中欧政策对话支持项目

EU-China Policy Dialogues Support Facility

EU-China: Close Cooperation on the Multilateral Agenda

中国 – 欧盟在多边主义议程上的密切合作

Joint European and Chinese Study on Multilateralism

中 – 欧多边主义联合研究

(July 2011)

Pierre Defraigne	Taming Global Finance and Coping with Monetary Polycentrism
Zhou Hong	Multilateralising the International Monetary System (Possible collaboration between the EU and China)
Jiang Shixue	China-EU Cooperation in the G20 from a Chinese Perspective
Thomas Renard	EU-China in the G20: Convergences and Divergences
Andrew Small	Cooperation between China and the EU in the UN Security Council (1)
Cheng Weidong	Cooperation between China and the EU in the UN Security Council (2)

This project is co-funded by the European Union and the People's Republic of China, implemented by a consortium led by Grontmij | Carl Bro A/S

本项目由中国和欧盟共同资助,由 **Grontmij | Carl Bro A/S** 实施,

This publication has been produced with the financial assistance of the European Union. The content of this report is the sole responsibility of its author/s and can in no way be taken to reflect the views of the European Union.

Table of Contents

Foreword

By Pierre Defraigne and Zhou Hong

The world economy is heading through a transitional phase towards a new balance in which emerging economies are increasing their share of global GDP while Western countries' share, caught in the eddies of the 2008 financial crisis, is shrinking (48%) and the least developed countries are lagging behind. The change is not just quantitative: the OECD countries share about the same institutions and values whilst the BRICS display with G7 countries and among themselves significant differences in their governance and development models. While real convergence between advanced and developing countries makes multilateral governance more inclusive and fairer, these differences make it also more difficult to organise.

The sharing of global economic weight and power with an emerging Asia is above all the result of the intrinsic dynamics of market capitalism in its quest of efficiency, lower labour costs and higher profits, combined with effective although diverse development strategies in Asia. It also reflects diverging demographic trends and in the savings patterns attached to them, as well as the change in sources of global labour supply whose productivity has been raised by the diffusion of technology worldwide. But the shift from the West to the East has been accelerated by severe market and policy failures: emphasis put on debt-driven growth led to an underestimation of both the financial instability risks and the impact of aggravating inequalities on household indebtedness and purchasing power. The main responsibility of the financial crisis lies with the United States, but the European Union has imported it. It rests both upon an oversized financial industry caught in the dynamics of competition for the highest returns on investment and bonuses on the one hand, and on complacent or deficient monetary policymakers and financial supervision authorities on the other.

What the financial crisis has dramatically brought to light is the difficulty for today's democracies to keep the balance between market forces and politics, when the latter is confronted with the growing complexity of advanced systems whose keys are in the hands of experts. This has proved particularly blatant in the case of finance where 'hyper-financialisation' has been outweighing political decision-making and bureaucratic management capacities, both at national and multilateral levels. This loss of control over finance has allowed it to generate instability and to aggravate social inequalities in both advanced and emerging economies. There is indeed a direct link between the deregulation of global finance and the deterioration of the national social contract which in all countries should provide the key to domestic stability, market openness and peace.

Since finance and money are intertwined realities, they must be tackled together. The taming of global finance by national and EU authorities, and the setting up of a genuine multilateral monetary system in line with the world economy's new balance, should therefore be addressed through a twin track approach. There is a difference though. On the one hand, while financial norms and rules should be discussed within the multilateral Basel framework, they actually remain within the remit of national or, in the case of Europe, EU authorities, because there are no alternative last resort lenders in case of a liquidity crisis, nor any alternative rescue authority in case of a solvency crisis. On the other hand, although an effective international monetary system requires a global institution, there is no prospect of an international sovereign authority which would be entrusted with the responsibility of issuing international liquidity, which is also the condition of acting as a last resort lender. Intergovernmentalism will keep prevailing in the IMF and the G20. Therefore before a new credible IMS is put into place, a muddling through phase is unavoidable focusing on an effective ad hoc cooperation on macroeconomic and financial policies among the three major economic blocs which dispose each of an international currency: the USA, the EU and China. Only such a voluntary coordination, based on shared basic principles, among the "Big Three" can give a direction to and secure the effectiveness of multilateral cooperation in monetary and financial matters.

***

This collection of papers from six authors, Zhou Hong, Jiang Shixue and Cheng Weidong from the Institute of European Studies of the Chinese Academy of Social Sciences, Pierre Defraigne from the Madariaga – College of Europe Foundation, Andrew Small from the German Marshall Fund of the United States and Thomas Renard from the Royal Institute of International Relations – Egmont is meant to provide an analysis from European and Chinese perspectives of the main challenges presently posed by the changing global order to China and the EU. The collection identifies the differences in analysis but also underlines common ground and explores proposals and recommendations for the boosting of a multilateral system. The papers tackle three specific questions, which are in our opinion particularly pressing in the reflection upon global governance: the reform of the international monetary system, the G20 and the reform of the United Nations Security Council. The papers were drafted after a six month exchange between authors and discussions at a first conference convened in Beijing on 22 November 2010 entitled "China and the EU as Global Partners"; and a second one held in Brussels on 26 May 2011 entitled "EU-China: Close Cooperation on the Multilateral Agenda".

The authors are grateful to the EU-China Policy Dialogues Support Facility (PDSF) for providing the platform for this fruitful exchange and to the European External Action Service (EEAS) from having promoted, funded and provided continuous support to the action.

Taming Global Finance and Coping with Monetary Polycentrism

By Pierre Defraigne
Executive Director
Madariaga – College of Europe Foundation
pdefraigne@madariaga.org

Introduction

While the criss-crossing of global firms' output chains across borders and the increase of intra-firm trade are driving markets towards more globalisation, trade multilateralism is levelling off, and competitive liberalisation brings back trade bilateralism, which undermines the World Trade Organisation (WTO). The financial sphere of the economy is also characterised by a growing contrast between the global functioning of financial markets and the move from a dollar-based international monetary order towards a complex system combining "monetary polycentrism" - as coined by Aglietta - with a wide array of floating and pegged exchange rates, hooked either to the dollar or to dominant regional currencies such as the euro, the yuan or currency baskets.

Unless multilateralism is given a serious boost, creeping continentalism, resulting from increasing bilateralist and regionalist trends, might eventually prevail as the shaping force of the world economic system, raising the prospect of protectionism and conflicts. Let us see how the rise of finance has damaged the International Monetary System (IMS) with financial markets taking over from multilateral institutions and curbing more and more the autonomy of government policies.

Currency and IMS

A currency fulfils three functions over the territory of one single country: a unit of account, a means of payment, and a store of value. But international trade and capital flows between countries raise the issue of convertibility among currencies and therefore of their exchange rates. The use of one or several dominant national currencies in international transactions reduces the need for currency conversion and eases trade, Foreign Direct Investment (FDI) and portfolio investment.

The IMS provides precisely for a workable framework facilitating the interaction between national currency systems and international trade and financial transactions. The IMS rests upon three forces whose relative importance has varied over time: governments in charge of national monetary regimes and particularly of international currencies, global markets that determine the hierarchy among international currencies, and international institutions, i.e. the International

Monetary Fund (IMF) with regard to monetary and financial stability and the Basel Group of Twenty (G20)-led Financial Stability Board with regard to the production of financial norms. These institutions formalise the operational cooperation among countries under the guidance of the Group of Seven (G7), yesterday, and the G20, today, but with an intellectual and political leadership exerted by Anglo-Saxon academics and United States (US) Treasury officials.

The IMS fulfils three major roles:

- the supply of international liquidity in the right proportion for financing world growth through enhancing international transactions, without fuelling either inflation or deflation;

- the smooth and fair adjustment of external imbalances so as to prevent structural exchange rates misalignments which act as an aggravating factor for such imbalances;

- the handling of financial crises including coping with the issue of an ultimate resort liquidity provider, either directly by governments or through the IMF's stewardship.

In that way, the IMS would prevent or limit:

- the volatility of exchange rates caused by destabilising capital flows;

- the accumulation of international reserves through undervalued currencies by emerging economies which they have used as an insurance policy against both trade protectionism (from the US Congress against Chinese exports) and conditionality attached to liquidity provided by the IMF in the Asian 1997-98 crisis.

Actual incarnations of the IMS have never fully achieved satisfactory results. The Gold Standard was too "mechanical" and came to a brutal end in the wake of World War I (WWI) which it had eventually contributed to bringing about. Bretton Woods I (BWI) worked for the benefit of the few and was soon led astray by its guardian, the US. The floating exchange rates and the abolition of capital controls under Bretton Woods II (BWII) kept world growth going and supported real convergence, but through the severe dysfunctions of the system as witnessed by huge structural imbalances. Current monetary polycentrism leads the world economy into uncharted waters. Let us go through a quick review of these historical episodes in the quest for an explanation of the dynamics at work: the red thread is to be found in unsolved social conflicts in which finance played a decisive role, and in the strategic rivalry for resources and markets between the established economic powers and the late comers. The sharing of the seigniorage attached to an international currency status is also a stake in this competition.

The Gold Standard, more than meets the eye

Industrial and financial market capitalism, born in the late 18th century in England, has definitely increased the pace of productivity growth in Europe and thereby has established its domination over the rest of the world for two centuries through technological superiority and colonial rule. Yet no multilateral system presided over that dramatic evolution: trade liberalisation triggered by the unilateral repelling of the Corn Laws by the United Kingdom (UK) (1846) led gradually to generalised free trade through the conclusion of a web of bilateral treaties which included the decisive Most Favoured Nation clause. In parallel, the Gold Standard secured both an international payments system and an adjustment mechanism for correcting external imbalances. But brutal job and wage cuts running consecutive to a restrictive monetary policy, entailed by an outflow of Sterling or gold reserves, gradually made automatic adjustment more difficult and this fed bouts of protectionism.

Last but not least, the competition for resources and markets among the established powers and the latecomers – Germany, Japan and Italy - turned into military rivalry, in particular between the British Royal Navy and the German Imperial fleet for the control of sea routes. WWI broke out under these circumstances.

The interwar period saw neither the restoration of the previous order, nor the birth of a new one. In fact it had no system at all. The desperate attempts by international bankers to restore the Gold Standard, anxious as they were to resume their pre-war international financial business, did not prevent the final collapse of the system in 1931.

It is the lack of a coordinated policy answer to the crisis of the 1930s which eventually resulted in an apocalyptic conflict, not anymore just between countries, but between systems, between fascism, a form of authoritarian capitalism, communism, a form of state capitalism, and the New Deal model of market capitalism initiated by Roosevelt in the USA.

Bretton-Woods I, a promising attempt at multilateralism

In the wake of World War II the Bretton Woods regime, inspired by the New Deal experience, was established under US leadership. Often referred to as the first attempt at multilateral governance for enhancing world growth through a more efficient division of labour and allocation of resources thanks to free trade and FDI, the BW system calls for two qualifications: on the one hand, it was a US-led system because the US was then the largest trading economy, the largest provider of aid[1] and, through trade, the largest supplier of international liquidity; on the other hand, it did not have a universal membership but it was circumscribed to most likeminded market democracies, with about the same level of development, sharing the same opposition to communist expansion, and adhering to the same belief in Keynesian economics as a way to reconcile capitalism and democracy. In fact most of them, except in Latin America, trusted Roosevelt's embedded liberalism.

BWI proved successful for the West because it combined the gradual return to free trade and the space for full employment domestic policies. Capital controls eased the capacity of monetary policies to pursue internal and external stability and to reconcile the convertibility of currencies

[1] The Marshall Plan for Western Europe was preceded by a massive support to Great-Britain and the freed countries from Nazi's invasion.

with the stability of exchange rates. Growth, full employment and a reasonably fair income and wealth distribution prevailed for three decades among participants in the system, mainly advanced Western countries. These remarkable achievements rested on the benefits of the centennial colonial rent in terms of a monopoly of manufacturing jobs and low commodity and energy import prices.

BWI provided an ambivalent multilateral IMS since it put the new gold exchange standard and the twin BW international financial institutions (IFIs) under US monetary hegemony. The US currency became indeed a legal surrogate for gold and this made the US the ultimate international liquidity provider bestowed with the discretionary power to choose between domestic and international priorities within a wider margin secured by seigniorage.[2] The existence of an implicit but effective pact, between free world countries and Washington, linking the dollar and the security of the West and of Japan and South East Asian countries, provided the rationale for the new "multilateral" BW regime.

The dollar-anchored exchange gold standard secured on the one hand currency convertibility, key to the return to free trade, and financial stability through fixed but adjustable exchange rates. Internal stability between employment and inflation was achieved through Keynesian policies made compatible with external stability through capital controls.

BWI proved effective and resilient until the early seventies when the original fault-lines of the system started to outweigh its benefits. These fault-lines resulted mainly from its asymmetrical character. As the last resort international liquidity issuer, the US enjoyed an "exorbitant privilege" from the start since the need from third countries for additional liquidity, entailed by growing trade and financial transactions, fuelled an almost inextinguishable demand for the dollar. High world growth depended on the right supply of international liquidity. Paradoxically, as the recovery took place in Europe and in Japan, the richest and largest economy of the world had gradually to switch from creditor to debtor status for supplying the necessary international liquidity. Relying on gold would have amounted to place the world economy at the mercy of the two main gold sources: communist Soviet Union and South Africa, then still marred with apartheid.

This pattern fitted in perfectly with Washington's own economic and strategic design. Besides being the largest and the most advanced economy of the world, the USA also indeed fulfilled the critical strategic role of containing communism both in Europe and Asia: the implicit deal struck with Western Europe and Japan as a counterpart for American protection was their acceptance to accommodate the constraints of a unilateral dollar policy.

Central to the evolution of BWI had been the growing gap between the volume of dollars in circulation and US gold reserves, which made the initial official price of gold in dollars ($35 per

---

[2] Privilege figured by the differential between interest paid and interest perceived today. See Eichengreen, B. (2011) The Exorbitant Privilege: the Rise and Fall of the Dollar and the Future of the International Monetary System, p. 4. See also (2010) The Stiglitz Report, (The New Press, New York), p. 163.

ounce) a virtual one as a double gold market set in. The collapse of BWI meant also a reversal of policies from Keynesianism to the supply-side and monetarism.

An international monetary non-system again:[3] towards finance's dominance in the anchor country

The delinking between the dollar and gold in August 1971 marked the end of BWI and the transition to BWII through the decisive switch from the fixed to the floating exchange rate system.

The dynamics sparked off by this systemic change soon forced European and other OECD countries to liberalise their own capital accounts, paving the route for global finance to emerge as a shaping force of the world economy and as a substitute for the BW IFIs in providing finance for developing countries and emerging economies. Behind the radical change of tack from the anchorage country with the shift to floating rates and capital deregulation, several factors were at work: the fast increase of international trade flows[4], technological innovation both as a tool and a market for innovative finance, and the growing demands of governments confronted with both development needs and new financial volatility constraints caused by liberalisation.

But the two main reasons for this silent revolution were eventually political. Firstly, the balance of bargaining power changed in the US between liberals, and especially "embedded liberals", and conservatives at the advantage of the latter, with growing acrimonious criticisms addressed to the New Deal legacy especially from Wall Street bankers. Then, enthused by the tremendous breakthrough of the IT revolution with its huge economic, financial and strategic implications, the leading forces in the US, both within and outside the government, undertook drastic transformations in their domestic model and international strategy under the influence of neoliberal first, and later of neoconservative thinking. Reagan in the US and Thatcher in the UK were the emblematic figures of the conservative turn. Market fundamentalism inspired by Hayek and Friedman put its faith into "efficient markets". It focused on growth through supply side and neutral monetary policies, insisting on tax cuts, labour flexibility and keeping social welfare at a minimum, relying on the "trickle down benefits of growth" for lifting the poor.

In that context, finance was seen as a source of growth and an engine of change, and therefore was given a priority. But the deregulation of finance amounted soon to handing over the responsibility of the economy from institutions to markets, from monetary policy to global finance. It did not harm the US economy. On the contrary, it freed the US government from the constraints attached to its former role as the official anchor country of BWI.

Thanks to financial liberalisation and deregulation, the US retained their privilege of remaining the main international liquidity supplier and this allowed them at the same time to expand domestic

---

[3] Williamson, J. in Kenen, P.B. (ed.) (1993) The International Monetary System: Highlights from Fifty Years of Princeton's Essays in International Finance (Westview Press).

