeting the challenges of an ageing population;
- work together to ensure that international commitments on labour and social issues are upheld.

Improve co-ordination on international development. Closer co-operation on international development issues would benefit the EU, China and partners in the developing world. There are significant downsides if we are not able to co-ordinate effectively, particularly in Africa but also in other developing countries. The EU and China should:

- engage in a structured dialogue on Africa's sustainable development. There should be transparency on the activity and priorities of both sides, providing a basis for full discussion;
- support regional efforts to improve governance in Africa;
- explore opportunities for improving China's integration into international efforts to improve aid efficiency, co-ordination and opportunities for practical bilateral co-operation on the ground.

Build sustainable economic growth. China has become a source growth for the EU and the world, but China's current growth model is also the source of important imbalances in EU-China trade. The Chinese government has recognised the importance of meeting macro economic challenges, of forward-looking fiscal, monetary and structural policies, boosting consumption and reducing inequalities. Increasing exchange rate flexibility will be an important factor, helping rebalance growth towards domestic demand and increasing Chinese households' purchasing power. Policies which would lead to a reduction of its current account surplus would increase China's control of its economy and contain risks of overheating, and at the same time meet China's shared responsibility to ensure a stable and balanced world economy.

As key economic powers, the EU and China should further develop their partnership and work together to tackle global economic issues; they should:

- deepen co-operation and share experience in formulating and implementing monetary, fiscal, financial, exchange rate and structural policies;
- co-operate towards the orderly unwinding of global imbalances;
- strengthen and upgrade their macro-economic dialogue.

3.3. Trade and economic relations

China's integration into the global trading system has benefited both Europe and China. The EU is China's largest trading partner, representing more than 19% of China's external trade. European companies trading with and investing in China have contributed to China's growth,

bringing capital goods, knowledge and technology that have been instrumental to China's development.

An economically strong China is in Europe's interest. China, especially its rapidly increasing middle class, is a growing market for EU exports. EU exports to China increased by over 100% between 2000 and 2005, much faster than its exports to the rest of the world. EU exports of services to China expanded six-fold in the ten years to 2004. European companies and consumers benefit from competitively priced Chinese inputs and consumer goods. Openness brings benefits to both China and the EU.

Nevertheless, in Europe there is a growing perception that China's as yet incomplete implementation of WTO obligations and new barriers to market access are preventing a genuinely reciprocal trading relationship. Imports from China have added to pressure to adjust to globalisation in Europe. This trend is likely to continue as China moves up the value chain.

For the relationship to be politically and economically sustainable in the long term, Europe should continue to offer open and fair access to China's exports and to adjust to the competitive challenge. The EU needs to develop and consolidate areas of comparative advantage in high-value and high-tech design and production and to help workers retrain. China for its part should reciprocate by strengthening its commitment to open markets and fair competition. Both sides should address concern over the impact of economic growth on natural resources and the environment. The EU will:

Insist on openness. The EU will continue working with China towards the full implementation of its WTO obligations and will urge China to move beyond its WTO commitments in further opening its market to create opportunities for EU companies. The EU will accept that it cannot demand openness from China from behind barriers of its own. The EU will urge China to honour its commitment to open accession negotiations on the Government Procurement Agreement in 2008 and work to bring them to a successful conclusion as rapidly as possible.

Level the playing field. Better protection of intellectual property rights in China and ending forced technology transfers are EU priorities, including through implementation by China of WTO obligations and will help create a better investment climate in China. The EU will press China to stop granting prohibited subsidies and reform its banking system, and encourage China to allow market forces to operate in its trade in raw materials.

Support European companies. The Commission will make a major effort to assist companies doing business with China, in particular small and medium sized enterprises while urging them to respect decent work standards. The EU will extend and strengthen the existing information, training and advice on protecting and defending IPR in China. A European Centre in Beijing should be opened. The EU-China Managers Exchange and Training Programme should be extended.

Defend the EU's interests: dialogue first. The EU has a clear preference for resolving trade irritants with China through dialogue and negotiation. The existing EU-China trade related dialogues should be strengthened at all levels, their focus should be sharpened on facilitating trade and improving market access and their scope extended. The EU and China also have an interest in joining their efforts in international rule making and global standard setting bodies. The EU will actively pursue global supervisory and regulatory solutions, promoting open markets and regulatory convergence, and build on co-operation with China through EU-China

regulatory dialogues. This will also help to ensure compliance of Chinese imports with EU standards for food and non-food products.

But where other efforts have failed, the Commission will use the WTO dispute settlement system to ensure compliance with multilaterally agreed rules and obligations. Trade defence measures will remain an instrument to ensure fair conditions of trade. The EU is actively working with China with a view to creating the conditions which would permit early granting of MES. Recent progress has been made on some of the conditions. The Commission will continue to work with the Chinese authorities through the mechanisms we have established and will be ready to act quickly once all the conditions are met.