[4] As Barry Eichengreen puts it: "control on capital movements (...) provided the breathing space needed to organise orderly realignments … ; they were also see as necessary for the reconstruction of international trade (…) but the conjunction of free trade and fettered finance was not dynamically stable", in Eichengreen, B. (1996) Globalizing Capital: A History of the International Monetary System, p. 194.

consumption and to conduct an ambitious and expensive military build up strategy. High interest rates in America in the late 1970s and early 1980s, allowed the US to attract huge capital inflows coming from the oil exporting countries and from wealthy people in developing countries. This permitted them to start up a huge current account deficit and a massive external debt denominated in dollars. Later, the IT revolution boosted productivity and provided the fuel for stock-exchange booms fed by an accommodating monetary policy. In such a way and despite the piling up of either private or public debt, or of both at the same time as is the case today, the US remained through the 1990s until recently an attractive place for portfolio investment. Tax cuts and the highly safe investment environment acted in the early 2000s as a new incentive for capital inflows despite the modest interest rates practiced by the Fed.

Easy money was allowed through two main factors: on the one hand, cheap manufactured goods imported from China contributed as a key factor to low inflation in the West for two decades while, on the other hand, massive purchase of US T-bonds by China contributed to maintaining low long-term interest rates on the public debt and on mortgage loans, a factor that would play a role in the real estate bubble and in the subprime crisis. But the main factor behind the Fed's accommodating monetary policy was the complacency of US monetary authorities vis-à-vis the 'irrational exuberance' of the stock exchange as put by the then Fed Chairman Alan Greenspan himself.[5]

Wall Street and the Pentagon have eventually been the two main drivers behind the US' easy monetary policy for two decades: it was mainly about making the rich richer and using strategic hegemony to make way for Western democratic values to win over Islamic fundamentalism or rogue states.

The dynamics of 'hyper-financialisation' in the US embodied three major perilous mechanisms: firstly, ingenious and apparently innocuous securitisation provided the way to turn individual risk attached to a loan into systemic risk; then wrong incentives such as stock options and bonuses pushed for "short-termism" and "hit and run gains" that made the system more opaque, more speculative and more unstable, in a stealthy manner which escaped the vigilance of supervisory authorities; eventually the quick rise of banks balance sheets soon erected moral hazard as a feature of financial and monetary governance because of the "too big to fail" option. But in parallel, the multiplication of the activities of offshore financial centres and tax havens over the last two decades contributed to an aggravation of both global financial under-regulation and under-taxation.

The nexus of the crisis which took root in the IMS anchor-country was therefore made of three factors which followed a specific sequencing: firstly, the rising inequalities under the growing pressure of finance against a backdrop of technological innovation and the globalisation of production; then the Fed's easy money policy and last but not least the unbridling of finance.

---

[5] Greenspan, A. "We need a better cushion against risk", Financial Times, (26 March 2009).

Polycentrism as a response to the dysfunctioning of the dollar-based IMS

The benefits brought by global finance in terms of growth were never impressive while the final bill in terms of instability and inequality proved devastating for Western market capitalism, which is likely to cope with the long-term consequences of the 2008 financial crisis for at least a "lost-decade". Yet a financial crisis was nothing new since financial crises had proliferated in the 1980's, mainly in developing and transition economies and were dealt with by the IMF with mixed success, without any systemic damage.[6] The first serious backlash came when they hit the Asian emerging economies in 1997-1998 partly because of domestic policy failures and partly because of a default of surveillance from the BW IFI's, too imbued with a neoliberal trust in the virtues of financial market auto regulation. Asian countries responded to the crisis and to the IMF's harsh treatment by building up strategic forex reserves, partly thanks to an undervaluation of their currencies. They did so in order to shelter themselves in the future from IMF tutorship, considered too much under US Treasury influence for their liking. But in 2008, the crisis broke out in Wall Street at the core of the Western capitalist system and it was of its own making because of the de facto collusion between Wall Street and US policy makers, the Fed and Treasury united in their quest for growth at any cost. The anchorage country being hit at its heart by the crisis, the IMS equilibrium was modified.

Meanwhile two important developments, which resulted partly from the IMS' dysfunctions, had taken place: the rise of China as a leading economy and as the main international creditor, and the monetary unification of Europe.

Today the world is therefore turning multipolar, including with regard to the IMS which has been characterised by Michel Aglietta as 'monetary polycentrism' (dollar, yen, euro and gradually the RMB). Agnes Benassy-Quéré and Jean Pisani-Ferry insist that the dollar will retain its dominant position despite the decline of the relative economic and strategic superiority of the US, since it remains an innovative and resilient economy able to deal with shocks, is financially open, endowed with the most liquid and deepest bonds market of the world and is so far providing the guarantee of a predictable anti-inflation policy. None among the contenders, despite the internationalisation of the euro and to a lesser extent of the yuan, can pretend to offer the same set of characteristics for replacing the dollar as a dominant international currency. Yet the US' growing indebtedness makes the dollar a potential target for speculation and a brutal depreciation would put even its dominant status at risk in a context of monetary chaos. Therefore one has to consider the rise of alternatives – not substitutes - to the dollar as desirable so as to prevent this chaos from occurring. But both the euro and the yuan have to strengthen their status as reliable

---

[6] The scissor effect resulting from the combination of high rates imposed by the Fed's then Chairman Paul Volcker in order to eradicate inflation in the US in the early 1980s and the falling commodities prices crisis, sparked off a major financial crisis among commodity exporting countries, mainly in Latin America and Africa, heavily indebted as a result of the massive recycling of petrodollars from OPEC countries towards developing economies a few years before. The IMF played a key role in providing a lever over these highly indebted countries, to their public (Paris Club) and private (London Club) creditors to prevent defaulting on their debt but accepting a rescheduling.

international liquidity and as anchorages for their neighbouring currencies. Yet multilateral governance remains essential for preventing a drift towards inward looking continental blocs. Multilateralism must rest upon the cooperation among the three major currency suppliers, as the core of the G20, and upon a strengthened role for the G20 dominated IMF.

The USA: towards a soft landing of the dollar

The US is both the pivotal global player and in fact the weakest link of the three major economic players because of the relative size of its private and mainly public debts which have been translated into a dollar denominated external debt (94.3% of GDP). Correcting the external imbalance (the current account deficit is 3.1% of GDP in 2011) will therefore call for a severe adjustment of both households and the State. The first adjustment has already started to increase their savings rates if only because of the threat to jobs and wages, which slow growth prospects bring about. The challenge is more serious with the State deficit (8.9% of GDP compared to 85.3% in the eurozone) and public debt (93.25% and 85.3% respectively). The problem stems from the low level of the US budget as a proportion of GDP compared to EU. As a proportion of collected taxes, the debt level is 216% in the US against 191% in the eurozone.[7] The reduction of the debt/GDP ratio will therefore call for an increase in taxes, which goes against the very deep instincts of a majority of US voters.[8]

If the American Congress proves unable to strike a bipartisan deal on restoring the health of the public finances, the risk, already evoked by some rating agencies, of a degradation of American debt is becoming a possibility for the first time ever. This could trigger the acceleration, despite the capital losses this would entail, of a restructuring of foreign portfolios away from the dollar, including China, the main creditor, and eventually a run on the dollar. The damage caused to the world economy is difficult to assess.

In reality the US is confronted with a triple challenge: i) restoring a balance between debt and growth, i.e. giving up the recourse to debt as a way to stimulate growth; ii) as a consequence, making tough fiscal choices which imply both higher taxes and a trade-off between domestic expenditures, e.g. health, and strategic ambitions; and, iii) changing the American lifestyle to adjust it to the constraints of climate change whilst recognising that the country has been built up on fossil energy-based mobility.

These three drastic changes would be eased by a sharing of efforts with the rest of the world. Only a multilateral governance system can help the US in discharging their monetary, strategic and climatic responsibilities.

The Eurozone: towards a reliable alternative to the dollar as a "polycentric currency"

---

[7] OECD Statistics online 2010

[8] Note the rather high level of non voters among US citizens, mainly from the lower income range.

The EU, confronted with the volatility of the dollar in the late 1970s, decided under a Jenkins-Schmidt-Giscard d'Estaing initiative to set up a European Monetary System (EMS) flanked by an Exchange Rate Mechanism. The latter aimed at stabilising intra-EU exchange rate variations within a narrow margin, which amounted to the establishment of a fixed exchange rate among European currencies pegged to a currency basket. In fact, the system operated like a D-mark zone, with the Bundesbank dictating the interest rate policy to the other countries, with high rates in the post reunification phase. After 10 years of functioning, the EMS confirmed the validity of the Padoa-Schioppa theorem, the so-called "triangle of incompatibility": the combination of the free movement of capital, fixed exchange rates and autonomous monetary policies does not work, something must give. Eventually in the case of the EMS, it was the national monetary policies that were replaced by a single monetary policy. The switch from a multiple-currency system to a single one, the euro, took less than a decade between the collapse of the EMS in 1992 and the birth of the eurozone, regrouping first eleven EU countries in 1999 against seventeen today.

The project, eased by German reunification and whose political motivation was the correlative need to anchor a larger Germany more firmly into Europe, was conceived first as a currency area, not as policy space. The main economic rationale of the eurozone was to tear down the last barriers to the four liberties of circulation (people, goods, services and capital) within the Single Market, i.e. the monetary transactions costs. The idea of sheltering the new bloc from external shocks was there too, but without specific additional tools. In fact the eurozone was a bold but hazardous project at the start: it was a currency without a government. Only an independent European Central Bank (ECB) was created as an institutional actor for the Economic and Monetary Union: moreover it was assigned the single and narrow objective of controlling the money supply and the short-term interest rates so as to keep core-inflation at a low level (below 2%). The hope of the "euro fathers" – Delors, Kohl and Mitterrand - was that the dynamics of integration would gradually bring in the euro toolkit, i.e. the economic governance policy instruments and institutions needed for ensuring cohesion and growth. The bet was huge and risky since the eurozone, being rather a heterogeneous patch of countries, was not meeting the Mundell criteria for an optimum currency area: it was exposed to asymmetrical shocks; there was no mobility of labour across countries and nominal wages were rigid. The loss of the nominal exchange rate as an adjustment tool was therefore likely to prove expensive unless a federal budget would act as a redistribution mechanism between countries as they were confronted with different phases of the economic cycle, and as an instrument of real convergence acting upon the structure. But the EU budget remained stuck to a 1% of GDP ceiling. In such conditions, it was obvious from the start that any serious difficulty in the world economy would put the eurozone in jeopardy. Its vulnerability was further aggravated by diverging competitiveness and fiscal performances between peripheral and core countries, under the umbrella of common low interest rates and strong exchange rates which eventually proved detrimental, respectively, for catch-up countries such as Spain and Ireland and non-competitive economies such as Portugal and Greece.

The current crisis brought about by financial markets' concerns for the sovereign debt sustainability of some peripheral countries, is today forcing the EU to remedy the main fault-lines of the eurozone against a background of recurrent tensions on the financial markets. So far the EU leadership has been able to secure the necessary institutional changes on time, so as to resist attempts by market forces either to make a country default or to get it out of the eurozone, which could trigger-off the unravelling of the eurozone and threaten the very unity of the EU. Since the launching of the euro, a huge enlargement of the EU has taken place (2004), bringing on board twelve more countries, most of them ex-communist countries from Central and Eastern Europe. The integration of these countries is taking time and for the time being, the EU-27's unity remains a challenge: the new Member-States are still in the process of absorbing the heavy pack of EU-legislation and modes of operation, and they are not ready for the new quantum leap that further integration progress would make necessary. Moreover, even within the historical hard core of founding countries, the mood is not presently in favour of new EU progress. Nevertheless, progress is made step by step under the leadership of the European Council. Yet the future remains fraught with dangers.

The EU-27 indeed carries the burden of an excessive public debt which is, in some countries, the legacy of an ill-functioning of democracy which has allowed for structural deficits to build up, and in others the consequence of the 2009-2010 anti-cyclical fiscal stimulus or, in some cases, the cost of the rescuing of the private banking sector. The ECB has been pursuing an accommodating policy through low interest rates and refinancing the peripheral countries' debt, going up to the limit of its mandate. But growth prospects will remain low in the EU for the upcoming decade. Several factors are at work here, all of them exerting a deflationary pressure on global demand: the need to restore the health of public finances, the rising trends of commodities, food and energy prices, and the vulnerability of the banking system. The growing threat on jobs might also encourage precautionary savings. Moreover, the EU's growth performance will be handicapped by the combination of ageing and innovation deficits. But the main challenge for the EU will be to maintain its unity which is also the key to the openness of the EU market.

The EU is presently undertaking two main important legislative works both aimed at stabilisation: regulation and supervision of financial markets; and, eurozone economic governance:

- The first is about stabilising finance through an EU-wide system of regulation and supervision in line with the Financial Stability Board's recommendations. The purpose of the legislation is key, but limited: stability and more responsibility for the banks with the view of limiting moral hazard through a strengthening of their capital ratios and limitations on derivatives;

- The second is about strengthening the integrity and the viability of the eurozone: the efforts here are all geared towards greater fiscal discipline and labour flexibility, with a financial stability mechanism aimed at preventing sovereign defaults through joint EU/IMF interventions, a rather odd tandem.

Whether this will suffice to provide the basis for a stable and strong euro remains to be seen, or is the euro deemed to be strong only because the dollar is weak? On top of slow growth, a euro out of line with the competitiveness needs of the eurozone might eventually result in a protectionist backlash in the EU.

The rise of China and the emergence of an additional international currency

China's economic miracle, following the path of the flying geese pattern initiated by Japan in the 1960s, has been the real driver of global change, steering the BRICS in their emergence process. What makes the Chinese route to rapid and massive development so conspicuous is that China opted, in a very experimental and gradual fashion, for an heterodox development strategy by combining the strengths of global market capitalism and state capitalism. On the one hand, China would provide the necessary infrastructures in time and quality, and an educated and highly motivated labour force would be subject to the authoritarian rule of the CCP. On the other hand, foreign companies would act as vehicles for access to badly needed technology and as gates of entry into large foreign markets. The funding of massive investments in export industries has been being ensured by the high savings of Chinese households through the state-controlled banking system. China's fast rising trade surpluses stem mainly from its huge competitiveness differential, achieved until recently in the low segments of the global value chain which implies huge imports of components from the neighbouring countries. But China is on the way to climbing up the technology ladder.

China has opted for a partial convertibility of the Renminbi (RMB), i.e. not extended to the capital account. It retains therefore partly the possibility to control its exchange rate through pegging the RMB to the dollar in varied guises.

Key to the pegging is the sterilisation of capital flows generated by China's current account surplus. Sterilisation was for a long time achieved though massive purchases of US T-bonds leading to the building up of huge foreign exchange reserves. This was a way for China to exploit the addiction of profligate American households to cheap manufactured exports from China while diminishing the risk of trade protectionism from the US Congress. The entry of China into the WTO in 2001, limited that risk. But the Asian crisis of 1997-1998 and its handling by the IMF under US influence had been somewhat reminiscent of the vilified concessions episode in the recent history of China. During the crisis, China kept its currency at a steady level, not accompanying the depreciation of East Asian currencies and thereby relieving these economies from an additional concern. At the opposite end China promoted currency swap mechanisms among Asian countries in the framework of the Chang Mai agreement (1998). This paved the way for further regional monetary cooperation in Asia with the view of sheltering their economies from US-led IMF intrusive tutorship in the future. Meanwhile several emerging economies opted for an under-appreciation of their own currencies in line with the depreciation of the dollar. Although the initial driver behind the huge structural current imbalances between America and China is the excessive US propensity to consume, leading to an excess of investment over savings, there is also some truth in the argument that the under-appreciation of the RMB, whose magnitude is highly controversial among specialists, did not ease America's efforts of adjustment, leaving imbalances at a dangerous level for the stability of the world economy.

Today China's growth performance remains both high and fragile. Despite very clever macroeconomic management by the Chinese authorities, as well as the long-term vision and planning of the CCP, China is confronted with huge short-term and structural challenges which might hamper its development potential in the future: among the first, domestic inflation, the slowdown on Western export markets and the potential volatility of the dollar; among the second, the shortage of arable land, the exposure to natural disasters, the large social and regional income gaps, the severe degradation of environment linked to both quick industrialisation and massive urbanisation.

China might also suffer from severe fault-lines in the financial sector which haven't surfaced yet, but which can be deduced from overcapacity in some sectors, including first and foremost real estate, and from the risk of a stock exchange bubble. China's central command of finance has proved a powerful tool of industrial policy, but it has certainly been diverted, through corruption or for political reasons, from a rational use of finance. This poses a twin problem: the real productivity of investment is sometimes questionable while the remuneration of households' savings is not high enough. The fragility of the financial sector which has been luckily sheltered from the Western financial crisis by capital controls, might appear as the Achilles heel of China as it gradually opens up its capital markets and relaxes its controls in the decade ahead. China has indeed at least three reasons to envisage the gradual opening up of its capital account: i) the strengthening of the RMB would help fight inflation; ii) the better functioning of the financial markets would ease the emergence of a more innovation-driven economy and relax the need to accumulate households savings; and iii) a stronger RMB and a better remuneration of savings would facilitate the move from an export-driven to a domestic-demand growth model. The first attempts made by China to test in Hong Kong and Singapore the international use of the Yuan, suggest that the monetary authorities are envisaging this evolution in the near-future. In fact, it has started in an experimental mode at a significant scale. China will then be confronted with the need to keep control over finance so as not to fall into the trap which the US and Europe have fallen. Strong ethics is indispensable for keeping the genie of finance in the bottle. This would be the reality check of the imprint of communism on market capitalism in China.

Conclusions

The abundance of liquidity left over from the bailing-out of Western banks following Lehman Brothers' bankruptcy, and from post-crash stimulus measures such as quantitative easing both in America for rekindling growth and, to a lesser extent in Europe, for preventing a sovereign default within the eurozone, has left the world economy awash with cash with the inherent risks of new bubbles and increased speculation particularly on commodity prices. Therefore, market and policy failures in the monetary and financial sphere remain a serious risk for the world economy at large for the decade ahead. A strong and genuine IMS would certainly help to cope with this difficulty.

But the very idea of a centrally unified monetary system looks today more remote than ever despite the IMF's recent strengthening in terms of resources and rebalancing in terms of voting rights and presence on the Board. The IMF will matter more in the future as it regains its legitimacy, not only through this strengthening and rebalancing, but also by departing from the "Washington Consensus". But its role will be effective if the close macroeconomic cooperation of the three largest economies clears up the main difficulties that lie ahead.

The world economy must indeed first and foremost get rid gradually of the large structural current account imbalances on which real convergence has built up, in particular between China and the US, and gradually bring down the excess of liquidity. The world financial and monetary system will have therefore to go through a transition where cooperation among major currencies will have to pave the way for the emergence of a Bretton Woods III as a truly multilateral and universal SDR-based system.

Such trilateral coordination should aim at improving the world's stable growth prospects through policy adjustment in the three major economies. Firstly, there is a need of raising long-term savings rates and stabilising public finances in the US, since the "exorbitant privilege" of the dollar seigniorage will be in the future severely restricted, even if the dollar remains an important international currency. Secondly, China will have to reshuffle its financial system so as to increase its effectiveness and resilience in order to move gradually towards the full convertibility of the yuan, whose appreciation would defuse the commodity-driven inflation and stimulate domestic demand, turning China from a surplus into a trade deficit country attracting foreign savings from the advanced countries. Thirdly, the EU must first and foremost turn the monetary union into a political union with the full attributes of a real power. This means to encompass both currency and defence, since the two are closely linked in the relationship of a country or a confederation of countries with the rest of the world. Growth in Europe must rest upon a robust and sustainable social model because cohesion is in Europe a condition of stability and openness. But this implies that Europe puts oversized finance back into the riverbed.

Hyper-financialisation as it has developed over three decades, is incompatible with any social model since the sharing of the value added is too biased in favour of the global shareholder and of the global financial industry. So the genie of deregulated finance should be put back in the bottle, a very challenging task indeed. Ideally financial regulation standards and supervisory institutions should be agreed upon within the G20, through the normative work of the FSB in Basel. Nevertheless, regulatory convergence could prove unattainable because competition among established and rising global financial centres would fuel a regulatory race where the collective preferences with regard to financial risk aversion make a difference and the weight of the banking lobbies another one. In such an occurrence, each global player should opt for the type of financial regulation and supervision that prevents destabilisation, tax evasion and criminal activities even if it implies strict surveillance of capital flows. The free movement of capital should indeed not be treated as an absolute must, but as a global public good once capital is neither under-regulated nor under-taxed. This condition implies that financial offshore centres opt for multilateral rules and norms in terms of financial regulation, and cease to act as tax havens.

World peace and prosperity rests on strong multilateral governance for delivering key global public goods: free trade, fair use of natural resources, the climate, and an effective international monetary system encompassing finance. The deregulation of finance was a major mistake by the West. Without a disciplined and reasonable financial sector, no monetary system can work effectively.

List of further readings

Aglietta, M. , Berrebi L., (2007) Désordre dans le capitalisme mondial, Odile Jacob.

Bénassy-Quéré, A. , Pisani-Ferry, J., (February 2011), The Long March Towards a Multipolar Monetary Regime, Cahiers CEPII.

Eichengreen, B. (2011), The Exorbitant Privilege: the Rise and Fall of the Dollar and the Future of the International Monetary System, Oxford University Press.

Rajan R. G. (2010), Fault Lines, Princeton University Press.

Multilateralising the International Monetary System (Possible collaboration between the EU and China)

2011/6/13

Zhou Hong, Chen Xin, Xiong Hou
Institute of European Studies
Chinese Academy of Social Sciences

Summary

The recent international financial crisis and its aftermath have prompted many international players, including the United States (US), the European Union (EU) and China, into thinking of a major reform of the current world financial system. However, due to the lack of common understanding on the issues to be targeted and prioritised in the upcoming reform, major players find themselves finger pointing at each other as the culprit for the chaotic international financial situation, and calls for reform have gone in many different directions. Before launching joint efforts for the cause of rebalancing the world economy and restructuring the international financial system, a common understanding, an extensive dialogue and a shared strategy and roadmaps among key players on the issues to be tackled are needed.

To evaluate the basic characteristics of our time, we found that the theoretical framework erected by Karl Polanyi more than six decades ago continues to be valid. According to Polanyi, when the balance of the four institutions of western civilisation - namely, the balance of power, the gold standard, the self-regulated market, and the liberal state - was broken, especially after the fall of the gold standard, the world was set on fire by catastrophe and war, which brought about the collapse of the old institutions and the emergence of the new institutions.[1]

The new institutions built upon the ruins of World War II continue to follow the basic principles of the pre-war period. The four new institutions shaping the post-war era are: the Pax Americana, the Dollar Hegemony, neo-liberal market capitalism, and the assertive State promoting universal values. The down-turn of neo-liberal capitalism marked by the financial crisis of 2008, and the accumulated imbalances between the dollar hegemony and the world system as a whole, instigates vacillation of the world system and ensures a fundamental change is at the corner.

As correctly pointed out by Pierre Defraigne, the current international financial system had major deficiencies from the outset of its birth. Designed as an international system governed by common rules, it is not immune to the politics of private interests rooted in the national soil. The

---

[1] Polanyi, K. (1963) The Great Transformation: The Political and Origins of Our Time. (Beacon Press Inc., fourth printing), p. 3.

fundamental principle for the international financial system, i.e. the “Washington Consensus”, works hand in hand with Dollar Hegemony without sufficient checks and balances. Under this hegemonic economic and financial order, underrepresentation of emerging powers and the developing world, together with an insufficient democratic process in decision making, signify the major structural weaknesses of the system.

Within the financial hegemonic order, the weakening of the American economy does not lead to lesser power on the part of the US, on the contrary, the international system has been more and more utilised for the realisation of US national interests, represented by a system of dual deficit (budget and trade) and a credit influx into the international market. While a handful of countries accumulate reserves as a safety net, as the main reserve issuer the US matches this with running large deficits. The imbalances and consequent huge cross-border financial flows put great stress on the financial intermediation process. Since a single sovereign currency is acting as a global currency, the US is given the power to manipulate with the dollar exchange rate for its own interests and at its own will.

In this situation, Chinese economists engage themselves into heated debates and have arrived at some consensus such as:

- The IMF has been watching poisonous capital entering the world market without sufficient surveillance, warning or disciplining and thus should strengthen its monitoring power by undergoing a major reform;

- The US dollar enjoys reserve currency status but takes a laissez-faire policy vis-à-vis cross border speculations, and on top of it, adopting a unilateral policy of allowing more dollars lash against the international financial market, and thus should be more strictly monitored and checked;

- Some developing countries, accepting advice from the IMF on the liberalisation of capital accounts, are facing the dual challenges of retreat of capital back to developed home countries and exposure to international speculation, and thus should receive more professional advice and financial assistance, etc;

The mainstream Chinese economists think that a major reform of the international financial system is desirable for the promotion of fair global trade and investment. They argue that:

- The improvement of Special Drawing Rights, (SDR or “Paper Gold”) and the realignment of currency exchange rates should be taken as an important reform step, because under the current situation, neither a return to the gold standard, nor to a system of a dollar standard, form realistic options.

- As the SDR cannot take over the roles of major reserve currencies such as the dollar and euro in the short run, multilateral surveillance over the largest currencies as a policy choice is strongly recommended. The crux of multilateral global economic governance rests with: first, an effective coordination among partners with different interests; second, realistic expectations and shared value systems among important players; third, operational multilateral surveillance over the most influential currencies and economies; forth, establishment of an early warning system for upcoming crises; and fifth, universal adoption of stricter self-discipline. The IMF as the institution for global financial governance should take over these tasks;

- To meet the goal of equity of the IMF, more democracy and transparency in the governance of multilateral institutions is considered to be an important insurance for a sound international financial system. The dominating role of the US needs to be changed and first steps have already been taken, with strong European support, towards bigger shares and greater voting weights for the BRICs. Further reform along these lines is needed, or a de facto American hegemony will remain unaffected. In addition, China is disproportionately underrepresented in the twin institutions, especially in the higher posts, and this should be reversed.

To sum up, the reform of the international financial system is desirable for regaining financial stability and efficiency and the direction of the reform should be leading towards multilateralism. It is workable too if most members reach consensus on targeting the imbalances and agree upon common rules of the game and for the healthy banking sectors; on embracing different development models; and on establishing a multilateral system, allowing regional arrangements based on subsidiarity. However, the adaptation to all of the above mentioned measures depend, ultimately, on a shared understanding and collective efforts for making things work better and not for gaining upon others' losses. For reaching this level of consensus, China and the EU should remain in very close dialogue and try to develop cooperation.

The world financial system and its embedded deficiencies

The multilateral agreements on the establishment of the International Monetary Fund (IMF) and the World Bank (WB), known as the core institutions of the Bretton Woods system, have been widely understood as an optimal solution to the economic recovery and international development needed at the time. These institutions, built on the basic principles of market capitalism, were born with embedded deficiencies, including those of imperfect competition, asymmetrical flows of information, and above all the imbalances of national powers behind business competition, occasionally turning competition into conflicts and hostilities among nations.

Based on the learning from the two World Wars, free trade and finance were reemphasised by the Bretton Woods institutions, together with safeguards, notably the mechanism for the balance between the real economy and liquidity, and with stable international exchange rates. It was a system typically represented by the pegging arrangement of the dollar with gold and other currencies with the dollar. In addition, to extend the market, private capital was mobilised and channelled by the World Bank into investment for development.

This system, however, is not immune to the politics of private interests rooted in the national soil, as pointed out by Pierre Defraigne. In the early 1970s, the weakening of American economic competitiveness, followed by more imports from Europe and Japan, led the US to adopt a credit expansion policy, the termination of the dollar's gold convertibility, realignment of key currency exchange rates, dollar depreciation, and the diversification of international reserves. The Bretton Woods system collapsed, but the twin institutions, the IMF and the World Bank survived. The concept of SDR emerged, but remained in theory. The *dollar standard* was introduced to replace *gold standard*, but without a stabiliser. Other currencies continue to be begged with the dollar, yet the dollar is no longer tied to gold. The result is "a new system without a system", an age of *dollar hegemony*. The key characteristic of such a system is to allow the US to export its own debts, and for the rest of the world to deal with the contingencies created by US policies.

The special position of the dollar goes hand in hand with the US' overall hegemony in the world. Balances and stability have been broken several times, mainly depending on the US, as the world's only hegemon, willingness to assume responsibility. Because of the inadequacy of democracy and the lack of the balance of power in the fair determination of exchange rates and other decisions, the US, the main reserve issuer and the largest deficit holder, could deploy "exorbitant privilege" to weaken the balance of payments discipline on the issuer country itself, and opt for overspending.

The political arrangement of such a system allows it to proceed with structural imbalances unchallenged, as it allocated the US disproportionate power in the decision making processes of the twin institutions, the WB and the IMF. The US holds 16% and 17% of voting powers in those two institutions respectively, enough to jeopardise any meaningful decisions in those institutions where the passing level is 85%. As a result, the "Washington Consensus" prevailed for decades, greatly benefiting big businesses and leaving underdevelopments and imbalances intact.

With the weakening of the American economy, the hegemonic position in the international system has been more and more utilised for US national interests, represented by a credit influx into the international market and a system of dual deficit (budget and trade). While a single sovereign currency is acting as a global currency, the US is able to manipulate the dollar exchange rate for its own interests and at its own will. During the Reagan Administration, the exchange rate for the strong dollar went down, during the Clinton Administration the weak dollar went up, during the Bush Administration the dollar experienced a 40% depreciation between January 2002 and 2008, and during the Obama Administration the dollar overflows in global capital markets.

The specific feature of the current crisis is that major saving-investment imbalances and consequent huge cross-border financial flows put great stress on the financial intermediation process. Between 2003 and 2009 (measurable) global reserves increased from $2.6 trillion to $6.8 trillion – an average annual rate of increase of about 15%, at a time when global GDP grew at an annual rate of 4.4%. This amounted to a big increase in deflationary pressure. However, the fact that the reserves were held mainly in dollars allowed the US to avoid deflation, and instead run a "Keynesian" domestic policy which set the stage for an unsustainable asset and consumption boom. The global imbalances interacted with the flaws in financial markets and instruments to generate the specific features of the crisis. The US government's policy of Quantitative Easing Two (QE2) sent a clear message to the rest of the world that the US does not have the slightest desire to assume its responsibility for the US dollar's status as the global reserve currency, and the international community has to respond together to a possible collapse of the world financial system, so far backed by Dollar Hegemony.

In sum, the fundamental issue leading towards the crisis originates in the fact that the "Washington Consensus" works hand in hand with Dollar Hegemony without sufficient checks and balances. Within this hegemonic economic and financial order, underrepresentation of emerging powers and the developing world, together with insufficient democratic processes in decision making, exposed the system's structural weaknesses.

Chinese experts' views on international financial reforms

In March 2009, China's Central Bank governor, Zhou Xiaochuan urged for international financial reforms in the face of the global economic downturn. Zhou said that financial reforms and regulatory measures for international financial organisations, including the IMF and World Bank, should be on the agenda for reevaluation and reform on the platform of the G20. On another occasion, Zhou proposed the construction of a super-sovereign reserve currency as part of the international financial system reform. He pointed out that the fast spread of the financial crisis has reflected the inherent deficiencies and systemic contingencies caused by using credit-based national currencies.[2] The goal of the reform should be to recreate stable standards for exchanges which are acceptable to all countries and disconnected from the interests and decision-making structures of individual nations. The extension and restructuring of SDR is proposed as a first step to this long-term goal. Zhou suggested a series of steps toward SDR usage including the establishment of clearing relations of SDR with other currencies; the application of SDR in international trade, pricing for staple commodities, investments, and business accounting; the establishment of SDR capitals; the improvement of SDR pricing and distribution systems; and broader application of SDR in the world's major economies.[3]

China's prominent economist Yu Yongding commented on Governor Zhou Xiaochuan by referring to America's prominent economist Joseph Stiglitz who, Yu believes, shares a similar diagnosis with Zhou by arguing that a more optimal future financial system should start with an increased distribution of the SDR. An extended SDR could, according to Yu, serve to tackle three major problems: the disconnection between the reserve currency and its issuer country's current account deficit, the lack of discipline on the part of the current account surplus countries, and lack of a stable international price carrier. Yu has repeatedly warned the Chinese public and policy makers since 1996 that the imbalances of China's economy, especially that between imports and

---

[2] "Chinese central bank governor calls for financial reforms", See: <http://news.xinhuanet.com/english/2009-03/29/content_11093809.htm>.

[3] Zhou X., "A Thought on the Reform of International Monetary System". See: <http://news.xinhuanet.com/fortune/2009-03/24/content_11060507.htm>.

exports, reflect and contribute to the imbalances of world economy.[4] He proposes sharper domestic reforms, including the readjustment of economic structures and growth patterns. In addition, he suggested that China should have more direct investments in Asia, Africa and Latin America. Besides participating in the process of international financial system reform with the rest of the G20, Yu urges regional financial cooperation and gradual but steady internationalisation of the RMB.