Build a stronger relationship. A key objective of the negotiations for a new Partnership and Cooperation Agreement, which will also update the 1985 Trade and Co-operation Agreement, will be better access to the Chinese market for European exporters and investors, going beyond WTO commitments, better protection of intellectual property and mutual recognition of geographical indications. China is already a major beneficiary of the international trading system and should assume a responsibility commensurate with those benefits, making a substantial contribution to reviving and completing the WTO Doha Round.

Many of these steps are not only in EU's interest. They are strongly in China's interest and an integral part of China's progress towards balanced and sustainable growth and development and global leadership and responsibility. The accompanying trade policy paper sets out a comprehensive approach to EU-China trade and investment relations for the medium term.

3.4. Strengthening bilateral co-operation

Bilateral co-operation spans a wide range of issues, including 7 formal Agreements, 22 sectoral dialogues, covering diverse and important issues from aviation and maritime transport to regional and macro-economic policy. Further development of the structured dialogue to exchange experiences and views on competition matters, as well as technical and capacity-building assistance as regards competition enforcement, remains important. Co-operation has been successful and positive. But more must be done to focus co-operation and ensure balance and mutual benefit, in all areas, but particularly on flagship areas such as science and technology co-operation. More should be done to strengthen co-operation on migration issues, people-to-people links, and the structures governing our official relations. Both sides should:

Ensure quality and increased co-operation in science and technology. Science and technology co-operation is a priority area for the Chinese government. China spends 1.5% of its GDP on a dynamic and growing research and development programme. Bilateral co-operation is also strong: China is one of the most important third countries participating in more EU research projects under the 6th Research Framework Programme, giving it access to 600 million euros of research, and China is an important partner on key projects such as ITER and Galileo. EU participation in Chinese programmes should be increased.

The Joint Declaration from the Science and Technology Forum in May 2005 set the context for taking co-operation forward, based on mutual benefit and reciprocal access and participation. Both sides should:

- consolidate and improve the visibility of co-operation. This will allow both sides to focus and set priorities effectively and to respond to dynamic issues such as emerging pandemics

or work on clean energy technologies; make it easier to examine scope for increased reciprocity; and provide a basis for more effective co-ordination with Member States;

- improve joint planning to ensure mutual benefit, and increase flexibility to fund the participation of European researchers in Chinese research programmes. Both sides should facilitate researchers' mobility which in the case of the EU is promoted through specific grants under the Framework Programme.

Build an effective migration relationship. Chinese and other migrants enrich the EU culturally and bring with them important skills and expertise. But there is a significant downside if the process is not managed effectively. There has to be an effective legal framework to facilitate people-to-people exchanges. But we need effective mechanisms to deal with those who abuse the system, with a focus on prevention and return. Both sides should work towards the early conclusion of an effective Readmission Agreement.

- The existing consultation mechanism should continue and be extended to cover both legal and illegal migration, and with renewed political commitment to make progress;
- Both sides should agree and push forward specific co-operation projects on e.g. the exchange of officials and training; and there should be exchanges on biometric technology;
- There should be a dedicated dialogue with the Ministry of Public Security covering migration and the fight against organised crime, terrorism and corruption;
- The EU-China Tourism Agreement (ADS) will need continued proactive and practical co-operation to ensure it functions effectively.

Expand people-to-people links. We should strengthen the full range of people-to-people links which underpin our relations through significant and sustained action on both sides, from cultural exchanges and tourism to civil society and academic links.

- Civil society and institutional links should provide direct support and impetus for political and trade relations. Both sides should facilitate direct links between civil society groups in the EU and China in all areas, and include them in sectoral dialogues where possible. Official non-governmental links should be strengthened and expanded. The European Parliament plays a central role and should expand co-operation with the Chinese National People's Congress. The EU should also strengthen links between ECOSOC and the Chinese Economic and Social Committee, political parties, and between other semi-official bodies.
- Education has been an area of particular success, with 170 000 Chinese students studying in the EU in 2005. We should continue to build on existing co-operation through programmes run by individual Member States and through the China-specific strand of the Erasmus Mundus programme. There have been positive examples of work to set up joint degree courses and joint campuses. We should also implement specific projects such as a European Law School. Both sides will continue to encourage EU students to study in China. To strengthen language capability, the Commission will support a specific programme to train Chinese language teachers to teach in Europe.
- Academic expertise in the EU on China needs to be improved and co-ordinated more effectively. Action is needed by both sides to support effective interaction between

European and Chinese academia. The Commission should continue to support an academic network on China, drawing together academic expertise to inform EU policy and co-ordinating information-sharing within the academic community; and there should be a small number of prestigious professorships on Chinese studies created and made available to European universities. There should be a permanent regular dialogue between European and Chinese think tanks.

Make bilateral structures more effective. Both sides should reflect on the structures which govern relations and consider whether they should be streamlined, improved or upgraded. The Commission's 2003 Policy Paper sought to expand sectoral dialogue between the EU and China. This has been very successful, and the majority function well and make an important contribution to our partnership. But progress should be reviewed. Both sides should also consider whether there are new bodies or mechanisms which would further contribute to EU-China relations.