Another prominent Chinese economist, Dr. Zhu Min, the Chinese representative to the IMF, wrote that the calls for reforming the international financial order came first from the EU countries. China agrees with the Europeans on the necessity of the reform, but argues that the first step towards a meaningful reform should start with more transparency, and with giving emerging economies and developing countries more rights of speech and more participation in rule-making processes. The second step should be the introduction of workable and effective financial monitoring standards, of early warning systems and risk prevention systems, especially a strengthened surveillance on the major reserve currencies. The third step should include the process of diversification of the international currency system, and the SDR should play a more important role in it.[5] Zhu proposed to extend the usage of RMB in bilateral trade deals and to enlarge RMB bond markets so as to raise its status in the international financial market. Concerning the IMF, Zhu believes that it should work to provide professional advice and coordination among all major international currencies, promote the extension of international trade and balanced growth, and contribute to the stability of exchange rates.

Zhu Min criticises the IMF for becoming a tool in the hands of a handful of developed countries. Its voting system, according to Zhu, clearly favours the world's richest countries to the developing world. The litigation procedures often put the purpose of development as the second importance after other goals.[6] Therefore, the voting system of the IMF should be reformed to favour developing countries more. Zhu suggests that the IMF should also be responsible for monitoring the internal economic practices, international payments and international capital flows, and extend credits based on professional standards and not political concerns. Moreover, the IMF should sit above conceptual differences, embrace diversified interests and make economic governance decisions based on multilateral principles, helping developing countries to participate in the decision-making processes, etc.[7]

Professor Li Qingyun, a Chinese State Council adviser, argues that SDR cannot become an international currency, but it can play the role of anchor to international exchange rates. As the IMF failed to play its role in monitoring the international monetary system and the Member States, it proved incapable of directing exchange rates and thus becoming a "fire fighting brigade". Li also believes that the IMF should be exercising effective surveillance on both the international

---

[4] Yu Y., (2010) Witnessing Imbalances, (SDX Joint Publishing Company, Beijing), pp. 291-308.

[5] Zhu, M., et al, (2009) Changing the Future Financial Crisis, (China Financial Publisher, Beijing). Chapter 7: Facing Future: reshaping global financial system.

[6] Ibid.

[7] Ibid.

monetary system and the Member States. He sharply criticises the United States for manipulating exchange rates and the international monetary system and calls for a major change in its monopolistic power in the field.[8] Li Qingyun even sees a hedging relation between the US and China, believing that the US is trying to encircle the RMB, and at the same time is manipulating the international financial system as well as the exchange rate.

The road towards a better international financial system

The problems in discussion here originate in the fundamental imbalances between the world financial market and its governing structure. On the one hand, the US dollar functions as the universal currency for business settlements and reserves, on the other, the political powers, and with that political interests and wills, are by far not united. Behind the exchange rate alignment, there is an interplay of vested interests.

Generally speaking, there are four alternatives in reforming the International Monetary System. One is to make adjustments within the present framework, so as to keep the Dollar Hegemony functioning in favour of US interests and at the expense of the emerging and developed countries. The global imbalances would continue until the next round of crises which might come soon. The second alternative may be the half return to the gold standard and making the major commodities like metal, oil, wheat, and soya etc, parts of the reference system of international payments. Mr. Robert Zoellick, the president of the World Bank group, clearly favours such a proposal when he suggested a new system which ‘should also consider employing gold as an international reference point of market expectations about inflations, deflations and future currency values’.[9] The third alternative has also been mentioned by Mr. Zoellick in the same article in the *Financial Times*, who argues for a system of multilateral currencies including the dollar, the euro, the yen, the pound and RMB, a system to be developed towards the internationalisation of currencies and then an open capital account. The World Bank report on *Global Development Horizon 2011* published on 17 May 2011, shares the same prospects predicting a Multicurrency International Monetary System by 2025, a system including the dollar, the euro and the RMB.[10] The fourth alternative is widely adapted by Chinese economists, which is focusing on the improvements of the SDR.

The mainstream reform-minded Chinese economists think that a major reform of the international financial system is desirable for the promotion of fair global trade and investment. They argue for the improvement of the SDR, multilateral surveillance over major reserve currencies, for more democracy and transparency in the governance of multilateral institutions, and for dealing with global macroeconomic imbalances. The implementation of these prioritised activities, however, depends upon the political will of the players involved, also upon the coordination, consensus and

---

8 Li Q. “Dialogue on exchange rate monopoly”. See: <www.cs.com.cn/xwzx/16/201011/t20101112_2666590.html>.

9 Zoellick, R. “The G20 must look beyond Bretton Woods”, Financial Times, (9 November, 2010).

10 The World Bank (2011) Multipolarity: The New Global Economy. Global Development Horizons 2011, (Washington DC).

compromises among them, and above all, upon the leadership that aims at providing a favourable monetary system and environment for all and not only for a handful of nations. Such leadership does not have to come from the most powerful nation, but will have to come from the most visionary mind.

What could be the driving forces for a major international monetary reform process? The multiple national political procedures and interests together with cultural and religious differences may hold that financial issues account for the parochial interests of nations, or even certain narrow interests within a nation, depending on the political processes there. In the short-term, there is no hope of rebuilding the international monetary system according to any of the grand designs on offer. The weaknesses of the euro and the RMB are too apparent for these currencies to constitute alternatives to the dollar. Chinese economists believe that both Europe and China have pressing homework to do. For China, there is an urgent need to further develop capital markets and to carry out the financial market reform, while at the same time internationalising the RMB, making the RMB first a trade currency, then a convertible currency, and a reserve currency. For Europe, there is a need to settle the issue of representation within the International Monetary System, and more critically, Europe has to find a more balanced and sustainable development model to be able to take the lead in the IMS.

For that reason, the age of US dollar is not yet over, and may only be transformed in a slow pace, like once happened to the pound: it continued to act as world currency even though the UK had already lost its superiority to the US in the inter-World Wars period. We are witnessing the predominance of the US dollar as an international reserve currency gradually sliding, its share declining from 71% in 1999 to 64.1% in 2006, while at the same time the share of the euro is increasing from 17.9% to 25.8%. Even though the core position of the dollar remains unchanged, the direction of change is moving towards less monopoly of the dollar. Therefore, an incremental instead of dramatic reform is more likely to happen.

In the age of IMS reform and transformation, windows for collaborations between China and the EU are more open than ever before. First and foremost, China and the EU are both responsible for a peaceful transformation of the IMS from dollar hegemony to a more multicurrency system. To guarantee a smoother transformation, both EU and China need to make commitments of stabilising their own currencies on their respective home fronts and adjusting their economic and financial policies accordingly. For China, steady steps are to be taken towards the internationalisation of the RMB, and with those steps more openness and a more balanced and sustainable development model to be adopted. China, for the first time, decided to participate in the World Bank organised International Comparative Project (ICP)，so that prices in China can be comparable with other countries. Currency swaps are more and more widely used as a normal practice between China and trading partners. For the EU, challenges are distinctively different. The goals of raising productivity and competitiveness can only be achieved in a more open, more flexible and more prosperous world market including China.

Secondly, in order to attain the common goals in achieving more balanced capital flows and more stable exchange rates, and avoiding “currency wars” as repeatedly predicted, reforms on the rules of the game of the IMS have to be taken as important and concrete steps. The new rules of the game often emerge as the results of political arrangements. The new arising platform of the G20 provides for such a new political decision making setting. Official working groups seeking to make changes to the IMS are already making proposals and, as an encouraging beginning, the process starts with a multilateral instead of unilateral fashion which may bring about fairer play in the new system. In a multilateral setting, China and the EU as two important uprising economies ought to be thoroughly represented. This representation partly depends on reformed organisational arrangements of posts and seats, partly depends on the power of persuasion by each of the important players including China and the EU and the ability to reach consensus between all.

Thirdly, between China and the EU there are many common or shared positions such as creating an alternative anchorage to the dollar, enforcing better regulations, preventing protectionism etc., the issue is how to turn common positions into common actions. There are already many concrete initiatives made by Chinese experts as mentioned above. There is more thinking and proposals by Chinese economists around the issue of bridging the current situation with a future blueprint, for example creating a regional monetary union within ASEAN, or even in bigger areas in Asia, so as to make the internationalisation of the RMB a natural evolution. But they are at the same time recognising that China is still underdeveloped in finance vis-à-vis most of the developed countries. Despite China's size, in terms of assets and liabilities, none of China's banks measure up to the clout of major western banks in international financial intermediation. This discrepancy might explain in part why China believes it needs to hold a large amount of foreign exchange reserves as a buffer against external shocks.

The Chinese believe that the EU's role in the transformation of China's role in a multilateralised IMS is crucial, as the EU could convey a clear signal to support a goal of a multicurrency system on the highest political level, the EU financial sectors could provide valuable technical assistance to the reform and opening up of China's financial sector. If such an opening up process went smoothly, the EU banks may benefit by gradually acquiring access into China's financial market. China and the EU could even start discussing currency swaps between the euro and the RMB, which may bear double positive fruits: for the convenience of large volumes of trade transaction settlements between China and the EU, and for the confidence in, and acceptance of, the RMB as an important currency in the world by China's most important trading partner, the EU.

China shall continue to support the stability of the euro. In the backdrop of the European sovereign debt crisis, China continues to hold and purchase European sovereign bonds. In the longer-term, China showed the willingness of supporting and even learning from the EU's efforts in strengthening economic governance on both EU and Member State levels.

In terms of international financial regulation, the Chinese do not argue for more regulation but for better regulation. The micro-regulations in Basel II must be supplemented by macro-regulations and the endogenous risks must be recognised and taken into account. The crisis is nothing but yet another instance of an all too familiar boom and bust cycle, a type of crisis that repeats itself over and over again, and cannot easily be cleared up by specific or even new and complex instruments, institutions, individuals or information. Moreover, reinforcing a regulatory mechanism that has failed to mitigate unstable cycles is not likely to be a successful strategy.

Some Chinese believe that the prevention of banking system failures is more important than the prevention of crisis in other industrial sectors because the costs of a banking system crisis to society are invariably enormous. Effective regulation of the banking system forms another commonality between the EU and China, where they may be able to share their policies and experiences and further extend this understanding in rebuilding the international monetary system. Regulators from both China and the EU, for example, could increase the existing capital adequacy requirements (based on an assessment of inherent risks) by, first relating to average growth of credit expansion and leverage. Regulators should agree on the degree of bank asset growth and leverage that is consistent with the long-run target for nominal GDP. Should the credit expansion exceeds the reasonable and agreed degree, the EU and China could together to increase the capital charge rate. The purpose of this capital charge is not to eliminate the economic cycle, something which would be unrealistically ambitious. Its aim is to ensure that during the boom the banks put aside an increasing amount of capital to be partially released when the asset prices fall back.

Secondly, capital charges should be related to the mismatch in the maturity of assets and liabilities. When regulators make little distinction on how assets are funded, there will then be a tendency for financial institutions to rely on cheaper, short-term funding, which increases systemic fragility. Therefore, the Geneva Report proposes to adjust market-to-market accounting to provide a further incentive to reduce maturity mismatches[11], and measures such as imposing a capital cost should be discussed together by partners, including China and the EU. So far, Europeans have proposed many good ideas on the improvement of international financial regulation, and China, generally speaking, has gone along with the EU proposals. As China is still inexperienced in filing proposals and initiating reform measures, a learning process with an experienced partner such as the EU forms a desirable policy choice by China. Technical and professional working together between important partners such as China and the EU on global issues gives political impetus for other multilateral endeavours. In addition, national initiatives should not be overlooked. China as a player is more ready than ever to contribute to a stable and more balanced world monetary system by changing its own development model as declared in the 12th Five Year Plan and through coordination with all partners. China is also open to discussion on a basket system acceptable to all traders in the longer run and a negotiation on the exchange rate in the short run. The regionalisation of RMB as a midway strategy towards full convertibility is taken into consideration and is undergoing experiments. Bilateral Swaps are widely adopted. Internal reforms towards more balanced development between urban and rural, coastal and interior, and transitions towards a more environmentally-friendly and low-carbon economy in China are speeding. Such developments should be able to prepare China with more capacity to play as a balancing power on the world stage.

---

[11] This paragraph is cited from <www.voxeu.org/index.php?q=node/2872>.

Stability, balance and development are the goals for international monetary system reform, to realise those goals, certain moral codes of conduct should be established for the international reserve currencies, such as a stable measurement and clear supply rules, flexible adjustment of supply according to the changes of needs, and disconnection from the economic situation and interests of the home countries. In order to turn this vision into practice, "unusual vision and courage"[12] is indispensible from the part of political leaders, especially political leaders in the major economies such as the US, the EU and China.

[12] Zhou, X., "A Thought on the Reform of International Monetary System". See:<http://news.xinhuanet.com/fortune/2009-03/24/content_11060507.htm>.

China-EU Cooperation in the G20 from a Chinese Perspective

Jiang Shixue
Institute of European Studies
Chinese Academy of Social Sciences
jiangsx@cass.org.cn

With the rise of its economic strength, China has increasingly exhibited its willingness or even eagerness to integrate itself with global organisations. The Group of Twenty Finance Ministers and Central Bank Governors (G20) is the premier forum for China's international economic development, which promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. Undoubtedly, it is in the interest of China to take an active part in the activities of this forum.

The European Union (EU) is the world's most important economic grouping. Despite the individual membership of Germany, France, the United Kingdom (UK) and Italy in the Group of Eight (G8), the EU has its own seat in the G20. Since the establishment of the G20 in 1999, the EU has considered it an important place to discuss and coordinate global economic policies. For each of the G20 Summits, it has put forward an ambitious wish-list. As a matter of fact, the first G20 Summit was proposed by French President Sarkozy and the EU Commission President Barroso.

China's and the EU's Positions towards the G20

China is against the notion of a G2 (the United States and China) or "Chimerica",[1] and has always maintained that the world order during the post-cold war era should be established upon the principle of multilateralism. It is interesting to note that, on the one hand, China does not believe that the G8, composed of the major developed nations and Russia, should have the legitimacy to govern the world; on the other hand, the United States thinks that China is not qualified for G8 membership. But China has been invited to attend the G8+5 gathering since 2003.[2] No less important is the fact that few people in China say that it is imperative for China to

[1] The G2, first proposed by C. Fred Bergsten in 2005, refers to the extraordinary importance of the bilateral relationship between the United States and China. "Chimerica" was first coined by historian Niall Ferguson and economist Moritz Schularick in late 2006. They argue that saving by the Chinese and overspending by Americans led to an incredible period of wealth creation that contributed to the global financial crisis of 2008–2009.

[2] The five developing countries are: Brazil, China, India, Mexico and South Africa.

join the G8, making it a G9.[3] Some cite the example of Russia, which has been seen as “a little boy” in the G8.

After the current global financial crisis broke out in 2008, more and more people around the world believe that the importance of the G8 has been greatly curtailed and some even say that it is almost dead. At the same time, the G20 has been given greater importance and expectation in dealing with the global financial crisis and other global issues. As the Leaders’ Statement of the Pittsburgh Summit declared, the G20 was designated to be ‘the premier forum for our international economic cooperation’.[4]

China expressed its interest in the G20 from the very beginning. In 2005, China acted as a chair and hosted the Seventh G20 Finance Ministers and Central Bank Governors Meeting, at which President Hu Jintao delivered a speech, saying that ‘in light of the current international context, G20 members must engage in flexible and pragmatic dialogues on the basis of equality and mutual benefits, seeking common grounds while shelving differences.’[5] He also said, ‘the G20 mechanism has included in its members the primary players of both the developed and developing countries as well as those in transition. Measured by population size, they account for 2/3 of the world total; by GDP, over 90 percent and by foreign trade, 80 percent. All this has made it a widely representative and influential international economic forum.’[6]

President Hu Jintao has participated in all the G20 Summits and believes that the G20, with its broad representation, offers an important and effective platform for concerted international efforts to counter the international economic and financial crisis.

China is satisfied and confident about its role in the G20. Published by the official web page of the Central People’s Government of the People’s Republic of China, one article reads, ‘at each G20 Summit, China was a focus of attention, and at each G20 Summit, President Hu Jintao’s speech received warm reaction from the international community. While the G20 Summit has become an important platform to join hands so as to deal with the international financial crisis and strengthen global governance, China has exhibited once again its wisdom and strength as a large developing country on this platform.’[7]

While some people in China expect that China would play a more important or a decisive role in the G20, others tend to hold a cautious view. As Yuan Peng, a Chinese scholar, points out, China needs to take an active part in the G20, but it must do what it can in a realistic way. After all, China is still a developing nation and over-expectation from within or outside will be counter-productive.

---

[3] Some Chinese scholars say that Russia is marginalised in the G8, and has not reaped any significant benefits from this membership. See: http://news.xinhuanet.com/world/2008-01/10/content_7398990.htm

[4] See:<www.pittsburghsummit.gov/mediacenter/129639.htm>.

[5] See: <http://english.gov.cn/2005-10/16/content_78589.htm>.

[6] See: <http://english.gov.cn/2005-10/16/content_78589.htm>.

[7] See: <www.gov.cn/jrzg/2010-06/25/content_1637276.htm>.

It is important for China to guard against the West's exaggerated expectations for China to take up excessive responsibility in dealing with the global issues.[8]

The EU also attaches great importance to the G20. It believes that the G20 'has become the premier global forum for international economic cooperation and for questions of global governance - a multilateral platform for strategic dialogue with key global partners.'[9] The web page of the EU's External Action reads, 'since 1999, the G20 has contributed to strengthen the international financial architecture and to foster sustainable economic growth and development. The G20 now has a crucial role in driving forward work between advanced and emerging economies to tackle the international financial and economic crisis, restore worldwide financial stability, lead the international economic recovery and secure a sustainable future for all countries.'[10]

On 2 April 2009, the UK hosted the second G20 Summit, which was a timely gathering for the leaders to review the achievements since the Washington Summit and plan for actions in the near future to deal with the global financial crisis. The then British Prime Minister Gordon Brown said at the end of the Summit, 'this is the day that the world came together, to fight back against the global recession. Not with words but a plan for global recovery and for reform and with a clear timetable.'[11] German Chancellor Angela Merkel also said at the London Summit, '[it is] a very, very good, almost historic compromise […] we have agreed to set up a clear financial market architecture […] we have taken an important step toward creating order in an area in the world where there was previously no order.'[12]

In a speech on 18 March 2009, President Barroso said, 'the G20 must take a holistic and ambitious approach. That is the only way the world can get out of this crisis without risking a worse crisis in future.'[13] In another speech on March 2009, President Barroso said, 'the G20 will not end this crisis overnight. But it can, it must, it will, make a difference.'[14]

China's and the EU's Wish-lists for the G20

China's remarkable economic progress over the past three decades has been partly attributed to its opening up to the outside world. Undoubtedly, a negative and unfavourable external environment and weak demand from the world market would curtail its export capacity, thus

---

[8] See: <http://bbs.cntv.cn/thread-14465527-1-1.html>.

[9] "Information Note to the Commission: Preparing for the Seoul G20 summit". See: <www.euractiv.com/sites/all/euractiv/files/g20%20-%20doc%20comm.doc>.

[10] See: <http://eeas.europa.eu/g20/index_en.htm>.

[11] See: <www.londonsummit.gov.uk/en/summit-aims/summit-progress/quotes-leaders/.

[12] See: <www.londonsummit.gov.uk/en/summit-aims/summit-progress/quotes-leaders/.

[13] José Manuel Durão Barroso, "Looking ahead to the European Council and G20". See: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/126&format=HTML&aged=0&language=EN&guiLanguage=en>.

[14] José Manuel Durão Barroso, "The G20 – a unique opportunity". See: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/160&format=HTML&aged=0&language=EN&guiLanguage=en>.

hindering its growth potential. Therefore, when the G20 was expected to play a more important role in dealing with the global financial crisis, China's reaction was very positive and swift. President Hu Jintao attended all the G20 Summits, and at each Summit he would deliver a speech, explaining China's positions towards the forum and the crisis.

By comparing the wish-lists put forward by China and the EU, the following conclusions can be reached:

a) First, items 1 to 4 in China's and the EU's wish-lists seem identical (See the table below). That is to say, both China and the EU stress the importance of achieving economic recovery and balanced growth; both emphasise the need to reform the international financial system; and both oppose trade protectionism;

b) Second, the EU highlights reforms of its domestic financial system, but China does not mention a word about it. This difference might be explained by the fact that China's banking system was not seriously hurt by the global crisis and it is not fully liberalised yet;

c) Third, the EU believes that it should lead efforts to set a global approach for introducing systems for levies and taxes on financial institutions so as to maintain a world-wide level playing field. But China has not put forward any suggestions on this issue;

d) Fourth, China has explicitly expressed its wish to upgrade the role of the G20 from a forum of crisis management to a platform driving international cooperation. The EU, though recognising the importance of the G20, has not foreseen this transformation;
e) Fifth, the EU's wish-list seems much longer and covers a wider area of topics than China's.

Major Points of the Wish-lists

China	**The EU**
1. Stimulate growth	1. Achieve a sustainable recovery
2. Promote balanced growth of the global economy	2. Achieve the agreed objective of strong, sustainable and balanced growth
3. Reform the international financial system	3. Reform the international financial system
4. Oppose protectionism	4. Drive a pro-active agenda on trade
5. Build a fair, equitable, inclusive and orderly new international financial order	5. Manage and prevent crises at the global level
6. Strengthen confidence	6. Improve the functioning of financial markets

7. Intensify cooperation	7. Protect employment
8. Establish an open and free global trading system	8. Promote responsible remuneration practices in the financial sector
9. Help developing countries	9. Set up strict compensation standards
10. Change the nature of the G20	10. Support the developing countries
	11. Ensure fiscal sustainability and achieve budgetary targets
	12. Establish a system of levies or taxes on financial institutions
	13. Deal with 21st century challenges
	14. Support the Millennium Development Goals
	15. Promote energy security

Areas of cooperation

Although the wish-lists put forward by China and the EU are not totally the same, there is still wide scope for cooperation between the two sides. Particularly in the following areas, where the possibility of strengthening China-EU cooperation in the G20 is enormous.

1. Help developing countries. The EU has repeatedly promised to assist developing countries, not only in tiding over the global financial crisis, but also in helping them to achieve the Millennium Development Goals. This position is certainly compatible with China's foreign diplomacy goal. So China can join hands with the EU to move towards this end.

2. Reform the international financial system. On 25 April 2010, the 186 countries that own the World Bank Group endorsed boosting its capital by more than $86 billion and giving developing countries a bigger say. On 5 November 2010, it was announced that the IMF Executive Board had approved far-reaching reforms of the way the IMF is run. China welcomes this action, but believes that this quota shift is just the start of IMF reform. This is not the end, not even the beginning of the end, but the end of the beginning. So the EU should support China's position in this area.

3. Combat climate change. The EU is working hard to cut its greenhouse gas emissions substantially while encouraging other nations and regions to do likewise. China sticks to the principle of "common but differentiated responsibilities". As both China and the EU share similar views on the climate issue, opportunities for future cooperation between the two sides should be enormous.

4. Improve codes of conduct and regulatory regimes for rating agencies. The impact of ratings on the financial system or economic situation of a country is enormous. The international rating agencies were criticised for their role in causing market panic, which played a negative role in the Greek debt crisis. This might be one of the reasons why the EU has been insisting on regulating the role of the rating agencies. China supports the position of the EU. It is also in China's interest to dismantle the credit rating monopoly by the international rating agencies such as Fitch, Standard & Poor's and Moody's, the world's three major credit rating agencies.

5. Reduce the dominance of the U.S. dollar. Of the many reform measures for the international financial system, the most daunting task would be to improve the international currency system and promote the diversity of the international monetary regime. Many European officials have expressed similar concern about the dollar's recent fall against the euro, which works against European exports. Therefore, the EU should support China's wish to reform the international monetary system.

6. Institutionalise the G20. A successful global platform to deal with global issues needs to meet three conditions: legitimacy (or representativeness), efficiency and effectiveness. The G20 seems to have acquired the best of the United Nations (legitimacy or representativeness) and the G7 (efficiency). But the G20 needs to improve its effectiveness by avoiding the danger of becoming a "talking shop". In order to make it more effective, the G20 should make itself more institutionalised, it requires: a permanent secretariat; a set of rules governing decision-making; and a functional mechanism of implementation. Where will the G20's permanent secretariat be seated? What are the rules and how should these rules be made? How is the EU represented in the G20? China and the EU can support each other on these important issues. China and the EU need to use their influence to push for the process of its institutionalisation. An institutionalised G20 would make it more effective, more efficient and more legitimate, thus better serving the interests of all the nations in the world.

Ways and Means of Cooperation

To strengthen cooperation in the G20, China and the EU should proceed along the following ways and means:

1. Respect each other's red lines. President Sarkozy once said, France as the Presidency 'cannot ignore each country's red lines.' Indeed, no country would like to see its "red line" crossed by others. What is China's red line?

China does not support the use of real exchange rates and reserves as indicators of monitoring world economic imbalances. According to the Communiqué of G20 Finance Ministers and Central Bank Governors meeting in Paris in February 2011, it "agreed on a set of indicators that will allow us to focus, through an integrated two-step process, on those persistently large imbalances which require policy actions." The indicators include: public debt; fiscal deficits; private savings rates; private debt; the external imbalance composed of the trade balance and net investment income flows and transfers.

The G20 Finance Ministers and Central Bank Governors meeting in Washington in April of 2011 agreed on indicative guidelines against which each of these indicators will be assessed.

The western media said, due to China's opposition, exchange rates and currency reserves were not included in the indicators. As a matter of fact, China was not “hijacking the G20”, nor is it “19 vs. 1” in the G20. As some Chinese commentators point out, Finance Minister Xie Xuren and Central Bank Governor Zhou Xiaochuan were speaking on behalf of nearly one-fifth of the world‘s population.

China’s foreign exchange reserves and RMB’s exchange rate are not villains causing the global economic imbalance. First, China is not the only country that has accumulated a great amount of foreign exchange reserves. Second, almost two-thirds of China's trade surplus is created by foreign investment. Its accumulation of foreign exchange reserves is a win-win outcome for both China and foreign investors. Third, there are other countries that have maintained a trade surplus for a prolonged period of time. For instance, Germany has kept this surplus for 58 years and Japan for 29 years. China has had it only since 1994. Fourth, technical factors matter. The 1990-2004 period was selected for the measurements as it was claimed that these years witnessed a build-up of massive trade and financial imbalances that helped spark the recent financial crisis. Therefore, the result might be different if the period was not for 1990-2004, either shorter or longer. Moreover, different weightings in the four different approaches to be used to measure the imbalance would turn out different results.

However, China has promised to proceed further with the reform of the RMB exchange rate regime to enhance exchange rate flexibility. But this process should be implemented in a gradual way.

In a press briefing during the annual meetings of the IMF and the World Bank in Washington D.C., on 8 October 2010, Zhou Xiaochuan vividly described China's policy position regarding the exchange rate issue: “westerners prefer the Western medication method that is quick but drastic, while Chinese people prefer traditional Chinese medication that is slower and gives time for different herbs to take effect.”

2. Strengthen coordination and consultation. Coordination and consultation is the core for any cooperation. The Nanjing meeting might be seen as a good example of cooperation. At the Nanjing meeting, four agreements were officially reached: 1) the need to kick-off the process of reforming the international monetary system; 2) the need to allow the RMB to have a bigger role in global finance, i.e., including the RMB in the basket of currencies that sets the value of the SDRs, whose basket now includes the dollar, Japanese yen, euro and British pound; the need to keep the role of the U.S. dollar as it is now; 3) The dollar will not be replaced by SDRs in the foreseeable future; and 4) the need to reform the IMF to make it more diverse and representative so as to offer the emerging market economies a big say in it.

3. Maintain favourable political conditions. Favourable political conditions are the prerequisite for cooperation between any two sides. It is encouraging to see that China-EU political relations have crossed over the recent years’ hurdles and are proceeding forward smoothly. If the two important players can continue to respect each other’s political systems and agree to disagree on certain issues, there will be a win-win scenario for both sides.

Moreover, both China and the EU need to persist in their endeavour to consolidate the Comprehensive Strategic Partnership. Some Europeans and even some Chinese doubt the fact that there is such a partnership as, in their eyes, China and the EU have yet to overcome such big hurdles as the “market economy status” and the “arms embargo”. This mentality of suspicion must be eliminated so as to promote cooperation in the G20.

4. Align China’s responsibility with its development level. This does not mean that China intends to dodge responsibility in global governance. After all, China is still a developing nation. The sad reality is, though its total GDP stands second in the world, its per capita GDP ranking lags far behind many nations of the world, let alone with the EU members.

5. Strengthen bilateral dialogues and consultations before the G20 Summit. The China-EU Summit is believed to play a very constructive role in strengthening the comprehensive strategic partnership in a spirit of equality, reciprocity and mutual benefit. The Summit should be a good occasion to exchange views on each other’s positions towards the G20. Furthermore, in order to promote China-EU cooperation in the G20, it might be productive to establish an ad hoc working group to coordinate their positions or even discuss their wish-lists before the G20 Summit takes place. Government officials and scholars can join in this group.

6. Choose the topics of common interest on the G20 platform. President Sarkozy said, ‘our first priority in our presidency of the G20 will be to implement the decisions already made.’ France’s wish-list includes: setting indicators to monitor world economic imbalances; reforming the international monetary system; strengthening financial regulation; combating commodity price volatility; supporting employment and strengthening the social dimension of globalisation; improving global governance; acting for development.

China is also concerned about these topics, but the order of priority is different. China seems to be more interested in how to: 1) reform the international financial system; 2) give developing countries a bigger say in managing world economic affairs; and, 3) maintain world economic stability.

Conclusion

Given the fact that China and the EU have increasingly become important players on the world stage, strengthening cooperation in the G20 is beneficial to global governance. Based on the comparison of the wish-lists of China and the EU, cooperation in the G20 between the two sides is very likely.

Although the wish-lists put forward by China and the EU are not totally the same, there is still wide scope for cooperation between the two sides. Areas of cooperation include: help developing countries; reform the international financial system; combat climate change; improve codes of conduct and regulatory regimes for rating agencies; reduce the dominance of the U.S. dollar; institutionalise the G20.

From a Chinese perspective, to strengthen cooperation in the G20, China and the EU should proceed along the following ways and means: respect each other’s red lines; strengthen coordination and consultation; maintain favourable political conditions; align China’s responsibility with its development level; strengthen bilateral dialogues and consultations before the G20 Summit; choose the topics of common interest on the G20 platform.

William Shakespeare said, “Now join your hands, and with your hands your hearts.” With a sincere heart, China and the EU can maximise their own interests through cooperation in the G20.

EU-China in the G20: Convergences and Divergences

Thomas Renard[1]

This paper focuses on the EU and China in the G20. The particularity of the G20 vis-à-vis other institutions studied under this project (IMF and UNSC) is that the EU is a quasi full member of it. Hence, this paper will heavily emphasise the EU over its Member States, although more research is certainly necessary to better understand the variable geometry and asymmetrical nature of the relationship between Europe and China.

This paper first gives a rapid history of the G20, focussing on a few recurrent themes, in order to possibly draw some lessons for EU-China cooperation in the forum. The paper then digs into EU-China perspectives on some core aspects of the G20 (status, membership, mandate, and the link with effective multilateralism). Finally, this paper analyses issues of convergence and divergence between the EU and China in the G20.

Lessons from the G20's history

The G20 emerged in the late 1990s, in the aftermath of the Asian financial crisis, as a meeting for Finance Ministers and Central Bank Governors, under the impulsion of Canada and the US. It was seen as a crisis management tool, but also as a means to invite emerging economies to assume a greater role in financial stability and sustainable growth for all. Paul Martin, then Canada's Finance Minister, was convinced that emerging economies needed to 'be at the table and be part of the solution'[2].

The original list of G20 members was not self-evident. It was clear that all G7 countries should be part of the broader G20, as they were driving the process, but the criteria for membership were unspecified, except for the fact that 'countries had to be systemically important to the global economy and have the ability to contribute to global economic and financial stability'[3]. Regional balanced representation was also apparently important, as witnessed by the inclusion of South Africa, but also the ruling out of extra European representation (beyond the G7 members), although it was agreed to offer a seat to the EU on the argument that it was the legitimate yet indirect representative for all EU Member States. A final unspoken criterion was the overall size of

---

1 Thomas Renard is a Research Fellow at Egmont – Royal Institute for International Relations. Email: t.renard@egmontinstitute.be. Online: www.thomasrenard.eu.

2 Martin, P. Interview conducted by Candida Tamar Paltiel, G8 Research Group, (Ottawa 18 November 2001). See: <www.g8.utoronto.ca/g20/interviews/Martin011118.pdf>.