- Annual Summits provide a good framework for maintaining contacts at head of government level. This should be supported by regular cross-cutting exchange and dialogue at technical, ministerial and more senior level. In addition, both sides should explore further options for flexible and informal opportunities to meet and exchange views;
- The recently agreed strategic dialogue at Vice Foreign Minister level should be a key mechanism covering regional and geo-political issues and adding focus, impact and value to the relationship;
- Both sides should undertake a thorough examination of the rationale, interrelationship and performance of the sectoral dialogues with the aim of maximising synergies and ensuring mutual benefit, and ensure interested stakeholders are involved where possible. The Commission will produce a series of Working Documents on specific sectoral challenges;
- A new independent EU-China Forum should be set up. On the EU side it should be at arms length from the institutions and should draw on civil society, academic, business and cultural expertise, providing policy input to political leaders and impetus to bilateral relations.

The EU should ensure that it speaks with one voice on the panoply of issues related to its relations with China. Given the complexity of the relationship and the importance of continuity, regular, systematic and cross-cutting internal co-ordination will be essential.

The EU's co-operation programme, delivered through the country strategy paper (CSP) and national indicative programmes, should continue to play a role in supporting the partnership between the two sides and China's reform process. But as China moves further away from the status of a typical recipient of overseas development aid, the EU must calibrate its co-operation programme carefully and keep it under review. Co-operation must be in both sides' interests, reflect the EU's own principles and values, and serve to underpin the partnership.

3.5. International and regional co-operation

The EU and China have an interest in promoting peace and security through a reformed and effective multilateral system. They should co-operate closely in the framework of the UN, working to find multilateral solutions to emerging crises, and to combat terrorism and increase regional co-operation, including through involvement by both in emerging regional

structures. This common interest, in strong multilateralism, peace and security should also be reflected in closer co-operation and more structured dialogue on the Middle East, Africa and East Asia, and on cross-cutting challenges such as non-proliferation.

East Asia. It is clear the EU has a significant interest in the strategic security situation in East Asia. It should build on the increasing effectiveness of its foreign and security policy and its strategic interest in the region by drawing up public guidelines for its policy.

China has a key role to play in the region and has been working to improve relations with its neighbours, including Russia and India, and with central Asia through the Shanghai Co-operation Organisation. But there remains scope for improvement in Sino-Japanese relations. The EU has an interest in strong relations between the region's major players and in continued regional integration.

Taiwan. The EU has a significant stake in the maintenance of cross-straits peace and stability. On the basis of its One China Policy, and taking account of the strategic balance in the region, the EU should continue to take an active interest, and to make its views known to both sides. Policy should take account of the EU's:

- opposition to any measure which would amount to a unilateral change of the status quo;
- strong opposition to the use of force;
- encouragement for pragmatic solutions and confidence building measures;
- support for dialogue between all parties; and,
- continuing strong economic and trade links with Taiwan.

Transparency on Chinese military expenditure and objectives. There is increasing concern caused by the opacity of China's defence expenditure. As expenditure continues to increase, China needs to be convinced of the importance of improving transparency. At the same time, the EU should improve its analytical capacity on China's military development.

Arms embargo. The arms embargo was put in place as a result of events in Tiananmen Square in 1989. The EU has agreed to continue to work towards embargo lift, but further work will be necessary by both sides:

- Current and incoming Presidencies should finalise technical preparations to ensure lift would not lead to a qualitative or quantitative increase in arms sales, and continue to explore possibilities for building a consensus for lift. The EU should work with China to improve the atmosphere for lift, making progress on China's human rights situation; working to improve cross-straits relations; and by improving the transparency of its military expenditure.

Non-proliferation. Non-proliferation represents a key area for the strategic partnership. International and bilateral co-operation is based on UNSCR 1540 and the Joint Declaration on Non-Proliferation agreed at the 2004 EU-China Summit. The EU is supportive of China's central role in work on the Korean peninsula and continued Chinese support will be crucial to progress on the Iranian nuclear issue. There has been a good start on dialogue and practical

co-operation to strengthen and enforce export controls. The EU should build on this, working with Chinese officials to encourage China to:

- comply with all non-proliferation and disarmament treaties and international instruments, and to promote compliance with them regionally and internationally;
- strengthen export controls of WMD-related materials, equipment and technologies as well as of conventional weapons and small arms and light weapons.

Both sides should work together to share practical experience in implementing and enforcing export controls, including through training for Chinese customs officials. They should consider scope for joint EU/Asia initiatives in the context of the ASEAN Regional Forum.

4. Conclusion

China is one the EU's most important partners. China's re-emergence is a welcome phenomenon. But to respond positively and effectively, the EU must improve policy co-ordination at all levels, and ensure a focussed single European voice on key issues.

We have a strong and growing bilateral relationship. But we must continue build on this. The recommendations in this Communication, which the Council is invited to endorse and complement through Council Conclusions, represent a challenging agenda for the EU to do so, and the Partnership and Co-operation Agreement provides an important practical mechanism to move this agenda forward.

A closer, stronger strategic partnership is in the EU's and China's interests. But with this comes an increase in responsibilities, and a need for openness which will require concerted action by both sides.