3 G20 Study Group (2007) "The Group of Twenty: A History", p. 20. See: <www.g20.utoronto.ca/docs/g20history.pdf >.

the forum: twenty was seen as a maximum number to ensure global legitimacy but yet maintain the effectiveness of small and informal clubs.

Although the Asian crisis was eventually solved, the Finance G20 continued to meet regularly, indicating a need for economic and financial coordination among developed and emerging economies. Yet, as the global centre of gravity was shifting not only economically but also politically, emerging powers were increasingly pushing for a voice in decision-making at the Leaders' level. A process was initiated by the leaders of the G8 to reach out to third countries and more particularly to emerging countries in the 2000s. Successive initiatives led to the Heiligendamm Process of rapprochement between the G8 and the G5 (Brazil, China, India, Mexico and South Africa). This process was seen as a positive step by emerging powers in the sense that their growing importance was thereby acknowledged; however, their non-formal inclusion in the G8, and their relative marginalisation from agenda-setting and decision-making remained a major irritant.

As another economic crisis broke out in 2008 – this time spreading from the West to the rest – the gradual enlargement of the G8 to some emerging powers embodied by the Heiligendamm Process was bypassed by the sudden upgrade of the G20 to the Leaders' level. It is significant to note that this upgrade, rather than expanding the G8 to emerging powers or creating a whole new body, was just one of the available options at the time. This option was promoted by French President Nicolas Sarkozy (then also rotating President of the EU) and President of the European Commission José Manuel Barroso. One argument for such an option was that the G20 was a natural forum for tackling the crisis, given its broad representation encompassing all major economies and representing most regions of the world. Another argument was that the G20 was already there, at the finance level, allowing a quite natural connection between the two levels – and the experience of the latter in dealing with the Asian economic crisis could be beneficial in solving the current one.

This short overview of the evolution of the G20 shows a certain amount of things. First, the G20 is traditionally a crisis-response forum. Yet, as the world is slowly recovering from the crisis, the G20 is consequently evolving from crisis-management to "something else" – but this something else has yet to be determined. Many options have been put on the table, but there is so far no consensus regarding the future of the G20. In fact, three of the core questions to the future of the G20 (membership, mandate, and the link with other multilateral institutions) have triggered constant debates since the very first meeting of the Finance G20 in 1999.[4] Second, the G20 is a Western creation and it remains largely dominated by Western powers, mostly regarding agenda-setting. In this context, cooperation between (Western) established powers and (non-Western) emerging powers is doomed to be challenging. Third, in spite of the previous observation, the EU and China have both been relatively supportive of the G20 since its inception, and they have managed to successfully cooperate on various significant issues, not the least in recent years to prevent the collapse of the global financial system or to avoid the spread of trade protectionism worldwide. Thus, as a coordination and cooperation mechanism, the G20 has demonstrated its raison d'être over the years.

[4] Op. Cit., G20 Study Group, p. 18.

To conclude this first section, the G20 is a “forum in flux”: in terms of membership, as witnessed by the constant invitation of additional actors, as well as in terms of the agenda, as evidenced by its broadening scope under the Korean and French presidencies. This seems rather appropriate for a “world in transition”, both economically and politically, in the beginning of the 21st century, but it also raises uncountable questions and challenges, not least regarding the legitimacy or the effectiveness of the G20. The next section will dig into some of these questions.

EU-China perspectives on the G20

a) Upgrading of the G20

From the EU point of view, the upgrading of the G20 was perceived positively, not least because the upgrade was a joint suggestion from Nicolas Sarkozy and José Manuel Barroso. For the EU, the upgrading of the G20 was not only seen as appropriate to deal with the global crisis, but it was also incidentally a recognition of the rising status of the EU itself, as it was considered as the 20th member of the group. The G20 is one of the rare instances among international organisations where the status of the EU is in line with its competences, and it is therefore understandably cherished in Brussels.[5]

The question of whether the G20 constitutes the appropriate forum to deal with the global crisis and the changing global environment is not only debated in Europe. Chinese scholars and practitioners have also debated the role of the G20 and China’s role in it. Beijing has held positive views on the Finance G20 since its creation, particularly in comparison to the negative views held by Chinese official media on the G7/8.[6] It is therefore not particularly surprising that Beijing supported (although timidly) the upgrading of the G20 to the Leaders’ level, while emphasising the imperfections of the forum (see below).

b) Membership of the G20

The EU is a quasi full member of the G20 (e.g. in the sense that it cannot hold the presidency) and it is represented by the President of the European Commission and the President of the European Council seated behind a single nameplate. However, the European representation within the G20 is not limited to a single nameplate as the EU sits alongside France, Germany, Italy and the UK. In this peculiar configuration, the EU delegation officially represents the 27 Member States and the European Commission via a sophisticated system of coordination among the Member States: traditionally, the EU’s position in the G20 is debated in the ECOFIN first (sometimes in the Eurogroup further ahead) leading to the adoption of “terms of reference” which then feed discussions among Heads of State or Government who adopt an “agreed language” ahead of the

---

[5] Emerson, M. with Balfour, R., Corthaut, T., Kaczynski, P., Renard, T. & Wouters, J. (2011) Upgrading the EU's Role as Global Actor: Institutions, Law and the Restructuring of European Diplomacy, (Brussels: Centre for European Policy Studies).

[6] Chin, G. (2010) “The Emerging Countries and China in the G20: Reshaping Global Economic Governance”, in Lesage, D. (ed.) “The Future of the G8 and G20”, Studia Diplomatica, vol. LXIII (2), pp. 117-118.

G20 summit – the EU's negotiating position. Recently, the enlargement of the G20 agenda has slightly challenged this well-oiled process (see below).

This multiple representation has raised many frustrations in and outside Europe. In Europe, some Member States have constantly sought to be invited to the G20 table on the argument that they rank in the top 20 global economies (e.g. Spain and the Netherlands). Most recently, some proposals have even emerged from smaller Member States to be represented via a system of constituencies, mirroring the system prevailing in the IMF Executive Board (e.g. Belgium and the Netherlands).[7] These proposals indicate that the EU seat, although better than no seat, and despite the EU's efforts to coordinate positions ahead of G20 meetings and to represent indirectly all 27 Member States (or at least the 23 "other" Member States), is still seen as imperfect by European capitals.

Seen from Beijing or from other emerging countries' capitals, Europe's multiple representation coupled with claims for additional seats from European Member States have triggered outspoken frustration over what they perceive as European over-representation in most international fora. This frustration has added another layer of difficulty in multilateral negotiations.

c) *Mandate of the G20*

The EU holds a discrete profile regarding the scope of the G20 agenda. In general, the EU's preference has been to stick to the G20's traditional agenda in order to stay focussed on solving the global crisis, although Brussels has not publicly opposed the enlargement of the agenda under the French presidency. The enlargement of the agenda during the French presidency raises some technical challenges for the EU though, as the coordination efforts that have traditionally taken place in the ECOFIN need to be replicated in the other relevant EU forums (on agriculture, development, etc) which seem to require some adjustments.[8] Beyond the French presidency, few EU officials even whisper, off the record, that the G20 agenda should enlarge to more strategic issues of prime importance, as the annual meeting of world Leaders offers a good opportunity for such discussions among established and emerging powers.[9]

China has been equally conservative on the issue of the G20 agenda's enlargement. Yet, the main difference with Brussels is that Beijing is not particularly at ease with the issues currently on the table at the G20 (not China's traditional concerns), explaining to a certain extent the rigidity of Chinese diplomacy in the new forum; whereas Brussels has promoted the G20 precisely to deal with issues of its own concern. Having this in mind, an enlargement of the agenda to non-economic strategic issues could further rigidify the Chinese posture, although it would simultaneously create more room for tradeoffs and linkages. On this particular question, the pros and cons are still being weighed-up in Brussels and in Beijing.

d) *The G20 and effective multilateralism*

---

[7] "Belgian minister calls for G20 representation", EUBusiness, 24 October 2010. See: <www.eubusiness.com/news-eu/belgium-g20-economy.6oa/>

[8] Interview with a Belgian diplomat, Brussels, 17 May 2011.

[9] Interview with an EU official, Brussels, 29 May 2011.

Another challenge raised by the G20 is that it contradicts to a certain extent the EU's claim of promoting "effective multilateralism", i.e. a 'rules-based international order' as the 2003 European Security Strategy puts it. Indeed, the G20 falls into the category of informal clubs or so-called "light multilateralism" and it entails the risk of undermining – or worse, sidelining – other existing institutions, notably the IMF or the World Bank. Some scholars in Europe have even deemed the G20 to be a 'dangerous'[10] form of multilateralism. Yet the G20 and formal international organisations are not necessarily at odds with each other. In a contribution sent to the UN, the EU said that the relationship between the G20 and formal organisations (such as the UN or the Bretton Woods Institutions) should be guided by 'principles of efficient division of labour, coordination and complementarity'[11]. It is suggested, notably, that the informal format of the G20 is favourable to creating 'political momentum' whereas the UN agencies are structured to provide a 'critical mechanism for implementation'.[12] Yet, in practice, it is not entirely clear how the G20-UN connection would function.

The Chinese, for their part, perceive the new G20 as a 'transitional mechanism' for a world in flux.[13] They have repeatedly emphasised that their preference goes for an inclusive multilateral system, calling for a greater involvement of the UN in global economic governance. Emerging powers 'have always been more interested in reforming the universal components of global governance, i.e. the UN Security Council, the IMF voting structures, etc. rather than just being part of an informal, however important, club.'[14] In a paper submitted to the UN Secretary General, China stated that the new global economic governance must follow three principal features: it must be representative (ensure participation of all members), equitable (all countries should be on equal footing) and effective (system should be results-oriented).[15] Chinese preference for the UN system is reinforced by the clarity of its great power status embodied by its veto power in the UNSC.

EU-China convergences and divergences in the G20

The EU and China do not always share the same priorities in the G20, which can at times lead to tensions, but certainly require additional efforts to coordinate positions. This section will offer a brief overview of the main points of convergence and divergence between the EU and China.

a) Convergences

---

[10] Tedesco, L. & Youngs, R. (2009) "The G20: A Dangerous Multilateralism?", Policy Brief, FRIDE.

[11] "EU initial views on "The role of the UN in global economic governance and development"", EU contribution to the UN, 18 May 2011, p. 5. See:<www.un.org/esa/ffd/economicgovernance/EU.pdf>

[12] Ibid., p. 5.

[13] Chin, G. Op. Cit., p. 118.

[14] Cooper, A. & Antkiewicz A. (2010) "G20 for Global Governance: Lessons from G8 Outreach", in Lesage, D. Op. Cit., p. 96.

[15] "China's position on the issues of global economic governance and development", China's contribution to the UN, 6 May 2011, p. 1. See: <www.un.org/esa/ffd/economicgovernance/China_UNTranslation.pdf>

Both actors support the global framework for growth, and have therefore a convergence of views on its global objectives. In Washington, China agreed on the identification of some indicators, as long as it's redlines (for instance excluding global reserves from the indicators) were taken into consideration. This should be considered as a positive step forward, although disagreements remain important, particularly at the technical level.

In comparative terms, there are also some similarities between the Europe 2020 strategy and the Chinese 12th Five Year Plan, notably regarding some of their core objectives (sustainable growth, social welfare, competitiveness) but also in view of the systemic reforms that they promote. In this case, the EU and China share a view that their own strategies can be a positive contribution to the global agenda. In other words: "do your homework first".

Regarding global governance, both the EU and China share the view that reform is needed, although Europe has a different take on this reform than China, which is generally under-represented (e.g. in IMF quotas) whereas Europe is generally over-represented. This makes convergence possible as illustrated by the agreement struck over the IMF in Gyeongju, South Korea, however slow and difficult, as clearly demonstrated by the nomination process of the next IMF director. The reform of global governance also entails the issue of how to link the G20 with existing institutions, an issue being discussed notably at the UN level as already alluded to above in this paper, but also the reform of the G20 itself (notably the question of its institutionalisation via the establishment of a secretariat, or the issue of aligning the G20 membership with IMF constituencies) which are currently being discussed under the leadership of British Prime Minister David Cameron.[16]

Finally, on the question of financial regulation, there has been little progress so far. Nonetheless, the EU and China do not fundamentally diverge on this issue and with some creative thinking they could even reach a compromise between the stronger regulation of the international system promoted by the EU and the controlled deregulation undertaken in China. In this issue, convergence is not natural but still very much possible.

b) Divergences

The most obvious divergence between the EU and China lies in the fact that both actors do not currently share the same priorities: while the EU is still in a difficult recovery phase after the crisis, China has already exited the crisis but is now fighting hard to control inflation and to control social unrest. This very fundamental divergence underpins many other discussions.

The most sensitive topic between the EU and China, on the other hand, is undoubtedly the currency issue – sometimes labelled "currency war" in the media. The EU is pushing for a greater convertibility of the RMB and somehow China has taken steps towards a greater internationalisation of its currency (talks for inclusion of the RMB in the SDR basket, or even labelling some of its trade in RMB notably with the BRIC countries) but these steps are still perceived as too little and too slowly.

---

[16] Interview with an EU official, Brussels, 29 May 2011.

The issue of commodities was put on the agenda by the French presidency, and the EU has grasped the opportunity to present a paper with the support from other developed countries. However, China and the EU have diverging views on some core topics, notably regarding raw materials. Sensitive issues include the growing demands from China for natural resources, or the access to resources (including rare earths).

Finally, the issue of development holds much potential for divergence, notably given the different approaches promoted by China and the EU, the former being best encapsulated in the famous expression the "Beijing consensus".

Some recommendations

As a conclusion, this paper offers three short recommendations:

1) *Strengthen the EU:* A stronger EU at home and in the G20 will be more capable of defending European interests. A stronger EU could take many forms, e.g. more integration, promoting a Eurozone constituency within the G20 (instead of multinational constituencies), or reinforcing mechanisms of coordination among Member States. Although it might sound counterintuitive, a stronger EU, more predictable and able to deliver, is also in the interests of China and other G20 partners.

2) *Build on the EU-China strategic partnership:* In the framework of the EU-China strategic partnership, there exist many mechanisms for coordination and cooperation spanning over a broad range of issues. These mechanisms should be exploited to their full extent and if needed new mechanisms should be set-up. More fundamentally, the EU and China need to develop necessary levels of confidence to give full meaning to their strategic partnership.

3) *Change the narrative:* The EU should develop a subtle new narrative vis-à-vis China, in order to convince its strategic partner that issues discussed within the G20 are not only important to the Western world, but that they are vital interests for China as well.

Further Reading

Jokela, J. (2011) "The G20: A Pathway to Effective Multilateralism?", Chaillot Paper 125, EUISS.

Lesage, D. (ed.) (2010) "The Future of the G8 and G20", Studia Diplomatica, vol. LXIII (2).

Pisani-Ferry, J. (2010) "China and the World Economy: A European Perspective", Bruegel Policy Contribution 3, Bruegel.

Cooperation between China and the EU in the UN Security Council (1)

Andrew Small
The German Marshall Fund of the United States

The UN Security Council (UNSC) is the central institution for addressing the security issues of greatest mutual concern to the European Union and China. While the majority of security matters between the United States (US) and China are dealt with bilaterally and in the context of the Asian region, for Europe and China the agenda is mostly global and multilateral in nature. Subjects such as Iran, Libya, Sudan, Burma/Myanmar, and Zimbabwe have been at the heart of the political and security debate between the EU and China, and the principal focus for deliberations has been UNSC resolutions and their implementation. While there are obvious difficulties in setting out an agenda for cooperation in a body where the EU itself is not represented, the UNSC in many ways provides a useful framework for thinking about the scope and potential for EU-China cooperation in global security affairs. This paper analyses the options and challenges for both sides.

In theory, the EU does not have a role to play in the UNSC. On issues of reform, individual Member States – notably Germany and Italy – have been openly pitted against one another, and Europe's two permanent veto-wielding members, the United Kingdom (UK) and France, have shown little interest in consolidating their positions into a single EU seat. Splits within the EU on major issues that have come before the Council, such as the war in Iraq, have reinforced the impression that, on UNSC matters, while dealing with the Europeans may be essential, there is no united "Europe" or EU to speak of.

While these headline facts are undeniable, the day-to-day reality is notably different. The UN has been a crucial vehicle for the EU's foreign policy strategy of "effective multilateralism". The EU pays two fifths of the UN's core budget and peacekeeping costs, and the European Commission has given more than 6 billion euros to UN funds and agencies over the last decade. Its Member States have invested considerably in UN humanitarian and security activities, a large proportion of which are focused in Europe's neighbourhood and in states with close historic ties to Europe. In the UN as a whole, EU Member States speak and vote together over 90% of the time, and most of the issues addressed by the UNSC are first treated in depth within the European institutions and latterly through EU caucusing. Implementation of UNSC resolutions and complementary measures are frequently channelled through the EU, whether that be the provision of peacekeeping forces, the enforcement of sanctions, or the leading of a negotiation process, such as that with Iran.

The strategic issues that have been covered in EU-China dialogues and summits have also traced the UNSC agenda closely, not only in terms of the subjects themselves – Iran, Sudan, Libya and so on – but also in terms of the hopes and tensions in the EU-China political relationship. Disagreements between Europe and the US in the UNSC over Iraq provided a good deal of the early impetus for upgrading the strategic partnership with China: an important, albeit implicit, goal for many in Europe was to see the EU and China cooperate to restrain US unilateralism. Conversely, in more recent years, disagreements between the EU and China over a range of issues addressed in the UNSC, such as Burma/Myanmar and Zimbabwe, have highlighted a perceived "values gap" between the two sides, and diminished the sense of possibility for cooperation on strategic issues.

In the coming years, the pressure on Europe and China to take on more responsibility in UNSC matters can be expected to grow. The likely UNSC agenda of the near future encompasses countries that form an arc running from China's Western border with Afghanistan and Pakistan through to Europe's Southern and Eastern borders in the Middle East and North Africa. At the same time, the US has signalled its intention to reorient away from Europe and Europe's periphery, reducing its security involvement in the Middle East and South-West Asia in order to focus on East Asia. The resulting gap will need to be filled by – among others – the EU, China, and regional and global multilateral organisations. This has already been in evidence in the case of Libya, where EU Member States felt obliged to take on a heightened role in the absence of US leadership. Whether this approach from the US can be sustained in the context of convulsions in the Middle East is questionable, but China and the EU need to be ready to deal with a world in which the US global footprint may look quite different to that of the past two decades. Their interests, on matters ranging from refugee flows to energy security, will be vitally affected either way.

A common agenda for China and the EU in the UNSC

While the reform debate will not go away, the future of the UNSC will still largely be defined by its capacity to address concrete security challenges. Recent years have seen a period of both competition and cooperation not only over the specifics of how to deal with the issues that have come before the Council – such as Iran or North Korea – but also over the legitimacy of dealing with certain subjects there at all – such as Zimbabwe and Burma/Myanmar.

EU-China cooperation in this field will therefore depend partly on devising a common agenda and partly on finding an effective and predictable way in which to manage differences. This will encompass several broad areas:

Peacekeeping challenges

The UNSC continues to take on a crucial role in addressing the internal security challenges that face many nation states, particularly in Africa where state capacity is often at its weakest. The maintenance of stability across perennially troubled areas such as the Great Lakes region will persist, and current unrest in the Middle East is likely to result in new requests for international security support, as is already being debated in the case of Libya. The resurgence of conflict risks between North and South Sudan is another area of acute concern. This cluster of issues, which closely engages European and Chinese troops and peacemaking efforts, more so in some cases than between any other two powers, is likely to provide one of the most important areas of direct EU-China security cooperation.

Peace diplomacy challenges

The UNSC's other pivotal role – reduced in recent years – has been to authorise and support peace mediation. Re-establishing and underpinning this function will be another important shared task for the EU and China in the coming years, given the desire of both sides to provide UN legitimacy for these processes and to retain a level of influence over them. Afghanistan is likely to be a central testing ground as NATO-led efforts start to recede in 2011 and all sides seek to establish a lasting settlement between warring parties, in a context where the UN role has been very much diminished in recent years.

Core security challenges

Despite the undoubted importance of peacekeeping and international mediation efforts, the continued centrality of the UNSC in decision-making on global security will hinge on its ability to deal with grand-scale strategic challenges, of which the Iranian nuclear question will continue to occupy one of the most prominent positions. China and the EU are both major actors vis-à-vis Iran, given their prominent economic and diplomatic roles, and the efficacy of UNSC efforts – which incorporate a dual-track of sanctions and engagement / packages of countervailing offers – will be crucially influenced by their ability to work in sync.

Managing Differences

The EU and China agree on a few common principles when it comes to dealing with many of these issues, whether that be non-proliferation norms, commitment to the stability of the states in question, or simply a shared belief that the UNSC should maintain its pre-eminence. In practice, both sides have also been willing to commit resources and troops in defence of these aspirations. However, there have also been important disagreements. These include:

Sanctions policy

Both China and the EU have supported the imposition of sanctions on Iran and North Korea but differences about the general principles guiding the two sides' approaches have dogged UNSC debates on these and other cases, as well as the subsequent implementation of the UNSC resolutions themselves. Disagreements persist not only about the legitimacy of the sanctions resolutions but also over the need to enforce the resolutions when agreement has been reached.

Responsibility to protect, sovereignty, and conditions on the use of force

While acquiescing to the UNSC resolution establishing a no-fly zone over Libya, grounded in the principle of the "responsibility to protect" (R2P), China has shown great disquiet since it was put into effect, arguing that the intervention in Libya has gone far beyond the scope permitted by the resolution. Differences between an "interventionist" Europe and a "pro-sovereigntist" China over the grounds for UNSC involvement in a range of internal conflicts have been persistent, with other instances such as Sudan also characterised by considerable mutual suspicion over each other's motives. Reaching a rough consensus on the meaning, scope and legitimacy of R2P resolutions will be important if they are to be successful in practice and act as effective precedents in deterring state leaders from committing mass atrocities.

Counter-terrorism

While disagreements over counter-terrorism issues are modest by comparison with other areas, the role of Pakistan has at times proved divisive. The recent separation of the Taliban and Al Qaeda in the 1267 committee has been an important step towards distinguishing between reconcilable fighters and irreconcilable transnational terrorist threats, but there have still been differences between China and other countries about the designation of supporters of groups such as Jamaat-ud-Dawa, which came close to precipitating a war between India and Pakistan through the Mumbai attacks of 2008. In light of the discovery of Osama Bin Laden in a Pakistani military town, the question of addressing support to terrorist groups from current or retired military officers – which China resisted after the Mumbai attacks – could well come before the UNSC again.

Over the longer term, it will be important for the EU and China to find a modus vivendi on these disputed areas. It is unlikely that any comprehensive agreement will be reached: they will continue to be debated and re-debated in each individual case. But closer consultation and joint study between the two sides will nonetheless be useful for the sake of predictability and strategic planning, while helping to ensure that the broader relationship is not harmed by an inability to anticipate recurring disputes. Moreover, failures in some of these areas have weakened the effectiveness of the UNSC and posed the risk that smaller groupings or individual states may come under pressure to take unilateral actions as a result. Examples include Israel in the case of a failure to deter Iran from acquiring nuclear capacity; India in the case of a failure to address state-sponsored terror groups emanating from Pakistan, or South Korea in the case of cross-border aggression from the DPRK. Both China and the EU have a strong interest in preventing this.

Conclusion

The EU and China are already overloaded with bilateral consultation processes, whether at track one or track two levels, and the addition of another is unlikely to be a helpful addition to the relationship. However, bringing the different multilateral security issues that both sides deal with under a single umbrella may be a constructive way to invest new energy in what has long been the weakest element in EU-China cooperation. The newest additions to the EU-China security agenda in recent years – such as peacekeeping and counter-piracy – could usefully be paired with a broader set of joint consultations on the UNSC agenda, peace-building, shared crisis-risks, counter-terrorism, and other security issues of mutual interest. This would provide scope for a discussion of both the practical and immediate, and the long-term, strategic and conceptual, usefully supplementing the strategic dialogue and the summits.

Representation issues will form part of a broader debate between the EU and the emerging powers, but with acute differences persisting within Europe, and with the UNSC likely to remain one of the least tractable elements in the reform of global governance, it is unlikely to be such a productive agenda item for China and the EU. Most important will be the larger task of ensuring that the UNSC is able to deliver results, particularly in issues where the EU and China play a heightened role or have notable interests at stake.

A few years ago, a debate raged over whether the UNSC would still matter in the period to come. The US was contemplating pursuing its agenda through other channels, whether unilaterally or in concert with other like-minded states. When it did resume its efforts to focus on the UNSC, some analysts foresaw deadlock, with China and Russia systematically pitted against the Western powers. In practice though, it has been possible to get business done, even on many of the most controversial issues that the Council has dealt with, and all sides have for the most part showed a spirit of goodwill and compromise. For the EU and China then, although the higher-order questions about the nature of global order and the rights and wrongs of intervention are important to keep in mind, the common agenda that could be shaped here is essentially a practical one, but one that nevertheless has the potential to give the two sides the “strategic dimension” in their relationship to which they have long aspired.

Cooperation between China and the EU in the UN Security Council (2)

Cheng Weidong
Institute of European Studies
Chinese Academy of Social Sciences

Summary

Both China and the EU both strongly support the United Nations Security Council (UNSC) playing a central role in coping with global threats and challenges and in safeguarding international peace and security. Both parties consider the authorisation of the UN and respect for international law to be priorities in taking international action. In addition, both sides are committed to promoting those bilateral strategic partnerships that have no direct conflicts of interests concerning significant security issues. Finally, 2 of the 5 permanent members of the UNSC are EU Member States and 2-3 EU countries will hold the elected non-permanent membership at the same time. China-EU cooperation will thus undoubtedly make great contributions in ensuring the UNSC plays a proper role, which is of practical significance to the future development of the UNSC.

In the UNSC, some forms of cooperation have already existed among all the member countries, without which, it is impossible for the UNSC to operate smoothly. However, no special cooperation arrangement has been established between China and the EU in the UNSC, not to say impacts on the operation of the UNSC. From the practice of the UNSC in the fields of UN reform, peacekeeping, non-proliferation, the responsibility to protect and intervention, etc, it can be concluded that until now China and the EU have had only limited cooperation in the UNSC. While each side thinks highly of the other's role in international peace and security, and both sides have recognised the necessity of cooperation, with different degrees of consensus and collaboration existing on certain issues, on the whole the cooperation between the two sides in the UNSC is limited. Nevertheless, some successes have already been achieved concerning their cooperation in areas where the EU has a single voice, such as nuclear non-proliferation.

Many factors may affect the cooperation between China and the EU, which mainly include: (1) The EU's status in the UN. The EU is not an official member of the UN and cannot represent all EU Member States in the UNSC. Therefore, there is often no common policy of the EU on many issues dealt with in the UNSC. In fact, sometimes there are many disagreements between EU Member States. In these circumstances, it is difficult for China to cooperate with the EU so it can only cooperate with some EU Member States. (2) The preference gap between China and the EU in the UN. China and the EU attribute a lot to different preferences on many issues, for example, on climate change. Sometimes it is not easy for one part to accept the views of the other. (3) Different perceptions of some basic international principles. Different understandings and

perceptions of basic international principles can sometimes determine and explain the different standpoints and polices of an actor on international issues. In this regard, the different perceptions on the principle of sovereignty and non-intervention are of particular significance. (4) The ability for cooperation. The ability for cooperation not only involves the EU's status in the UN but also involves the political will, resolution and ability to resist the pressure of powerful countries which take a more unilateralist approach.

In view of the status quo and responsibilities of the UNSC, the possible areas for cooperation between China and the EU may consist, in particular, of the reforms of the UN, peacekeeping, nuclear proliferation and sanctions, and the responsibility to protect and intervention. Although cooperation between China and the EU does exist in all these fields, there are still disparities and a long way to go before forming deep-going and comprehensive cooperation. China-EU cooperation in the UNSC is different from bilateral cooperation between both sides. The former is based on international law and a kind of multilateralist approach, and the objective of cooperation is not just for bilateral interests but for dealing with the issues of global and long-term significance. Therefore, the primary purpose of cooperation is to help the UNSC to fulfil its tasks in the field of peace and security by strengthening the role of the UNSC; China-EU cooperation should be based on universally accepted international law and strengthening the legitimacy of the operation of the UNSC; China-EU cooperation should highlight the efficiency and effectiveness of the UNSC; and dialogue and negotiation are the best ways for China-EU cooperation.

The UNSC is the central UN agency for safeguarding international peace and security, however, it is now encountered with a great number of dilemmas and challenges. Meanwhile, the international community has pinned high expectations on the UNSC, hoping that it plays a core role in international peace and security affairs; while on the other hand, a lack of efficiency and effectiveness of UNSC operations has caused wide-spread dissatisfaction, which thus raises the need to reform the UNSC. How to pull itself out of the present dilemmas is one of the most difficult problems facing the UN, which not only has great bearing on the future of the UNSC itself, but on international peace and security.

Both China and the EU strongly support the UNSC playing a central role in coping with global threats and challenges and in safeguarding international peace and security. Both parties consider the authorisation of the UN and respect for international law to be priorities in taking international action. In addition, both sides are committed to promoting bilateral strategic partnerships that have no direct conflicts of interests concerning significant security issues. Finally, 2 of the 5 permanent members of the UNSC are EU Member States and 2-3 EU countries will hold the elected non-permanent membership at the same time. China-EU cooperation will thus undoubtedly make great contributions in ensuring the UNSC plays a proper role, which is of practical significance to the future development of the UNSC.

In the UNSC, some forms of cooperation have already existed among all the member countries, without which, it is impossible for the UNSC to operate smoothly. However, no special cooperation arrangement has been established between China and the EU in the UNSC, not to say impacts on the operation of the UNSC. In view of the status quo and responsibilities of the UNSC, the possible areas for cooperation between China and the EU may consist, in particular, of the reforms of the UN, peacekeeping, nuclear proliferation and sanctions, and the responsibility to protect and intervention. Although cooperation between China and the EU does exist in all these fields, there are still disparities and a long way to go before forming deep-going and comprehensive cooperation.

Review of China-EU cooperation in the UNSC so far

In some fields, the cooperation between China and the EU in the UNSC has been conducted while in other fields the cooperation has been very limited. The bilateral cooperation in the UNSC between China and the EU can be reviewed in the following aspects.

1. Reforming the UNSC

Since the 1990s there have been many calls for reform of the UNSC. However, no consensus has yet been reached on how to reform it in practice. Reforming the UNSC is extremely complicated and politically sensitive, requiring a common understanding of most of the Member States in the UN General Assembly and the ratification by two-thirds of UN Members including that of all the permanent Members (P-5). In fact, the process leading to consensus is that of cooperation.

China and the EU have common points on some of the matters concerning the UNSC's reforms, recognising the necessity of and providing support to its reform. However, they have not reached agreement on the approaches of reforms and on the priorities to take.

China's opinions on the reform of the UNSC mainly include prioritising the strengthening of the representativeness of developing countries in the UNSC, a consensus based on the broadest consultations among all the Member States, and a reform programme taking into account the interests and concerns of all the parties concerned. China opposes imposing any plans as approved only by a few member countries of the UN.

The EU's position on the reform of the UNSC is somewhat complicated. Until now, no consensus has been reached within the EU, with divergent opinions among its Member States on this issue, which can roughly be divided into two groups. One group, including the United Kingdom (UK), France, Germany, Denmark, Greece, Austria, Sweden, Finland, Czech Rep., Slovenia, Slovakia and Latvia, is in favour of the programme forwarded by "Group of Four", that is, Japan, Germany, India and Brazil, that suggests expanding the scale of the UNSC and bidding for the permanent seats on the UNSC. The other group composed of Italy, Spain and Malta supports the "United for Consensus" plan put forward by Italy, Pakistan, Argentina and Canada and strongly objects to increasing new permanent seats. In addition, the proposal for a single seat for the EU or an additional seat allocated to the EU in the UNSC has frequently been referred to, which, however, has not been mentioned in the EU's official documents.

Due to the divergences among the EU Member States and the fact that no single policy has been formulated at the EU level, it is almost impossible for China to coordinate and cooperate with the EU on the reform of the UNSC. China's position is very clear, based on which, it could have communicated and cooperated with the EU if the latter also had a unified position. However, due to the present situation, China has no other choice but to cooperate with the individual Member States. However, except for agreement between those countries of common interests and preferences, like the "Group of Four" and "United for Consensus" group, no close cooperation has yet been formed among the UN Member States, and no consensus even among the P-5. The reform programme of the UNSC is still under discussion.

2. Peacekeeping

Some common points exist between China and the EU as to peacekeeping missions. Firstly, both believe that UN peacekeeping operations (PKOs) are an important and effective means in maintaining international peace and security, and thus supporting the UN to play an active role in this aspect. Secondly, both hold that peacekeeping actions should be decided and authorised by the UNSC and comply with the UN Charter. Thirdly, both parties advocate, as a priority, cooperation with regional organisations in peacekeeping. Fourthly, China and the EU are both strong supporters of and active participants in peacekeeping operations. In 1990 China started to participate in peacekeeping operations led by the UN and a total of 14,000 personnel have been dispatched in 24 peacekeeping missions until 2009. At present, more than 2,100 Chinese peacekeepers are conducting all kinds of tasks in 10 task areas and China is the biggest contributor of troops among the permanent members of the UNSC. The EU also pays great attention to peacekeeping and has established good relationships with the UN in this field. The EU and its Member States together pay more than 40% of peacekeeping expenses. In November 2006, a total of 11,140 men and women, or around 13.5% of UN peacekeeping personnel, came from the EU.[1]

China insists on conducting its peacekeeping operations on the basis of the three principles put forward by the former UN Secretary-General Dag Hammarskjold. That is, the principles of approval, neutrality and no use of force. It means that a UN peacekeeping force could be deployed only with the approval of the country on whose territory it would function, it could not intervene in the internal affairs of that country, and it would be armed only for self-defence, not fighting unless attacked. When participating in peacekeeping missions led by the UN, China attaches great importance to the leading role of the UNSC and stresses compliance with the UN Charter. Although China emphasises the importance of peacekeeping operations as one of the means of maintaining international peace and security, it believes it is not the only one and that the fundamental solution lies in the eradication of the roots of conflict.

The framework for EU-UN cooperation in peacekeeping was defined in the Joint Declaration of September 2003. Although in practice, the EU has contributed to UN peacekeeping in different ways, in general, EU Member States are reluctant to deploy their personnel in UN-led operations and prefer the UN-mandated but EU-led PKOs. As to the principles of peacekeeping, it seems that the EU does not insist on Hammarskjold's three principles which are the basis of the so-called 'first generation of peacekeeping operations' and practices of the so-called 'second generation of PKOs' which were characterised mainly as not necessarily obtaining consent of all relevant parties to a conflict and authorising the use of force to fulfil PKOs.[2]

From the above-mentioned principles and practices of China and the EU, great disparities exist between China and the EU concerning PKOs, although both China and the EU share some consensus on the significance of PKOs and highlight the pivotal role of the UNSC.

3. Nuclear proliferation and sanctions

China and the EU recognise that nuclear proliferation is becoming a more and more serious threat to international peace and security and have committed to cooperate with each other in

---

[1] How the European Union and the United Nations Cooperate. See: <www.unric.org/html/english/pdf/Leporello_EU-UN_e.pdf>.

[2] Geeraerts, G., Chen, Z. & Macay, G. (2007) "China, the EU and the UN Security Council Reform", *Asia Paper*, vol.2, no.6. See: < www.vub.ac.be/biccs/documents/Asia_paper_Macaj_2007_China_the%20EU_and_UN_Security_Council_Reform_Asia_Paper_vol_2__6_BICCS_Brussels.pdf>.

this field.[3] Both side reached some agreement on how to deal with proliferation issues, such as efforts that should be made to address proliferation issues through political and diplomatic measures and international cooperation within the framework of international law. China and the EU also identified how to cooperate in the area of non-proliferation, including enhancing the role of the UN, consultation and coordination on proposals to strengthen the international nuclear non-proliferation system, etc.

Both China and the EU have played an important role in the field of non-proliferation. The EU has tried to solve Iran's nuclear problem through the E3 format (composed of the representatives of Germany, France and the UK) which is considered as acting on behalf of the EU. The EU's proposals or policies concerning Iran's nuclear issues have been largely adopted by the UNSC and get supports from non-European permanent members of the UNSC including China. For example, on 12 January 2006, the EU issued its first public statement asserting the immediate referral of Iran to the UNSC. China and other non-European permanent members supported the EU's statement. China also supported most of the UNSC's resolutions which imposed sanctions on the Iranian government. Generally speaking, China and the EU have cooperated very well on the issue of Iran's nuclear programme. The former High Representative of the Common Foreign and Security Policy (CFSP) of the EU, Javier Solana said that cooperation on Iran's nuclear issue was an example of an active strategic partnership between the EU and China.[4]

However, China and the EU do have different opinions on the ways of solving the nuclear crisis in Iran as well as in other countries. Generally, China and the EU have cooperated very well on nuclear proliferation issues. Certainly there is still some room for both parties to cooperate further.

4. The responsibility to protect and intervention

After the end of the Cold War, and with the development of new conflicts and their impacts on people, the non-intervention principle has been challenged and the Western world has advocated a new concept of humanitarian intervention for protecting civilians. Humanitarian intervention means that under certain circumstances such as acts of genocide, massive oppression of people, other states should have legitimate reasons to take military actions without the consent of a sovereign government.

China's attitude towards humanitarian intervention and the responsibility to protect principle is a little different from the western understanding, but that does not mean China opposes the concept of the responsibility to protect. In fact, in its "Position Paper of the People's Republic of China at the 65th Session of the United Nations General Assembly", China states that it is

---

[3] Joint Declaration of the People's Republic of China and the European Union on Non-proliferation and Arms Control, (9 December 2004).

[4] Biedermann, R. (2009) "The European Union and China in Security Relations—Already Strategic Partners?", Journal of Asia-Pacific Studies，Vol. 7, p. 34.

deeply concerned about the life and property of civilians affected and threatened by armed conflicts, and urges the parties concerned to abide by international humanitarian law and the relevant Security Council resolutions in good faith and give full protection to civilians caught up in armed conflicts. That said, China thinks that the responsibility to protect civilians rests first with the government of the country involved. When providing assistance, the international community and external organisations should seek the consent of the recipient countries, fully respect their sovereignty and territorial integrity and refrain from interfering in local political disputes or impeding the peace process. Therefore although China has recognised the principle of responsibility to protect, she insists prudence should be taken when judging a government's ability and will to protect its people and peaceful means should be the priority option.

China is very cautious about the use of force to solve international conflicts, and even suspicious of using force in internal conflicts. China gives priority to peaceful and diplomatic means in solving conflicts, and only requires that all possible peaceful means are sought before taking any military action. The EU's attitude towards using force is a little ambivalent. In fact it is hard to say that the EU has a uniform and consistent stance and practice towards the use of force. In the recent case of Libya, different Member States of the EU had different views on using force against Libya. But it seems that generally the EU is not so suspicious of using force as China is.

Although different in many aspects about using force, China and the EU share some consensus. Prominently, both parties emphasise that the UNSC is the only legitimate body which can grant permission to use force against a country, and without the authorisation of the UNSC the use of force should not be resorted to expect for self-defence. In practice, considering that the EU usually does not have a common and single policy on using force, it is unclear if China and the EU have had cooperation on the matter of using force. Surely China and some EU Member States, especially Britain and France have had some kind of cooperation in the UNSC in this respect.

5. Concluding remarks

Until now, China and the EU have had only limited cooperation in the UNSC. Each side thinks highly of the other's role in international peace and security, both sides have recognised the necessity of cooperation and different degrees of consensus and collaboration have existed concerning certain issues, however, on the whole, their cooperation in the UNSC is limited. Nevertheless, some successes have already been achieved concerning their cooperation in areas where the EU has a single voice, such as on nuclear proliferation.

The reasons for limited China—EU cooperation in the UNSC

Although both parties have some common ground for cooperation in the UNSC, just as was mentioned above, both sides have had only limited cooperation so far. We should analyse the reasons for this phenomenon so that we can find an appropriate way for further cooperation.

1. Non-equivalent status in the UNSC

In the UNSC, China's status and the EU's status are different. China has full membership of the UN and is a permanent member of the UNSC, has veto power in the UNSC and full and complete competences to participate in the UNSC's activities and decision-making. The EU is only an observer at the UN, regardless of what kind of observer it is; and it participates in activities under the mandate of the UNSC as a regional international organisation, meanwhile, the EU has limited competences in the area of the CFSP and has limited representativeness in the UNSC. Although the EU is trying to speak with one voice in the UNSC, it cannot represent the EU and cannot guarantee the uniformity or unified position of all Member States. In fact, the Member States have different opinions and positions on many issues. The reform of the UNSC is a typical example.

These non-equivalent and different competences determine that in many situations the EU can only play a very limited role in the matters concerning or dealt with by the UNSC, especially in the case where the EU Member States have different opinions and positions. Under this circumstance, it is usually the case that China will choose to cooperate with some Member States of the EU.

2. Different perceptions on many issues

Different understandings of and perceptions on basic international principles sometimes can determine and explain the different standpoints and polices of an actor on international issues. In this regard, the different perceptions on the principle of sovereignty and non-intervention are of particular significance. As to the UNSC and international law principles, there are some manifest differences between the two parties that have significant influence on the cooperation that was mentioned just now in areas such as peacekeeping, the use of force, etc. For example, in July 2010, the EU and Canada adopted new sanctions against Iran that targeted its foreign trade, banking and energy sectors, but China did not agree with the EU's unilateral sanctions against Iran and thought dialogue and diplomatic means were the best way to resolve the Iran nuclear issue. The main differences between China and the EU include: (1) China pays a lot of attention to dialogue and diplomatic solutions and is very cautious about sanctions; (2) China opposes unilateral actions and highlights the role of the UNSC and multilateral mechanisms. China's preferential method of dealing with nuclear issues can also be discerned from its positions on North Korea's nuclear programme. But China's method has been criticised by some foreigners including Europeans. They believe that China has not done enough to guarantee the effectiveness of the sanctions. In fact, the differences between the attitudes and methods dealing with proliferation issues between China and the EU as well as some other western counties lie in the perceptions on what are the best ways to solve these kinds of problems and not on the willingness for cooperation.

3. Different interests in different matters, events and areas

It is obvious that due to geopolitical reasons, the different development levels of both sides and the different problems both are facing, each party will sometimes have different interests when faced with the same situation. Different interests sometimes determine different preferences for each side. Therefore, in some situations, there is a gap in preferences between China and the EU. For example, in the case of North Korea's nuclear issue, although China and the EU share some basic objectives, such as opposing North Korea's development of nuclear weapons and persisting in the complete denuclearisation of the Korean peninsula, China insists on a peaceful solution through dialogue and negotiation, while the EU and the US hope for more pressure and sanctions from the international society, especially from China. Apparently, there are some differences in this matter between China and the western world, including the EU. One of the important reasons for these differences is because China and the EU are in different situations and therefore have different interests. As to China, North Korea is a neighbour. China not only considers the objective of denuclearisation, but also considers the different affects of different methods on China's security and stability. Therefore, China is more cautious in using sanctions and other pressure.

Further cooperation between China and the EU

Although there are some differences and difficulties, further and effective cooperation between China and the EU is and will be pivotal to the efficiency and effectiveness of the UNSC and both sides share some commonalities in their cooperation. Therefore, both sides should make efforts commonly to further cooperation in the UNSC. Some suggestions are as follows:

1. Principles for cooperation

China-EU cooperation in the UNSC is different from bilateral cooperation. The former one is based on international law and follows a kind of multilateralist approach, and the objective of cooperation is not just for bilateral interests but for dealing with the issues of global and long-term significance.

(a) The primary purpose of cooperation is to strengthen the role of the UNSC

Strengthening the role the UNSC in global governance will benefit the whole world and the long-term interests of international society. China-EU cooperation should be helpful for strengthening the UNSC and not for pursuing narrow self interests, so that the UNSC can play a more effective and efficient role in dealing with global issues concerning peace and security.

(b) China-EU cooperation should be based on universally accepted international law

China and the EU should promote the application and effectiveness of international law including the Charter of the UN and strengthen the legitimacy of the operations of the UNSC. Legitimacy is one of the fundamental resources of the effective authority of the UN as well as all other international organisations, and the legitimacy of the UN lies in its abidance by international law, especially the fundamental principles of international law.

(c) China-EU cooperation should highlight the efficiency and effectiveness of the UNSC

Efficiency and effectiveness problems harm the credibility of the UNSC. China and the EU should cooperation to propel reform of the UNSC, provide the resources and other support to the actions approved by the UNSC and help to arrive at agreement on significant and urgent global issues.

(d) Dialogue and negotiation are the best method for China- EU cooperation

In a multilateral context, it is dialogue and not coercion, persuasion and not bullying that can promote sincere cooperation. It is normal that different interests, views, standpoints, cultural traditions exist among different countries. No country or bloc of countries can think that it is only correct. Only dialogue and negotiation can help arrive at consensus that is the basis for the countries to accept collective decisions and measures.

2. Areas and matters for cooperation

As just mentioned above, the EU has different competences and abilities in different matters concerning or dealt with by the UNSC, therefore, both sides should select some possible and feasible areas and matters to cooperate with each other on.

(a) Agenda setting

The UNSC faces too many challenges and issues. Different countries have different priorities, but it is impossible for the UN to deal with every issue at the same time. Therefore, it is necessary to initiate and determine the most important and urgent issues. In this area, China and the EU can cooperate.

(b) The reform of the UNSC

Although the EU has limited say in this matter and there are different plans between Member States, it is still important for both sides to cooperate, which would be of great importance for the success of UNSC reform. The key for cooperation in this area may lie in consensus on the objectives of the UNSC's reform, which still needs a lot of study and reflection. To my understanding, it should be noted that, although the reform should reflect the new realities of current international structures and politics, the most important is not to add several permanent members of the Security Council but to strengthen its ability for action. Maybe it is a starting point for cooperation.

(c) Peacekeeping operations and actions approved by the UNSC

Although there are differences and disparities in PKOs and other actions approved by the UNSC, there is still some room for both sides to cooperate in these actions. Both sides can provide support to PKOs, in some activities such as anti-terrorism, fighting piracy, etc. China and the EU also can enhance communication on better practices in this area.

(d) Maintaining and safeguarding basic international principles and a multilateralist approach in international relations

Generally accepted international principles and multilateralism are the basis of the stability and peace of international society. Both China and the EU share a lot of commonalities in this respect. However, the most important is that both sides should cooperate and support each other in practice to safeguard our common understandings and perceptions.

3. The way for further cooperation

Although some issues related to security and peace may have been mentioned in some dialogues at different levels, so far, China and the EU have not developed a comprehensive mechanism for better cooperation in the UNSC.

For further cooperation, both sides should establish some specific mechanisms within and outside the UNSC. Within the UNSC, a kind of close consultation mechanism should be established between China and the permanent and non-permanent members from the EU. Outside the UNSC, a specific consultation framework should be established between the two sides to strengthen bilateral consultation on the issues related to and dealt with by the UNSC.

Reading List

Biedermann, R. (2009) "The European Union and China in Security Relations—Already Strategic Partners?", Journal of Asia-Pacific Studies，Vol. 7.

Biscop, S., Frnacioni, F. et al, (2005) "The European Union and the United Nations: Partners in Effective Multilateralism", Chaillot Paper, No.78, www.iss-eu.org

Cabestan J., (2006) "European Union-China Relations and the United Nations", Asian Perspective, Vol.30, No.4

Cora True-Frost, C. (2007) "The Security Council and Norm Consuption", International Law and Politics, Vol.40

Fullilove, M,, (2006) "Angel or Dragon? China and the United Nations", The National Interest, Sep/Oct.

Geeraerts, G., Chen, Z. & Macay, G. (2007) "China, the EU and the UN Security Council Reform",AsiaPaper,vol.2,no.6.See:<www.vub.ac.be/biccs/documents/Asia_paper_Macaj_2007_China_the%20EU_ad_UN_Security_Council_Reform_Asia_Paper_vol_2__6_BICCS_Brussels.pdf>

Holslag, J & van Hoeymissen, S (ed.) (2010), "The Limits of Cocialization: The Search for EU-China Cooperation towards Security Challenges in Afican", Policy Report, Brussels Institute of Contemporary China Studies

Pirozzi, N.(2010) “The EU’s Contribution to the Effectiveness of the UN security Council”, Documenti IAI 10, Istituto Affari Internazionali, http://www.iai.it/pdf/DocIAI/iai1014.pdf

Rasch, M., (2008) The European Union and the United Nations. The Functioning and Coherence of EU External Representation in a State-centric Environment. Leiden: Martinus Nijhoff Publishers

Stähle, S., (2008) “China’s Shifting Attitude towards United Nations Peacekeeping Operations”, The China Quarterly, September.

Taylor, P. (1999) “The United Nations in the 1990s: Proactive Cosmopolitanism and the Issue of Sovereignty”, Political Studies, XLVII

Wuthnow, J.(2010)“China and the Process of Cooperation in UN Security Council Deliberations”, Then Chinese Journal of International Politics, Vol.3

Zhang C.,(2008) “Possibility of Cooperation: China and EU in Darfur,” International Review, Vol. 51